



**6th Annual Conference of the  
EuroMed Academy of Business**

**Confronting Contemporary Business Challenges  
through Management Innovation**

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# **6th EuroMed Conference of the EuroMed Academy of Business**

CONFERENCE READINGS BOOK PROCEEDINGS

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## **Confronting Contemporary Business Challenges through Management Innovation**

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

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## FOREWORD

The Annual Conference of the EuroMed Academy of Business aims to provide a unique international forum to facilitate the exchange of cutting-edge information through multidisciplinary presentations on examining and building new theory and business models for success through management innovation.

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

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

This year the conference attracted over 250 people from over 65 countries. Academics, practitioners, researchers and Doctoral students throughout the world submitted original papers for conference presentation and for publication in this Book. All papers and abstracts were double blind reviewed. The result of these efforts produced empirical, conceptual and methodological papers and abstracts involving all functional areas of business.

## **ACKNOWLEDGEMENT**

Many people and organizations are responsible for the successful outcome of the 6th Annual Conference of the EuroMed Academy of Business.

Special thanks go to the Conference Chair Professor Vitor Ambrosio, the Conference Organising Committee and the Faculty of Estoril Higher Institute for Tourism and Hotel Studies, in Portugal, for accomplishing an excellent job.

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

The last but not the least important acknowledgment goes to all those who submitted and presented their work at the conference. Their valuable research has highly contributed to the continuous success of the conference.

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# **BOOK OF CONFERENCE PROCEEDINGS**

## ANALYZING BASIC COMPONENTS OF PRODUCTION COST IN GREEK SHEEP AND GOAT FARMS

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### ABSTRACT

Sheep and goat farming in Greece is of high importance because of the production of food, the insurance of adequate employment and steady income to a large number of farmers and the creation of added value in the products. Despite the high productivity and the excellent quality of the products the sheep and goat industry has low competitiveness due to high production costs. The efforts for the restructure and improve of the competitiveness of the industry should focus primarily on reducing the production costs.

The aim of this study is to research and analyze the parameters that compose the total cost of production in sheep and goat farms as well as to determine their significance. This paper tries to define the basic components of production costs, which form clusters of sheep and goat farms, with same behavior in the management of cost production. The analysis is also possible to lead to the creation of rational proposals for restructuring of farms and business management.

The application of principal component analysis revealed two main components (axes) for the cost: the first axis explains the 51%, while the second the 22% of the total variance. The first axis  $F_1$  is associated with the depreciation, maintenance, insurance costs and the permanent fund, while the second axis  $F_2$  is related to the feed costs, the value of self-produced feed, the total variable capital expenditures and other costs. The Hierarchical Cluster Analysis, based on factors scores, per cost component, in any goat sheep farm of the sample there was applied a grouping into three clusters, with similar demographic characteristics.

**Keywords:** sheep and goat farms, restructuring, cost of production, management of breeding farms

## INTRODUCTION

Sheep and goat breeding (small ruminants) is traditionally one of the most dynamic sectors in Greece, contributing to the rural income with a percentage about 18% and 28.07% to the total gross value of livestock production (Eurostat, 2011, Ministry of Rural Development and Food, 2012; FAO, 2012). Sheep and goat farming is practiced in a high percentage (85% of animals and 80% of farms) in mountainous and disadvantaged areas of Greece, which constitute the 85% of its surface area and in this way regions that are not suitable for intensive use are reclaimed. Moreover, sheep and goat farming, is contributing decisively to the regional development and maintenance of the social fabric in areas with particular problems (Ministry of Rural Development and Food, 2011).

In Greece there are 99,026 sheep-goat farms. The predominant form of sheep and goat farms composed of small family farming-pastoral extensive form, which are characterized by low inputs and rely on the movement of animals to find food (grazing). Nowadays however, there is a decline of small farms and nomadic development and a systemic-stabled sheep and goat high productivity on business structures (Kitsopanides, 2006; Rancourt *et al.*, 2006; Theocharopoulos *et al.*, 2007<sup>a</sup>; Aggelopoulos *et al.*, 2009).

In Greece, the total number of sheep reared amounts to 12.8 million animals and it's the first country in the EU, where sheep constitute the 55.8% of the animal population, followed by the UK with 23.4%. Across the EU, Greece has the first place in rearing goats (4 million goats) and the third in sheep (8.8 million sheep) after the UK (31million sheep) and Spain (16.6 million sheep) (FAO, 2012; Eurostat, 2012). The bulk of Greek sheep and goat farms (95%) has as a productive direction to the milk which herds of genetically heterogeneous farms, which consist of animals with different breeds and mostly unknown cross genotypic composition, showing great variability in terms of morphological, physiological and productive characteristics (Chatziminaoglou, 2001; Ministry of Rural Development and Food, 2011; Tzouramani, 2011).

Thus, Greece produces the 23.5% of the total goat milk produced in the EU, farm the second position after Spain (23.8%) and the 14.5% of the meat production by still farm the second place after the United Kingdom with 28.2% (FAO, 2012). It is also remarkable that Greece has

the largest annual production of sheep milk per capita (72.2 kg) and displays high quality goat meat as a result of a series of parameters that characterize the Greek reality as the extensive farming system, the domestic breeds and the administered feed (Zygoyiannis, 2006; Ministry of Rural Development and Food, 2011).

Despite the high productivity and the high quality of the products, the sheep and goat sector has low competitiveness due to the high production costs compared with other EU countries (Vlontzos and Soutsas, 2006; Aggelopoulos *et al.*, 2009). The majority of farms in the country operates under increasing returns to scale, so an increase in size to achieve lower production costs and improved profitability is necessary (Theocharopoulos *et al.*, 2007<sup>b</sup>). The total cost of production in a sheep and goat farm configures the feed costs, the annual costs of livestock, the annual costs of fixed assets and the remuneration of labor (Kitsopanidis, 2006).

The high cost of production in the Greek goat-sheep farms is one of the major problems of the industry, resulting in reduced efficiency and low competitiveness in relation to other EU countries. As a result, every effort for business development of the industry should be coupled with reducing production costs. This study aims to identify and analyze the factors that affect the total cost of production and the determination of their significance. This work attempts to define the key components of production costs in sheep and goat farms. With the formation of clusters of farms according to "their behavior" on cost variables, it is possible to determine rational restructuring proposals, based on similar efforts to reduce production costs, and their demographic characteristics.

## **MATERIALS AND METHODS**

For the conduct of survey we selected the Prefecture of Grevena, a region with a remarkable development of the sheep and goat farming. The variety of rearing conditions in this area allows the generalization of the research results, with no significant deviation from reality (Tsiouni, 2011).

For the research there were used financial data from sheep and goat farms in the region. The techno-economic data in this study were collected using a properly structured questionnaire, after personal interviews with farmers-owners of farms during the period 2007-2009. The sampling method followed for the selection of the sample was layered random (Siardos, 2005). The final sample included 65 sheep and goat farms. The sample size is the 4.7% of the total sheep and goat farms in the study area and it is the 0.03% of the total number of sheep

and goat farms in the country. It is also the 0.22% of the total sheep population in the country and 29.6% of the Prefecture.

It is also worth mentioning that in the final analysis there were included small, medium and large farms and as a result there is a great variation in the cost parameters that are taken under consideration. This is important because the cost components will be referred to a wide range of general and industry farms. Therefore, the findings will refer to the field of sheep-goat industry as a whole and not to specific categories of farm sizes.

For the study and analysis of production costs were calculated the annual expenditure of fixed capital (buildings, machinery, livestock breeding, etc.), costs of animal feed, the value of self-produced animal food, the total expenditure of variable capital (veterinary costs, costs of foreign mechanical work, etc.) and other expenses (taxes, expenses of electrification, communication, etc.) (Doll and Orogen, 1984; Damianos and Skuras, 1999; Kitsopanides, 2006; Aggelopoulos, 2007 and Aggelopoulos *et al.*, 2009). Table 1 shows the classification of the basic costs of production in the sheep-goat farms of the sample.

Table 1. Classification of the basic production expenses in the sheep-goat farms of the sample

production categories	expenses	Minimum (€ per animal)	Maximum (€ per animal)	Mean (€ per animal)	Std. Deviation
Depreciation		6.7	98.8	31.8	21.5
Insurance premiums		0.5	11.9	3	2.1
Maintenance		0.4	33.7	6.8	5.8
Interest		4.2	66.6	18.2	11.3
Animal food		127.6	232.3	175.3	19.3
Self-produced animal food		0.0	172.3	42.6	50.8
Other capital expenses		3.9	92.5	28.8	19.5
Expenses of variable capital		12	249.1	79	51.3

Based on the figures in Table 1, we observe that the first component is significantly correlated to all cost parameters (€ per animal) are (in descending order) the animal food, the expenses of variable capital, the self-produced animal food, the depreciations, the other capital expenses, the interest of fixed capital και and in the end the expenses of maintenance and insurance premiums.

Through the application of Principal Component Analysis (PCA), we examined the structural cohesion of the variables that compose the overall production cost, and their importance in its final formulation (Hair *et al.*, 1995; Sharma, 1996; Cattell, 1978; Dunteman, 1989; Tabakis,

2001; Aggelopoulos *et al.*, 2009). These variables are represented using non-observable variables-factors, according to the following mathematical formula:

$$F_i = \sum_{j=1}^p w_{ij} Z_j = w_{i1} Z_1 + w_{i2} Z_2 + \dots + w_{ip} Z_p, \quad (i = 1, \dots, m \leq p \text{ and } j = 1, \dots, p)$$

Where  $w_{ij}$ 's are the coefficients (or loadings) for factor or component,

$i (F_i)$  multiplied by the measured value for variable  $j (Z_j)$ . So, each principal axis is a linear combination of the original measured variables.

Then, based on the extracted Factors scores of sheep and sheep farms in these two axes, applied the Hierarchical Cluster Analysis. The formation of clusters of farms was based on the criterion of Ward, while the squared Euclidean distance was used as a measure of (in) similarity of farms (Hair *et al.*, 1995; Sharma, 1996). The analysis was performed with the statistical package SPSS ver. 13.0. Variables before entering the analysis were transformed into z-scores. The stability of the results, with respect to the input sequence of goats farms in the analysis, was tested with the help of software PermuCLUSTER ver.1.0 (Spaans and Van der Kloot, 2004).

## RESULTS

The application of PCA highlighted two axes (components) cost: the first axis explains 51% of the total variance, while the second 22% of the total variance (Table 2).

The first axis  $F_1$  associated with depreciation, maintenance, insurance premium and the interest of the fixed capital, while the second axis  $F_2$  associated with animal food, the value of self-produced food, total variable capital expenditures and other costs. The first axis  $F_1$  can be characterized as the axis of fixed capital expenditure, while the second axis  $F_2$  can be characterized as the axis of the expenses of animal feed and variable expenses (Table 3).

Table 2. Total Variance Explained

Component	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	4.067	50.842	50.842
2	1.780	22.250	73.092
3	0.907	11.340	84.432
4	0.595	7.443	91.874
5	0.409	5.111	96.985
6	0.137	1.718	98.703
7	0.102	1.272	99.975
8	0.002	0.025	100.000

Extraction Method: Principal Component Analysis

Table 3. Rotated Component Matrix

Data of cost	Components	
	F1	F2
Depreciation	0.977	
Insurance premiums	0.974	
Maintenance	0.941	
Interest	0.938	
Animal food		0.813
Self-produced animal food		0.669
Other expenses		0.665
Variable capital		0.567

\*Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization

Following the application of hierarchical cluster analysis and based on the scores per cost component achieved by the sheep and goat farms in the sample, we group them. Table 4 presents the averages of the factors scores per cluster.

Table 4. Averages of the factors scores

Clusters	F1	F2
C <sub>1</sub>	0,308961	1,735458
C <sub>2</sub>	-0,53485	-0,29669
C <sub>3</sub>	1,518448	-0,72176

Figure 1, shows the profile of the clusters of sheep and goat farms, according to the two components of the cost

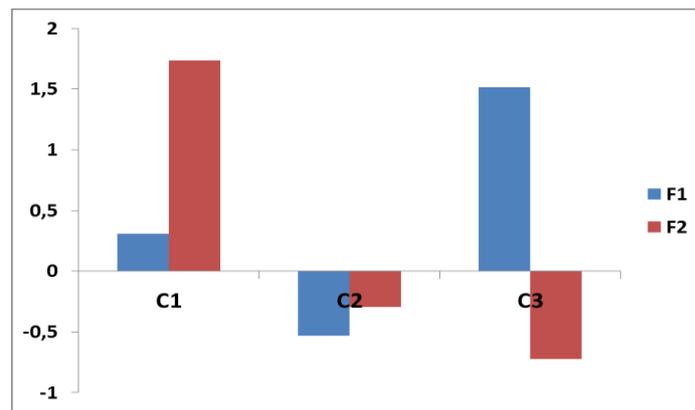


Figure 1. The profile of the clusters of sheep and goat farms, according to the components of the cost.

The application of the method highlighted three clusters of sheep and goat farms. In the first cluster (C<sub>1</sub>) included 12 sheep and goat farms (form 12.5% of total sample). The second cluster (C<sub>2</sub>) included 41 sheep and goat farms (63.1% of total sample), while the third cluster (C<sub>3</sub>) included 12 sheep and goat farms (18.5% of total sample).

As it is clear from the analysis, the first cluster (C<sub>1</sub>) consists of farms where the second axis F<sub>2</sub> concludes the main component of the cost. In the farms of the second (C<sub>2</sub>) and the third cluster (C<sub>3</sub>) the first F<sub>1</sub> axis concludes the main component of the cost.

The three clusters of farms are distinct for the variables of cost of the first axis F<sub>1</sub>, while in the axis F<sub>2</sub> cluster C<sub>1</sub> is different from clusters C<sub>2</sub> and C<sub>3</sub>.

Then, the profile of cluster was studied in compare with the eight cost variables (Table 5).

Table 5. Profile of clusters based on cost parameters

Cost parameters	Cluster of farms		
	C <sub>1</sub>	C <sub>2</sub>	C <sub>3</sub>
Depreciation (per animal)	42.02 <sup>b</sup>	24.32 <sup>c</sup>	63.39 <sup>a</sup>
Insurance premiums (per animal)	3.57 <sup>b</sup>	1.93 <sup>c</sup>	6.15 <sup>a</sup>
Maintenance (per animal)	9.87 <sup>b</sup>	3.69 <sup>c</sup>	14.26 <sup>a</sup>
Interest (per animal)	21.21 <sup>b</sup>	12.28 <sup>c</sup>	35.40 <sup>a</sup>
Expenses of animal food (per animal)	186.85 <sup>a</sup>	175.77 <sup>ab</sup>	161.87 <sup>b</sup>
Value of self-produced animal food (per animal)	104.55 <sup>a</sup>	31.63 <sup>b</sup>	18.21 <sup>b</sup>
Other expenses (per animal)	55.99 <sup>a</sup>	19.84 <sup>c</sup>	32.25 <sup>b</sup>
Expenses of variable capital (per animal)	160.35 <sup>a</sup>	59.52 <sup>b</sup>	64.12 <sup>b</sup>

\*For each cost parameter the averages that have different letters differ significantly at a significance level  $\alpha = 0,005$ , according the results of the Tukey HSD test.

The three clusters are diversifying in: depreciation, insurance premium, maintenance, interest and other costs. For the cost of animal food it is observed a variation between the first (C<sub>1</sub>) and the third cluster (C<sub>3</sub>). Between the value of self-produced food and the variable capital expenditures it is observed a difference between the first (C<sub>1</sub>) the second (C<sub>2</sub>) and the third cluster (C<sub>3</sub>).

The profiles of the clusters based on the cost parameters, it is also shown in Figure 2.

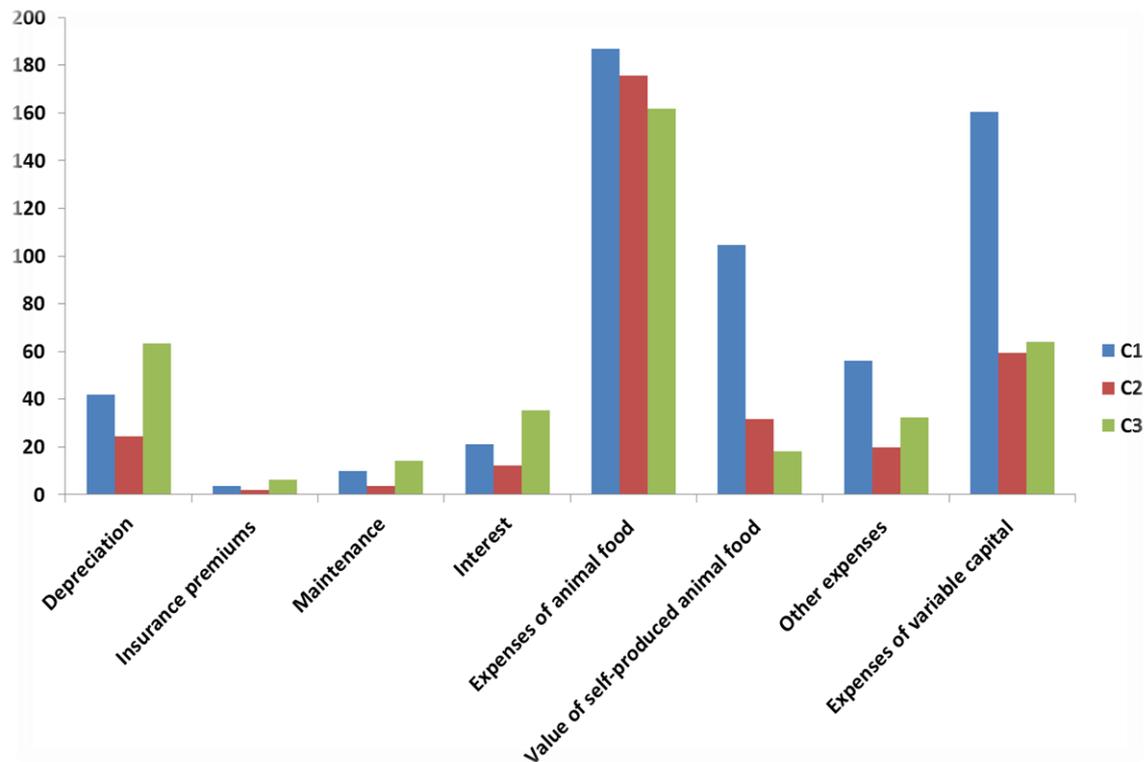


Figure 2. Configuring clusters, based on cost parameters

Then it was analyzed the second-level profiles of the three clusters, based on demographic characteristics. Table 6 presents the analysis of farms clusters according to their size. We observe that the total sample consists of large (46.1%) and medium size (38.5%) sheep and goat farms. The size distribution of the farms in three clusters is the following: the first cluster (C<sub>1</sub>) consists of small (41.7%) and medium-sized farms (41.7%). The second cluster (C<sub>2</sub>) consists mainly of large (58.6%), followed by medium-sized farms (34.1%) and while the third cluster (C<sub>3</sub>) consists mainly of medium-sized farms (50%). The size distribution is shown in figure 3.

Table 6. Profile of clusters according to their size.

Clusters	Size of farms				Total
	M <sub>1</sub> : 0-199	M <sub>2</sub> : 200-399	M <sub>3</sub> : 400-599	M <sub>4</sub> : >600	
C <sub>1</sub>	5 41.7%	5 41.7%	2 16.7%	0 0%	12 100%
C <sub>2</sub>	3 7.3%	14 34.1%	11 26.8%	13 31.7%	41 100%
C <sub>3</sub>	2 16.7%	6 50%	2 16.7%	2 16.7%	12 100%

The statistical test of independence  $\chi^2$  revealed a statistically significant relationship between the clusters and the size of sheep and goat farms ( $\chi^2 = 1.765$ ,  $df. = 6$ ,  $p\text{-value} = 0.05$ ). The intensity of the relationship is moderate (Cramer's  $V = 0.313$  and  $0.2 < CV < 0.4$ ).

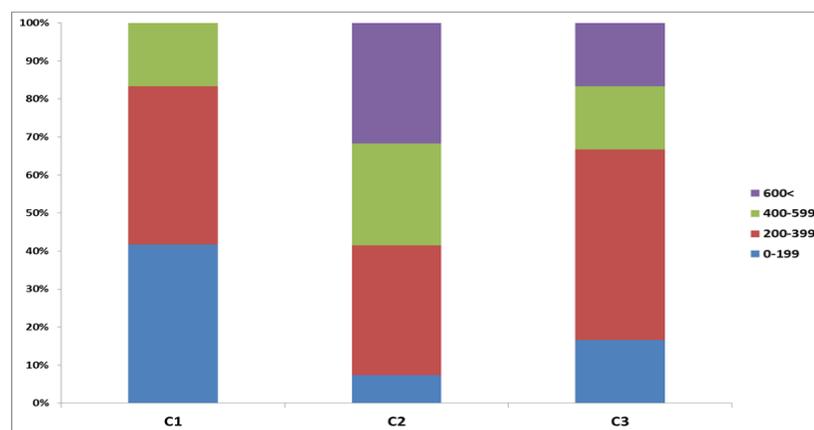


Figure 3. Profile of clusters according to their size

Table 7 shows the profile of the clusters, according to the type of farm

Table 7. Profile of the clusters, according to the type of farm

Clusters	Type of farms			Total
	T <sub>1</sub> : Sheep farms	T <sub>2</sub> : Goat farms	T <sub>3</sub> : Sheep and goat farms	
C <sub>1</sub>	8 66.7%	1 8.3%	3 25%	12 100%
C <sub>2</sub>	15 36.6%	4 9.8%	22 53.7%	41 100%
C <sub>3</sub>	7 58.3%	0 0%	5 41.7%	12 100%

Total	30	5	30	65
	46.2%	7.7%	46.2	100

According to table 7, the first cluster (C<sub>1</sub>) consists mainly of sheep farms (66.7%). The second cluster (C<sub>2</sub>) consists mainly of mixed farms (53.7%), while a high percentage has also sheep farms (36.6%). Finally the third cluster (C<sub>3</sub>) consisting of sheep farms (58.3%), while the mixed farms have also high percentage (41.7%).

The statistical test of independence  $\chi^2$  revealed no statistically significant relationship between the clusters and type of sheep and goat farms ( $\chi^2 = 5.166$ ,  $df = 4$ ,  $p\text{-value} = 0.2$ ).

Table 8 presents the analysis of clusters of farms according to their geographical location. In a high percentage, the sheep and goat farms are installed in mountain areas (43.1%), although a large proportion of these are transhumance farms (40%), while a small number of farms located in semi-mountainous (12.3%) and lowlands (4.6%). Specifically, the farms of the first cluster (C<sub>1</sub>) are installed in the majority in semi-mountainous areas, while 25% are installed in mountainous areas and another 25% are transhumance farms. The second cluster (C<sub>2</sub>) consists mainly of transhumance farms (48.8%) and farms in mountain areas (39%). Finally, 75% of farms in the third cluster (C<sub>3</sub>) are located mainly in the mountainous areas 75% and 25% are transhumance farms. The geographical distribution of farms clusters is shown in Figure 4.

Table 8. Geographical distribution of clusters

Clusters	Geographical area of farms				Total
	P <sub>1</sub> : Mountainous	P <sub>2</sub> : Semi- mountainous	P <sub>3</sub> : Lowland	P <sub>4</sub> : Transhumance	
C <sub>1</sub>	3 25%	4 33.3%	2 16.7%	3 25%	12 100%
C <sub>2</sub>	16 39%	4 9.8%	1 6.4%	20 48.8%	41 100%
C <sub>3</sub>	9 75%	0 0.0%	0 0.0%	3 25%	100%
Total	28 43.1%	8 12.3	3 4.6	26 40	65 100%

The statistical test of independence  $\chi^2$  revealed a statistically significant relationship between the clusters and the geographical identification of sheep and goat farms ( $\chi^2 = 16.88$ ,  $df = 6$ ,  $p$ -value = 0.01). The intensity of the relationship is moderate (Cramer's  $V. = 0.359$ ,  $0.2 < CV < 0.4$ ).

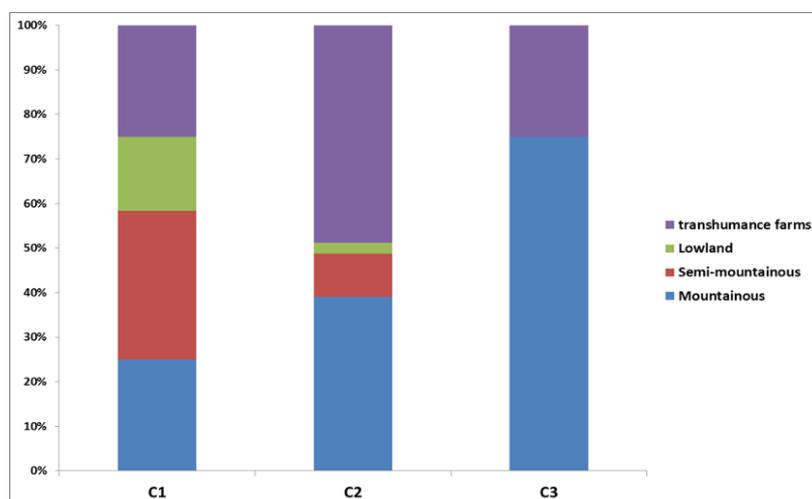


Figure 4. Geographical distribution of clusters.

In Table 9, shows the profile of clusters, based on the educational level of their owners. The owners of sheep and goat farms in the sample have mainly elementary and secondary education level. The majority of the owners with elementary education appear in the third cluster (C<sub>3</sub>), and the owners who attend some high school are in the second cluster (C<sub>2</sub>). Of the total of 65 owners only 2 people have university education and allocated to one of the first (C<sub>1</sub>) and the second cluster (C<sub>2</sub>).

Table 9. Profiles of clusters, according to owners education level.

Clusters	Type of farms			Total
	G1: Elementary school	G2: High school	G3: University	
C <sub>1</sub>	7 58.3%	4 33.3%	1 8.3%	12 100%
C <sub>2</sub>	25 61%	15 36.6%	1 2.4%	41 100%
C <sub>3</sub>	8 66.7%	4 33.3%	0 0%	12 100%
Total	40 61.5%	23 35.4%	2 3.1%	65 100%

The statistical test of independence  $\chi^2$  indicated no statistically significant relationship between the cluster and the educational level of the owners of sheep and goat farms ( $\chi^2 = 1.620$ ,  $df = 4$ ,  $p\text{-value} = 0.1$ ).

## CONCLUSIONS AND SUGGESTIONS

Sheep and goat farming is one of the most important sectors of the Greek livestock with high potential for further development. However, the dynamic of the industry impacts the increased costs of rearing sheep and goats, and as a result there is a reduced artificial efficiency and low competitiveness in relation to other EU countries. Strengthening the development direction can be achieved by reducing production costs.

In the presented study there was a research on the factors that affect the cost of production and a determination of their significance.

The application of Principal Components Analysis revealed two major cost components, showing that the first cost component, named the annual fixed capital costs (costs that are affected by the amount of the investments in farms), as the main reason for the difficulty in raising sheep and goats.

Then the application of hierarchical analysis in clusters formed three groups of farms, based on cost data, and demographic characteristics. The first cluster ( $C_1$ ) consists of farms that the key components of their costs are the costs of feed and variable capital. These small and medium sized farms are located in mountainous and hilly areas. The farms of the cluster seem to be mainly sheep type farms where the owners have an elementary education.

The second cluster ( $C_2$ ) consists of farms whose key components of their costs are the annual costs of permanent capital. These are large farms, which are mainly transhumance farms and located in mountainous areas. The farms of this cluster appear to be mostly mixed with their owners being of an elementary education.

The third cluster ( $C_3$ ) consists of farms whose key components of their costs are the annual costs of permanent capital. In this cluster there are mainly medium-sized farms, which are located in mountainous areas. The farms of the cluster seem to be mainly type sheep farms and the owners are also of an elementary education.

The recommended policy measures that aimed to the restructuring of the Greek sheep and goat farming and they improve its competitiveness and they are based on the above analysis are:

For the sheep and goat farms in the cluster C<sub>1</sub> it is suggested to reduce the user cost of animal food. In particular the reduce of animal food expenses is associated with the proper use and quality improvement of animal food that it is used. Selecting the most proper and effective way of preparing the animal food, the establishment of a well-balanced and economical diet, the knowledge of animal food nutrients content and their suitability as well as the proper facilities blending power and storage of animal food are leading to a better utilization of this factor. Furthermore, it is necessary to connect the plant and animal production. The systematic and organized cultivation of animal food, is expected to help to the increase of the offered quantity and thus to the reduce of the offered price to the farmers.

For sheep and goat farms in clusters C<sub>2</sub> and C<sub>3</sub> it is suggested the better use of fixed capital (buildings, machinery, etc.). The inclusion of the farms in financial programs which will aim at improving the building and mechanical equipment is expected to reduce annual costs and improve their efficiency. Moreover, the installation of automated feeding systems, would improve the quality of animal food, lead to the reduction of animal food cost and improve work efficiency and management of animals.

Generally, the organization of training programs for the breeders-owners of farms will help to promote new technology in all phases of production process. The training is necessary for issues that are related with milking, animal husbandry management, organization and management of livestock farms and animal food preparation.

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## FACTORS INFLUENCING THE DECISION-MAKING PROCESS OF THE NEW WINE CONSUMERS

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### ABSTRACT

This research aims to highlight the determinants able to predict consumption trends, in order to provide important marketing evidence to wineries whose goal is to penetrate new markets. To achieve this aim, the research focuses on the average US consumer, represented by a Missouri population. The reasoned action approach (Fishbein and Ajzen, 2010) was applied to 140 wine consumers from Missouri. Behavioural and normative beliefs were surveyed to study their influence on attitudes and subjective norms, which affect intentions and behaviours. The gathering of information was divided into two phases: an exploratory analysis and a survey by questionnaire. The results confirm the new trends in wine consumption and the emerging predominant role of friends in influencing wine consumption. The importance of family as a reference social group is overshadowed. The sensory characteristics of wine remain relevant, and the role of health in determining the choice to consume wine is confirmed as controversial. The study highlights that the social pressure resulting from reference people and groups is losing significance in relation to attitudes, expressed by the opinion that the individual shapes about behavioural consequences.

**Keywords:** Consumer behaviour, Wine, Reasoned action approach, Average US consumer, Wine marketing

### INTRODUCTION

The determinants of wine consumption behaviour are a very complex subject of study because of the complexity of wine itself, given its multiple intrinsic and extrinsic factors and its material and immaterial nature, which characterise quality perception. Further, consumers associate a risk level to their choices, resulting from the fact that wine quality is objectively

and subjectively ascertainable only after it has been purchased and when the consumption behaviour has been fully realised.

For the wine industry to understand drinking choices and establish marketing strategies, knowledge of the consumer's decision-making process, which leads to consumption behaviour, is more important than ever.

Many studies aimed at explaining consumption behaviour have drawn from social psychology and applied the reasoned action approach, as formulated by Fishbein and Ajzen (2010). This approach has been used to explain which elements determine human behaviour in many different life domains, including politics, health, discrimination and consumption.

The current study applies the reasoned action approach to offer new insight into the wine consumption behaviour of a population that is approaching wine choice with an increasing interest in wine. This approach provides an appropriate framework to evaluate the cognitive factors determining the wine consumer's decision-making process.

The article is structured as follows. First, the reasoned action approach is discussed through a literature review. In this regard, the review gives special attention to the main applications in the field of food. Second, the objectives and method are presented, allowing the paper to join in the debate initiated by three previous applications of the reasoned action approach to wine consumption. The empirical results are discussed, and some future research investigation lines are recommended.

## **LITERATURE REVIEW**

The reasoned action approach is the basis of two theories that aim to explain the decision-making process that leads individuals to their behaviour: the theory of reasoned action (TRA) and the theory of planned behaviour (TPB).

Developed by Fishbein and Ajzen (1975), TRA argues that the behavioural intention underlying a behaviour is able to capture its motivational factors and indicates how hard a person is willing to perform that behaviour. In turn, behavioural intention is determined by attitude, namely, the degree to which a person positively or negatively assesses or qualifies a behaviour, and by subjective norm, which refers to the social pressure carried out by reference people or groups that a person perceives in performing or not performing the behaviour.

Salient information, or beliefs, explains behaviour at a more basic level than that of attitude and subjective norm. Many beliefs are available to people for all behaviours, but only a

relatively small number of them is readily accessible when people choose to perform that particular behaviour. These salient beliefs are the dominant determinants of behavioural intention and behaviour (Ajzen and Fishbein, 1980).

The relations between attitudes and intentions, and consequently behaviours, are based on the expectancy value model (Fishbein and Ajzen, 1975), according to which the evaluation of the attributes ( $e_i$ ) associated with the behaviour and the strength of these associations ( $b_i$ ) determines the attitude (A):  $A \propto \sum b_i e_i$  (Ajzen, 2012). Attitude can explain behaviour with significant correlation if the principle of compatibility is respected and the expression of attitudes and behaviour refers to the same action, target, context and time (Fishbein and Ajzen, 2010). Among attitudes, scholars have recently distinguished instrumental and affective components to reinforce the prediction capability of intentions taking into consideration advantages/disadvantages, benefits/costs, and liking/disliking of the behaviour (Ajzen, 2011; Conner and Armitage, 1998; Elliott and Ainsworth, 2012). This advance enables a better understanding of the role of emotions, affects and irrationality in the decision-making process (Ajzen, 2011).

New research developments have enlarged the explicative power of the normative construct through the distinction between injunctive and descriptive beliefs (Cooke *et al.*, 2007; Ravis and Sheeran; 2003). Thus, normative beliefs include the perception of approval/disapproval stemming from the main referents, social pressure and situation expectation. The association of these beliefs with the motivation to comply ( $m_i$ ) shapes the subjective norm (SN), contributing to the prediction of behavioural intentions:  $SN \propto \sum n_i m_i$  (Ajzen, 2012).

TPB was developed from TRA by Ajzen (1991, 2005) to overcome a fundamental limitation: it can only be applied to behaviours under people's volitional control. However, many behaviours, although under volitional control in principle, can present serious difficulties in their execution that are related to non-motivational factors, such as the availability of opportunities and resources, in terms of time, money, skills or the cooperation of others (Ajzen, 2005, 2012). TPB overcomes this limitation thanks to an additional predictor of intentions and behaviour: perceived behavioural control (PBC) (Ajzen, 2012). The same concept was previously proposed by Bandura (1977) with the construct of perceived self-efficacy. PBC depends on the individual's beliefs about the opportunities or constraints facilitating or limiting their intentions and behaviours ( $c_i$ ), and on their power to control these factors ( $p_i$ ):  $PBC \propto \sum c_i p_i$  (Ajzen, 2012). PBC acts through intention or directly on behaviour. The correlation between intention and behaviour is facilitated by the conditions of an actual behavioural control.

TRA and TPB models have been broadly applied in various domains, especially in the past decade. Investigations have just begun in food and drink choice analysis. Much research has aimed at explaining and predicting the individual's decision-making process in situations involving risky behaviour (in terms of abuse or malnutrition), food safety, healthy eating, dietary changes from a medical, sociological or psychological point of view (for example, Berg *et al.*, 2000; Brug *et al.*, 2006; Collins *et al.*, 2011; Fila and Smith, 2006; Lloyd *et al.*, 1993; Paisley and Sparks, 1998; Povey *et al.*, 2000). To date, few studies have assumed a marketing perspective. Seminal studies in the food domain were proposed by Sparks *et al.* (1995) and Shepherd and Raats (1996). Use of the reasoned action approach contributes to the investigation of the person–food interface and its integration with the consumption situation and the wider choice context. Scholars are making an effort to identify and measure whether the food decision-making process is characterised by specific constructs that determine intentions and behaviour. For example, two additional components, personal identity and moral factors, are proposed by Shepherd and Raats (1996) in organic food choice.

In addition to organic food (Arvola *et al.*, 2008; Dean *et al.*, 2008; Tarkiainen and Sundqvist, 2005), in recent years, studies have focused on different and topical themes, such as halal meat consumption (Alam and Sayuti, 2011; Bonne *et al.*, 2007), genetically modified foods (Chen, 2008; Cooke *et al.*, 2007), risk perception for dairy products (Lu *et al.*, 2010), the propensity towards imported soy-based dietary supplements (Chung *et al.*, 2012) and food safety practices (Brannon *et al.*, 2009). Empirical advances support the extension of TPB in food choice analysis in the antecedents of attitudes (Chung *et al.*, 2012), in new constructs explaining intentions (Bonne *et al.*, 2007) and in the relationship between attitudes and subjective norms (Tarkiainen and Sundqvist, 2005).

In the domain of beverage consumption, the TRA and TPB models have investigated risky situations, such as the binge drinking phenomenon, especially in young generations (for example, Dempster *et al.*, 2005; Norman, 2011; Todd and Mullan, 2011). With respect to wine, only a few studies have applied the reasoned action approach to consumption behaviour (St James and Christodoulidou, 2011; Thompson and Vourvachis, 1995; van Zanten, 2005). Thompson and Vourvachis (1995) investigated the British wine drinker, van Zanten (2005) the Australian consumer, and St James and Christodoulidou (2011) the Californian consumer. They obtained different results in relation to the weight exerted by subjective norms and attitudes in influencing behavioural intention and behaviour; they are in agreement in omitting PBC in explaining wine consumption behaviour. These results initiated a debate in the *International Journal of Wine Business Research* (*International Journal of Wine Marketing* until

2006), to which this paper aims to contribute with further insight into the analysis of the wine consumer's decision-making process. The assumption is that the influence of the wine consumer's life cycle emerges as a relevant determinant of product involvement and favourable intentions. The role of personal and cultural background factors is apparent, but these have not yet been investigated in depth by scholars from a marketing perspective.

## OBJECTIVES

The innovative element of the current study is its subject. It aims to understand wine consumption behaviour in a population that is approaching wine for the first time and increasing its interest towards wine. This research aims to highlight the determinants able to predict consumption trends, in order to provide important marketing suggestions to wineries whose goal is to penetrate new markets.

To achieve this aim, the research focuses on the average US consumer, represented by a Missouri population.

The US population consumed 32 million hectolitres of wine in 2012, becoming the world's largest wine consumer. The per capita consumption is 10.3 litres, 24% more than the previous 10 years, and it has grown since the 1990s (Wine Institute, 2013). The heterogeneity of the US population translates into states in which wine consumption is consolidated (California, New York and Florida), and states in which wine consumption is still in a primordial stage (such as Missouri, Nebraska and Kansas). These represent potentially interesting catchment areas for European wineries. Most of the studies on US wine consumers have focused on the Californian consumer (St James and Christodoulidou, 2011; Thach, 2012; Thach and Olsen, 2004). In order to provide a more representative contribution of the US consumer than those outlined by previous research, this study investigates the factors that influence the behaviour of wine consumption in Missouri. A survey was conducted in St. Louis, the home of the stereotypical US consumer, far away from the Californian consumer on the west coast of the United States. Missouri can also be counted among the states that are entering the wine market, both from the production point of view—whose business, however, can only be competitive at the domestic level because of the climatic conditions that prevent the use of *Vitis vinifera*—and from the consumption point of view, presenting Missouri as an interesting destination for foreign producers.

## METHOD

As proposed by Fishbein and Ajzen (1975), the analysis was divided into two phases: an exploratory phase and a phase of survey by questionnaire.

The exploratory phase aimed to determine the salient beliefs and the reference people and groups in wine consumption behaviour, which was useful for carrying out the second phase. The study involved 22 respondents. As in the studies of Thompson and Vourvachis (1995), van Zanten (2005) and St James and Christodoulidou (2011), open-ended questions were used to discover (i) advantages and disadvantages in drinking wine; (ii) free associations with the action of drinking wine; (iii) people or groups that would approve or disapprove of the wine drinking of the respondent; and (iv) people or groups that come to mind when thinking about drinking wine. Processing of the information provided the salient beliefs and the reference people and groups that influence wine consumption behaviour; these are listed in descending order of frequency in Table 1.

Salient beliefs	Referents
Wine is good for health	Family
Wine is sociable	Partner
Wine has a good taste/flavour	Friends
Wine helps to relax	Close Friends
Wine is a cultural product	Colleagues
Wine is good with food	

*Table 1 - Salient beliefs and referents in drinking wine*

The results of the exploratory phase were used to build the survey questionnaire of the second phase of analysis (see Table 2). The questionnaire presents some new elements when compared with those of previous studies, which arose from the results of the first phase and the important contribution of studies in other fields that have applied the reasoned action approach (Dean *et al.* 2008; Esses and Maio, 2002):

1. Items about affective attitudes have also been included in the questionnaire to analyse attitude better. Therefore, the respondents were asked about feelings aroused by drinking wine. The other studies on wine consumption behaviour consider only cognitive attitudes, namely, the characteristics and consequences perceived in drinking wine.

Theory components	Items
Behaviour	Wine drinking frequency
Behavioural Intention (BI)	Intention to drink wine sometime in the next month
Attitude (A)	Drinking wine characteristics Consequences of drinking wine Feelings from drinking wine
Subjective Norm (SN)	Thinking of reference people or group concerning the respondent's drinking wine Reference people or group's drinking wine in the next month
Behavioural Beliefs (b)	Wine is good for health, sociable/fun, has good taste/flavour, good for relaxing, a cultural product, goes well with food
Outcome Evaluations (oe)	Importance of health, sociability/fun, taste/flavour, relaxing, cultural approach and food matching when drinking wine
Normative Beliefs (NB)	Opinion of family, partner, friends, close friends, colleagues about the respondent's drinking wine in the next month
Motivations to Comply (MC)	Respondent's general will to do what family, partner, friends, close friends, colleagues want

*Table 2 - Survey components and items*

2. The subjective norm was analysed through what reference people and groups think about the respondents' wine consumption behaviour, as the other analogues studies do, and by investigating the wine consumption behaviour of the reference people and groups.
3. The exploratory analysis revealed new items for the components behavioural beliefs and outcome evaluations, which are linked to the relaxing properties of wine and its cultural component. Important items of other studies were not salient, namely, the feeling of sophistication (St James and Christodoulidou 2011), link to special occasions and quality assessment through the price (Thompson and Vourvachis, 1995).
4. New reference people or groups emerged concerning normative beliefs and motivations to comply, namely, the partner and the split among close friends and acquaintances. Guests were not found to be important, unlike in the study of Thompson and Vourvachis (1995).

The questionnaire was given directly to 140 people in St. Louis, the main urban centre of Missouri. The information was processed out using Stata 11 software.

## RESULTS

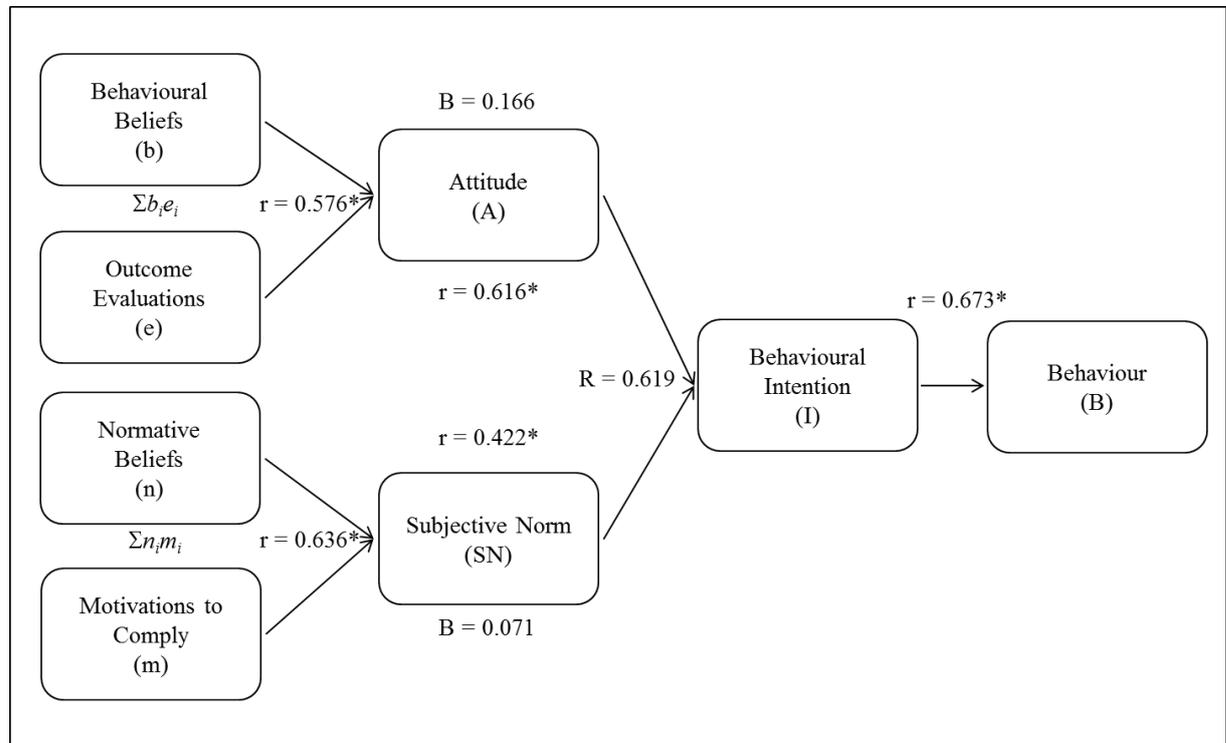
Socio-demographic characteristics and wine consumption frequency of the sample are summarised in Table 3. The sample consists of males and females in almost equal measure; the number of individuals aged below 40 and the number above 40 were also almost equal. Respondents were mostly married, had high education levels and were employees, freelance workers or managers. More than half of the sample claimed to consume wine at least once a week.

Attributes	Levels	n	%
Gender	Males	68	48.6
	Females	72	51.4
Age class	21–30 years old	47	33.6
	31–40 years old	21	15.0
	41–50 years old	35	25.0
	More than 50	37	26.4
Relationship status	Single	48	34.3
	Engaged	11	7.9
	Married	81	57.9
Education level	High school	21	15.0
	Technical school	8	5.7
	College	104	74.3
	Master's degree	7	5.0
Employment	Student	19	13.6
	Worker	12	8.6
	Employee	61	43.6
	Freelance/Manager	31	22.1
	Unemployed	4	2.9
	Other	13	9.3
Wine drinking frequency	Never	11	7.9
	Once every three months	17	12.0
	Once a month	21	15.0
	Once a fortnight	19	13.6
	Once a week	26	18.6
	Two to six a week	35	25.0
	Once a day	11	7.9

Table 3 - Sample characteristics (N = 140)

Figure 1 shows the application of TRA to wine consumption behaviour, as was the case in the other studies about wine consumption (St James and Christodoulidou, 2011; Thompson and Vourvachis, 1995; van Zanten, 2005). The formulations proposed by Ajzen and Fishbein (1980) were applied to bring out the correlations among model components. Each behavioural belief was multiplied by the corresponding outcome evaluation, and these products were summed ( $\sum b_{ie}$ ). The same procedure was carried out for normative beliefs and motivations to

comply ( $\sum n_i m_i$ ). The six items of attitude were summed instead (A), as were the two items of subjective norm (SN).



\* $p \leq 0.01$

Figure 1 – The determinants of wine consumption behaviour

Simple correlations and linear regressions were applied to estimate the relationship between the different model components. As stated by Ajzen and Fishbein (1980), a correlation level greater than 0.30 is considered acceptable in this type of study, and a correlation greater than 0.50 is considered a strong relation. In this application, most of the correlations are higher than 0.50, showing the strong link between the model components. As in the other studies about wine consumption, it was found that both attitude and subjective norm influence behavioural intention to drink wine (St James and Christodoulidou, 2011; Thompson and Vourvachis, 1995; van Zanten, 2005) and behavioural intention is influenced more by attitude than by subjective norm, in line with the two more recent studies. As suggested by van Zanten (2005), this can be explained by the fact that group influence on intention is obvious for wine consumption because wine is often consumed in situations of conviviality. In today's society, far from the days of prohibition, subjective norm is less important because the influence of reference people or groups perceived by the average US wine consumer is more related to conviviality dynamics than to social pressure.

The relevance of attitude in determining behavioural intention is evidence that, for the analysed sample, personal evaluations about the behaviour are more important than the opinions of others in deciding to perform the behaviour.

Tables 4 and 5 show the importance of the different factors concerning attitude and subjective norm in explaining the model components.

The correlation between attitude and salient beliefs is presented in Table 4. As in the other studies on wine consumption behaviour, taste or flavour is the most important determinant of attitude. The relaxing and sociable properties of wine are also important in shaping attitudes. The link with food and the cultural connotations of wine were found to be of little influence. The health properties of wine appear to be controversial and are not significant in determining attitudes.

Salient beliefs	Attitude	
Good taste/flavour	0.568	**
Relaxing	0.479	**
Sociable/fun	0.391	**
Food matching	0.281	**
Cultural product	0.233	*
Health	0.136	

\*\* $p \leq 0.01$ ; \* $p \leq 0.05$

Table 4 - Correlation between attitude (A) and salient beliefs (be)

Correlations between subjective norm and the influence of reference people and groups emerged (Table 5). Close friends and acquaintances were found to be the most important reference groups in determining the subjective norm of the individual. The judgement and behaviour of family members appears to be less important than in the other studies about wine drinking behaviour (St James and Christodoulidou, 2011; Thompson and Vourvachis, 1995; van Zanten, 2005).

Referents	Subjective Norm	
Close friends	0.592	**
Friends	0.544	**
Partner	0.534	**
Family	0.524	**
Colleagues	0.493	**

\*\* $p \leq 0.01$ ; \* $p \leq 0.05$

Table 5 - Correlation between subjective norm (SN) and referents (NBMC)

## CONCLUSIONS

To increase its effect, decisions on wine marketing should consider how consumers structure their decision-making process and what determines their choices. This research shows that TPB can be an important instrument to achieve this aim.

The study shows a strong correlation between behaviour and behavioural intention. However, there is a part of behaviour which has not yet been explained and should probably be investigated by considering PBC. This component has not been included in the other studies that applied the reasoned action approach to wine consumption, but it could provide important explanatory results.

The study highlights that subjective norms, namely, the social pressure resulting from reference people and groups, is losing importance in relation to attitude, expressed by the opinion that the individual shapes about behavioural consequences. In this regard, a personal relationship between the individual and wine emerges. From these two trends, the reference people and group, previously exerting social pressure through norms, have become the target of the individual's behavioural choices, highlighted by the social component of the wine itself. Further, the reduction of the role of social pressure leads to new issues in assessing the effect of policy in nutrition education, reduction of risk behaviours and encouragement of positive behaviours.

This research provides wineries with guidelines for implementing strategies towards an emerging market, represented by the average US consumer. The results confirm a new trend in wine consumption and the predominant role of friends in influencing wine consumption that has emerged. The role of family as a reference social group is overshadowed. The sensory characteristics of wine remain relevant, and the role of health in determining the choice to consume wine is confirmed as controversial. These are important directions for strategies to penetrate these new markets.

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## DO FEMALE MANAGEMENT DECISIONS IN CRISIS TIMES DIFFER FROM MALE DECISIONS? AN EXPLORATORY STUDY

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### ABSTRACT

The purpose of this study is to explore management decisions during the on-going financial crisis from a gender perspective. An empirical analysis was conducted using a sample of 132 personal surveys involving the managers of independent small travel agencies. This paper finds some significant gender differences in strategic management decisions in crisis times. Thus, the findings provide useful empirical evidence for leadership development that will enhance leadership effectiveness from a gender viewpoint and facilitate advances in women business management theory.

**Keywords:** Gender; gender management decision; crisis management; leadership; gender differences, Spain, travel agencies.

### INTRODUCTION

Nowadays companies face manifold challenges that often deal with uncertainty. Thus, to lead an enterprise it is not sufficient to possess only technical skills in the industry. In addition, to demonstrate an effective and efficient leadership style, managers have to develop social and emotional capabilities (Mandell and Pherwani, 2003; Melero, 2011).

Several studies underline the change that has been going on in the labour market, starting with the massive incorporation of women in the workforce. In most developed nations this tendency started in the 70s and by now women account there for approx. 50 % of the total workforce (Hopkins *et al.*, 2008). Prior research has shown that female capabilities, acquired through education and participation in the workforce, are not reflected in the daily workplace reality. Female participation in leadership roles is still very low compared to the above

mentioned two factors education and workforce participation. (Alonso-Almeida, 2011; Appelbaum *et al.*, 2003; Broadbridge and Hearn, 2008).

One reason to explain this situation is the idea that men and women define success in private and professional life differently (Mainiero and Sullivan, 2005; O'Connor, 2001; O'Neil and Bilimoria, 2005). According to these studies men and women use different leadership styles resulting in different business decisions (Hackman *et al.*, 1992; Mandell and Pherwani, 2003). These differences lead to the use of different leadership styles between men and women that manifest themselves in the way decisions are made and management is executed. Therefore, according to the results of prior studies, the female leadership style seems to be less effective when analysing performance in companies run by men and women (Alsos *et al.*, 2006; Fairlie and Robb, 2009). Pioneer cross-sectorial studies obtained mixed results with regard to gender-related capitalization, external financing and performance but mostly showed that women achieved worse performance. Nevertheless, latest research did not find any differences in performance. Especially when longitudinal studies were conducted (Aterido and Hallward-Dreiermeier, 2011; Lafuente and Rabetino, 2011) they even show a significantly higher performance in women-led companies.

There is little empirical evidence available about what kind of decisions female managers make. Even though some attempts have been made to identify differences in male and female leadership styles, research has room for improvement (Amagoh, 2009; Appelbaum *et al.*, 2003). The main reason is that most of prior research is based on a macro level perspective. Thus, it is necessary to deepen the knowledge on female leadership from a micro level viewpoint -firm level-, in order to help women to overcome barriers that hinder them to take up the positions they deserve.

The remainder of this paper is structured as follows. Section two discusses the theoretical arguments concerning decision making from a gender approach. Section three describes the empirical design of this study. Section four presents a quantitative analysis, followed by section five, which presents the study's findings and concludes this paper with several major implications drawn from the research.

## **DECISION MAKING: A GENDER APPROACH**

For many years, predominant research stated that male leadership was most effective in the business world in terms of financial performance (e.g. Cooper *et al.*, 1994; Alsos *et al.*, 2006;

Fairlie and Robb, 2009). Given that the business world has been created out of a male vision (Dye *et al.*, 2005), the ideal leader is characterized by traits that most men own (Broadbridge and Hearn, 2008; Schein, 2007) called this the 'think-manager; think-male' effect which apparently qualifies men as better leaders. This form of thinking currently prevails in developed countries (Bosak and Sczesny, 2011; Rodler *et al.*, 2001).

A number of authors (e.g. Eagly and Carli, 2007; Eagly and Sczesny, 2009; Melero, 2011) summarized the different characteristics in leadership among men and women. Thus, leadership theory has identified two orientations: task-oriented and interpersonally oriented leadership. According to gender roles, female managers would be more prone to lead with an interpersonal orientation, while male managers should be more likely to apply a task-oriented style (Powell and Graves, 2003). Task-oriented leadership pursues the maintenance of authority, hierarchy and achieving business goals over all while interpersonally oriented managers build their leadership on empowering their subordinates, motivating them and showing concern about their development at work as a mean to achieve business goals. Eagly and Carli (2007) mentioned that although some studies found that both men and women have the same task-oriented leadership, women shown more interpersonal orientation than men (e.g. Melero, 2011).

Another way to describe leadership styles is the differentiation between democratic and autocratic. In this line of reasoning Bird and Brush (2002) argued that men have a strategic style of management characterized by centralized decision making -autocratic- and women prefer a participative decision making characterized by high commitment to the employees -democratic-. This same idea was found in the meta-analysis done by Eagly and Johnson (1990).

On the other hand, globalization, increased client focus, the search for new markets and other factors like increased care for the environment, corporate social responsibility and the necessity to relate to different stakeholders of a company put the focus on new capabilities needed to lead companies. This gives way to a new leadership style, called transformational leadership. As Eagly and Carli (2007) asserted these type of leaders help their employees to develop their full potential and face difficult situations with innovation. It seems that women use a leadership style that is concerned with the employees they work with to keep their motivation up (Barbutto Fritz *et al.*, 2007; Davis *et al.*, 2010). This is consistent with prior literature regarding female leadership styles (Bird and Brush, 2002; Hackman *et al.*, 1992; Mandell and Pherwani, 2003; Melero, 2011). Thus, women directors prioritize stable

employment and their responsibility for the employee (Danes *et al.*, 2007) as well as long-term client-relationships (Krishnan and Park 2005; Schaap *et al.*, 2008). For these reasons, previous research suggested that in transformational leadership -opposite to transactional leadership focused in the conventional manner to manage a company-, female capabilities are more important and women are better adapted to understand the changes that take place in the market (Carless 1998; Eagly and Sczesny 2009; Schein 2007; Schaap *et al.*, 2008).

Although women leadership has changed over time, some authors (as Eagly and Carli 2007; Melero 2011) suggested men and women tend to make managerial decisions consistent with their gender-specific leadership styles. Thereby, this study proposes the following hypothesis:

*Hypothesis: Gender is a significant factor in explaining strategic managerial decisions in critical situations -as a financial crisis- according to gender-specific leadership style.*

## **METHODOLOGY**

To analyse the impact of gender on strategic decision making 136 tourist companies were surveyed. To ensure that the proper person was surveyed this study only considered questionnaires when person pointed out he or she was the decision-maker person. In total, 64 companies were led by women and 69 by men, which translate to 47.8 % female led companies and 52.2 % male led companies. The survey took place between November and December of 2009 when the Spanish tourist sector was reviving from the past economic crisis. Since the beginning of the crisis, tourism declined until the end of 2009 (UNWTO, 2010) and rebounded in 2010. The rebound was confirmed in 2011 (UNWTO, 2011) and is predicted to stay in 2012.

Travel agencies were chosen for two reasons. First, data from Spanish universities show that a majority of women choose this major (Rodriguez-Anton *et al.*, 2009). However, the sector is not considered to be a female one (Williams, 1992). Secondly, fierce competition exists within the sector (Alonso-Almeida and Llach, 2011).

Most companies focus on retail, no matter if male-led (65.1 %) or female-led (64.9 %). There are slightly more male-led retail agencies. Women lead most of the wholesale agencies whereas men dominate the tour-operators, even though this type represents only a small percentage of the entire population (8.2 % out of the total). In this study, like in previous research (e.g. Appelbaum *et al.*, 2003; Schein, 2007; Aterido and Hallward-Dreimaier, 2011;

Bardasi *et al.*, 2011), female-led companies are younger and smaller, if employees are concerned. Moreover, women have less professional experience than men. 59.4 % of the women interviewed have less than five years of work experience in contrast to 40.3 % of the men. A priori, this is a normal observation since in the sample 45.7 % of all the female-led companies had owners younger than 30 years old.

In order to analyse the leadership styles of men and women and their subsequent differences in the companies they lead the measures taken to confront the economic crisis that started in 2008 were researched.

The literature regarding strategies undertaken in times of crisis was considered and from it possible measures to confront the crisis were identified. In total 22 measures were chosen. Thus, the scale used was adapted from literature. The surveyed managers were asked if they applied these measures and to what extent. The measures taken to confront the crisis were classified using a 5 point Likert scale with 1 if the measure was not used and 5 if the measure was applied fully.

## RESULTS

In order to test the hypothesis an exploratory factorial analysis was undertaken which allowed to group the 22 named measures. First, a reliability analysis over all items was conducted. The coefficient obtained for Cronbach's Alpha was 0.836 which can be considered very good. Moreover, no significant benefits were accrued with regard to Cronbach's Alpha if some of the observed elements were eliminated (Malhotra, 1981). Thus, the unidimensionality of the scale can be accepted.

In order to group the 22 measures taken, a factor analysis was undertaken using the maximum likelihood method. The KMO test result, with a value of 0.770 is compatible with a good level of adjustment. Bartlett's test of sphericity took statistical values of 937.278 and a critical

value of 0.000 which leads to the rejection of the null hypothesis that the correlation matrix is equal to the identity. The study of the communalities after extraction and the anti-image matrix showed the suitability of all nine items. Convergence was achieved in few iterations.

For the extracted factors only those with an Eigenvalue above or equal 1 were taken into account. Afterwards, a varimax rotation using Kaiser's normalization was carried out for the

business decisions whose values are synthesized in table 1. Here only factor loads over 0.4 were considered. Table 1 displays of the resulting nine factors those three that have differences among men and women.

Table 1. Factorial analysis of the business decisions taken during the crisis

Factor 1 PROACTIVE MEASURES		3.18	3.36	3.01	.041*
We increased spending on advertising	.766	2.52	2.63	2.47	
We strengthened the commercial area	.604	3.38	3.55	3.19	
We looked for new business channels	.590	3.70	3.91	3.52	
We improved processes to save operating costs	.416	3.11	3.37	2.87	
We entered into strategic alliances with other companies to offer joint services	.474	2.61	2.78	2.46	
Factor 2 SOCIAL VALUE		2.49	2.71	2.28	.042*
We decreased or eliminated our training budget	.804	2.49	2.73	2.26	
We decreased or eliminated our budget for internal and external social spending	.662	2.40	2.63	2.16	
Factor 3 DRASTIC MEASURES		2.59	2.86	2.36	.016***
We renegotiated prices or payment conditions with suppliers	.639	2.71	2.67	2.79	
We reduced personnel in all departments	.523	2.80	2.84	2.76	
	<i>Factorial Load</i>	<i>Total Mean</i>	<i>Men Mean</i>	<i>Women Mean</i>	<i>ANOVA</i>

\*=Statistically significant, \*\*\*=Statistically highly significant

The first factor groups proactive measures. According to literature (Alonso-Almeida and Bremser, 2013; De Sausmarez, 2004; Enz *et al.*, 2011; Kimes, 2009; Okumus *et al.*, 2005) companies have to undertake these actions to overcome the crisis. The above cited researchers found that during previous economic crises strengthening of the commercial area and increased marketing spending were crucial to reach new market segments, put in the consumer's mind the company's image and conquer clients of companies that closed down and thus needed new service providers.

The second factor includes activities that companies eliminate in order to reduce costs before recurring to other cost cutting measures. It comprises measures like personnel development and corporate social responsibility. From an internal viewpoint these factors motivate employees and impulse a professional career development through educational measures. On the other hand, from an external viewpoint these factors are important for small companies since actions undertaken in this domain increase their visibility and strengthen their market positioning (Tullberg, 2005). Those activities are also important since they enable firms to maintain a high degree of service quality towards the final customer despite the changes that might be caused by the crisis.

The third factor groups the most drastic cost cutting measures as for instance lay-offs and renegotiation of corporate debt. In the case of service industries the lay-offs go in line with a service-level reduction and thus might lead to lower degrees of client satisfaction or the loss of the client (Alonso-Almeida and Bremser, 2013; Pearce and Michael, 2006). Even though these measures are easy to undertake and are more often used by companies than desired they carry a high social cost.

Subsequently an ANOVA analysis was conducted in order to determine difference between the decisions taken to face the crisis in male and female-led companies. The results have been included in the last column in table 1. As can be seen significant differences were found in the displayed three. Robust statistics from ANOVA found the same results.

It is evident that significant gender differences were found in decision making in the following categories: Factor one groups measures that according to literature are called proactive ( $F=4.241$ ; Squared Mean= $4.072$ ). Those actions help to maintain or increase the business activity in crisis times. Factor two describes measures that concern responsibilities towards employees ( $F=4.524$ ; Squared Mean= $6.260$ ) and factor three combines drastic

measures of cost reduction that companies can make use of in times of crisis ( $F=6.007$ ; Squared Mean= $7.193$ ). Differences are significant on the factor level only.

## **DISCUSSION OF RESULTS AND CONCLUSION**

### *Discussion of the results*

The findings obtained shed light about women's strategic decisions in companies and how they lead. The study has found that in the factors in which men and women took different

decisions women received lower values. This implies that women used those measures to a lesser extent than men. Therefore, it means that women apply less proactive measures in crisis times than men. Proactive measures are necessary to optimize and evaluate all the resources of the company and to strengthen inter-company relationships that the firm developed before the crisis (Pearce and Michael, 1997). These findings could be related to the fact that women could take fewer risks than men (Bardasi *et al.*, 2011). But it could also indicate that women use other measures of risk and based on them make different decisions (Eagly and Carli, 2007). It is needed to deepen this issue with qualitative data.

According to the leader style attributed to women, they keep the social measures intact and use to a lesser extent than men drastic measures to reduce costs. Thus, they might not be able to reduce costs as far as men. The biggest difference has been found in this third factor where male-led companies are those that use drastic measures mostly. However, since this study researches service industries, the results suggest that in male-led companies staff is dismissed and more pressure is put on remaining personnel whereas female-led companies follow a more responsible and sustainable business model (Thompson *et al.*, 2010). Therefore, the research hypothesis (*Gender is a significant factor in explaining strategic managerial decisions in critical situations -as a financial crisis- according to gender-specific leadership style*) is partially supported, because some similarities in making-decision in crisis times have been found, but also some differences have been disclosed. These differences are according to the leader style deployed by gender, albeit in the last two decades both women and men managers are changing and making a balance between task and person oriented strategic decisions (Rodler *et al.*, 2001).

In addition, the research showed that agencies led by women were in general smaller and younger. This data contains a mixed meaning. On the one hand it could mean that women in this specific subsector have fast access to management positions given their educational background and the glass ceiling does not exist or is easier to break than in other sectors. It would also imply that there are fewer barriers to reach top management positions in this kind of companies than in other sectors. This fact is supported by literature because previous research has shown that around the world tourism companies have more diversified and more equal boards of directors and administrative councils than companies operating in other sectors (Alonso-Almeida, 2011). Therefore, this sector presents a good starting point to research management from a gender perspective. On the other hand, this fact could underline what some authors have discovered (e.g. Ndemo and Maina, 2007) that women are 'pushed'

to create their own jobs since they cannot find adequate ones in the labour market. Thus, one could find young women leading companies in this sector despite having on average less experience than men. Although it could be a critical factor for firm performance, not always manager experience is significant (see Aterido and Hallward-Driemeier, 2011). The analysis of this specific situation of the tourism sector exceeds the limits of the current study but it will be included in future research.

### *Conclusions*

The resulting findings allow extracting a series of relevant conclusions for successful leadership. A study realized by Barsh *et al.* (2008) for the McKinsey Leadership project states that currently there are no differences between men and women regarding academic education, dedication and professional preparation. Given the need for more leaders that are able to manage successful companies it is hoped that more women will make it to the top.

First, the studied companies -both led by women and men- seem to have chosen the right measures to confront the crisis and survive. On the one hand, companies led by men decided to use new distribution channels via new technologies and networking while at the same time taking drastic measures to reduce costs and lay-off people. On the other hand, companies led by women strengthened their relationships with clients and added value to their offering while keeping employment and employment benefits (social value) as stable as possible. In the current economic situation managers who develop a leadership based on transformational leadership are better ready to understand the changes that take place in the market.

Secondly, with regard to the results using a statement made by Krishnan and Park (2005) both women and men are qualified to respond to the environment's difficulties and take the best decisions to maintain a company in the market. Companies should overcome their reluctance and strike down the barriers that hinder women to climb to the top given that the prevailing legends regarding underperformance and real results do not correspond to reality. On the contrary, companies might lose valuable opportunities to add to their human resources women that bring with them an innovative and fresh vision regarding business decisions. The current crisis has underlined that companies cannot continue to waste talent but instead have to break with former values and reinvent the way they operate and react in the market. In order to do this, they need well qualified and experienced men as well as women.

Inasmuch this article does not attempt to explain differences in performance, but only to verify that managerial decision are affected by gender. Performance in women-led companies should be a subject expanded in the future to satisfy that limitation. There it could be useful to employ hard financial figures and in depth business cases.

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## THE INTERRALATED EFFECTS OF CULTURE AND RELATIONSHIP QUALITY ON THE RELATIONS BETWEEN PORTUGUESE EXPORTERS AND ANGOLAN DISTRIBUTORS.

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### ABSTRACT

The objective of this research is to investigate the role of the relationship quality and culture between Portuguese companies and their export market intermediaries in Angola. In particular, we aim to understand the importance that the quality of the relationship has and the role of cultures in export activities.

An important aspect of this study is precisely the fact that it includes an African country, about which, in terms of the marketing literature, there is a strong lack of studies.

In terms of methodology we opted for a qualitative analysis; we present the results of two case studies of Portuguese exporting companies and one case study about an Angolan intermediate.

In general, the results are that the business relationships are influenced by trust, commitment, culture and similar values. As in the past Angola belonged to Portugal, communication is facilitated because both countries share some cultural traits. Such factors will influence the trade relations between Portuguese exporters and their Angolan distributors.

**Keywords:** Angola, Portugal, Exporter, Distributor, Relationship Marketing, Culture.

## INTRODUCTION

This study is of great relevance since, increasingly, Portuguese companies are not confined to the domestic market but they seek new markets to ensure their survival. Thus, it becomes relevant to analyze the quality of the relationships and culture in the relations between the Portuguese export companies and their intermediaries in the Angolan market. For this purpose we used the input from Morgan and Hunt (1994) that systematizes the KMV model.

The choice of the Angolan market is due to the fact that it is an expanding market, and also one of the most promising countries in the African continent. The trade balance in terms of Portuguese exports to Angola, from January to May 2011, is about € 787,923 thousand, according to data provided by the National Institute of Statistics (INE).

In addition, Angola currently is a major destination for the Portuguese exports outside the EU, being the fifth in the ranking of destination countries, accounting for an output of 4.55%, according to data provided by INE.

The objective of this research is to investigate the role of the relationship quality and culture between Portuguese companies and their export market intermediaries in Angola. In particular, we aim to understand the importance that the quality of the relationship has and the role of cultures in export activities, within this context.

## LITERATURE REVIEW

A growing liberalization, integration and competition in world economies since the post-war period have been responsible for the increasing engagement of firms in exporting activities (Douglas and Craig, 1995), because export plays a vital role in the world economic affairs and its importance is expected to grow further as markets become more globalized.

Export development has been highly regarded by both public and corporate policy-makers, due mainly to the substantial macroeconomic and microeconomic benefits derived from external trade. From a macroeconomic perspective, exporting can enable national economies to enrich their foreign exchange reserves, provide employment, create backward and forward linkages, and, ultimately, lead to a higher standard of living (Czinkota, Rivoli and Ronkainen, 1992). In microeconomic terms, exporting can give individual firms a competitive advantage, improve their financial position, increase capacity utilization, and raise technological standards (Terpstra and Sarathy, 1994).

The exporting phase of the firm's internationalization process is defined as the transfer of goods or services across national boundaries using indirect or direct methods (Young, Hamill, Wheeler, and Davies, 1989).

The interest in the impact of buyer-seller relationships in business markets has increased over the past decades. This interest reflects the importance of distribution in the value chain and the relevance of social networks and personal relationships for many conductive exchange transactions (Dwyer, Schurr and Oh, 1987).

In the same way, Achrol (1991, p. 78, 89) forecasts the rise of 'true marketing companies' within networks of functionally specialized organizations whose interrelationships, being driven, are "held together and coordinated by market driven focal organizations" by means of "norms of sharing and commitment based on trust".

Talking about exports, once a domestic manufacturer decides to introduce a product into a foreign market, a difficult question must be solved. Should the new product be distributed via a company-owned distribution channel, or is it more efficient to outsource distribution to an independent organization? Anderson and Coughlan (1987) believe that, for an economist, this is a question of vertical integration, the choice being between primarily captive agents (company sales force and company distribution division) or primarily independent intermediaries (independent sales agents and distributors). The former solution is an integrated channel, which generally gives the manufacturer more control than the latter, which is a non-integrated channel (Anderson and Coughlan, 1987).

#### *Relationship Marketing*

According to Dwyer et al., (1987); Palmatier et al., (2007); Sheth and Parvatiyar, (1995) quoted by Gupta and Sahu (2012), the evolution of relationship marketing has been one of the most significant developments in marketing over decades, particularly regarding to industrial marketing.

Relationship marketing refers to all business activities directed towards establishing, developing and maintaining successful relational exchanges (Morgan and Hunt, 1994).

Relationship marketing brings stability and decreased uncertainty to business, by acting as a barrier to competitor entry and maintaining a stable and solid base according to Alexander and Colgate (2000) (quoted by Gupta and Sahu, 2012).

According to Grönroos (1994), relationship marketing aims to "establish, maintain and improve relationships with customers and other partners as well as the maintenance of corporate profit, so that all objectives of all parties are satisfied." That is, there is a mutual exchange and fulfilment of reciprocal promises.

Chien and Moutinho (2000) argue that the level of involvement in relationships and information exchange are instrumental to the development and maintenance of marketing relationships and for buying behaviour and legitimacy.

In the case of bilateral relationships, the actors in exchange episodes are often committed to continuing relationships which involve neither a unified hierarchy nor necessarily comprehensive and detailed contractual obligations (Heide and Stump, 1994). This type of business relationship is driven by shared behavioural norms which allow for the adoption of common business behaviour, wherein opportunistic motives are constrained because of the long term benefits of conforming to system norms and other social pressures (Dwyer, Schurr and Oh, 1987). Marketing represents how important it is to develop and nurture relationships, especially when in the international arena.

According to Morgan and Hunt (1994) the expectation of reducing overall costs is a reason to build a committed relationship, thus affecting the customer-supplier relationship. The partners, in turn, should prevent opportunistic behaviour that would be detrimental to one of the parties.

The theory of Morgan and Hunt (1994) is assumed to be relevant in explaining the relationship between exporters and local intermediaries based on the concepts of trust and commitment, concepts which are central to the development of business activities based on the establishment, development and maintenance of successful relational exchanges. Thus, it can be concluded that whenever they are successful, relational exchanges contribute to cooperation between the parties involved.

According to Vahlne (1997), companies decide to choose to start the process of internationalization through exports to render markets closer in psychological terms.

Gupta and Sahu (2012, p. 63) state that an "effective relationship marketing programme provides better results in terms of increased customer base, sales and profitability". They maintain that marketing literature provides some important dimensions of relationship

marketing like commitment, trust, cooperation etc., these factors being very important for inclusion in any firm's marketing program (Gupta and Sahu, 2012).

### *Trust*

Within relationship marketing, trust has been recognized as an important concept (Lagrosen, and Lagrosen. 2012). Morgan and Hunt (1994) conceptualize trust as existing when one party has confidence in the reliability and integrity of the other exchange partner.

For Nicholson, Compeau and Sethi (2001), trust is the security in the reliability and integrity of the other party.

According to Abosag, Tynan and Lewis (2006), trust is based on emotion. These authors consider that trust that one party puts in the other party is based on feelings and emotions generated by love, empathy, politeness, similarity and concern for the other part, which is demonstrated in their interaction.

In Marshall's (2003) view, based on Blau (1994), trust is the belief that another person will fulfil its obligations and generally do what he can.

To Hakansson (1982), trust increase is a social process that takes time and must be based on personal experience. Therefore, interaction is important for interpersonal confidence building (Zaheer et al., 1998, Nicholson et al., 2001).

According to Boersma, Margreet, Buckley and Ghauri (2003), trust is on the expectation that one of the parties will be reliable in the fulfilment of the agreements, will play its role in a competent manner and will act honourably even when promises or guarantees of performance have been given. Relational trust is the perceived ability and willingness of the other party to act in order to consider the interest of parties in the relationship (Selnes and Sallies 2003). According to Abosag et al. (2006), trust emerges from the foresight of a part on his partner as for meeting future actions/behaviours to fulfil the promises (Zaheer et al., 1998), forecasts being based on an accumulated knowledge gained through interaction of the parties (Harris and Dibben, 1999) or based on the reputation of the partner or on other relationships (Johnson and Grayson, 2005). The expectations of the parties can be a good indicator of the level of confidence. In this sense it may be said that when the trust level is high, the expectations can be predicted with confidence as all parties feel secure in their interaction. But when trust is low, expectations will be clouded by uncertainties. From the standpoint of

Morgan and Hunt (1994), "willingness to trust" should be seen as a result (or alternatively, a potential indicator) of trust and not as a part of its definition.

Blois (2003) based on Baier (1986), states that trust is the acceptance of vulnerability to possible but not expected bad faith (or lack of good faith).

To Marshall (2003), quoting Carnevale, Pruitt and Carrington (1982), trust is a concomitant expectation that the other (in a dyad) will reciprocate.

Next are presented some authors' testimonies that corroborate that trust is crucial in business relationships.

Berry and Parasuraman (1991, p. 144) argue that the "company-client relationship requires trust in marketing services, since the customer generally buys first and then experiences."

According to Berry (1993, p. 1), "in the retail sector, trust is the basis of loyalty." In this sense, he concludes that the greatest obstacle to the success of alliances is the lack of confidence. It is also relevant to examine this concept from the perspective of the level of individualism of a country (Hofstede, 1980). According to Abosag et al. (2006) this perspective is crucial because people from an individualistic culture give more room for professional interaction and give little room for personal interaction.

Trust is a complex concept with multiple meanings and dimensions (Abosag et al., 2006). Defining the scope of trust is difficult and can be frustrating. A common feature in the various definitions is that trust involves a part that depends on the other party to fulfil its obligations. Trust was conceptualized in several ways. Some studies have conceptualized it as an unidimensional concept (Morgan and Hunt, 1994, Jap 1999; Gabarino and Johnson, 1999) while others conceive trust as a two-dimensional construct (Geyskens et al., 1996, Doney and Cannon, 1997; Joshi and Stump, 1999, Nicholson et al., 2001). Still others propose a multidimensional approach to the study of trust (Rodriguez and Wilson, 1995; Brashear et al., 2003; Miyamoto and Rexha, 2004, Johnson and Grayson, 2005). All these studies show a lack of consensus on the conceptualization and operationalization of trust. Once that trust is knowledge driven, missing or incomplete knowledge creates the need for trust.

According to Obadia (2008), an international organization, wherein the legal differences between countries make it difficult to enforce contracts (Zhang et al., 2003), the existence of trust is even more important, because the partners need to trust the promises made by the other partner (MacNeil, 1980). In this sense, trust is central to all relational exchanges abroad.

In short, trust exists when a partner has faith, hopes and believes he can deliver (something) to someone without fear of loss or damage, that is, to indulge in full security.

### *Commitment*

According to Berghall (2003), the concept of commitment, in business relationships, regards a phenomenon in which one side of the social interaction limits its behavioural alternatives, due to the presence of a long-term orientation.

To Morgan and Hunt (1994), committed relationships exist only when there is an enduring desire to maintain a relationship considered as important.

Some authors believe that the level of commitment a partner feels towards a relationship is of major importance in relationship development and subsequent success (Morgan and Hunt 1994; Wilson 1995).

To Abosag et al. (2006), commitment is like an asset, a good and/or an intention to continue to maintain a relationship in the future. A committed relationship is known as an enduring desire to maintain a relationship (Dwyer et al., 1987; Geyskens et al., 1996; Mooman et al, 1992; Morgan, and Hunt, 1994).

Commitment is often seen as an ongoing "investment" into activities which are expected to maintain the relationship (Blois, 1998). Commitment has also been found to be reciprocal in nature, and that successful relationships relying on commitment from both parties (O'Malley, Patterson and Evans, 1997).

According to Selnes and Sallis (2003), a commitment to collaboration is defined as the joint belief that the relationship is important enough to ensure joint efforts to maintain and strengthen the relationship.

To Abosag et al. (2006), a committed relationship is increasingly important; as suggested by Gundlach et al., (1995, p. 78), commitment "may very well become a focal point of explanation in marketing."

To Conway and Swift (2000), commitment can be seen as an intention to continue the course of an action or activity or desire to maintain a relationship.

Berry and Parasuraman (1991, p. 139), argue that "relationships are built on a mutual commitment."

According to Kim and Oh (2002), commitment is the extent to which a company is dedicated to a close and lasting relationship with the channel partner. It should be noted, however, that some authors warn for the fact that a committed relationship is a difficult and complex phenomenon, and a deeper understanding of this concept is hampered by the lack of a clear and complete commitment (Abosag et al., 2006).

To Rodriguez and Wilson (2002), commitment reflects the relative strength of an individual's identification with, and involvement in, a particular organization.

As mentioned by Abosag et al. (2006), who examined the role of specific investments in developing commitment throughout the life cycle of a relationship, a transaction specific investment (TSI) highlights the commitment at the exploration phase and has a positive effect during the decline phase. According to these authors, the parties recognize the need to maintain their relationship, due to the high costs associated with termination or the continuous, safe access to important benefits. In summary, since relationships require investments, the parties recognize the need to maintain their relationship, since the costs associated with termination of these and looking for new partners are very high. According to Abosag et al. (2006) in the relationship marketing literature, it is assumed that the parties' ability to exercise greater social interaction reduces uncertainty (Achrol and Stern, 1988) acts as a barrier against opportunism of the partner, improves the quality of the relationship, helps to build satisfaction in the relationship (Selnes, 1998), increases the attractiveness of the relationship (Harris et al., 2003), and leads to better cooperation.

Besides the analysis of the instrumental dimension (financial commitment) it is also relevant to study the affective commitment. This one is more personal, involving social interactions among individuals with partner organizations. However, as it is reported by Gundlanch et al. (1995) the behavioural aspect of the affective commitment is critical in terms of developing trust, reciprocity, integrity and solidarity, which are required to maintain long-term relationships. Meyer and Allen (1991) argue that the level of emotional commitment in a relationship does not affect the degree of calculation commitment and vice versa. Abosag et al. (2006) contradict this argument and, instead, they argue that the parties may increase the commitment to a course of action.

The key factor in the early development of affective commitment, according to Abosag et al. (2006), is the social bond/emotion. A social bond leads to the creation of the emotional dimension and the cognitive dimension of commitment (meaning perception, knowledge,

beliefs shared by parties), which are important antecedents of affective commitment (Sanchez and Iniesta, 2004).

Despite it is understandable that a tight personal relationship helps the duration of trade relationships, a personal relationship may have a negative impact on trade relations in some situations. In this regard, Alajoutsijarvi et al. (2000) report the damaging impacts of personal conflicts in trade relations. They point out that the costs of the emotions at the end of relationships can be high when the level of affective commitment is high (Meyer and Allen, 1991).

Trust and commitment are key elements for relationship marketing strategy success (Siguaw, Simpson and Baker, 1998).

Moreover, Tellefsen and Thomas (2005) argue that the link between personal trust and personal commitment has not been fully examined or tested in the literature.

### *Culture*

In the international environment, culture is an element of paramount importance when a company decides to internationalize. There isn't much agreement on how culture should be defined. The choice of a theoretical and conceptual frame means the choice of different objects, methods and research instruments and perspectives. Next we present several views for this concept.

Parsons (1951,1954,1960 and 1964) consider the culture of human societies as a coherent whole, harmonious and functional in relation to the imperatives of the social system and he believes that the social order will eventually be formed whenever the symbolic values are formulated in a coherent and harmonious manner and internalized by social actors.

Hall (1973, 1977 and 1990) uses criteria to differentiate cultures in order to facilitate international comparisons and an anthropological description of the different national cultures. That is, he identifies two behavioural criteria which are significant in terms of the impact on the approaches to work and professional relationships: "Polychromic cultures" (that means that a number of actions are fulfilled at the same time or in the same period) and "monochromic cultures" (refers essentially to the performance of an activity at a time) and "reference to the context" (organization of information that may be implied (high context) or explicit (low context), versus "content of the message" in human communication in societies. According to this author, Portugal and Africa fit into the "high context" category.

National culture is like a collective mental program of the human mind or a system of patterns and meanings about the way of thinking, feeling and acting on common problems that characterizes and distinguishes one group or category of people from another group or category (Hofstede, 1980 and 1991).

Hofstede, Trompenaars and other authors use an onion diagram, wherein culture is depicted as consisting of several layers, in which centre, in the main and deeper level, are the values, while the external layers are more visible, namely the level of symbols, heroes and rituals.

In Hofstede's research, which has more than 30 years, Portugal exhibits the following scores: Average to high power distance (63), low individualism (27), low masculinity (31), very strong need to control uncertainty (104) and short-term orientation (30). Angola exhibits the following scores: Power distance (80), low individualism (25), masculinity (45) and need for control of uncertainty (85) (Hofstede, 1980 and 1991).

Skarmeas et al. (2001) suggest that the constructs reflecting cultural differences should be included in studies about the relations between exporters and importers. Conway and Swift (2000) reported that, when there is a high level of psychic distance, the establishment and/or development of business relationships can be damaged. Swift (1999) mentions studies that address the impact of culture on the interaction process between buyers and sellers. Kale and Barnes (1992) suggest that international interactions should be affected by aspects of the national culture. Shankarmahesh et al. (2003) conclude that a strong organizational culture, characterized by low level of individualism, power distance, uncertainty avoidance and masculinity, favour the maintenance of international relations. Mehta et al. (2003) add that it is necessary to include aspects of cultures when the research deals with feelings and behaviours of actors belonging to different countries, since underlying the culture of each country are "systematic differences in behaviour" (Steenkamp, 2001). Companies with international operations need to evaluate the possible impact of cultural differences on the partners' reaction to the marketing strategies. Rodriguez and Wilson (2002) argue that, on one hand, cultural distance contributes to the emergence of communication problems, distrust and distant interpersonal relationships, and, on the other hand, an intercultural adjustment is required for the development of commitment in the relationship.

## **OBJECTIVE AND RESEARCH QUESTIONS**

The objective of this research is to investigate the role of the relationship quality and culture between Portuguese companies and their export market intermediaries in Angola. In

particular, we aim to understand the importance that the quality of the relationship has and the role of cultures in export activities. This objective can be deployed into two research questions:

RQ1) How do the differences and the similarities between Portuguese and Angolan cultures and the values influence the quality of the relationship in trade relations between the Portuguese exporting companies and their Angolan distributor(s)?

RQ2) Why do trust and commitment influence business relationships between the Portuguese exporting companies and their Angolan distributor(s)?

## **METHODOLOGY**

According to Yin (1994) the case study methodology is more suitable when the research questions involve the "how" and "why", as it happens in this research, allowing to greater contact with the players involved, resulting in a more detailed and thorough analysis, which allows us to highlight details that might otherwise go unnoticed.

The geographical scope of this study is Portugal and Angola. Given the cross-cultural nature of this study we will take into account the specific nature of these markets.

This methodology has been applied to the field of international strategic management, since one has access to information from those involved in decision making, which results in being able to better analyze, and in more depth, one's options (Rialp, 1998).

According to Morse and Richards (2002), in areas where the skills are not well cemented or where existing theories seem inadequate, it is appropriate to opt for this type of analysis.

When choosing a single case study or multiple case studies, it was taken into account that a "potential weakness of a case study relates to the fact that this case could prove to be different from what was initially expected" (Yin, 1994, p. 41). According to this author the option for a single case is justified only if that case is critical (in order to test a well-founded theory).

According to Huberman (1994), the selection of the cases should be guided by theory, in order to establish a reference from which one can meet the objectives of the investigation, not to mention the limitations of time and resources. According to Eisenhardt (1989), the selected cases may have the function to replicate previous cases to extend the theory or they may still be chosen to fill a theoretical category or to exemplify polarized cases. According to Dubois and Gadde (2002) more interesting than the similarities to be found among the cases, are the

differences and their possible explanations. In this sense, it will be interesting to study contrasting cases. Based on what was proposed by Yin (1994), the choice of the cases should meet with certain objectives between the three possible options:

- Selecting cases fulfilling the theoretical categories in order to extend the theory.
- To opt for cases that serve as replication, to test the theory, or
- To choose contrasting cases to extend the theory.

In summary, cases should be relevant (George and Bennett, 2005) and with a potential for learning (Dubois and Gadde, 2002), in order to be able to build a more complete and noticeable mosaic.

The criteria for the selection of the case studies were:

- To be successful Portuguese export companies to the Angolan market.
- To export to the Angolan market through a distributor based in Angola.

In order to fulfil the criteria and to meet with the suggestion of the authors mentioned above it was decided to ask to the Agency for Investment and External Commerce of Portugal (AICEP, EPE), in August 2011, the most recent list of the fifty largest Portuguese companies exporting to the Angolan market.

According to Miles and Huberman (1994), one of the advantages of using a qualitative methodology is that the analysis may focus around phenomena in their natural environment, and therefore the data collection occurs close to the situation under consideration.

The methods to determine the reliability of a measuring instrument used in qualitative research are the validity of interviews, the validity of documentary analysis and the validity of the observation techniques. According to Yin (1994), a case study can be used to test a theory.

## **POPULATION AND SAMPLING**

The sampling process is not random and is based on the latest data provided by AICEP in August 2011, including the list of the top 50 Portuguese exporters and their respective counterparts (Angolan distributors). In short, companies were not selected randomly, nor

intended to be a representative sample of any manufacturing business (belonging to different sectors in order to have an overview of the market). We are interested in companies that have been engaged in long-term relationships with their distributors.

The sample was selected according to the criteria of external validity/reliability. As for the activity sector, we opted for companies belonging to different sectors of the market, in order to get as much information about manufacturer-distributor relations in different businesses, therefore increasing this study validity.

The option to select companies within the list of the 50 largest Portuguese exporting companies and their respective pairs provided by AICEP was based on the fact of these being an added value to this investigation.

The sample was made up by two case studies of Portuguese export companies (Petróleos de Portugal- Petrogal. S.A. (Galp Energia) and Unicer Bebidas, S.A.) and one case study of an Angolan distributor (Mota & Tavares Lda.).

Unicer Bebidas, SA. |Unicer| actually is the Portuguese company, in all the sectors of activity that exports more to Angola. Unicer is a company that is now 125 years old and exports to Angola since the middle fifties of the twentieth century.

Mota & Tavares Lda. |M&T| was founded 50 years ago and it imports from Portugal since 1970.

Galp Energia |GE| founded in 1976, belongs to the oil and power sector, is present in Angola since 1982.

## DISCUSSION

The **first research question** investigates how the differences and the similarities between Portuguese and Angolan cultures and the values influence the quality of the relationship in trade relations between the Portuguese exporting companies and their Angolan distributor(s)

The following interviewees' statements, and the respective theoretical explanations, will help us to understand the influence of culture and values in this context

Both Portuguese and Angolans speak the same language, which may represent "a trade facilitator" (Ghemawat, 2001):

*“The Lusophone component of Galp Energia operates as a further **facilitating factor** of the relation of cultural affinity between the parties,” |GE|*

*“...the same language, other easiness.” |M&T|*

Although the Portuguese and the Angolans share the same language, the way to communicate must be adapted to the local culture.

*“Unicer made a huge effort to communicate locally either by **the use of local expressions** in language, or through the **“Angolanisation”** of events like the Super Bock Super Rock.. |Unicer|*

There are many common habits and customs:

*“Portuguese companies at this time, some Angolans have **bought from Portuguese companies for a simple reason: habits and customs**, there were 500 years. And Portugal and Angola, like it or not, created a family of 500 years that is almost difficult to separate.” |M&T|*

*...“The culture is the same, because the Portuguese have a culture of long years of qualities and customs of Angola, the food, habits of dressing, are equal. Now what happens is that sometimes, both on one side as the on the other, are not properly prepared and make things easier, and then things go wrong. But **the culture is the same**, no differences. Habits, customs of the Angolan and Portuguese are the same and you cannot change them.” |M&T|*

Other important cultural traits are the notion of time (Hall, 1977) social hierarchies and national pride and nationalism.

*“The African concept of time is completely different from the European concept. There is a **bias for the short term**. The African reality is more oriented living day after day and the moment without a long-term referential. This fact often leads to misunderstandings as for a benchmark for the **assessment of investments”**.*

Angola may be considered a p-time country (Hall, 1977) since *“there is an established tolerance for delays and non-fulfilments.” |Unicer|*

As for distinct social hierarchies, *“it still prevails **the importance of age and position** in the family as a benchmark of social relations. For example, the **importance of the elder** in decision making and in social relations.”*

Angola is a low individualism country, and status oriented and so, the *“**recognition by the group** is determining of the individuals’ attitudes. |Unicer|*

National pride and nationalism are quite obvious in the following statement: *“There is an extreme sense of belonging to the Angolan nationality and patriotism; therefore, the business behaviours must take into consideration this sense of belonging. It is easy to adopt behaviours that offend the notion of “Angolanity” which can have severe negative repercussions on business and on brands. It’s easy to be perceived as neo-colonial.”* |Unicer|

These statements show the importance of cultural empathy, defined by Phillips et. al. (1994) (quoted by Swift, 1999) as the ability to (a seller) to put himself in a buyer position, from another culture. As previously maintained by LaBahn and Harich (1997), cultural sensitivity is needed to succeed in international markets, since importers may be susceptible to behaviours they deem inappropriate. Sensitivity to time conception differences, to a very stressed sense of nationalism and to social hierarchies is of paramount importance in doing business with Angolans.

An expression of nationalism is the landlord behaviour, which is very deeply rooted in the Angolans’ beliefs and business practices, maybe due to the several centuries of the Portuguese colonization:

*“The Angolan deems to be the owner of his country and therefore he thinks he can take possession of some income from foreign business operating in his country. This leads, for example, to the requirement of quotas and shares in companies without capital inflows* |Unicer|.

The influence of values like honesty, credibility and transparency on trade relations success, between Portuguese and Angolan companies, is quite clear from the following statements:

*“One of the main bases is honesty...” ... “...because of this aspect Angola prefers to work with the Portuguese than with any other, this is known. ... “Most of moral values are honesty from both parties. Knowing that I will deliver a product and the customer will be satisfied with the product, he will not be badly served: This is the main base, don’t sell to the customer a pig in a poke. This is the main base in moral values.”* |M&T|

*A business with a Portuguese is always faster. And if there is understanding and honesty from both parties it is always much, much faster than with any other foreign business.”* |M&T|

To be credible *“the Company must demonstrate financial and operational capacity, i.e. the existence of physical facilities and human resources in order to succeed in marketing the company’s products* |Unicer|.

Being transparent in trade relations, in this context, is also important to succeed:

*Will to share market knowledge and philosophy of information share about the market, customers and business conditions in order to enable maximum efficiency of the joint operation and maximizing value. |Unicer|*

Understanding the importance of local values, like masculinity and status recognition, and social practices, like rumour spreading, and being able to convert them into strategies may represent the difference between product success or failure

*“Crucial to the success of the product has also been the creation of myths about the brand. The Super Bock became known in the Angolan market as the GTI, beer with power to the riot troop. That is, through “rappers” and expressions of contemporary Angolan popular music a myth was created that **responds to the desires of masculinity in society** and that corresponds to the diffusion of the belief that Super Bock is a strong beer only **for those who have power**, those who are manly, hence Super Bock for the riot troop...Displays of virility are a form of trust building or of coming together with partners. This is an example of how the knowledge of cultural realities, at the consumer level, can be used for the communication strategy for a product/brand. This however requires **the knowledge of the idiosyncrasies of local consumers and of the culture that shapes their behaviours.**”*  
|Unicer|

*“The rumour spreads very fast and can be used as a weapon of guerrillas to positively influence the performance of the company’s products, as well as, if not controlled, it can cause irreparable damage to a brand or a business relationship with a distributor.”* |Unicer|

Understanding local business ethics idiosyncrasies and being able to cope with them is of paramount importance

*“Most relationships, in Angola, are defined outside the current legal context. There is a prevalence of personal relationships and plots. **They set up creative ways to make money that sustain an entire subsistence economy.** Without knowledge of the rules in force in the informal sector, on which substantial part of the distribution networks of consumer products is based, **you cannot successfully do business in Angola.**”* |Unicer|

**Summing up, the common language, the habits, customs and social practices, the notion of time, the social hierarchies, the national pride and its expression, the existence of cultural empathy, the people’s values, the masculinity expression and the business ethics, strongly**

**influence the trade relations between the Portuguese exporting companies and their Angolan distributor(s).**

The **second research question** investigates why does trust and commitment influence the relationships between the Portuguese exporting companies and their Angolan distributor(s). The following interviewees statements help us to understand how to build trust and commitment, and their influence on business relationships, within this context

*"... **trust must exist** between both parties. The activity of Galp Energia in the Angolan market has demonstrated the existence of this perennial feature, and **both parties have fulfilled their commitments.**" |GE|*

*"Exactly. This is **the main base**, there has to be **trust and commitment.**" |M&T|*

*"I have been working with Portugal **for many years**, I have good relationships, and they all are **my friends.**" ... "He is a friend of mine and when I come to Portugal, I have all cars, I have to go to the factories, so I can only say good things about Portugal. **In every corner I have a friend, friend.**" |M&T|*

*"Most important, from both parties, not just one. If both parties have this behaviour, **the deal will go far and builds friendships**" |M&T|.*

*"... the relationships with our partners are based on **mutual trust** which has proved to be robust **over the years.**" |GE|*

The trust dimension "benevolence" aims to assess whether the customer sees the exporter as a friend and believes that he is on his side (Siguaw et al., 1998). These statements show the importance attached to affective trust and its role in building relationships that last "for many years" |M&T| and "robust over the years" |GE|. The commitment dimensions portrayed here are the continuity commitment - which can be referred to as the importer's desire to continue the relationship with the distributor (Skarmeas et. al. 2002) – and the affective commitment which is more effective than the calculation commitment in maintaining relationships (Sanzo et. al., 2003). From the statements, one may confirm that trust is a precondition for increased commitment (Mietilla and Moller, 1990) and, like commitment, it is often stated as a vital factor in successful relationships, mutual trust being a main factor in long-term relationships (Takala and Uusitalo, 1996).

Opportunistic behaviours can damage trust. Li and Ng (2002) state that there may be opportunistic behaviours in export channels, when the cultural gap and psychic distance hinder communication. This may explain why the Angolan importer M&T trusts more the Portuguese exporters:

*"Pig in a poke. And in Portugal, throughout this time I have no problem. I do not mean that there are no individuals, but I have no problem."* |M&T|

*"It helps a lot, because the culture is the same, the habits are the same and there is an understanding and doing business is fast because that is what sometimes, when you are going to do business for example with a Chinese guy, with an individual of another country that has not the same language, it is not the same culture, the same customs and habits, it is always more difficult, more time consuming".* |M&T|

Confirming the interviewee's statement, Harris and Ghauri (2000) note that sharing the same language, beliefs and understandings is required for high quality interactions and trust development to occur.

The level of trust in a relationship has been assessed by evaluating in what extent one partner is on the other's side (Siguaw et al., 1998), in what extent a partner is concerned with the other partner's business (Johnson et al., 1996) and in what extent one partner can count on the other when circumstances change or in an emergency situation (Sanzo et al., 2003). All these three trust items are recognizable in the following M&T's statement.

*"...he phoned me to say he was troubled with the payment of things, it was not much, \$30 000 or \$45 000 and if I could help out. I sent, I transferred that money and I told him not to send the goods, to keep them until we see how it goes in the next 15 days; a week later there was a withdrawal then the goods were settled within the price they could sell. Therefore it was this help that I gave because otherwise he said he would have been obliged to shut down the factory."* |M&T|

The following statements show the importance of the dimension "competence" (Walter et al., 2003) in building trust:

*"You have to develop a climate of mutual trust, so that Unicer has confidence in the ability of the entity distributor to meet its commitments and to respect the values of the brand, not causing any damage to its image and possessing the ability to distribute products with success."* |Unicer|

*"...distributors must demonstrate their ability by repeatedly placing orders."* |Unicer|

Reputation is also a process of building calculation trust (Doney and Cannon, 1997), that is a company may be trusted "because they are who they are" (Conway and Swift, 2000)". Elg (2002) argues that trust may be based on the general reputation of the company

(To build reputation) *"the distributor and/or its members **must have to demonstrate an enduring presence in the market and to be able to attest by his reputation the medium/long-term commitment to the market.**"* |Unicer|

The demonstration of commitment in relationships should be a priority, in order to build partners' trust (Buttle, 1996) since commitment serves to discriminate between those "who stay" and those "who leave" (Mummalaneni, 1987, quoted by Wilson, 1995)

*"It has always remained the same, simply because here **in Porto (Portugal) everyone knows me.** Now after independence, because I was in debt in the market square here in Porto, \$ 7 million, it was a supply to the state (Angolan) and the state did not pay me, then tomorrow, we will pay tomorrow. And then they decided to pay **and I paid** by two or three instalments, here in Porto, **I had no problems ...**"* |M&T|

*"Especially if you have paid in advance. Portugal does not, **Portugal if one pays in advance; they fulfil (the contract).** It is very difficult to miss their commitments. Even me, I appreciate in all the imports."* |M&T|

The fulfilment of one's obligations can build trust. This is quite obvious from these statements. Cognition based trust may result from the perception of performance behaviours and achievements of the partner, such as ... the fulfilment of the responsibilities of a part towards the other (Chen et al., 1998). Trust may be conceived as a belief in the reliability of the partner and the fulfilment of its obligations (Schurr and Ozane, 1985).

*Over the years **I have credit, a friendship** with all the companies, **all give me credit.** We have a great friendship, **over 30 or 40 years.**"* |M&T|

Parkhe (1998) identified three common issues in trust definitions: trust is related to uncertainty about the future, trust entails vulnerability and it is granted to someone whose behaviour is not under one's control. This being said, credit granting means that you trust the other party, since you don't know for sure that you'll receive the money.

Granting distribution exclusivity creates the conditions to build calculation commitment (Gilliland and Bello, 2002) as it becomes apparent from the following statements:

*“Firstly, commitment to the UNICER brand and products and desire to work in exclusive with company’s brands...reflection of the desire of the operator to develop UNICER brands”. |Unicer|*

**Summing up**, the statements above reveal the great importance of building trust and commitment in the relationships with the Angolan importers. Friendship is valued and it leads to long lasting relationships, i.e., benevolence trust builds continuity commitment and affective commitment.

Between Portugal and Angola the psychic distance is low, which may explain why mutual trust is higher comparatively to other markets, allowing for faster and easier business negotiations and giving rise to less frequent opportunistic behaviours.

If a partner shows he is concerned with the other partner’s business and is helpful when an emergency occurs, this may be a path to trust building and a catalyst to sound relationships.

While the regular fulfilment of obligations, the exhibition of ability and credit granting are trust builders, granting distribution exclusivity may be a way to build calculation commitment.

## CONCLUSIONS AND IMPLICATIONS

The general objective of this paper is to investigate the role of relationship quality and culture between the Portuguese export companies and their intermediaries in the Angolan market. In this particular case, we aim to understand the importance of the quality of the relationship and the role of culture and shared values in the export activities.

The three case studies analysed relate to two Portuguese companies that export to the Angolan market and one case study concerning an Angolan distributor.

One of the objectives of this paper was to understand the influence of cultural differences and similarities, between the Portuguese and the Angolans, on export relationships.

A common cultural issue is the language. It became apparent that language facilitates the relationship, although the knowledge and the use of local expressions may be necessary. Common habits and customs, acquired by the Angolans through centuries of Portuguese colonization, may influence the choice of Portuguese suppliers over suppliers from other countries. Even though, a certain “Angolanisation” may be required.

On the contrary, the African concept of time is completely different from the European concept. There is a bias for the short term which may hamper business objectives setting, the assessment of investments, definition of strategies, etc.

Angola is almost a new born independent country which may partially explain the existence of a very strong sense of belonging to the Angolan nationality and patriotism. Thus, it is very important to avoid behaviours that offend the notion of "Angolanity". An expression of this is the landlord behaviour, meaning that the Angolans claim they can take possession of some income from foreign business operating in his country, somehow reducing the attractiveness of doing business locally.

Other cultural traits are the reverence for elder people, the importance attached to social position and to recognition by the group. The knowledge of these realities may help in, for example, having a proper social behaviour and in carrying out business negotiations and in choosing the right advertising messages and opinion makers.

Values like honesty, credibility and transparency on trade relations are valued and are of paramount importance in doing business with local partners besides hastening business. Portuguese business partners are generally viewed by the Angolan importers as, honest and credible. Other values, like masculinity, may be used in advertising campaigns to successfully position brands. Fast rumour spreading is a local reality that, if properly used, may benefit companies and brands.

Understanding business ethics idiosyncrasies - which are different from those in most Western European countries - like creative ways to make money, and being able to cope with them, may represent the business success or failure

Another objective of this paper was to understand why trust and commitment influence the relationships between the Portuguese exporting companies and their Angolan distributor(s).

From the interviewees' statements, one may confirm that trust and commitment are the main bases to build and develop relationships within this context and the former is a precondition for the later. It is also clear that affective trust has an important role within this process

As it has been shown previously, the cultural gap between Portugal and Angola is small, which may prevent opportunistic behaviours and consequently reinforce the level of trust in business relationships between these two countries.

Several trust builders are identifiable in the statements, such as being concerned with the partner's business, assistance when an emergency situation occur, perceiving the other partner as a friend, knowing that the other party is on one's side, credit grant and exclusive distribution grant.

The dimensions "competence", "reputation", "fulfilment of the obligations" and "reliability" are also evident.

In general, the results show that trust, commitment, culture and similar values affect the way how relationships are managed and its outcomes. Confirming some theoretical proposals, it becomes quite clear that these constructs affect the trade relations between Portuguese export companies and their Angolan distributors. It is also evident that the knowledge of some market idiosyncrasies is indispensable to succeed in the Angolan market.

The implications of this study for management are very important since managers can realize how they can do business/international trade in this specific market, Angola.

However the study's results should be interpreted with caution. Given its qualitative nature, there are limits to their generalization.

Future investigation can replicate this study in other colonizer/colonized pair of countries in order to assess if the results hold.

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## PARTNER SELECTION IN CO-OPETITION: A THREE STEP MODEL

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### ABSTRACT

Co-opetition partnerships refer to developing cooperation efforts between competitors. The scarcity of studies conducted in this field to date provides limited contribution for the understanding of the partner selection process in this particularly paradoxical concept. This paper aims to contribute towards a better understanding of the partner selection process, which anticipates a successful co-opetition partnership. This study follows a methodology based on systematic combining for the qualitative analysis of four cases of domestic co-opetition in Portugal. A sample range of eight companies was selected for a series of semi-structured interviews. After data was collected, coded and analysed, results indicated that prior personal relationships between decision makers are facilitators for the implementation of cooperation partnerships with competitors.

Based on these findings, this paper proposes a 3-step model to explain the process of partner selection for co-opetition partnerships. According to this model, after opting to commence a new cooperative business alliance, the manager undergoes a first unconscious selection based on his/her own prior personal relationships, followed by a conscious and judicious selection based on specific criteria related to partner's operational skills, resources, effectiveness and trust.

**Keywords:** co-opetition, partner selection, personal relationships, networks

### INTRODUCTION

*"Sleeping with the enemy"* is how Quint (1997) illustrates co-opetition. Indeed, co-opetition partnerships imply tight cooperation between competitors simultaneously entailing a *"war and peace"* concept (Brandenburger and Nalebuff, 1996) that involves the notion of *"compete*

*and cooperate at the same time*”, as stated by Novell's CEO Raymond Noorda (Ritala, 2010; Luo, 2007). Co-opetition is thus inherently paradoxical as the question of why a company would join forces with a competitor and share its competitive advantages appears to be dubious. (Schmiele and Sofka, 2007). This paradox also lends itself to the question of how a firm would then proceed to select a competitor to partner as co-opetition. In other words, what are the criteria, factors or considerations that influence the selection of a competitor and its reciprocal acceptance of combining strengths to create a co-opetition strategy. While many researchers attempt to explain why the phenomenon occurs (Bengtsson and Kock, 2000; Dagnino and Padula, 2002; Zineldin, 2004), not many have described how the “enemy to sleep with” is chosen. Curiously, in a study on domestic co-opetition, Schmiele and Sofka (2007) observed that the prevalence of co-opetition partnerships was higher among graduated managers. In the same study, the authors report that the same phenomenon is unnoticed in international co-opetition. In the exclusion that co-opetition is not directly linked to the managers' level of education, Schmiele and Sofka (2007) propose that the existence of prior personal ties could facilitate the formation of domestic co-opetition partnerships, as personal networks are known to be important channels for the flow of knowledge. This observation marks the foundation of our research question: How are competitors chosen to team up for a co-opetition partnership? To answer this question, we have conducted an exploratory qualitative analysis following an abductive approach and therefore, hypothesis has not been formulated.

We've commenced by identifying four cases of domestic co-opetition and conducted interviews with top managers in order to determine how each co-opetition partnerships started. Case analysis was carried out through a Systematic Combining methodology (Dubois and Gadde, 2002) based on Grounded Theory (Glaser and Strauss, 1967) in order to propose an answer to our research question. From the analysis of these cases we learnt that prior personal relationships impacts positively on the creation of co-opetition partnerships and we've proposed a model to explain this process further. The proposed 3-step model comprises of an unconscious pre-selection of partners based on prior personal relationships, followed by a conscious selection based on judicious criteria and finally concluded with an invitation for partnership.

## LITERATURE REVIEW

- **Co-opetition partnerships**

The concept of co-opetition has been introduced in the academic literature in 1996 by Bradenburger and Nalebuff (Ritala, 2010). The term is a portmanteau of “cooperation” and “competition” aimed to describe the ambivalent nature of a partnership between competitors. Despite the inherent paradox in co-opetition (Brandenburger and Nalebuff, 1996; Schmiele and Sofka, 2007), reasons pointed out as leading to such alliances are the sharing of costs, risks and/or knowledge in Research & Development (Dagnino and Padula, 2002; Schmiele and Sofka, 2007), Product Development (Bengtsson and Kock, 2000; Zineldin, 2004), Innovation (Zineldin, 2004), Production (Dagnino and Padula, 2002) and Marketing (Bengtsson and Kock, 2000; Zineldin, 2004; Ritala, 2010). Bengtsson and Kock (2000) reminds us that the complexity of such relationships results from the intertwining of two opposite interactions, in that partners can benefit from both: from collaboration partners can reduce costs for new product development, reduce lead times and benefit from partner's core competences; from competition, each firm is driven to differentiate themselves and their products and services and to perform more efficiently than its partner.

It is commonly accepted that partner selection is one of the most influential factors for the success of business alliances (Geringer, 1991; Shah and Swaminathan, 2008). The relevance of the choice is of such importance that Cummings and Holmberg (2012) refer to partner selection criteria as critical success factors, given that an unfit initial partner selection may even destroy the best possible alliance management capabilities. However, to the best of our knowledge, no research has been made on the partner selection process prior to the launch of a co-opetition partnership. For this reason, our literature review on partner selection is based on the existing literature for Strategic Alliances.

- **Factors for an enduring partnership**

On exploring long-lasting alliances, Zineldin (2004, p.781) identifies 7 factors that determine the development of enduring and mutually beneficial business relationships:

- *All parties are committed to be engage in an interactive exchange relationship;*
- *Each party can contribute with something valuable for the other parties;*
- *Relationship is perceived by all parties as mutually rewarding, by which each party is willing to give something of value in order to receive something equally valuable in return;*

- *Each party is free to negotiate the terms and conditions for the cooperation agreement;*
- *All parties are able to freely communicate and interact with each other;*
- *All parties recognise that ethical values, interdependence, commitment and adaptation are crucial for a sustainable long-term relationship;*
- *All parties can find a positive balance between pros and cons of the relationship.*

It is interesting to notice that all these factors make reference to partners (the parties), thus clearly indicating that the success of mutually beneficial business relationships depends firstly in a good selection of partners – the right match, on their joint coordination, on their mutual acceptance and understanding.

- **Partner selection process**

Motivations for the choice of partners should be clearly distinguished from motivations for a partnership formation. On such differences, Al-Khalifa and Peterson (1999) stress that motivations involved in partner selection differ from motivations for entering into a partnership, the former being a “means” for the achievement of the “ends” implied by the latter.

Bierly and Gallagher (2007) describe alliance's partner selection as a complex process influenced by three endogenous factors – fit, trust and strategic expediency – depending on the extent of two other exogenous factors – uncertainty and time constraints. According to the authors, as long as the company has sufficient time and information, the search for strategic fit is the first step when choosing a partner. When information is lacking and uncertainty rises then trust becomes important as a selection criterion. However, these factors can only explain the process in the absence of any significant time constraints, otherwise response will be based on strategic expediency, described as the ability to make effective partner selection decisions under time pressure. The authors describe that in such cases skilled managers will tend to effectively rely on intuition due to the difficulties imposed by time constraints in following a rational decision-making approach.

- **Partner selection criteria**

General motivation to partner selection has been described as being related with several purposes. The first and most cited approach was introduced by Geringer (1991) who had first

distinguished task-related and partner-related dimensions of selection criteria. In Geringer's (1991) conception, task-related criteria refer to operational skills and resources, which are required for the success of the partnership, whereas partner-related criteria group factors are associated with the efficiency and effectiveness of partners' cooperation. Despite this classification being widely accepted by many scholars, as Das and He (2006) notice it's not always clear and remains somewhat confusing, as the same criterion may be enclosed in either set of dimensions in different studies. Das and He (2006, p.126) hence suggest the following grouping of criteria in these 2 major categories:

- *“Task-related criteria: complementary products or skills; financial resources; technology capabilities or uniqueness; location; marketing or distribution systems, or established customer base; reputation and image; managerial capabilities; government relationship, including regulatory requirements and government sales; help in faster entry into the target market; and industry attractiveness.*
- *Partner-related criteria: strategic fit or interdependence, or compatible goals; compatible or cooperative culture and ethics; prior ties and successful prior association; trust between top managers; strong commitment; similar status, including size and structure; reciprocal relationship; commensurate risk; and ease of communication.”*

In addition to these two sets of partner selection criteria, Cummings and Holmberg (2012) also introduce learning-related and risk-related dimensions of selection criteria. In this conception, learning-related criteria refer to the partner's attributes that enhance learning from knowledge transfer, whereas risk-related criteria are those arising from the interdependence nature of alliances.

Altogether, the widely accepted and cited task-related and partner-related dimensions of partner selection criteria, despite being a structured and valuable attempt to explain the partner selection process, it is not always a solid or self-sufficient approach to describe that phenomena completely. It seems that there still remains an absence of an unifying theory capable of explaining partner selection process as a whole in strategic alliances in general and in co-opetition in particular. It seems as well that the study of influential factors or selection criteria for the choice of partners has not yet been depleted.

- **Prior personal relationships**

As Ganguli (2007) notices, the dominating and most relevant part in a co-opetition strategy is cooperation. Corporate success on cooperating companies depends, to a great extent, on the quality of cooperation, since it's directly linked with its cooperation experience (Fink and Kessler, 2010). Effective cooperation, in turn, relies on how good a relationship is between all the involved parties.

Studies on the field of partner selection seem to point at task-related and partner-related criteria to be on the basis of the choice of decision makers. Nevertheless, an additional criterion that seems to have been neglected may be the inter-personal relationships between entrepreneurs or decision makers, which is likely to be a relevant factor for partner selection in many cases – particularly in co-opetition partnerships where sharing information between partners means as well sharing information between competitors. In such cases, personal trust between partners stand as the basis of the business alliance itself.

## **RESEARCH**

- **Methodology**

The starting point for this research was to answer how competitors are chosen to team up for a co-opetition partnership. As such no hypothesis was advanced for this purpose and investigation was held with a free spirit. We have conducted an exploratory study to collect qualitative data in an abductive approach. Data have been processed through a Systematic Combining methodology (Dubois and Gadde, 2002) based on Grounded Theory (Glaser and Strauss, 1967). Following such methodology the existing literature is taken as starting point for research, from which new data is systematically collect and analysed for the emergence of new concepts and categories until saturation is reached (Goulding, 1999).

- **Sampling**

The selection of cases was based on a Purposive Sampling technique as the most suitable for randomly selecting appropriate informants among the population segment with the most information on the researched topic (Guarte and Barrios, 2006). Following such technique the selected sample encompassed eight Portuguese companies with forged alliances with national competitors from four cases of established co-opetition partnerships in the sectors of

wine, tourism and construction industries. Only two partners at each partnership were selected even though two of the partnerships included five partners, in which cases partners were selected at random. For the purpose of this analysis any co-opetition relationships involving international partners were disregarded. Table 1 presents a characterization of the analysed sample.

Cases	Sector	Established	Purpose	Companies
Case A	Wine	2002	Promote sales by increasing region's brand awareness	wine Partner A.1 Partner A.2
Case B	Construction	2007	Promote internationalization enhanced complementary offer	with Partner B.1 Partner B.2
Case C	Wine	2010	Promote sales by increasing product category awareness	Partner C.1 Partner C.2
Case D	Tourism	2012	Expand product portfolio based on complementary offer	Partner D.1 Partner D.2

Table 1: Sample characterization (Source: the authors)

Case A represents a partnership of five competing wine producers from the same region who decided to jointly promote their region in international markets. These producers realized that their strength together was higher than when each one was promoting separately, therefore as a group they were able to “*cause a greater impact and a leave a better impression*” (Partner A.1). Even though they recognize that their promoting efforts are beneficial to all the wine producers from that region, the group perceives added value in their co-opetition partnership, which has been active for over a decade.

Case B stands for a partnership of competitors in construction industry. All companies are based in the same geographical region and compete in their domestic market. As a consequence of their membership and involvement in the local industrial association, top managers knew each other well previously. Such relationship had great impact in the creation of this co-opetition partnership, as stated by Partner B.1: “*I’m convinced that our personal relationships had great influence*”. This group remains active only in some previously defined external markets where all partners cooperate based on their complementarity of skills and competences.

Case C is a partnership between two competing Port wine companies aimed to “*promote Vintage Port wine next to opinion makers and consumers*” (Partner C.1). Both companies are major players in all Port wine categories, marketing their brands globally. However, they realized that their top category wine suffered from low recognition in a certain strategic market. These companies thus teamed up as a solution for a specific problem in a specific region.

Case D is a case of co-opetition in the domestic market incorporating two hotel chains with “*a perfectly complementary offer*” (Partner D.1), as each operates in different regions and with different hotel categories. The creation of this partnership encompassed synergies allowing each company to expand their own product portfolio and market presence. Partner D.2 reported that the contact was facilitated by “*prior relationships between both CEO’s resulting from their work together in the Tourism Association*”.

- **Data collection and analysis**

Data was obtained by semi-structured interviews to top managers or decision-makers at each target firm. Conversations followed an adaptive guideline in order to assure the inclusion of topics emerging from previous interviews. The aim of the interviews was to discuss the selection of partners for each partnership, namely by discussing how the partnership was created, how was each partner selected and why was each particular partner chosen to participate in the alliance. Interviews were digitally registered and the content transcribed for content analysis using RQDA software. The analysis aimed at partner selection criteria and initial codification consisted within four criteria dimensions including 19 selection criteria based on revised literature. At a later stage one new dimension and two new criteria emerged from the analysis. Additionally three existing selection criteria were included in the emergent dimension. Table 2 presents a list of all the criteria used and their origins, as well as a summary of identified occurrences and respondents. Following these codifications, we were able to determine the criteria most consistently referred to and thus establish the ground for the understanding of partner selection process.

- **Research Findings**

Content analysis to respondents’ testimonials is presented in table 2, listing all analysed partner selection criteria. Column “*Respondents*” shows how many respondents mentioned each criterion. Column “*Occurrences*” shows how many times each criterion was identified in

respondents' testimonials. The last five rows refer to dimensions of partner selection criteria and indicate the authors who associate each criterion to a specific dimension. As example, first row reads: "Prior Personal Ties, as a partner selection criterion, was mentioned by eight respondents in a total of 26 occurrences. This criterion is pointed as partner-related by Das and He (2006), as risk-related by Cummings and Holmberg (2012) and as network-related by the authors of this study".

Codings	Respondents	Occurrences	Network Related	Partner Related	Task Related	Risk Related	Learning Related
Prior Personal Ties	8	26	the	Das and		Cumming	
Prior Successful Shared Business	7	16	the	Das and		Cumming	
Similar Status	5	10		Das and			
Similar Positioning	5	9		the			
Shared Vision	5	7	the	Das and			
Ease of Communication	5	6		Das and		Cumming	
Complementarity	4	9			Das and		Cumming
Strategic Fit	4	9		Das and			
Managerial Capabilities	4	7			Das and		
Vicinity	4	6			Das and		
Reciprocal Relationship	4	5		Das and			
Compatible Goals	3	8		Das and			
Reputation and Image	3	8		Das and	Das and		
Trust	3	6		Das and			
Compatible Culture	3	5		Das and			
Commensurate Risk	3	3		Das and		Cumming	
Commitment	2	2		Das and			
Established Customer	2	2		Das and	Das and		
Established Supply	1	2			Das and		
Technology	1	2			Das and		Cumming

Table 2: Interviews content analysis on partner selection criteria (Source: the authors)

In all four analysed cases of co-opetition partnerships it notoriously prevails that prior personal relationships between managers from all partnering companies were very present. This reference was usually mentioned when respondents were confronted with the question of "How did this partnership start?". In those cases where this fact was not mentioned in the first answer, it would eventually come up at a later stage during the interview. In the final

count, all eight respondents referred to this fact 26 times. On this qualitative data analysis, coded criteria "Prior Personal Ties" accounts for acquaintances that may come from family or friendship ties, as well as from business ties resulting from previous business associations. Even though it was not highlighted specifically as a criterion of selection, the fact that the leaders of each organization already knew each other was consistently referred to by all respondents and indicated as facilitator or as a catalyst for the partnership formation. Table 3 presents statements from all respondents supporting this interpretation.

Cases	Partners	Statements
Case A	Partner A.1	<i>"There were already some relationships, either family or friendship based"</i>
	Partner A.2	<i>"These 5 families already knew each other and had friendly relations"</i>
Case B	Partner B.1	<i>"[This partnership] was the result of conversations that we kept regularly in the industrial association"</i>
	Partner B.2	<i>"One of the factors for this idea to take shape was the fact that the CEOs already knew each other personally"</i>
Case C	Partner C.1	<i>"We know each other personally and we are friends for a long time"</i>
	Partner C.2	<i>"If we didn't know each other probably this partnership would never happen"</i>
Case D	Partner D.1	<i>"There are personal relationships between both presidents, and that certainly facilitated contact"</i>
	Partner D.2	<i>"There were already some contacts between both presidents as they already knew each other"</i>

Table 3: Statements on Prior Personal Relationships (Source: the authors)

The next most mentioned criteria were "Prior Successful Association" and "Shared Business Networks". Seven respondents mentioned that managers had previously and successfully experienced working together in informal or formal associations with the current partner(s). On this matter Partner A.1 stated that *"it was common to get together in wine shows and we used to cause a good impact. We then concluded that we had to do it in a more organised and formal way"*. The latter accounted for 6 respondents highlighting the fact that leaders of each company gathered previously in common business networks such as sector clusters or industrial

associations, as stated by Partner D.1: *“The presidents from both companies have previously worked together in the National Tourism Association”*.

Another relevant set of ideas was coded as *“Shared Vision”*. An example is the statement of Partner C.1: *“We knew that we have the same philosophy [about the market] and we both have very similar views about how to develop our market approach”*. In our opinion, such knowledge can only be acquired as a result of a close connection between top managers from both companies. Even though this code did not sum up many occurrences, it was referred to by a considerable number of respondents.

As expected from literature review, many of the cited criteria for partner selection fit partner, task, risk or learning-related dimensions. However, from the analysis of the most cited facts emerged a new dimension of partner selection criteria, presented in table 2 as network-related. This new proposed dimension highlights the importance of networks when considering a competitor for a partnership. When weighting the risks of such alliance, the experience of a positive personal relation seems to ease the managers' mind and may even serve as a facilitator for a formal gathering given that other partner or task-related criteria are met as well.

Considering that all the analysed cases revealed the existence of prior personal relationships between top managers, two thoughts must be clarified before deepening the discussion of these results: a) these cases were selected only based on the fact of encompassing domestic co-opetition partnerships. No knowledge about their origins was founded prior to our analysis; b) due to the qualitative nature of this analysis and its abductive approach, one cannot infer that prior personal relationships are a prerequisite for the creation of a co-opetition partnership, or that they are somehow common to all co-opetition cases. This last thought will be explored in our conclusion.

## DISCUSSION

A new perspective of partner selection process emerged from our analysis. We observed that all analysed cases of domestic co-opetition were preceded by a prior relationship between managers<sup>1</sup>, for all analysed partnerships seem to have been born from a previous personal

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<sup>1</sup> Note: in this sense “manager” refers to top managers, decision makers or any other actors who may have the power to decide and implement company's strategy.

relationship. The phenomenon might be explained by a 3-step model including the awareness of a problem, a primary unconscious selection and a secondary conscious selection. Firstly the manager identifies a problem whose solution involves establishing a cooperation strategy. Secondly, the manager identifies a set of potential partners for cooperation. This mental yet unconscious process originates a group of potential partners, which is restricted to the manager's network of connections. This potential group includes just any potential partners with whom the manager has or had a relationship, thus excluding any eventual possible partners who have no relationship with the manager. Thirdly, the manager makes a finely tuned selection within the potential group. It is now a conscious selection according to a set of judicious criteria, mixed and weighted according to whatever aspects the manager finds relevant. At this stage such judicious criteria may be partner-related (such as strategic fit between companies, management commitment towards the project or similar status among all partners), task-related (such as complementarity of products or resources, managerial capabilities or access to a specific technology) and even risk or learning-related (such as a commensurately risky partner or the possibility to acquire knowledge from the partner). This pondered selection gives origin to the viable group, which will be addressed with an invitation for a partnership. Figure 1 illustrates this process.

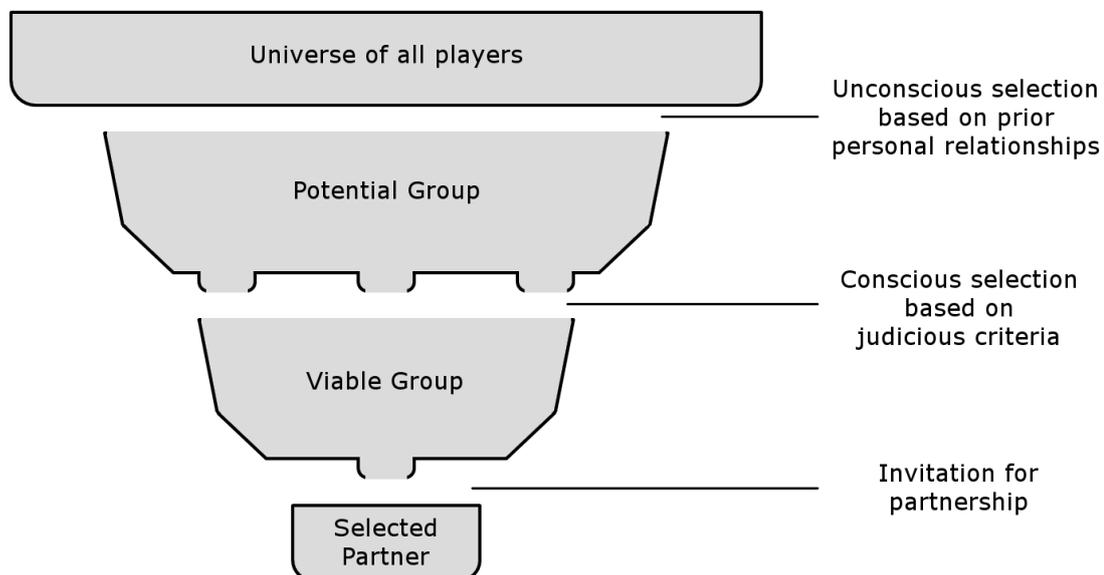


Figure 1: Three step model for partner selection (Source: the authors)

The most relevant contribution for the understanding of partner selection process is the inclusion of a step resulting in the creation of a potential group of partners. It entitles a

self-limited selection given that there is no conscious systematic approach to all existing players in the market. This unstructured mental step is then the bottleneck that will trim down the offer of partnership possibilities from a theoretically large universe of partners into a limited group of acquaintances.

## **CONCLUSIONS, LIMITATIONS AND RECOMMENDATIONS**

Our research aimed to contribute to the understanding of partner selection process in co-opetition partnerships. The goal was to determine how companies choose partners for collaboration among their competitors. Having as starting point the existing literature on partner selection process and partner selection criteria for strategic alliances, an exploratory study was specifically directed to domestic co-opetition partnerships. Despite the similarities found with the existing literature on strategic alliances, a new dimension of partner selection criteria emerged from our research. Criteria such as prior personal relations, prior successful association, shared business network and shared vision were now included in the proposed network-related dimension referring to the set of criteria used by managers with regards to their network of relations.

Results suggest that selection of partners for co-opetition is firstly based on the existence of prior previous relationships. Regardless of their personal or business nature, the experience of positive prior relationships seems to contribute as a facilitator and even a catalyser for the formation of co-opetition partnerships. Our model proposes that managers undergo an unconscious phase of picking potential partners thus mentally limiting the range of possibilities to their network of connections, from which viable partners will then be elected. These findings suggest that the experience of positive prior relationships seems to endorse the reduction of risk perception towards a potential partner, thus lessening the uncertainty that usually accompanies a cooperation partnership with a competitor.

Despite the fact that this study aimed for objectiveness and accuracy, results are supported on qualitative analysis, which invariably comprises a personal interpretation of observations. Additionally, this is an exploratory study, for which it does not intent to confirm a given hypothesis. The contribute of this study is then to present a new hypothesis to explain partner selection processes for co-opetition partnerships, for which we would recommend a broader study supported on quantitative analysis to validate the proposed model.

In turn, the proposed 3-step model suggests a possible approach for the understanding of partners' selection processes for domestic co-opetition partnerships. However, it does not imply that all domestic co-opetition partnerships are created according to this model, as one cannot conclude from this study that a network of personal or business relationships is a prerequisite for co-opetition. It is also not implicit that the process is extensible to all kinds of co-opetition partnerships. In fact, we cannot infer on the model's application for international co-opetition partnerships, and it would probably require a certain degree of adaptation in order to be applicable to intra-organisational forms of co-opetition. Additionally our results do not allow a conclusion on the model's exclusivity for co-opetition partnerships. In fact, it is inconclusive as to whether the model can be applied to other partnership governances or broadly to all kinds of strategic alliances in general.

Yet another limitation is that the sample is entirely formed by Portuguese companies. Thus it is bounded to the culture, the economic environment and even the way of doing business in one single country. Research results would be largely enriched with the extension of this study to other countries and continents in order to represent other business contexts and cultural environments. Additionally, the sample reflects only cases of domestic co-opetition partnerships, for which it would be interesting to develop further studies including cases of international co-opetition in order to determine whether the proposed model remains applicable in such cases.

Finally, co-opetition is a peculiar kind of strategic alliances with the main characteristic being that partners are as well competitors. Such paradoxical cooperation entails great risks, such as opportunistic behaviours, disclosure of critical knowledge and loss of competitive advantages. The greatest contribution of this study is hence highlighting the importance of personal relationships in business networks as an influential criterion for partner selection, acting as a risk reduction factor thus facilitating the selection of strategic partners for the creation of co-opetition partnerships.

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## CORPORATE FINANCIAL DISTRESS AND BANKRUPTCY: A COMPARATIVE ANALYSIS IN FRANCE, ITALY AND SPAIN

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### ABSTRACT

The paper presents a competing-risks approach for investigating the determinants of corporate financial distress. In particular a comparative analysis of three European markets - France, Italy and Spain – is performed in order to find out the similarities and the differences in the determinants of distress.

By using the AMADEUS dataset, two possible causes of exit from the market are considered: bankruptcy and liquidation. For identifying the variables that influence the risk of leaving the market, a competing-risks model for each country is estimated and is compared with a pooled model including all the three countries. In addition, the performance of the competing-risks approach is evaluated versus the single-risk model, in which all states are considered without any distinctions.

The reached results show that the competing risks approach leads to a saving in the number of selected variables that becomes more significant when the model is estimated for each country separately. Moreover, the selected variables for each country enable to identify similarities between the different exit routes across the markets. Some of the differences between Spain and the other two countries may be related to the dissimilar definition of the distress states.

**Key words:** Competing-risks model, Default risk; Financial ratios; Hazard model.

### 1. INTRODUCTION

Business failure has been widely studied since the seminal papers of Beaver (1966) and Altman (1968). A large amount of the literature is devoted to analyze the firms' survival and to investigate the determinants of the exit decision, without considering possible distinctions among different status (Ohlson, 1980; Zmijewsky, 1984; Lennox, 1999; Shumway, 2001, among others) and without estimating the dynamical evolution (Sexton *et al.*, 2003;

Balcaen and Ooghe, 2004; Chava and Jarrow, 2004; Hillegeist *et al.*, 2004; Dakovic *et al.*, 2010; Amendola *et al.*, 2011a).

To overcome these limitations, some authors applied advanced versions of the logistic regression model (e.g. the mixed logit, multinomial error component logit and nested logit model) (Jones and Hensher, 2004, 2007; Hensher, Jones and Greene, 2007; Dakovic *et al.*, 2010) and the competing-risks models (Bhattacharjee *et al.*, 2002; Dickerson *et al.*, 2003; Headd, 2003; Rommer, 2004, 2005; Chancharat *et al.*, 2010; Amendola *et al.*, 2011b).

Therefore, in order to examine the effect of explanatory variables across the diverse states of financial distress, a multi-state approach can be used. Theoretical evidence for considering multi-exits was provided by Schary (1991) which analyzed acquisition and bankruptcy as alternative routes, while Lau (1987) had previously proposed a five state prediction model for estimating the probability that a firm enters each of the considered states. The increase in information on different types of exit and the development of statistical methods and computational techniques have caused a renewed interest in analysing how financial factors affect firm survival and the different causes of entry and exit of firms from the market.

Our interest is to investigate the causes of business failure of three European markets - France, Italy and Spain - in order to study the determinants of the probability of alternative exit routes and find out whether there are connections among the predictors of distress in the different countries.

A similar problem has been focused by some previous studies that compare the determinants of failure in several countries. For example, Hunter and Isachenkova (2000) explain the differences in the predictors of failure in Russian and UK firms. Their main results are that liquidity and gearing are not effective for failure in Russian firms, while size, profitability and turnover are good predictors. For the UK firms, it seems that profitability, gearing and liquidity are all important for predicting failure. Bhattacharjee *et al.* (2004) analysed UK and US firms by means of competing risks model, in order to identify the variables influencing the bankruptcy and the acquisition. They found out that adverse macroeconomic conditions increase the bankruptcy hazard while decreasing the acquisition hazard. The difference is related to the diverse bankruptcy definition in the two countries. Ooghe and Balcaen (2002) focus on whether a failure prediction model can be transferred across countries. They used a dataset of Belgian company accounts to build a failure prediction models potentially appropriate for different countries.

To the best of our knowledge, only one paper (Rommer, 2005) analyzes the business failure reasons in the three European markets considered here. Our contributions differ from Rommer (2005) in two main issues. Firstly we considered a larger data set including a huge number of variables and an extended sample period. Secondly, we focus our analyses on a two-way competing-risks model based on the two main exit routes (bankruptcy and liquidation).

In order to compare the effects of micro-economic indicators and firm-specific variables on the different states, we estimate a competing-risks model for each country. This model, unlike the traditional logistic framework, enables to incorporate the time to event as dependent variable in determining the probability of a firm being in a distressed status. Moreover, it allows taking into account whether and when the exit occurs, monitoring the evolution of the risk of each exits type over time. Furthermore, for sake of comparison, we also estimate a *pooled-country model* in which all countries are pooled together and a *pooled-state model* in which all financial distress states are considered at the same time. The significant variables and their sign are compared across the three country models in order to determine the similarities and the differences in the variables that influence the financial distress.

The paper is structured as follows. Section 2 gives the notion of business failure and illustrates the data. Section 3 briefly reports the methodology used in the analysis. Section 4 describes the reached results while the last session gives some concluding remarks.

## **2. THE NOTION OF BUSINESS FAILURE AND THE DATA BASE**

Business failure has been defined in many different ways and it is not easy to agree on a widely accepted definition (Karels and Prakash, 1987; Crutzen and van Caillie, 2007). A failure state has been analyzed from different perspectives depending not only on the context and the characteristics of the firms but also on the interest of researchers (Dimitras, Zanakis and Zopounidis, 1996). In many studies, business failure is defined as a series of different situations that lead to the closing down of the firm due to relevant financial problems (Morris, 1997). However, this definition only concentrates on the financial disease without taking into account other difficulties that can affect the firms' health in the early stages of the failure process (Argenti, 1976).

Given that the empirical literature distinguishes between *economic* and *juridical* business failure (Ooghe and Van Wymeersch, 1986; Weitzel and Jonsson, 1989), the present analysis refers to the economic concept, focusing on those companies that have experienced permanent financial disease, including companies that have voluntarily chosen liquidation for whatever reason. Therefore, our sample is composed of those companies that belong to a specific sector of activity and had entered the economic procedure of bankruptcy in three European countries (France, Italy and Spain) in the period 2004-2010. In particular, we considered a firm as exiting in period  $t$  when it was the last year the firm was in business or active. This study focuses on these countries since they are inspired by the French Commercial Code (La Porta *et al*, 1998; Rommer, 2005).

The data used in this paper have been extracted from the Amadeus database, a pan-European database, provided by Bureau Van Dijk (BVD). Since our main interest is in investigating the determinants of firms that end up in financial distress in the three markets and in comparing them in terms of different forms of exit and country-effects, we focus on three mutually exclusive states of exit from the market: *bankruptcy*, *dissolved* and *liquidation*.

The bankrupt status includes those firms that have been legally declared as being unable to meet financial obligations to creditors and are under court supervision. The dissolved status includes the company that no longer exists as a legal entity, but the reason for this is not specified. This means that the company is dead, has no more activity or is no longer included in the companies register. The last state includes those companies that no longer exist because they have ceased their activities and are in the process of liquidation. The reference group is provided by active firms.

The distribution of our population consists of 874 companies that went bankrupt, 311 that had entered voluntary liquidation, and 548 that were dissolved. There are 27,292 companies in the active state. The distribution of firms by state and by countries is displayed in Table 2.1.

Looking at the Table 2.1, it can be noted that there are no firms that go bankrupt in Spain and there are no firms that are dissolved in France and Italy. This situation may be related to the different corporate failure laws (García-Posada and Mora-Sanguinetti, 2012). For this reason we decide to join the bankruptcy and the dissolved state for the rest of the analysis.

Table 2.1: Financial distress

	France	Italy	Spain
Active	13,102	12,292	1898
Bankruptcy	264	610	0
Dissolved	0	0	548
In liquidation	37	273	1

The predictors' database for the period of interest (2004 - 2010) is elaborated starting from the financial statements of each firm included in the sample, for a total of 197,181 balance sheets. In particular, we compute  $nv = 72$  indicators selected as potential predictors among the most relevant in highlighting current and prospective conditions of financial distress (Table 2.2) (Dimitras *et al.*, 1996; Altman, 2000; Altman and Hochkiss, 2006).

The selected predictors reflect the main aspects of the firms' structure such as liquidity, operating structure, profitability, turnover and size and capitalization, as shown in Table 2.2. Moreover, some firm-specific variables, such as national legal status, firm size, firm age, publicly quotation, are also considered. These covariates are transformed into dichotomous variables.

A preliminary analysis is made on the database of predictors to analyze the impact of missing data and investigate the bivariate linear relations among them. Those covariates with a high percentage of missing and with a significative correlation coefficient are excluded from the analysis. It is consider as significant those correlation coefficients greater or equal to  $|0.80|$  point out that correlation below that value are not harmful for an appropriate variable selection. Then we test them at a significance level 5% and we reject the null hypothesis that there is no correlation.

Table 2.2: Financial predictors

	nv
Liquidity	17
Operating structure	13
Profitability	16
Turnover	15
Size and Capitalization	11

### 3. THE METHODOLOGY

The methodology used in this paper in order to compare the determinants of business failure in the three European countries considered is the competing-risks model, one of the most popular settings of the multi-state models (Andersen *et al.*, 1993 and 2002). This model

can be considered as an extension of the mortality model for survival analysis and is based on one transient state (state alive) and a certain number of absorbing states that are the death from different causes. All possible transitions are from the state alive. In this paper, we consider two possible causes of exit from the market: bankruptcy and liquidation, and we estimate the probability of transition from state active to the two states.

Let  $T$  be the observed time of exiting the market and let  $D$  be the cause of failure. The possible causes are labelled from 1 to  $K$ .

The main quantity in competing-risks model is the *cause-specific hazard function*, that is the probability of failing due to a given cause  $k$ , after one has reached the time point  $t$ :

$$\lambda_k(t) = \lim_{\Delta t \rightarrow 0} \frac{P[T \leq t + \Delta t, D = k | T \geq t]}{\Delta t}, \quad k = 1, \dots, K$$

Since the cause-specific hazard function may be depend on a set of covariates, the Cox Proportional Hazard model for each cause of exit can be considered:

$$\lambda_k(t | X_k) = \lambda_{k,0}(t) \exp(\beta_k^T X_k(t))$$

where  $\lambda_{k,0}(t)$  is the baseline cause-specific hazard of cause  $k$  which does not need to be explicitly specified,  $X_k$  is the vector of covariates to  $k$ -type cause at time  $t$ , and  $\beta_k$  is the vector of covariates coefficients to be estimated by optimizing the partial likelihood for each cause:

$$L_k(\beta_k) = \prod_{i=1}^{n_k} \frac{\exp(\beta_k^T X_{ik}(t))}{\sum_{l=R(t_{ik})} \beta_k^T X_{lk}(t)}$$

where  $n_k$  is the number of firm in specific hazard  $k$ , and  $R(t_{ik}) = \{l | t_{lk} \geq t_{ik}\}$  is the set of firms at risk at time  $t_{ik}$ .

#### 4. THE EMPIRICAL RESULTS

This section provides the empirical results obtained from the estimated competing-risks model for each country and for the pooled data set. The effect of strategic factors on the

likelihood of exiting the market for different reasons in the three European countries are investigated and the determinants of various exit routes are compared.

The variables considered as the initial set of explanatory variables in the model, in order to assess their effect on the hazard rate of each exit route for each country, are synthesized in Table 2.2. The most relevant variables for each state and each market are selected by stepwise procedure. Then, the significance of the estimated coefficients is checked and the variables that are not significant at least at 10% level are eliminated. This significance level is chosen in order to compare the determinants of exit routes selected in the paper with the results of a few papers in the literature (Chancharat et al, 2010; Rommer, 2004 and 2005).

In addition to the competing-risks model, a single-risk model is estimated where all states of financial distress are pooled together, for all countries.

The number of variables selected and their sign are synthesized in Table 4.1, while the sign of the estimated coefficients for the competing-risks and single-risk models for each country are shown in Tables 4.2, 4.3 and 4.4.

The results show that in the single-risk model (i.e. for predicting the business failure) and in pooled-country model (in which we consider all countries together), 33 variables are selected as potential predictors. Instead, in the competing-risks model, in which the exit routes are estimated separately, a less number of variables are chosen (Table 4.1).

When the single-risk and the competing-risks models are estimated for each country separately, the results show that there is a saving in the number of selected covariates in France and in Spain (Table 4.1).

Now, looking at the sign of covariates, the results show some remarkable differences supporting the need to use not only the competing-risks model over the pooled one, but also the model for each country over a pooled-country model. Moreover, the variables are different in the determinants of the three exit routes and in their sign, not only between the competing-risks and single-risk models, but also between the states for the three countries.

In order to interpret efficiently the results, it is important to state that a positive sign of estimated coefficients means that the failure risk is high for firms with higher values of that variable, while if the sign is negative, the failure risk is lower for higher values of the variable. For further investigation, the hazard ratios, obtained by computing the exponential of coefficients are also checked, giving a measure of the covariates effect on the hazard (the results are available upon requests from the authors).

Table 4.1: Number of variables selected

	Single-risk model				Bankruptcy/Dissolved				Liquidation			
	Pooled-count	France	Italy	Spain	Pooled-count	France	Italy	Spain	Pooled-count	France	Italy	Spain
Firm-specific variables	4	0	6	4	5	1	5	4	4	1	4	0
Liquidity ratios	6	5	6	7	6	6	7	4	2	1	2	0
Operating structure ratios	5	3	5	4	3	2	1	4	3	1	3	0
Profitability ratios	5	5	8	3	4	4	8	3	3	1	6	0
Size and capitalization ratios	6	2	3	3	4	2	4	3	4	0	3	2
Turnover ratios	7	2	5	6	6	2	5	6	4	2	6	0
Total	33	17	33	27	28	17	30	24	20	6	24	2

The results for each exit route and for each country are illustrated in order to compare the determinants among the states and the countries.

Looking at the results of the single-risk model (in which all exit routes are pooled together, without distinguishing between them) for the pooled-country model, it can be noted that the joint-stock companies have a greater probability of failure, while the limited partnership and consortium have a lower probability of exit the market. At the same time, the old firms (more than 23 years) have a positive coefficient and their hazard rate decreases.

Then, high values of IND03, IND30, IND46, IND15, IND41, IND47, IND64, IND72, IND10, IND13, IND38, IND50, IND62, IND19, IND20, IND21, IND56, IND59 correspond to increase the hazard rate and the probability of failure, while the coefficients of the IND04, IND06, IND27, IND33, IND47, IND53, IND54, IND61, IND11, IND37, IND70 are negative and consequently the probability of failure is lower.

Unlike the results of the pooled-country model, the joint-stock companies have a lower probability of being bankrupted and dissolved in Italy and Spain. The old firms have a lower hazard rate. As concerns the size of firms, the medium firms in Italy have a higher risk of failure, while for the very large companies the hazard rate is lower. In Spain, the situation is lightly different. In fact the large and very large firms have a higher probability of being dissolved. The difference between Italy and Spain is related to the fact that the definition of the two failure states (bankruptcy and dissolved) is divergent. Moreover, there are some financial ratios in common between the three countries, even though the sign of coefficients is

different. For example, IND06, IND24 has a negative coefficient for Italy and France, while it is positive for Spain. The difference of sign is again related to the nature of the states included in the model.

The results of the competing risks framework for the pooled-country model showed that the joint-stock companies, limited companies, limited partnership, limited cooperative societies have a higher risk of being bankrupted. Then for the limited partnership the probability of liquidation is lower; while for consortium and limited cooperative societies the risk of liquidation is higher. As concerns the financial ratios, high values of IND03, IND30, IND15, IND49, IND64, IND72, IND13, IND38, IND20, IND21, IND56, IND69 correspond to high risk of being bankrupt. Moreover, some covariates, such as IND54, IND41, IND71, IND72, IND08, IND20, IND21, have positive coefficients, related to a higher risk of being liquidated. Then, IND04, IND06, IND27, IND33, IND47, IND53, IND54, IND11, IND37, IND70 have negative effect of the bankruptcy, and IND06, IND13, IND54, IND61, IND10, IND11, IND13, IND19, IND58 effect negatively the risk of liquidation.

By checking the results of the competing risks model for each country, it is observed that in Italy more variables are needed for predicting bankruptcy and liquidation than in France and in Spain. One possible reason is related to the period considered in the paper, which included the period 2007-2010 characterized by the global financial crisis. It seems that the effects of the financial crisis have a deeper impact in Italy than in France and Spain.

Table 4.2: The sign of covariates for the pooled model

Code	Variable	Area	Pooled-Country	France	Italy	Spain
SPA	Joint-stock company - Legal Form	Firm-Specific	+		-	-
SAS	Limited Partnership - Legal Form	Firm-Specific	-		+	
Consortium	Consortium - Legal Form	Firm-Specific	-		-	
Old	Old - Age	Firm-Specific	-		-	-
Medium	Medium - Size	Firm-Specific			+	
VeryLarge	Very Large - Size	Firm-Specific			-	+
Large	Large - Size	Firm-Specific				+
IND01	Current assets/Fixed assets	Liquidity			+	
IND03	Cash & cash equivalent/Current liabilities	Liquidity	+			+
IND04	(Current assets - Stock)/Current liabilities	Liquidity	-			
IND06	Working capital/Total assets	Liquidity	-	-	-	+
IND07	Net current assets/Total assets	Liquidity			+	
IND24	Cash flow	Liquidity		-	-	+
IND27	Cash flow/Shareolders funds	Liquidity	-			-
IND30	Current liabilities/Total assets	Liquidity	+	+	+	+
IND31	Current liabilities/(Current liabilities + Non-Current liabilities)	Liquidity		-		-
IND33	Cash & cash equivalent/Total assets	Liquidity	-		-	+
IND35	Cash & cash equivalent/Sales	Liquidity		-		
IND46	Financial Expenses/(Current liabilities + Non-Current liabilities)	Operating structure	+		+	+

Code	Variable	Area	Pooled-Country	France	Italy	Spain
	liabilities)					
IND47	Financial Expenses/Sales	Operating structure	-		-	-
IND53	EBIT/Operating revenue	Operating structure	-	+	+	-
IND54	Sales	Operating structure	-	-	+	-
IND61	EBIT/Financial Expenses	Operating structure	-	-	-	
IND15	Profit (Loss) for Period/Shareolders funds	Profitability	+	+	+	
IND17	Profit (Loss) for Period/Sales	Profitability			+	-
IND29	Profit (Loss) for Period/(Current liabilities + Non-Current liabilities)	Profitability			+	
IND39	EBITDA/Sales	Profitability		-	-	
IND41	EBIT/Fixed Assets	Profitability	+	+		+
IND49	EBIT/Total assets	Profitability	+		+	
IND64	EBIT	Profitability	+		+	
IND71	Standard deviation ROE	Profitability		-	-	
IND72	Standard deviation ROA	Profitability	+	+	+	+
IND10	Shareolders funds/(Current liabilities + Non-Current liabilities)	Size and capitalization	+	+	-	
IND11	Shareolders funds/Capital	Size and capitalization	-		-	-
IND13	(Long Term Debt + Loans)/Total assets	Size and capitalization	+		-	
IND38	Current assets/Current liabilities	Size and capitalization	+			
IND50	Current assets/Total assets	Size and capitalization	+	+		-
IND62	Total assets	Size and capitalization	+			+
IND19	Sales/Current assets	Turnover	+		-	
IND20	Debtors/Sales	Turnover	+	+	+	+
IND21	Sales/Shareolders funds	Turnover	+		+	+
IND36	(Current assets - Stock)/Sales	Turnover			+	-
IND37	Working capital/Sales	Turnover	-			-
IND56	Cash & cash equivalent/Depreciation	Turnover	+	-	+	+
IND69	(Debtors/Operating revenue)*360	Turnover	+			
IND70	(Creditors/Operating revenue)*360	Turnover	-			-

Table 4.3: The sign of covariates for the bankruptcy state

Code	Variable	Area	Pooled-country	France	Italy	Spain
SPA	Joint-stock company - Legal Form	Firm-Specific	+			-
SAS	Limited Partnership - Legal Form	Firm-Specific	+		+	
Consortium	Consortium - Legal Form	Firm-Specific			-	
Old	Old - Age	Firm-Specific	-		-	-
Medium	Medium - Size	Firm-Specific		+	+	
VeryLarge	Very Large - Size	Firm-Specific			-	+
Large	Large - Size	Firm-Specific				+
SRL	Limited Company - Legal Form	Firm-Specific	+			
SCARL	Limited Cooperative Society- Legal Form	Firm-Specific	+			
IND03	Cash & cash equivalent/Current liabilities	Liquidity	+		-	+
IND04	(Current assets - Stock)/Current liabilities	Liquidity	-		+	
IND06	Working capital/Total assets	Liquidity	-	-	-	
IND07	Net current assets/Total assets	Liquidity			+	
IND24	Cash flow	Liquidity		-	-	+
IND27	Cash flow/Shareolders funds	Liquidity	-			-
IND30	Current liabilities/Total assets	Liquidity	+	+	+	
IND31	Current liabilities/(Current liabilities + Non-Current liabilities)	Liquidity		-		
IND33	Cash & cash equivalent/Total assets	Liquidity	-			
IND34	(Current assets - Stock)/Total assets	Liquidity		-	-	-
IND35	Cash & cash equivalent/Sales	Liquidity		-		

Code	Variable	Area	Pooled-country	France	Italy	Spain
IND46	Financial Expenses/(Current liabilities + Non-Current liabilities)	Operating structure				+
IND47	Financial Expenses/Sales	Operating structure	-			-
IND53	EBIT/Operating revenue	Operating structure	-	+		-
IND54	Sales	Operating structure	-			-
IND61	EBIT/Financial Expenses	Operating structure		-	-	
IND15	Profit (Loss) for Period/Shareolders funds	Profitability	+	+	+	
IND17	Profit (Loss) for Period/Sales	Profitability				-
IND29	Profit (Loss) for Period/(Current liabilities + Non-Current liabilities)	Profitability			+	
IND39	EBITDA/Sales	Profitability		-	-	
IND41	EBIT/Fixed Assets	Profitability			+	+
IND49	EBIT/Total assets	Profitability	+		+	
IND64	EBIT	Profitability	+		+	
IND71	Standard deviation ROE	Profitability		-	-	
IND72	Standard deviation ROA	Profitability	+	+	+	+
IND08	Shareolders funds/Fixed assets	Size and capitalization			-	
IND10	Shareolders funds/(Current liabilities + Non-Current liabilities)	Size and capitalization	+			
IND11	Shareolders funds/Capital	Size and capitalization	-		-	-
IND13	(Long Term Debt + Loans)/Total assets	Size and capitalization	+		-	
IND38	Current assets/Current liabilities	Size and capitalization	+			-
IND50	Current assets/Total assets	Size and capitalization		+	+	
IND62	Total assets	Size and capitalization		-		+
IND19	Sales/Current assets	Turnover			-	
IND20	Debtors/Sales	Turnover	+	+	+	+
IND21	Sales/Shareolders funds	Turnover	+		+	+
IND36	(Current assets - Stock)/Sales	Turnover			+	-
IND37	Working capital/Sales	Turnover	-		-	-
IND56	Cash & cash equivalent/Depreciation	Turnover	+	-		+
IND69	(Debtors/Operating revenue)*360	Turnover	+			
IND70	(Creditors/Operating revenue)*360	Turnover	-			-

Table 4.4: The sign of covariates for the liquidation state

Code	Variables	Area	Pooled-country	France	Italy	Spain
SAS	Limited Partnership - Legal Form	Firm-Specific	-		+	
Consortium	Consortium - Legal Form	Firm-Specific	+		+	
Medium	Medium - Size	Firm-Specific	+		+	
SRL	Limited Company - Legal Form	Firm-Specific		-		
SCARL	Limited cooperative societies - Legal Form	Firm-Specific	+		+	
IND06	Working capital/Total assets	Liquidity	-	-	-	
IND33	Cash & cash equivalent/Total assets	Liquidity	-		-	
IND46	Financial Expenses/(Current liabilities + Non-Current liabilities)	Operating structure			+	
IND53	EBIT/Operating revenue	Operating structure	+		+	
IND54	Sales	Operating structure	-	-		
IND61	EBIT/Financial Expenses	Operating structure	-		-	
IND17	Profit (Loss) for Period/Sales	Profitability			+	
IND29	Profit (Loss) for Period/(Current liabilities + Non-Current liabilities)	Profitability			+	
IND39	EBITDA/Sales	Profitability			-	
IND41	EBIT/Fixed Assets	Profitability	+		+	
IND71	Standard deviation ROE	Profitability	+		+	
IND72	Standard deviation ROA	Profitability	+	+	+	

Code	Variables	Area	Pooled-country	France	Italy	Spain
IND08	Shareolders funds/Fixed assets	Size and capitalization	+			-
IND10	Shareolders funds/(Current liabilities + Non-Current liabilities)	Size and capitalization	-		-	
IND11	Shareolders funds/Capital	Size and capitalization	-		-	
IND13	(Long Term Debt + Loans)/Total assets	Size and capitalization	-		-	
IND62	Total assets	Size and capitalization				-
IND18	Sales/Fixed assets	Turnover		+		
IND19	Sales/Current assets	Turnover	-		-	
IND20	Debtors/Sales	Turnover	+			
IND21	Sales/Shareolders funds	Turnover	+		+	
IND36	(Current assets - Stock)/Sales	Turnover			+	
IND56	Cash & cash equivalent/Depreciation	Turnover			+	
IND58	Non-Current liabilities/Sales	Turnover	-		-	
IND70	(Creditors/Operating revenue)*360	Turnover		-	+	

## 5. CONCLUSION

Competing-risks models for corporate failure in three European markets – France, Italy and Spain - have been estimated based on micro-economic indicators and firm-specific variables. The determinants of financial distress have been investigated highlighting the similarities and dissimilarities across countries. In particular a competing-risks approach has been used to estimate the risk of exit the market for two main reasons: bankruptcy and liquidation.

The reached results show that there are some differences and some similarities in financial ratios for predicting the financial distress in the three countries considered in the paper. In particular, it seems that in Italy a greater number of variables are needed to estimate the probability of failure, while in France and Spain the number of covariates is less. Moreover, the results show how there is a saving in the number of business failure determinants when a model for each country is estimated and/or a model for each exit route is considered.

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## SPANISH SAVINGS BANKS: AN ANALYSIS OF THEIR PERFORMANCE

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### ABSTRACT

This paper analyses the determinants of the performance of the savings bank in Spain. We study whether the efficiency, the core capital, the delinquency ratio, the liquidity, the number of branches and the profitability influence in the performance of these entities. We find evidence that the efficiency and the core capital lead to greater performance. However, the results indicate that the higher the delinquency ratio, the lower the performance it will be. The results indicates that entities opened new bank offices uncontrollably, without a proper analysis of their viability and profitability, under the euphoria of real state loans, have now a network that means a heavy weight for them, both at the personal and structural level, which causes a clear drop in performance. Only the entities that have maintained a solid core capital, can keep their position during the financial crisis. They had greater financial strength and improved ability to carry out the provisions without damaging excessively its capital, and so its solvency.

**Keywords:** saving banks, performance, financial crisis, Spain

### 1. INTRODUCTION

During years Spanish savings banks have growth in unsustainable and disorganized way by opening new branches and expand throughout the country, accessing zones outside its core area. They have proven to be the weakest part in the national financial system (Parejo *et al.* 2010). With the global economic crisis, which later becomes debt crisis, the saving banks have been caught off, fully indebted, and with more weight on its balance of credits than liabilities, appearing a grater risk of liquidity. The unnecessary excess of capacity, based on growth of promoters and builders loans, with high default risk, was not assessed at the time (Franco, 2012),, the excessive borrowing in wholesale markets by the saving banks, which cause

significant weakening of its core capital, and the high rate of default ratio in Spain, caused that the balance sheets of financial institutions remain flooded of property assets that are losing value day by day. No other choice but to support the majority of saving banks or groups of them, and as a result, the nationalization of many of them.

In this paper, we study the reasons for which savings banks have suffered this situation as well as the structural imbalances that have occurred and why they have unchecked commercial banks behaviour (García-Cestona and Surroca, 2008). For this, we carry out a study of the economic factors that determine the performance of Spanish savings banks. That is, we test indicators or variables concerning financial institutions and the effects on their performance. With this analysis, some conclusions that reflect the reality of the situation of financial institutions could be obtained. The variables that have been analysed on the most part of saving banks are: the efficiency ratio (euros spent, primarily in personnel and structure, for every dollar obtained); the core capital that gives strength to the entities; the default rate of loans to individuals, businesses and institutions; the liquidity of the entities; the number of offices opened through the Spanish territory; and net interest income of financial products in liabilities (deposits) and assets (financing). These variables were analysed in connection with the performance of these financial institutions, identifying those that have had a high degree of success in their business, and those that have not survived to the present situation by his weakened situation.

## **2. HYPOTHESES**

The scope and framework of this study can be explained by the changes that have taken place in the role of the savings banks sector in recent years in the Spanish financial sector. In this section, we analyze the factors that contribute to explaining the performance of savings banks and we develop our hypotheses.

The efficiency ratio compares the operating expenses and revenues. An entity that seeks to be more efficient obtaining higher revenues from lower expenses can reduce expenses maintaining the quality of service or increase revenues without incurring in more expenses (Prior, 2003). As financial expenses are the same for all entities (legal cost of money), the way to obtain more revenues is paying deposits with a lower interest rate or charging credits with a higher interest rate. A savings banks can also increase its efficiency reducing operating revenues, such as salaries, central services expenses, number of branches, technology expenses, buildings and so on. If savings banks are able to keep its number of clients despite

closing branches, synergies emerge due to save staff and rental costs. However, cost reduction does not necessarily imply an improvement in efficiency, as the evolution of income also influences in this magnitude. Currently, as incomes are decreasing, the efficiency is worsening in the banking sector. To solve this problem, mergers are taking place to obtain long-term synergies.

An entity with better efficiency ratio significantly improves its profit and, consequently, its ROA.

*H1: Savings banks with greater efficiency ratio obtain a better performance.*

The core capital of a financial entity is made up of nominal capital and reserves and defines the solvency level. A higher core capital indicates that an entity has a higher equity compared to risk-weighted assets. These assets include deposits from central banks (no risk) and industrial interests with a high risk. Entities should decrease risky assets and increase its equity, but savings banks are private foundations and cannot issue equity. An entity that has a higher core capital is more sensible and solvent and it is expected that its credits to clients have lower default risk.

The relationship between the core capital and performance is not direct. Five years ago, some savings banks had relatively lower core capital, but bigger profits. This occurs because entities obtained higher profits at the expense of a higher risk. To avoid this, regulator is stricter with financial entities and, now, the core capital must be higher than 8%. In the long-run, a higher core capital is indicative of a higher performance. The determinant factor of the core capital is not the equity of the entity, but the risk-weighted assets, which marks the entity capacity to generate revenues.

*H2: When a savings bank has a higher core capital, it obtain a better performance.*

The delinquency ratio informs about the default credits to total credits. The higher this ratio is, the lower opportunities to obtain revenues, which have adverse effects in the performance of the entity. The delinquency ratio establishes the quality of credits and its risk. An entity that analysed credit risk during boom economic years, it has a better delinquency ratio than those entities that gave credit without quantifying risks.

As a consequence of the economic expansion, Spanish savings banks have expanded business by opening branches in areas affected by the bust in houses prices (Bachiller and Lasa, 2013). With this practice, savings banks captured property developers as clients. When the houses prices fell, savings banks had to include properties into their balance sheet and the credit to

property developers resulted default. As the Moody's Investors Service (2006) indicates, some savings banks had 24,000 millions of default credit from property developers when they were inspected. When the business expansion derives from buildings without risk analysis, the delinquency ratio increases and performance decrease.

*H3: Savings banks with a lower delinquency ratio obtain a better performance.*

The liquidity can be defined as the degree to which an asset can be bought or sold in the market without affecting the asset's price. As it is a temporal indicator of economic situation, an entity can have a good liquidity position in the short term by an excess of debt, but this does not mean that the entity will be able to meet its responsibilities in the long term. When a financial entity cannot meet their payment obligations, the entity is more vulnerable, especially in the current economic situation. Now, it is expensive and difficult to find funding in the market (Ibercaja, 2012), therefore the lack of liquidity leads to savings banks to get into debts. The extra cost derived from higher interest rates affects the income statement.

An entity that does not have capacity to pay their loans due to the lack of liquidity can cause a panic situation into the financial system by the default risk. To solve this, the European Union has introduced massive injections of liquidity into financial entities at a low cost. Excess liquidity does not always cause an improvement in the performance of the entity, but an illiquidity situation can generate a worse performance.

*H4: Savings banks with a higher liquidity obtain a better performance.*

In the period of economic growth, savings banks opened branches to cover more businesses and to be more efficient and profitable. The higher the number of branches is, the higher the economies of scale are (for example, economies of scale due to central services). Financial entities also open branches to be present in most of Spanish regions. This marketing decision aims to improve the image of the entity.

This variable does not follow a fixed criterion of direct or inverse relation, although depending on the economic cycle, and the over sizing of the entity, may have an implication or another. In a period of economic expansion, if the entity is small, for expanding, it must increase the number of offices, to capture new business and increase the volume of activity, and since the activity is expansive, to increased benefits. If the entity is large and implemented nationwide, increasing the number of offices does not involve excessive improved profitability, unless expanding in new geographic areas, previously unconquered. Under recession, is always true that the improved performance is achieved on the basis of reducing the number of offices. As the entity has been oversized (excess of branches), it

should be reduced to cost containment, trying to keep the business achieved in the expansionary phase.

*H5: Savings banks with a lower number of branches obtain a better performance.*

The main activity of an entity is based on capturing customer money to lend to other customers. Since the overall interest rate that is paid to the lender is less than the interest rate that the borrower receives, it generates a margin. Such net interest income is the most important item in the income of the entity (supplemented by utility commissions and other concepts), which has a direct relationship to the benefit. In addition, this indicator is affected negatively with the default rate, as the default of a credit finance income decreases.

Therefore, there is a direct relationship between the margin and the ROA of the entity. However, an entity with high net interest income, but with a portfolio of industrial stocks or real state losing value continuously under the crisis, may be unable to offset this loss with its high margin and will arrive into a lower ROA.

Net interest income is the core of the financial business. However, this can be benefited in some cases (mainly with businesses other than financial), but mostly hurt by loss of value of the assets of the entity, whether real estate, industrial portfolios, etc. Certainly, an increase in net interest income will produce a better performance on profitability of the entity.

*H6: Net interest income of a saving bank is directly related with ROA.*

### **3. METHODOLOGY AND DATA**

We have used the panel data methodology to analyze the factors that determine the performance of savings banks. Our database is made up of observations of 38 entities over 4 periods (2006-2009). We then run panel data estimations to explain the determinant factors of the performance. Data is collected from annual reports from savings banks for 2006 to 2009.

To analyze the performance, we use the return on assets (ROA) as dependent variable. This profitability indicator is calculated by dividing revenue by total assets. We focus on the financial dimension of the savings banks' performance. Hodge (2000) shows that only a few

performance indicators are common across studies and, among these, profitability is the most frequently used.

The variables used in the study as explanatory factors of the performance of savings banks are:

- Efficiency. Efficiency ratio defined as general, administrative and amortization expenses to profit margin. The higher the ratio is, the most efficient the entity is. This variable has been inversed to facilitate its interpretation.

- Core Capital. Defined as the equity capital and reserves (or retained earnings) to risk-weighted assets ratio. We introduce this indicator because is indicative of the entity risk.

- Liquidity. Ratio calculated as credits to deposits. It is an indicator of the dependence of entities on funding requirements.

- Delinquency. Ratio defined as past-due credits divided by total credits. This variable measures the quality of a bank's loan portfolio.

- Branches. The number of branches has been included as variable in the regression as the period analysed coincides with the great expansion of savings banks in Spain.

Intermediation margin. The intermediation margin, defined as the sum of net interest income from financial service activities. The intermediation margin is indicative of the traditional business of the banking sector: granting credit and capturing deposits.

With this information, a regression is run to study the relationship between performance and several factors (efficiency, core capital, liquidity ratio, delinquency ratio, branches and intermediation margin).

$$ROA_{it} = \beta_0 + \beta_1 \text{Efficiency}_{it} + \beta_2 \text{Core\_capital}_{it} + \beta_3 \text{Liquidity}_{it} + \beta_4 \text{Delinquency}_{it} + \beta_5 \text{Branches}_t + \beta_6 \text{Intermediation Margen}_{it} + \varepsilon_{it}$$

Panel with T = 4 and N = 38.

## 5. RESULTS OF THE STUDY

The results obtained using the panel data methodology are presented (see Table 1).

**Table 1: panel data regression analysis**

Variable	Coefficient	Std. Error	Z-Statistic	Prob.
Constant	<b>0.5902869</b>	0.2640609	2.24	0.025
EFFICIENCY	<b>0.0059722</b>	0.002701	-2.21	0.027
CORE CAPITAL	<b>0.0781742</b>	0.0118457	6.60	0.000
LIQUIDITY	0.0005135	0.0012911	0.40	0.691
DELINQUENCY	<b>-0.1594029</b>	0.0127015	-12.55	0.000
BRANCHES	-0.0000555	0.0000867	-0.64	0.522
INTERMEDIATION MARGIN	0.0001384	0.0001331	1.04	0.299
R <sup>2</sup> = 0.5461				
Wald Chi <sup>2</sup> = 266.48 Prob>chi2 = 0.000				

As can be observed, there are three statistically significant variables in the regression: efficiency, core capital and delinquency. The Wald test indicates statistical significance in the model.

- The coefficient of efficiency is positive, so this variable is directly related to the performance of savings banks. That is, when a company is more efficient, it shows better performance than when is less efficient. This result is coherent with our initial hypothesis (a more efficient entity obtains a better performance). When a savings bank saves costs, it manages optimally its resources and its ROA is higher.

- As can be seen, the variable core capital is positively related to performance. That is, when the core capital is higher, the savings bank obtains a better performance. This supports our hypothesis that an entity that manages efficiently its risk, is more profitable and has a better performance.

- In our model, liquidity ratio is not related to performance, so we cannot accept our hypothesis. The higher dependence to external funding is not an explicative factor of the performance of the savings bank.

- The delinquency ratio is inversely related to the performance. This supports our hypothesis, that is, a savings banks with less past due credits obtains a poor profitability. This relationship indicates that the credit risk generates a worse performance.

- The variable branches is not related with the ROA of savings banks. The performance of savings banks does not depend on the number of branches, but the profitability obtained in every branch.

- Finally, the intermediation margin is not related with the ROA. This is not consistent with our hypothesis, but it is logical as commissions and other products not included in this margin also determine the profit of savings banks.

## 6. CONCLUSIONS

With the significant drop in revenues produced in recent years, due to the narrowing of interest margins, the efficiency ratio has become one of the main indicators to optimize resources and improve productivity and performance of the entities. Those savings banks that were not concerned with this aspect in good times could hardly sustain a positive bottom line under the decrease in incomes. Logically, those who have efficient production systems and optimize their expenses have been able to survive under the current financial situation.

Our results indicate that only the entities that have managed to maintain a solid core capital, can keep their position during the financial crisis, in spite of the significant increase for supplies demanded by the government of the country. They had greater financial strength and improved ability to carry out the provisions without damaging excessively its capital, and so its solvency.

The type of credit provided to the national productive system, the public administrations and the private client, is a very important variable for the performance of the entities. Those entities that provided credit without prudent risk assessment, found a higher default rate on these loans, which obviously hurts his performance. This occurs due to the important provisions on outstanding claims that have been set by national and international supervisors and, also, from the arrival of goods derived of the lack of payment of real state developers, builders and end final customers. These assets arrive in the banks' balance sheets but on the current real estate situation, lose value continuously, causing loss of balance value of the entity.

Today business in financial institutions is largely influenced by withdrawal of business from the past. Most of the revenue of the entities, especially in the asset, comes from past operations that endure over time. Those entities that put in the market very cheap credit, with

low intermediation margins, now are with a default business, since money seeking from abroad is much more expensive than that provided by the borrowers.

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## COMPENSATION-BASED SKILLS DEVELOPMENT APPLIED TO MANUFACTURING EMPLOYEES: A CASE STUDY IN QUEBEC

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### ABSTRACT

The concept of “skill” has been the subject of considerable research in recent years, particularly revolving around management skills within firms, without necessarily connecting skills to a framework of learning. The question can be asked: What happens when a model of skills development is applied to production employees whose tasks are simple and routine? This paper addresses this question, as well as the related social and managerial issues, through a case study of the implementation of a skill-based pay system in a middle-sized manufacturing company. The case study reveals surprising results with regard to the effects on employee retention and increased productivity, as well as the effects on employee identification to the company. Needless to say, a direct relationship had been established between the skills development model used and the pay increases, which could be seen as substantial when compared to the prevalent wages within the industry and for other jobs in the area. The most important limitation of this study is related to the methodological approach, which precludes any theoretical generalizations. Nonetheless, this article opens the door to further research based on new hypotheses. It is also hoped that the findings will help practitioners understand the process used in this instance and transfer the critical elements in order to achieve similar success within their organizations.

**Keywords:** Social constructivist model of skills, skill-based pay system, SME, personnel turnover.

### INTRODUCTION

Although the literature is replete with examples of the use of compensation-based skills development systems, few have explored the effects of skills learning in a manufacturing setting. This paper addresses this through a case study of a medium-sized Quebec company. The paper first clarifies the concept of skills and proposes a social constructivist model of

skills development that illustrates the acquisition of contextualized knowledge. The concept of skill-based pay system is then presented and its main advantages are exposed. After a brief explanation of the methodological approach, the case study itself is presented and discussed. The paper concludes by recalling the contributions, limitations and further research avenues opened by the case study.

## DEFINITIONS AND CONCEPTUAL FRAMEWORK

This section presents the main definitions delineating the complexity of the concept of skills, both to help the reader develop a sufficient understanding of the concept and to determine the most appropriate choice for use in the current study. We will then discuss the conceptual framework and describe what is entailed in a skill-based pay system.

### *Definitions*

The first clarification that must be made is between the concept of qualifications and the concept of skills. The concept of qualifications is a more instrumental notion in which the person acquires the abilities involved in carrying out a specific task, whereas the concept of skills refers to knowledge development with regard to actions, but also with regard to organizational contingencies. The distinction is thus made within a broader relative view. While the concept of qualifications connotes a single goal, the concept of skills refers not only to acquiring knowledge, but also to realizing the individual's potential within an organizational setting that has its own dynamics.

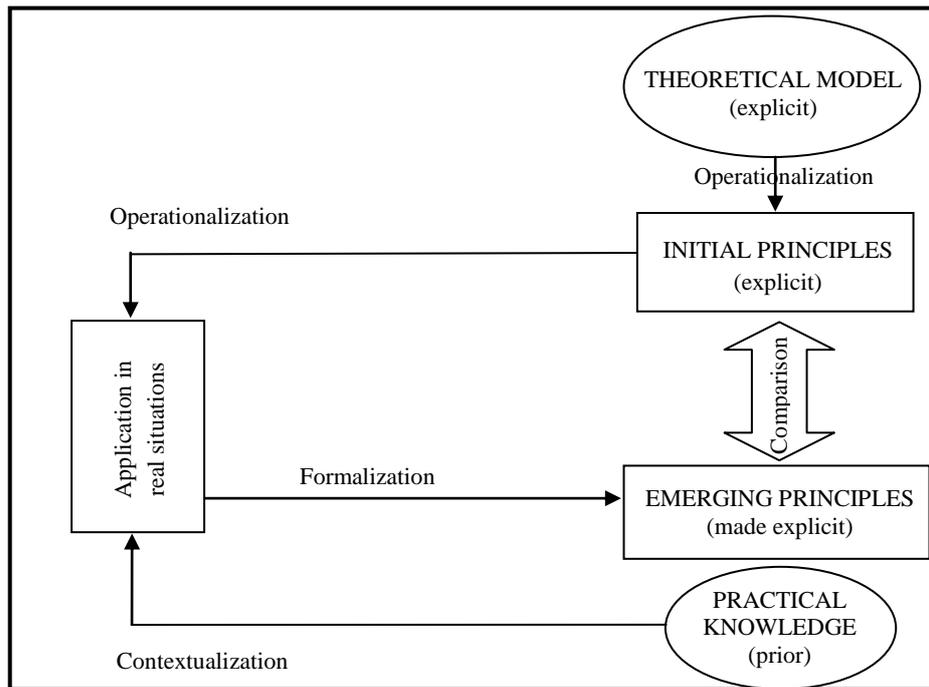
To understand what the concept of skills means in practice, several authors have developed definitions whose perspectives converge on the realization of the individual's potential. Carré and Caspar (1999) define skills as the knowledge that makes it possible to act and/or resolve the problems of a company within a particular context by mobilizing various abilities in a systematic approach. For Le Boterf (1997), skill refers to the application of many forms of knowledge in a given situation and context. In earlier work, the definition developed by Katz (1974) refers to three types of knowledge: conceptual skills (i.e., the ability to analyze, understand and make connections), technical skills (i.e., knowledge of task-specific methods, procedures and techniques), and personal intelligence (i.e., intra- and interpersonal skills). Although these definitions are all worth examining, the most pertinent definition for our purposes is that developed by Samurçay and Pastré (1995). For these authors, the concept of skills involves a goal, a purpose; they are acquired for a particular activity and through

performance of that activity. Skills are thus learned through specific training or by carrying out the task to which the skill applies. Finally, the application of a skill can be either explicitly or tacitly integrated in the execution of a given action.

This definition is particularly appropriate for use in this study because it points to the development of knowledge and takes its meaning within the social constructivist paradigm, thus finding its epistemological *raison d'être*. It is within this conceptual framework that the present case study was carried out (Jonnaert, 2006). Despite this, it is impossible in this case to separate the development of action and knowledge from the achievement of organizational objectives, which were established beforehand, independently of the workers involved. The solution to this paradox lies at the intersection of management's intentions and the commitment of the production personnel. Clearly, as each party may have differing rationales, there is a shared need for collaboration (Edwards, 1986).

#### *Conceptual framework*

More specifically, the conceptual model used to construe the realities of the situation is based on a principle of oscillation between assimilation and accommodation during the learning process. A phenomenon of repeated iterations of oscillations between these two modes can also be added. That is, knowledge is acquired through a cyclical process in which new information is first assimilated and then integrated into existing cognitive frameworks through action, thus modifying those frameworks (accommodation). The model below (Strauss and Corbin, 1990; Ouellet and Guilbert, 1997) illustrates this acquisition of contextualized knowledge. It is a social constructivist model because acquisition of knowledge is based on the principle of repeated iterations between theory and practice; employees build their knowledge through practice.



This model makes it possible to see the cycle of learning in context and to grasp the full process of operationalization of knowledge. This model has previously been used in non-business contexts, but is also relevant and easily be adapted to production workers in the manufacturing sector.

#### *The skill-based pay system*

But even if skills development is, as we shall see, mutually beneficial to employees and to the company, skills development is not self-induced; employees need to have a concrete reason to get involved in the process. The most obvious and efficient starter is to be found is a compensation system that rewards skills acquisition, that is some form of skill-based pay system. A skill-based pay (SBP) system is usually defined as “a system of compensation in which people are paid for the number, type and depth of skills they have developed” (Ledford, 1991). In this type of system, compensation is determined by the variety of skills the employee has acquired or by the number of positions the employee could effectively fill (Tremblay, 1996). Thus, the more employees progress in learning different skills, the better paid they will be. In fact, the concept of skill points to a significant change in the new employment agreement, thus restructuring the social relationship between employer and employee, in keeping with the conceptual framework of this paper (O’Neal, 2000).

From a managerial point of view, there are five main reasons for implementing a SBP plan (St-Onge, Haines and Klarsfeld, 2004; Tremblay, 1996).

1. To develop and maintain productivity in the most efficient manner possible.
2. To promote more flexible use of the workforce. Through flexibility in job positions and by training a group of available and mobile employees (versatility), the company is better able to deal with problems related to absent employees, staff turnover or temporary staffing requests during certain periods or to deal with critical situations. Greater employee versatility also helps meet production and service delivery requirements.
3. To increase the quality of products and services. Skill-based compensation can also give rise to greater accountability with regard to quality control among members of a work team because of their increased versatility and the skills they have acquired.
4. To make better use of new technologies and support new management values. For this purpose, a more flexible workforce enables the organization to adapt more easily and quickly to changes in technology, modifications of production processes, or new additions to the product line.
5. To have more motivated and involved personnel, improve teamwork, and enhance job descriptions to create more opportunities to reward the occupants of those jobs. With regard to this last point, Vroom's expectancy theory (1964) holds that employees will be more motivated to develop their skills to the extent that a reward they are likely to value (i.e., their pay) is accorded based on those acquired skills. Indeed, this theory postulates that a person's motivation to achieve a result or adopt a behaviour is greater when they perceive a stronger link between their efforts and the result (or behaviour), when they perceive a stronger link between this result (or behaviour) and rewards received, and when they value those rewards (St-Onge, Haines and Klarsfeld, 2004). In general, SBP systems fulfill all three of these criteria.

Several studies have pointed out the advantages of this approach to compensation. For example, a study by Ledford (1991) confirms that establishing an SBP system improves employee attitudes toward their pay, their job and the organization, as measured over two years. Another study of employees who had recently been switched to an SBP plan showed that they considered this system of compensation to be more fair and found that it had several advantages compared to traditional systems: higher wages compared to those offered in the job market, more rich and varied work, enhanced career opportunities and greater personal control over wages (St-Onge and Peronne-Dutour, 1998). According to another

study, employees of firms using SBP systems viewed their company's financial performance (estimated based on sales growth and the size of profits) in a much more positive light compared to employees of organizations that do not use this method of compensation (St-Onge, Haines and Klarsfeld, 2004). Finally, a study of 214 organizations conducted by Mitre *et al.* (2011) showed significant associations between this form of compensation and increased productivity.

The present article is a contribution to this body of research. Its specific contribution is that it applies manufacturing employees whose tasks, as we observed before, are simple and routine.

### **METHODOLOGICAL APPROACH: CASE STUDY**

The literature is filled with explanations of the case study approach. Although not diametrically opposed, there are rather contrasting notions as represented by, on the one hand, Yin (2003), who considers case studies to be, on the theoretical level, illustrative studies that strive to confirm one or more hypotheses, and on the other hand, Hammersley and Gomm (2000), who view case studies as a more ethnographic approach that gives a voice to the subjects and attempts to give a broad and detailed description of social phenomena. Our thinking in this case is based on a formalized and structured model of learning, which is closer to the view put forward by Yin (2003). However, given that there are few similar case studies in the literature, it has been difficult to establish hypotheses in advance; in this sense, this case study can be considered exploratory, and thus similar to ethnographic research. Despite this apparent paradox, Hamel (1998) asserts that there is common ground that can minimize this obstacle, in that both approaches seek to explain a phenomenon within its context. The purpose of this paper then is not to resolve the debate, but to examine the realities of what we consider a vector of a social and managerial phenomenon with theoretical and practical value.

Data collection took place between September 2010 and March 2011. The data source was company documents, as permission was granted to consult all records considered relevant to our research. Subsequently, five interviews were conducted, each lasting approximately 90 minutes. Two interviews were conducted with the company president to gain an understanding of his vision, the problems he faced, and the decisions made with regard to setting up a skill development model for production employees. Three interviews were

conducted with the director of human resources to examine the process of setting up the model as well to obtain additional information concerning how it functions. Concomitantly, the employees were observed for a total of ten hours on the factory floor.

## THE COMPANY

We will first present a description of the company and the issues it was dealing with, followed by an explanation of the different skill levels that the employees need to acquire to obtain wage increases. Finally, we will discuss the tangible results obtained by both the employees and the company.

### *History of the company*

This SME is located north of Montreal, Quebec, and was acquired in 1995 by a company headquartered in Vancouver, British Columbia.

The company is a leader in the design and manufacture of plastic cartons for specialty eggs such as omega-3 and organic eggs. The products are made of PET<sup>2</sup> and contain a minimum of 50% recycled material. In addition to producing egg cartons using recycled material, the company shows its commitment to environmental values in various ways including, for example, lighting its offices with compact fluorescent bulbs and entrusting disposal of hazardous wastes to a specialized firm (Perreault-Labelle, 2010, in lesaffaires.com). Similarly, by producing strong, precision-made egg cartons that protect the eggs during shipment and handling, the company limits the number of broken eggs and the resulting waste. The company's innovative products are sold across Canada and exported throughout the Americas and Europe. The company has approximately 80 employees who work in three shifts.

The president is a chemical engineer by training, and has been head of the company since 2008. He has worked in the plastics and packaging sector for over 20 years. His management philosophy is based on creating a healthy and safe workplace for the employees. In his opinion, it is the cornerstone of efficient and productive operations. An ardent advocate of workplace health and safety and accident prevention, he believes that profitability and

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<sup>2</sup> PET stands for polyethylene terephthalate. It contains oxygen, hydrogen and carbon and its disposal is considered "harmless" by the Confederation classification. PET is a polyester, that is, a plastic, and is commonly used in the textile industry. Recycling PET can result in a 50% reduction in energy use.

sustainability are generated by sound management, which includes worker health and safety. "If an employee is injured, everyone loses as a result. In addition to the injured individual, the incident impacts the family, the co-workers and productivity." The president also asserts that by dealing with the health and safety of its employees, the company is sending them a message that they are important to the company and that they will be held accountable for their behaviour and obligations to their co-workers. He believes that educating and training the employees with regard to health and safety will always be profitable for the company.

The values the company president attempts to transmit thus include integrity and the importance of employee well-being, a good working environment, teamwork and coaching. With regard to training, he holds that it is one of the best means available to make the work interesting for employees.

#### *The Challenges*

At the time that the company president assumed his duties, the turnover rate was 67%, which reflected mainly turnover among operational personnel (plant employees). This statistic indicated to management that they were constantly hiring new employees. The challenge was thus to retain employees, which led to a key question: How could the company increase employee involvement to elicit a greater degree of commitment?

The chosen solution was to set up a compensation system based on the acquisition of skills. Before 2010, there was no established salary structure. With a starting wage of \$10/hour<sup>3</sup> and an average increase of 3% per year, employees had to be very patient to reach \$15/hour.

#### *The skills-based pay system for operations positions (plastic thermoforming machine operator and senior plastic thermoforming machine operator)*

The company underwent a major reorganization in 2010, eliminating the assistant supervisor level (which was between the supervisor and the machine operators) to place greater emphasis on the operator positions.

As mentioned above, to meet the challenge of improving employee retention, the company had decided to connect pay levels to the development of progressive skill levels indicating the extent of the production employee's qualifications and ability to perform the tasks required at each level. Each skill level targets the acquisition and application of specific skills. Table 1

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<sup>3</sup> The minimum wage in Quebec was \$9.90 /hour in 2012. As a comparison, the minimum wage in France was €8.90/hour in 2010. Any further comparisons should take the cost of living of each country into account.

presents the details of the skill levels for the program set up at the company.

	Level		2010 Hourly Wage	2011 Hourly Wage
New hires	A0	3 months	\$10.50	\$10.50
Grade 1	A1	1-2 years	\$11.00	\$11.20
Grade 2	A2	1-2 years	\$11.25 – \$11.75	\$11.40 – \$11.95
Grade 3	A3	1-2 years	\$12.00 – \$12.50	\$12.20 – \$12.65
Grade 4	A4	1-2 years	\$12.50 – \$13.50	\$12.70 – \$13.70
Senior Grade 1	S1	1-2 years	\$13.50 – \$14.00	\$13.70 – \$14.20
Senior Grade 2	S2	1-2 years	\$14.00 – \$14.50	\$14.20 – \$14.70

Table 1. Payroll structure for production employees.

All employees are hired at the A0 pay level and remain at that level for three months. During that period, they receive the following training:

- Full integration training, lasting 2 to 3 weeks depending on how quickly the employee learns. During this time, a trainer works closely with the employee to provide the basic training.
- Health and safety training on procedures such as wearing PPE, lockouts, ergonomic working methods, etc.
- Training concerning the manual and automatic operation of the plastic thermoforming machine.
- Training on the process of collecting production data.

After the three months integration period, the trainees are evaluated by the supervisor, using an assessment form, and by the trainer, to confirm that they can apply the concepts they have learned. If the assessment is positive, the employee receives A1-level certification and the commensurate wage increase. All new employees will then progress through the skills development program with four possible skill levels. The trainer monitors the progress of each employee and serves as the resource person for the workers at all times.

In the following one to two years, the employees receive training to qualify them for certification at Level A2. The assessment is carried out during the second year, when the trainer observes that the new concepts are consistently applied, again depending on how quickly the employee learns. This assessment consists of both written tests and observation by the trainer on the factory floor. Upon successful completion of the tests and a positive assessment by the trainer, the employee receives A2-level certification. This certification entitles the employee to a performance-based wage increase, within the range established for this grade, a decision made by the director of operations and the human resources committee. The same process is repeated for progression from each level to the next.

Notably, A2-level certification involves comprehensive training in quality control; A2-certified employees thus become accountable for the quality of their work.

Level A3 includes training on managing priorities, organizing production activities to maximize productivity (resulting in a significant reduction machine downtime), preparing production reports, and performing basic mechanical procedures.

Level A4 consist mainly of training on carrying out somewhat more advanced mechanical procedures.

For new employees, progressing from Level A1 to Level A4 requires six years on average. All employees should be able to reach Level A4.

### *Results*

This compensation plan, which is based on increasing the versatility of the employees and upgrading their professional skills, resulted in a decrease in the turnover rate and an increase in retention of skilled workers. Indeed, the turnover rate dropped from 67% in 2008 to 8% at the end of 2011. Several other improvements were observed, including:

- a decrease in overall costs, despite the increase in payroll;
- a 19% increased in productivity; and
- stimulation of interest in skills development and promotion of a culture of continuous improvement and lifelong learning.

As O'Neal (2000) has stressed, the use of SBP usually comes about in response to the need to encourage workers to act less like simply occupants of a certain job and more like the "owners" of the primary means of production: themselves.

## DISCUSSION

As was suggested, a social constructivist conceptual framework is useful to understand the situation in this case study, because this framework helps establish links between the abilities of the workers and a contextualized situation where they need to adjust according to the principle of oscillation. That is, the employee acquires skills through explicit theoretical instruction followed by validation of the skill in practice, or even the development of new skills or, at a minimum, the ability to adapt to new tasks; the oscillation between theory and practice is easily observable. The case study also illustrates that skills development induced by a skills-based pay system does indeed generate most of the benefits put forward in the literature that we have previously exposed.

But, in spite of the clear benefits, this model of workplace learning linked to compensation has some limitations. It can potentially lead to insidious competition among employees whose ability to respond to the requirement for skills development depends on their logical-spatial and reasoning abilities, which are clearly unique to each person in a given situation. Employees who do not voluntarily participate may also be marginalized by the system or by their peers, leading to various forms of exclusion. In practice, there is also potential for conflict between the employees who participate in a skill-based compensation system and those who are excluded. In addition, managers must be prepared to be patient when setting up such a system, particularly in the modern business world where short-term profitability is viewed as the prerogative of any company.

Several exportable elements of success emerge from this case study. First, we noticed that it is critical that the skill profiles for each level be clear and well thought out: they must be both appropriate to the company's mission and attainable starting from the current knowledge base of the personnel. The compensation levels must be perceived by the employees as sufficiently generous to serve as a motivation and stimulus for learning. Managerial leadership, in the form of a consistent focus on human resource development, is also needed to implement this type of compensation system. Finally, this leadership must remain steadfast despite the vagaries of the market during the transition period, which may appear long in the eyes of shareholders.

## CONCLUSION

This case study makes four significant contributions to the field. First, on a theoretical level, it helps strengthen the social constructivist model as a valid explanatory framework for the

implementation of compensation systems based on skill acquisition. There has been a tendency in the literature to favour a problem-solving approach in business settings, relegating the social constructivist framework to the context of education. Second, this study highlights the appropriateness of using this conceptual framework in real time business context, paving the way for future research on the impact of socialization with regard to performance indicators for employees and for the company itself. Third, in practical terms relevant for managers, the findings elucidate several critical elements that can be transferred to other organizations and contribute to their renewed success.

Finally, this case study emphasizes the importance of skills development in giving a legitimate meaning to work, in contrast to a merely instrumental vision that focuses on how to achieve short-term results.

Of course, these results need to be used with care. This is a single case-study, which precludes any theoretical generalizations. Obviously, many replications in different companies with different skills-based pay system and different ways to implementing SBP would have to be conducted, possibly using different methodologies, before generalizations can be attempted.

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## TOWARD A LUXURY BRAND DEFINATION

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### ABSTRACT

A luxury brand represents social and cultural meaning which are used by consumers to fulfill their social goals toward brand conspicuousness. Consumer-brand relationship is considered an important variable in understanding the meanings that consumers bring to their lives when involved in symbolic consumption. Although research on consumer-brand relationships has been developed in the last years, this variable has never been operationalized in the luxury brands field. Of greater importance is that, while the term is used extensively, a clear definition of what constitutes a luxury brand has not been developed. Without a clear, consistent and accepted definition there is likely to be confusion in research outcomes due to investigations involving different product types. This paper attempts to provide a definition of the Luxury brand and the development of a model which describes its product and behavioral components. The model is a result of an investigation of the theoretical literature as well as the application of an author's developed scale that measures the relationships consumers develop with luxury brand.

**Keywords:** luxury brand, consumer brand, definition luxury, luxury model

### INTRODUCTION

Although for several years luxury brands had not receive considerable attention as a topic of research (Vigneron & Johnson, 1999, 2004; Beverland, 2004), it is accepted that the luxury industry has been increased since the 90's with the creation of conglomerates such as LVMH, Gucci group and Richemont (Okonkwo, 2009). In the last two decades, the luxury construct has gained relevance in the literature due to the importance that luxury brands have assumed in contemporary consumption and communication activities (Chevalier & Manzalovo, 2008). For Peirce, all knowledge and meaning is derived, with its basis in

experience (Mick, 1986). Accordingly, it is a person's experiences with a brand that determine the meaning(s) that consumers will attribute to their familiar brands (Heilbrunn, 1996). Grönroos (2001) adds that the sum of experiences that the consumer establishes with a brand forms the "brand relationship".

The consumption of brands gives meaning to the lives of the consumers (Levy, 1959; Kassarian, 1971; Sirgy, 1982; Malhotra, 1988; McCracken, 1989; Biel, 1993; Holt, 1995, 2002). That meaning is the result of the way the consumers live and perceive their experiences with brands. A brand relationship, or a consumer-brand relationship, is based on the assumption that a brand is a partner in a dyadic relationship with the customer (Fournier, 1998; J. Aaker et al., 2004; Aggarwal, 2004). Thus, a brand relationship is a source of meaning to the person who engages it (Fournier & Yao, 1996). While there is increasing research relating to luxury brands there is no clear, consistent or agreed upon definition of what actually constructs the elements of a luxury brand. While there generally the concept of luxury has become like the classic definition of art, "I may not know what excellent art is, but I know what I like." It is clear that luxury has product, economic and cultural aspects as what may be luxury in one culture or region may be a mundane product in another. Kleenex, low end cars and even ice may be seen by some as a luxury item. This makes it clear that the definition of luxury product or brand is essential to assure that the term has a broadly accepted meaning resulting in a standardized use of the term. Without such agreement it will be increasingly difficult to compare research results as investigations in this area increase.

There is some agreement in the literature that a luxury brand represents social and cultural meaning (Wilcox et al., 2009) that are used by consumers to fulfill their social goals toward brand conspicuousness. These social goals may be of social-adjustive order, or value-expressive order, or a mix of both (Shavitt, 1989). A luxury brand carries out important symbolic meaning that fulfills consumers' psychological needs. The great emphasis on psychological benefits versus lower emphasis on functional benefits is one of the aspects that characterizes luxury brands and allows distinguishing them from non-luxury brands (Vigneron & Johnson, 2004). In this vein, the study of luxury brands should imply to understand the meanings that consumers bring to their lives when involved in symbolic consumption.

The study of brand relationships has emerged as an interesting topic in recent years. The research of Fournier (1998) appears as an innovative example since it imported the interpersonal relationship metaphor to the universe of the consumer-brand relationships

(Keller, 2003). According to Aggarwal (2004) "Once, products and brands are associated with human qualities people may interact with them in ways that parallel social relationships, and their interactions are guided by the norms that govern these relationships" (p. 88). Thus, it makes sense to view the study of consumer-brand relationships under the umbrella of the theories of social relationships.

Although research on consumer-brand relationships has led to a better understanding of consumer behavior and company positioning as they relate to luxury brands a clear definition of what constitutes a luxury brand derived from this research has not been developed. This paper offers a review of the research as it relates to developing a definition of a luxury brand which can be used to promote better understand the key value dimensions behind a luxury brand choice and usage. A clear definition of luxury brands can help; to assure that those involved in luxury brand research are investigating the same types of products/services, lead to a focus of future research in luxury brands, extend the knowledge in the field and stimulate further empirical research on consumer-brand relationships. At the managerial level a clear definition of luxury brands should allow practitioners to define strategies and actions to address lasting consumer-brand relationships.

## **TOWARD A DEFINITION OF A LUXURY BRAND**

This study explores the definition of luxury brand products based on two measures, first the luxury product characteristics and second consumer's psychological association to the luxury brand products. The luxury product characteristic is controlled by the luxury product owners where at the base the luxury product requires high quality offering with high price as well as charming and different product aesthetics. The product owner drives the product further to exclusivity by making it hard to attain by general public and adding extraordinariness to its features. At the highest level of its luxurious characteristic the product matures to a well-respected sign established firmly within the luxury brand consumers.

At its base the luxury consumer's psychological characteristics requires a firm understanding and assurance of the luxury product's high quality. This characteristic is a perceived quality and could stem from the luxury product's image and aesthetic more than the product's true quality. At a later stage the luxury consumer enjoys belonging to a premium social status and seeks positive attention from others by being part of a very select group possessing the luxury brand product. As the consumer's psychological characteristic

matures to the highest level, a sense of self identification and togetherness to the luxury brand develops. At this stage the feeling toward the product is matured to the point where the consumer perceives a total sense of natural righteousness to be a regular client of the luxury product.

Initially the behavioral relationships to brand were investigated by Fournier (1998) in which facets of Brand Relationship Quality were determined. These were further examined Aaker, Fournier and Brasel (2004). Aaker et al. (2004) offer a model to understand consumer-brand relationships, in which brand personality significantly influences and predicts Relationship Strength and Partner Quality (an unidimensional scale) is a mediator of this relationship. According to their model, Relationship Strength is a multi-dimensional scale including four constructs: Commitment, Intimacy, Satisfaction, and Self-Connection. They concluded that: (1) sincere brands tend to facilitate strong and stable relationships based on trust but are more susceptible to the transgression effects which may be irreversible; and (2) the brands of excitement tended to nurture less stable relationships but that customers are more benevolent with their transgression acts and the reparation of problems may actually serve to reinforce the relationship. These two types of consumer-brand relationships fit with bi-dimensional model for intimate interpersonal relationships developed by Fletcher et al. (1999). Fletcher's et al. (1999) personality research explored interpersonal relationship theory and expressed relationships as developing the behavioral characteristics of passion and intimacy-loyalty. The work of Fletcher and Aaker was expanded by Nobre, Becker and Brito (2010) who further defined the influence of the behavioral characteristics as well as their effect on partner quality. These studies, attempting to refine the relationship between behavioral characteristics and brand loyalty investigated a broad spectrum of goods. Among all, four characteristics of Commitment, Partner Quality, Intimacy-Loyalty and Passion are considered as four-measures of LUXBRAND-RELATIONSHIP. At the highest maturity level where the luxury product and luxury consumer's psychological characteristics intersect, these four dimensions would emerge and define the relationship between the luxury consumer and luxury product at the most in-depth level.

#### Luxury brands

In defining a luxury brand different aspects and dimensions should be taken in account, such as the product category, the degree of luxury associated with the brand and the context of use. According to Chevalier and Manzalovo (2008), a restrictive definition of luxury brand, such as "almost the only brand in its product category, giving it the desirable

attributes of being scarce, sophisticated and in good taste. It also has a slightly understated and aristocratic dimension" (p. viii), does not make sense in the reality of consume. A luxury brand image relies on strong consumer involvement; therefore the notion of luxury brand is partially built on the consumer perceptions which help to create an image of luxury (Vigneron & Johnson, 2004).

Familiar brands are purchased by the consumers to satisfy different goals, necessities, and expectations, according to a dichotomy of meaning: functional attachment and existential attachment. This dichotomy serves as a basis to classify the several categories of meanings which consumers assign to brands (Heilbrunn, 1996): brands with functional significance, brands related to deepening experiences, brands as extension of the self, brands that embody cultural and personal values, brands effectively related to a close person or a personal environment, brands that act as an extension of memory, brands associated with a social exchange and/or status.

#### Consumer-brand relationships

Consumer-brand relationships represent a source of value for both brands and consumers (Blackston, 1993, 1995, 2000). This value is founded on the meaning that the relationships with brands have and bring to the lives of people (Fournier, 1998). Baumgartner (2002) states that people use consumption for self-creation and "strong self-brand connections are associated with better quality stories involving the brand" (p. 289). Thus, the experiences with brands influence the development of the individual identity. A relationship does not necessarily imply loyalty, but loyalty implies the establishment of a relationship – "relational condition of brand loyalty" (Fournier & Yao, 1996, p. 3). Loyalty is just a particular kind of a relationship (Jacoby & Chestnut, 1978). Thus, the relational approach may provide a better and broader understanding of the phenomena that arises between the customer and the brand. Adopting a relational view of consumption is consistent with the need for a more holistic approach for developing brand knowledge (Keller, 2003). Additionally, Gummesson (2003) emphasizes that reality cannot be analyzed based on independent objects but as a social construct that includes all interactions and relationships. Thus, in the analysis of brand consumption the emphasis should be placed on the consumer-brand relationships as a whole and not individually on the brand or the consumer (Heilbrunn, 1996).

Blackston (1993) developed a communicational model based on consumer-brand relationships similar to the interpersonal relationships. According to this model the relationship concept is defined as “the interaction between consumers’ attitudes toward the brand and the brand’s “attitudes” toward the consumer” (p. 113). The author states that successful consumer-brand relationships rely on the consumer perceptions of the brand’s attitudes and on brand’s ability on creating meaning to the consumer. The Brand Relationships Model (Blackston, 1993, 1995, 2000) states that a brand can be viewed as having two dimensions: the objective brand (i.e., one-dimensional brand image) and the subjective brand (i.e., the brand attitude). Brand-customer relationships are an important source of value and flexible an area more easily changed or adjusted than the elements that make up the objective brand.

#### Cognitive Characteristics

Quality appears in many literatures as a basic requirement of luxury products. A research by Heine and Phan (2011) identified several concrete and abstract constructs that when evaluated as an aggregate, forms an encompassing definition of quality. The literature acknowledges that different product categories lead consumers to evaluate product quality using differing dimensions (Saricam et al., 2012), but in general the higher the rating of these constructs the higher the product quality (Heine & Phan, 2011). Product quality is also a cornerstone for rationalizing the purchase of often higher-priced luxury brand products (Eastman & Eastman, 2011). The cognitive perception of quality is often cited as being more influential than actual quality (Heine & Phan, 2011; Eastman & Eastman, 2011), and it is this psychological perception of quality that forms one of the bases of luxury brand image. Consumers often expect higher comparable quality in luxury products, and it is unlikely that a luxury image can be sustained without sustaining high levels of product quality (Christodoulides, Michaelidou, & Li, 2009).

Aesthetics is a distinct characteristic often cited as being a significant in the perception of luxury (Townsend & Sood, 2012). Aesthetics is a product characteristic of an abstract dimension that is difficult to compare in concrete terms. But studies have shown that product design is a highly valued attribute of luxury products (Heine & Phan, 2011). Aesthetic design and ideology is often an extension of highly creative individuals, and the aesthetic characteristics they imbue into a product brand frequently resemble works of art, inducing emotions of exclusivity and superiority (Dion & Arnould, 2011). There appears to be

an innate tendency in humans to appreciate and pursue aesthetic pleasure (Townsend & Sood, 2012). The inherent non-functionality of aesthetics represents a cultural relativity of luxury (Heine & Phan, 2011) and can be meaningfully understood in terms of consumer perceptions of aesthetic product features, creating a link between high aesthetics and a luxury image.

Price is the other product characteristic that is a basic requirement of luxury. Kapferer's (2012) absolute concept of luxury illustrates that in current socio-economic context, wealth is the only remaining consistent differentiator of social status (Han, Nunes, & Dreze, 2010). To this end, raising the price of products creates social separation and the image of luxury to those who are unable to afford. Price has proven to be the most objective characteristic in evaluating the luxuriousness of a product (Heine & Phan, 2011) and requires no psychological perceptions except to know the price. Although price alone does not create luxury image (Eastman & Eastman, 2011), as not all expensive products are considered luxury, low-priced products are never considered luxury, and therefore is a basic requirement for luxury.

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. 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. It would appear then that product value is not only a function of price and actual quality but also the quality that is perceived. The concept can be expressed as:  $Value (F) = Price + Quality_{actual} +/- Quality_{perceived}$

These three product characteristics can be categorized as the basic building blocks of luxury products. This correlates with the most basic cognitive psychological functions consumers use to evaluate these characteristics, and their perceptions of these characteristics are the fundamentals of a luxury brand image. When these three luxury product characteristics interact with luxury brand consumer perceptions and judgments, this creates satisfaction (Saricam et al., 2012) at the most basic level in a luxury brand relationship between the product brand and the consumer.

### Extrinsic Characteristics

Extrinsic product characteristics are those that serve a social purpose for the consumer. Rarity, when defined as limited availability, is one such product characteristic. Rarity come in two forms, concrete (Heine & Phan, 2011) and virtual (Kapferer, 2012). Concrete rarity is physical limitations on production capacity that adds value for consumers that have access (Heine & Phan, 2011). Kapferer (2012) describes a concept of virtual rarity, where luxury brand products using selective distribution and marketing strategies create value through artificial inaccessibility. Uniqueness is an abstract product characteristic that is derived from qualities of unique product design (Dion & Arnould, 2011) or construction that can be either functional or trivial, that is almost exclusive to the image of luxury (Heine & Phan, 2011). The perception of uniqueness in this characteristic enhances the desirability of a product brand and therefore derives value in its consumption (Vigneron & Johnson, 2004).

Consumers use the extrinsic product characteristics of rarity and uniqueness, and their concrete or abstract connections with luxuriousness to exhibit social status and association or dissociation from social groups (Han, Nunes, & Dreze, 2010). The study by Han, Nunes, and Dreze (2010) clearly indicates that the majority of consumers actively signal to those equal and above their perceived social status using the consumption of prominent luxury product brands. High price is also frequently perceived as a differentiator of social status, where conspicuous consumption of luxury is used for the purposes of conveying social status (Eastman & Eastman, 2011). Social association (Wilcox, Kim, & Sen, 2009) and social dissociation (Han, Nunes, & Dreze, 2010) are consumer aspirational goals, where consumers of perceived higher social status consume luxury to dissociate from those of perceived lower status, and vice versa.

An inference that can be made between extrinsic luxury product characteristics and extrinsic luxury brand consumer psychological attributes, is that the more rare or more unique a product characteristic is perceived, the higher the perceived social value, and therefore the higher price premium and luxuriousness attained. Luxury product brand consumers derive social status and social association through the display of these product characteristics (Podoshen & Andrzejewski, 2012). The interactions between product brand and consumers at this level develop a luxury brand relationship of prestige, being defined as a distinction of perceived social values within a socioeconomic context (Vigneron & Johnson, 1999).

### Intrinsic Characteristics

Intrinsic product characteristics exist at the highest level of sophistication and include a complex integration of concrete and abstract attributes. Symbolism is one such product characteristic, and can refer to human values and lifestyles that exceed functional benefits (Heine & Phan, 2011). Symbolism can be thought of as the spiritualization of a product brand that embodies iconic and intemporal ideologies with little emphasis on physical form factor (Dion & Arnould, 2011). Luxury product brands often have a 'war chest' of subtle symbols, immortalized through public displays of superiority, but discreetly embedded within luxury product features (Kapferer, 2012). A similar product characteristic with more concrete basis is heritage. Heritage encompasses attributes such as country of origin (Godey et al., 2011), historical foundation (Kapferer, 2012), and authenticity (Alexander, 2008). A prestigious heritage is constructed and sustained through time and culture by product brands that are imbued with historic notions of luxury (Kapferer, 2012; Alexander, 2008), and is often perceived as being of superior quality, uniqueness, and authentic (Dion & Arnould, 2011).

Consumers' understanding of a product brand's symbolism and heritage drives intrinsic perceptions of the self. Sophisticated symbolism and prestigious heritage are sought by consumers of the highest caliber who have the financial capacity to consume without regard to functionality or social pursuits. Consumer psychological characteristics of self-esteem (Truong, McColl, & Kitchen, 2010) and self-affirmation (Townsend & Sood, 2012) are tied with these product characteristics because they induce an inward valuation of one's identity and worth (Townsend & Sood, 2012). Consumption of luxury product brands laden with subtle symbolism and heritage is related to emotional qualities of indulgence and a self-expression of individuality (Eastman & Eastman, 2011). Due to the transcendence of these intrinsic characteristics from functionality and social pursuits, the value attributable to symbolism and heritage defy traditional means of price valuation (Kapferer, 2012), the perception of luxury of which is driven beyond cognitive and extrinsic characteristics.

At this level of interaction between luxury product characteristics and luxury brand consumers, a strong relationship is created based on the constructs of commitment, partner quality, Intimacy-Loyalty, and passion. This framework is to show how the combination of the physical characteristics of luxury products and psychological perceptions of luxury create a luxury brand relationship with the consumer. This model depicts how the physical and psychological aspects of luxury brands inter-relate in a hierarchical structure of values.

Luxury product physical characteristics can be considered as a varying range of dimensions that increases proportionately with perceived luxuriousness. The major characteristics can be further categorized into concrete and abstract features, with quality having many sub-characteristics. Price is recognized as the function of physical costs of production and the perceived value. It is the most basic requirement of luxury definition in the current socio-economic context because wealth remains the only consistent differentiator of social status.

Luxury brand psychological characteristics largely derive from the consumers' perception of the luxury product physical characteristics. On a basic level, consumers develop a positive perception of the quality and aesthetics of a product, inducing satisfaction. On a secondary level, consumers use luxury brand products as an extrinsic signal of higher social status and association with, or dissociation from specific social groups, relying on the rarity and extraordinary physical characteristics to create self-connection. On an advanced level, luxury brand psychological characteristics become more intrinsic and spiritual, which correlate with increasing symbolism in physical characteristics. As luxury brand products exhibit higher degrees of desirable physical characteristics, it induces higher levels of psychological perceptions of value within consumers. Together, they create brand partner-quality and stronger consumer luxury brand relationships, which have been elusively attributed as the magic or passion behind luxury brands.

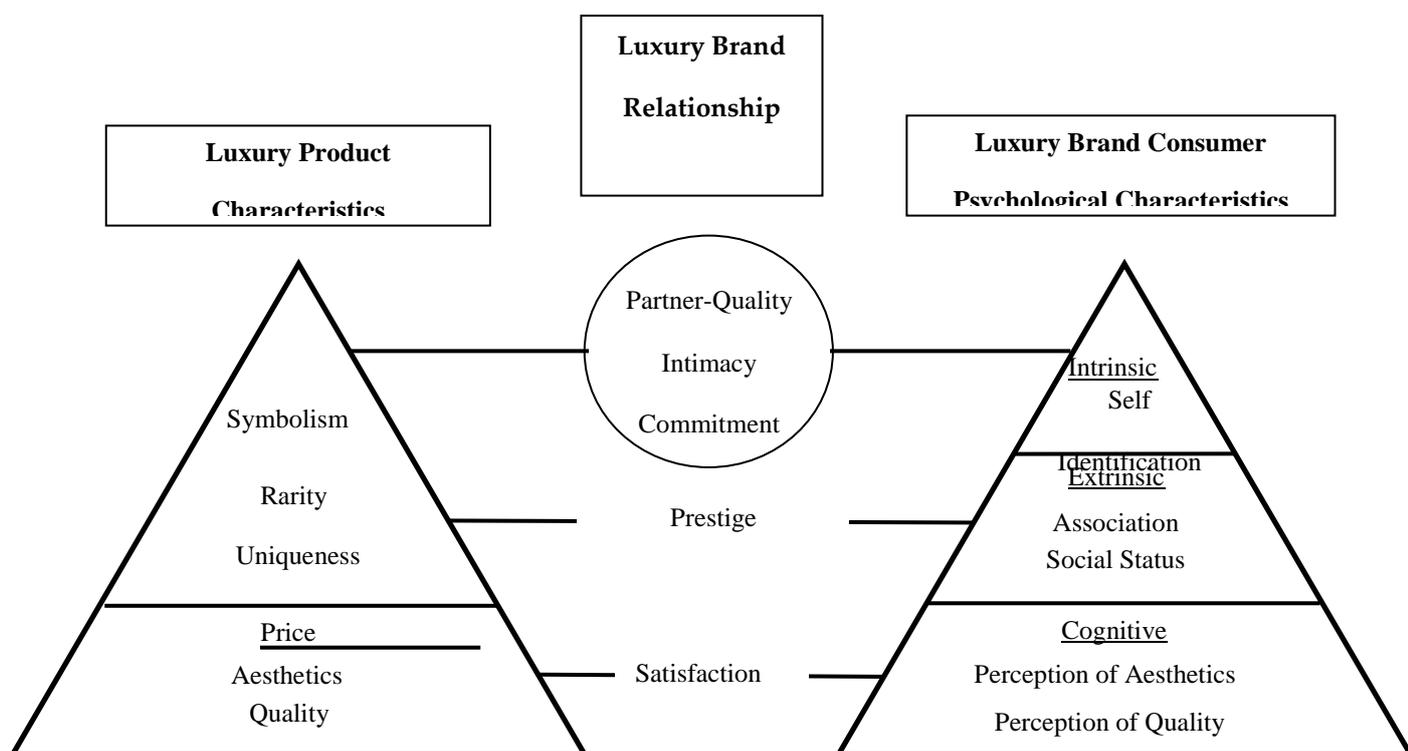
#### The Luxbrand relationship and partner quality

Commitment is defined according to Morgan & Hunt (1994) as a lasting and strong desire to keep the relationship and the willingness to make efforts toward it, and is described according to the Gundlach, Achrol, and Mentzer (1995)' works by items that reflect the instrumental nature of the investments in commitment, the time horizon that the construct implies, and more widely, the behaviors suggesting loyalty. Partner Quality Inferences are an important subclass of character inferences (Altman & Taylor, 1973). Consumers make inferences through the observation of a brand's behaviors. The sum of these inferences will form a global evaluation that the customer develops of the brand and its role as partner in a relationship (Blackston 1993), and will act as a mediating variable on the effects of brand personality on the relationship strength (Aaker et al., 2004). Partner Quality Inferences are nurtured in judgments of equity and justice, in socio-emotional benefits, and have the purpose of calibrating the belief the customer has in his relationship with the brand. It includes aspects of dependability, reliability, trust, support and accountability, regarding brand's performance in terms of respect for promises, avoidance of failures, problem-solving

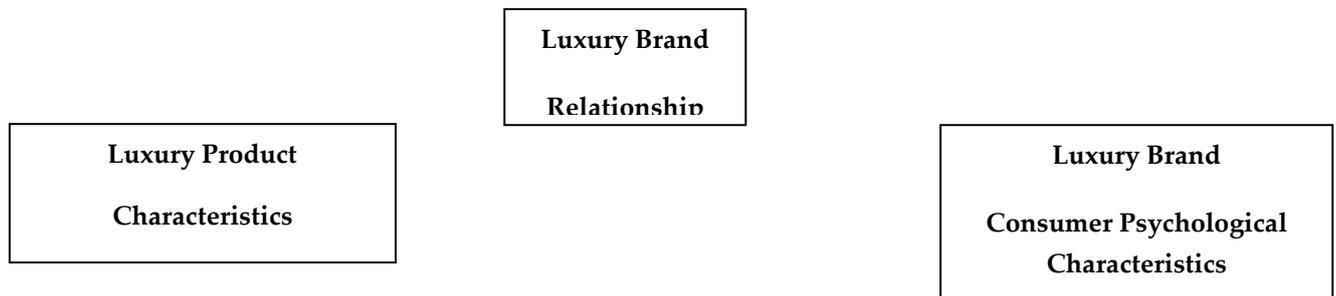
processes and long-term consumers' interests served. The partner-quality construct includes items that focus on aspects of trust and trustworthiness (Moorman, Deshpandé, & Zaltman, 1993; Sheppard & Sherman, 1998; Braun & Zaltman, 2000), "behavioral indicators of benevolence", "problem-solving prowess", "perceived reliability and dependability" (Aaker et al., 2004, p. 7), and transgression commission (Smith, Bolton, & Wagner, 1999).

Two more constructs, intimacy-loyalty and passion, emerge and represent the two Relationships Ideals of intimate (romantic) inter-personal relationships proposed by Fletcher, Simpson, Thomas and Giles (1999). In a new approach to the interpersonal relationships field, Fletcher et al. (1999) developed the Relationship Ideals, a factorial model for explaining intimate (romantic) relationships, which is composed by two basic factors: Intimacy-Loyalty and Passion. Relationships of Intimacy-Loyalty are caring, respectful, honest, trusting and supportive; and relationships of Passion are related to feelings of exciting, fun and independence. The authors note that results may not be necessarily generalized to other relationship domains and social contexts but that issue could represent an interesting direction of research. According to Aggarwall (2004) customers will relate to brands in ways that resemble their social ties. Aggarwall further states that the norms of interpersonal relationships are a basis for the assessment that customers make of their relationships with brands.

**Table 1. A DEFINATION OF A LUXURY BRAND: THE MODEL**



**Table 2. A DEFINATION OF A LUXURY BRAND: RESEARCH SUPPORTING THE MODEL**



<p><b><u>Intrinsic</u></b></p> <p><b>Symbolism</b> (Heine &amp; Phan, 2011; Kapferer, 2012; Dion &amp; Arnould, 2011)</p> <p><b>Heritage</b> (Kapferer, 2012; Godey et al., 2011; Alexander, 2008; Dion &amp; Arnould, 2011)</p>	<p><b>Commitment</b></p> <p><b>Partner-Quality</b></p>	<p><b><u>Intrinsic</u></b></p> <p><b>Self-Affirmation</b> (Townsend &amp; Sood, 2012; Eastman &amp; Eastman, 2011)</p> <p><b>Self-Esteem</b> (Truong, McColl, &amp; Kitchen, 2010; Eastman &amp; Eastman, 2011)</p>
<p><b><u>Extrinsic</u></b></p> <p><b>Rarity</b> (Heine &amp; Phan, 2011; Kapferer, 2012; Dion &amp; Arnould, 2011)</p> <p><b>Uniqueness</b> (Heine &amp; Phan, 2011; Vigneron &amp; Johnson, 2004; Dion &amp; Arnould, 2011)</p>	<p><b>Prestige</b></p> <p>(Vigneron &amp; Johnson, 1999; Podoshen &amp; Andrzejewski, 2012)</p>	<p><b><u>Extrinsic</u></b></p> <p><b>Association</b> (Han, Nunes, &amp; Dreze, 2010; Wilcox, Kim, &amp; Sen, 2009)</p> <p><b>Social Status</b> (Han, Nunes, &amp; Dreze, 2010; Vigneron &amp; Johnson, 2004; Eastman &amp; Eastman, 2011)</p>
<p><b><u>Cognitive</u></b></p> <p><b>Price</b> (Heine &amp; Phan, 2011; Kapferer, 2012; Eastman &amp; Eastman, 2011)</p> <p><b>Aesthetics</b> (Heine &amp; Phan, 2011; Townsend &amp; Sood, 2012; Dion &amp; Arnould, 2011)</p> <p><b>Quality</b> (Heine &amp; Phan, 2011; Eastman &amp; Eastman, 2011; Saricam et al., 2012)</p>	<p><b>Satisfaction</b></p> <p>(Saricam et al., 2012)</p>	<p><b><u>Cognitive</u></b></p> <p><b>Perception of Aesthetics</b> (Heine &amp; Phan, 2011; Townsend &amp; Sood, 2012)</p> <p><b>Perception of Quality</b> (Heine &amp; Phan, 2011; Christodoulides et al., 2009; Eastman &amp; Eastman, 2011)</p>

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## AN INTEGRATIVE APPROACH OF ONLINE TRUST ANTECEDENTS AND CONSEQUENCES ON PURCHASE INTENTION

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### ABSTRACT

Various typologies of trust were suggested in the literature. Although abundant literature has examined online trust, the different approaches were scarcely integrated to explain consequences of online trust. This paper addresses this gap by adopting an integrative approach to online trust antecedents and explaining its consequences on perceived risk and purchase intention. A survey is carried out on a sample of Indonesian cyberconsumer. The findings show that Purchase intention is determined by perceived risk and online trust. Besides, there is significant impact of personality based trust, cognitive based trust and institutional based trust on online trust.

**Keywords:** Online trust, personality based trust, cognitive based trust and institutional based trust, Perceived risk, Purchase intention

### INTRODUCTION

The digital age deeply changed the way people communicate, learn, and shop. Nowadays, More than 2 billion people are using the Internet in the world (WorldInternet stats, 2011). As a reaction, businesses have been doing E-commerce and offering their products and services online. To positively integrate the online environment, businesses have to deeply comprehend cyber consumer behaviour, to meet cyber consumer expectations. According to Yoon (2002, p.50) "Electronic commerce can be characterized as transactions on the Internet which are conducted between individuals and firms through different forms of online-linking media such as shopping mall web sites or portals". Although the recent exponential rise in online transactions, several issues still hinder the development of e-commerce. It has been

demonstrated that cyberconsumers browse trading website to seek information and very few would proceed with the buying stage in their buying decision processes (Chen and Barnes (2007). This highlights trust and risk perception as critical issues for the future of e-commerce. Trust is important when consumers start to form an intention to buy products online (Kim et al., 2008). Moreover, it has been found that trust has strong relationship with perceived risk (Yoon, 2002 and Kim et al. 2008) which also has an effect on purchase intention (Chang and Chen 2008, Yoon 2006, Kim et al., 2008, Li et al. 2008). Consequently, it is very important for any business to identify and understand online trust, consumer risk perception and their impact on online purchase intention.

Various typologies of trust were suggested in the literature. McKnight and Chervany (2001) suggested four concepts: disposition to trust, institution-based trust, trusting belief and trusting intention. McKnight, Choudhury, & Kacmar, (2002) focused on the web vendor to define trust as beliefs and intentions or willingness to rely on another party. Li et al. (2008), Brown et al., (2004) suggested a personality based conceptualization of online trust.

Cognitive Based Trust is another conceptualisation of online trust ( Li et al, 2008 and Meyerson et al, 1996) which suggest two dimensions: reputation of the web vendor (Li et al. 2008, Mcknight et al.2002 and Gefen et al. 2003) and calculative trust (Li et al. 2008). Moreover, Yoon (2002 ) demonstrated that website properties factor is a significant antecedent to online trust and that assurance of transaction security and personal variables both play a role in enhancing web-site trust.

Although abundant literature examined trust in a Website, the different approaches to trust were scarcely integrated to explain consequences of online trust. This paper addresses this gap by adopting an integrative approach to online trust antecedents and explaining its consequences on perceived risk and purchase intention.

The research objectives are (1) to examine the antecedents and consequences of online trust in terms of perceived risk and purchasing intention, and (2) to investigate these antecedents and consequences using a sample of Indonesian cyberconsumers shopping at kaskus.com.

## **THEORETICAL BACKGROUND**

In the literature, trust has been found to be essential in B2B and B2C relationship (Rosseau et al, 1998, and Doney and Cannon, 1997, Doney et al. 2007). It is an important factor that

enables companies to build long term relationships with consumers and generate their loyalty (Fletcher and Peters, 1997 and Selnes, 1998). Morgan and Hunt, (1994) defined trust as something that arises when one group or individual believe in the reliability and integrity of his exchange partner. With regards to consumer trust there are two perspectives in the study of trust. Firstly, individual trust related to the personality characteristics. Lewicki and Bunker (1995) conceptualise individual trust as a belief, expectancy or feeling that is deeply rooted in the personality, with its origins in the individual early psychological development and can also be based on individual experiences. In addition, satisfaction from exchange with other people can develop individual trust (Sheppard and Sherman, 1998). Secondly, trust can be considered between individual and their social institutions and trustiness can be built based on social environment recommendations (Buttler, 1991). Online environment emphasises the importance of trust and the absence of trust may be one of the most important obstacles of accepting online trade (Isaac and Volle 2008).

## CONCEPTUAL MODEL

Online trust has been triggering the debate since the last two decades. The rise of online shopping is also, it became critical for businesses to comprehend the online trust antecedents and consequences. Typologies of trust were suggested in both B2B context and B2C (Hofstede, 2010, Gulati and Sytch, 2008, Mcknight et al. 2002). In online context, online trust has five antecedent that differently contribute to it (Li et al., 2008 and Wang, 2010): the knowledge-based trust, the cognition-based trust, the calculative-based trust, the institution-based trust and the personality-based trust

## PERSONALITY BASED TRUST

Doney and Cannon (1997) defined trust as the perceived credibility and benevolence of a target of trust. Mcknight and al. (2002) added a third dimension of trust, which is the integrity. These dimensions are widely accepted and used in research (Bhattachjee 2002, Gefen et al. 2003). The first dimension of trust, perceived credibility, is the extent to which one partner believes that the other partner has the required expertise to perform the job (Denis 2007, Chouk et Perrien 2003, Gefen 2002, Morgan et Hunt 1994) effectively and reliably (Ganesan 1994). Then, trust based on a partner's expertise and reliability focuses on the objective credibility of an exchange partner: expectancy that the word or written statement of

the partner can be relied on (Wang et Emurian, 2005). Wang and Emurian (2005) refer to the belief that the electronic supplier has the required knowledge to do his job effectively. The second dimension of trust, benevolence, is the extent to which one partner is genuinely interested in the welfare of the other and is motivated by the search for common gain (Denis, 2009). It reflects the belief that the supplier wishes well to the user despite its own profits (Gefen 2002, Ganesan 1994). Benevolence is thus the belief that the electronic merchant is interested in user interests (Wang and Emurian 2005, Chouk and Perrien, 2004, Chen and Dhillon, 2003, Bhattacharjee, 2002). The third dimension of trust, the perceived integrity, is the belief that the other party accepts the honesty and the respect of promises and commitments (Isaac and Volle, 2008, Chouk and Perrien, 2004, Gefen, 2002). The perceived integrity is the confidence that the merchant-mail do not exploit the vulnerability and that it will honor its commitment by promising to protect the security of transactions and the confidentiality of information (Jannouri et Gharbi, 2008, Wang and Emurian 2005, Chouk Perrien and 2003, Bhattacharjee 2002). Based on the above discussion, we posit:

*H1: Benevolence in personality based trust is positively related to Online Trust*

*H2: Integrity in personality based trust is positively related to Online Trust*

*H3: Competency in personality based trust is positively related to Online Trust*

## **COGNITIVE BASED TRUST**

Parayitama and Dooleyb, (2009) demonstrated that cognition-based trust is a moderator in the relationship between cognitive conflict and decision outcomes. Cognitive based trust is built through people use of their common knowledge – own mind or asking relatives or friends- when they want to purchase online a particular product (Li et al, 2008). In the same vein, Meyerson et al. (1996) explained that cognitive based trust arises from first impression rather than experiential personal interactions. Based on this first impression, Li et al. (2008) and Mcknight et al (2002) pointed out that reputation of web vendor as being an antecedent factors of cognitive based.

Reputation is another dimension of cognitive based trust (Mcknight et al., 1998, Li et al., 2008, Jarvenpa et al., 1999). Reputation is the extent to which buyers believe that the selling organization is honest and concerned about its customers (Doney and Cannon, 1997). Organization's reputation and size were found to contribute to trust (Anderson and Weitz,

1989, Ganesan, 1994, Doney and Cannon, 1997). Mcknight et al., (1998) explained that reputation categorization can be known through second hand information i.e. relatives and friends. Sabater and Sierrathe (2005) emphasized that the main sources of information used by the trust and reputation models are direct experiences and information from third party agents. Quelch and Klein (1996) and Lohse and Spiller (1998) speculate that the reputation of the store will influence perceptions of the website. In addition, Powel (1996) also mentioned that reputation may reflect to the professional competence. Jarvenpaa et al. (1999) added that reputation of a website has become the most significant antecedent of cross cultural trust building in consumer. In addition, Gefen (2000) explained that when people lack of information and experience about particular vendor, the cognitive process will be running based on second hand knowledge and impressions. Doney et al (1991) added calculative or cost and benefit calculation dimensions as an antecedent of cognitive based trust. Furthermore, Shapirro et al. (1992) stated that calculative based trust is driven by economic principles, when people shaped by their rational assessment of the cost and benefits of another party cheating or cooperating in the relationship. Moreover, people tend to trust when the trustee is thought to have nothing to gain, or the cost overwhelms the benefit, from being untrustworthy (Shapiro et al., 1992). Paul and McDaniel (2004) evaluated calculative trust in an initial interpersonal trust context and argued that as long as the trustor is vulnerable to the non-performance of the trustee, calculative trust is effective. Based on this discussion, we posit:

*H4: Reputation in cognitive based trust is positively related to Online Trust*

*H5: Cost/Benefit Calculation is positively related to Online Trust*

## **INSTITUTIONAL BASED TRUST**

Bachmann and Inkpen (2011) claimed that institutions can be an important and efficient facilitators of trust that develop through legal provision, corporate reputation, certification exchange partners and community norms, structures and procedures. Besides, the authors add that institutions matter differently according to stages of a trustor-trustee relationship, level of assets specificity, level of maturity of the business and the rapidity of decision making requirement.

Mcknight et al. (2003, p. 339) defined Institutional based trust as “the belief that needed structural conditions are present (e.g., in the Internet) to enhance the probability of achieving

a successful outcome in an endeavor like e-commerce". According to Mcknight et al (2003) there are two dimensions of institution trust based which are: structural assurance and situational normality. Trust is supported by institutions through the use of guarantees, regulations, promises, legal recourse, or other procedures are in place to promote success structures that create an environment that feels safe and secure to participants (Bachmann and Inkpen 2011, Shapiro, 1987; Zucker, 1986). Corbitt et al (2003) explained that a quality of web vendor developed through usefulness, timeliness and advance of the website can build trust. Selnes (1998) mentioned that quality of web vendor is achieved through giving correct and accurate information about products or other information about company also being part of quality of web vendor. Quality of web vendor influences trust beliefs (Mcknight et al. 2002). Moreover, situation Normality is another dimension of institutional based trust which means that a people will believe that the situation they face is normal, in or in proper order because it is favorable (Baier, 1986). In addition, with regards to the e-commerce, people who step in this situation will feel that the internet environment is appropriate well ordered, and favorable for doing transaction (Mcknight et al., 2003). Based on this discussion, we posit:

*H7: Quality positively is related to Online Trust*

*H8: Situation Normality is positively related to Online Trust*

## **ONLINE TRUST, PERCEIVED RISK AND PURCHASE INTENTION**

Trust and perceived risk are strongly related (Mayer et al., 1995, Mcknight et al, 2002, Corbitt et al, 2003, Lu et al. 2005, and Zhao et al, 2010). Mcknight et al (2002) found that online trust affect perceived risk. Perceived risk is the perceived probability of loss or harm (Rousseau et al. 1998). Graziolli and Jarvenpaa (2000) mentioned that high perception of perceived risk will adversely affect consumer willingness to share personal information, follow vendor advice, and also their purchase intentions. In addition, trusting another party's behavior involves risk as the trustor is unable to confirm his/her decision outcomes prior to performance (Doney et al., 2007). Furthermore, perceived risk comes from uncertainty condition and undesirable as a result of purchasing product from ecommerce or online shopping (Lim, 2003). In uncertainty condition, customers rely on their trust beliefs to reduce their feeling about how much perceived risk they will have when shopping online (Zhao et al, 2010). Moreover, trust can reduce the levels of perceived risk associated with transaction process (Pavlou, 2003) especially when know little about the seller (Koufaris and Sosa, 2004).

Intention is a plan or will to behave in certain ways whether a person will do it or not (Ajzen and Fishben, 1980). Yoon (2002) and Kim et al. (2008) online trust significantly affect purchase intention. Besides, online purchase intention is significantly correlated with online perceived risk (Kim et al., 2008). Chang and Chen (2008) also stated that perceived risk has a mediator effect between trust and purchase intention. Rousseau et al. (1998) demonstrated that trust and perceived risk has a significant effect to the purchase intention of consumer. Based on the above discussion, we posit:

*H9: Online Trust is negatively related to Perceived Risk*

*H10: Online Trust is positively related to Purchase Intention*

*H11: Perceived risk is positively related to purchase intention*

## CONCEPTUAL MODEL

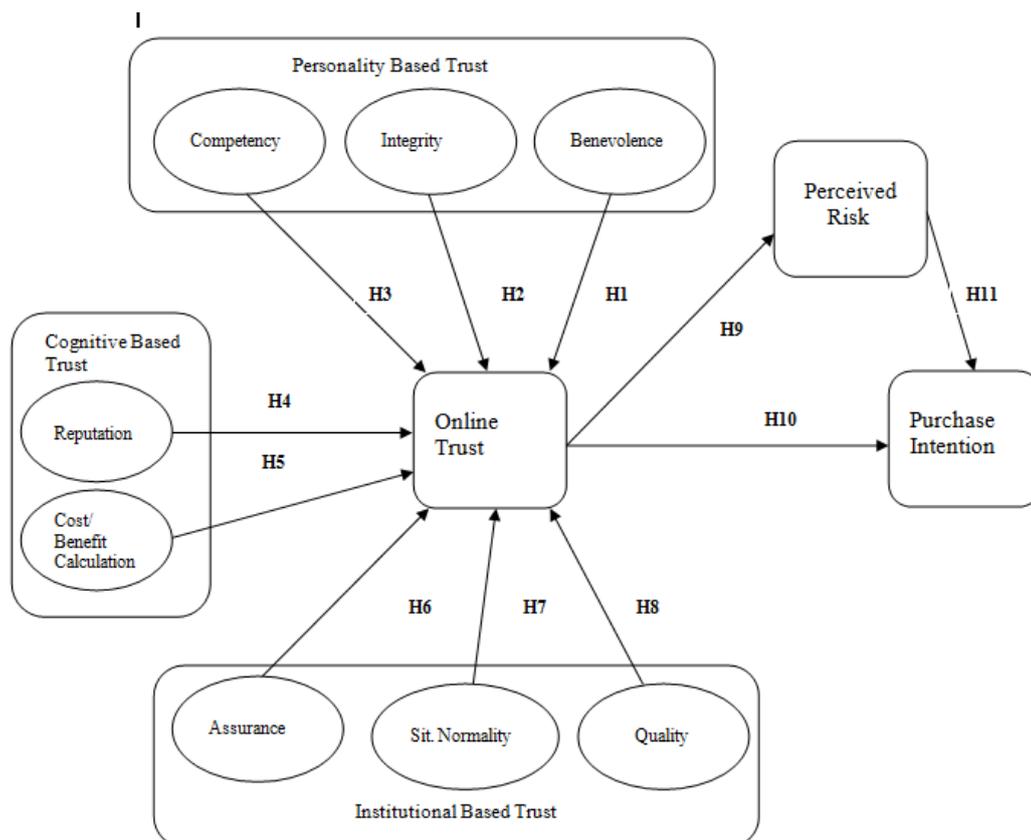


Figure 1: An integrative approach to online trust antecedents and consequences.

## RESEARCH METHODOLOGY

A survey is carried out to collect primary data. A questionnaire was designed by adapting measures from prior research to ensure the content validity of the scales. The measurement of personality based trust (competency, integrity and benevolence) was adapted from the scale developed by Li et al., (2008). Besides the three dimensions attributed to the personality based trust, the two dimensions of cognitive trust (reputation and cost/benefit calculation) were measured respectively using the scales developed by Mcknight et al., (2002) and Gefen et al., (2003). The two first dimensions of institutional (structural assurance and situation normality) were measured by the scale developed by Gefen et al., (2003), the third dimension (quality) was measured by the scale of Mcknight et al., (2002). The scale of Chang and Chen, (2008) was used to measure online trust. Perceived risk was measured by the scale of Corbitt et al., (2003) and purchase intention was measured by the scale of Pavlou, (2003). Finally, the survey instrument used in this study consisted of a total of 39 items related to the eleven constructs of the research model. The items were measured using a 5-point Likert-type scale for all constructs. The questionnaire is translated to Indonesian then back translated to English by two experts to check translation reliability.

A snow ball sampling method was applied. The questionnaire was emailed to kaskus.co.id e-shoppers who were asked to forward it to all their contacts that are also shopping on kaskus.co.id. Kaskus is the biggest merchant website in Indonesia with more than 3 million members (Kompas, 2011). Individuals sell new or used product to other individual in auction or "buy it now" system (Kompas, 2011). Indonesian customer is a massive market with strong purchasing power (Guardian, 2011). A pilot test was conducted and the wording of the items used in the questionnaire was slightly modified. 401 questionnaires were completed.

The male respondents were 53.5% and female respondents were 46.5%. 45.3% of total respondents were between 19-25 years old. 23% of total respondents were between 26-35 years old, followed by 20% of total respondents who were between 36-45 years old. Most of respondents were in bachelor (29.8% ) degree followed by college (27.8%), master degree (20%), high school (14.5%) and other education level (8.1%). The most of the respondents were students ( 37%), respondents from corporate employee were 25% of total respondents, followed by government employee (18.3%) and entrepreneur were (16%). 44% of total respondents have an expenses between 5 to 10 million Rupiahs per month; followed by 32.5 who have expenses 1 to 5 million Rupiah per month.

## DATA ANALYSIS AND RESULTS

### *Measurement model*

A confirmatory factor analysis using Amos 16 was conducted to test the reliability and the validity of the measures. Some common model-fit indices were used to assess the model overall goodness of fit (GFI, AGFI, RMR, RMSEA, NFI, TLI, CFI, Normed Chi-square). As shown in Table I, the majority of the model-fit indices approach or exceed their respective common acceptance levels. So, we can conclude that the measurement model has an acceptable fit with the data collected. Therefore, we can evaluate the psychometric properties of the measurement model in terms of reliability, convergent validity and discriminant validity.

Fit indices	Recommended value	Measurement model
GFI	> 0,9	0,910
AGFI	> 0,9	0,859
RMR	< 0,1	0,078
RMSEA	< 0,08	0,039
NFI	> 0,9	0,936
TLI	> 0,9	0,962
CFI	> 0,9	0,975
Normed $\chi^2$	< 5	1,594

**Table I: Measurement model goodness fit**

Within confirmatory factor analysis, T test associated with each factorial contribution is much higher than 1.96, thus confirming the significance of the relationship of each indicator with the corresponding construct. Construct reliability, which reflects the internal consistency of the scale items measuring the same construct for the collected data (Straub, 1989), was assessed by computing Jöreskog's rho. As can be seen in Table II, the  $\rho$  coefficient for each construct was above 0.715, exceeding the common threshold value (0.70) recommended by Fornell et Larker (1981). Thus, it is determined that the scale was reliable or internally consistent. The convergent validity of the constructs was estimated by calculating the rho of convergent validity ( $\rho_{cv}$ ) which indicates the average variance extracted by the construct. The average extracted variances are for the majority above the recommended 0,5 level (Fornell et

Larker, 1981) which mean that more than half of the variances observed in the items are accounted for by their hypothesized factors. However, both integrity and purchase intention measures have a rho of convergent validity nearby the common 0.5 value, respectively 0.499 and 0.497. We can conclude to their acceptable validity. Thus, all factors in the measurement model have adequate reliability and convergent validity (Table II).

Construct	Reliability ( $\rho$ of Jöreskog)	Convergent validity ( $\rho_{cv}$ )
Competency (CMP)	0,738	0,518
Integrity (INT)	0,726	0,499
Benevolence (BNV)	0,757	0,513
Reputation (RPT)	0,723	0,567
Cost / Benefit calculation (CBC)	0,719	0,566
Assurance (ASS)	0,771	0,622
Sit. Normality (SN)	0,737	0,525
Quality (QLT)	0,833	0,666
Online trust (OLT)	0,715	0,593
Perceived risk (PR)	0,785	0,524
Purchase intention (PI)	0,745	0,497

**Table II: Measurement model reliability and convergent validity**

To examine discriminant validity, the shared variances between factors is compared to the average variance extracted of the individual factors (Fornell et Larker, 1981). This analysis shows that the shared variance between factors is lower than the average variance extracted of the individual factors, confirming discriminant validity (Table III).

	CMP	INT	BNV	RPT	CBC	ASS	SN	QLT	OLT	PR	PI
CMP	0,720										
INT	0,681	0,706									
BNV	0,487	0,568	0,716								
RPT	0,621	0,523	0,328	0,753							

	CMP	INT	BNV	RPT	CBC	ASS	SN	QLT	OLT	PR	PI
CBC	0,702	0,559	0,505	0,618	0,752						
ASS	0,363	0,366	0,336	0,436	0,476	0,789					
SN	0,489	0,483	0,486	0,530	0,584	0,493	0,725				
QLT	0,580	0,710	0,692	0,400	0,546	0,332	0,511	0,816			
OLT	0,653	0,569	0,528	0,616	0,378	0,716	0,457	0,549	0,770		
PR	0,085	0,001	-0,063	0,140	0,036	-0,034	0,144	-0,043	0,035	0,724	
PI	0,643	0,499	0,458	0,470	0,546	0,393	0,453	0,548	0,686	-0,151	0,705

**Table III: Measurement model discriminant validity**

In summary the measurement model shows adequate reliability, convergent validity and discriminant validity.

## STRUCTURAL MODEL

A path analysis is conducted on the structural model in order to determine the direct and indirect effects of the research variables on purchase intention. Similarly to measurement model a set of indices is used to examine the structural model goodness fit (Table IV). In comparing fit indices with their corresponding recommended values, we conclude to an acceptable model fit.

Fit indices	Recommended value	Measurement model
GFI	> 0,9	0,963
AGFI	> 0,9	0,872
RMR	< 0,1	0,049
RMSEA	< 0,08	0,077
NFI	> 0,9	0,966
TLI	> 0,9	0,921
CFI	> 0,9	0,973
Normed $\chi^2$	< 5	4,771

**Table I: Structural model goodness fit**

Thus, we can examine the path coefficients of the structural model. As shown in Table V, standardised path coefficients, t-values and variances explained for each significant equation of the hypothesized relations between constructs in the research model are presented.

As expected, the basis hypothesis (H1, H2, H3, H4, H5, and H7) were supported, in that online trust is determined by personality based trust dimensions (competency, integrity and benevolence), cognitive based trust dimensions (reputation and cost / benefit calculation) and institutional based trust dimension (situation normality). The two institutional based trust dimensions (assurance and quality) seem to have no effect on online trust, so the hypothesis H6 and H8 were rejected.

Online trust and perceived risk have direct effects on purchase intention. Thus, we conclude to the validity of the hypothesis H10 and H11. However our results show that there is no direct link between online trust and perceived risk, so H9 is rejected. We also note that perceived risk is not a mediator of the relationship between online trust and purchase intention. The explanation power of the model is 50,5%, that is 50,5% of the variance of the purchase intention is explained by exogenous variables perceived risk and online trust which is determined for 74,6% by personality based trust dimensions (competency, integrity and benevolence), cognitive based trust dimensions (reputation and cost / benefit calculation) and institutional based trust dimension (situation normality).

Relation	Estimateur standardisé	t de Student	p	R <sup>2</sup>
CMP → OLT	0,570	13,617	0,000	0,746
INT → OLT	0,093	2,471	0,013	
BNV → OLT	0,163	4,949	0,000	
RPT → OLT	0,134	3,767	0,000	
CBC → OLT	0,277	6,906	0,000	
SN → OLT	-0,089	-2,644	0,008	
OLT → PI	0,689	19,563	0,000	0,505
PR → PI	-0,174	-4,947	0,000	

**Table V: Hypothesis testing results**

## **DISCUSSION, IMPLICATIONS AND RESEARCH LIMITATIONS**

This research in vein with previous findings (Isaac and Volle, 2008, Mcknight and al. (2002), Chouk and Perrien, (2004), Gefen, 2002, Doney and Cannon 1997) demonstrated that online trust has three categories of antecedents: personality based dimensions - competency, integrity and benevolence-, cognitive based trust dimensions - reputation and cost/benefit calculation- and institutional based trust dimension which is situation normality.

However, assurance and quality dimensions related to institutional based trust (Corbitt et al 2003, Selnes 1998, Mcknight et al., 2003) were found to have insignificant effects on online trust. According to Bachmann and Inkpen farmework (2011), this finding can be justified because Indonesian consumers are at an advanced stage in their relationship with kaskus.com (searchcowboy, 2011). Besides, kaskus.com is a mature business and purchasing goods on Kaskus.com is commonplace. Therefore, Indonesian consumers make swift decisions with little concerns of assurance and quality. Moreover, the website has a strong reputation and is provided with the requested certification.

We also found a direct effect between online trust and perceived risk on purchase intention. This result confirms previous authors' findings (Lu et al. 2005, Zhao et al, 2010, Kim et al., 2008, Chang and Chen 2008). The more an individual trusts a website, the less he perceives risk and the bigger is his intention to purchase on this website. Surprisingly, we did not find a significant relationship between perceived risk and online trust. This can be explained by the nature of the activities that can be done on Kaskus.com ranging from information seeking, news and gossips, social events, to hobbies and advertising. Besides, Kaskus.com has more than 2,5 million users which emphases it as Indonesia's largest community. This might explain the low perceived risk amongst this community.

The findings of this research have several managerial implications. Online brands have to develop integrity, competency and benevolence dimensions

These results provide valuable insights for professionals who should consider influencing online purchasing by promoting professional competency, benevolence and integrity. They should, certainly, create informative interfaces for potential cyber consumers, provide fast page downloads, short transaction times and frequent-user advantages for active users. Thus, practitioners should give an extra attention to prevent cyber consumers from consequently experiencing access difficulties, system crashes, drop outs, service delays and system malfunctions which consequently decrease their trust belief. Moreover, professionals should

reveal their integrity and credibility by respecting their promises, by developing the features of security and privacy, and by promoting their trustworthy brand.

This empirical study has some limitations. First, the study findings and implications are obtained from a single study that examined a particular website context. Thus, additional research efforts, replicating the study on other website are needed to evaluate the validity of the investigated model and our findings. Second, this study was conducted with a snapshot research approach. This reduces the ability of this study to reflect the temporal changes in the research constructs, especially when e-shopping experiences increase. Longitudinal evidence might enhance our understanding of the causality and the interrelationships between variables that are important to online purchase intention.

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## GENERATIONAL DIFFERENCES AND EMPLOYER BRANDING SEGMENTATION

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### ABSTRACT

The modern workplace worldwide is facing the new reality of multigenerational challenges. While organizations are struggling to manage values-diverse workforce, the ability to understand various generational needs and expectations, and to target them with tailored employer branding activities, could be a winning strategy to attract, retain and engage key talent. Therefore it is the purpose of this paper to explore generational perspective in employer branding. It is also the particular ambition of this study to promote the yet largely unexplored field of employer branding in higher education. Specifically, generational differences in the work values are investigated in 19 Lithuanian higher education institutions ( $N=1105$ ), identifying particular aspects of employment experience that are the most significant to Generation Y, Generation X, Baby Boomers and Traditionalists. The paper also examines how data differentiates between and across two types of higher education institutions, i.e. universities and colleges. Implications and recommendations for generational segmentation in employer branding in higher education are presented.

**Keywords:** employer branding, generational differences, work values, segmentation, higher education.

### INTRODUCTION

“... the traditional rules of management, motivation, and reward fly out the window. Can this be the essence of the change going on in the workplace today? Can it be as simple, and as complicated, as a change

in philosophy about the reason for working? Maybe. Time will prove this theory right or wrong. But many employers say that this is precisely what they're seeing. They describe the tremendous repercussions this change in values and principles is having on management's mode of operations – on the way executives recruit, communicate with, manage, motivate, and retain employees in order to remain competitive in the marketplace" (Marston, 2007: 4).

In modern economies where products and services become very alike, industries get overcrowded and competition for the best employees is almost as fierce as competition for customers, organizations are most likely to be heartily investing in distinctive employment practices and differentiating themselves from their competitors in the labour more than the product market (Lievens and Highhouse, 2003; Sørensen, 2004; Berthon et al., 2005). Employment practices determining the employment experience "guide the firm in selecting *particular* types of people with *particular* kinds of aptitudes and abilities to pursue *particular* goals in *particular* kinds of ways, motivated by *particular* kinds of rewards" (Baron, 2004: 5). It is no longer enough for organizations to manage their human resources effectively. In order to attract, select and retain the right employees and talents, organizations have to look for a "secret sauce" (Sartain and Schuman, 2006) – to immerse themselves in *employer branding*, i.e. identify *what* is so special and valuable about them, what exactly the current employees or possible candidates love and embrace about a particular work place, to create an employer value proposition and market it both internally and externally, winning the label of an attractive employer and in the same vein, signaling what kind of people the organization is eager for. In other words, employer branding refers to "how a business builds and packages its identity, from its origins and values, what it promises to deliver to emotionally connect employees so that they in turn deliver what the business promises to customers" (Sartain and Schuman, 2006: vi).

Most of the approaches for clarifying and uncovering employer brand are aimed at discovering "what is common among employees, their shared needs, motivations, perceptions and values. However, most organizations are diverse" (Barrow and Mosley, 2011: 100) and the simple fact is that different people have different perceptions about the value and importance of different job characteristics (Schokkaert, 2009). Even though "different" has many names, after a few decades of coping with gender, racial, ethnical, and cultural diversity, the modern workplace worldwide now is most sharply facing multigenerational challenges (Zemke et al., 2000).

The concept of *generational differences* and the conflicts, collisions, challenges and opportunities this diversity presents is a *topic of popular* discussion in a vast amount of management practitioner literature. Recent years have witnessed a steady march of studies on the development of generational competencies offering bundles of insights, methods and tools on how to effectively recruit, retain, motivate, manage each generation, and bridge the gap (Marston, 2007; Lancaster and Stillman, 2003; Espinoza et al., 2010; Martin and Tulgan, 2006; Sujansky and Ferri-Reed, 2009; Lipkin and Perrymore, 2009; Dorsey, 2009; Elliott-Yearly, 2011). However, only limited and mixed empirical evidence for generational differences in work values is available to reliably demonstrate whether or not and to what extent these differences exist (Smola and Sutton, 2002; Cennamo and Gardner, 2008; Hansen and Leuty, 2012; Parry and Urwin, 2011; Twenge et al, 2010; Tolbize, 2008). Moreover, while organizations are struggling to manage a values-diverse workforce with “different ways of working, talking, and thinking” (Zemke et al., 2000:11), and work hard to attract and retain talent, surprisingly far too little attention to shifting demographics has been paid in the theory of employer branding. It is only lately that some books, articles, investigative pieces, podcasts, and blogs about approaching employer branding from a generational perspective have emerged (Gruber, 2012; Employer Branding Today, 2013; Scrivener, 2013; Hubschmid, 2012; Hughes, 2013).

Therefore it is the aim of this paper to explore generational differences in work values and to provide evidence and insights for application of market segmentation approaches in the context of employer branding. The target population of the study was higher education institutions, since this sector has been – albeit with a *few exceptions* (Stensaker, 2007; Temple, 2006) – largely *unexplored* in branding literature, despite evidence showing it to be worth such thorough research. Namely, knowledge-intensive industries and knowledge-based organizations are merely dependent on the expertise, competencies and excellence of their employees, thus the ability to effectively attract and retain best possible faculty and staff is crucial to them.

## **THEORETICAL BACKGROUNDS OF GENERATIONAL DIFFERENCES**

“The problem of generations is important enough to merit serious consideration” (Mannheim, 1952: p.286).

‘Generation’ is a cohort of people, born around the same time, raised in a unique era and sharing significant social and historical life events and experiences at critical development

stages (Parry and Urwin, 2011; Twenge et al., 2010; McCrindle and Wolfinger, 2011). As Kotler et al. (2009: 347) assert, “each generation is profoundly influenced by the age in which it is reared – the music, films, politics and defining events of that period ...”, and as a result generational behaviors, work values and preferences do differ (Zemke, et al., 2000; Smola and Sutton, 2002; Hansen and Leuty, 2012; Cugin, 2012; Buahene and Kovary, 2007; Schultz et al., 2012; Hu et al., 2004). This “difference of attitudes between people of different generations, leading to a lack of understanding” (Oxford Dictionaries, 2013) termed as a ‘*generation gap*’ has always existed, but as a phenomenon in fields of marketing and business management literature it has attracted increasing attention since the late 1960s when two generations, the *Traditionalist* and *Baby Boomers*, have been fighting and learning how to co-exist (Howe and Strauss, 1992; Simons, 2010). A new generational gap emerged in 1990 when *Generation X* rushed into the labor market with their different visions of society and self (Howe and Strauss, 1992), and, eventually, after *Generation Y* has joined the battle, it is the first time in history when four different generations are working side by side, sharing and dividing the labor market (Hansen and Leuty, 2012; Tolbize, 2008). Furthermore, the near future (or already a new reality) of work demographics brings with it five generations in the workplace at once and “this mixed, multi-generational environment is a new diversity challenge for ... organizations everywhere” (Shah, 2011: para. 2).

Nevertheless there is little agreement on the starting and ending points for generations with high discrepancies of time spans (Smola and Sutton, 2002, Crowley and Florin, 2011; Burke, 2004; Tolbize, 2008; McCrindle and Wolfinger, 2011; McCrindle, 2006; Buahene and Kovary, 2008; Simons, 2010. Zemke et al, 2000; Becker, 2012; European Commission, 2011; Hansen and Leuty, 2012), the majority of literature defines *Traditionalists* as those born before 1946, *Baby Boomers* as individuals born between 1946 to 1964, *Generation X* as people born between 1965 and 1980, and *Generation Y* as including members born between 1980 and 1994 (Hansen and Leuty, 2012) (see Table 1). The newest *Generation Z* is reported to begin as early as 1991 or as late as 2001.

Generation	Birth Years
Traditionalists (aka Veterans, Matures, Silent Generation, WWII Generation)	Born before 1943/1945/1946/
Baby Boomers	1943/1945/1946/– 1960/1964/1970
Generation X (aka Baby Bust Generation, Gen Xers, Pragmatic Generation)	1960/1963/1965/1968/1970– 1976/1979/1980/1985
Generation Y (aka Millennials, Nexters, Digital generation, Echo Boomers, Generation www, Generation E, Net Generation, Gen Yers, Generation Me, Unlimited Generation)	1977/1978/1980/1981/1985– 1994/1998/2000
Generation Z	1991/1995/2000/2001 – Present

Table 1. *Generational time spans*

Admitting that there are some theoretical grounds to consider generational differences across national contexts and cultures (Schewe and Meredith, 2004), though “the notion of global generations as the incidence of ‘global’ events becomes more common” (Parry and Urwin, 2011: 92), providing with comparative approach, and facilitating the process of assigning particular work values to particular generation.

Despite some ambiguity in defining and delineating generations, most researchers agree on the inherent attributes of each generation (Hansen and Leuty, 2012; Twenge, 2010) and argue that generations “can be characterized by a certain set of attitudes and beliefs” (Smith, 2008: 8). Elaborating on this idea further, a qualitative and empirical literature review on generational diversity provides the means to categorize some aspects of each group’s behaviors, needs, personality traits, workplace perceptions, perspectives, interaction styles and preferences as summarized below.

- Traditionalists have grown up in the “do without” era, they believe in hard work and sacrifice, honor and compliance, are dedicated, very uncomfortable with change and aim at building a legacy (Buahene and Kovary, 2007). Traditionalists feel appreciated if their experience is respected, perseverance admired and knowledge valued (www.mcfrecognition.com). Characterized by high levels of loyalty, they believed they would (and commonly did) work for the same company their entire career (Marston, 2007). Described as liking structure, authority, formality and hierarchy (Burke, 2004), “averse to risk and strongly committed toward teamwork and collaboration” (Tolbize, 2008: 2), Traditionalists are gradually retiring.
- Baby Boomers are the Post-Second World War generation that lived through, adapted to, and created the incredible change. They are ambitious, loyal to the team, value personal growth, equality and collaboration (Buahene and Kovary, 2007). Having grown up in a healthy economic era, Baby Boomers strive for status, leadership, career and higher salary. They want their opinion to be heard and valued, and contribution recognized (Cennamo and Gardner, 2008). Baby Boomers are result driven, they give maximum effort (Burke 2004), are described as willing to “go the extra mile” (Zemke et al., 2000) and living to work (Marston, 2007; Smola and Sutton, 2002), which has started the workaholic trend (Tolbize, 2008).
- Generation X is referred to as a “bridge generation” which can easily understand Baby Boomers and, at the same time, connect with Generation Y (McCrinkle, 2006). Grown up in the era of distrust for national institutions, members of Generation X tend to be cynical,

skeptical, pessimistic, pragmatic, comfortable with change, more independent, self-reliant, autonomous and not overly loyal (Tolbize, 2008; Hansen and Leuty, 2012; Smola and Sutton, 2002). Research has found that Generation X is placing increased importance on compensation, working conditions, security, moral values (Hansen and Leuty, 2012), quick promotion (Smola and Sutton, 2002), flexibility, work-life balance, continuous learning, challenging work and supervisor relationship (Buahene and Kovary, 2007; Tolbize, 2008; Burke, 2004).

- Generation Y, which was raised in the era of financial boom, is the most highly educated generation (Tolbize, 2008). Its members embrace diversity, learn quickly (Burke, 2004), are devoted to their own careers (Marston, 2007), confident, optimistic, innovative, techno-savvy, loyal to peers, not title or company; they expect continuous change, rapid career growth and personalized experiences (Buahene and Kovary, 2007). Generation Y feels comfortable with multitasking, connects responsibility with personal goals, builds parallel careers ([www.mcfrecognition.com](http://www.mcfrecognition.com)) and is characterized by productivity, networking and openness (Employer Branding Today, 2012). Besides, several studies have revealed that representatives of Generation Y are more active volunteers but not “more caring, community oriented, and politically engaged than previous generations” (Twenge et al., 2012: 1060).
- Generation Z, commonly referring to people born from the mid 1990s to 2010, seems to be still miles away from the workplace, but it will take a flash of time for those bright, flexible and tech-savvy youngsters to enter the labor market, and some of them are already there. Influenced by the Internet, technology, war, terrorism, the recession and social media, members of Generation Z are connected globally to their peers and knowledge, and “expect to be able to work, learn, and study wherever and whenever they what” (Renfro, 2012, para. 9). By 2020, 36% of the workforce will be made up of this generation of employees, who have specific expertise, create no long-term plans, make no long-term contracts, are not loyal, expect quick results and quick promotions, are comfortable with and even dependent on technology, more socially responsible, constantly multitasking and always connected.

While generations demonstrate a number of differences in their work-related attitudes, research indicates many points of agreement as well: they all like teamwork; fair, ethical and collaborative/friendly workplace culture; want to be valued, supported and involved (Tolbize, 2008). As Smith (2008: 25) has concluded, “all generations basically want and value

the same things” – people expect to be respected, recognized, remembered, coached, consulted and connected. However, even though “people may want the same things, but they want them delivered in different packages, depending on when and how they grew up” (Ibid.).

## EMPLOYER BRANDING AND MARKET SEGMENTATION

“...organizations of all shapes and sizes have much to learn if we are to attract and keep the talent we need to succeed. And, by the way, it’s not all about the millennials ... it’s really about everyone in the workforce” (Smith, 2008: 5).

Market segmentation, defined as “the process of dividing a market into distinct groups of buyers who have distinct needs, characteristics, or behavior, and who might require separate products or marketing programs” (Kotler and Armstrong, 2010: 73), has been analyzed in marketing since 1970s and remains one of the key elements of its success. Demographic segmentation, which is considered to be the most common one, deals with – among other demographic values – age, generation, and the changing age structure of global population. Referred to as ‘generational marketing’ (Schewe et al., 2000), it makes a huge impact on today’s marketing strategies which attempt to appeal to the consumers’ emotions, beliefs, values and attitudes.

In the context of human resource management, segmentation “is a tool used to identify the most significant and meaningful way of dividing people into groups who can be catered for differently according to their specific needs” (Barrow & Mosley, 2011: 100). Although proving to be beneficial and helping companies “to be more efficient and effective in attracting, retaining and motivating both current and potential employees” (Moroco and Uncles, 2009: 181), application of market segmentation approaches to employer branding context is definitely yet unexplored and underappreciated, though idea itself is not entirely new (Hubschmid, 2012; Dahlström, 2011) and “is likely to grow in both frequency and sophistication over the coming years” (Barrow and Mosley, 2011: p. 100). Still, only the top companies which extensively apply employer branding strategies focus their efforts to offer a particular “package of functional, economic and psychological benefits provided by employment” (Ambler and Barrow, 1996: 187) to particular generation. Best practices of multigenerational employer branding include a pharmacy innovation company *CVS Caremark* ([www. cvscaremark.com](http://www.cvscaremark.com)), which sends a message to mature employees saying “Talent is

Ageless”, or the world’s largest home improvement retailer *Home Depot* ([www.homedepot.com](http://www.homedepot.com)), which targets the next Generation Z by “looking for the bold, the dreamers, the innovators and the problem solvers” under the slogan “Who’s next?”. And similarly, the second largest professional services network *Deloitte* ([www.deloitte.com](http://www.deloitte.com)), assuring that “we understand that your personal life and your professional life deserve an equal amount of attention ... and provide a comprehensive array of benefits that can help to provide balance and flexibility”. Isn’t it exactly what Generation X is looking for?

It is asserted that one of the most useful approaches of segmentation is to cluster people according to their different attitudes towards employment, for instance in such types as ‘Work-Life Balancers’, ‘Want it All’ and ‘Pleasure Seekers’ found by Tesco or ‘Ambassadors’, ‘Career Oriented’, ‘Company Oriented’ and ‘Ambivalent’ as produced by TNS analysis (Barrow and Mosley, 2011).

It should be noted though that for segmentation in employer branding to be necessary and economically feasible, the first thing to determine is whether the wants and the needs of an employee are heterogeneous enough, and whether different groups are not too small, or the total number of them too great (Neely et al., 2002; Barrow & Mosley, 2011).

Nonetheless, the first and the biggest issue to address in relation to generational employer branding is to accept that different generations choose and stay with companies for very different reasons, that generations are not sharing the same definition of ‘success’ (Marston, 2007), and that they work, think differently and have different sets of priorities (Espinoza et al., 2010). Further, it should be answered what kind of employment experience the organization wants to create, how it may need to vary by generational segment, and “how your employer brand can and should mean different things to different people” (Sartain and Schuman, 2006: 40). All these actions may be defined as ‘generational competence’ or ‘generational perspective’ – the ability of organizations to understand various generational identities, to appreciate diverse needs of each generation and to meet them. As Kupperschmidt (2000: 65) asserts, “a generational perspective enables managers to leverage employee uniqueness as a source of learning, productivity, and innovation and to create and role model a shared vision of positive co-worker relationships”.

Using internal research, organizations must answer, for the employee, the fundamental question “What’s in it for me?” if I work there (Sartain and Schuman, 2006). Clarifying generational expectations should be viewed as a starting point for every employer’s branding campaign (Hubschmid, 2012), which assists organizations in developing efficient target

group-oriented employer branding strategies to attract, retain and engage key talent and enhance productivity (Fraone et al., 2008).

## METHOD

The study reported here was carried out in 19 Lithuanian higher education institutions – 7 universities ( $N = 715$ ) and 12 colleges ( $N = 390$ ) – during the period from March until November 2012. Table 2 below shows the demographic characteristics of the total sample ( $N = 1105$ ). Age intervals used in the questionnaire to cluster respondents into age groups were adapted (with one year start-date and end-date error) from the Statistics Lithuania (2012), which commonly follows them to report about research and development personnel by age.

Characteristics	Frequency	Percentage
<b>Gender</b>		
Females	636	59,6
Males	431	40,4
<b>Age</b>		
<=25	25	2,3
26-35	317	28,9
36-45	308	28,1
46-55	239	21,8
>55	206	18,8
<b>Employee group #1</b>		
Academic staff	808	74,1
Administrative staff	282	25,9
<b>Employee group #2</b>		
Subordinate staff	837	77,3
Supervising staff	246	22,7

Table 2. Demographic characteristics of the sample.

To collect the data, invitations to participate in the present study were sent by email to employees of higher education institutions, whose management had expressed survey approval. The email contained a link to a web-based anonymous questionnaire. Although e-mail surveys are prone to poor response rates and it is possible that results will be biased, it is still the most effective method to reach respondents in scattered faculties, departments and divisions of higher education institutions. The list of items was randomly mixed not to provide respondents with a clue as to what dimension is being measured and to avoid inertia and bias. Twofold 10-point response scale was used for evaluation of each item. Firstly, respondents were asked to assess whether a statement reflects actual employment experience in a particular higher education institution, with “1” used to indicate “least experienced”

(lowest perceived experience), and “10” – “most experienced” (highest perceived experience). Secondly, the respondents were asked to evaluate how important such employment experience is to them, with “1” used to indicate “least important” (lowest perceived value) and “10” – “most important” (highest perceived value).

An Organizational Attractiveness Extraction Scale (OAES), originally developed by the authors, was used to measure the perceived actual and desirable characteristics of employment experience in higher education institutions. Particularly, the research was focused on the measurement of employment-based identity as perceived actual and desirable characteristics of employer’s attractiveness. Following the best practices of scale development, both deductive and inductive methods were used in item generation. As for deductive scale development, 8 international methodologies of workplace attractiveness assessment were analyzed. In parallel, applying an inductive approach, three focus groups of university staff (total  $N=70$ ) and four focus groups of students (total  $N=160$ ) were conducted with the aim of identifying dimensions of organizational attractiveness in a university. Further, content validity was used to refine dimensions that make up the attractiveness of the higher education institution as an employer and to expand them with the statements collected during the pilot surveys. After collection of initial data ( $N=186$ ) the scale was purified and resulted in a total row of 67 items measuring 11 factors, i.e. *Organizational Culture, Fairness & Trust, Teamwork, Academic Environment, Strategic Management, Job Satisfaction, Supervisor Relationship, Compensation and Benefits, Training & Development, Work-Life Balance, and Working Conditions*. In order to test reliability of OAES with the present study data, a series of Cronbach’s alphas were calculated for each of the 11 factors ranging from 0.675 to 0.953 with only one factor (*Work-life Balance*) returning coefficient lower than 0.70.

Additionally, Affective Commitment Scale developed by N. J. Allen and J. P. Meyer (1990) was used to measure employees’ loyalty, or employees' perception of their relationship with the organization and their reason for staying.

## DATA ANALYSIS

To explore generational differences in higher education, respondents were categorized into four generations based on the age intervals used in survey, as they approximately pertain to the generational birth frames. Only 25 respondents indicated being younger than 25 years old and presumably composing a mix of late Generation Y and early Generation Z members. This group was not included in further analysis. The group of respondents born between 1977-

1986 and aged 26-35 in 2012 was labeled as Generation Y; the group of those who were born between 1967-1976 and were aged 36-45 in 2012 was labeled as Generation X; the group of people born between 1957-1966 and aged 46-55 in 2012 was labeled Baby Boomers; and finally, the group of those who were born before 1956 was labeled as Traditionalist. The latter group is likely to contain some Baby Boomers as well, however, since the number of employees aged 65 and older was low and accounted to almost 8 percent of the total academic workforce in Lithuania (Statistics Lithuania, 2012), the highest margin of above 55 years old was employed to facilitate data analysis.

The data of the survey was analyzed using the IBM SPSS Statistics 19 for Windows software package. The aim of this study was to explore and describe generational differences in the preferences for work values and employment experience in academic workplace, consequently only the data from *Importance scale*, which indicated the employees' needs, wants and expectations, was used in further analysis. Table 3 reports descriptive statistics – the means, standard deviations and ranks for OAES item scores for each generational group.

The Kruskal-Wallis test was used to determine whether the generational groups' distributions were identical. The results of the Kruskal-Wallis test were significant ( $H(3)=16.727, p=.001$ ); the mean ranks of importance values are significantly different among the four generations. Accordingly, considering statistically significant differences, analysis of rank ordered data was performed, exploring most wanted employment experience facets for each generation. Additionally, total mean of responses, referred to as *Importance Index* [ $M=8.960$ ], was calculated to facilitate interpretation of results.

It can be seen from the data in Table 3 that Generation Y places most importance on an interesting job [ $M=9.60; SD=.914$ ], supervisor guidance [ $M=9.44; SD=1.154$ ], supervisor attention and respect [ $M=9.43; SD=1.107$ ], recognition of performance results and competencies [ $M=9.40; SD=1.056$ ], job meeting one's experiences and abilities [ $M=9.38; SD=1.059$ ]; supervisor support [ $M=9.37; SD=1.060$ ], study quality assurance [ $M=9.36; SD=1.253$ ], keeping promises [ $M=9.34; SD=1.198$ ], possibility to combine work and personal life needs [ $M=9.33; SD=1.388$ ], and help and support from colleagues [ $M=9.32; SD=1.133$ ]. Other generations also have a fairly high regard for these work values, except Traditionalists, who were found to value recognition for performance results [ $M=8.95; SD=1.614$ ] and proper prioritizing between work and life [ $M=8.91; SD=1.565$ ] much lower than Generation Y, and below the Importance Index.

Analyzing the preferences of work values of Generation X, it could be concluded that an interesting job [ $M=9.50$ ;  $SD=1.224$ ] which meets one's abilities and experience [ $M=9.45$ ;  $SD=1.000$ ] is the first priority as in the case of Generation Y. Further, "walk the talk" is most appreciated by Generation X [ $M=9.42$ ;  $SD=1.133$ ], fairness of treatment [ $M=9.40$ ;  $SD=1.116$ ] is considered as very important, keeping promises [ $M=9.40$ ;  $SD=1.189$ ] is most valued, and good atmosphere is embraced [ $M=9.38$ ;  $SD=1.059$ ]. Generation X also places more importance on consistent administrative support provided to faculty members [ $M=9.37$ ;  $SD=1.091$ ], appreciation of best employees [ $M=9.35$ ;  $SD=1.232$ ], attentive supervision [ $M=9.35$ ;  $SD=1.122$ ], and study quality assurance [ $M=9.32$ ;  $SD=1.53$ ]. It should be noted that, again, Traditionalists do not perceive consistent administrative support [ $M=8.87$ ;  $SD=1.502$ ] as a must, with scores falling below the total average.

When it comes to the work values of Baby Boomers, echoing the previous groups' results, they place the highest emphasis on an interesting job [ $M=9.43$ ;  $SD=1.144$ ], fairness of treatment [ $M=9.41$ ;  $SD=0.899$ ], job and experience match [ $M=9.32$ ;  $SD=1.210$ ] and reward of achievements [ $M=9.29$ ;  $SD=1.198$ ]. Good relationship with colleagues [ $M=9.26$ ;  $SD=1.040$ ] and procedures promoting transparency [ $M=9.29$ ;  $SD=1.257$ ] are also most valued by Baby Boomers. However, further preferences of attentive supervision [ $M=9.24$ ;  $SD=1.247$ ], study quality assurance [ $M=9.23$ ;  $SD=1.391$ ] and keeping one's word [ $M=9.21$ ;  $SD=1.130$ ] overlap with both Generation Y's and Generation X's priorities. In agreement with Generation X, Baby Boomers place increased importance on faculty support [ $M=9.22$ ;  $SD=1.056$ ]. Largest discrepancies are observed in the Traditionalists' case, where three of ten highest work value preferences of Baby Boomers, i.e. recognition of results [ $M=8.95$ ;  $SD=1.614$ ], faculty support [ $M=8.87$ ;  $SD=1.502$ ] and procedures promoting transparency [ $M=9.96$ ;  $SD=1.464$ ], are found below Importance Index.

Dimensions		Generation Y			Generation X			Baby Boomers			Traditionalists		
		Mean	SD	R	Mean	SD	R	Mean	SD	R	Mean	SD	R
Organizational Culture	1. Work environment is collegial.	9.03	1.471	39	9.07	1.471	35	9.00	1.448	36	8.95	1.495	29
	2. Good atmosphere prevails in my institution.	9.17	1.430	22	9.38	1.059	6	9.18	1.192	12	9.08	1.468	16
	3. Openness and sincerity is encouraged in my institution.	8.42	1.739	64	8.58	1.659	61	8.52	1.557	60	8.55	1.535	57
	4. Ethical standards are followed.	9.02	1.426	41	9.24	1.320	20	9.17	1.363	13	9.09	1.454	13
	5. High quality performance culture is being created in my institution.	9.09	1.431	33	9.13	1.277	30	9.00	1.334	37	8.90	1.433	35
	6. Conflicts are harmonized and resolved effectively.	9.01	1.377	44	9.15	1.426	25	9.11	1.231	24	8.84	1.597	40
	7. Environment is community-friendly in my institution.	8.50	1.951	59	8.69	1.782	57	8.56	1.726	57	8.71	1.500	53
	8. Constructive criticism is appreciated.	8.66	1.633	55	8.69	1.739	56	8.73	1.587	53	8.72	1.649	52
	9. Informal communication is frequent.	8.11	2.058	67	8.32	1.745	65	8.29	1.813	66	8.17	1.943	65

Dimensions	Items	Generation Y			Generation X			Baby Boomers			Traditionalists		
		Mean	SD	R	Mean	SD	R	Mean	SD	R	Mean	SD	R
Fairness & Trust	10. Creativeness and initiative is fostered in my institution.	8.95	1.440	46	9.20	1.153	21	9.15	1.184	19	9.05	1.418	17
	11. Academic freedom is valued.	9.00	1.377	45	9.08	1.406	34	9.06	1.456	31	8.97	1.522	25
	12. Remuneration system is clear and objective.	9.11	1.574	30	9.06	1.665	36	9.01	1.497	34	8.92	1.615	31
	13. Procedures promoting transparency are developed.	9.16	1.343	24	9.28	1.350	15	9.20	1.257	10	8.96	1.464	27
	14. Equal opportunities are ensured.	9.09	1.477	32	9.25	1.180	19	9.07	1.218	30	8.97	1.524	26
	15. Clear standards for promotion and tenure are articulated.	9.14	1.362	27	9.13	1.493	26	9.16	1.238	17	8.98	1.505	24
	16. Promises are kept in my institution.	9.34	1.198	8	9.40	1.189	5	9.21	1.130	9	8.99	1.344	23
	17. I have trust in my institution's leadership.	9.02	1.495	40	9.11	1.363	32	9.10	1.196	27	9.13	1.126	8
	18. Decisions are made without bias.	9.07	1.402	34	9.18	1.393	22	9.12	1.203	23	8.91	1.571	33
	19. Employees are treated fairly.	9.30	1.110	13	9.40	1.116	4	9.41	.899	2	9.19	1.171	5
Teamwork	20. Words match actions in my institution.	9.24	1.144	19	9.42	1.133	3	9.09	1.366	29	9.01	1.444	20
	21. I can rely on my colleagues.	9.26	1.129	16	9.13	1.352	29	9.00	1.319	35	9.03	1.450	18
	22. I enjoy working alongside like-minded people.	8.48	1.698	60	8.61	1.776	58	8.56	1.779	58	8.38	1.793	61
	23. I have good relationships with my colleagues.	9.31	1.196	12	9.31	1.102	12	9.26	1.040	5	9.23	1.135	3
	24. My colleagues are helpful and supportive.	9.32	1.133	10	9.29	.978	13	9.13	1.169	21	9.20	1.128	4
	25. Effective internal communication is developed.	8.75	1.636	53	8.89	1.738	48	8.78	1.533	52	8.54	1.738	58
	26. Cooperation is promoted to get the jobs done.	8.45	2.010	61	8.46	2.076	63	8.48	2.062	63	8.37	2.047	62
	27. Employees share their ideas and knowledge.	8.64	1.665	57	8.58	1.781	60	8.52	1.718	62	8.64	1.654	54
Academic Environment	28. High study quality is pursued	9.36	1.253	7	9.32	1.530	10	9.23	1.391	7	9.08	1.669	15
	29. My peers are the best scientists and lecturers.	9.05	1.468	35	9.18	1.437	23	9.19	1.250	11	9.03	1.363	19
	30. Students are good and motivated in my institution.	9.03	1.602	38	9.01	1.653	40	8.93	1.552	40	8.79	1.768	45
	31. Innovative training methods are encouraged in my institution.	8.87	1.703	50	8.75	1.876	52	8.83	1.627	46	8.88	1.594	36
	32. A favorable research environment is created in my institution.	9.26	1.358	15	9.08	1.700	33	9.13	1.501	22	8.83	1.750	42
Strategic Management	33. Organizational, departmental and employee integrity is ensured.	8.12	1.898	66	8.27	2.114	66	8.44	1.773	65	8.24	1.941	64
	34. Policies, procedures and responsibilities support strategy implementation.	8.66	1.605	54	8.74	1.706	53	8.80	1.641	49	8.76	1.541	48
	35. Sustainability and corporate social responsibility are fostered.	8.45	1.867	62	8.71	1.756	55	8.79	1.615	51	8.54	1.711	59
	36. Employee participation in decision making is promoted.	8.44	1.854	63	8.46	1.953	64	8.52	1.730	61	8.33	1.895	63
	37. University is building positive reputation and image.	9.11	1.588	29	8.97	1.591	42	9.10	1.627	26	9.11	1.649	10
	38. A clear strategy and direction is set and aligned with vision and values in my institution.	8.79	1.663	51	8.92	1.552	46	8.96	1.307	38	8.73	1.670	50
Job Satisfaction	39. I like my job and find it interesting.	9.60	.914	1	9.50	1.224	1	9.43	1.144	1	9.28	1.290	2
	40. My job is intellectually challenging.	9.15	1.575	25	9.02	1.696	38	9.11	1.451	25	9.10	1.420	11
	41. I can realize my ideas and potential.	9.32	1.215	11	9.02	1.580	39	9.09	1.429	28	8.84	1.574	41
	42. I know what is expected of me at work.	9.02	1.455	42	9.12	1.354	31	8.87	1.621	42	8.91	1.309	32
	43. My job meets my experience and abilities.	9.38	1.059	5	9.45	1.000	2	9.32	1.210	3	9.31	1.063	1
	44. My job feels meaningful.	9.16	1.334	23	9.31	1.167	11	9.16	1.311	16	9.01	1.359	21
	45. I feel that I and my efforts are valued.	9.05	1.597	36	8.91	1.823	47	8.85	1.735	45	8.83	1.711	43
	46. I have career opportunities in my institution.	9.13	1.512	28	8.84	1.673	51	8.86	1.477	44	8.62	1.659	55
Supervisor Relationship	47. My supervisor gives me feedback about my progress.	9.03	1.526	37	9.04	1.547	37	8.66	1.784	56	8.79	1.700	46

Dimensions	Items	Generation Y			Generation X			Baby Boomers			Traditionalists		
		Mean	SD	R	Mean	SD	R	Mean	SD	R	Mean	SD	R
	48. My supervisor listens to me and takes my opinion into account.	9.43	1.107	3	9.35	1.122	9	9.24	1.247	6	9.17	1.194	6
	49. My supervisor supports me.	9.37	1.060	6	9.28	1.226	16	9.15	1.147	20	9.09	1.499	12
	50. I have trust in my supervisor.	9.26	1.412	17	9.17	1.522	24	9.16	1.507	18	9.15	1.337	7
	51. My supervisor gives me guidance.	9.44	1.154	2	9.25	1.383	18	9.17	1.440	15	9.11	1.526	9
Compensation & Benefits	52. Effective employee incentive scheme is functioning in my institution (for loyalty, achievement, etc.).	8.92	1.613	48	8.95	1.784	45	8.79	1.627	50	8.56	1.886	56
	53. Additional benefits are offered to motivate employees.	8.52	1.860	58	8.59	1.697	59	8.45	1.775	64	8.03	2.004	67
	54. I am getting paid enough for my job.	9.14	1.507	26	8.96	1.839	43	8.81	1.953	47	8.75	1.873	49
	55. The best employees are appreciated in my institution.	9.27	1.184	14	9.35	1.232	8	9.17	1.217	14	9.09	1.446	14
	56. Employees' performance results and competencies are recognized and rewarded.	9.40	1.056	4	9.28	1.318	17	9.29	1.198	4	8.95	1.614	28
Training & Development	57. I receive enough training to do my job in the best manner.	8.90	1.491	49	9.13	1.422	27	8.71	1.784	55	8.73	1.663	51
	58. I have opportunities for personal growth in my institution.	9.19	1.451	21	8.96	1.691	44	8.86	1.655	43	8.99	1.429	22
	59. Employee training and development meet my institution's aims and objectives.	8.65	1.834	56	8.57	2.004	62	8.53	1.934	59	8.48	1.962	60
	60. Talents are nurtured in my institution.	8.78	1.733	52	8.86	1.499	49	8.73	1.685	54	8.87	1.492	37
Work-Life Balance	61. I have enough flexibility in my work.	8.95	1.678	47	8.72	1.901	54	8.80	1.771	48	8.80	1.604	44
	62. I can harmonize my needs in work and personal life.	9.33	1.388	9	9.29	1.249	14	9.02	1.367	33	8.91	1.565	34
	63. My work load is manageable.	8.16	2.334	65	8.00	2.342	67	8.10	2.199	67	8.10	2.040	66
Working Conditions	64. I am provided with all necessary equipment and resources to do my job well.	9.24	1.379	18	9.00	1.710	41	9.03	1.574	32	8.93	1.671	30
	65. Safe and comfortable working environment is created in my institution.	9.11	1.479	31	9.13	1.517	28	8.88	1.596	41	8.86	1.815	39
	66. Consistent administrative support is provided to faculty members.	9.21	1.276	20	9.37	1.091	7	9.22	1.056	8	8.87	1.502	38
	67. I am not experiencing stress in my work.	9.01	1.478	43	8.85	1.591	50	8.93	1.510	39	8.78	1.627	47

Table 3. Descriptive statistics for OAES items on Importance scale by Generation

It is apparent from the Table 3 that Traditionalists are consistent with other generations above on three aspects of employment experience, which are a job that is interesting [ $M=9.31$ ;  $SD=1.063$ ] and meets one's experience [ $M=9.31$ ;  $SD=1.063$ ], and attentive supervision [ $M=9.17$ ;  $SD=1.194$ ]. Similarly to Baby Boomers, Traditionalists embrace good relationship with colleagues [ $M=9.23$ ;  $SD=1.135$ ], just like Generation Y, they value helpful colleagues [ $M=9.20$ ;  $SD=1.128$ ], and, like both these groups, place much emphasis on fair treatment of employees [ $M=9.19$ ;  $SD=1.171$ ]. Traditionalists also agree with Generation Y on high importance of supervisor guidance [ $M=9.11$ ;  $SD=1.526$ ]. In contrast to other generations, Traditionalists express their appreciation for trusty supervisors [ $M=9.15$ ;  $SD=1.337$ ], leaders [ $M=9.13$ ;  $SD=1.126$ ], and the institution's positive reputation and image [ $M=9.11$ ;  $SD=1.649$ ].

Eventually, the data of *Affective Commitment Scale* was checked and strong evidence for significant differences between generations ( $F(3,1033) = 22.587, p < .001$ ) was found, supporting previous findings (AON Hewitt, 2012) and showing declining employee loyalty with each younger generation with Traditionalists being most loyal [ $M=8.00; SD=1.909$ ], Baby Boomers [ $M=7.66; SD=2.031$ ] and Generation X [ $M=7.11; SD=2.111$ ] getting less loyal and, finally, Generation Y representing the least loyal group [ $M=6.58; SD=2.202$ ].

Further analysis was performed on the level of overarching values, i.e. eleven OAES dimensions. To determine whether identified generational work value preferences are universally applicable, the non-parametric Mann-Whitney U test was used to compare mean values of universities and colleges and indicated statistically significant differences ( $p < .001$ ) between generations in these two subsamples on all dimensions on *Importance scale*, without exceptions. Given these statistically significant differences, the remaining analyses were performed separately for universities and colleges, but only the data from 10 higher education institutions – five universities ( $N = 672$ ), and five colleges ( $N = 262$ ) – was analyzed, as the samples of the remaining 9 institutions did not exceed 30 respondents, which is considered too small for segmentation.

Kruskal-Wallis non-parametric test was used to compare generational groups inside higher education institutions. Results indicated (Table 4) that there were statistically significant differences in attitudes between generations within all universities, except University B ( $H(3)=5.664, p=0.129$ ), and in all colleges, except College D ( $H(2)=2.071, p=0.355$ ), where no evidence of significant differences between generations was found.

	University A (N=119)	University B (N=69)	University C (N=98)	University D (N=268)	University E (N=118)	College A (N=65)	College B (N=50)	College C (N=42)	College D (N=44)	College E (N=61)
Chi-square	13.935	5.664	10.409	21.052	13.286	16.705	21.528	22.438	2.071	30.815
df	3	3	3	3	3	3	3	3	2	3
Asym p. Sig.	.003	.129	.015	.000	.004	.001	.000	.000	.355	.000

\*p value of  $<.05$  is statistically significant

Table 4. Results of non-parametric Kruskal-Wallis test for ten higher education institutions.

In order to identify the most preferable work values and to determine whether any group-preferential pattern could be observed in the subsamples of five universities and five colleges, three dimensions with the highest mean values and ranks, perceived as the most important by employees, were listed and summarized in Table 5 for each generational group with indicated frequency.

This analysis is quite revealing in several ways. First, it is apparent from table below that all or most of the generational groups across surveyed universities and colleges agree on one or

two highest priorities in work values. Namely, *Supervisor Relationship* and *Job Satisfaction* are embraced by Generation Y, *Fairness & Trust* is most valued by Generation X, *Academic Environment* and *Fairness & Trust* are most appreciated by Baby Boomers, and *Job Satisfaction* and *Fairness & Trust* are most desired by Traditionalists in the universities' subsample. In the same way, *Working Conditions* and *Fairness & Trust* are most appreciated by Generation Y, *Supervisor Relationship* is most valued by Baby Boomers, and *Supervisor Relationship* and *Fairness & Trust* are most expected as employment experience by Traditionalists in the colleges' subsample. Interestingly, no clear pattern emerged for Generation X in the colleges' subsample. Secondly, it is evident that certain employment facets are given the highest importance only in particular institutions, therefore revealing their specificity.

Work values:	Generation Y	Generation X	Baby Boomers	Traditionalists
<b>perceived as most important by Universities' employees</b>	Supervisor Relationship 5/5 Job Satisfaction 4/5 <i>Academic Environment</i> 2/5 <i>Fairness &amp; Trust</i> 2/5 <i>Working Conditions</i> 1/5 <i>Organizational Culture</i> 1/5	Fairness & Trust 5/5 Job Satisfaction 3/5 Compensation & Benefits 2/5 Academic Environment 2/5 Supervisor Relationship 2/5 <i>Organizational Culture</i> 1/5	Academic Environment 4/5 Fairness & Trust 4/5 <i>Job Satisfaction</i> 3/5 <i>Supervisor Relationship</i> 2/5 <i>Teamwork</i> 1/5 <i>Organizational Culture</i> 1/5	Job Satisfaction 5/5 Fairness & Trust 4/5 <i>Supervisor Relationship</i> 3/5 <i>Academic Environment</i> 2/5 <i>Working Conditions</i> 1/5
<b>perceived as most important by Colleges' employees</b>	Working Conditions 4/5 Fairness & Trust 4/5 Supervisor Relationship 3/5 Compensation & Benefits 2/5 <i>Academic Environment</i> 1/5 <i>Work-Life Balance</i> 1/5	Supervisor Relationship 3/5 Job Satisfaction 3/5 Fairness & Trust 3/5 Teamwork 3/5 <i>Working Conditions</i> 1/5 Compensation & Benefits 1/5 <i>Academic Environment</i> 1/5	Supervisor Relationship 4/5 Academic Environment 3/5 Job Satisfaction 2/5 Fairness & Trust 2/5 Working Conditions 2/5 Strategic Management 1/5 Training & Development 1/5	Supervisor Relationship 4/5 Fairness & Trust 4/5 <i>Strategic Management</i> 1/5 <i>Academic Environment</i> 2/5 <i>Job Satisfaction</i> 1/5

Table 5. Work values perceived as most important by employees of universities and colleges.

## CONCLUSION AND DISCUSSION

The contribution of this study is threefold. Firstly, it provides evidence for generational differences in work values in higher education. Secondly, it explores the generational diversity between and across universities' and colleges' subsamples. Thirdly, it elaborates on yet properly unexplored field of employer branding segmentation based on the criterion of age.

The results of this study support previous observations (e.g. Tolbize, 2008), indicating that generations, starting with dedicated Traditionalists and ending with self-concerned Generation Y, are **successively** less loyal to their employers. Furthermore, consistently with previous research (Smith, 2008; Burke, 2004; Marston, 2007; Meister and Willyerd, 2010; Zemke et al., 2000; Tolbize, 2008, Twenge et al., 2010), Generation Y was found to be driven by personal relationships with colleagues, flexibility to combine work and personal life needs, sense of greater good expressed as a concern for study quality assurance, need for immediate, straight and continuous supervision, and inclusive, transparent management style (measured

there as Fairness & Trust). There was no clear evidence found to support recent findings that representatives of Generation Y are placing less importance on social interaction and “more value on work that provides extrinsic rewards” (Twenge et al., 2010: 1133), except for higher emphasis on working conditions, which was particularly observed in the colleges’ subsample. Interestingly, Strategic Management was not given much importance by Generation Y in universities and colleges and by Generation X in universities, which could be explained both by particularity of academic workplace, which is “built on a culture of individualism and academic personal autonomy” (Coaldrake and Stedman, 1999: 1) and generational values of independence, flexibility, and ‘challenging authority’. The results of this study also indicate that Generation X holds high expectations for security provided by credible, trusted and fair leadership, and places increased importance on salary, namely Compensation & Benefits. Generation X was not, as expected (Smola and Sutton, 2002), found to place much emphasis on work-life balance, and continuous learning and working conditions (Hansen and Leuty, 2012; Tolbize, 2008). The findings of this study suggest that Baby Boomers exceptionally value Academic Workplace which “serves as as symbolic economy, in which academic performance assumes a symbolic value that is worth little in other occupations” (Bauder, 2006: 232), accordingly providing Baby Boomers with a particular sense of achievement, recognition and contribution that motivates them (Cennamo and Gardner, 2008). Finally, consistently with previous findings (Burke, 2004), Traditionalists were found to be the most distinct generational group, which values authority, institutions’ reputation and image, wants to be heard, collaborative and cares the least about compensation, benefits and recognition of results.

The results of this study also support previous evidence (Tolbize, 2008; Smith, 2008) that generations have many points of agreement or a ‘common good’ that is shared by all and not much dependent on generations. Specifically, the study indicates that all generations in higher education appear to be predominantly driven by job satisfaction, i.e. work which is interesting and meets one’s experience and abilities. These findings support the idea that higher education institutions have preserved a continuous identity that is bonded by “love”, settled by academic men of ideas and ruled by personal autonomy, collegial self-governing and altruistic commitment (Clark, 1986). The research has also found that such work values as Fairness & Trust and Supervisor Relationship are embraced almost unanimously by all four generational groups. These findings are consistent with previous research showing that trust is among the key universal values and the defining principles of great workplace ([www.greatplacetowork.com](http://www.greatplacetowork.com)) as well as interpersonal relationships (especially in the area of

supervisor-subordinate relationship) are leading psychological growth, development and long-term satisfaction (Montana and Charnov, 2000; Sachau, 2007).

Summarizing it could be concluded that, supporting previous research on generational differences, people raised in a particular era and sharing specific historical and social experiences and events tend to have similar work values and employment experience preferences. However, although the results of this study indicate that generations differ, this diversity – as investigation of generational preferences in universities' and colleges' subsamples revealed – is increasing when analysis is being gradually detailed elaborating upon types and, especially, individual higher education institutions. Therefore, it clearly suggests that generational 'packages of work benefits' should be neither generalized nor 'prescribed' to all institutions. On the contrary, altogether these findings argue for individual approach and specific case analysis researching the wants, needs and expectations of employees in a particular organization.

All in all, this study provides new evidence for generational segmentation and encourages organizations to apply generational perspective in their employer branding strategy. And the main reason for demographical targeting is not generational differences per se. Due to the effects of ageing society, this will be the most noticeable between 2015 and 2035, when a large part of the Baby Boomers will retire (European Commission, 2012) and "the competition to attract and retain key performers will become more fierce – companies will solicit candidates and not vice versa" (Dahlström, 2011:10). Therefore, in order to reach the right employees in today's complex and segmented society, "every future leader will have to be culturally dexterous, knowing how to motivate and reward people of different backgrounds" (Ibid.:11). Generational employer branding targeting individuals based on their generational preferences or even personal values becomes imperative for organizational survival and success in winning the war for talent.

Finally, considering the fact that higher education institutions are increasingly facing the challenges and opportunities presented by the aging academic workforce, and employing disproportionately higher numbers of older people in the labor force in general (Kaskie et al., 2012), they are even more sensitive to generational differences and struggling with "reallocation of resources and staffing policies for the older and the younger generation of academics" (Enders and de Weert, 2004: 11). Additionally, regarding the particularity of higher education institutions, making them a "substantial reservoir of knowledge, talent and energy" (European Commission, 2008: 11), yet admitting that "in many countries the career

patterns and employment conditions of academic staff as well as the attractiveness of the academic workplace for the coming generation are of a major concern" (Enders and de Weert, 2004: 12), higher education institutions should start building their strong employer brands as a leading strategy to attract and retain multigenerational talent.

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## COMPARING THE PERFORMANCE OF FAMILY CONTROLLED BUSINESSES AND NON-FAMILY CONTROLLED BUSINESSES DURING THE CRISIS IN ITALY

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### ABSTRACT

The article draws a comparison between family and non-family businesses' financial and economic performance in the years 2006, 2008 and 2009. The objective is to assess how Italian companies have reacted to the international crisis which started in 2008 and identify possible differences between family and non-family firms.

Only few studies examine the crisis effect and how Family Businesses reacted compared to Non-Family Companies. Moreover, the main contributions in this field focus on large companies, while small and micro enterprises represent the majority of the European economic fabric.

The sample was built based on the European Commission's family business definition. It includes 3,200 Italian firms, 1,600 family businesses and 1,600 non-family ones, divided into four size categories.

The analysis of the indicators for the 3,200 companies over the period shows that family businesses have higher profitability in terms of Return on Investments and Return on Equity and suffered the crisis as Non-Family Businesses because the contractions recorded by these indexes are at the same level. The financial structure analysis reveals both categories have the same debt level and Family Businesses show an higher debt sustainability in terms of Net Financial Position on EBITDA. Overall, the analysis of variations 2006-2008 and 2006-2009 shows that family businesses are able to better respond to crises.

**Keywords:** Family Business, Company Performance, Financial crisis, Italian Companies

## INTRODUCTION

Family businesses are one of the most common firm types in the world (Family Business International Monitor, 2008). Anderson & Reeb (2003) show that one third of the S&P 500 index firms are controlled by one family, whereas the Instituto de la Empresa Familiar (2009) considers that in Europe there are around 17 million family businesses, representing 60% of the total and employing around 100 million people. In Italy, their presence is even more widespread, as 73% of firms are family-run and employ 52% of the workforce (Family Business International Monitor, 2008).

Family businesses are not only quite widespread, but they also play a fundamental role in the economy. The IFERA report (2003) estimates that family businesses' contribution to European GDP averages 50%. Astrachan (2003) considers this contribution to be even higher in the US, where it reaches 64%.

Precisely because family businesses play such an important role in the economy, in time many researchers have analysed their economic and financial performance. A large literature identified unique features in family firms such as altruism, trust and long term commitment that can in principle enhance company performance (Davis, 1983; Chami, 1999).

Different authors explained the influence of the family factor on business' performances. Chrisman et al. (2003) and Dyer (2006) focused on agency theory showing the presence of certain family members lowers the agency costs improving results, whereas Donaldson and Davis (1997) and Miller (2006) used the stewardship theory to investigate the positive and the negative influence of the family on company's economic and financial performances. Others such as Sirmon and Hitt (2003) and Habbershon et al. (2003) assert family businesses have a competitive advantage basing on the Resource Based View theory.

Different authors empirically compared the economic and financial performances of family businesses with non family businesses. Anderson & Reeb (2003) investigated the Tobin Q and ROA ratios in S&P 500 companies, showing that family businesses achieve better performance, while Villalonga & Amit (2006) looked at the companies included in the Fortune 500 list and reached the same conclusions, but only as far as the first generation is concerned. European companies studies are basically in line with the American ones (Górriz & Fumás, 2005; Cucculelli & Micucci, 2008; Barontini & Caprio, 2005; Maury, 2006). In Italy, Favero (2006) and Gnan & Songini (2003) traced similar conclusions to international studies' results.

The international crisis started in 2008 is the deepest since 1929 and recession represent a significant test for the continuity and the solidity of a company. During economic downturns, the management behavior and decision could differ compared to stable periods. This makes

interesting the investigation of the performance differences between family and non-family businesses. According to Braun and Latham (2011) family firms are deemed to exhibit strong stewardship and stakeholder orientations, and the combination of a clear leadership and ample resources could positively smooth performance effects over the course of a recession.

Few authors had the opportunity to empirically analyze the behavior of family businesses during such downturn period. Lee (2006) examined the company performances during the 2000 recession finding the family firms are characterized by higher employment stability, without analysing financial performances.

Though literature on family businesses' performance is quite vast, we have identified some aspects which need a closer examination. We particularly make reference to studies examining the link between Family and Non-family businesses and the economic crisis and to researches whose samples include small and micro enterprises, which represent the most important part of the Italian and European economic fabric (Family Business International Monitor, 2008).

Based on the results of our literature review, we intended to assess the impact that the 2008 economic crisis has had on Italian Family and Non-Family businesses' performance.

## **LITERATURE REVIEW**

The lack of a single unambiguous definition of family business does not favour comparisons among the authors who have written on this subject.

Literature includes several definitions and, to this day, none has been universally accepted by academics. Astrachan, Klein & Smyrniotis (2002) state that there often is no definition of family, which creates further problems at international level, where families and cultures differ in space and time.

Some researchers define family business based on the degree of involvement of the family, which is measured through variables such as ownership, management and succession (Chrisman et al., 2003). Other definitions only use ownership, which can vary from total possession to owning the majority of voting rights. Others take into consideration the management aspect.

Westhead et al. (1998) examined the definitions given by previous studies, highlighting that the real problem is not so much that of establishing the difference between a clearly family-run business and a clearly non-family one. Rather, according to them, the real challenge is classifying what lies in the middle. The authors consider that the percentage of family business varies significantly based on the definition used.

Astrachan et al. (2002) developed a scale to measure the family's influence over the enterprise using three dimensions: "power", "experience" and "culture". These were then used by Klein et al. (2005), who measured them developing the so-called "F-PEC scale".

Habbershon et al. (2003) introduced a new perspective, called "familiness", which describes those unique resources and abilities that stem from the family's involvement in and interaction with the enterprise.

In 2007 the European Commission launched a project called "Overview of family-business relevant issues: research, networks, policy measures and recent studies". The project identified more than 90 definitions and highlighted that, even within the same country, several different ones are used. One feature many of them share is that they are hardly suitable to be effectively used for statistical purposes. The Commission's definition uses objective parameters to identify family businesses, based on relations among shareholders and on the composition of the business' governance. This allows for a standard definition which can be used in any investigation and grants a certain degree of comparability among different studies.

The European Commission recommends the use of this definition of family business within the Member States of the European Union in order to produce comparable quantitative results at cross-European level.

## **FAMILY FIRMS AND PERFORMANCES**

There are several articles comparing the financial performances of Family Businesses against Non-Family Businesses (Anderson & Reeb, 2003; Villalonga & Amit, 2006; Barontini & Caprio, 2005; Maury, 2006), but only few observed the differences during a downturn period (Lee, 2006).

Recession is a particular period for the human gender and for its organisations, in which resources become scarce and the competition for survival higher. The Evolutionary Theory, in particular Evolutionary Psychology, could contribute to explain the peculiarities of Family Businesses in such a hard period.

In the evolutionary theory, the family is the main mean by which transmitting the identity in the future (Emlen, 1982). This gives family companies a special power to infuse meaning, self-sacrifice and altruism into their workers. According to Nicholson (2008), Family Firms have an advantage because their forms fit better with the human nature than Non-Family firms.

Nicholson (2008), after reviewing the Darwinian perspective, suggests that Family Businesses are able to generate unique advantages through their capacity to link naturally diverse individuals together in a common enterprise and purpose.

Other theories explore the interaction between the family and the business from different point of views. Miller et al. (2006) use the stewardship theory to analyze the relationship between governance and business performances. They recognize the emotional involvement of the family plays a strong role in the company, because the future of the family is strictly tied to to the future of the company. The authors observe the strong motivation of family members brings advantages such as employee retention, higher accountability and cautious investments. Miller et al. (2006) observe also the negative consequences a family involvement in the company could cause low involvement of the entire organization and incautious strategic decisions. Donaldson and Davis (1997) argue that Family Businesses represent most fertile ground to the application of the stewardship theory because the interest alignment between management and property is easier and frequent. The family, acting as the company "guardian", adopt a conservative behavior that lead to better performances, especially during economic downturns.

Chrisman et al. (2003) through the agency theory assert that the presence of relatives in the company reduce the agency costs allowing better economic performances. According to Dyer (2006), Family Businesses have lower agency costs because of the trust and the value condision within family members that lead to better monitoring of the targets.

On the other hand, the same author observe that conflicts within relatives could represent a source of higher agency costs. In fact some members could present different opinions in terms of power distribution, remuneration, risks and responsibilities. Schulze et al. (2001) agree with Dyer (2006), asserting the "altruism" that distinguishes Family Businesses could cause moral hazard issues and have consequences on company economic and financial performances. Greenwood (2003) says this altruistic behavior has a negative impact on other difficulties family businesses face and on company results.

In general, the findings of these studies suggest that family businesses perform better than non-family ones. Such evidence is found by some studies that value performance through both accounting and market indicators. In fact, Anderson & Reeb (2003) conducted an analysis on the companies included in the Standard & Poor's 500 index. Their research indicates that family businesses have better economic and financial performance compared to non-family businesses. In particular, they analysed the ROA and Tobin Q trends. Both indicators showed higher results for family businesses, particularly when family shares

amount to less than 30%. The higher this percentage, the worse the results. Villalonga & Amit (2006) concentrated their attention on Fortune 500 list of companies, finding that the family business' value, measured through the Tobin Q, grows when the founder is involved in the enterprise and plays an active role in its governance.

The literature lack of evidences about the behavior of Family Firms during economic crisis. Lee (2006) examined the same sample as Anderson and Reeb (2003) and assessed the enterprise's competitiveness and stability. He measured the revenues growth rate, profits over revenues and market capitalization during the period 1992-2002, which included the 2000 recession. He observed that family businesses grew more in terms of revenues and profit before the downturn and they presented flat performances for the period 2000-2002. However his main finding concerns the employment, because showed that Family Businesses maintain employment stability during temporary downturns.

## **RESEARCH QUESTION AND HYPOTHESES**

As explained in section 3, literature on family business performance is quite vast. However, while examining literature we identified some gaps which have become the starting point for our research question.

First of all, there are few studies investigating the impact of the recent economic crisis on companies and comparing family businesses' reaction to that of non-family firms in Italy.

Another point arising from literature analysis concerns the type of indicators used. Several studies focus on indicators that measure market performance (Filatotchev et al., 2001; Villalonga & Amit, 2006; Poutziouris, 2006) or operating performance, such as productivity and efficiency in the use of resources (Gòrriz & Fumàs, 2005; Mannarino et al., 2011). Those studies assessing the typical economic and financial indicators in companies focus on the main tools such as turnover, ROA and ROE (Thomsen, 2000; Anderson & Reeb, 2003; Gnan & Songini, 2003; Lee, 2006; Maury, 2006; Favero, 2006). While these indicators can summarize company performance, they are not able to explain many of its aspects. Particularly when studying the effects of an economic crisis, the set of indicators used needs to be widened, so as to have a clearer and more complete vision of the company's situation.

Given these gaps, we want to investigate how family businesses performed against non family business during the 2008 economic crisis.

As showed by evolutionary theory, stewardship theory and agency theory, the family has strong incentives to protect the company over the long run and for these reasons the company performances should be better than non family businesses. On the other hand there

are other factors and empirical studies that show negative influence of the family on company's performances, especially after the first generation. Given what emerged from the literature review, the hypotheses we want to test are:

$H_0 : \text{FBIndex}_{200X} - \text{NFBIndex}_{200X} = 0$  against  $H_1 : \text{FBIndex}_{200X} - \text{NFBIndex}_{200X} \neq 0$

Where  $\text{FBIndex}_{200X}$  and  $\text{NFBIndex}_{200X}$  are the means of a generic performance indicator called "Index" for the year 200X.

Because we'd like to investigate the impact of the 2008 downturn, we compare the means of each performance index for the years 2006, 2008 and 2009. We use the t-statistic on the differences among the means of a specific financial index to verify if that difference is significant or not.

## **METHODOLOGY AND DATA**

For the purpose of this study, we adopted the family business definition put forward by the European Commission because it fits the needs of our investigation and grants that our results are significant at European level, as they are fully comparable with other studies.

The sample was built based on the European Commission's family business definition. It includes 3,200 Italian firms, 1,600 family businesses and 1,600 non-family ones, divided into four size categories: micro, small, medium and large, including 400 firms each.

As highlighted in the literature review, only few studies examine small and micro family businesses, despite the fact that they represent the majority of the European economic fabric. Therefore we decided to include these types of firm in our sample to find possible behavior differences due to their size.

For classification purposes, we used turnover as our main criterion, creating the following four categories: Micro enterprises (total turnover not exceeding 2 million Euros); Small enterprises (turnover between 2 and 10 million Euros); Medium enterprises (turnover between 10 and 50 million Euros); Large enterprises (turnover exceeding 50 million Euros).

Firms were randomly selected and classified using the AIDA – Bureau Van Dijk database, which includes data from corporations, excluding banks, insurances and trust companies.

From the database, we collected economic and financial information concerning the years 2006, 2008 and 2009, as well as information on shareholders which we used to classify firms as family/non family.

A second gap highlighted in the literature review concerns the lack of indicators used for the appraisal of companies' economic and financial performance.

As a consequence, in order to assess the economic and financial performance of companies, we have identified a broader and more complete set of indicators, allowing for a thorough understanding of all the aspects that have characterized the sampled companies during the economic crisis: turnover, added value, added value/turnover, number of employees, average cost of employees, total debt/total assets, net financial position/EBITDA, operating cash flow, operating cash flow/turnover, ROI, ROS, ROE, investment turnover.

The analysis of the sample indicates that almost 80% of family businesses belong to either one of two macro-sectors: manufacturing (58.5%) and wholesale and retail trade (20.9%). This is not the case for non-family businesses: although manufacturing remains the main activity (37.3%), their distribution in the different sectors is more even. It can also be noted that the majority of firms within the "Transport and warehousing" macro-sector are non-family.

MACRO-SECTOR	FB (#)	NFB (#)	FB %	NFB %
Manufacturing activities	936	596	58,5	37,3
Wholesale and retail trade; Motor vehicles repair	334	107	20,9	6,7
Transport and warehousing	40	186	2,5	11,6
Construction	105	62	6,6	3,9
Insurance and financial activities	37	95	2,3	5,9
Professional, scientific and technical activities	33	87	2,1	5,4
Information and communication services	25	91	1,6	5,7
Electricity, Gas, Steam and Air-conditioning supply	3	110	0,2	6,9
Others	87	266	5	17

*Table 1: Industry distribution of the sample*

## RESULTS

The database analysis produced the following results:

Index	Family Businesses			Non Family Businesses			Difference FB-NFB (%)		
	2009	Delta	Delta	2009	Delta	Delta	2009	2008	2006
	M€	2008/ 2009	2006/ 2009	2009	2008/ 2009	2006/ 2009	2009	2008	2006
Turnover	59.201.806	-14,1%	2,4%	65.466.332	-12,7%	-1,9%	-10,6%	-8,7%	-15,3%
Added Value	10.531.088	-9,7%	3,1%	13.922.514	-13,0%	-0,2%	-32,2%**	-37,2%*	-36,6%*
Added Value/Turnover	17,79%	5,1%	0,7%	21,27%	-0,4%	1,7%	-19,6%*	-26,2%*	-18,4%*
Employees	173	-1,0%	16,1%	177	0,3%	3,6%	-2,3%	-1,1%	-14,7%
Cost per employee	37.935	-2,4%	-2,9%	47.744	-8,7%	0,2%	-25,9%*	-34,6%*	-21,9%*
Total debt/Total Assets	61,30%	-2,3%	-6,2%	59,09%	-1,3%	1,8%	+3,6%*	+4,6%*	+11,2*
Net Fin. Pos./EBITDA	3,03	49,1%	84,7%	5,36	49,1%	128,1%	-76,9*	-89,7%*	-43,2%*
ROA	3,30%	-39,4%	-47,4%	3,05%	-32,8%	-45,3%	+7,6%*	+16,5%*	+11,3%*
ROI	4,50%	-41,3%	-52,1%	3,59%	-14,2%	-51,2%	+27,9%**	+45,4%*	+21,8%*
ROS	2,42%	-29,3%	-37,5%	2,62%	1,0%	-39,9%	-8,3%	+24,1%*	-12,4%**
ROE	4,71%	-50,8%	-61,7%	2,13%	-37,8%	-68,6%	+54,8%*	+64,2%*	+44,9%*
Investment Turnover	1,86	-17,0%	-23,3%	1,32	-15,5%	-19,5%	+29,0%**	+30,4%*	+32,5%*
Operating CF	2.941.783	-19,3%	-10,7%	3.481.143	-16,3%	-12,6%	-18,3%	-14,1%	-20,9%
Operating CF/Turnover	4,97%	-6,0%	-12,8%	5,32%	-4,2%	-10,9%	-7,0%	-4,9%	-4,7%

\* Sign. 1%

\*\* Sign.5%

\*\*\* Sign. 10%

Table 2 – Means, deltas and t-statistics of the analysed data in 2009, 2008 and 2006

The examination of 2009 data shows that on average family businesses are smaller, and have a lower turnover (-10.58%) and less employees (-2.31%) than non-family businesses. However these numbers are not supported by a significant level of the the t-statistic value, so we cannot conclude that family businesses are smaller than non family businesses. On the other hand, the t-statistic values support, at a 5% level, that the average added value for Family Businesses is lower (-32.87%) and their added value /turnover ratio indicates that, for every Euro of turnover, non-family firm are able to create around 4% more value.

We can observe that there is a large difference (21,91% in 2006 and 25,86% in 2009) between the average cost of employees in family businesses and non family business. This difference is significant at 1% level.

From a financial point of view, there are no substantial differences in debt levels; however, the Net Financial Position / EBITDA ratio is clearly favourable to family businesses (3.03 compared to 5.36), which indicates that they are more able to pay their financial debts with their operating results.

The operating cash flow and its weight on turnover has the same characteristics as the first indicators, as family firms generate lower cash flows both in absolute terms (-8.33%) and in relative terms (4.97% vs. 5.32%), but the t-statistic does not provide strong support to this result.

Though we can not assert that family businesses have smaller dimensions and lower performance in absolute terms, but the analysis of the main profitability indicators highlights the fact that they performed better in 2009.

Comparing family firms' ROI with that of non-family ones, the first is higher by 27.86% (4,50% FB vs 3.59% NFB). Equity profitability is even higher, as the difference between the two ROE is 54.78% (4,71 FB vs 2.13% NFB). Analysing the ROA, which is the index main authors (Anderson and Reeb, 2003; Lee, 2006; Barontini and Caprio, 2005) used to compare company performances, we have the same result. The Family Business ROA in 2009 is 7,58% higher that the Non Family Business one (3.30% FB vs 3.05% NFB).

Profitability ratios provide the strongest evidence in favour of family businesses, since the t-statistics are significant at 1% level, except for the ROI in 2009, which is significant at 5% level. The analysis of 2008 data led to conclusions that are similar to those for 2009. In 2008, too, family businesses appeared smaller in terms of turnover (-8.72%) and number of employees (-1.14%) without support by the t-statistics, but performed better from the point of view of the indexes, with significant evidence given by the t-statistics.

The ROI of family businesses for 2008 is 7.66%, 3.5 percentage points higher than that of non-family firms; as for the ROE of the same year, the difference between family- and non-family businesses is even larger (9.57% compared to 3.43%).

Although the added value / turnover ratio is higher for non-family firms both for 2008 and 2009, it is important to underline that the cost reductions performed by family firms were higher than their revenue contraction.

This is highlighted by the fact that their indicator grew (+5.13%), while the non-family firms' indicator remained basically stable (-0.39%). For both types of company the average number of employees stayed the same (-1.04% compared to +0.31%), but there is some difference in the average cost per employee. In both years this figure in family businesses is around 26% lower than in non-family ones; however, it varies in a significantly different way: non-family firms achieved an 8.72% cost reduction, against a 2.4% reduction for family businesses.

With reference to the operating profitability, family businesses have higher results than non-family ones in both years (7,66% compared to 4,18% in 2008 and 4,50% compared to 3,59% in 2009). However, in 2009 the gap between the two ROI values tends to narrow because the family firms' index decreases by 41.30% compared to a -14.80% for non-family firms. Breaking down the ROI into its factors we find that the significant reduction for family businesses is partly due to a lower profitability on sales (-29.29%) and to a decreased investments turnover (-17%). On the other hand, the negative variation of non-family firms is solely due to the reduction of the investments turnover (-15.48%).

The ROE follows suit: both types of company show a contraction of this index from 2008 to 2009, though this is stronger for family businesses (-50.79% compared to -38.96%). Despite this, family businesses' ROE is still higher both in 2008 (9,57% vs. 3,49%) and in 2009 (4,71% vs. 2,13%).

## CONCLUSIONS AND LIMITS

This work aimed at giving a contribution to existing literature on family business, trying to fill some gaps highlighted in the literature review. They mainly concern the fact that there are no studies analysing the performance of family businesses, during a period of serious crisis like the one that we are living.

The analysis of indicators for the period 2006-2009 leads to conclude that, in general, both types of business significantly felt the impact of the 2008 economic crisis. This is confirmed by the fact that the majority of variations on indicators are negative.

However, the findings show that family businesses were able to better mitigate its negative effects; indeed, they had better economic and financial performance. Evidence of this is, first of all, the analysis of the ROE and the ROI, which show higher values and lower contractions compared to 2006 for family firms.

The ability to handle the negative trend is also confirmed by the assessment of the profit and loss account values.

Not only were family businesses able to improve their effectiveness more than non-family firms, but they also showed a certain amount of cost efficiency, so much so that their added value grew more than their revenues.

Finally, considering leverage, Italian companies are in general less able to cope with their debts. However, within this overall negative trend, once again family businesses stand out for their virtuous behaviour, showing a lower Net Financial Position/EBITDA value than non-family firms, as well as a lower contraction of this figure.

These conclusions give a significant contribution to existing literature on family business. On the one hand, they confirm the findings of the main European and US authors on family business performance. On the other hand, they add new elements that can widen the field of study in two directions: from the point of view of time, an analysis carried out at a time of economic crisis is a considerable contribution to what was found in previous literature; from the point of view of size, widening the scope to include Small and Medium enterprises gives greater significance to the research itself, given that for the most part family businesses belong to this category.

This work has some limits. The main one is that it analysed only Italian firms. However, even though this is a limit, it also offers a stimulus for future studies, which will be able to carry on the analysis at European level.

A second limit, is due to the fact that we provided strong evidence of the differences between family business and non family business performance using the t-statistic, but we don't say anything about the causes of the differences. A multivariate regression analysis could be done with the updated data.

A further stimulus to continue the present work is linked to the fact that today the world economy is still on the threshold of a real recovery. Therefore the analysis of family businesses' behaviour in a upturn phase would represent a natural continuation of this research.

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## ONLINE LABORATORY FOR LEARNING ACCOUNTING IN PRACTICE – AN IDEA AND IMPLEMENTATION

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### ABSTRACT

We start to build a programme aiming at creating an online laboratory for obtaining practical experience in professional accounting to enable students to develop an understanding of the business environment and relate the acquired knowledge and skills to accounting and financial practices and to develop professional judgment, analysis and problem-solving skills.

The initiative is an integral part of Europe 2020 Strategy, where stimulating entrepreneurship, creating conditions for development of microenterprises, as well as improving the human capital quality are the tools to be used to fight unemployment. Studies on the business world's real needs have inspired the scientific circles, including the University of Warsaw's Faculty of Economic Sciences, to initiate and develop such teaching programmes that would provide students of various universities and faculties – not only economic – with an opportunity to gain practical experience in running a microenterprise, with a special focus on accounting, which is often fundamental to success in business.

The article presents learning projects being implemented by the University of Warsaw and based on the international e-learning platform FASTER (Financial and Accounting Seminars Targeting European Regions). We are proposing ways how the platform could be developed further and how it could integrate new forms of teaching students towards entrepreneurship, such as ERP, illustrating business operations with real accounting documents, process approach and IT modelling and process analysis tools.

**Keywords:** online laboratory, web based model for accounting, e-learning, stimulation of entrepreneurship, process approach

## **INTRODUCTION**

We start to build a programme aiming at creating an online laboratory for obtaining practical experience in professional accounting to enable students to develop an understanding of the business environment and relate the acquired knowledge and skills to accounting and financial practices and to develop professional judgment, analysis and problem-solving skills.

We intend to introduce students to the modern technological environment of business decisions using spreadsheets, database software, business process management (BPM) techniques and integrated database application technologies (ERP) through exposure to accounting processes and software package(s). The programme will make use of hands-on computer applications and case studies on real situations that enable students of economy to obtain practical experience in professional accounting.

## **EUROPE 2020 – ENTREPRENEURSHIP AS A TOOL TO FIGHT UNEMPLOYMENT**

According to Europe 2020 strategy, entrepreneurship and self-employment are key to sustainable and inclusive growth. The agenda for new skills and jobs is expected to help the EU reach its employment target for 2020: 75% of the working-age population (20-64 years) in work. In case of Poland, the target has been set at 71%. The initiative provides activities that will help speed up reforms to improve flexibility and security in the labour market (the so-called flexicurity model), equip people with the adequate skills for the jobs of today and tomorrow, improve the quality of jobs and ensure better working conditions, as well as improve the conditions for job creation. Currently, there are 23 million unemployed across the EU – 10% of the active population. In its activities aimed at supporting entrepreneurship and self-employment, the European Commission focuses its efforts on business start-ups by unemployed and people from disadvantaged groups, sustainability and quality of work of sole proprietorships and micro entrepreneurs, support for social entrepreneurs and seeks to increase knowledge about entrepreneurship and self-employment. The European Social Fund promotes entrepreneurship through financial and business support services. According to data published by the Central Statistical Office, in the period 2009-2011 microenterprises and small

businesses constituted an important segment of the Polish economy, generating almost 40% of GNP and employing nearly 2.4 million people.

year	number of employees vs. value added	total	small	of which micro	medium	large
2009	average number of employees	6 554 917	2 413 391	1 361 022	1 605 280	2 536 246
	Value added	804 864	303 215	218 237	145 501	356 147
2010	average number of employees	6 495 266	2 334 809	1 282 217	1 584 703	2 575 755
	Value added	830 807	303 582	213 651	146 310	380 914
2011	average number of employees	6 595 759	2 398 175	1 303 034	1 592 734	2 604 850
	Value added	862 864	309 288	214 615	147 070	406 507

*Table 1. Value added and average number of employees of Polish enterprises in 2009-2011*

In 2011 in Poland, 1 711 thousands non-financial micro enterprises conducted activity, which is an increase of 3.3% compared to 1 655 thousands micro enterprises in 2010. As in previous years, the micro enterprises, employing up to 9 persons, dominated among all enterprises, representing 95.8% of the total population (small units employing up to 49 persons – 98.9%). The share of medium and large units accounted for 0.9% and 0.2% of all enterprises. Due to the basic legal form of entities, 94.3% of the micro enterprises belonged to natural persons.

As far as economic development is concerned, it is important to stimulate development and growth of micro enterprises and small businesses through improvement of the human capital. For this aim to be achievable, it is necessary to facilitate access to information and knowledge needed to set up and run one's own business successfully.

Today, skills and knowledge acquired at the university do not meet the expectations of potential employers, hence there is such high unemployment among graduates. Graduates from specialist faculties are particularly threatened by unemployment, due to their lack of professional experience, as well as the fact that there are no vacancies in companies.

	2010	2011	2012
Unemployed with tertiary education level	1 122	1 203	1 247
Total unemployment of new entrants at 4th quarter	287	336	350
of which school leavers	152	173	171
increase in number of enterprises (in thousands):			
micro-enterprises	51	56	no data
small units (bigger than micro)	2,4	2,4	no data
medium enterprises	33	-24	no data
large enterprises	54	22	no data

Table 2. Increase in unemployment of new entrants relating to number of enterprises established in 2010-2012 (in thousands)

Although the number of new micro enterprises is growing, it is still by far insufficient, since it accounts for 33% of the number of unemployed university graduates. For the sake of comparison: in 2010 only 33 medium-sized and 54 large enterprises were established, but one year later the first group shrank by 24, while the second grew by 22 only. Analyses of the causes of companies bankruptcies (Zakrzewska-Krzyś, 2012) reveal that only two thirds of all new companies manage to survive the first two years, while after four years less than 50% of them are still on the market. 74% of all bankruptcies occur in the small business sector. The main causes include insolvency, poor management, inadequate financial control, especially in the area of working capital or cost level management (Kowalewska *et al.*, 2011). Therefore, the purpose of business-related education is not only to provide knowledge required to set up a firm, but first of all to develop business skills that would guarantee financial stability of the enterprise, with no risk to its continuity.

## FROM TEACHING ACCOUNTING TO STIMULATION OF ENTREPRENEURSHIP

Teaching practical, technical business skills should focus on developing business competence, not only in the field of management or accountancy, but also – in the system approach to the entire organization and its business processes, not only in terms of relations between functional areas inside the organization, but also those going outside, such as contacts with

clients, suppliers, public institutions and administration bodies – all of them affect both the profits and the tax burdens. Making the right and prompt decisions in a company requires regular inflow of comprehensive and reliable business-related information that provide a basis for strategic, tactic and operating decisions. Sources of information used for making managerial decisions include data from accounting records, as well as financial reports, where effects of company business operations are aggregated.

number of enterprises	small - but bigger then micro			micro			medium			large		
	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011
Total	49	54	55	1605	1 655	1 712	15,8	15,8	15,8	3,1	3,1	3,1
legal persons (keeping books of account)	28	28	29	90	88	98	13,5	13,5	13,5	3	3	3
natural persons keeping:	21	26	26,5	1515	1567	1613	2,3	2,3	2,3	0,1	0,1	0,1
books of account	7	7	7,5	19	14	15	2	2	2	0,1	0,1	0,1
tax books of revenues and expenditures	14	19	19	1067	1106	1 154	0,3	0,3	0,3			
revenue account				342	351	357						
tax card				87	96	87						

Table 3. Basic information on micro enterprises by form of accounting records in 2009-2011 (in thousands)

Reliability of information and its usefulness to managers depend on quality and informational capacity of the accounting records. It is therefore surprising that only 6.6% of the micro enterprises kept books of accounts. Most of them (67.5%) kept tax books of revenues and expenditures only for tax purposes (Table 3), recording their revenues (sales of goods and services and other revenue items) and costs (categorized into trade goods and materials at purchasing prices, purchase-related costs and payroll-related expenses (in cash and in kind) and other cost items), without recording any settlements with recipients (accounts receivable) or suppliers (accounts payable) and computing their taxable income

only, instead of finding out the baseline result. Teaching programmes should emphasize the role of an accountancy information system in business management, since if chosen well, it not only provides an overview of the current standing of the company, but also signals any operational problems that may emerge in the future or predicts bankruptcy. It is worth showing the role of finance and accounting in the company, not only as a supporting process, but as the central point (the heart) of an efficient flow of information, documents and managerial decisions.

The purpose of introducing to university curricula courses teaching practical business-related knowledge – in the form of hands-on exercises and workshops, with business case simulations and samples of documents, contracts and tax return forms used in real-life business transactions and formal procedures – is to provide students with an opportunity to practice and gain experience required by employers, as well as to encourage them to start their own business (in the form of self-employment or a micro enterprise).

Acceptable practical experience is extremely important in all areas of accounting including the areas of receivables, payables, financial statements, reconciliation of taxes, including mainly VAT and income tax and cost analysis, as well as bookkeeping with use of IT accounting. It is this experience which distinguishes graduates with any accounting qualifications in the job market. Practical experience is required to protect the interests of enterprises, employers and the general public by ensuring that trained accountants have obtained the professional training necessary to competently apply the knowledge, skills and values of the profession. Practical experience is also required to bookkeeping and calculating tax obligation resulted from VAT tax of sales over purchases and income tax of taxable base (profit) or wages and salaries paid out to employees.

In practical accounting teaching, students should be able to notice relations between the areas of finance and accounting and organization's other functional areas, as well as its external environment. They should be aware that the area of finance and accounting is not only the basis for drawing up a basic financial statement, but it is the core of the document and managerial information flow across the organization. In particular, ignorance of the cost of sales leads to setting the selling price incorrectly, below the cost. Without monitoring the status of accounts receivable, liquidity and ability to pay the liabilities is jeopardized and consequently, an impatient supplier may file a petition in bankruptcy or initiate debt enforcement proceedings. Terms of payment offered to customers, if too long, may lead to

shortage of cash needed to pay VAT to the Tax Office and hence – to the bank account seizure (see Figure 1).

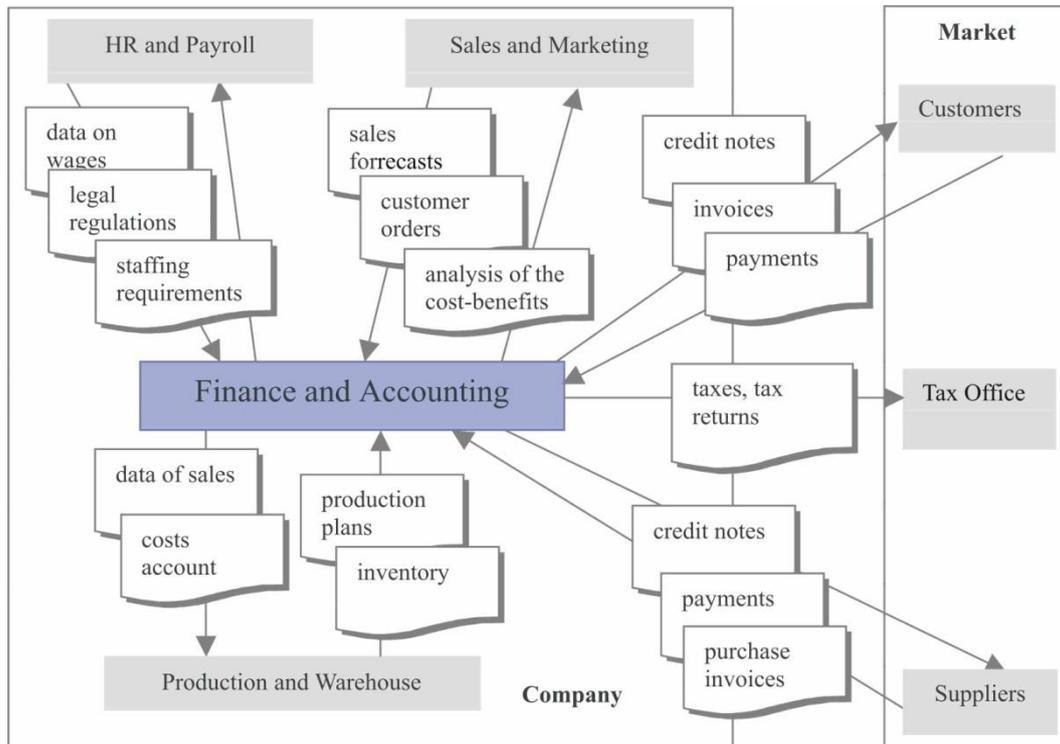


Figure 1. A map of the finance and accounting areas relations

In our opinion, sole traders running micro-enterprises do not need any knowledge of recording business operations in bookkeeping accounts – what they need is to understand the impact of these operations on the balance sheet, their tax-related consequences and their influence on relations with various business partners.

## LITERATURE REVIEW

Since '90s process approach has been management paradigm in big organizations and number of studies prove that it is a starting point for increasing effectiveness of those organizations [Hammer, Champy, 1993; Rummler, Brache, 1995; Harmon, 2007]. In microenterprises process approach is natural part of functioning in the early stages of business life cycle [Marciszewska, 2009], when they are focused on maintaining customers' relations and satisfying their needs and the owner is personally involved in enterprise's activities. Along with development and increase of company size, when organizational structures start to formalize, employees and managers are being employed, role of owner and manager separate, small enterprises lose their natural flexibility and ability to respond to

clients' needs. In such circumstances they should systemize their processes not only to avoid problems that plague big enterprises [Hammer, Champy, 1993; Gabryelczyk 2000], but also to increase their competitiveness and make right management decisions [Harmon, 2007; Kaplan, Cooper, 1998]. Studies show process approach as a starting point for implementing controlling and activity based costing [Gunasekaran, Marri, Grieve, 1999; Kluge 2009]. Activity Based Costing requires process approach [Kaplan, Cooper, 1998]. Owners and managers of small enterprises often can't find methods and tools to measure customer profitability, effectiveness of organization, or to identify main cost drivers. They mistakenly think that process management, ABC, or Activity Based Management are concepts targeting mainly big enterprises, although studies prove that in small companies ABM can be low-budget investment [Adamska, 2005]. Thus we postulate continuing familiarization of future micro- and small enterprises with concepts, methods and techniques of modern business.

### **EVOLUTION OF THE APPROACH TO TEACHING ACCOUNTING AT THE UNIVERSITY OF WARSAW TOWARDS EXPANSION OF THE E-LEARNING PLATFORM FASTER**

Since October 2008 Faculty of Economic Sciences has been offering facultative programme of Accounting Information Development, which expands teaching Financial and Managerial Accounting at specialisation of Business Economics by Business Information Systems, Computer Accounting in business processes (RAKSSQL and Symfonia Premium), Controlling and International Financial Reporting Standards (IFRS). We implemented RAKSSQL and Symfonia Premium packages for educational purpose few years earlier, but we have been using them for facultative separate courses dealing with recording group of documents describing one period transactions of the enterprise. Student has to use knowledge of financial accounting to record different accounting documents using computer packages.

An approach like this, based on recording various accounting documents, without paying attention to the type of business operations described in these documents, although represents another step further, taking students closer to the business reality than descriptions of operations in instructions to exercises, still remains abstract and is far from any practical, process-based performance. During courses of Computer Accounting in business processes we familiarize students with the principles of business management using integrated financial - accounting software. Students use RAKSSQL and Symfonia Premium packages in order to obtain knowledge of business transactions' book keeping.

In March 2011 we applied for a grant to support an international project initiated to build an e-learning platform for teaching accounting in practice, integrated with tools facilitating search for a job in accounting and finance, both in domestic and international companies.

Longlife learning project FASTER enables implementation of the concept of the practical education in the field of the entrepreneurship. The Programme for EU Action in the Field of Lifelong Learning (the Lifelong Learning Programme – LLP) aims to contribute through lifelong learning to the development of the EU as an advanced knowledge society, with sustainable economic development, more and better jobs and greater social cohesion. In particular, it aims to foster interchange, co-operation and mobility between education and training institutions and systems within the EU so that they may become a world quality reference. In this way, it addresses the modernisation and adaptation of education and training systems in the participating countries, particularly in the context of the goals set in the EU 2020 Strategy and brings European added value directly to individual citizens participating in its mobility and other co-operation actions. The European Commission's Lifelong Learning Programme creates education and training opportunities, enables people at all stages of their lives to take part in stimulating learning experiences, as well as helping to develop the education and training sector across Europe. Key Activity 3 Development of ICT-Based Content EU actions aim to harness the power of Information and Communications Technologies (ICT) to develop innovative education and training practices, improve access to lifelong learning and help develop advanced management systems.

FASTER (Financial and Accounting Seminars Targeting European Regions) is a two year KA3 ICT - Multilateral Project (2011-2013) funded by the Lifelong Learning Programme co-financed by the EU (75%). FASTER develops an innovative ICT e-learning toolbox emphasizing on a teaching & information exchange web mechanism comprising of a resources and glossary and e-courses in order to facilitate the flow of existing practical knowledge produced in the daily routine of financial services of enterprises. FASTER links studies and working environment, meets standard academic requirements to obtain industrial recognition as well as works complementarily to the already acquired academic background of interested parties. The educational feature of FASTER Platform includes the development of 8 e-modules starting from basic financial accounting, through charts of accounts, code for accounting books, public limited companies and limited liability companies law, consolidation of financial statements of groups of companies, tax accounting, financial reporting and its analysis with business valuation, accounting ERP, ending on

International accounting standards. Each e-module contains a concise-relevant theoretical review supported by Power Point presentations, self assesment tool including Yes/No questions and multiple choice questions, as well as exercises and problems to be answered and solved by the user.

The end web based product of the project is the development of the FASTER PLATFORM in five languages (English, Greek, Bulgarian, Polish and Slovakian). Interactive web-based educational applications and case studies on real accounting situations provide accumulated knowledge in forms suitable to non-formal, practical learning, serving both Erasmus and Leonardo Da Vinci strategic objectives. The courses are in 5 languages. Furthermore accounting, taxing, legislative differentiations between nations are spotted. The idea to allow and encourage the mobility of EU citizens to work in foreign countries, demands not only knowledge of finance and accounting, but training based on local conditions (law, terminology and ethics) and familiarity with national law & taxes. FASTER will also include a job-seeker tool for finance and accounting, including job vacancies and e-CVs, enabling transnational pursuit of jobs. FASTER as the longlife learning programme will foster longterm career advancement and international mobility, ensuring that the professional development of certified general accountants remains a lifelong experience. It will also be designed to provide graduates with degrees in disciplines other than accounting, or people employed in business, with the foundation studies to become a professional accountant. The online programme will meet standard academic requirements to obtain industrial recognition.

During the first year the requirement analysis was completed with the participation of 133 academics, 1030 graduates and undergraduate students, 176 people interested in vocational training and 97 employers who replied to the FASTER interviews and online questionnaires. In total, requirement analysis gathered 1528 online replies to questionnaires and 64 replies to interviews. Participants in the requirement analysis considered as very important: the usefulness of an on line platform in teaching accounting and analyzing accounting information as well as the use of new technology in developing accounting skills.

When making a survey on the demand for the e-learning platform FASTER, we found out that accounting knowledge is also needed by those of entrepreneurs, employees of sales, marketing and debt collection departments, investment consultants, who do not have any educational background in economics. This observation made us aware of the need for developing the e-learning platform FASTER towards teaching non-economists business.

The EU Commission has also noticed the importance of propagating practical knowledge of business, which helps spread one's wings and gives courage when making decision to set up and develop one's own business, starting with a micro-enterprise. In the justification of Priority IV of the Human Capital Operational Programme, the Commission stressed that to enhance the competitive position of the Polish economy, it is necessary to provide stronger linkage of the science sector to economy needs, as well as to increase the research and development sector staff qualifications in the field of intellectual and industrial property protection, research project management and commercialisation of the results or research and development studies. Projects of this type will contribute to enhancing the qualifications of the R&D sector staff, improvement of the quality and effectiveness of research and consequently – the growth of the innovation of the economy. The purpose of Priority IV is to adjust education at the tertiary level to the needs of the economy and the labour market, enhance the attractiveness of education at the tertiary level in the field of mathematical-natural and technical sciences, as well as to improve the qualifications of the R&D staff.

The purpose of the e-learning platform FASTER expansion occurring under entrepreneurship-related education modules of two EU projects: 4.1.2 OP Human Capital - Increasing the number of graduates of specialisation "Mathematics" at the University of Green Mountain (2012-2015) ("Mathematics") and 4.3 OP Human Capital - Modern methods, medicines and therapy for the health care and the economy of Europe of the 21st century - interdisciplinary education in the area of biomedical sciences on master and doctoral studies ("Biotechnology"), is to create a virtual laboratory for learning accounting in practice.

January 2012	FASTER e-learning	<ul style="list-style-type: none"> <li>– Financial accounting</li> <li>– Accounting plans</li> <li>– Accounting for public limited companies (S.A.) – limited liability companies (Ltd) – Groups of companies - Code for accounting books.</li> <li>– Tax Accounting</li> <li>– Balance sheet issues</li> <li>– Analysis of financial statements - business valuation</li> <li>– Accounting ERP</li> <li>– International Financial Reporting Standards (IAS / IFRS).</li> </ul>
June 2012	Development of FASTER for "Mathematics" at University of Green Mountain	<ul style="list-style-type: none"> <li>– Company law and legal background of the business activity</li> <li>– Managerial Accounting and Cost Account</li> <li>– Computer Accounting in business processes (RAKSSQL and Premium)</li> </ul>

January 2013	Development of FASTER for "Biotechnology"	<ul style="list-style-type: none"> <li>- Organizational-legal aspects of the business activity</li> <li>- Creating financial intelligence with Cashflow game</li> <li>- Basic accounting and accounting recording of the small company</li> <li>- Tax regulations in the business activity</li> <li>- Business plan and analysis of financial position of the enterprise</li> <li>- Bookkeeping of limited liability company using the Symfonia Premium</li> </ul>
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*Table 4. Expansion of FASTER platform towards teaching business skills*

The table 4 shows the planned expansion of FASTER towards setting up practical business classes for non-economists: mathematicians and biologists, presented as an evolutionary process from establishment of a path of facultative courses Accounting Information Development through expanding the international e-learning platform FASTER in order to teach accounting in practice and thereby stimulate entrepreneurship. The purpose of the projects is to encourage the target group members to set up and develop their own businesses in the form of self-employment (freelancing) or micro enterprises with a status of a civil law partnership, a commercial partnership or a limited company. This form of employment enables young people to start working at the time of the economic recession and growing unemployment. The ability to run a business eliminates the risk of occupational and social exclusion. Providing a comprehensive background needed to set up and run a business to graduates of technical faculties associated with the knowledge-based economy and prepared to work in professions expected to be in greatest demand within the time frame until 2020, will have a positive effect on their occupational activation and self-actualisation, as well as on the growth of GNP and reduction of unemployment.

## **PROCESS APPROACH IN PRACTICAL TEACHING OF ACCOUNTING**

The basic task of accountancy today is to meet information-related needs of various users, both internal, including the management and external – mainly the equity owners (shareholders) and outsiders: loan providers, creditors and public institutions.

Meeting the requirement to provide a complete, consistent and up-to-date information is impossible without advanced IT tools and the accounting system integration with organization's other information systems. This integration is made possible by integrated IT systems supporting management processes in the area of sales, procurement, warehouse

management, production, fixed assets, customer and supplier payments, finance (bank and cash), HR or payroll. Financial and accounting systems, as well as ERP-class tools (Enterprise Resource Planning) are mainly used for automation of business operations recording and for creating reports (trial balances, VAT registers, balance-sheet, income statement, tax returns). As these functionalities provide a basis for operating organization's financial and accounting processes, universities teaching economics in Poland have been trying to familiarize their students with the accountancy rules and the use of accounting software for more than a decade now. Most of the tasks, i.e. entering documents in accounting records or generating purchase orders, are automated and this is obviously the basic benefit of using an integrated system, but in the process of teaching accountancy it may impede students' understanding of the business processes performed by the system.

Experience gained during financial accountancy classes in six subsequent editions of the Inter-Faculty Post-Graduate Accountancy and Financial Audit Studies co-organized by the Faculty of Economic Sciences and the Faculty of Law and Administration of the University of Warsaw, attended by 866 students in total, justifies a conclusion that full automation of the accounting operations recording in an integrated financial and accounting software represents a considerable barrier to understanding the rules of business operations recording and their effect on the proprietary and financial standing reflected in a financial statement. Our assumptions are supported by the findings of the postgraduate students' learning outcomes evaluation (Białek-Jaworska, 2011).

The incomprehension of the general business concept, of business processes occurring in the company and of relevant source documents, as well as the inability to distinguish between business events and business operations, purchase invoices and sales invoices, especially when accounting document bears the "invoice" title only – all this may result in incorrect recording of operations. Hence a proposal to include modern, business process based management concepts, methods and tools in the accountancy courses contents. To understand how ERP systems work, one first needs to understand how business works.

Building a process-oriented organization is a time-consuming task and requires resources to be engaged in identification, modelling, analysis and improvement of processes, but on the other hand, defining a company based on description of its business processes has a strong effect on students' imagination, while facilitating abstract thinking and deeper understanding of how accountancy works in practice. Looking at a company in the context of its business processes enables understanding how the organization functions and what activities generate

value for the client and result from the basic operations. Such aspects as description and documentation of business processes, defined flow of accounting documents within the company structure and description of the accounting documents processing should be addressed by an accounting policy document and should constitute a basis for the economic knowledge management framework in the company.

In terms of legal requirements specified in art. 10 of the Polish Accounting Act, the accounting system documentation can be evaluated based on very generic criteria only, where the existence or non-existence of documents required by regulations is identified. The wording of statutory requirements is so complex, with multiple components involved, that they permit an entirely arbitrary approach to description of the documentation's accounting system actual status. Meanwhile, bookkeepers and company managers are seeking to identify the rules governing the financial performance and to distribute the relevant knowledge across the unit's decision-making and operational structure, both in its content-related (the valuation rules) and technical aspects (book keeping methods, especially computer-based, particularly when subsidiary ledgers are independent on the financial and accounting software – e.g. HR-payroll program or sales dedicated program) (Gospodarek, 2008).

Thus, the process approach gains importance in the area of accounting policy building and this is a good rationale for broadening the use of the process concept in teaching accounting and business skills. The purpose of process modelling, i.e. representing processes by means of graphic symbols is to document these processes in order to be able to control them, while in the aspect of teaching accounting it supports the entire process of learning, where the student:

studying process maps, is able to identify and understand the activities that bring value to the organization, the logical and temporal interfaces between process activities, and thereby identifies relevant documents, assigns them adequately to processes and activities,

identifies the information and documents transformed within a process, as well the information and documents obtained as a result of the process, regardless any formal boundaries of the organization's units,

understands the flow of information, work, decisions and documents and thereby is able to draw correct conclusions in the area of balance-sheet related and tax-related consequences of business operations, as well as in the area of managerial decisions concerning relations with various business partners.

Process modelling is effected by means of dedicated IT tools, where various types of models (process maps, value chain diagrams, process flow, document models, organizational structure models) are not only created, but they can also be collected in a database, thereby allowing for analyses and simulations, e.g. of the given process cost in various time units or process sensitivity to changes in availability of resources. In the business process modelling and analysis courses at the Faculty of Economic Sciences of the University of Warsaw, ARIS and ADONIS systems are used and experience shows that they make it easier for students to understand the business organization operation before studying theoretical microeconomics or financial models. The “Accounting ERP” module of FASTER platform explains the place and the role of accountancy in describing business processes and their impact on the company financial and proprietary standing presented in its financial statement. Other projects where FASTER is used – „Mathematics” and „Biotechnology” – “Accounting ERP” evolved towards process approach in teaching accounting and business skills, reflecting not only the flow of documents, but also showing those sources of information and activities within the processes that determine the decision making. In most management models accounting is regarded as an auxiliary component, supporting organization’s main core processes, but the outputs from the accounting system are needed for these processes to be performed correctly and for their outcomes to be reflected in financial statements and activity reports. The role of a micro-enterprise owner or a small business accountant is evolving too, because in order to manage the business efficiently he or she should have access to similar type of information as the one being provided to a major corporation’s CFO.

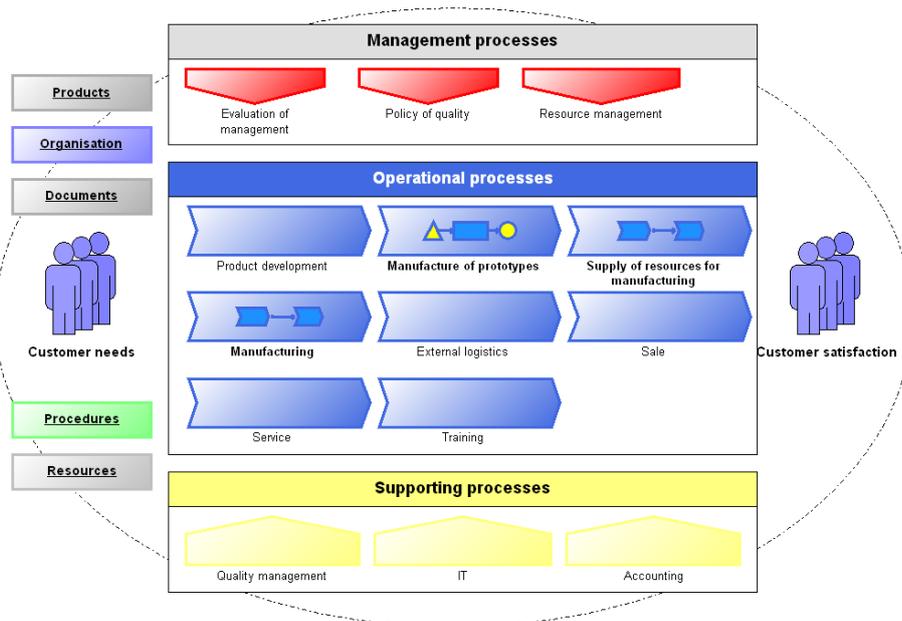


Figure. 2. An example of a process map created in ADONIS system

The process approach is inscribed in the basic logic of integrated management systems, despite their modular structure and functional division into such functions as Accounting, Inventory, Sales, Purchasing, etc.

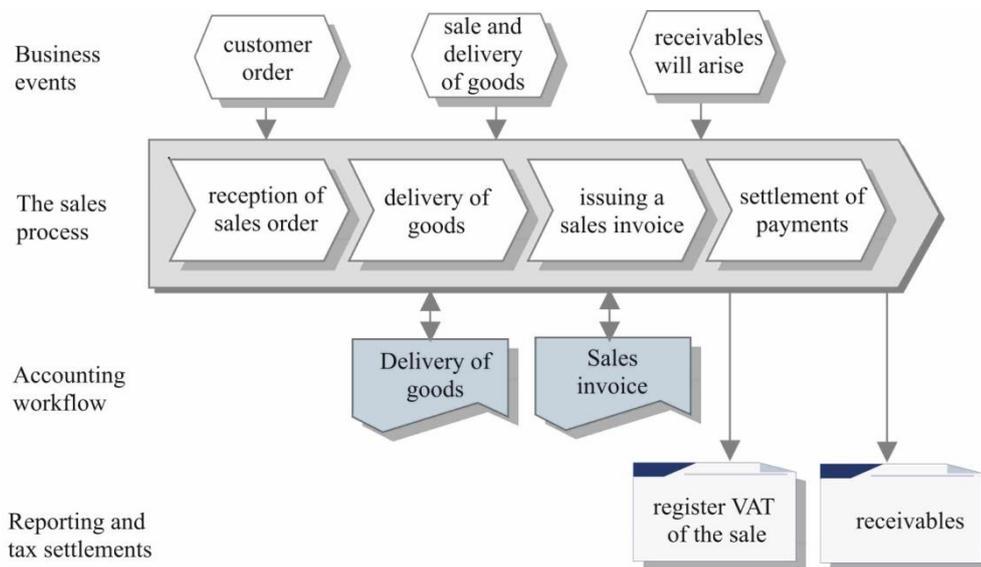
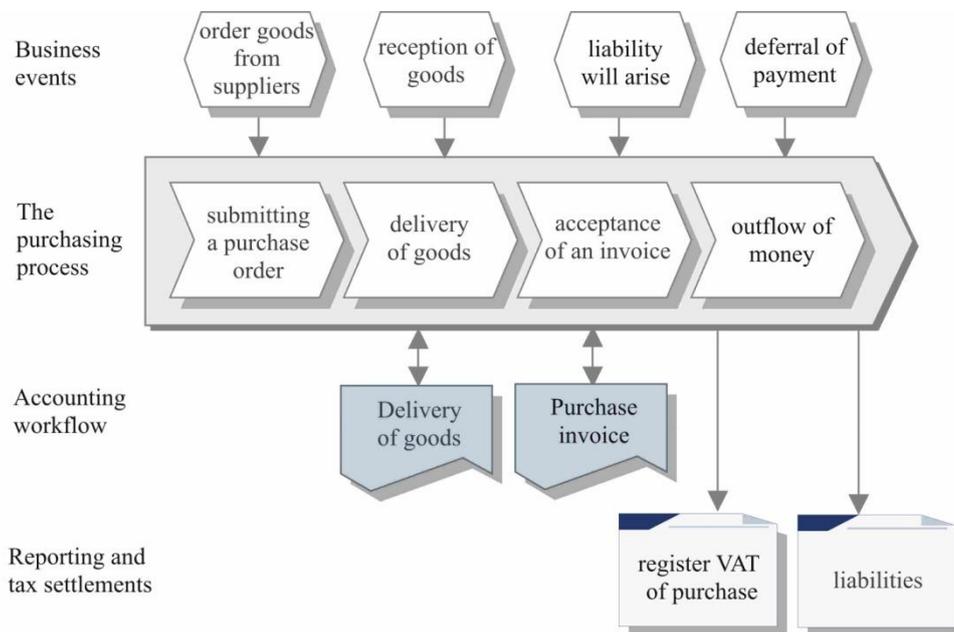


Figure 3. Data and document flow in the sales process – process visualization based on ARIS system



Figure

4. Data and document flow in the purchasing process – process visualization based on ARIS system

The nature and the essence of integration in IT systems is implied by business processes. When the organization is regarded through the prism of its processes, the way how one department works affects the performance in other areas and the employees can see the effects of their work and understand how activities are interrelated, and thereby they share

responsibility for the entire process instead of focussing on isolated tasks performed within traditional structural units. For example, if the sales department personnel is aware that the way how the store documents and the invoices are filled affects the accounting operations directly, they will most probably generate less errors.

In further development of the e-platform FASTER and implementation of the business skills teaching programmes („Mathematics” and „Biotechnology”), we are preparing process maps and models illustrating company document and data flow. Process visualization enables students to spot the activities and the operations that initiate the circulation of accounting documents and result in tax obligations.

The process approach applied in learning business skills through the prism of accounting, taxes and legal regulations applicable to businesses, has a chance to provide practical knowledge and to equip students with practical skills needed to plan and run one’s own business. In our view, it is worth to expand FASTER platform by incorporating IT tools into it, along with concepts that facilitate understanding of micro-enterprises operation, including ERP systems, illustrating business operations with real accounting documents, process approach and IT tools designed for process modelling and analysis. Our activities correspond to implementation of Europe 2020 Strategy.

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## COMPARISON OF POLISH AND BULGARIAN PREFERENCES OF TEACHING TOOLS IN THE ACCOUNTING FIELD AND THEIR DETERMINANTS

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### ABSTRACT

The present research paper analyzes the results collected by a survey conducted in 2012 in Poland and Bulgaria. The purpose of conducting such a survey was at first place to identify which teaching tools and methods are considered to be most useful in the process of teaching accounting using the e-learning platform and secondly to test and estimate the gained accounting knowledge among four target groups: students, people interested in vocational trainings, academics in accounting and employers from the two countries.

The reason to conduct the survey in Poland and Bulgaria, was to compare results among groups in different circumstances such as educational curricula in the area of accounting, tax system and law stability, national accounting laws and regulations and their relation to international financial reporting standards (IFRS). Moreover, the results of the survey allowed us to determine what could be the determinants of stakeholders' preferable teaching tools, both between groups and countries.

Participants were asked to fill out questionnaires covering their age, occupation and experience in the field of accounting, use of computer and internet in daily life, opinion about the need of existence of e-learning platform with theoretical courses and practical applications and finally their assessment of specific methods of teaching in accounting. In addition academics were asked about their methods of teaching (especially if they are using e-learning platforms, ERP systems and Internet

during classes). As for the employers, additional aspect about need and ways of employees' trainings, was raised.

**Keywords:** accounting, e-learning, teaching tools, accounting practice, training

## INTRODUCTION

The present research paper analyzes the results collected by a survey conducted in 2012 in Poland and Bulgaria. The purpose of conducting this survey was at first place to identify which teaching tools and methods are considered to be most useful in the process of teaching accounting using the e-learning platform and secondly to test and estimate the gained accounting knowledge among four target: students, people interested in vocational trainings, academics in accounting and employers from the two countries.

Organization of such a survey in Poland and Bulgaria, aims a comparison to be made between the answers of the target respondents in different circumstances such as educational curricula in the area of accounting, tax system and law stability, national accounting laws and regulations and their relation to international financial reporting standards (IFRS). Moreover, the results of the survey allowed us to specify what are the determinants of participants' preferable teaching tools, both between groups and countries and to identify if after the technology progress in the recent years, the people still have some concerns using educational platforms and how they find the necessary accounting information/knowledge.

The survey was conducted by using questionnaires which were distributed among the target groups. The questionnaires contained common questions for all target groups but also specific ones for the different participants. The gathered data include age, occupation and experience in the field of accounting, use of computer and internet in daily life, opinion about the need of existence of e-learning platform with theoretical courses and practical applications, assessment of specific methods of teaching in accounting, academics' methods of teaching (especially usage of e-learning platforms, ERP systems and Internet during classes), the need and ways of employees trainings. All these data allow us:

- to compare the preferences of teaching tools in the accounting field among the target groups and the respective determinants for these preferences;
- to identify the gaps between the knowledge gained during the studies in the university and the knowledge needed in the daily accounting work;

- to assess how adequate are the accounting studies to the market demands.

## SAMPLE CHARACTERISTICS

Questionnaires were distributed during February and March 2012 to a study group of 1395 students, 260 people interested in vocational trainings in accounting, 279 academics in accounting and 126 employers, in Bulgaria and Poland. From among all distributed questionnaires there were 807 positive responses. The exact data covering total population of groups, population of participants and percentage share of answers is shown in Fig. 1

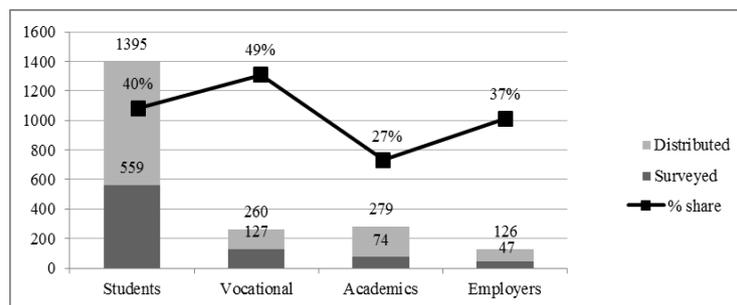


Figure 1. Distributed questionnaires and positive responses by target groups

The number of positive responses from target groups indicates their interest in existence of e-learning platform on accounting containing theoretical and practical courses. Biggest interest show people interested in vocational trainings who are active on the labor market (49%). They see the need of broadening their knowledge, improving their skills and gaining qualifications in the field of accounting. Deeper analysis show, that the main reason for majority of vocational people is their personal interest (71%), followed by the employers' suggestions (28%) and the needs of the labor market (15%). (Fig. 2)

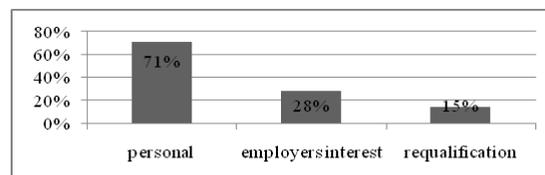


Figure 2. Reasons of interest in accounting of people interested in vocational trainings (%)

The second group open to innovation in learning are students (40%). Those, who just start working in accounting field, clearly see the gap between theory and practice and the need to adjust education systems to market requirements.

Also employers seem to notice lack of necessary practical knowledge among accounting employees (37%), but the share is smaller than previous groups, because the process of recruitment and assessment should turn down those who are not well prepared for market demands. The employers probably see the possibility of e-learning platform as a cheap training tool, especially in aspect of improving skills of low-level employees.

The least interested group are academics (27%). The cause may be that academics are used to their standard and trusted teaching methods. Such low response may also imply that academics highly assess self-prepared educational material and do not see a need of its changing or using e-learning in accounting. On the other hand, academics who gave positive responses, even if they use standard methods of teaching, view interactive tools (such as e-learning platforms) as a good assistance in refreshing students' knowledge and practical verification of their skills.

As mentioned before overall, 807 stakeholders (197 men and 610 women), participated in our survey. The specific data of gender of participants is shown in Tab. 1

	Bulgaria (%)		Poland (%)		Total (%)	
	Male	Female	Male	Female	Male	Female
Students	38	62	23	77	24	76
People interested in vocational trainings	17	83	20	80	20	80
Academics in accounting	35	65	30	70	32	68
Employers	19	81	40	60	34	66

*Table 1. Participants by gender and group*

As we can see the majority in all target groups were women (76% of all participants), which can indicate that the field of accounting is more popular among them than among men.

## **STUDENTS' SAMPLE**

The sample among students includes 392 graduates and 167 under-graduates. Percentage distribution of students in Bulgaria and Poland is shown in Figures 3 and 4.

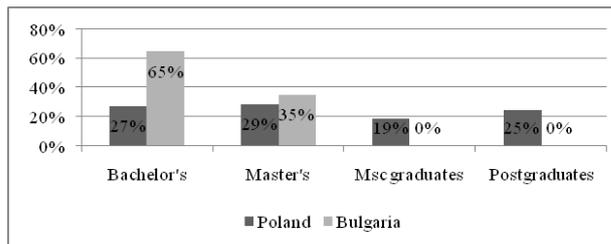


Figure 3. Distribution of students' questionnaires by academic degree and by countries (%)

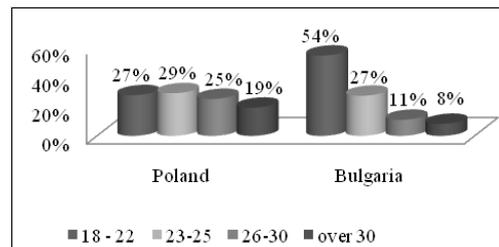


Figure 4. Distribution of students' questionnaires by age and by countries (%)

More than 3/4 of all student participants are women (62% in Bulgaria, 77% in Poland), the aged groups are shown in Figure 4 by country. In Bulgaria the significant part of the students are in bachelors programs (65%), while in Poland majority of respondents have already graduated from bachelor's degree (73%) (Fig.1). Almost 40% of the Polish participants of student's group presently work as accountants and only 11% of Bulgarian students work in the field of accounting.

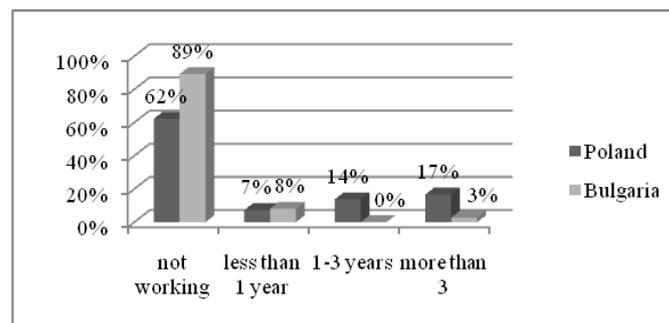


Figure 5. Students target group by working experience in the field of accounting

Of total Polish (Bulgarian) respondents with experience in accounting, 19% (75%) of them have experience less than 1 year, 37% (0%) - between 1 and 3 years, and 44% (25%) of respondents have an accounting experience more than 3 years. (Fig. 5)

## PEOPLE'S INTERESTED IN VOCATIONAL TRAININGS SAMPLE

In comparison between the countries' participants interested in vocational trainings – it is visible that the female participants that took part in Bulgaria (83%) and Poland (80%) predominate. Two thirds of the respondents currently work, without studying (66%), mainly

those from Poland (76%), while almost  $\frac{1}{4}$  are studying and working (23%), mostly from Bulgaria (70%). Only 11% of respondents don't have any job, mostly because their studying (only in Poland there are 5% unemployed participants). (Fig. 6)

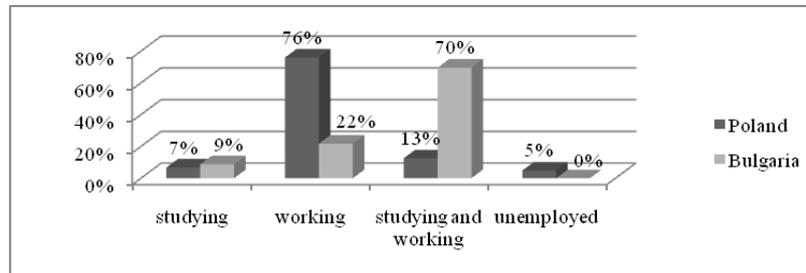


Figure 6. Distribution of vocational questionnaires by working status and by countries (%)

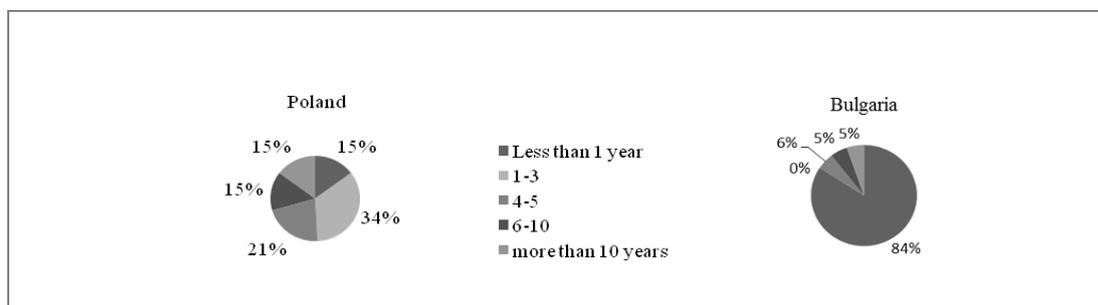


Figure 7. Experience of vocational respondents in accounting (%)

The majority of participants are working in the field of accounting, particularly those from Bulgaria (90%), while in Poland (66%). In Bulgaria the greater is the share of accountants with experience less than 1 year - 84% (15 % in Poland), while in Poland most participants have 1-3 years of experience (34%) (Fig. 7).

## ACADEMICS SAMPLE

The survey includes 74 academics from different universities and educational institutions. Once more women's share dominates in the sample (65% in Poland, 70% in Bulgaria). The academic degree of the respondents is shown in Figure 8.

In Poland about 36% of the survey's participants have academic accounting experience between 11 and 20 years, followed by those with less experience (4-10 years) (30%), those with the biggest time of service as academics (over 20 years) (26%) and those with minimal experience (8%). On the other hand in Bulgaria majority of academics are those with 0-3 years of academic accounting experience, followed by those with experience between 11 and 20 years (19%), finally ending on both: those with minimal and highest experience

(10%). (Tab. 2)

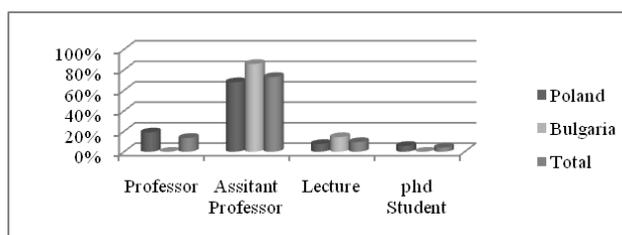


Figure 8. Distribution of academics' questionnaires by academic degree and by countries (%)

In Poland young academics are reserved to new, unverified methods of teaching. Contrary to Polish academics, Bulgarian PhD students are open to innovative teaching methods (Tab. 2).

Practice experience ↓	Teaching experience →	Poland					Bulgaria				
		0-3	4-10	11-20	> 20	Total	0-3	4-10	11-20	> 20	Total
no		4%	8%	6%	8%	25%	0%	0%	0%	0%	0%
less than 1		0%	2%	4%	4%	9%	52%	0%	0%	0%	52%
1-3		0%	11%	9%	4%	25%	10%	0%	0%	5%	14%
4-5		4%	4%	8%	2%	17%	0%	0%	0%	0%	0%
6-10		0%	4%	0%	2%	6%	0%	10%	5%	5%	19%
more than 10		0%	2%	9%	8%	19%	0%	0%	14%	0%	14%
<b>Total</b>		8%	30%	36%	26%	100%	62%	10%	19%	10%	100%

Table 2. Academics' respondents by experience in teaching of accounting and in accounting work (%)

The academics with both practical and teaching experience over 10 years are about 15% of all academics in Poland and in Bulgaria. Moreover Polish academics with longer teaching experience are more interested in new ways of teaching, regardless exact time of teaching or work experience (about 30% per each age range over 4 years, and about 5% per working experience), while noticing students' weaknesses in systematic work and developing new skills. Meanwhile in Bulgaria, apart from PhD students, only senior academics with long practical experience display such interest. (Tab. 2)

Additionally academics were asked about non-traditional ways of teaching

accounting. E-learning courses are popular in Bulgarian curricula – 81% of academics offer such methods, and are rarely offered at Polish universities (11%). As for the ERP systems, fluent use of such programs is considered important in future accounting job (96% in Poland, 76% in Bulgaria). (Fig. 9)

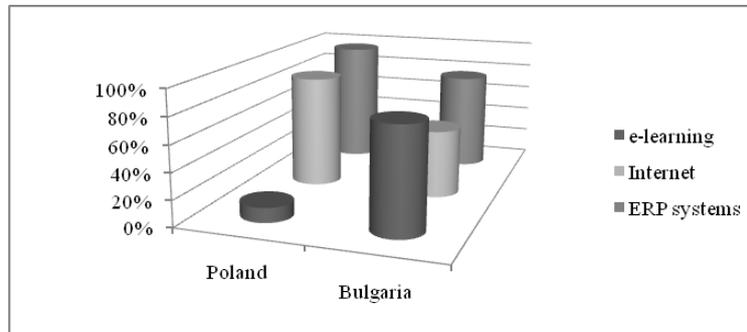


Figure 9. Electronic tools in teaching of accounting

## EMPLOYERS' SAMPLE

The survey includes 47 employers: 27 from Poland and 20 from Bulgaria, among whom women are still majority (80% of Polish respondents and 60% of Bulgarian). (Tab.1).

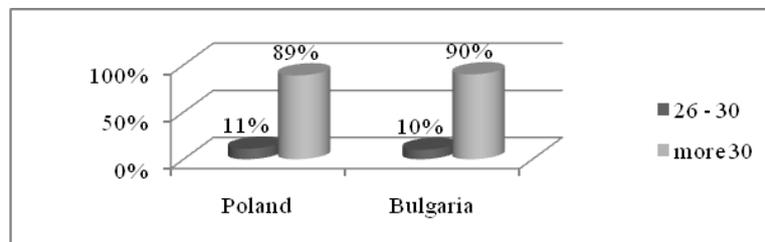


Figure 10. Employers by age and by countries (%)

In Figure 10 is shown the age group of the employers. In Poland 85% of the respondents work in the field of accounting with predominance of those with working experience more than 3 years (Fig.12). In both countries employers fully agree that constant development of their employees is important (Fig. 11).

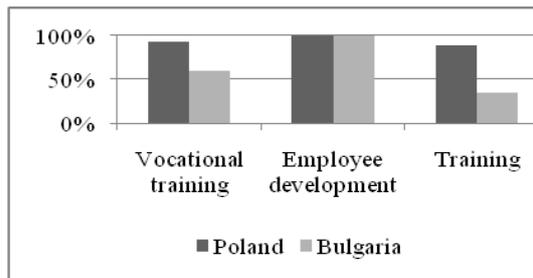


Figure 11. Employers trainings and opinion

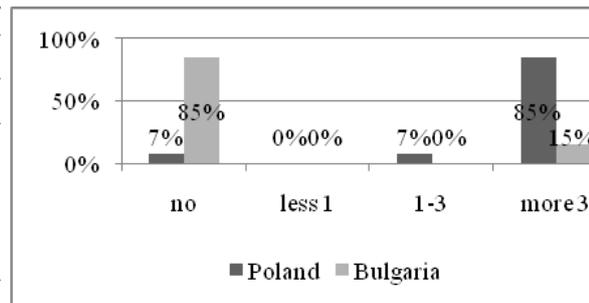


Figure 12. Experience of employees in accounting

country \ skills	Poland		Bulgaria	
	Computer	Internet	Computer	Internet
Student	99%	96%	89%	84%
Vocational	100%	98%	96%	65%
Employers	100%	100%	100%	100%

Table 3. Computer and Internet use (%)

In respect to the opportunities for e-learning in accounting, almost all of surveyed groups use computer in everyday life, the result are presented in Table 3. Easy and natural use of computer and Internet may have positive influence on perception of self-development interactive tools such as e-learning platforms. Furthermore, modern teaching methods offer more flexibility (no fixed time lines), lower costs of teaching and higher comfort and satisfaction from self-development.

## TEACHING TOOLS IN THE ACCOUNTING FIELD

In the last part of the questionnaires participants were asked to assess which tools used in teaching is in their opinion an effective and comfortable way of learning accounting and evaluating knowledge and skills. The respondents chose one level of importance, per each tool, out of 5 levels (1 – not at all, 2 – a little, 3 – enough, 4 – a lot, 5 – very much). For the need of analysis the importance level is accumulated result of answers “a lot” and “very much”. The results for all groups from 2 countries are described in Table 4. It is visible that, the highest esteem and the smallest dispersion from all categories of respondents receives the practical method with examples of use of accounting theory in practice and case studies.

Tools	PL Poland BG- Bulgaria	Students		Vocational		Academics		Employers		Total	ANOVA
		PL	BG	PL	BG	PL	BG	PL	BG	-	MS <sub>B</sub> /MS <sub>w</sub> F test p value
Examples with case studies	importance	96%	97%	99%	100%	92%	90%	100%	65%	96%	2,433 0,267 9,118 (0,000)*
	mean	4,81	4,43	4,90	4,83	4,62	4,52	4,78	4,15	4,767	
	median	5	4	5	5	5	5	5	4	5	
	std deviation	0,485	0,647	0,327	0,387	0,686	0,813	0,424	0,988	0,534	
Glossary	importance	81%	86%	90%	91%	77%	86%	96%	50%	82%	1,911 0,795 2,402 (0,019)*
	mean	4,30	4,24	4,44	4,43	4,09	4,29	4,52	3,70	4,299	
	median	5	4	5	5	4	4	5	3,5	5	
	std deviation	0,921	0,760	0,786	0,662	0,966	0,845	0,580	1,218	0,897	
Accounting databases	importance	84%	57%	81%	83%	75%	81%	63%	60%	80%	3,397 0,794 4,691 (0,000)
	mean	4,33	3,73	4,36	4,13	4,06	4,29	4,00	3,75	4,258	
	median	5	4	5	4	4	5	4	4	4	
	std deviation	0,840	0,804	0,891	0,694	0,794	1,007	1,038	0,851	0,865	
Accounting sites	importance	76%	57%	82%	65%	79%	76%	70%	65%	75%	1,937 0,866 2,238 (0,029)
	mean	4,14	3,65	4,26	3,96	4,08	4,14	3,89	3,90	4,110	
	median	4	4	4	4	4	5	4	4	4	
	std deviation	0,963	0,789	0,881	0,824	0,756	1,108	0,974	0,788	0,935	
Regulations and legislations	importance	73%	65%	84%	78%	83%	76%	85%	50%	75%	2,632 0,984
	mean	4,03	3,70	4,32	4,00	4,30	4,10	4,22	3,70	4,071	

Tools	PL Poland BG- Bulgaria	Students		Vocational		Academics		Employers		Total	ANOV A
		PL	BG	PL	BG	PL	BG	PL	BG	-	MS <sub>B</sub> /MS <sub>w</sub> F test p value
database s	median	4	4	5	4	5	4	4	3,5	4	2,674 (0,010)
	std deviation	1,018	0,661	1,007	0,798	0,845	0,995	1,013	1,218	0,999	
Multiply choice tests	importanc e	75%	51%	75%	91%	72%	81%	67%	80%	74%	0,528 0,915 0,577 (0,775)
	mean	4,11	4,16	4,16	4,43	4,08	4,24	3,96	4,20	4,129	
	median	4	4	4	5	4	4	4	4	4	
	std deviation	0,994	0,764	0,882	0,662	0,978	0,889	1,055	0,768	0,955	
Slides	importanc e	75%	73%	79%	74%	51%	71%	59%	75%	73%	3,056 0,920 3,320 (0,002)
	mean	4,06	3,84	4,07	3,83	3,47	3,86	3,70	4,10	3,986	
	median	4	4	4	4	4	4	4	4	4	
	std deviation	0,959	0,928	0,927	0,937	1,085	1,014	0,869	0,912	0,969	
Text	importanc e	73%	86%	80%	87%	66%	71%	52%	50%	73%	1,003 1,039 0,965 (0,455)
	mean	4,03	4,05	4,13	4,30	3,85	4,10	3,96	3,70	4,030	
	median	4	4	4	4	4	5	4	3,5	4	
	std deviation	1,051	0,780	0,966	0,703	0,988	1,136	1,055	1,031	1,019	
False / True questions	importanc e	73%	62%	76%	91%	64%	76%	59%	60%	72%	1,371 0,950 1,442 (0,185)
	mean	4,02	3,76	4,06	4,43	3,83	4,10	3,85	3,90	4,006	
	median	4	4	4	5	4	4	4	4	4	
	std deviation	0,999	0,830	0,901	0,662	1,014	1,091	1,063	0,852	0,977	

Tools	PL Poland BG- Bulgaria	Students		Vocational		Academics		Employers		Total	ANOVA
		PL	BG	PL	BG	PL	BG	PL	BG	-	MS <sub>B</sub> /MS <sub>w</sub> F test p value
Accounting journals	importance	65%	41%	70%	61%	72%	57%	81%	75%	65%	1,869
	mean	3,85	3,41	3,93	3,65	3,92	3,67	4,07	4,15	3,849	1,114
	median	4	4	4	4	4	4	4	4	4	1,677
	std deviation	1,101	0,832	1,036	0,982	0,851	1,278	0,874	0,813	1,059	(0,111)
Books and e-books	importance	64%	54%	72%	70%	68%	62%	70%	45%	65%	1,614
	mean	3,80	3,59	4,06	3,78	3,92	3,86	3,89	3,45	3,830	0,984
	median	4	3	4	4	4	4	4	3	4	1,640
	std deviation	1,020	0,762	0,922	0,998	0,895	1,153	1,050	0,944	0,995	(0,121)

\* difference of means is significant ( $p < 0.05$ ); MS<sub>B</sub> - Mean Square Between groups; MS<sub>w</sub> - Mean Square Within groups

Table 4. Preferred tools of accounting education (in order of their overall significance)

Using ANOVA at  $p = 0.05$  it is visible, that greater differences are between groups than within groups (Tab. 4). The only group which does not follow such rule are employers in Bulgaria (65% by importance). The high position is explicable, because, although base knowledge of theory is a must in the field of accounting, inability to implement theory in market-accounting events makes accountants useless, because they are unable to faithfully reflect actual financial standing of the company in financial statements. Such inability may lead to extra costs for companies, mostly deriving from higher costs of control, additional costs of dismissal or trainings and even financial penalties. As for the groups, vocational people find examples as most significant (99% in Poland, 100% in Bulgaria), followed by students (96% PL, 97% BG), academics (92% PL, 90% BG) and employers (100% PL, 65% BG). Vocational people find it more useful than students, because they are more experienced in the

field of accounting and had more time to assess inadequacy of pure theory. Academics, may lower practice's significance, due to their goal to provide students with full accounting theory during studies, in hope that they will develop practical skills in future job.

Examples with case studies	Students PL/BG		Vocational PL/BG		Academics PL/BG		Employers PL/BG	
	MS <sub>B</sub> /MS <sub>W</sub>	4,885	0,248	0,114	0,115	0,147	0,523	4,528
ANOVA test F / p-value	19,726	0,000*	0,993	0,321	0,281	0,598	8,776	0,005*

Table 5. Differences in mean significance of examples with case studies between and within groups by countries

\* difference of means is significant ( $p < 0.05$ ); MS<sub>B</sub> -Mean Square Between groups; MS<sub>W</sub> - Mean Square Within groups

The 35% divergence between Polish and Bulgarian employers (Tab. 4) might be a result of sample characteristics. Using ANOVA at  $p = 0.05$  it is visible, that greater differences are between Polish and Bulgarian employers than within these groups (Tab. 5). As mentioned before, 85% of Bulgarian employers are not currently working in the field of accounting and don't have any accounting experience, which is why they may not clearly see the difference between theory and practice. On the other hand, in Poland only 7% of them have not had any direct contact with accounting (Fig. 12). Similar results ANOVA test at  $p = 0.05$  shows only for Polish and Bulgarian students, which may also result from significant difference in accounting experience between Polish and Bulgarian students.

Glossary	Students PL/BG		Vocational PL/BG		Academics PL/BG		Employers PL/BG	
	MS <sub>B</sub> /MS <sub>W</sub>	0,114	0,831	0,001	0,586	0,551	0,872	7,698
ANOVA test F / p-value	0,138	0,711	0,002	0,966	0,631	0,429	9,377	0,004*

Table 6. Differences in mean significance of glossary between and within groups by countries

\* difference of means is significant ( $p < 0.05$ ); MS<sub>B</sub> -Mean Square Between groups; MS<sub>W</sub> - Mean Square Within groups

The next, overall, most popular tool is teaching of accounting terms in foreign languages (glossary). Once more the group which finds it very important is the group of vocational people (approx. 90%), followed by students (81% PL, 86% BG). The Tab. 4 show that significance of teaching foreign financial and accounting terms is more important in

Bulgaria (apart from employers), especially among students and academics. Although ANOVA ( $F(7,799)=2,402, p<0.05$ ) shows greater differences are between all eight groups than within groups (Tab. 4.), comparison by countries for the same kind of respondents points the difference between groups greater than within groups only for Polish and Bulgarian employers (Tab. 6). The positive 5% gap between students may derive from that, more Bulgarian students often look for a job at international companies, such as the “Big Four” audit companies, where fluent foreign language is extremely mandatory, than Polish students. In Poland students usually aim to start working in a bit smaller companies with less severe requirements. What is worth mentioning is that, academics in Bulgaria notice accounting jobs’ trends among students and evaluate highly the need of understanding accounting terms used in foreign accounting documents and documents concerning international movement of products and services (export, import, intra-community delivery of goods) teaching (86%), while in Poland such tool is less important for academics. Moreover, Polish academics pay lesser attention to knowledge of foreign business language (77%) rather than Polish employers (96%), Polish vocational (90%) and even Polish students (81%). On the contrary, Bulgarian academics evaluate language skills higher (86%) than Bulgarian employers (50%). It may indirectly indicate poor level of compatibility between theory at academic level and practice on the market. High difference between Polish and Bulgarian employers, much greater than within these groups (Tab. 6) comes from the fact that on Polish labor market, knowledge of foreign business language is standard requirement even in national companies.

Accounting databases	Students PL/BG		Vocational PL/BG		Academics PL/BG		Employers PL/BG	
	MS <sub>B</sub> /MS <sub>w</sub>	12,588	0,703	0,956	0,740	0,790	0,738	0,718
ANOVA test F / p-value	17,919	0,000*	1,293	0,258	1,070	0,304	0,774	0,384

*Table 7. Differences in mean significance of accounting databases between and within groups by countries*

\* difference of means is significant ( $p<0.05$ ); MS<sub>B</sub> -Mean Square Between groups; MS<sub>w</sub> - Mean Square Within groups

The other teaching tools are also differently evaluated by the target groups. ANOVA analysis supports such conclusion at mean level for Accounting databases, Accounting sites, Regulations and legislations databases and Slides (Tab. 4). For instance access to accounting

databases with financial statements is important for vocational people (approx. 82%) and academics (75% PL, 81% BG). The least interested group are employers (63% PL, 61% BG) – maybe, because the information from financial statements is useful only in long-term strategies, such as M&A (mergers and acquisitions) activities (in Poland) or financial investments (in Bulgaria). As ANOVA test show, there is very significant gap in needs among Polish and Bulgarian students in and less significant difference between vocational people in Bulgaria and Poland and between such groups of academics ( $MS_B > MS_W$  in Tab. 7). The cause may be curricula in both countries. Especially during the bachelor's studies in Poland, the emphasis is on how to read the financial statements in order investment decisions to be taken, how to compare the financial statements of different companies and to teach the students from where the information included in them comes from. In comparison, in Bulgaria, the emphasis is more on usefulness of the accounting information in the efficient management of the companies and that is why more important seems to be the examples. In addition there are also more easy ways of getting access to such databases in Poland (especially electronic databases) than in Bulgaria, which raises the importance of accounting databases for vocational people in Poland.

Accounting sites	Students PL/BG		Vocational PL/BG		Academics PL/BG		Employers PL/BG	
	$MS_B$	$MS_W$						
$MS_B / MS_W$	8,401	0,908	1,730	0,760	0,068	0,754	0,001	0,810
ANOVA test F / p-value	9,249	0,002*	2,278	0,134	0,091	0,764	0,002	0,967

Table 8. Differences in mean significance of accounting sites between and within groups by countries

\* difference of means is significant ( $p < 0.05$ );  $MS_B$  - Mean Square Between groups;  $MS_W$  - Mean Square Within groups

Comparing data from Tab. 3 it is explicable that those with poorer Internet skills would avoid using Internet as an efficient way of finding accounting information. Results (Tab. 4) clearly show that searching accounting information on accounting sites is less popular in Bulgaria (among all groups range from 57%-76%), than in Poland (range from 70%-82%). Furthermore in Poland many good quality sites contain described examples of theories, which is very useful in learning process (and explain the greater differences between Polish and Bulgarian students and groups of vocational people by the countries than within these groups shown by the results of ANOVA (Tab. 8)). Although in Bulgaria there are more good quality forums where accountants provide help, which is more problem-concerned, but it is also more time consuming (due to reply time).

Regulations and legislations databases	All respondents in Poland vs Bulgaria		Students PL/BG		Vocational PL/BG		Academics PL/BG		Employers PL/BG	
	MS <sub>B</sub>	MS <sub>w</sub>								
ANOVA test F / p-value	5,583	0,018*	3,765	0,053	2,000	0,160	0,812	0,371	2,570	0,116

Table 9. Differences in mean significance of regulations and legislation databases between and within groups by countries

\* difference of means is significant ( $p < 0.05$ ); MS<sub>B</sub> - Mean Square Between groups; MS<sub>w</sub> - Mean Square Within groups

The next analyzed tool are the links to national and international regulations and legislations. All groups in Poland find it more significant than the groups in Bulgaria, and ANOVA test shows much greater differences between countries for all respondents (Students, Vocational, Academics and Employers together) than within respondents in the country, although at  $p=0.05$  it is not significant for any separate group of respondents (Tab. 9). This definitely comes from differences in tax and accounting regulations in both countries. Firstly in Poland there are about three times more differences between financial and tax income. This is extremely important for vocational people's group (84% in Poland), where majority works in accounting, employers due to possible tax control (83% in Poland) and academics, who should emphasize the problem of disparity in law during classes. Compared to the significance of differences between countries in assessment of importance of regulations and legislations by students, employers and even vocational peoples, for academics ANOVA analysis points greater differences within groups (characteristic respondents from one country) than between countries, which suggests that perception of role of regulations and legislations in teaching accounting differs between academics inside country: Poland or Bulgaria. (Tab. 9) Furthermore, in Poland not listed companies are not obliged to prepare financial statements in compliance with IFRS, but in accordance to national standards, which differ significantly from international ones. In Bulgaria national standards are very similar to IFRS, so mentioned problem does not seem so essential. In addition, links to regulations and legislation allow accountants to be up to date with current changes in law (which in Poland happens even few times a year, while in Bulgaria significant changes are rare).

In regards to the form of educational materials, ANOVA shows contrary source of differences in preference of form of educational materials, preferences of text differ more

within groups of respondents and preferences of slides differ more between countries (Tab. 10). Students in Poland prefer slides over text (75% to 73%), in Bulgaria otherwise, 86% for text and 73% for slides (Tab. 4). The significant role of practice as well as lack of lectures of accounting in Poland, indicates that the Bulgarian students are more theoretically prepared. Thus it is not surprising for Bulgarian students to wish more advanced materials with practical examples and case studies, which is usually offered in form of text (on seminars).

Groups of respondents compared by countries	Text				Slides			
	MS <sub>B</sub>	MS <sub>W</sub>	test F	p-value	MS <sub>B</sub>	MS <sub>W</sub>	test F	p-value
Students PL/BG	0,026	1,073	0,024	0,877	1,638	0,916	1,787	0,182
Vocational PL/BG	0,543	0,856	0,634	0,427	1,096	0,863	1,270	0,262
Academics PL/BG	0,912	1,064	0,857	0,358	2,235	1,136	1,967	0,165
Employers PL/BG	0,794	1,093	0,727	0,398	1,804	0,787	2,292	0,137

*Table 10. Differences in mean significance of educational materials (text vs. slides) between and within groups by countries*

Contrary in Poland, students still lack basic knowledge, so they prefer concise description of various accounting aspects in form of slides (lectures) rather than deep analysis of them. Moreover due to lack of time during classes and broad material Polish students are asked to complete their knowledge, which is why Polish academics use text forms and upload them on sites. Meanwhile in Bulgaria academics use slides during lectures and distribute them via mails (common practice is the lecturers to distribute materials via e-mails in Bulgaria or to upload them on the internally used e-learning platforms). Educational materials in form of text dominate over slides in vocational group, whereas employers prefer slides. Of course vocational people possess basic knowledge of accounting issues, so theory on slides may be not sufficient to their needs. Theory in form of text usually provides more well-arranged advanced information. As for employers it seems that slides are necessary as summary of accounting issues, while dealing with advanced problem lies in scope of employees' responsibilities. According to data, in Bulgaria students put pressure neither on m/c tests nor true/false questions, but rather on open questions and exercises, which are better ways of evaluating practical knowledge. In case of Poland, as mentioned in previous paragraph, the lack of knowledge definitely hinders solving practical exercises. That's why Polish students prefer questions which check the theoretical knowledge. All other groups in Bulgaria display more concern on both ways of assessment than Polish groups (Tab. 4). It

seems that they treat it as a good and fast way of repeating and checking acquired knowledge. ANOVA analysis points greater differences within groups (characteristic respondents from one country) regarding preferences of Multiply choice tests (in spite of vocational people) and True/false questions for academics and employers. Differences between countries play greater role in explaining Bulgarian and Polish vocational preferences for both ways of checking acquired knowledge rather than differences within groups (from the same country) (Tab. 11).

Groups of respondents compared by countries	Multiply choice tests				True/false questions			
	MS <sub>B</sub>	MS <sub>W</sub>	test F	p-value	MS <sub>B</sub>	MS <sub>W</sub>	test F	p-value
Students PL/BG	0,083	0,961	0,087	0,768	2,414	0,979	2,464	0,117
Vocational PL/BG	1,387	0,719	1,928	0,167	2,678	0,746	3,588	0,061
Academics PL/BG	0,398	0,910	0,437	0,511	1,057	1,073	0,984	0,324
Employers PL/BG	0,646	0,893	0,723	0,400	0,027	0,960	0,028	0,868

*Table 11. Differences in mean significance of multiply choice vs true/false questions between and within groups by countries*

Students in the both countries are the least interested in the additional literature. Main reason is the high cost of purchasing along with the not easy access to good accounting books, but the preferences differ more between countries than within these groups (Tab. 12  $MS_B > MS_W$ ), as well as the searching particular information in books is too high time consuming. The negative difference in Bulgarian case can be explained by the fact that the books don't cover solving of practical issues and are another database of theoretical knowledge. As for the academics in Poland, the higher popularity may be connected to concern about poor students' theoretical knowledge and small amount time to improve it during classes but it depends more on individual characteristics than differences between countries,  $MS_W > MS_B$  (Tab. 12). As for journals, only employer's preferences depends more on individual characteristics than differences between countries  $MS_W > MS_B$  (Tab. 12).

Groups of respondents compared by countries	Further reading (books)				Journals			
	MS <sub>B</sub>	MS <sub>W</sub>	test F	p-value	MS <sub>B</sub>	MS <sub>W</sub>	test F	p-value
Students PL/BG	1,524	1,011	1,508	0,220	6,788	1,178	5,764	0,017*
Vocational PL/BG	1,425	0,877	1,626	0,205	1,482	1,054	1,406	0,238

Academics PL/BG	0,068	0,948	0,072	0,789	1,000	0,977	1,023	0,315
Employers PL/BG	2,213	1,014	2,183	0,146	0,066	0,720	0,092	0,763

*Table 12. Differences in mean significance of books/e-books and journals between and within groups by countries*

Other authors also analyzed the usage, effectiveness and impact on the studies of different tools using during the teaching process. According to the analysis about the preferences of the students of structure of the power points presentations (Apperson, Laws & Scepanisky, 2006) using in class-room, it is determined that mostly the students prefer the studying material to be presented in power point form because that way the class is more understandable, clear and organized and this form facilitates their learning. Other researchers, who examined how helpful the power point presentations are for the learning and if the different types of power point presentations have different impact on the learning, concluded that this form of presenting the material is beneficial, but can be harmful in case the material is pertinent to the presentation (Bartscha, & Cobern, 2003). Making more attractive the content of the material presented on the slides, visualization is used (e.g. pictures, diagrams, charts etc.) but not always the visualization helps the learning, from learning perspective the text slides are better because of the short-term memory of the learners (Blokzijl & Andeweg). Most preferable tool for assessment of the learners' knowledge is the tests (e.g. multiple-choice, true/false) which are easy to be created and to be used, but the negative aspect is that the students do not spend enough time to prepare themselves (Roediger & Elizabeth, 2005). Alternative of the class-room studies, are the web-based environment studies but the effectiveness of this form of learning depends on the instructional design and how the student's approach and process the curriculum materials (Chang & Yang, 2010).

Main conclusion based on the conducted survey is that at first place all target groups prefer more the practical-oriented teaching tools – the examples demonstrating the accounting theory on practice, the cases studies giving the opportunity to show the gained knowledge and to reduce the knowledge gaps, and the glossary, containing the English terms. Secondly, we can conclude that the inability to put into practice the theory in market-accounting events and cases leads to extra costs for companies, mostly deriving from control, additional costs of dismissal or trainings and even high financial penalties. Third, the gaps in the accounting and legislation knowledge can be reduce by using e-learning platforms in case

these platforms provide adequate teaching materials in forms which are suitable for the end users.

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## DIFFERENCE IN VALUATION AS AT THE BALANCE SHEET DATE USED BY THE NEWCONNECT LISTED COMPANIES

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### ABSTRACT

Disclosure requirements of listed companies, containing financial statements and accounting policy with applied valuation methods, is a very important due to the need to provide shareholders knowledge necessary to make investment decisions and reduce information asymmetry, especially at NewConnect – a share's market based on an Alternative Trading System and dedicated for companies from Centre and Eastern Europe with brief history relatively, innovative, engaged in R&D, generating losses more often than profits.

The paper discusses consequences of allowance companies listed on the NewConnect stock exchange to use different financial reporting standards: Polish, national applicable in the issuer's country, not only Polish but foreign as well, or recognised standards on an international scale (IFRS). The paper aims to answer a question about the reason for allowing the legal possibility of preparing financial statements according to such different accounting standards. It seems that applicable regulations not enough are protecting investors, aren't delivering comparable financial information to them, preventing them from comparing financial results established according to various accounting standards. Maybe differences in the influence of diversifying methods of valuation of assets and liabilities, on the financial result and the equity (revaluation reserve in equity), within groups of companies applying the same (especially Polish) accounting standards are significant enough to exceed differences in the effects between groups of companies applying different accounting standards: Polish, foreign or IFRS. It would explain the legitimacy of authorizing the public trading of companies applying different accounting standards. The paper presents received findings of the conducted research of significance of difference in accounting policy of 414 companies listed on the NewConnect stock exchange in Poland, including 383 using Polish accounting standards, 27 using IFRS and 4 basing

on foreign accounting law applicable in their country (quantitative analysis) and qualitative analysis of accounting policy on valuation of 355 firms.

**Keywords:** accounting standards, IFRS, valuation of assets and liabilities, alternative trading systems

## INTRODUCTION

Disclosure requirements of listed companies, containing financial statements and accounting policy with applied valuation methods, is a very important for the proper functioning of stock exchanges around the world. This is due to the need to provide shareholders knowledge necessary to make investment decisions. Applied methods of the balance sheet valuation are reflecting the adopted concept of evaluations, concerning the realization of the main purpose of the financial statement: transaction method (continental (European) model based on income statement) or method of the value (Anglo-American model regarding mainly balance statement) with opposing tendencies: conservative or mark-to-market accounting.

The issuer listed on most of Alternative Stock Exchange, notably the NewConnect in Poland, prepares financial statements in accordance with the national applicable in the issuer's country, not only Polish but foreign as well, or recognised standards on an international scale (IFRS). As companies listed on NewConnect have brief history relatively, are conducting Research and Development activity, as a result of which largely they are making a loss, a question about the reason for allowing the legal possibility of preparing financial statements according to such different accounting standards seems justified. It seems that applicable regulations not enough are protecting investors, aren't delivering comparable financial information, preventing them from comparing financial results established according to various accounting standards. In the paper we verify, if differences in the influence of diversifying methods of the evaluation of assets and liabilities, applied by issuers as part of their accounting policy, on the financial result and revaluation reserve in equity, within groups of firms applying the same (especially Polish) accounting standards are significant enough to exceed differences in the influence of valuation between groups of firms applying different accounting standards: Polish, foreign and IFRS. It would explain why companies listed on NewConnect are allowed to apply different accounting standards. The NewConnect is an alternative choice for companies, which through a stock debut wish to raise capital for the development of, and which are not able to meet the requirements associated with the

issuance of shares on a regulated securities market. It directs its offer above all to, developing from a variety of industries, including new technologies, both small and medium-sized start-ups' (edifying their story), as well as firms with a strong position, from Centre and Eastern Europe.

## **NEWCONNECT AS AN ALTERNATIVE STOCK EXCHANGE OF CENTRE AND EASTERN EUROPE**

Capital market more widely opens to the small and medium-sized companies. Alternative financial markets, with issuance and turnover of securities for smaller operators, are formed all over the world for over 40 years (the oldest market is an American NASDAQ2) and in Europe for 17 years (Alternative Investment Market (AIM) operated by the London Stock Exchange). A characteristic feature of AIM is its internationality - in the middle of 2013 there were 226 foreign companies (no-British) among the 1085 listed ones. For comparison on the NewConnect market (a share's market (functioning from 30.08.2007) based on an Alternative Trading System, which is operated outside the regulated market by Warsaw Stock Exchange) quoted is only 9 foreign companies (no-Polish). It is worth noting that the AIM market also benefited American companies despite the opportunities available on the home market [Kordela, 2010]. The majority of alternative platforms from European market were formed in the first decade of the 21st century, such example is Alternext (2005 year, it is operated by NYSE Euronext market). Currently there are 202 listed companies on this market, of which 8 companies are no European ones and 8 are located outside the alliance of French, Dutch, Belgian and Portuguese markets. Conceptually, Alternext market was supposed to be an alternative market in the euro area reference for young firms, however, a lot of companies with long experience, even twenty, have taken advantage of it. The advantage of platform is a good protection for the interests of investors, manifesting itself in the larger market entry requirements and obligations after the firm debut information [Porębski, 2009].

In addition, it is worth to indicate German Standard Entry (2005), the Scandinavian First North (2006), Italian MAC (2007), Norwich Axess (2007), Austrian Dritter Market (2007), Italian AIM Italia (2008) and Spanish Mercado Alternativo Bursatil (2008). The reason of formation of these markets was to allow access to the booming capital of the smaller companies, which one wants to have innovation in the future and very often capital-investment [Kachniewski, 2007]. In accordance with the concept of an alternative market, promotion entities with large growth prospects associated with simplified formalities and lower, compared with the stock market, cost of entry and operation in the market. Simpler

and cheaper entry procedure, however, translated into a higher risk of investing in these markets, which offset is potentially high return which is the result of an increase in the prices of securities. In comparison to alternative European markets the NewConnect market has a small number of foreign companies, but it is relatively young and his goal is to become the leader mainly in Central and Eastern Europe.

Companies listed on the NewConnect (NC) market represent different branches, including innovative sectors, based especially on the intangible assets (e.g., telecommunications, computer science, biotechnology, alternative energy). Most companies listed on NC belong to sectors: trade, other services, computing, financial services, media and technology. Also foreign companies are interested in the offer of NewConnect market. At the end of 2012, you could observed the quotations of 9 foreign companies established in the Czech Republic, Bulgaria, Ukraine, the United Kingdom, Netherlands and Switzerland.

NewConnect's companies, depending on their listing, could hit to the one of the three segments that are created by Warsaw Stock Exchange. The most important, but also the smallest segment is NC Lead Segment (created in 2010). NC Lead' goal is to promote businesses that have a high chance of transferring their listing to the main market of the Warsaw Stock Exchange securities. Companies, which want to be in this segment, must fulfill a lot of quality criteria, including: the average number of transactions of the issuer's shares has been greater than 5 transactions per trading day or the average value of trading has been greater than PLN 5,000 per trading day; the average price of the issuer's shares has been greater than PLN 0.50 and its average volatility has been no greater than 15%; the issuer's shares have been listed on the NewConnect market for at least 12 calendar months and the company complies with information about the obligations with due diligence, provides high quality of published information. In June 2013 only 19 issuers of 437 companies listed on NewConnect belong to this segment. The next segment - the NC High Liquidity Risk (HLR) includes the company's enhanced liquidity risk. Firms, which start to be listed on this market, have the average value of free-float shares in the past three months no higher than PLN 1,000,000. There were up to 150 companies in this segment in June 2013. The last segment - Super High Liquidity Risk (SHLR) includes the company's enhanced liquidity risk and additionally characterized by strong volatility of share price or being in the liquidation or bankruptcy (35 firms in June 2013). The result of classification into the SHLR is the removal of company's shares from the participants' list of NewConnect market indices, transfer of its shares to the single-price auction system, and in the worst scenario - withdrawal from the NC market. Within 6 years of existence of NC, there were 40 withdraws, the majority in 2013.

## **FINANCIAL REPORTING STANDARDS ALLOWED TO BE APPLIED ON THE NEWCONNECT MARKET**

The big interest in the NewConnect market stems primarily from the small formal requirements (relating to the admission to trading and arising from the obligations of information), low-cost debut (the ability to take advantage of the private tenders) and quotations, excellent exposure of the company to investors, the promotion and visibility of the company and the lack of compulsion applied national accounting rules changes to IFRSs.

Mainly due to the low cost of the debut, companies choose emission of shares in the form of private tender. This offer is directed to a maximum 99 investors. It is also simpler, faster and less expensive than public emission. Moreover, it does not apply to the requirements of the Polish Act about Public Tender and there is no obligation to prepare a prospectus or information memorandum. However, in this case companies cannot use medias as the way to find the investors, they have to guide the offer directly to potential investors. In both case (public and private tender), the decision to broadcast on the NewConnect market must precede the change of the legal form of the company to a joint-stock company (or limited shelf) and the consent of the general meeting of the company.

The issuer prepares financial statements and comparative data in accordance with the national applicable to the issuer or recognised standards on an international scale. In case of issuers of securities, who wish (or are going to) to have their securities listed on the NewConnect market, prepare the Polish draft individual and consolidated financial statements according to the Polish laws, while units forming part of the group, in which the parent undertaking draws up consolidated accounts in accordance with IFRS (article 45 paragraph 1 b and article 55 paragraph 7 of Polish Accounting Act). Issuers, who are outside of Poland, draw up individual and consolidated financial statements according to the rules applicable in compliance with their national requirements, or according to IFRS. Only the issuers, who wish to apply for admission of its securities to trading on regulated markets, must prepared their consolidated financial statements according to IFRS and the separate financial statements according to IFRS (or according to Polish law or to other national accounting standards in force in the country of the issuer). (Annex No. 3).

Polish Accounting Act absolves small capital group from obligation of preparing consolidated financial statements. A parent company may not prepare consolidated financial statements if at the balance sheet date of the financial year and the balance sheet date, of the year preceding the financial year, the total data of the parent and all subsidiaries of each level without performing consolidation exemptions, meet at least two of the following conditions

(article 56. of Polish Accounting Act): total year employment is no more than 250 people (full-time), total carrying amount in the Polish currency does not exceed the equivalent of 7.5 million euros, total net revenue from the sale of products and goods, and financial operations in the Polish currency did not exceed the equivalent of 15 million euros.

By mid-2012, a small capital group listed on NewConnect, in accordance with the above mentioned article 56, did not prepare consolidated financial statements. The parent company informed investors about their results and their own financial situation and assets. However, in accordance with the revised in June 2012 The Alternative Trading System Rules, a parent company, in spite of non-compliance with conditions related to balance sheet, employment or income from art. 56. of Polish Accounting Act, is committed to the consolidation in situation if the issuer is listed on NewConnect or seeks to enter NewConnect market (§ 11 point 2 of the Annex No. 1 and § 5 point 2 of the Annex No. 3). Until March 2013 there were 113 units of dominant capital groups on NewConnect, that published consolidated financial statements.

By the end of the first month of the financial year, the issuer is obliged to identify , in the form of a current report, and meet the dates of transfer in the financial year of the periodic report (quarterly and annual), taking into account holidays. Annual report (both individual and consolidated) shall be transmitted immediately after the release of the opinion of the Auditor, but not later than within 7 days from the date of its receiving by the issuer and not later than 6 months from the date of the balance sheet, on which it was drawn up the annual accounts, as well as no later than 15 days before the date of the ordinary General Assembly, responsible for the approval of the annual financial statements, contained in the annual report.

Although most commonly committed errors by companies listed on NewConnect are: not respect of the time limit, failure to observance of the timetable for the publication of regular reports, no publication of periodic report updates in compliance with the schedule set up, change of publication date with a date which is out of the maximum set up time for publication of periodic reports. Unfortunately, the companies present also unreadable reports without attachments listed in the content of the reports, make adjustments for invalid reports or contain a lot of corrections to published reports.

If the issuer does not perform its obligations, the organizer of the Alternative Trading System may admonish him, and information about the reminder post on its website, suspend trading in financial instruments of the issuer in an alternative system, and even exclude financial instruments of the issuer from the Alternative Trading System (§16 of the Rules).

Companies listed on NewConnect are burdened with higher than average risk, certainly higher than on a regulated market. This risk is increased also by the lack of detailed data about companies (lower information requirements) and the lack of State oversight. As a result, the purchasers of shares are those who accept a higher level of the risk in their business like venture capital funds, investment funds, individual investors willing to take a high risk [Dykto, 2010].

## LITERATURE REVIEW

Selection of the appropriate accounting policy affects a number of internal and external decisions concerning the company, including secure capital placement, borrowings and loans, taking correct investment decisions, as well as minimizing the risk of receiving the expected economic benefits from their trade relations [Brzezina, 1995]. By choosing the valuation principles (conservative or market), you need to be guided by the objectives of financial reporting resulting from the accounting structure, needs an economic interpretation of financial statements and their importance for users (banks or stock-market investors) [Hendriksen, van Breda, 2002]. In agency theory, choosing the right agency principal-agent contract (based on outcome or preserving agent) may affect the accounting policy [Eisenhardt, 1986] and consequently on the value of a business [Watts, Zimmerman, 1986]. Empirical studies show the positive impact of the company's results on management salaries [Barkema, Gomez-Mejia, 1998], which raises moral hazard.

In situation of too strongly rising profits leading to political costs or large profit declines causing reduction of management's revenue, a logical behavior of managers is income smoothing, which means the use of a variety of possible solutions within the framework of the accounting policy, including the selection of appropriate valuation methods, so as to increase their control over the fixed result [Coenenberg, Haller, 1992]. Therefore, a well-functioning accounting system should reduce the asymmetry of information and contribute to a better functioning of the market by supplying as accurate picture company [Stiglitz, 2006] and exposing assumptions and valuation methods applied to its findings. The overriding role of accounting is to ensure the protection of property owners (Board of Trustees controls), that the management gives a report to the owner on the facts occurred in the accounting period and not on expectations or manager's rating [Mattessich, 1995]. It argues for the conservative approach based on historical cost rather than a valuation at fair value [Le Coutre, 1933].

As it is shown, the adoption of adequate accounting policies, including the selection of the valuation methods of assets and liabilities, affects the functioning of company in the economy, the efficient management in the face of conflict, access to debt financing, the asymmetry of information and security of investments of shareholders.

## **ACCOUNTING POLICY OF VALUATION ADAPTED BY NEWCONNECT LISTED COMPANIES - EMPIRICAL RESEARCH**

We conducted qualitative inquiry of accounting policy adapted by NewConnect listed companies on the basis of Introductions to the Financial Statements and Additional Information (Notes) to the published individual financial statements for 2010-2011. Our research contained 355 companies, including 8 preparing financial statements in accordance with IFRS and 1 preparing financial statements in accordance with the Czech Accounting Act. We analysed methods of valuation of assets and liabilities as at the balance sheet date (the end of accounting period) and their impact on companies' financial position. Below we are presenting received findings of the conducted research.

Valuation (measurement) is a process of determination of the value of assets and liabilities under the fundamental accounting concept of historical cost or one of the value based concepts. The historical cost is a concept that relates to the purchase (acquisition) price (cost) or the cost of manufacture. Value based concepts relate to the net realizable value (net selling price) or present value of future cash flows or fair value.

Valuation (measurement) of assets and liabilities is conducted at least as at the initial recognition date of an item and as at the balance sheet date (the end of accounting period). The initial valuation (conducted when the item is recognised in accounting books) depends on the way the item is gained. The asset is usually valued at:

- a) acquisition (purchase) price (or cost of purchase) - if it is acquired;
- b) cost of manufacture - if it is produced (manufactured);
- c) fair (market) value - if it is received free of charge;
- d) nominal value - if it is a part of equity or an individual amount of receivables
- e) other reliably and reasonably estimated amount - if it is provision or accruals (appraisal of future costs) when other specific operation appears.

All companies listed on NewConnect use nominal value to measure shareholders' equity which is in accordance with the Polish and IFRS requirements. Second most used valuation is the acquisition price - 89% of investigated companies declare to use it to measure their assets, especially intangible and fixed assets. It is also popular valuation of inventory, together with

purchase cost and manufacturing cost. About 44% of companies declare to apply market value and fair value to measure investments and financial liabilities as at the balance sheet date as well as for initial valuation of assets received free of charge. About 33% of companies declare to apply cost of manufacture to measure intangible and fixed assets. Adjusted acquisition price is applied most rarely (17%), only to long term financial investments, if a maturity date is specified for a given asset. In comparison with the IFRS requirements (*IAS 16 Property, plant and equipment*) the tangible assets should be initially measured at its cost which is the cash price equivalent. The cost includes beside the purchase price, the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

In general 40% of companies have not set up any provision, overstating the economic results, but also breaking the prudence principle of the conservative estimate. Financial statements of all NewConnect listed companies are subject to the audit obligation. Meanwhile, accruals for costs of obligatory audit of the financial statements have been set up by less than 14% of companies. According to the *IAS 37 Provisions, Contingent Liabilities*, there are two approaches concerning the accounting treatment of the audit costs – if as at the reporting date any audit work is performed then the audit fees have to be accrued and shown in the financial statements, but in case no audit activities have been performed during the last period, the entity has not obligation based on past event and accruals are not created. An extremely important element of the work connected to the preparation of financial statements is to perform an accurate evaluation of assets and liabilities on the balance sheet date.

Valuation as at the balance sheet date depends on: the type of assets/liabilities, time for which the item is held by the company and the way of using of the assets and discharging the liabilities. For different types of assets/liabilities we use different methods of valuation described in the article 28 paragraph 1 of the Polish Accounting Act. Each company should choose appropriate methods of valuation (initial and for closing books purpose), suitable for conducted activity and describe it in own accounting policy. Especially the division into fixed (long-term) and current (short-term) items, according to criterion of time in which item is held by the company, is very important because of different impact of valuation at balance sheet date on the company financial position. Valuation of current items, even by market value, affects current period profit or loss, and valuation of fixed (long term) assets by market value sometimes impacts reserve capital according to the principle of keeping capital (financial assets). Reserve capital serves the function of "shock absorber" of negative effects caused by decreasing of market value in part exceeding the purchase price.

The way of using of assets and discharging liabilities is especially important, because Polish accounting standards allow valuation by market or fair value only for items used for investment purpose, including investment properties, investment intangible assets and financial items used for investment purposes. Other items used in operating activity cannot be valued in market or fair value as at the balance sheet date. Regarding the liabilities *IAS 39 Financial Instruments, Recognition and Measurement* determines the financial liabilities to be classified either to financial liabilities at fair value through profit or loss, either to other financial liabilities measured at amortized cost using the effective interest method and the commercial payables to be initially recognized at nominal value and subsequently measured at their amortizing value less any payments associated with settling the liability.

Unfortunately, not all companies listed on the NewConnect market provide information about used or planned (in the case of a zero balance sheet items) valuation methods. After analyzing the provided information most frequently used method is the valuation according to acquisition prices. In the case of fixed assets valuation at acquisition price is applied by 73% of the companies investigated, and valuation at manufacturing cost is applied by 50% of companies, and for purpose of intangible assets valuation 69% of companies apply acquisition price and manufacturing cost - 44% of them. In Poland a company can evaluate property, plant and equipment and intangible assets at the acquisition price or manufacturing cost or adjusted value (after revaluation of property, plant and equipment based on separate acts), less depreciation or amortization charges and impairment losses.

In Poland companies could measure fixed assets in revalued amount only in 1996, based on the Regulation of the Finance Minister from 20 January 1995 on depreciation of fixed assets and of intangible assets, as well as of revaluation of fixed assets. According to IAS 16 Property, Plant and Equipment is initially measured at its cost, subsequently measured either using a cost or revaluation model, and depreciated so that its depreciable amount is allocated on a systematic basis over its useful life. Under the revaluation model, revaluations should be carried out regularly, so that the carrying amount of an asset does not differ materially from its fair value at the balance sheet date. The increase in the carrying amount is reported in the equity as revaluation reserve, the reduce in the carrying amount is recognized as an expense. In most cases, companies listed on the NewConnect market apply a straight-line depreciation - 84% of the investigated companies declare this method. In turn, only 5% of the companies use digressive depreciation methods. In addition, only 1% of companies declared that the depreciation rates used in balance sheet differ from the tax ones. Most of companies, which

declared the methods of measuring inventory, choose the valuation at acquisition price, manufacturing cost and purchase cost (all methods are used by 31-34% firms). Meanwhile the Polish Accounting Act is implying valuation of tangible current assets at the acquisition price or manufacturing cost not higher than their net selling price as of the balance sheet date which is the same as the requirements imposed by the IAS 2 Inventories.

Financial liabilities are usually measured at market or an otherwise determined fair value (12%) and adjusted acquisition price (8%). Immovable property and intangible assets classified as investments are usually valued at acquisition prices – 38% of the analysed companies used this method. The subsequent valuation of the investment properties according to *IAS 40 Investment Property* is based on the *model of the fair value* and any difference between the fair value and the book value of the asset should be reported directly in the Comprehensive Income statement as profit or loss for the period when it arises. Other used valuations are manufacturing cost (15%), market or fair value (14%) and revalued amount (3%). Another long-term investments are usually valued at acquisition price (36% of all firms), less often at fair value (18%) and adjusted acquisition price (9%) (see Table 1).

Valuation methods	Selected items of the balance sheet				Investments			
	intangible assets	fixed assets	inventory	financial liabilities	immovable property and intangible assets	fixed assets and participating interest in other undertakings	amounts receivable and loans granted	short-term
manufacturing cost in which standard cost	44%	50%	34%		15%			
acquisition price	69%	73%	34%		38%	36%		
purchase cost			31%					
including: not higher than net selling price			13%					
revalued amount		13%			3%			
market or fair value				12%	14%	18%	6%	32%
adjusted acquisition price				8%		9%	4%	9%
at the lower of acquisition price or market price (value)								12%
equity method						2%		

Table 1. Methods of valuation of selected items of assets and liabilities (100% - 355 companies)

Receivables are valued at the required repayment amount, observing the conservative accounting principle. In turn, amounts receivable and loans granted classified as financial

assets are usually measured at market price or otherwise determined fair value (6% of all firm) and adjusted acquisition price (4%). Short-term investments of listed companies are usually valued at market price or fair value – method applied by 32% firms. Shareholders' equity, save for treasury shares, and any other assets and liabilities may be valued at their nominal value, that for the investigated companies is obvious. The NewConnect listed companies often don't include in their reports information about the valuations of assets, which they do not have. As a general rule, if the balance sheet position is set to zero, in the introduction to the report lacks information concerning valued methods of this position. It can be assumed that many companies creates accounting policy under the current needs, assuming that, in the case of the emergence of new assets or liabilities, they will supplement it by annexes.

From the point of view of testing in case of impairment of assets, the way of using of assets and discharging liabilities is extremely important, because it determinates its net selling price or in case of its lack - its fair value (determined in other way), especially when assets can be held for internal use by the company or for sale or resale. The impairment loss decreases the value of asset to net selling price or in case of its lack - to in other way determined fair value [article no. 28 point 7 of Polish Accounting Act]. In accordance with *IAS 36 Impairment of Assets*, the impairment loss decreases the value of asset to recoverable amount (the higher of an asset's fair value less costs to sell (sometimes called net selling price) and its value in use). Impairment loss is recognised when it is very likely that an asset controlled by the company will not bring, in whole or in part, expected benefits in the future. The impairment loss is an expense in the income statements (unless it relates to a revalued asset where the value changes are recognized directly in equity). In 2010-2011 testing in case of impairment of assets, conducted by NewConnect listed companies, resulted in write-downs on the value of assets, most often for trade receivables (60%), long-term receivables (35,77%), long-term investments in related enterprises (26,48%) and inventories of materials (24,23%) (Table 2). Impairment occurs when there is a huge probability that controlled component of assets will not bring in the future, in greater part or totally, predictable economic profit.

Type of assets valuation	Type of impact of	in balance sheet - revaluation reserve	in P&L statements	
			other operating activity	financial activity
Long-term (non-current) receivables		1,69%	11,55%	13,80%
Long-term investments:				
1. Investment properties		1,41%	10,99%	5,92%
2. Investment intangible assets		2,54%	4,51%	4,23%
3. Long-term financial assets in related enterprises		4,51%	2,25%	11,55%
4. Long-term financial assets in other enterprises		5,07%	1,69%	15,49%
5. Other long-term investments		2,54%	1,97%	11,27%
Current assets:				
Inventories – Materials			24,23%	
Inventories - Semi-finished products and work in progress			13,52%	
Inventories - Finished products			16,06%	
Inventories - Goods for resale			18,87%	
Trade receivables			51,83%	18,87%
Financial receivables			1,97%	13,52%
Current financial assets				29,30%

*Table 2. Effects of adjustment of the value of separate assets in 2010-2011 (% of NewConnect listed companies)*

Provisions for impairment of amounts receivable are recognised in other operating expenses or financial expenses, as applicable, depending on the type of amount receivable to which the provision relates. These provisions are an expense contrary to the provision found in the credit side of the balance sheet and form a sort of liabilities. Cancelled, time-barred or uncollectible amounts receivable should decrease the impairment provisions previously recognised in this respect. The amounts receivable in respect of which no or partial impairment was recognised, should be classified as other operating expenses or financial expenses, as applicable.

Apart from that, adjustment of the value of assets or liabilities relates usually to prudence principle, measurement of the amount due to the company or creditors, changes of exchange rates or their revaluation to fair value. In accordance with the article 30 paragraph 1 of the Polish Accounting Act and the IAS 21 The Effects of Changes in Foreign Exchange Rates assets and liabilities expressed in foreign currencies should be measured no less frequently than on the balance sheet date at the average exchange rate effective on that date and published by the National Bank of Poland.

Adjustment of the value of assets or liabilities can be recognised in the income statements, as other operating or financial revenues or costs, or in the balance statements - directly in equity, as an increase or a decrease in revaluation reserve, or even in cash flow

statements (foreign exchange rate differences or other adjustments). When an increase of assets or a decrease of liabilities appears, a company can recognise revenues (incomes), for instance positive exchange differences of receivables or liabilities expressed in foreign currency, increase of market or fair value of current financial investments or a reversal of impairment in case of terminating causes which lead to forming a write-down. When a decrease of assets or an increase of liabilities appears, a company can recognise expenses (costs), for instance negative exchange differences of receivables or liabilities expressed in foreign currency, or impairment of assets. Revaluation of long-term financial assets over their purchase price resulted in the revaluation reserve. In purpose to verify presumption stated in the introduction concerning significance of differences in the influence of diversifying methods of the evaluation of assets and liabilities, on the financial result and the equity between groups of companies applying different accounting standards: Polish, foreign and international, we conduct ANOVA analysis. To measure the influence of the applied evaluation on the financial result, relying on data presented in the profit and loss account, we create the following indicator:

*Revaluation effects in net income* =  $(- \textit{impairment} + \textit{profit-rov-inv} - \textit{loss-rov-inv}) / \textit{net income}$

where: *impairment* - revaluation of non-financial assets (included in Other operating charges),

*profit-rov-inv* - revaluation of investments (included in Financial income),

*loss-rov-inv* - revaluation of investments (included in Financial costs).

In the conducted analysis we use dates of valuations effects only directly presented in separate items in Profit and loss statement in accordance with Polish accounting act. On account of presenting the effects of an increase of non-financial assets' values, including reversal of impairment, in one common position: other operating income, in the above indicator we omitted these effects of the valuation. Similarly on account of the presenting the exchange differences, both realised and unrealised (from valuation as at the balance sheet date) in one common position: „Other“ included in Financial income or Financial costs, we didn't take them into account in the constructed indicator measuring effects of the valuation in net income. As equity (own funds) contains net income and revaluation reserve, we separate this effects and measure the influence of valuation of long-term financial assets as at the balance sheet date on revaluation reserve. The influence of the applied valuation of long-term financial investments on the equity, presented in the revaluation reserve, we measured as follows: *Revaluation effects in equity* =  $\textit{revaluation reserve} / \textit{equity}$ .

The table 3 presents received findings of the conducted quantitative research of significance of difference in accounting policy of 414 companies listed on the NewConnect stock

exchange, including 383 using Polish accounting standards, 27 using IFRS and 4 based on foreign accounting law applicable in their country. Regarding results of ANOVA analysis, differences in the influence of diversifying methods of the evaluation of assets and liabilities, on the net income, within groups of companies applying the same (especially Polish) accounting standards ( $MS_w=2,044$ ) are more significant than differences in such effects between groups of companies applying different accounting standards: Polish, foreign and international ( $MS_B=0,035$ ). Although the ANOVA analysis for significance of differences in valuation effects in equity, especially in the revaluation reserve, shows different mean effects of valuation and greater differences between groups applying different accounting standards ( $MS_B=465,38$ ) than within groups using the same (especially Polish) accounting standards ( $MS_w=6,883$ ), mean valuation effects in equity for companies applying Polish accounting standards is the lowest and has got the lowest standard deviation compared to the companies preparing financial statements in accordance with IFRS or other foreign accounting standards.

Groups by accounting standards	N	valuation effects in equity (revaluation reserve)						revaluation effects in net income					
		Min	Median	Max	Mean	Variance	Std Dev	Min	Median	Max	Mean	Variance	Std Dev
Polish acc standards	383	-0,032	0,000	0,803	0,011	0,006	0,075	-5,02	0,000	20,671	-0,02	1,866	1,366
IFRS	27	-0,005	0,000	4,185	0,192	0,647	0,804	-8,78	0,000	6,929	-0,07	4,907	2,215
Foreign acc standards	4	0,000	0,063	61,251	15,344	936,648	30,605	0,000	0,000	0,000	0,000	0,000	0,000
ANOVA / Levene's Test		F test	p-value	$MS_B$	$MS_w$	L Test	p-value	F test	p-value	$MS_B$	$MS_w$	L Test	p-value
		67,613	0,000*	465,378	6,883	67,795	0,000**	0,017	0,983	0,035	2,044	0,975	0,378

\* difference of means is significant ( $p<0.05$ );  $MS_B$  -Mean Square Between groups;  $MS_w$  -Mean Square Within groups

\*\* difference of variances is significant ( $p<0.05$ ) - Levene's Test

Table 3. Differences in mean revaluation effects in equity and net income between and within groups by accounting standards

The table 4 presents significance of difference in valuation of 414 companies listed on the NewConnect by 14 sectors. ANOVA analysis presents that differences in the influence of diversifying methods of the evaluation of assets and liabilities, on the net financial result as well as the revaluation reserve in equity, between sectors (groups of companies conducting almost the same operating activity and using similar accounting valuation) is much greater than within companies from the same sector applying similar accounting policy (for revaluation reserve  $MS_B = 19,81 > MS_w = 8,75$  and for net income  $MS_B = 2,934 > MS_w = 2,01$ ).

Groups by sectors	N	valuation effects in revaluation reserve		revaluation effects in net income	
		Average	Variance	Average	Variance
construction	31	<b>0,056</b>	0,019	<b>-0,076</b>	0,595
eco-energy	14	<b>4,375</b>	267,978	<b>-0,258</b>	0,453
trade & e-commerce	78	0,020	0,009	<b>0,048</b>	1,191
informatics	38	0,000	0,000	-0,317	2,353
investments	24	<b>0,070</b>	0,043	<b>-0,077</b>	0,593
media	34	0,000	0,000	<b>0,907</b>	15,095
real estate	19	0,000	0,000	-0,164	0,275
health	22	0,000	0,000	-0,020	0,022
recycling	8	0,000	0,000	-0,159	0,130
technology	34	0,004	0,000	<b>0,058</b>	1,543
telecommunications	12	0,000	0,000	-0,101	0,043
financial services	36	0,001	0,000	-0,244	0,283
other services	51	0,001	0,000	-0,222	0,611
holiday	13	<b>0,322</b>	1,347	<b>0,151</b>	0,401
ANOVA	F test	2,263	<b>0,007*</b>	1,459	0,130
	MS <sub>B</sub> MS <sub>W</sub>	<b>19,810</b>	8,755	<b>2,934</b>	2,010

\* difference of means is significant ( $p < 0.05$ ); MS<sub>B</sub> -Mean Square Between groups; MS<sub>W</sub> -Mean Square Within groups *Table 4. Differences in average revaluation effects in equity and net income between and within groups by sectors*

The received findings of qualitative and quantitative analysis support our presumption that differences in accounting valuation applied by NC firms of different sectors are so significant that exceed differences between different accounting standards: Polish, foreign and IFRS.

## CONCLUSION

Based on the conducted research we can notice that differences in the influence of diversifying methods of the evaluation of assets and liabilities, applied by issuers as part of their accounting policy, on the financial result and the equity (revaluation reserve in equity), within groups of companies applying the same (especially Polish) accounting standards are significant enough to exceed differences in the influence of valuation between groups of companies applying different accounting standards: Polish, foreign and IFRS. It explains why companies listed on NewConnect are allowed to apply such different accounting standards.

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## THE PRINCIPLE OF KNOWLEDGE MANAGEMENT AND THE NEW MODEL OF THE ORGANIZATION IN THE KNOWLEDGE- BASED ECONOMY

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### ABSTRACT

Organizations have always realized that access to quality information and knowledge will help them remain competitive. However, with the advent of rapidly changing business environments, managers are now realizing they need to develop an effective knowledge strategy and provide employees with best available knowledge to support the decision making process. The paper addresses this within the context of how Decision Support Systems, Artificial Intelligence and Information Technology can aid the transformation process of knowledge. The 21<sup>st</sup> century brings along the recognition for the necessity to understand and measure the activity of knowledge management, for which reason organizations and system organizations, together with decisional governmental factors, do their best in order to develop policies that would promote these benefits. Knowledge Management (KM) implies any activity regarding the capture and the diffusion of knowledge within the organization. In our study we analyze the impacts and dimensions of KM upon the innovation and labour productivity within the organization, and how KM affects the firm's innovative performance. A key component of knowledge management is to provide access to stored knowledge components to improve decision making and to facilitate knowledge acquisition by the user. Now, enterprises should create – entirely – new ways of working to survive in a competitive environment. Organizational transformation depends of the creation of a powerful vision of what future should be like. We claim that an in depth understanding of the current functioning is also required.

**Keywords:** knowledge-based economy, knowledge management, the new model of the organization, knowledge, explicit and implicit knowledge, innovation, productivity, diffusion of knowledge

## 1. INTRODUCTION

Innovation is built on collective knowledge sharing activities of, especially, tacit knowledge (Howells 1996, Nonaka *et al.* 1995 and 2000, Gibbons 1994). Dialogue and frequent interaction between different individuals or groups forms the basis for knowledge recombination and creation of innovation. Due to this interaction, relationships and perspectives are shared between employees creating a cooperative atmosphere useful for the transfer of tacit knowledge (Gold *et al.* 2001). At this point, KM gains importance: it is seen as a managerial tool which can promote the knowledge creating and sharing processes essential for innovation. Theoretical approaches, as well as implementation strategies of KM, concentrate a lot on IT related issues (Swan *et al.* 1999, Nonaka *et al.* 2000, 6), Alavi *et al.* (2001). However, knowledge sharing activities cannot be enhanced by IT networks alone. KM is rather an organizational device, a problem-solving tool, which increases knowledge exploration and knowledge exploitation success of firms (Swan *et al.* 1999, 264). Hence, there is a need for a shift towards organizational and personnel issues in KM (Carter *et al.* 2001).

## 2. CHANGES IN KNOWLEDGE MANAGEMENT AND LITERATURE REVIEW

Knowledge Management, new as it is, is changing. In the opinion of Firestone, and McElroy (2002) there are at least three accounts of how it is changing and about how we should view The New Knowledge Management (TNKM). One account, by Mark Koenig (2002), sees KM as a field that was originally driven by information technology, the Internet, best practices, and later lessons learned, and most importantly knowledge sharing. This theory sees a second stage of KM as about human factors, organizational learning, and knowledge creation viewed as the conversions among tacit and explicit knowledge. The third stage of KM is the stage of the arrangement and management of content through taxonomy construction and use, and like the first is also heavily biased towards information technology.

The second view of change, by David Snowden (2002), is a bit more subtle than the first. According to this theory, the first age of knowledge management is one in which the word knowledge itself was not at first 'problematic,' and in which the focus was on distributing information to decision makers for timely use in decisions. The second age replaced the information technology focus with one on tacit/explicit knowledge conversion inspired by Nonaka's SECI model. It is just ending. Snowden contends that the third age will be one in which: knowledge is viewed paradoxically as a thing and a flow; context, narrative and content management will be central to our view of KM; Further, he believes that there will be an understanding of organizations as engaged in sense Knowledge Management, new as it is, is changing. There are at least three accounts of how it is changing and about how we should view 'The New Knowledge Management' (TNKM). One account, by Mark Koenig (2002), sees KM as a field that was originally driven by information technology, the Internet, best practices, and later lessons learned, and most importantly knowledge sharing. This theory sees a second stage of KM as about human factors, organizational learning, and knowledge creation viewed as the conversions among tacit and explicit knowledge. The third stage of KM is the stage of the arrangement and management of content through taxonomy construction and use, and like the first is also heavily biased towards information technology.

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The third view of change, first presented by Mark W. McElroy (1999) based on work hosted by the Knowledge Management Consortium International (KMCI) and continuing

partly under its auspices since then, views first generation KM, also called 'supply-side KM,' as primarily about integrating ('supplying') previously created knowledge through knowledge distribution, sharing, and other integrative activities. It is typically associated with two well-known phrases that serve as the mantras for advocates of the 'knowledge sharing' side of KM: (1) It's all about capturing, codifying, and sharing valuable knowledge, and (2) It's all about getting the right information to the right people at the right time. The third view sees second generation KM as first appearing in the mid-90s and as being focused not only on 'supply-side' knowledge processing such as knowledge sharing, but also on 'demand-side' knowledge processing, or 'knowledge-making' in response problem-induced demands. This combined focus on knowledge integration and knowledge production is the defining characteristic of second generation KM (SGKM), or alternatively, The New Knowledge Management (TNKM). But an important aspect of it is also the recognition that organizations are permeated with complex adaptive systems phenomena, and that knowledge management in them is about using KM to enable or reinforce self-organization in knowledge processing for the purpose of achieving sustainable innovation in support of organizational adaptation.

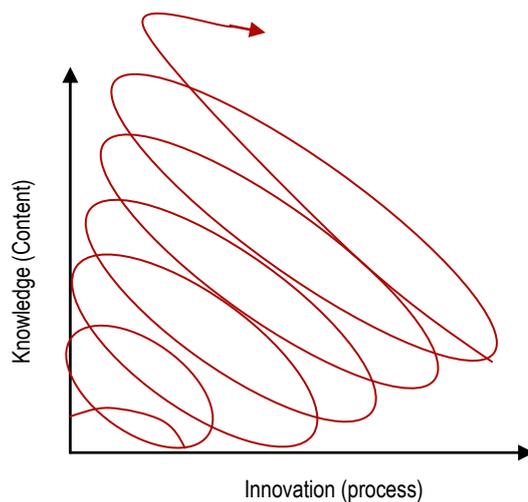
So in light of these contrasting views the questions arise: which of the three views is correct? Are there two generations, stages or ages of KM? Is a third age about to begin? Or are there already three? Are the changes best seen as occurring along the information technology dimension? Or along linguistic dimensions such as taxonomy construction, context, and narrative? Or in terms of whether we view organizations as mechanisms, or CASs, or CASs modified by human Promethean interventions? Or just in terms of the popularity of different intervention types from one period to another? Or is change in KM best viewed as occurring in terms of the shifting focus of management on the scope of knowledge processing as identified by McElroy?

### **3. THE NEW MODEL OF THE ORGANIZATION IN A KNOWLEDGE-BASED ECONOMY**

In the past decades, there has been a (re)birth of the principles and practices related to education, development, and learning. With the advancement of technology and the increasing complexities of the marketplace, executives began to realize that learning no longer could be isolated to the classroom. A new *community of practice* merged to focus on the learning organization. Ray Sata (1987) and CEO of Analog Devices, in a *Sloan Management*

*Review* article described the business implications: ‘... an organization’s capacity to learn as their only sustainable competitive advantage – especially in knowledge-intensive industries’. An entire new way to view the innovation process was born.

One way to show the relationship between these key elements of modern management is presented in Figure 1. Managers need to focus on *knowledge* as the evolution from data and information. This provides a way to describe the *content* that needs to be managed. The second focus is on *innovation* as the process. However, in this regard we are framing the process from the movement of ideas rather than the advance of technology *per se*. The *methodology*, which is the real-time *learning*, is the only way to increase the content level of knowledge and ensure business results through the full innovation process. The increasing spiral represents an accumulation of value throughout the process if both domains (*i.e.* content and process) are managed simultaneously. Anything less is a suboptimal strategy.



**Figure 1.** Integrated Focus: Knowledge and Innovation

Current market conditions are likely to intensify over the next decade. Organizations must develop new ways to incentives, capture, and utilize new ideas expeditiously. The intangibles must become measurable in both qualitative and quantitative terms. The answers are unlikely to be found in current practice. In fact, the most superior benchmarking capabilities of best practices – even in KM – can provide only signals of direction as companies try to gauge their proximity to the norms of best-in-class.

Internal knowledge of the firm refers to product and process specifications and capabilities, technology capabilities, inter-operability, reconfigurations, organizational culture, employee skill sets and leadership. The external knowledge refers to the knowledge of markets, competitors, technological trends, changing consumer preferences and others. It also refers to the knowledge present in other players in the marketplace and other collaboration mode acquires the knowledge for its own use (Ștefănescu & Ștefănescu2008).

The globalization appears when the companies, the regions, the nations and the continents are in the permanent competition in the attraction of investments, the thing that depends in a great measure on the conditions which influence the competition in the businesses. The competition in the businesses, at its turn, bases more and more on the capacity of answering promptly at the clients' needs. This thing means the control of a big volume of knowledge through the medium of the utilization of the information technology (Rodrigues 2002). Of course, the knowledge itself is not a new concept; it always is the base of the human activity. That what appears as the novelty is the rhythm in which it creates, it accumulates and it is diffused, in an economy and in a society based on a new scientific paradigm. The conditions of work and life were redefined, the markets and the institutions got a new form after the new rules and the possibilities of information exchange. More, the knowledge becomes not only the incomes source for the population, the businesses and the nations, but it also becomes a primary source of differentiation between these. In other words, although the knowledge is the key of the rising competition, it can also bear at a regress of the social cohesion and at a discrepancy more and bigger between the regions, the countries and the continents.

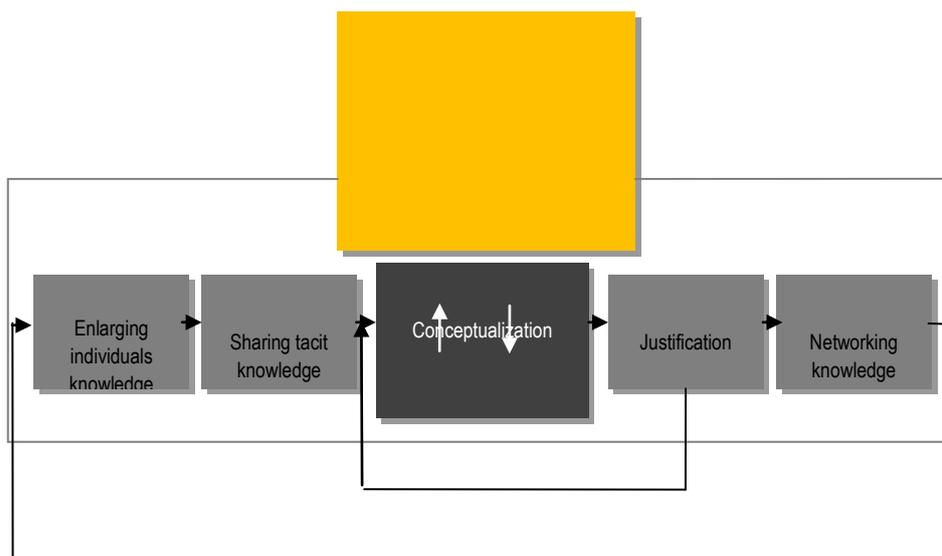
And now the knowledge is the key source, the human factor, which materializes a big part from the knowledge, this gets a terrain more and bigger. This thing does not lead towards a capital question: in what measure can the well trained human source counter-balance with the European populations in the continuous process of ageing?

The European leaders already have recognized that the transition towards a knowledge-based economy also implies a fundamental exchange, and that all the provocations that Europe meets must be reformulated in the light of this terror.

#### **4. KNOWLEDGE AS STRATEGIC POINT OF KNOWLEDGE-BASED ECONOMY**

From the beginning of the 70s, the most advanced economies of the world passed through a process of structural exchange, passing from the industrial economy based on the work, with the capital resources and the creation, the diffusion and the exploitation of the new knowledge. One from the main features of this exchange is the structural intension of the research activities. In the rising *knowledge-based economy*, which is also named the *learning economy*, the economical increasing depends more on the investment in the information, what bears to the increasing of the production capacity, than the traditional factors of production (Lundvall and Jonhson1994). With the other words, the knowledge brings with itself the other types of investments (Abramovitz and David 1996). Within the production function, where the knowledge becomes the basal factor, the human resources and the professional abilities play a more important role. The human factor is the key element in the creation of new knowledge and in the dissemination and their assimilation in the big sectors of the industrial, commercial and social life.

*Process of generating information/ knowledge in the market*



**Figure 2.**Organizational Knowledge Creation Process

Organizations nowadays are playing a critical role in mobilizing tacit knowledge held by individuals and provide the forum for a 'spiral of knowledge' creation through socialization, combination, externalization, and internalization. As knowledge emerges as an ever more important feature of advanced industrial development, it is necessary to pay

increased attention to the processes by which it is created and the assessment of its quality and value both to the organization and society.

The new elements of knowledge were however the source of the big economic progress in the past. The importance of the knowledge for the economical increasing was recognized in the specialty works from the last two centuries. The economists, as the historians always were conscious of the importance of the accumulation of the necessary knowledge for the rise on long term (see the classical operas Marx and Schumpeter). Abramovitz and David (1996) say that the importance of the intangible investment increased in a considerable way in the perspective. In the second half of the 19<sup>th</sup> century, the rise of the physical resources on the worked hour counted for the two thirds from the rise of the work productivity, and at the end of the 20<sup>th</sup> century represented only a fifth from this.

What is new is the movement of the production and of the knowledge dissemination. In the production process, in the accumulation in the infusion of the knowledge a fundamental exchange happens, and this thing had the bigger implications than the technical or economic implications. Without being exhaustive, we could describe the **transition process towards a knowledge-based economy** from three points of view (Lundvall2001, 45 – 60, Rodrigues 2002, 1 – 27, Soete 2002, 28 – 53, Viginier2002): the impact of the new key technologies on the process of creation, the diffusion and the exploitation of new knowledge and implicitly on the economical rise, the intensification in the production, the diffusion and in the implementation of the technological organizational and institutional innovations; the rising impact on all the aspects of the society.

#### ■ The impact of the new key technologies

The new technologies and their crowned of success diffusion had a decisive impact on the economy and on the society. The three new technologies are staying at the base of the transition process towards a knowledge-based economy now. Essentially, there are the Information Technologies and Communications (ITC), which remained still from the 8s0. Recently, the biotechnology demonstrated that it has an increased potential and it had a recognized impact on many fields of the economic and social life. A third key technology of the 21<sup>th</sup> century is the nanotechnology. These key technologies have the revolutionary qualities. Technically, the key technologies are those which give rise to the new technologies and influence decisively those which already are existent; with the other words they have

horizontal effects on many industrial sectors, with the consequences on all the economy. They can be a catalyst for the radical technological progress, which can bear not only at the exchanges in the innovation process of the firms, but they can also have a strong impact on the society. ITC, the bio- and nanotechnology seem to have all the features of the key technologies, namely they can influence strategically the new products, the processes and the employment. Really, ITC has already had an important role, as the basal mean, of collection, of stockage and diffusion of the codified knowledge. With its help the information exchange is made easier, without the temporary or partial compulsions. It increases the efficiency of the knowledge production and it hurries the accumulation of these.

The bio- and nanotechnologies have a horizontal impact on all the industries. They generate the technologies included in a larger gamut of products and of processes, as the semiconductors of nanoscale would be which will revolutionize the information technology.

More, these technologies seem to react more and more one with the other, creating the new fields and the applications as the bio information science (*e.g.* IT which helps at the study of the genetic chain) or the nano-biotechnology. Their use more and more often in the diverse technological borders, what makes that the distinction be made harder and the products and the processes be redefined. Therefore, the rising utilization of these technologies changed significantly the perception about the innovation process in the last decade. In fact, many authors classify the innovator capacity less in function of ability of discovering the new technological principles, but in function of ability of exploiting systematically the effects of the new combinations from the cadre of knowledge already existent (David and Foray (1995)). The access at the knowledge of the already existent artistic works becomes more and more important and helps the innovators that they know the other innovators' work. In the knowledge-based economy, the scientific and technological system evolves towards a structure of the production of the more complex 'socially distributed' knowledge. After how Soete (2002) affirmed the ex-system was more based 'on a simple dichotomy between, on the one hand, the wanted learning and the generation of the knowledge (the research labs – the development and the universities) and, on the other hand, between the activities of production and consumption, where the motivation of making was not the accumulation of new knowledge, but the getting off the contrary effects'. In the knowledge-based economy this dichotomy is somewhere destructive.

With the other words, there is a bigger diversity of 'the learning organizations', where the production and the knowledge assimilation become the basal objects (David and Foray

1995, 16 – 38, Smith 2002). Moreover, Ștefănescu A. (2008) shows that organizations invest in information technology in an effort to more expeditiously gather and analyze information and to create and share knowledge that can be leveraged for improving performance.

The motivation of this paper is to draw attention to important issues of technology in capturing, codifying and disseminating knowledge throughout the organizations. It reflects the need to store not just different forms of knowledge, but different types of knowledge. However, it should be remembered that an overemphasis on technology might force an organization to concentrate on knowledge storage, rather than knowledge flow. New insights and opportunities are available to organizations if they are able to integrate knowledge across shared and different contexts.

The Internet has enabled the creation of virtual communities, networked through technologies only available just a few years ago. As the Internet is becoming the standard form of collaboration between organizations, the trend of the e-knowledge network looks set to continue. While technology can greatly enhance an organization's knowledge management strategy, it does not necessarily ensure an organization is managing its resources and capabilities in the right way. However, technology is vital to enable the capturing, indexing, storing and distribution of knowledge across and with other organizations. Knowledge is more than a fad and it is now at the centre of an organization's strategic thinking. The essence of any knowledge management strategy can be summed up by the following quote, from Drucker (Drucker (1993)'... *A company's key to success resides not so much in its work and capital as in the capacity to treat knowledge, corporate knowledge, be it explicit or tacit.*'

#### ■ Technological, organizational and institutional innovations

It is clear that the diffusion of a knowledge-based economy represents more than a temporary intensification in the production of technological innovations in some sectors.

A bigger exchange happens in all the sectors of activity, from the manufacture and the agriculture, under the influence of the new technologies. The technological innovations invade all the economic sectors and they change our lives. More, this exchange is not only technological, but includes the institutional and organizational basal innovations, because it reformulates the rules after that the economies, the businesses and the institutions works, because of the new possibilities of changing and of exploiting of the knowledge. The

knowledge management becomes a key element of the strategically management, putting into service the relation between the marketing, the research and the production, and modifying the way in which the organization works. Beyond these organizational innovations, the diffusion, during the years 90, of the protection of the intellectual right for the new types of knowledge, was an essential innovation, because it made more attractive the instruments in the products and in the companies of high technology. During the 90s, the offices of European and American patent magnified the concept of invention which is protected by a patent, presenting the new field as the *life sciences*. From 1995, The *Patenting Office* approves inclusively the researches about the genetic chain. During the 90s it was recognized in USA and in a part of Europe, the author right at the software packet (the program of computer without the physical intervention). In the last years, the intellectual protection was extended by the businesses methods (Viginier 2002, 148 – 152).

In USA, it helped and even it stimulated the industries of software and biotechnology, the market of the high-tech actions and the creation of pilot programs by the researchers. In this context, the development of a capital market in USA, which offers the supplementary resources for the investments in the creation and the accumulation of knowledge, became a basal institutional innovation in the 90s, and it shows that the private financial sector is ready to invest in the new activities based on the knowledge.

The last ten-fifteen years were the witnesses of the exchanges of mark in the production process, as: the extensive use of the assisted production technologies on the computer, the advance in the information technologies and communication, the emergence of the new ideas concerning the organization of the firms, the exchanges in the requirements of the abilities which concern the work and in the workers' preferences for the conditions of more flexible work. Starting from this premise, of recent date, the numerous authors formulated a new paradigm of the firm. Some from these concentrated their attention on the technological exchanges and some of them found that the introduction of the new organizational practices represents the main feature of this paradigm of the exchange.

A third group concentrated, first of all, on the exchange which intervened, in the last 20 years, in the demand at the level of the firm for the force of highly qualified work and at same the time on the analysis of the factors which led at this exchange.

Milgrom and Roberts (1990) concentrated their attention on the manufactured, proclaiming the replacement of 'the production of mass by a vision of the flexible firm and by

a multi-product vision which is characterized through the quality and the big speed of answer at the conditions of the market, while they use the equipment's of advanced technologies and the implications of these for the efficiency and the performance of the firm and of the new form of organization'. The exchanges concerning the techniques of production and of the implication of these for the efficiency and the performance of the firm are the principal subjects of their theoretical analysis.

Lindbeck and Snower (2003) analyze the exchange starting from 'the taylorist organization (characterized by the charges specialization) at the holistic organization (the relation of the posts, the integration of the charges and the learning from the charges)'.

Bresnahan (2003) considers that the relative demand of force of highly qualified work being the departure point of the analysis, considering that the rising use of the complementary systems of the information technology, the placement of the force of highly qualified work within the organization and the innovative products are the motors of the technological exchanges. A central point in all the types of analysis and a common feature of these studies is the existence of the complementarities between the factors which bear at the mutual rise of their impact on the performance of the firm. From the variety of the realized investments in the knowledge field (the education, the software, the research-the development, the training, etc.), the knowledge management (KM) is the least known equally, quantitatively and qualitatively, but also that of the implied costs and of the balance of this in the profit of the organization. The motivation which stayed at the base of this study starts from the imperious need to know more about these new activities based on the knowledge, about the actual state of the KM as the organizational process between the diverse types of companies and sectors, the multitude of methods and instruments which also developed on the economic effects of the actual practices of the KM.

The denomination of knowledge-society is used in the entire world today. This denomination is an abbreviation of the term of knowledge-based society. The knowledge society supposes (Drăgănescu 2001): an extension and the thoroughness of the scientifically knowledge and of the truth about the existence; the use and the KM which is existent under the form of the technological and organizational knowledge; the production of new technological knowledge through the innovation; a dissemination without the precedent of the knowledge to all the citizens through the new means, using prevalently the Internet and the e-book and the use of the learning methods through the e-procedures (e-learning), the knowledge society has a global character and it is a globalization factor; the knowledge

society is fundamentally necessary for assuring a sustainable society ecologically; the knowledge society represents a new economy in which the innovation process (the capacity to assimilate and to convert the new knowledge for creating the new services and products) becomes determinant.

The innovation, in the knowledge society, follows the improvement of the productivity, not only the classical productivities in rapport with the work and the capital, but also the new productivities in rapport with the energetic resources and the natural materials, with the protection of the environment. Because of that the new economy supposes the encouragement of the creation and of the development of the innovator enterprises with a structure of own knowledge. Such enterprises are born from the cooperation between the firms, the universities and the governmental or public institutes of research (inclusively the academic institutes).

There were defined two big classes of vectors of the knowledge society (Drăgănescu2001): the technological vectors; the functional vectors. A vector of the knowledge society is an instrument which transforms the informational society in a knowledge society. For making the first steps in the knowledge society it is necessary the detent of a minimum number of alike vectors. The first alike vector is the creation of an developed Internet which is a technological vector, then the technology of the e-book (the technological vector) and the knowledge management, (the functional vector with two valences, one for the economical and organizational working of an enterprise, of the corporations, of the multinationals or of the companies, the other for the moral use of the knowledge in the globalized society). But the number of these vectors of the knowledge society is much bigger, every new vector bringing a step before in the development of this society.

## **5. KNOWLEDGE MANAGEMENT FOR ENTERPRISES, ORGANIZATIONS, INSTITUTIONS, NATIONAL AND LOCAL ADMINISTRATIONS**

One from the first studies of our country regarding the KM was published by Ștefan Iancu (2001). In this study the accent is put on the notion of intellectual capital and of economical, creative and innovating organization. In the occidental literature (Thomas and Prusak,1998,Koulopoulos, Spinello and Toms 1997, Leonard-Barton 1955,Nonaka and

Hirota 1995, Thomas 1997) a series of dedicated volumes to the enterprises and to the knowledge appeared.

The problem of the management in rapport with the knowledge is looked in two ways: as the organization management which is preoccupied of the utilization and of the integration of the different types of knowledge; as the proper knowledge management. In fact, these aspects must normally joint in a general vision about the organization and the knowledge management.

The specialty literature abounds in the definitions of the KM (Earl and Scott 1999, 29 – 38.). The most referred definition of the KM is in our opinion the definition given by the *Knowledge Management Practices Survey* in accordance with which, ‘...the knowledge management implies any systematic activity regarding the capture and the diffusion of the knowledge by the organization...’ Another assimilated definition of the KM concept would be that this represents the conceptualization of an organization as integrated system of the knowledge, and the effective management of the organization uses the respective knowledge.

The information refers to the knowledge and the innovation processes and at the artefacts which tolerate them.

In this definition, the focus is put on the organization management which must in fact include KM, too. The anterior definition avoids, it is recognized, not only the KM, but especially the extremely delicate problem of the knowledge measurement. The diverse authors present the considerations about the different aspects of the KM in the largest meaning of the notion or only from one from the two mentioned points of view before. Thus, C. Grayson shows in every organization there are the hidden knowledge tanks which are not known and which must be knowledge mining, captured, organized and transferred for contributing at the rise of the value, of the profit and of the efficiency. Madhavan and Grover (1998) pay attention to the KM for the *development of new products* (DNP). The DNP management must put the accent on the processes of the cognitive groups and not on the social processes, for using the tacit knowledge of the members and for becoming interesting firstly for the members of the group. The group needs a leader who constitutes such a group. Marshall (1997) shows us that the KM refers to the control and the utilization of the intellectual capital in an organization. The author affirms clearly that not information, but the knowledge is the biggest asset of an institution. He recommends that an institution have a

Chief Knowledge Officer. This must count on the intranet of the institution for assuring the discovery and the creation of knowledge in the institution.

For Romania, the phenomena and the processes which happen on the international plan, contouring the transition from the industrial society at a new type of society, represents a chance, that of the integration in the process of transition from the industrial society at the knowledge society, without running over all the preliminary stages. The Romanian reconstruction can determine the fundamental mutation which stays at the base of this transition: the mutation from the specific institutional centre of the industrial society (the enterprise) at the institutional centre of the knowledge society, the school and the research institutes, which does not act 'from outside' of the productive system, but as the endogenous factors of the production process.

## 6. CONCLUSIONS

In the modern knowledge-based economies, the firms increased the individual and collective knowledge as the major factor of the economic performance. The firms were bigger and their relations with the intensive industries in the technology were stronger, they were in measure to implement the KM policies, as they promoted the culture for the information and the diffusion of the knowledge, motivating the personnel and the managers that they remain in the company, making the partnerships and the fusions for the acquisition of the knowledge, implementing the KM rules.

Another motivation of this paper is to draw attention to important issues of technology in capturing, codifying and disseminating knowledge throughout the organizations. It reflects the need to store not just different forms of knowledge, but different types of knowledge. However, it should be remembered that an overemphasis on technology might force an organization to concentrate on knowledge storage, rather than knowledge flow. New insights and opportunities are available to organizations if they are able to integrate knowledge across shared and different contexts.

The Internet has enabled the creation of virtual communities, networked through technologies only available just a few years ago. As the Internet is becoming the standard form of collaboration between organisations, the trend of the e-knowledge network looks set to continue. While technology can greatly enhance an organisation's knowledge management strategy, it does not necessarily ensure an organisation is managing its resources and

capabilities in the right way. However, technology is vital to enable the capturing, indexing, storing and distribution of knowledge across and with other organisations. Knowledge can be viewed in a number of other contexts, it is vital each is addressed if an organisation is to improve performance.

- Successful knowledge strategies depend on whether organisations can link their business strategy to their knowledge requirements. This articulation is vital to allocating resources and capabilities for explicating and leveraging knowledge.
- The competitive value of knowledge must be addressed to assess areas of weakness. Strategic efforts should be made to close these knowledge gaps to ensure the organisation remains competitive. The strategic value of knowledge should be addressed, focusing on the uniqueness of knowledge.
- Finally, an organisation should address the social aspects affecting knowledge initiatives, namely cultural, political and reward systems. Beyond the management roles proposed in the paper, the environment should promote co-operation, innovation and learning for those partaking in knowledge based roles.

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## ARE CONSUMERS OF HEALTHY FOOD ECOLOGY MINDED AS CONSUMERS OF HEALTHIER FOOD IN ISRAEL?

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### ABSTRACT

Healthy food consumption is a cultural trend, based on the assumption that natural ingredients have a positive impact on health. Healthier food is focused mainly around the phenomenon of obesity represented by calories, fat, trans-fat, sugar or salt. We found that the profiles of consumers of healthy and healthier food are different. The healthy Israeli consumer is ecology minded and care of the health of his children. There is no difference between both genders. The positioning of healthy products must be focused on content value related to ecology, children's health and on preventive medicine for their relatives.

The healthier food consumer has a different profile than the healthy food consumer. He is not ecology minded. Nutrition content related to obesity is the only common denominator of healthier food consumers.

**Keywords:** healthy food, ecology, consumer behavior, healthier content, product positioning

### INTRODUCTION

Seventy nine percent of top executives in the food and beverage business agree that healthy nutrition is the key issue driving the industry forward, ahead of convenience and price growth pressure (Deloitte, 2012).

Healthy food is a global and growing trend (Nielsen, 2012; Feunekes et al., 2008; Nørgaard and Brunsø, 2009; Grunert, Willys, 2007). The desire to maintain good health is of prime concern for consumers, and they read labels in order to obtain information about ingredients, nutrition (Wills et al., 2009), and negative nutrients in food products (Cowburn and Stockley, 2005; Drichoutis et al., 2006).

Consumers in North America show the highest confidence in understanding nutrition labels. Nearly six in ten (57%) regional respondents indicated that they mostly understand the details of such labels. This result is based largely on U.S. respondents, as consumers in the U.S. appear more comfortable with the labels than are Canadian consumers. Fully 58% of U.S. respondents report mostly understanding the information, compared with 49% of Canadian respondents (Nielsen, 2012).

Eight in ten Americans make an effort to eat healthfully; 42% are highly concerned with the nutritional content of the foods they purchase (FMI, 2011a,b). The overall U.S. healthy foods sector has sales of approximately \$140 billion (NBJ, 2011a). Nine in ten American consumers agree that processed foods are not as healthy as fresh foods (MSI, 2010). In 2011, 56% switched to whole-grain bread, 42% to whole-grain pasta, and 39% to whole-grain rice (FMI, 2011a). Forty seven percent stopped buying foods they perceive to be unhealthy, and 46% buy new healthy products that they have not bought before (FMI, 2010). Sales of organic food reached \$23.4 billion in 2010, and natural food sales were \$18 billion (NBJ, 2011).

European consumers are split, with 45% reporting a strong understanding of nutritional labels. Sixty percent of Portuguese respondents largely understand nutrition labels, the highest percentage for any country reported in the study. Similarly, at least half of respondents mostly understand food labels in Italy (59%), Denmark (53%), and Spain (50%). French consumers are the least likely to understand nutrition labels, with only 31% (Nielsen, 2012).

The Asia Pacific region has the lowest percentage of consumers with a full understanding of nutrition labels, and only 31% are mostly comfortable with this information. One fifth of consumers in Taiwan and Hong Kong and one quarter of respondents from China and South Korea indicate that they mostly understand nutritional labeling.

Customers driven by emotions buy and consume healthy products Customers driven by brain buy healthier products (Kemp and Kopp, 2011; Garg et al., 2007). A reduced-salt snack is better than a fully salted snack, but it remains a salty product (GulAygen, 2012). By healthy food, top executives in Deloitte's research refer to both healthy and healthier foods.

Few studies tried to analyze separately these two growing markets in order to adapt products to the two different consumers' profile.

Food manufacturers are satisfying the consumers' desire for healthy and healthier versions of their products (Dawson et al., 2008; Golan et al., 2009). General Mills launched

FiberOne, Kellogg of Kashi, a healthy product. The introduction of Smart Balance by GFA Brands (Grunert and Willys, 2007) is a move to offer mainly healthier versions of existing products.

The objective of the present research is to analyze the profile of the consumer of healthy and healthier food in Israel, and to compare it with similar consumers in other countries.

## **NEW FOOD TRENDS**

A majority of consumers worldwide agree that there are benefits to eating healthy foods such as whole grain/high fiber foods (71%), yogurts with acidophilus cultures/probiotics (63%), or healthier products such as iodine-enhanced cooking salt (58%) and cholesterol-reducing oils and margarines (56%) (Nielsen, 2012). Regional differences reflect customs and traditions. Soy milk ranks fourth on the list of products purchased regularly and occasionally in Asia Pacific, and tenth or lower in Europe, the Middle East, and North America. Cholesterol-reducing oils and margarines are more popular in Latin America (73%), the Middle East/Africa (71%) and North America (64%) than in other parts of the world.

Healthy products meet a demand by consumers seeking natural foods in order to prevent major risk factors for a range of chronic diseases, including cardiovascular diseases, cancer, and diabetes (WHO, 2011). Fifty eight percent of American consumers buy healthy products in order to prevent diabetes, 57% to loose excess weight, 56% to prevent high cholesterol, 48% to prevent digestive disorders, 46% to lower the risk of cancer, and 42% to prevent cardiovascular damage (Hartman, 2010). Cocoa/dark chocolate is now in the top quintile of consumer ingredients of high interest/awareness, on par with antioxidants, vitamins/minerals, omega-3s, and whole grains (HealthFocus, 2010). Young adults aged 18-24 remain the top users of functional foods and beverages (Mintel, 2009). Oatmeal and yogurt are the products most frequently purchased for their specific health benefits (Packaged Facts, 2012).

Fifty percent of consumers deliberately avoid preservatives, 49% MSG, 47% artificial flavors, 44% colors/dyes, 43% hormones/antibiotics, and 29% genetically modified organisms (GMOs) (Hartman, 2010a). Two-thirds of moms monitor their children's diets very closely; 60% of families practice some form of healthy eating strategy (MSI, 2010; FMI, 2010). More than one-third make a strong effort to increase their child's consumption of calcium,

vitamins/minerals, whole grains, protein, and vitamins C and D; 24% are working to increase fiber intake, 20% omega-3s, and 18% probiotics (MSI, 2010).

Saturated/trans fat was at the top of consumers' "to avoid" list. Fifty nine percent of shoppers considered information about both to be highly important. Next on the list is fat content, which is very important to 56% of consumers, followed by salt/sodium at 52%, calories at 48%, and chemical additives at 47%.

Dietary supplements are a key indicator of interest in individual nutrients concerning fortified foods, and their use is at an all-time high: 69% of adults took a supplement in 2011. Among users of supplements, 53% took them regularly, 36% used a variety of them, and 71% took a multivitamin (CRN, 2011). Omega-3/fish oil passed calcium last year as the second most-used supplement; calcium was tied with vitamins D and C for third place.

Organic foods belong to this category. Organic products are pesticide-free, hormone-free, contain no chemicals, no pollutants, no antibiotics, and no genetically altered organisms. Consumers of organic foods support "non-mass marketed" products (Zahaf, 2009; Fotopoulos and Kryskallis, 2002; Larue et al., 2004; Wier and Calverley, 2002; Grankvist et al., 2007).

Some studies have demonstrated the effects of organic foods. For example, an organic diet may reduce the risk of Parkinson's disease (Baker, Thompson, and Engelken, 2004), whereas consumers of products exposed to pesticides had a 1.6 times greater risk of developing Parkinson's disease (Baker, Thompson, and Engelken, 2004).

Scholars have profiled organic buyers in order to describe who they are and what their purchase intentions are (Davis et al., 1995; Fotopoulos and Krystallis, 2002; Roddy et al., 1994). Based on observation of the organic food industry, Tutunjian (2004) noticed that organic consumers share attitudes and values rather than demographics. The socio-economic profile of organic food consumers shows that organic purchasing grows as consumers reach into their 30s and have no children.

People who are among the highest spenders on organic food are on average more affluent and younger (Padel and Foster, 2005), well-educated, professionals or white collar workers, willing to pay a premium for organic foods and ecology minded (Hamzaoui-Essoussi and Zahaf, 2012).

Choosing to feed an organic diet to a baby is said to have many health benefits, including lowering a baby's risk of asthma and allergies, decreasing the chances of being selective or picky eaters, improving the baby's digestion and immune system, and decreasing exposure to toxic chemicals (Protecting the next generation, 2009).

Consumer behavior with respect to healthier products is related mainly to obesity. In 2011, low-fat/fat-free remained the largest selling products related mainly to obesity but including also lowering a baby's risk of asthma and allergies, decreasing the chances of a child being selective or picky eater, and improving the baby's digestion and immune system

. In 2011, low-fat/fat-free remained the largest "avoidance market" (i.e., nutrients consumers are seeking to avoid) in supermarkets, with sales estimated at \$46 billion; sales of reduced-calorie products were \$10.4 billion, and sales of low sodium/ low-salt offerings totaled \$10 billion (Nielsen, 2011).

The market for healthier products is broader than that for healthy foods. More than half (53%) of consumers worldwide consider themselves to be overweight, up from 50% three years ago (Nielsen, 2012). The worst situation is in North America with 63%, and in South America and Europe with 58%. According to 70% of global online respondents, the most popular way to shed unwanted weight is cutting down on fats. Trimming back on chocolates and sugary foods (62%) and eating more natural, fresh foods (55%) round out the top three ways in which consumers are changing their diets.

During the period 2007-2010 we observe significant changes in the obesity trend in Europe. Excess weight affects 30-70% and obesity 10-30% of adults in EU countries. Among children of primary school age, the highest prevalence of excess weight (based on Cole et al. cut-offs and measured data) was found in Italy (8-9 years, 35.9%), Portugal (7-9 years, 31.5%), and the Czech Republic (6-10 years, 30.6%); the lowest rates were found in the Czech Republic (11-14 years, 14.1%) and France (7-9 years, 15.8%). Surveys based on self-reported weight and height found a prevalence of excess weight of 21.8% in Belgium (5-9 years) and 19.5% in Sweden (8 years) (WHO, 2011)

The positioning of healthy food as healthier food could extend the market to incorporate a wider range of customers.

## CONSUMER SEGMENTATION

A worldwide survey has found that around a quarter (24%) of the shoppers worldwide always check the nutrition information on the packaging, and 37% check when considering purchasing a product for the first time (Nielsen, 2009). In European countries these values were lower: 18% and 34%, respectively. Significantly more women than men pay

attention to the list of ingredients, nutritional grid, and nutritional claims. According to the UK Food Standards Agency (2011), the ingredients and nutritional value of a product were checked by significantly more respondents with higher education levels than by those with lower education. Moreover, high-income consumers were more interested in the list of ingredients than low-income consumers were.

With respect to the information that consumers look for on a nutrition label, the most frequently mentioned items of information across various studies were calories (Grunert and Wills, 2007; Misra, 2007; Grunert et al., 2010), fat, sugar, and salt (Grunert et al., 2010). These are the characteristics of the healthier food consumer. Less requested was information about iron (Marietta et al., 1999; Misra, 2007), dietary fiber (Marietta et al., 1999; Misra, 2007; Grunert et al., 2010), and vitamin A (Marietta et al., 1999; Misra, 2007), characterizing the healthy food consumer.

In March 2006, after several years of preparatory research and consultation with stakeholders in the food industry, the UK Food Standards Agency (FSA) (2011) announced a scheme for front-of-pack labeling using color-coded signs. The FSA allowed supermarkets and manufacturers to develop their own label designs with an individual look and feel, but recommended that the schemes should comply with four core principles: information about fats, saturated fats, sugars, and salt (which is the information sought by consumers of healthier food).

Unilever has developed a single-score system for the healthier market segment that combines points based on six factors: trans fat as a percentage of energy, saturated fat as a percentage of energy, fat quality as a ratio of saturated to non-saturated fat, salt per unit of energy, total sugars per unit of energy, and added sugar as a percentage of weight (Nijman et al., 2007). Positive points are assigned for beneficial components, such as dietary fiber or fruit and vegetable content for the healthy market.

## **PURPOSE OF THE RESEARCH**

Food companies agree that healthy and healthier food is a growing market with a potential for high profit (Nielsen, 2012). In each country the maturity of potential consumers and their behavioral profile changes according to local culture and openness to new trends. In the present research we propose to compare the profile of the healthy and healthier food consumer in Israel with that portrayed by the research studies cited above and their attitude about ecology.

### *Hypotheses*

If we assume that the Israeli consumer of healthy or healthier food has the same profile as similar consumers in developed countries, the following hypotheses must be proved:

**H1:** The customer of healthy food in Israel is ecology minded. educated and affluent (average-high income), a woman, prefers fresh products and is single.

**H2:** The customer of healthier food is mainly a woman with high education, medium-high income, interested in nutritional content.

### *The sample*

The sample has been randomly selected at Tel-Aviv and surrounding region. We selected participants within a medium-to-high economic and educational level who were more than 23 years old, students in Bar Ilan university or related to them: family or friends.

We explained to the interviewees the objective of the research. The majority, around 80% completed the questionnaire immediately. Others returned them to us by mail. Ten questionnaires were not fully completed and were not included in the study. The final sample included 160 questionnaires.

### *Questionnaire and Variables*

The questionnaire contained four groups of variables:

The first group included personal data: gender, marital status, number of children, age and salary.

The second group included food consumption habits: expenditure for food, scope of products, purchasing frequency, brand, price, nutrition, fresh products, ecology.

The third group was related to healthy food: fiber, no trans fat, no cholesterol, no sweetener, no preservative, minerals, iron.

The fourth group was related to healthier food: low calorie, low fat, low carbohydrates.

Responses were graded on a 5-point scale ranging from 1 (not important) to 5 (very important).

### *Dependent Variables*

The two dependent variables were:

**HF:** Healthy food – sum of scores assigned to each variable belonging to the third group.

**HRF:** Healthier food – sum of scores assigned to each variable belonging to the fourth group

We used the sum of scores for each group of variables because we were interested to take in account the different relative importance of each variable in the group of variables by each one.

## RESULTS AND DISCUSSION

Based on former studies cited above, we assumed in both hypotheses that women tend to be more responsive to healthy and healthier food. This turned out not to be the case of Israeli consumers. Both men as women, whether more or less educated, are consumers of healthy and healthier food.

According to the first hypothesis the consumers of healthy food are assumed to be single with higher income, ecology minded, and with a preference for fresh products. Israeli consumers of healthy food have a higher income (Income), care about ecology, consume fresh products (Fresh), but are concerned with healthy food because they have a family and children (Nchildren).

Their level of expenditure (Expenditure) for food is higher than average and they consume a wider range of products (Scope) than their lower-income peers (Table 1).

The first hypothesis was partially rejected. The higher income and ecology variables were the only ones that were positively correlated with healthy food in both the international and the Israeli cases.

**Table 1: Correlations between Healthy and Healthier variables and customer's profile variables**

		Healthy (HF)	N. children	Ecology	Income
Healthier (HRF)	Pearson correlation	.092	-.018	.025	-.119
	Sig. (2-tailed)	.245	.826	.754	.134
	N	160	160	160	160
Healthy (HF)	Pearson correlation	1	.229	-.182	.256
	Sig. (2-tailed)		.004	.021	.001
	N	160	160	160	160

		Fresh	Nutrition	Expenditure	Scope
Healthier (HRF)	Pearson Correlation	.094	.249**	-.079	-.029
	Sig. (2-tailed)	.238	.001	.322	.719
	N	160	160	160	160
Healthy (HF)	Pearson Correlation	.191	.032	.180*	.173*
	Sig. (2-tailed)	.016	.692	.023	.029
	N	160	160	160	160

Consumers of healthier food have a different profile, and the only significant variable is their interest in nutritional content.

In the following regression, three independent variables, number of children, the habits of buying fresh products, and the attitude toward ecology,, confirm their positive correlation with the healthy behavior attitude (Table 2). The second hypothesis was partially confirmed because of emphasis on nutritional content.

**Table 2: Regression between HF and customer profile variables**

R <sup>2</sup> adjusted: .108		B	Std. Error	Sig.
	(Constant)	14.761	1.955	.000
	N. children	.371	.118	.002
	Ecology*	-.464	.181	.011
	Fresh	1.022	.407	.013

\*1 was the highest mark and 5 the lowest

A healthier behavior attitude as the dependent variable is explained only by the independent variable, Nutrition content (Table 3)

**Table 3: Regression between HRF and customers's profile variables**

R <sup>2</sup> adjusted: .056		B	Std. error	Sig.
	(Constant)	7.376	.302	.000
	Nutrition	.323	.100	.001

The profile of the Israeli customer of healthy products differs from the "classic" profile described in the studies cited above. More than in the past, families care for their children from the point of view of their security, but also of their health. The number of children in Israel is the highest among OECD countries, close to 3 per family, compared with an average of 1.74 in OECD countries (OECD, 2011). This may be the result of the survival effect of the Holocaust and of the conflict situation in the Middle East today. In Israel, children have become one of the main motivations for buying healthy food, especially in

young families. These families are prepared to spend more money on food and prefer to buy fresh products.

The profile of the Israeli consumer of healthier food is similar to the international one. It can be a man or a woman, with low or high income, and with low or high education. The only parameter of interest to the consumer of healthier food is nutritional content.

## CONCLUSION

Positioning of healthy products in Israel must focus on content value related to ecology, children's health and on preventive medicine for their relatives. This is probably true of other countries as well. The issue is the care for their health. In developed countries a lower number of children may also correlate with their health as expressed by MSI (2010) for the American consumer: "two-thirds of moms monitor their children's diets very closely". Firms in the food market should conduct research in this area. As in other researches, consumers of healthier food consume also more fresh products and are ecology minded.

The healthier food consumer has a different profile than the healthy food consumer. He is easier to persuade to purchase a product by outlining its nutritional content, mainly related to weight loss. Symbols on the label, as suggested by the UK Food Standards Agency could be the best way to arouse the interest of this group of consumers.

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## ENTREPRENEURSHIP AND "CLUSTERIZATION PROCESS" IN THE TOURISM AND AGRICULTURE SECTOR\*

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### ABSTRACT

The development of a cluster in rural areas requires appropriate environmental and human capital conditions. Our research shows that businesses at the "family care" level of entrepreneurship attempt to establish new trends in business and are open to improving their entrepreneurial level. Entrepreneurs at three of McClelland's entrepreneurial levels are ready to invest in their own businesses and to cooperate with other businesses. The "need for power" level is even ready to seek external sources of financing. "Connectors," those able to transfer knowledge, are strongly entrepreneurial, ready to take risks, and to pursue new trends in business. But "mavens," who have knowledge, are not ready to share their business knowhow with other businesses. "Salesmen," those able to transform knowledge into added value, belong to the family care entrepreneurial level and are ready to take risks in order to improve entrepreneurship in family business.

Missing in the Western Negev is the networking between businesses, which is needed to create common interests. An open incubator can fill this gap by improving current business activities and generating new, common business activities; supporting connectors and salesmen in their advancing family care businesses; improving efficiency; and supporting mavens by a wider transfer of knowledge using research centers and relevant training programs.

**Keywords:** entrepreneurship, cluster, value chain, networking, rural development, open incubator, tipping point

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## **INTRODUCTION**

Entrepreneurship in rural areas is a challenge in many developed countries. Because farms require increasing means of production (land, machinery, irrigation, etc.) in order to compete, the agricultural workforce is leaving the agricultural production cycle, which necessitates the development of business initiatives in other areas. The rural population of the European Union decreased by 0.8% between 2010 and 2011, compared with a 5.8% growth in the urban population (Eurostat, 2012). To keep the balance between village and town, the EU initiated a program called Leader +, which aims to help develop projects that provide employment in rural areas. Dozens of projects have been approved to be implemented and supported by this program. In a recent document, the European Commission indicated that despite various programs that encourage employment in the rural areas, these areas represent only 17% of all areas of employment growth in the last decade (2012, EU).

The percentage of the rural population in Israel is changing slowly. In 1995, about 510,000 people lived in rural areas compared with about 640,000 in 2010, an increase of 25%. By contrast, the urban population grew from 5.1 to 7.0 million, an increase of about 37%. In the south of the country the situation is worse. Between 2009 and 2010, 72,000 people left the region, compared with 68,000 people who arrived (CBS, 2011), a net loss of 4,000 people.

Existing rural entrepreneurship in the Western Negev is not capable of jumpstarting economic development. The share of earnings from agriculture in household income is decreasing. Industry creates almost no new employment and during the hot summer months tourism is weak.

## **STUDY OBJECTIVE**

The objective of the study is to determine whether the existing entrepreneurial level is able to generate the development of clusters in two main rural sectors of this region, agriculture and tourism, and under which conditions.

## **ENTREPRENEURIAL THINKING**

According to Schwab (2011), entrepreneurship is the innovative fuel that generates employment and economic growth. To promote entrepreneurship, it is necessary to combine economic, social, and cultural activities (Hart, 2003). Wennekers, Uhlaner, and Thurik (2002)

and Peña et al. (2010) distinguished between activity at the level of the entrepreneur (supply side) and that of the business environment (demand side). At the level of entrepreneur, they refer to the ability to establish and develop businesses and examine the entrepreneurs' priorities, education and training, skills, and knowledge. At the business environment level, they refer to environmental conditions that create opportunities for entrepreneurship, such as culture, taxation, R&D, capital, health, economic development, immigration, science and technology, and aid organizations.

The connection between the entrepreneur and business environment levels requires the implementation of a model that supports and encourages appropriate networking between entrepreneurs, and a supportive and nurturing business environment. First, we examine the studies that deal with the profile of the entrepreneur (supply side) and discuss ways to promote entrepreneurship that generates economic development. Next, we consider the business environment (demand side) and the models implemented to promote economic development based on the promotion of entrepreneurship.

The literature on entrepreneurs focuses on aspects of their cognitive perceptual ability and the degree of risk they are willing to take (Pena et al., 2010). Craid (1992) referred to communication skills, analytical skills, knowledge, and the ambition of the entrepreneur. Kurilsky (2000) stressed the entrepreneurial spirit that directs the entrepreneurship. Shane and Venkataraman (2000) emphasized the importance of the combination of identifying an opportunity and realizing it as a major factor in the success of entrepreneurship. According to Wennekers and Thurik (1999), entrepreneurial ability becomes stronger with increasing intensity of activity, level of innovation, willingness to take risks, competitive aggressiveness, and desire for independence. The greater this capability, the better the business results (Keh et al., 2007; Stam & Elfring, 2008; Wiklund & Shepherd, 2005) and the stronger the business growth (Moreno & Casillas, 2008) are.

McClelland (1961, 1977) focused on the motivational potency of distinct levels of self- and social actualization. He calls the first level of motivation beyond necessity the "need for achievement." This level requires personal responsibility, calculated risks, performance feedback, and task accomplishment.

The second level of motivation is defined as "need for affiliation," requiring the "approval" of the community and conformity with its "wishes and norms." The third level of motivation is characterized by the "need for power" to exercise control and maintain leader-follower relationships. Bijaoui (2011) showed that some participants in the Songai (Benin) training

programs had the capability to achieve the first and the second level and a few of them the third level.

Gilad and Levine (1986) and Verheul et al. (2010) distinguished between necessity entrepreneurship and business entrepreneurship. They claimed that the former, defined by them as “push theory,” affects economic development only slightly, whereas the latter, defined as “pull theory,” has a more meaningful effect on economic development.

Bonnet, Nelson, and Le Pape (2011) showed that in the 2007-2011 period 10% of initiatives accounted for 50% of new employment (business entrepreneurship). This means that if we want initiatives to have a greater impact on economic development we must identify and encourage entrepreneurs who have a greater ability than others to influence economic development, in other words, entrepreneurs who are business- and not necessity-minded. Gladwell (2000) argued that socio-economic phenomena can spread like an epidemic if specific entrepreneurial and environmental conditions are fulfilled: those defined by the law of small numbers, stick factor and context.

The law of small numbers is based on three elements: maven entrepreneurs, those in possession of knowledge; connector entrepreneurs, those capable of transferring knowledge; and salesman entrepreneurs, those able to transform knowledge into added value. A small group of mavens and connectors is likely to affect a large number of salesmen and through them create a viral process of economic development.

Giacomin et al. (2011) examined common types of entrepreneurship in 27 countries and found that the share of business opportunity entrepreneurs among new businesses is largest in the Scandinavian countries (Sweden, Norway, Denmark, and Iceland) and in Anglo-Saxon countries (Britain, the U.S., and Ireland), followed by France, Germany, Italy, Belgium, and the Netherlands. Necessity entrepreneurship is more characteristic of European Mediterranean and Eastern European countries.

Entrepreneurship education greatly affects the number of initiatives, in particular the number of business entrepreneurs. Fayolle and Gailly (2009) demonstrated that the introduction of programs for entrepreneurial education to engineering schools increased the rate of business entrepreneurship among students. Research by the Kauffman Center clearly shows that students who completed their entrepreneurship studies are more successful in sales and in the volume of employment they create.

Entrepreneurship education affects entrepreneurship capacity differently for different entrepreneur profiles. The Center for Entrepreneurship at Kingston University studied the effect of the Bright Future training program on the entrepreneurial capacity of trainees (Athayde, 2010). The enrichment program has significantly increased the desire of trainees to become business entrepreneurs: 71.4% of participants in the training program were convinced that they had the skills to start a business, compared with 42.4% before the training. For trainees aged 20-30, the training program had a significantly positive effect on creativity and the willingness to take risks. The desire to work in a team, however, was strengthened at the expense of readiness to lead, especially among those aged 31-44. Strengthening of creativity was particularly evident in trainees with education in social sciences and the arts.

## MODELS FOR ECONOMIC DEVELOPMENT

A cluster is defined as a "geographic concentration of competing, complementary, or supporting firms that develop sale-purchase relationships, use the same pool of technologies, and share customers and existing human resources pools." Firms in a cluster develop competitive advantages based on human capital, the knowledge generated in the environment, and local and international demand (Porter, 1990, 1998). But in order to generate a cluster, business entrepreneurship and an "ignition process" initiated by private interest or a public organization are needed.

### *The incubator as the starting point of a cluster*

The Silicon Valley cluster started as a technological incubator established by the University of Stanford in the early 1950s. Creative enterprises such as HP and Intel were established there in 1967 by former Fairchild Semiconductors employees. The area became a point of attraction for small and large companies alike specializing in the same fields, such as Sun and Apple.

The biotechnology cluster in San Diego developed around the university and research institutes: the Salk Institute, Scripps, and the University of California, San Diego. The initiative began in 1965 with the establishment of Torrey Pines Mesa biotech, which operated as an incubator. The development of the area into a cluster began with the entrepreneur Ivor Royston, who in 1978 founded the company Hybritech, to be acquired in 1986 by Elli Lilly (Bennett, 2008). The success of the Silicon Valley and San Diego clusters is credited largely to the creative entrepreneurship of isolated individuals, at the beginning of their way, who persuaded developers and other firms to follow them.

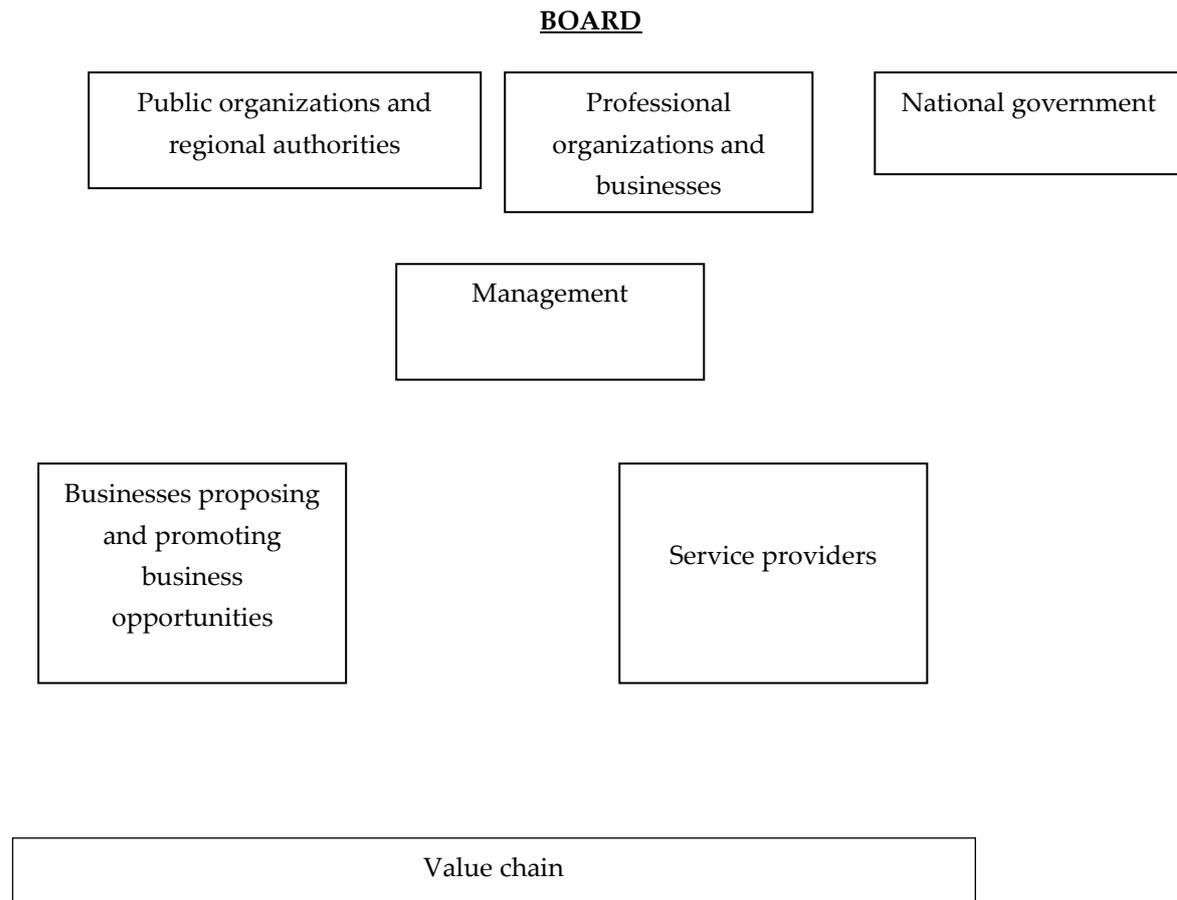
*Government policy initiating a cluster*

Cluster development in Europe is the result of government initiatives in cooperation with local authorities (European Union, 2007). Programs such as EXIST and BioRegio in Germany are the result of federal and regional decisions to support the development of specialized clusters (Colovic-Lamotte & Tayanagi, 2004). The Finnish government supported the networking program "Networking" as a first step, which later developed into specialized clusters in the field of communications in Turku and Oulu. Companies such as Nokia and ABB were part of the same network (TEKES, 2005). Since 2001, the Japanese government has implemented a new policy presented in the Industrial Cluster Plan (METI) and the Intellectual Cluster Plan (MEXT) (Colovic-Lamotte & Tayanagi, 2004). METI includes 19 projects in local clusters, including those dealing with metal parts for machines and parts for aircraft (Higashi-osaka), manufacturing of original equipment for the environmental industry (Hitachi), as well as clusters related to ceramics and metals. MEXT acted primarily to expand the budget of universities and to improve the infrastructure and human resources for technology transfer and patent strategy.

*Open incubator as the generator of a cluster*

Regular incubators create a temporary framework for new small businesses and support a limited number (several dozen) of them. The businesses belong to different business areas, and there is no basis for cooperation between them. At the end of the process, which lasts one or two years, every business must cope with the business environment outside the incubator. It took several years for Stanford incubator and for the San Diego Institute for Research and Development of Torrey Pines Mesa to generate a cluster.

The open incubator (Bijaoui & Tarba, 2012) handles existing and new businesses that belong to the same business area, located in their natural setting. It guides the individual business as a regular incubator would, and it supports the business sector along the entire value chain. The structure of the open incubator is as follows:



The Board represents the interests of the region and of the selected business sector. Management establishes the networking between the businesses belonging to the same value chain and proposes common initiatives related to business opportunities or common business activities. .

Ketels (2004) specified the following conditions for the success of a "clusterization process:"

- Taking advantage of proximity for cooperation
- Linkages between the firms' activities to advance common goals
- Active interaction between firms in the cluster
- Critical mass of firms required to accomplish significant achievement

*Rural "clusterization process"*

In the Lublin area in Poland farmers organized into 110 groups of related industries, and together they market their agricultural produce (fruits and vegetables) to retailers in Poland and the European Union (Walukiewicz, 2003). Also in the Lublin region eight different associations of related industries were established, with various specializations in the field of agricultural tourism, including a hospitality industry with a flavor of local culture and folklore, and manufacturing products such as local fabric for tourists. The association, Ziemia Lubartowska (The Lubartow Country), combines the roles of a common board and management for the different open incubators.

Maniwa, in the north of Okayama in Japan, is an area 80% of which is covered by woods. In 1992 a group of 20 people concerned by the aging of the population and the need for renewal of the traditional industry (Anbumozhi, 2007) initiated the clustering process based on 34 timber plants, 16 plants for drying wood, and dozens of factories producing furniture. Their goal was to establish ecological industries based on wood-processing waste, manufacturing ethanol for the production of energy, cellulose, and construction materials. About 75 small and medium-size firms now specialize in these fields. The local university collaborates with the University of Tokyo in developing knowledge in the field of energy. The area has become a center specializing in energy and has attracted investment and other entrepreneurs.

In Udine, Italy, the manufacturers of wooden chairs in 11 local councils, consisting of more than 1,200 businesses, organized the Italian Chair District as a collective, flexible, and efficient network that combines contemporary influences with local culture. The management of the District acts as an open incubator for part of the value chain (chair manufacturing), and emphasizes common promotional activities. Most businesses employ fewer than 20 employees. A total of 14,000 workers are employed and 250 exporters operate in the cluster.

In 1865 in the U.S. state of Vermont, the first cooperative specializing in the production of cheddar cheese was established. Since then, cheese producers have multiplied in the region. In 1998, the Vermont Cheese Council, the board/management of the open incubator, organized support for cheese manufacturers by the transfer of knowledge from the Vermont Institute for Artisan Cheese and from the local university in training, research, and technical services.

In the southeast of Ohio eight counties organized together and formed the Appalachian Center for Economic Networks (ACENet), a kind of open incubator for the purpose of

developing a "clusterization process" based on processing of agricultural products. From an initial number of about 12 specializations, today they have reached 100. The ACENet Development Center includes a kitchen incubator and a farmers' market. It created a common brand and helped develop find new markets. The opening program, Entrepreneurship in Action, funded by the Appalachian Regional Commission, enables expansion of the clusterization process into packaging, tourism, and the arts.

Networking in the cases cited above was generally initiated by the businesses and supported by local authorities or public institutions: universities, research institutes, or professional associations. They encouraged the activities of the businesses and provided solutions in the areas of training and technical or business knowledge. The degree of support provided by the authorities varies between cases. In the case of Maniwa, 75 firms producing goods from waste wood decided to create a network. The main support from a public institution was provided by the local university in collaboration with the University of Tokyo.

In Udine chair manufacturers have created a network of cooperation among themselves and co-opted the local authorities and public institutions to establish the appropriate supporting infrastructure. In Vermont the networking initiative originated with the cheese makers, and local authorities supported them through the establishment of the Cheese Committee. In Ohio eight local authorities self-organized and together formed a network of producers of processed agricultural products. The authorities initiated the creation of a joint brand.

## **ENTREPRENEURSHIP AND "CLUSTERIZATION PROCESS" IN THE RURAL AREA OF THE WESTERN NEGEV**

### *Tourism generators*

Crouch and Ritchie (1999) developed a complementary approach to the traditional approach to tourism based on local attractions (destination attractiveness) using the concept of destination competitiveness. It is based on four elements: qualifying determinants (location, dependence, safety, cost), destination management (sources, marketing, organization, information, service), core resources and attractors (physiography, culture and history, commercial ties, mix of activities, special events), supporting factors and resources (infrastructure, accessibility, supportive resources, and initiative). Kim and Wicks (2010) distinguished between local, natural, and historical attractions (endowed resources), and

centers that have evolved over time (created resources) such as festivals or other special events.

The hospitality area in the Western Negev evolved around three endowed resources: desert nature, historical sites, and religious sites. The created resources, such as special events, developed around the endowed resources (Figure 3).

#### Endowed resources

- Desert nature

A wide variety of changing landscapes over a small region, desert flora and fauna, many paths in the area that offer various field trips. At the edge of the area there are hot springs that create an environment of relaxation and the possibility to develop paramedical treatment options.

- History

The main historical sites are those of early Jewish settlement in the region and heritage sites connected to the battles of the War of Independence and its aftermath. At the edge of the area there are the ancient historical sites from the times of the Nabateans who controlled the incense route. The remains of four cities are left in the Negev, as well as several fortresses, khans, milestones, portions of ancient roads, remains of ancient agriculture, and waterworks that were declared a World Heritage Site.

#### Created resources

- Nature and the blooming season

February to mid-March is the blooming season in the Negev. The Red South Festival takes advantage of the period of the anemones in bloom and of the pleasant weather to offer a range of activities that attract domestic tourism to the Negev, among them organized tours, open markets of local produce, including cheeses, fruits, and vegetables, music shows, and more.

- Nature and agriculture

There are larger tracts of land in the Western Negev where potatoes are grown. These gave the impetus for a Potato Festival that takes place each year in April, during Passover. The festival includes tours of the potato fields, cooking shows and

demonstrations, activities and workshops for children, potato characters, street theater, and a farmers' market.

- Religion

Netivot in the Western Negev has become a cultural and educational center of the ultra-Orthodox community, especially the Mizrachim, thanks to the activity and the graves of famous rabbis who made their residence there. The most famous among them are Baba Sali (Rabbi Israel Abuhatzzeira), Baba Shalom (Rabbi Shalom Ifergan), and his son Rabbi Yaakov Ifergan. These centers have become a focus of attraction to a wide public.

#### *Agriculture generators*

In the Western Negev, kibbutzim, which are cooperative structures, are responsible for most of the production of crops, mainly potatoes and carrots. Moshavim, private structures, specialize mainly in vegetables, particularly tomatoes, peppers, and fresh spices. At present, no large agricultural organizations are operating in this area, as they used to in the past. Some of the growers are organized and cooperate in selling their produce. Most of them must deal with the local market, a cartel of large retail chains and wholesalers. More than 100 export companies are active in the international market, but few have been able to guarantee stable revenues for the growers.

#### *Human capital and the feasibility of the open incubator in tourism and agriculture*

Our research is focused on two main and related issues: whether the required entrepreneurial capabilities are present in the region, and how the open incubator must proceed in order to generate a "clusterization process."

#### The sample

In the agriculture sector we have identified approximately 500 growers in the Western Negev. Of these, we have selected randomly 53, 13 of which specialize in field crops and 40 in vegetables. In tourism we have selected a sample of 62 businesses, representing 35% of the business population in various specializations: guest houses, agro-tourism, attractions, restaurants, and catering. The total sample contains 113 businesses.

<b>Agriculture</b>	<b>Sample</b>	<b>Estimated Population</b>	<b>%</b>
Field Crops	13	40	33
Vegetables	40	460	8
Total	53	500	10

<b>Tourism</b>	<b>Sample</b>	<b>Estimated Population</b>	<b>%</b>
Guest house	23	44	52
Agro-tourism	8	23	35
Attractions	17	64	27
Other	12	60	20
Total	60	176	31

### The questionnaire

To evaluate the level of entrepreneurship required for the clusterization process initiated by the open incubator, we used McClelland's and Gladwell's classifications as dependent variables, and entrepreneurial attitude as an independent variable.

The questionnaire includes the following variables.

### Dependent variables

- Parameters classifying the entrepreneur at his relevant level of entrepreneurship according to McClelland:

*Family care* represents the necessity level: the entrepreneur operates a business by necessity in order to meet the needs of his family.

*Wider Business* represents the first McClelland level, "need for achievement:" the entrepreneur is ready to invest in his business in order to achieve personal and professional objectives.

*Appreciated by others* represents the "need for affiliation:" the entrepreneur develops and invests in a business in order to improve his economic and social status.

*Lead* represents the third highest McClelland level, "need for power:" the entrepreneur intends to be one of the leaders.

- Groups of parameters evaluating the attitude of the entrepreneur according to Gladwell's classification:

*Connector*: brings people together, has a wide range of contacts, participates in events, consults, likes challenges, is curious, is ready to cooperate, likes to socialize.

*Maven*: finishes the job, plans, solves, has a different view.

*Salesman*: is able to convince and is close to customers.

Answers for each parameter were recorded on a scale of 1-5, 1 representing the lowest level and 5 the highest. Some parameters required a yes (1) or no (0) answer.

### Independent variables

We defined two groups of independent variables:

- Entrepreneurial behavior: readiness to take risks, plan, cooperate, join forces, solve problems, consult, convince, transfer responsibility, acquire knowledge, understand customer needs, socialize, develop relations, participate in events, innovate, and open new horizons.
- Expected support and readiness to invest: in the current business, in marketing and sales, in training, in management, in export, in new trends, in financing, in the brand, in negotiation, and in a new organization.

### Hypotheses

We checked the following hypotheses:

H1: Businesses at the family care entrepreneurial level are focused don't seek for new trends in business and don't cooperate with other businesses.

H2: Businesses at the business wider (need for achievement) entrepreneurial level are seeking new knowledge and are ready to cooperate with other businesses .

H3: Businesses at the appreciated by others (need for affiliation) entrepreneurial level are seeking new trends in business and are ready to cooperate with other businesses

H4: Businesses at the lead (need for power) entrepreneurial level are able to convince and are seeking external financing.

H5: Connectors are at the need for affiliation entrepreneurial level and explore new trends in business.

H6: Mavens are at a high entrepreneurial level, possess business knowledge, and are ready to cooperate.

H7: Salesmen belong to the family care entrepreneurial level but are ready to take risks and to become also connectors.

### Results and Discussion

The family care entrepreneurial level displays weak entrepreneurial behavior ( $R^2$  weak, 0.170). Contrary to expectation, entrepreneurs at this level are seeking new trends in business but do not cooperate with other businesses.

H1, was partially rejected.

#### **Coefficients<sup>a</sup>**

R <sup>2</sup> = .170	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	3.778	.213		17.772	.000
Customer support	.114	.048	.212	2.369	.020
New trends	.168	.053	.286	3.177	.002
Cooperate with other businesses	-.353	.148	-.209	-2.384	.019

Dependent Variable: Family care

The need for achievement level of entrepreneurship shows a stronger entrepreneurial orientation ( $R^2 = 0.223$ ). Entrepreneurs are ready to cooperate and are interested to invest in training in order to improve their knowledge. They are also developing new trends in business. H2 was confirmed.

**Coefficients<sup>a</sup>**

R <sup>2</sup> = .223	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.617	.461		3.511	.001
New trends	.214	.075	.251	2.853	.005
Bring people together	.287	.095	.264	3.009	.003
Invest in training	.224	.081	.230	2.746	.007

Dependent Variable: "Wider business "

Entrepreneurs at the appreciated by others (need for affiliation) level are seeking new business trends and are ready to cooperate. They have a similar profile as the need for achievement level, but more emphasized ( $R^2 = .355$  compared to  $R^2 = .223$ ).

H3 was confirmed.

<b>Coefficients<sup>a</sup></b>					
R <sup>2</sup> = .355	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-1.226	.581		-2.112	.037
Bring people together	.509	.120	.339	4.234	.000
New trends	.368	.094	.312	3.899	.000
Invest in training	.386	.103	.287	3.759	.000

Dependent Variable: Appreciated by others

Entrepreneurs at the lead level, representing McClelland's need for power level, are able to convince and are seeking external financing to expand their business. They are also ready to cooperate with other businesses. H4 was confirmed.

<b>Coefficients<sup>a</sup></b>					
R <sup>2</sup> = .347	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-1.898	.607		-3.126	.002
New trends	.299	.097	.257	3.067	.003
Bring people together	.293	.130	.198	2.265	.025
Convince	.350	.139	.220	2.515	.013
Financing	.275	.092	.235	2.973	.004

Dependent Variable: Lead

Connectors are strongly entrepreneurial ( $R^2 = 0.522$ ), at the level of need for affiliation (appreciated). They are following new business trends and are ready to take risks. H5 was confirmed.

Coefficients <sup>a</sup>					
R <sup>2</sup> = .522	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	16.375	1.314		12.461	.000
New trends	1.107	.303	.263	3.653	.000
Take risks	1.430	.329	.300	4.352	.000
Appreciated	1.480	.263	.414	5.631	.000

Dependent Variable: Connector

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.723	.522	.509	3.34422

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	16.375	1.314		12.461	.000
	New trends	1.107	.303	.263	3.653	.000
	Take risks	1.430	.329	.300	4.352	.000
	Appreciated	1.480	.263	.414	5.631	.000

Dependent Variable: Connector

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.744 <sup>a</sup>	.554	.538	3.25725

Predictors: (Constant), Salesman, Appreciated, New trends, Take risks

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
	(Constant)	14.889	1.409		10.564	.000

	New trends	.941	.302	.221	3.113	.002
	Take risks	1.113	.360	.235	3.087	.003
	Appreciated	1.439	.257	.398	5.609	.000
	Salesmen	.492	.236	.165	2.085	.039
Dependent Variable: Connectors						

The entrepreneurial orientation of mavens is also strong ( $R^2 = 0.372$ ), at the level of need for affiliation. They possess business knowhow but are not ready to participate in the creation of a new common organization.

H6 was not confirmed.

#### Coefficients<sup>a</sup>

R <sup>2</sup> = .374	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	12.554	.802		15.651	.000
Appreciated	.296	.122	.197	2.428	.017
Create a new organization	-1.588	.464	-.260	-3.422	.001
Business knowhow	.912	.171	.433	5.321	.000

Dependent Variable: Maven

Salesmen belong to the family entrepreneurial level but are ready to take risks and to be also connectors. H7 was confirmed.

#### Coefficients<sup>a</sup>

R <sup>2</sup> = .408	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-.698	1.060		-.658	.512
Family	.531	.177	.221	3.001	.003
Take risks	.596	.133	.373	4.478	.000
Connector	.100	.028	.297	3.579	.001

Dependent Variable: Salesman

## CONCLUSIONS

The Western Negev has unique tourist attractions that combine desert landscapes, agriculture, and history. Entrepreneurs at the family care level are seeking to follow new trends in business and are therefore open to raising their entrepreneurial level. Entrepreneurs at the family care entrepreneurial level are seeking for new trends and the three of the McClelland entrepreneurial levels are ready to invest in their own businesses and to cooperate with other businesses. The need for power level is even ready to seek external sources of financing.

Connectors are strongly entrepreneurial, ready to take risks, and to follow new trends in business. Mavens are not ready to share their business knowhow with other businesses within the framework of a common organization. Salesmen belong to the family care entrepreneurial level and are ready to take risks in order to improve entrepreneurship in family businesses.

Missing in the Western Negev is the networking between businesses, which is needed to create common interests. The open incubator described above can play this role by providing the required support, including:

- improving current business activities and generating new common business activities in order to convince the mavens to share their knowledge with others and improve the entrepreneurial level of family care businesses;
- supporting connectors and salesmen in their support of family care businesses;
- improving efficiency;
- supporting mavens by a broader transfer of knowledge using research centers and relevant training programs.

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## CONCEPTUALIZING, VISUALIZING AND MEASURING CORRUPTION, STATE CAPTURE AND THEIR IMPACT IN ITALY.

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### ABSTRACT

*Many researches outlined that one of the most relevant obstacles to development is the weakness of public administrations at both local and central state level. Also in developed countries low efficiency of public administrations is considered an obstacle to overcome the crisis and to recover development growth. Why does this happen? For sure because principles, criteria, techniques of good management are not tailored to the peculiarity of public interest organizations, but also because “pathological degeneration” oriented people to use it as an instrument to exercise power.*

*After summarizing the most relevant negative effects of the State Capture and Society Capture Degeneration, the paper analyses why NPM was not sufficient to break the vicious circle of inefficient public administration. In the second part, it highlights that the recovery of credibility and legitimacy of public administration system cannot be delegated only to managerial tools, quality of policies, institutional reforms (all important and sometimes necessary measures), but mainly to the recovery of a strong social sense of ethics.*

*This research aims to propose a conceptual framework on State and Society Capture in Italy, focusing corruption like also a management problem. Its main objective is to prevent and control “the negative corruption effect” attempts toward the common good, also characterized by capital rationing, penalizing the present-day as well as the future community. This paper also focuses on corruption events and their causes (Klitgaard, 1988; Rose – Ackerman, 1999; Caiden, 2001; Heidenheimer, Johnston, 2002; Bull, Newell, 2003; Huberts, 2005; Lamboo, 2005; Treismann, 2007; Lasthuizen, 2011, Borgonovi, 2012) and shows that the (ab)use of power activities is able to warp not only the citizens’ behavior, but also the State and sometimes the entire Society (Esposito, 2010).*

*Keywords: State Capture, (ab)use of power, integrity distortion, rules, accounting regulation*

## INTRODUCTION

The financial and economic crisis that broke up in 2008, even if some early signs have been identified since 2007, was analyzed mainly with regards to the relationship between financial and real economy, role of market and state intervention (government bail-outs of banks, real estate investing institutions, automotives and other enterprises in strategic sectors). Policies to restore public finance balance, to reduce or at least not to increase public debts, to favour the economic recovery, to avoid some countries' defaults in order to defend Euro and the world economy have been discussed at national and supranational level (European Union, Euro Group, G8, G20, IMF, World Bank). Inadequate attention was given to the hidden or, even worse, black economy impact on legal (or transparent) economy.

As the black economy grows, it becomes harder and harder to support economic growth and social development through adequate public policies.

In this context the public sector has the goal and the responsibility to promote social sustainability in order to facilitate growth and development, taking into account all stakeholders' requirements, in one word to pursue public interest. The Italian critical situation is due to many factors: a rigid labour market, a vast majority of SME that are not able to challenge the global competition, a high level of public debt and, consequently, a high level of interests, a fragmented financial system, as well as a political system where parties in power sometimes operate only to favor specific interests, so that they become accountable to people willing to use *corruption* and *bribery* to achieve their goals (Borgonovi, 2005; Broadman, Recanatini, 2001; World Bank, 1997).

In order to overcome the (ab)use of power (Ricci, 2010), organizational, reporting and anti-corruption models<sup>4</sup> may be helpful to monitor, prevent, control and report the phenomenon of corruption (Klitgaard, 1988; World Bank, 1997; Broadman H.G., Recanatini F., 2001; OECD/PUMA 2002; Meneguzzo, 2005; Borgonovi, 2002, 2006, 2009, 2012; Ricci, 2010; OECD/PUMA 2002), alteration, *integrity distortion* and State capture, both in service delivery and regulatory functions (Mintzberg, 1996; Schick, 2003; Scott, 2000; Rawls, 1971; Moran, 2002; Bresser Perreira, 1999).

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<sup>4</sup> E. Borgonovi, *Principi e sistema aziendali per le amministrazioni pubbliche*, pagg. 2, 18, Egea, Milano, 2002. In reference to the anti-corruption paradigm, see: Ian Senior, *Corruption – The World's Big C. Cases, Causes, Consequences, Cures*, London, The Institute of Economic Affairs, 2006 .

The main questions the paper tries to answer can be synthesized as follows:

- i. What is the impact of corruption and crime on the Italian economy and, in particular, on the economic difficulties of southern Italy?
- ii. What do the terms *State capture* and *Society capture* mean?
- iii. Have the interventions to reduce crime and corruption been effective?

The paper propose a conceptual framework (deductive approach) and an analysis of the Italian case (inductive approach). Section 2 presents the general framework to analyze the phenomenon of corruption and its relation to crime. In section 3, the relationship between corruption and economic development is analyzed. In section 4, the main findings about the Italian case are discussed. Sections 5 deals with legislation to fight organized crime and to dismiss local government in case of crime and corruption infiltration. Section 6 deals with the policy of reinforcing accountability. Section 7 deals with recent legislation to fight corruption. Finally, some conclusive remarks are drawn in section 8.

## **METHODOLOGICAL PROCESS**

The research is based on a literature review, *visualizing* a theoretical framework, useful to investigate the variables and the dimensions producing State Capture and corruption in the Italian case.

As corruption is in itself an obscure and confused phenomenon, it is impossible to have a large database of homogeneous data. So, this paper is based on a methodology that is summarized as follows. From the literature analysis was designed a conceptual framework that was used gathered information from (i) a national survey and (ii) data published by Transparency International. The population of the study are the Institutions dissolved from Mafia infiltration in City Councils.

The definition of the framework is the deductive part of methodology, while the inductive part was realized through the analysis of the literature on the subject and the empirical analysis with the administration of questionnaires both at the top of public companies both to the National Secretaries of the major Italian parties. For the former, in particular, were chosen elected administrators: Mayors of Italian local authorities. Only municipalities with more than 10,000 inhabitants, municipalities where the policy exceeds the local civic responsibility and for which the relations among elected, voters and political parties could reasonably be regarded as more solid or consolidated balances.

After an in-depth study of national and international literature about integrity distortions (corruption, tax evasion, ab-use of power) and New Public Management (from now on NPM) theories, Italian local governments and their model of governance are explored following an inductive/deductive method.

The analysis of corruption level achieved by some Italian local governments in crisis, is measured on the responses to a semi-structured questionnaire by councilors and public managers, looking at understanding the potential link between good governance practices and a suitable accountability system able to improve citizens' and stakeholders' participation and loyalty (Borgonovi, 2005). The paper aims with measuring political commitment in order to undertaking responsible policies and involving stakeholders into strategic decision-making processes ruling out client and patronage behaviors.

Through a questionnaire the paper analyzes which are the key factors in defining political accountability and how transparent and efficient public governance model might improve government performance in managing public resources, in providing public services and in getting better inter-governmental relationship. The work doesn't fail critical perspective on accountability and limits of transparency (Roberts, 2009; Messner, 2009) because this study in experimental way is the first stage of a largest research on the possible methods in assessing accountability.

## **“CONCEPTUALIZING”**

### **THE CONCEPTUAL FRAMEWORK**

Literature defines integrity as the quality of acting in accordance with relevant moral values, norms (Lawton, 1998; Pollock, 1998) or rules (Benjamin, 1990, Klochars, 1997; Solomon, 1999; Kaptein, Wemp, 2002; Lashuizen, 2011). Lack of integrity or distortion in politicians' and public officials' behavior causes the condition of *State capture*: actions of individuals, lobbies, companies, in both the private and public sector, that may influence the enactment of laws, regulations, decrees and other government policies to their advantage through illicit and non-transparent provision of benefits to public officials (Broadman, Recanatini, Klitgaard, Helmann, Jones, Kaufmann).

The World Bank (2000), defines *State capture* as *the tendency by some elites, firms and groups of power and/or interest, to illegally contribute to the formation of laws, policies and regulations of the State.*

Hellmann (2002), defines *State capture* as *group of companies' efforts to contribute to the design and approval of laws, policies, and regulations of the State, to their advantage, by providing illicit private gains to the officials, to maintain public order.*

Broadman and Recanatini (2001) define *State Capture* as *a form of corruption that is particularly harmful in the ability of companies to subvert the entire political process to ensure that policies and regulations favorable to their interests are enabled or captured.*

In the World Bank Transition Report (2000) on the analysis of "anti-corruption" measures, a distinction is made between *State capture* and *administrative corruption*. The latter is defined as an intentional distortion (Di Tella 1999; Broadman and Recanatini, 2001) in implementing laws, rules and regulations as a result of illegal and non-transparent provision of personal benefits to public officials. In addition, the report points out the way politicians and state officials may either promote or be subjected to corruption. The authoritative body Transparency International defines *corruption* as *"abuse of entrusted power for private benefit"*, either material or not, linked to political and/or professional ambitions.

The aim of corruption is to allow undeserved advantages to stakeholders. The economist Ian Senior underlined a further aspect of corruption, as he argued that there is corruption *"when a briber secretly does a favor to a corrupted or an appointed person, in order to influence some actions that may benefit both the corruptor and the appointed person, and on which the corrupted has authority"*.

The World Bank Report also propose a taxonomy of institutions being captured (executive, legislative, judicial system, independent regulatory agencies), type of capturer (private companies, interest groups, political leaders), and type of benefits provided to public officials (money bribes, in-kind gifts, shares or property rights in companies and businesses). Capture through corruption may also occur beyond the borders of the State by companies and foreign investors or by foreign governments (Mauro, 1995; Kaufmann, 1999; Hellman 2002).

Among several corruptive phenomena (legal, business-based, political, legislative, etc.), OECD identifies a clear distinction between corruption, State capture, abuse of office, lobbying activities and conflict of interests (OECD/PUMA, 2003). Furthermore, OECD

identifies a set of causes that interdependently contribute to produce the phenomenon of corruption and State capture (Cepiku, 2002, 2004): *i*) inadequate compliance with accounting and reporting procedures, *ii*) weakness of the system of internal and external control, *iii*) legal appointments of non professional people, *iiii*) lobbying and funding activities aimed at substituting private to general interest, *iiiii*) weakness of public guarantees for contracts.

However, as corruption is a complex and difficult issue, researchers, academics or organizations dealing with it have different points of view (Burke and Cooper, 2009). Actually, there are many disciplinary perspectives (in the fields of macroeconomics, political science, sociology, public management, business management, business ethics, law and administrative law), that can be considered more inductive and descriptive in Northern America, UK and Northern Europe, more deductive and normative in Germany, France, Italy (Borgonovi, 2005; Borgonovi, Fattore, Longo, 2009; Meneguzzo, 2005; Cepiku, 2004; Mussari, 1990, 2004; Bianchi, 2009; Ricci, 2010) and Southern Europe in general. Several scholars focused on economic determinants (annex 1), political determinants (annex 2), regulation determinants (annex 3), geo-cultural determinants (annex 4). Moreover, many institutions carried out surveys on corruption diffusion in different Countries (annex 5).

Until recent years, economics and managerial studies showed inadequate interest in corruption. These disciplines were much more oriented to understand the physiological behavior of enterprises, markets, economic systems rather than their pathological aspects. Economics and management theories have been defined with the aim of enhancing an efficient functioning of economic systems, enterprises and public institutions. Corruption was considered mainly an effect of anthropological, ethical and moral attitude.

In the last two decades, it has become clearer and clearer that weaknesses and even failure in economic development and international cooperation, increase in public deficits and debts in many developed countries, economic crisis, bankruptcy of companies and banks have been caused or accelerated by corruption. Black and grey money flows generated by corruption, as well as by rackets and drugs deal, caused distortion in international trade, financial transactions, public works, international tenders and market functioning in general. Corruption affects the market creating deviance, malformation, deformation and degeneration (Heidenaiemer, 1970; Banfield, 1975; Neild, 2002; Johnson, 2003-04; Stiglitz, 2003; Ireland, 2003; Booth, 2006; Dine, 2008). Therefore, economic ethics and business ethics have become a more and more relevant issue for research and teaching in the fields of economics and management.

To summarize, corruption is an informal economic process that generates hidden costs in the market transaction, in particular with regard to business government relations (because of alterations in politicians' and public officials' integrity). This process leads to: *i*) private profits and benefits to the detriment of the public community; *ii*) State capture and Society capture; *iii*) competition distortions, hindering economic growth. This is how corruption becomes a systemic failure of legal and formal economy.

### **FROM NEW PUBLIC MANAGEMENT (NPM) TO PUBLIC INTEGRITY MANAGEMENT (PIM)**

The New Public Management, or simply management applied to public administration, as it is in the Italian *Economia Aziendale* or German *Betriebswirtschaftslehre*, is undoubtedly an advancement in comparison to the bureaucratic model. Actually, it enables to deal not only with sovereign functions for which legal and formal criteria are prevalent, but also with functions for which economic and social criteria are relevant or prevalent. Nevertheless, it shows more than one weakness in an increasingly multicultural, pluralistic and fragmented society, in which the involvement of many subjects is needed to reach common objectives. So the government governance and the system governance frameworks have been developed.

But the main problem that bureaucratic, New Public Management, government governance models cannot solve is the "pathological degeneration" of public administration that has been considered, or has been characterized, as a means to exercise power by authoritarian governments or representative bodies (politicians), who pursue particular instead of general interests. This degeneration has determined the phenomenon defined as "state capture", that happens when visible or invisible lobbies, and often organized crime, infiltrate in the administration as well as in political bodies. A wider vicious circle arises because through the infiltration in the public administration interest groups (and criminality) condition the whole society ("society capture"). This phenomenon has been studied until present in relationship with transition economies [Hellman, Jones and Kaufmann, 2000].

The main consequences of this degeneration can be summarized as follows:

1. Progressive loss of respect for the law (e.g. substantial and increasingly weakening of attention, also formal) and loss of the sense of public institutions (weakening of attention to public interest and common good);
2. Progressive delegitimization of public institutions in both the political (e.g. elected bodies, political parties) and the technical/professional component (e.g. employees and public officials);
3. Low levels of functionality and productivity of the public administration, that causes an increase of costs for citizens, families, businesses, other economic and social activities and reduce the rate of development and competitiveness of the whole country;
4. Permeability of the public administration, especially in public procurement processes, to the interference of politics (or politicians), to the pressure of interest groups (establishments) that hinder the modernization process, to the infiltration of groups of obscure power (freemasonry of any kind) and organized crime, and to the spread of corruption (bribery);
5. Distortion in the processes of recruitment and career development of personnel, that are not implemented on the basis of merit and professionalism.

Anyway it must be clear that it is inappropriate to consider public administration as a great and homogeneous Molok. Actually, the public system is composed by thousands of public administrations, such as an economic sector is composed by thousands of enterprises. So some of them are characterized by high levels of functionality, effectiveness, efficiency, productivity, while others display in a more or less extensive way the negative phenomena mentioned above.

## **VISUALIZING**

### **CORRUPTION AND ECONOMIC PERFORMANCE**

Economic development theories underline a negative relation between underdevelopment and corruption of public bodies (both central and local governments), that is confirmed by many empirical researches and evidence-based analyses. The higher the corruption, the lower the development or, as in the case of developed countries, the lower the increase in GDP. This is at the same time a direct and indirect consequence of the impact of corruption on legal environment weakening, public administration inefficiency and unfair or distorted competition. Broadman and Recanatini's explanation is appreciable from a theoretical point of view (see formula below adapted), but it reveals perhaps a lack of empirical robustness in

some of the institutional indices that are likely to be endogenous to corruption: if it is true that low quality of government, weak institutions, low level of real democracy, low trade/GDP ratio may clear the way for corruption, it is also true that the diffusion of corruption prevents the strengthening of legal context and public administration reforms, creating a vicious circle.

Several programmes of the World Bank, IMF, Regional Development Bank and bilateral or multilateral agreements for economic development did not achieve the expected results (according to a macroeconomic model) because of corruption in government. For this reason, in the last 10-15 years a chapter on institutional building was introduced in all dossiers that refer to economic development and economic stability international agreements. The national responses involve fighting against corruption, whereas regional integration is seen as a way of introducing external pressure for better policies. This implies going beyond the trade agenda into deeper issues of policy reform. The question would then become whether peer pressure at the regional level can bring about responsive national institutions to global challenges. "Answering this question is more likely to provide policy makers with a handle on how to bring about the positive interaction, rather than simply liberalizing their economic regimes in the hope that the appropriate institutional change will materialize". (OECD working paper n.181-How globalization improves Governance, November 2001).

In Transparency International NGO 2011 ranking, underdeveloped countries are stable in the lowest positions (2009-2011). The main exceptions are the BRICS countries, characterized by a high growth rate but still affected by an unequal distribution of wealth (a strict minority of very rich people compared to the vast majority of really poor population). Out of 183 countries, Russia is ranked 143, India 95, China 75, Brazil 73, South Africa 64. If we consider the developed countries, the main exceptions are those countries characterized by high public debts or deficits and economic weakness. In the Euro zone, Italy and Greece are ranked 69 and 80 respectively (see table 3.1 and 3.2). The analysis is based on a number of factors, from the existence of anti-corruption task forces to the degree of transparency and the presence/absence of conflicts of interest. Even if the rank is based on surveys carried out in each country by 12 independent agencies that collected documented opinions with statistical representativeness, it does not show the actual but only the perceived corruption. There is no doubt that interpretation of surveys in some countries can be controlled and even manipulated by governments for political and international reputation reasons. Nevertheless, the negative relation between corruption and economic performances is confirmed. The 2011

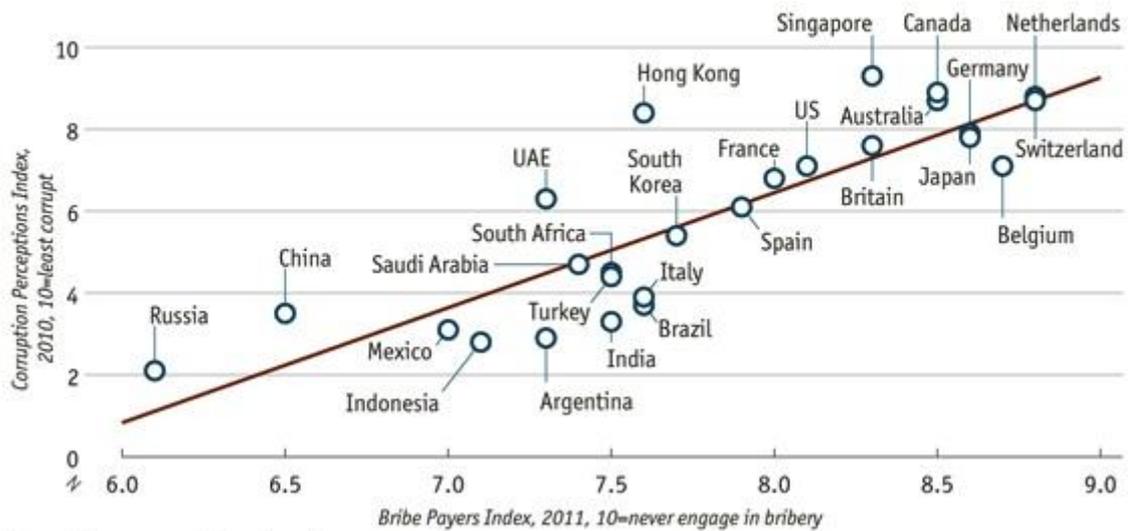
Report underlines that the Euro zone difficulties are partially related to some national governments' inability to fight corruption and tax evasion, pointing out that lack of transparency and high corruption are among the key factors of the crisis which is now gripping Europe.



(Source: Transparency, 2011)

Data on perceived corruption in the last three years (Transparency International NGO Ranking) show that economic underdevelopment or low economic growth rate are also a consequence of the impact of corruption on the competitiveness of enterprises and overall economy. Countries at the top of the corruption ranking are mostly the same ranked at the top of competitiveness. Furthermore, the World Bank economic studies show that the investment rate increases when the incidence of corruption decreases: recovering two points in a hypothetical corruption scale from 10 to 1 (from low to high incidence), the investment rate/GDP would grow at least by 4% and the GDP per capita would increase at least by 0.5% per year. "Confirming available results in the literature, a detectable significant direct effect from trade policy is not measured; however reducing trade barriers may still bring positive corruption reductions in the long run. More open economies, enjoying more foreign competition and investing abundantly in institution building, will normally register lower corruption levels." (OECD working paper n.181-How globalization improves Governance, November 2001).

### Perceived corruption levels by country and companies' propensity to bribe



Source: Transparency International

In Italy, some institutions and independent researchers and think tanks (Italian Central Bank, Treasury Department, Finance Ministry, Italian Statistical Institute and others) estimate that corruption reaches 70 billion Euros, around 4.5% of GDP, that is a relevant part of the hidden economy estimated in 150 billion Euros, around 9.4% of GDP. Even if corruption is a general phenomenon in society, Public Administration can be considered its privileged place, especially with regard to public procurement of goods and services, planning permissions, trade licenses and permits, credit-granting or subsidized loans to private enterprises. It is clear that the Country's economic recovery may be facilitated by an effective policy to reduce corruption. This is a requirement to attract foreign investments that nowadays are constrained also by bureaucratic procedures.

Moreover, corruption is strongly related to crime, as described in the next section.

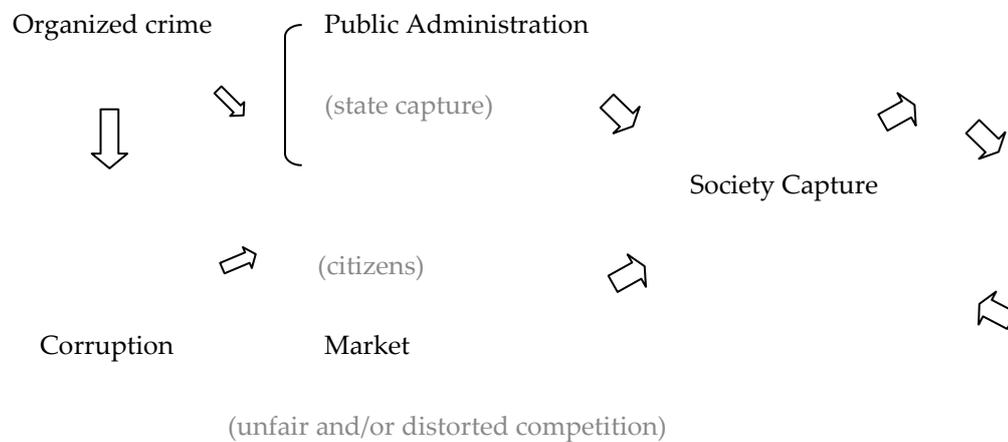
### CORRUPTION AND CRIME: THE DARK SIDE OF ECONOMY IN ITALY

Corruption is a dimension of informal economy and is strongly related to criminality. Mafia, organized crime and racket collect money and manage hidden economic activities that strengthen corruption power. They have their own rules and, in some way, can be considered as "a State in the State". Organized crime influence Public Administration and market behavior in different ways: extortions, murders, lobbying on election processes and public officials'/managers' appointments, and, above all, corruption. As mentioned above, the

negative influence on Public Administration can be defined as State capture, while the negative influence on market can be defined as unfair and distorted competition. Analyses of investigative activities of public accounting (*Corte dei Conti*), administrative jurisdiction (*Consiglio di Stato*), and civil and criminal jurisdiction (*Courts*) outlined a structural system of patronage and collusion among businessmen, politicians and public officials, undermining the proper functioning of the tendering system (Francesconi, 1994; Pozzoli, 2005a). This system creates a growing risk of political interference in all decisions concerning management of public utilities and outsourced services such as school meals, cleaning services, waste disposal (Farneti, 1997; Mussari, Grossi, 2004; Pavan, Mudu, Zuccardi Merli, Grossi, 2004; Pozzoli, 2005b). In order to provide financial resources to corrupt politicians during election campaigns, organized crime and businessmen contribute to distort market competition.

So, in some analyses and legal settlements, corruption is considered to be a financial crime against Public Administration, market and society. The relationship can be summarized as follows:

Table



In its 'Socio Economic Crime Observatory', the National Council for Economy and Labour (CNEL) has placed corruption in government management (1996) at the centre of its study and research, started in the mid-90s. It has highlighted the risk of infiltration by organized crime with relation firstly to EU funding in southern Italy (Act 488), secondly to public works and then to the *silent conquest of pieces of the legal economy* and Public Administration also in the northern Regions of the Country.

Mafia “is one of the main obstacles to economic and social progress”. It is estimated that Mafia turnover in Italy is around 160 billion euro/year. So “in thirty years mafia has destroyed about 20 percent of southern Italy GDP. [...] Even southern Regions commonly considered to have a less relevant Mafia presence, such as Apulia and Basilicata, showed a 16% lower GDP than the expected in a “virtual Region” without Mafia infiltration in the same period (this “virtual Region” was defined taking into account the average economic development of Veneto, Abruzzi, Molise and Umbria). [...] From 1950 to 1970 the economic growth rate of the two Regions was equal to the virtual one. [...] From 1970 to 2010 the gap increased as Mafia density, became similar to other southern Regions like Sicily, Calabria and Campania. For example, in 2010 10 cases of Mafia collusion out of 100.000 Apulia inhabitants were discovered, which is a similar density to that of the three above-mentioned Regions. [...] Nowadays, without Mafia, Apulia’s and Basilicata’s per capita GDP would be the equivalent to California’s (Italian Central Bank report, March 2011). This negative effect is estimated only taking into consideration lower foreign investments due to Mafia presence.

Mafia is a “glocal” phenomenon, which has influenced the development of Italian capitalism and is related to very complex historical, cultural and economic reasons: the failure of the entrepreneurial culture, the “Mafia clan or family” as the basis of all social relationships, a weak democracy, the code (or conspiracy) of silence. Local because Mafias are rooted in local culture and environment, global because different Mafias are strictly connected to each other.

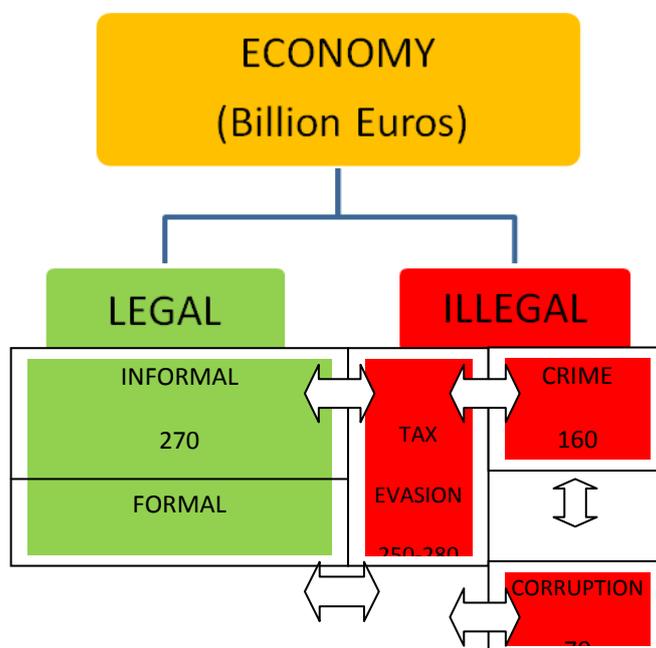
The anthropologist Francis A.J. Ianni (1972) approaches the Mafia phenomenon differently from the dominant social scientific model of organized crime, that links criminal organizations to businesses or governments. Actually, the formal organization model, defined by Donald Cressey, suggests that crime families are rationally structured in order to create profits, and that they have a system of authority that is based on positions with job titles, endures beyond their existing personnel, and is designed for efficiency. On the contrary, Ianni proposes a view of Italian-American or Sicilian Mafia families not as formal organizations, like governments or businesses. They are not rationally organized in clear hierarchical positions and functions in order to “maximize profits” and carry out tasks efficiently. Rather, they are traditional social systems based on the *Godfather’s* power and organized by actions and cultural values, that are completely different from modern bureaucratic virtues.

## MEASURING

### THE “INFORMAL” ECONOMY EFFECTS IN ITALY

Crime and corruption are a part of the illegal economy and interact with tax evasion (estimated around 250-280 billion Euros in Italy). The legal economy can be divided into a formal and informal component. The former is worth around 1,600 billion Euros, the latter involves the work of volunteers, housekeepers, family-care givers, self-production and consumption communities (such as monasteries). It is impossible to measure informal economy, even if it is estimated around 15-20% of the formal GDP in Italy (around 300 billion Euros). The legal economy interact with the illegal one through tax evasion, that is also an effect of criminal activities and corruption. It can be said that there is a huge overlap among tax evasion, crime and corruption. Black money obtained as a consequence of criminal activities is laundered through corruption and enter into the legal economy, both informal and formal. These complex relations are summarized in the next table:

Table: Relation between legal and illegal economy



How is it possible to break this negative relationship and release State and Society from capture? In Italy some policies has been adopted:

- a. An intelligence department against Mafia (DIA);
- b. A legislation to dismiss local governments directly captured by organized crime (Cosa Nostra in Sicily, 'Ndrangheta in Calabria, Camorra in Campania, Sacra Corona Unita in Apulia);
- c. Reinforcement of accountability at all levels of Public Administration;
- d. Anti-corruption legislation.
- e. Educational System and corruption in Italy

### **AN INTELLIGENCE DEPARTMENT AGAINST MAFIA AND LEGISLATION TO DISMISS LOCAL GOVERNMENTS**

In the '70s the unclear and very dangerous relationship among Mafia, politics, Public Administration and business became stronger and stronger. An exemplary case was the Michele Sindona's affair. In 1975 two different legal proceedings related to the bankruptcy of Banca Privata Italiana (Italy) and Franklin National Bank (USA), both owned by Michele Sindona, started. In the following four years Michele Sindona tried to corrupt Giorgio Ambrosoli, who was in charge of the Banca Privata Italiana bankruptcy proceeding, also asking for help from some politicians. As Giorgio Ambrosoli resisted all attempts of corruption and collaborated with USA authorities to condemn Michele Sindona both in Italy and the US, he was murdered by Cosa Nostra on July, 11<sup>th</sup> 1975. Michele Sindona was condemned to prison for 25 years in the US and 15 years in Italy for bankruptcy, and then to life imprisonment in Italy for Giorgio Ambrosoli's murder. In 1983 he committed suicide or was poisoned in an Italian jail. In 1980 a list of 500 affiliates to a Freemasonry lodge was discovered (including many politicians, judges, Generals and high Officials of the Army, Navy and Air Force, diplomats, entrepreneurs, bankers, university professors, publishers of the most important Italian newspapers and many others). The investigation activity declared that the aim of the 500 members was to manipulate information and to direct public policies, businesses and financial activities towards illegality. The commitment of judges together with a special parliamentary committee brought to the introduction of a law against illegal associations in 1983 (Legge Anselmi).

In the early '90s judges Giovanni Falcone and Paolo Borsellino activated special investigation actions against Mafia and obtained the introduction of DIA, with the aim of collecting and

organizing information on its activities all over the Country, coordinating interventions to prevent and fight crimes. Another objective of DIA was to disclose the dark relation among politics, business and organized crime. Indeed, businesses are often used to launder dirty money generated by crimes. Those proposals have been hampered by some politicians, judges and businessmen colluded or corrupted. This is the reason why the two judges have been murdered by Mafia.

Since the early '90s some laws have been introduced, in accordance to which the President of Republic can dismiss local government councils when Mafia infiltrations are discovered by local representatives of the central government. The last version is Art.143 of Decree 267/2000. The authors carried out a survey on 60 municipalities in Campania, representing a quite significant sample (44,3%) of the total municipalities dismissed in Italy since the early '90s. The negative effect of crime infiltration is clear, as it does appear by the main findings, that can be summarized as follows: all municipalities were affected by financial troubles, as they were not able to respect the financial stability objectives (constraint of expenditure increase and cash flow balance). None of the dismissed municipality had adopted the General Socio-Economic Development plan (3 years), that was compulsory in accordance to Decree 267/2000. Public infrastructures, activities and financial plan of most of them were only a "cut and paste" from documents approved by other municipalities or were more or less the same, year by year. It is clear that these documents are completely meaningless. None of them introduced cruel accounting (in substitution of commitment accounting), analytical cost accounting, managerial control system, as indicated by Decree 267/2000. Moreover, 12 out of 60 municipalities in Campania and 9 out of 25 municipalities in Naples province were dismissed twice in a 20-year period and all of them showed heavy financial troubles, as they were no longer able to guarantee mandatory public services. In the period covered by the survey, some municipalities were dismissed three times and one four times (Casal di Principe, the Casalesi's clan headquarter).

The above mentioned research on Campania's dismissed municipalities also analyzed the state-of-the-art of reporting and monitoring systems of local authorities (ex art.143 Tuel). Politicians, council members, secretary generals and top managers didn't answer questions aiming at verifying the actual knowledge and use of management tools to monitor and report (like planning, control, budgeting, personnel evaluation), creating paths to social reporting, adopting an ethical infrastructure of each institution as an essential investment to strengthen the level of trust and legitimacy by the administered community. Moreover they did not

know the OECD anti-corruption manual at all. This part of the questionnaire was answered only by 20.7% of the sample.

#### SOME EVIDENCE FROM ITALIAN CASE STUDY

Local authorities dissolved pursuant to art. 143 Decree 267/2000, in Italy, from the date of entry into force of Law (1991) on the date of September 2009 are 152 and are the reference standard to which we sent the questionnaire.

A semi-structured questionnaire has been submitted to municipalities in the sample in order to assess accountability through some key factors able to evaluate accountability level achieved. According to authors, analyzing the responses on a questionnaire, it's possible to inflect seven key factors with the aim at understanding how important is accountability for municipalities interviewed in planning and control activities and in improving citizens' loyalty and participation.

A suitable accountability system may improve managers social responsibility and responsiveness toward their stakeholders allow them able to evaluate the actions taken and results achieved (Cardillo, 2008). According to Perks R. (Perks, 1993) the term public accountability may be applied to any entity in which exist a responsibility toward the public community.

The questions proposed in the questionnaire allow authors able to evaluate how municipalities adopt each one of the seven key factors of Ricci's scale. This process is useful to understand and assess the accountability level and political commitment in order to take politic and strategic decisions. For this reason the authors are going to assign a score on the responses collected in the questionnaire taking into account the number of possible solution proposed by authors for each questions.

As regards the first one of seven key factors, all municipalities interviewed realize the planning process implementing the Anticipatory and Programmatic Relation (60%) and the Electoral Mandate Program.

No one's adopt the General Developing Program perhaps due to the fact that this isn't yet mandatory document for municipalities

To support the management in the strategic and operative decision making process, each one adopts cost accounting system (50%) and only the 30% implement accrual accounting system, perhaps due to the complexity of policies and strategies (Esposito, Landi, Serluca, 2012).

The roles and responsibility for administrative officers are defined by Administrative manager and by Mayor, while Town Clerk and Chief Executive don't have relevant powers. The subjects and officers responsible to measure performance and results are the Internal Audit office or an external Team of Evaluation. Only for three municipalities the Town Clerk is responsible to evaluate performance (see previous table). This is a paradox because, according to authors, actors responsible to assign role and responsibility in the entity is not the same subjects responsible to evaluate results and performance.

In order to managing officers and administering activities, the major part of municipalities adopt financial and accrual accounting without a systematic bookkeeping process. Other ones consider financial accounting the best one tool to measure results and activities.

There isn't an extended accounting system adopted by municipalities interviewed because looking at the following activities, they just use financial accounting instruments.

For some municipalities managerial control has been implemented recently (2008/2009), just for one, it has been set up on 1999.

Internal Audit has both control and collaborative function. In the half of the sample, municipalities have participated Public Utility Companies, but only 30% of municipalities have a specific Department and a suitable accounting system in monitoring controlled companies.

Looking to external accountability, the questionnaire tests the capability of Local governments in crisis to communicate in a transparent way toward their stakeholders. Even if, there have been a financial crisis with a wrong and distorted use of public resources by politicians and parties in power, they do not realize any Social Reporting process and they don't know Standards or Guidelines for Social Reporting.

Social Responsibility could be considered as a culture of "to be transparent and responsible". Municipalities whose City Council has been broken up due to corruption and bribery that don't have a social reporting process highlight the low inclination towards the context in which the entity operates and towards citizens and stakeholders. These responses means

there isn't any social control or power from citizens and community where municipalities operate.

The Internet is the common external communication instrument followed by e-mail and newsletter. Only one recourse to television or radio. The website is up-data every day.

On website are available a lots of administrative documents such as Annual Reports and Town Council Resolutions, while is not available on the Internet benchmarking indicators due to the fact that they don't have performance indicators to compare with other municipalities.

There isn't a homogeneous point of view in defining the key factor to assess accountability but all the evidence makes it clear that they give much more importance to the planning process and to define internal duties and internal control evaluation in assessing accountability, then other five key factors proposed. To define an entity as accountable they take into account the manager responsibility in the action undertaken and the stakeholder's expectations in the decision making process. Less weight, overall, appear to play benchmarking activity and the use of technology to communicate toward internal subjects and external environment.

No one of municipalities answerers, implement all seven key factors proposed, only some of them, in except benchmarking activity, adopt some activities provided also by Local Government laws (programming programming process, accounting system, etc).

In an experimental way, looking at total score gained by each one of municipalities interviewed as regards seven key factors, it is possible to assess accountability level achieved. Total score has been calculated taking into account the average of score gain respect of each one of seven key factors proposed in the questionnaire.

## **REINFORCEMENT OF ACCOUNTABILITY**

During the last three decades Italy has been characterized by efforts to introduce a management approach in public institutions at central, regional and local level. Consistently with the Italian approach to management ("Economia Aziendale"), similar but not completely equal to NPM, principles, criteria and techniques of

- administrative productivity and efficiency,

- expenditure containment and cost control,
- quality of services,
- effectiveness and efficacy of policies,
- economic sustainability,
- formal procedure simplification,
- clients-citizens orientation

became more and more popular in the scientific world and have been experimented in advanced public institutions. “Economia Aziendale” is rooted in Continental Europe’s institutionalism theory and approach, while NMP is rooted in North America’s and UK’s scientific management theory and approach. Nevertheless, the transition from a bureaucratic to a managerial model was unsuccessful for many reasons: worsening of the political arena and adverse selection of elected administrators, weakening of public institution credibility, prevailing of individual interest on public interest, inadequate managerial education, both in junior and executive managers.

All the more so, managerial culture and techniques were not effective to challenge Mafia informal economy. Something more is needed that can be achieved through the transition from management to accountability, that means openness in public procurement and personal recruitment procedures, easy accessibility to public documents, urban planning and other strategic choices, government decision-making processes, disclosure of accounting and social reporting to all citizens.

Accountability has been conceptualized in terms of responsibility – ensuring that officials (and extensively also private managers) are responsible for respecting the law or code of ethics (Bovens, 1999). The concept of accountability emphasizes the role of external actors in enforcing the respect of laws and codes of ethics. A stronger citizens’ “voice” generates incentives for public officials to budget and deliver services of the quality and quantity expected by their clients. Only accountability can strengthen the “voice” influence when the exit solution (as it happens in the market) is not available. The concept of responsibility relies more on public servants’ internalized values and understanding of the law and appropriate behavior. Such a standard of personal responsibility may be acceptable and enforceable in countries with strong and credible public institutions, but this approach may be risky when the level of agreement on behavior standards is low. On the other hand, in terms of responsiveness, accountability system is closely related to civil servants’ willingness to really serve citizens rather than to pursue their own interest. This concept points out the numerous

pressures that impinge on public servants' behavior and the expected difficulties they may face in determining an appropriate course of behavior.

Management can improve the internal functioning of Public Administration and govern formal economic and social relationships, but only society, that means citizens' pressure, can remove or at least reduce corruption and its connection with crime. The hope is that the transition from accounting and government to accountability and system governance paradigm, that implies the involvement of many public and private economic and social bodies, could be more successful in fighting crime and corruption, not only in increasing economic growth. To eradicate or to minimize corruption and crime is a prerequisite for economic growth and sustainability. Actually, a better accountability and governance system could break the vicious circle around the political consensus, as synthesized in the following table:

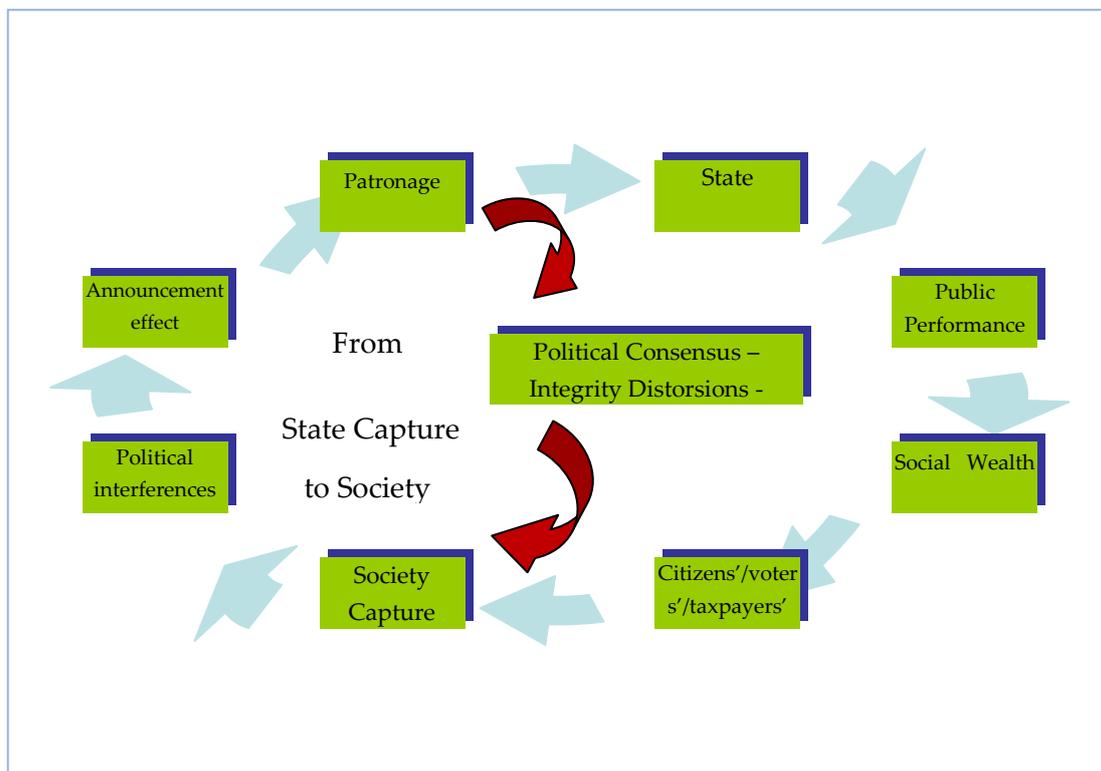


Table: Political consensus determinants and society capture

Indeed, accountability (that enables to recognize merits and professionalism and to evaluate Public Administration's performances) can reduce the level of patronage, that connects public managers and employees to political parties and organized crime. The "vicious circle" leads to Public Performance deterioration, due to political pressure to manipulate public resources, in order to pursue hidden agendas.

Accountability approach helps to redefine the models of spoils system in order to ensure independence and accountability in the recruitment and appointment of public managers. Moreover, it facilitates public employees' review and top managers' evaluation and it guarantees the assignment of incentives or penalties according to the performance achieved.

Accountability also reduces the misuse of the announcement effect, that arises when politicians try to get consensus by announcing some programs or actions that are not concretely implemented. As accountability is related to Public Administration's actual results, the negative connection between organized crime and political consensus is broken. Managerial and accountability reforms and the efforts to fight organized crime, poor political game, inefficiency and waste of resources have been unsuccessful in Italy, in particular in southern regions.

## ANTI-CORRUPTION LEGISLATION

The conceptual framework concerning the issue of anti-corruption legislation is clearly defined by Clifford Chance, a leading global law firm based in London, that reports *"corruption is illegal in many countries in the world, but what constitutes corruption varies considerably from jurisdiction to jurisdiction and the murky grey area between acceptable corporate behaviour and corruption can be very large. A number of international agreements on corruption have tried to set common standards, and to improve the ability of national authorities to prosecute corrupt individuals and companies by mechanisms on information sharing and extradition. Differences remain, however, causing headaches for multinationals wanting to implement global anti-corruption compliance policies"*. The same report is analyzed in different countries.

In France *"The offences of corruption are set out in the Criminal Code. The offences of corruption in relation to foreign public officials (Law of 30 June 2000) and corruption in relation to private individuals (Law of 4 July 2005) were recently added to the offences of corruption in relation to public officials in the French legislation. Both passive and active corruption fall within the scope of the legislation"*.

In Germany *"The principal corruption offences (Straftaten) concerning public officials (Amtsträger) are defined in ss. 331 et seq. of the Criminal Code (Strafgesetzbuch ("StGB"))*. Further legislation - the European Bribery Act (EU-Bestechungsgesetz, "EUBestG") and the International Bribery Act (Gesetz zur Bekämpfung internationaler Bestechung, "IntBestG") - has extended the scope of the offences".

In the UK *“The Bribery Act 2010 creates statutory offences of bribing and being bribed. It is due to be brought into force in April 2011. Until then the Prevention of Corruption Acts 1889-1916 are still the applicable law. The Bribery Act offences of bribing another person are set out in Section 1. ... The offences of bribing and being bribed apply equally to bribery in the public and the private sector. Section 6 of the Bribery Act sets out a separate offence of bribing a foreign public official.”*

In the U.S. *“It is a crime under US law to bribe both domestic and non-US government officials, and to engage in private commercial bribery. Bribery, however, falls under several distinct federal and state criminal statutes. In general, the prohibited conduct involves paying, offering, attempting or promising to pay, public officials improperly to influence their official acts, or, in the private context, causing an employee or agent to act in a way contrary to the interests of their employer. US law also generally recognizes the concept of aiding and abetting a violation and conspiring to engage in violative conduct as separate criminal offences.”*

The United Nations Convention against corruption, signed by 140 countries, states that *“The purposes of the Convention, stated at Article 1, are: to promote and strengthen measures to prevent and combat corruption more efficiently and effectively; to promote, facilitate and support international cooperation and technical assistance in the prevention of and fight against corruption, including in asset recovery; to promote integrity, accountability and proper management of public affairs and public property. All Parties to the Convention are required to criminalize: the bribery of national and foreign public officials, as well as officials of public international organizations; the embezzlement, misappropriation or other diversion of either public or private funds by a public official to whom the funds have been entrusted; the laundering of proceeds of crime; and obstruction of justice. In addition Parties must consider criminalizing trading in influence, the abuse of functions by a public official, illicit enrichment and private sector bribery”*.

The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, signed by 38 countries, states that *“The Convention requires Parties to make the bribery of foreign public officials (as defined) a criminal offence, as well as related offences of incitement, aiding and abetting, authorization, attempt and conspiracy. Parties must also (in accordance with their legal principles) establish the liability of legal persons for the bribery of foreign public officials, and must put in place effective penalties, including seizure and confiscation or comparable monetary sanctions.”*

These examples of legislation, agreements and conventions are a clear signal of awareness all around the world of the danger that the connection among crime, corruption, politics, public

administration and private businesses can provoke to the legal economy and sustainable development. In Italy, the first attempt to fight crime and corruption is the Rognoni-La Torre law (1983) to fight against organized crime. The enactment of this law swung between successes and failures, but it was not enough effective in stopping corruption. Only seizure (confiscation) of Mafia assets and their donation to non-profit organizations and social enterprises positively reduce Mafia's economic power, so that it is becoming a more and more successful strategy to fight corruption. In March 2010, after many political scandals and cases of corrupted politicians and officials, the Italian Government submitted a law proposal against corruption to the Parliament. Surprisingly, this proposal has not been approved yet (at the time this paper was written - January 2012). It is interesting to underline that, if we consider the number of Google reports, there are only 45.200 entries regarding the law proposal and 1.880.000 entries regarding the decree over the period March 2010 - January 2012. The evidence is a misleading effect: most of the Italian citizens are convinced that the law has already been enacted (decree), while it is only a proposal (decree proposal) to be discussed and approved.

## CONCLUSIVE REMARKS

The phenomenon of corruption, crime and bribery infiltration in the economy and in particular in the public sector has been studied by several sociologists, anthropologists, political scientists, while economists and management scholars demonstrated little interest. Awareness of the negative economic impact of corruption, crime and bribery infiltration has only recently grown. In the last decade, national legislation in many countries and agreements and conventions of international and supranational organizations have been adopted. Nevertheless, the enactment was poor and at least unsatisfactory.

The phenomenon strangled the economic growth in Italy, in particular in southern regions with a high Mafia density. Recently, it also attacked some northern regions. A special legislation to fight organized crime and, consequently, to reduce corruption and crime, was introduced in 1983 but it can be considered widely unsuccessful. The attempt to enact this legislation and to break the vicious circle among Mafia, politics and black business caused a real war, where dozens of faithful civil servants (Giorgio Ambrosoli, Giovanni Falcone and Paolo Borsellino are the most well-known cases) were murdered.

The introduction of NPM, according to the Italian model of “Economia Aziendale”, did not achieve the desired effect of increasing productivity and efficiency, downsizing the public sector, improving the quality of public services, increasing transparency of actions taken by public managers, and, worse, reducing the black economy related to crime, bribery and corruption. Moreover, even legislation to dismiss local governments in which crime and corruption was discovered, did not achieve its objectives. The survey demonstrated that the renewal of councils did not wipe out infiltrations.

Therefore, the authors are convinced that only a wide participation of citizens and their empowerment through a public accountability and governance system can give chances to fight against crime and corruption. Accountability means:

- a) to implement social and not just bureaucratic control: that means to create some communication tools (social balance, office budget and report) to grant citizens' participation to political choices in the planning, managing and control stages;
- b) to redefine the models of spoils system to ensure independence and accountability in the selection and appointment of public managers;
- c) to review the pattern of recruitment and evaluation of public employees and top managers to assign awards or penalties according to the results achieved;
- d) to organize an inter-institutional task force to support collaboration and create a single database able to match information: an anti-corruption network can become a more effective “watchdog” to prevent crime and corruption.

Obviously, none of these interventions can solve the problem on its own (Lasthuizen, Huberts, Heres, 2011). Only an integrated approach can substantially reduce the negative impact of crime and corruption on the public sector and overall economy. Cultural and social changes are the keystones to strengthen the legal and to fight the informal illegal economy.

Ethical behavior requires to go beyond mere professionalism in order to reject proposals and policies “idealistic” or impractical. Ethical behavior requires not only to develop knowledge, technical skills (such as macro-economic or public finance knowledge) but also to strengthen negotiating ability, to communicate properly and to push through unpopular choices. Ethical behavior requires to overcome the resistance to change, through the ability to develop proposals aimed at implementing the win-win strategy.

Synergizing good public management with strong ethics can also help to break the vicious circle of State Capture and Society Capture, to create the conditions to overcome the crisis erupted in 2008 and to restore hope in the future, that - as stated by S. Augustine - has two children: the anger and the courage to change. In concrete terms, hope for a better future is based on:

1. Willingness to criticize what is negative in public administration as well as in market economy;
2. Challenge to the established power, both economic and political;
3. Will to set high and challenging goals and not to accept mere objectives of rationalizing the existing economic systems and public administrations;
4. Belief that change does not mean to approve reform bills or to recover public finance equilibrium, but means the capacity to implement reforms and to realize them substantially.

In conclusion, quoting J. Maritain, even public administration ethics requires “to have a tough spirit (e.g. principles, virtues) but a tender heart (in behavior towards others)”. It means that who works in public administrations, and also those who want to diffuse ethics in, of and for the public administrations, must be resolute and firm in proposing laws, operating rules, policies, evaluation criteria for the administration, and flexible in applying principles and rules to specific situations. Equity and ethics demand to treat differently different situations. This attitude doesn't weaken principles, rules or general criteria but rather reinforces them.

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**ANNEX**

## Determinants of Corruption

## Reconstruction and classification of literature

## Annex 1 – Economic determinants of Corruption

Source: Adapted from World Bank

Variable	Positive-Significant	Negative-Significant
<i>Economic Factors</i>		
Income	Braun-Di Tella (2004), Frechette (2001)	Brown, et al. (2005), Kunicova -R.Ackerman(2005), Lederman et al. (2005), Braun-Di Tella (2004), Chang-Golden (2004), Damania et al. (2004), Dreher et al. (2004), Alt-Lassen (2003), Brunetti-Weder (2003), Graeff-Mehlkop (2003), Herzfeld-Weiss (2003), Knack-Azfar (2003), Persson et al. (2003), Tavares(2003), Fisman-Gatti(2002), Paldam (2002-01), Frechette (2001), Bonanglia et al. (2001), Swamy et al. (2001), Abed-Davoodi (2000), Rauch-Evan (2000),

		Treisman (2000) Wei (2000), Ades-Di Tella (1999), Goldsmith (1999-97), van Rijckeghem-Weder (1997)
Income distribution	Paldam (2002)	Pasquino (2008); Della Porta, Vannucci (2002)
Government expenditure		Bianchi (2009), Borgonovi (2002, 2005), Meneguzzo (2005), Cepiku (2002, 2004); Mussari (1990, 2004)
Economic amount related to (ab)use of power		Ricci (2010)
From State Capture to Society Capture		Esposito (2010)
Integrity violations		Lasthuizen, Huberts, Heres (2011)
Public Procurement		Pashev (2011)
<i>Economic Institutions</i>		
Foreign aid	Ali-Isse (2003)	Tavares(2003),
Import share		Herzfeld-Weiss (2003),

Variable	Positive-Significant by	Negative-Significant
<i>Economic Processes</i>		
Foreign aid	Ali-Isse (2003)	Tavares(2003),
Import share		Herzfeld-Weiss (2003),
		Fisman-Gatti (2002),
		Frechette (2001),
		Treisman (2000),
		Ades- Di Tella (1999)
Raw material export	Herzfeld-Weiss (2003), Tavares (2003), Bonaglia et al. (2001), Frechette (2001)	Frechette (2001)
Trade openness		Gurgur-Shah (2005), Brunetti-Weder (2003), Knack-Azfar (2003), Persson et al. (2003), Fisman-Gatti (2002), Bonaglia et al. (2001), Frechette (2001), Wei (2000), Ades-Di Tella (1999), Laffont and N'Guessan (1999), Leite-Weidmann (1997)
Economic freedom	Graeff-Mehlkop (2003), Paldam (2001)	Kunikova-R.Ackerman (2005), Gurgur-Shah (2005), Ali-Isse (2003), Graeff-Mehlkop (2003), Park (2003), Treisman (2000), Goldsmith (1999)
Entry barriers, Competitiveness	Broadman-Recanatini (2002-00)	Gurgur-Shah (2005), Suphacablasai (2005)
Structural reform		Abed-Davoodi (2000)
Infrastructure		Broadman-Recanitini (2000)
Budget constraint		Broadman-Recanatini (2002-00).
<i>Demographic Factors</i>		
Schooling	Frechette (2001)	Ali-Isse (2003), Alt-Lassen (2003), Brunetti-Weder (2003), Persson et al. (2003), Evan-Rauch (2000), Ades-Di Tella (1999-97), van Rijckeghem-Weder (1997)
Population	Damania et al. (2004), Alt-Lassen (2003),	Tavares (2003)
Female labour force	Knack-Azfar (2003), Fisman-Gatti (2002)	
		Swamy et al. (2001)

## Annex 2 – Political determinants of Corruption

Source: Adapted from World Bank

Variable	Positive-Significant by	Negative-Significant by
Democracy		Kunicova-R Ackerman (2005),
civil freedom		Lederman et al. (2005,)
		Gurgur-Shah (2005),
		Chang-Golden (2004),
		Damania et al. (2004),
		Herzfeld-Weiss (2003),
		Knack-Azfar (2003),
		Broadman-Recanatini (2002-00),
		Paldam (2002),
		Bonaglia et al. (2001),
		Frechette (2001),
		Swamy et al. (2001),
		Treisman (2000),
		Wei (2000),
		Ades-Di Tella (1999-97),
		Leite-Weidmann (1997)
		Goldsmith (1999),
		Braun -di Tella (2004),
		van RijCkeghem-Weder (1997)
Press freedom,		Lederman et al. (2005,)
Media		Suphacahlasai (2005),
		Brunetti-Weder (2003)
Decentralization,	Brown et al. (2005),	Gurgur-Shah (2005),
	Kunikova-R.Ackerman (2005),	Lederman et al. (2005,)
	Damania et al. (2004),	Fisman-Gatti (2002),
	Treisman (2000),	Ali-Isse (2003),
federalism	Goldsmith (1999)	Wei (2000)
District dimension		Chang-Golden (2004),
Closed list	Kunikova-R.Ackerman (2005),	Lederman et al. (2005,)
	Persson-Tabellini (2003),	Chang-Golden (2004)
system	Persson et al. (2003),	
Presidentialism	Brown et al. (2005),	
	Kunikova-R.Ackerman (2005),	
	Lederman et. al (2005),	
	Chang-Golden (2004)	
Number of parties	Chang-Golden (2004)	
Political instability	Park (2003)	
	Leite-Weidmann (1999)	
Ideological Polarization		Brown, et al. (2005),
Coalition of parties		Kunicova-R.Ackerman (2005),
Central planning		Abed-Davoodi (2000)
Women in public positions		Swamy et al. (2001)

## Annex 3 – Regulation determinants of Corruption

Source: Adapted from World Bank

Variable	Positive-Significant by	Negative-Significant by
Public officials' and Employees' wage		Alt-Lassen (2003), Herzfeld-Weiss (2003), Rauch-Evan (2000) van Rijckeghem-Weder (1997),
Quality of bureaucracy		Gurgur-Shah (2005), Brunetti-Weder (2003), van Rijckeghem-Weder (1997),
Merit system		Rauch-Evan (2000)
Rule of law		Damania et al. (2004), Ali-Isse (2003), Brunetti-Weder (2003), Herzfeld-Weiss (2003), Park (2003), Broadman-Recanatini (2000), Leite-Weidmann (1997), Ades-Di Tella (1997),

## Annex 4 – Geo-cultural determinants of Corruption

Source: Adapted from World Bank

Variable	Positive-Significant by	Negative-Significant by
Population with particular religious affiliation	Paldam (2001), La Porta et al (1999)	Chang-Golden (2004), Herzfeld-Weiss (2003), Persson et al. (2003), Bonaglia et al. (2001), Paldam (2001), Treisman (2000), La Porta et al (1999)
Ethnic heterogeneity	Lederman et al 2005), Suphachalasi (2005), Herzfeld-Weis (2003), Treisman (2000), La Porta et al (1999)	Bonaglia et al. (2001)
Colonial past	Gurgur-Shah(2005) Tavares (2003)	Herzfeld-Weiss (2003), Persson et al. (2003), Swamy et al. (2001), Treisman (2000)
Distance to large exporter	Ades-Di Tella (1999)	Bonaglia et al. (2001),
Legal origin	Gatti (1999), La Porta et al (1999)	Suphachalasai (2005),
Area size		Bonaglia et al. (2001),
Latitude		La Porta et al (1999)
Masculinity	Park (2003)	
Natural resources	Leite-Weidmann (1997)	

## Annex 5: Surveys on corruption diffusion

(Source: Adapted from de Haan, Seldadyo, 2005)

Institution	Survey	Rating Range		First Published	Last Published	Country Coverage	Subject Measure
	Name	Corrupt	Clean				
Institute for Democracy in South Africa, Ghana Centre Democratic Development, Michigan State University	Afrobarometer Survey	Percentage Fairly-very common	Percentage fairly-very rare	1999	2004	12	1. How common corruption among public officials 2. Whatever or not corruption worse under the previous regime
Business Environmental Risk Intelligence	Political Risk Index	0	100	1970s	2003	50	How frequently corruption required in business
Columbia University	State Capacity	Severe	Low	1990	2003	95	Severity of corruption
Standard and Poor's DRI Economist	Country Risk Review	0	10	1996		106	Immediate and secondary risk events
Intelligence Unit	Country Risk	1	10	1980	2004	115	Pervasiveness Of corruption
Freedom House	Nation in Transition	7	1	1995	2003	27	Level of corruption
Institute for Management Development	World Competitiveness Yearbook	0	10	1987	2005	60	Bribing and corruption in the public sphere Bribing and corruption in the economy
Impulse	Exporter Bribery Index	10	0	1994		103	Proportion of deal involved corrupt payments
Information International	Survey of Middle Eastern Business				2004	31	How common bribes How costly they for doing business How frequently public contract awarded to friends and relatives
International Country Risk Guide	Political Risk	0	6	1982	2004	144	Gov. Off. To demand special payments Illegal payments generally expected
International Working Group	Crime Victim Survey			1989		58	Gov. Off. To ask to pay a bribe for his service
Latinobarometer	Latinobarometer Survey	100	0	1988	2003	17	1. Corruption 'increased a lot', a little; 'decreased a lot' a little; or 'remained the same' the last 12 months 2. Direct experience of corruption 3. Proportion of corrupt civil servants
Merchant International Group	Grey Area Dynamics	100	0	1990s	2004	155	Range from bribery of gov. Ministers to inducements payable to the humblest clerk
Multilateral Development Bank					2002	47	widespread the incident of corruption

## THE IMPACT OF LACK OF COOPERATION BETWEEN MUNICIPALITIES AND ACADEMIC ORGANIZATIONS ON ECONOMIC DEVELOPMENT IN SLOVAKIA

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### ABSTRACT

The paper deals with the issue of human resources as the important factor of territorial and economic development. The aim of the paper is to characterize the situation in the field of human resources as a key factor of territorial development and its development by universities in the Slovak regions as a potential competitive area, to identify the problem areas and highlight the important role of universities in the context of territorial development based on internal resources. The theoretical part defines the role of human resources in the process of competitive advantage creation, its importance especially in relations with the universities and research institutions by methods of scientific abstraction, synthesis and analysis. The analysis of the paper draws from the outputs of secondary research and selected results of primary research. Firstly, a questionnaire survey in the local municipalities of Slovak Republic was conducted, and then structured interviews were realized with the managers of regional self-governments. The research results aimed on theoretical aspects of exploring issue were gained through questionnaire survey in the form of Delphi method realized with the experts in the research field. The description method, deduction, synthesis and analysis, and the statistical apparatus were applied. The final section contains a list of the proposals, which implementation would contribute to develop the quality human resources in Slovak regions. Slovakia has good prepositions for building creative economy and industries based on the skilled and educated human resources, what can initiate the creation and use of further competitive advantages.

**Keywords:** human resources; territorial development, universities; cooperation.

## INTRODUCTION

Human resources have always been a part of the competitive advantage factors, each approach to competitive advantage, and each of the authors, who are devoted to this issue; consider human resources as very important for the formation, existence or use of a competitive advantage. A number of authors (e.g. Borseková, 2012, Vaňová 2006; Skokan 2004, Martin, Kitson, Tyler 2004, Barney 1991, 1997, 2002, Ulrich, Lake 1991, etc.) consider human resources as a key factor for competitive advantage in the territorial economic and social development. They become a part of the territorial offer, but also the holder of strategic decisions in the territorial progress and efficient use of its endogenous resources.

The aim of the paper is to characterize the situation in the field of human resources as a key factor of territorial development and its development by universities in the Slovak regions as a potential competitive area, to identify the problem areas and highlight the important role of universities in the context of territorial development based on internal resources.

The paper is an output of the project VEGA 1/1010/11 Theoretical and methodological basis of planning in terms of public administration and the possibility of its application in the Slovak Republic.

## HUMAN CAPITAL AS A COMPETITIVE ADVANTAGE IN THE TERRITORY

Considering several approaches and research studies (Vaňová 2006; Martin 2004, 2005; Kitson, Tyler 2004; Annoni, Kozovska 2010; Huovari 2001; Boschma, Cooke 2007; Skokan 2004; Gardiner 2003; Kloudová 2010; Florida 2002; Barney 1991, 1994, 1997, 2002; Hall 2003, 2004) is possible to define sources of unique characteristic of territory which are based on endogenous resources and should be considered as factors of competitive advantage based on resources. Our more than 3 years long research has confirmed that the human resources are the most important factor for proper identification and exploitation of the competitive advantage on the regional level. The quality of human potential is inimitable characteristic of the region and plays crucial role for identification, building and utilization of competitive advantage in the area (Borseková, Vaňová, 2010, 2011, 2012).

Human capital is generally seen as a set of knowledge, abilities and skills of the individuals, used in the activities that stimulate economic development and growth (Muhamad, Sulaiman, Sanus, 2012). Human capital with high quality can represent an important competitive

advantage, because the human is a holder of the development, decides about utilization of potential and resources available in the territory.

There exist various studies that declare the positive relation between human capital and the economic development. Glaser et. al. (2004) researched the positive affects of human capital on the political institutions, what fosters economic growth. Castelló-Climent (2008) finds evidence that and educational improvement experienced by the majority of the population influences democracy via both implementation and sustainability of democracies. Coe et al. (2009) deal with the specific role of institutions for knowledge creation and they evidence that better institutions increase the returns to R&D investments, and also increase the benefit from international R&D spillover and human capital formation. The positive interaction between human capital and institutions is declared also by Dias, Tebaldi (2012). They see the institutions as a key factor to set up the path of human capital accumulation, which fosters technology and output growth. In their empirical study they confirmed that the structural institutions positively affect long-term economic performance.

The importance of human capital and institutions (universities, research institutes) stresses also the innovation systems literature (e. g. d'Agostino, Scarlato, 2012, Barbosa and Faria, 2011, Lundwall, 1992). The authors underline the influence of intangible assets and specific institutional characteristics on innovation capacity at the regional level. They research the different aspects of social and institutional quality on innovations and economic development (Crescenzi, Rodriguey-Pose, 2011; Agostino, Scarlato, 2011; Sterlacchini, 2008). The special attention was given to the research of correlation between local capital, educational institutions and quality of life by Winters (2011). He confirmed by multivariate regression that the human capital stock and the presence of educational institutions make areas nicer to live and increase the quality of life.

Our previous resources (questionnaire survey through the Delphi method realized among the experts from theory and practice dealing with issue of competitive advantage – from March to November 2011; empirical research among the managers and employees in all Slovak regional self-governments realized through structured interviews in 2012) shows that among experts from theory and praxis, high quality human capital is the most important factor of competitive advantage. Based on the results of the questionnaire survey, when human resources are extremely good they can act as a separate competitive advantage due to the fact that the quality human capital can act as a catalyst of innovations, creative thoughts and ideas. It favors the territory with such high quality resources to others and increasing the competitiveness of the territory or generates new jobs in the same time.

The dominant role of quality human resource (educated, skilled and talented) in the territorial development reflected the new economic approach – creative economy. The creative economy is defined as industries that have their origin in individual creativity, skill and talent, and which have a potential for wealth and job creation through generation of ideas, products and/or services (The Office of Cultural Affairs & Special Events 2010). The creative economy has the potential to generate income and jobs through promoting social inclusion, cultural diversity and human development (Deisbury and Basu 2010). The roots of creative economy are found in the knowledge economy, but the main point of creative economy is human creativity producing ideas and creative content, the realization of which initiates a production characterized by high added value and marked economic growth. It follows that the creative economy can be understood as a new evolutionary stage of the knowledge economy (Florida 2002).

UNCTAD defines creative economy as an evolving concept based on creative assets potentially generating economic growth and development. It can foster income generation, job creation and export earnings while promoting social inclusion, cultural diversity and human development. It embraces economic, cultural and social aspects interacting with technology, intellectual property and tourism objectives. It is a set of knowledge-based economic activities with a development dimension and cross-cutting linkages at macro and micro levels to the overall economy. It is a feasible development option calling for innovative, multidisciplinary policy responses and interministerial action. At the heart of the creative economy are the creative industries (UNCTAD, 2010).

Arts, culture, and the sciences belong to the main pillars of the creative economy. It contains the production of a creative sector, which is a part of the tertiary sector including companies doing business in areas such as research, development, science, media, film, theatre, music, art, architecture, leisure time activities, and sports. The creative sector plays an important role in the competitiveness of economically developed countries (Kloudová and Stehliková 2010).

In connection with the development of the creative sector has formed a new working class named creative class. Among the first authors who have dealt with this issue belong John Howkins and Richard Florida. The authors highlight the economic contribution of scientists, artists and people with talent who have the ability to come up with new, original, unconventional and creative ideas that generate the highest added value in advanced economies (Kloudová, 2010, p. 13-14). The creative class includes the creative professionals and the creative core. The creative core includes all real creative workers – designers, programmers, artists etc. The abilities of creative core are developed with assistance of the

creative professionals. They are usually higher educated and oriented on solution of specific problems. They come from the academic environment of universities and research centers. They influence the further creative development in the territories (Florida, 2002).

Florida (2002, p. 74) states that in the last century in advanced economies (especially in the USA) there has been significant growth of creative workers to the detriment of worker professions. Many researches support this claim. For example the Report in Nova Scotia Building the creative economy in Nova Scotia (Hamilton, Arbic, Baeker, 2009) states that the creative industries in 2005 were 3, 4% of total world trade and exports reached \$ 424, 4 billion. The growth of world trade in creative goods and services was 8, 7% from 2000 to 2005. The report also states that the industry related to culture and directly and indirectly related activities in Canada have created a significant economic impact and formed 7, 4% of GDP. Cultural sector together with its directly and indirectly related activities in 2007 employed 1, 1 million workers, while almost the same number as employing agriculture, fishing, mining, and service sectors combined. The importance we attached to the creative economy and high quality human resources in terms of global economic and financial crisis. Several surveys showed that the creative sector was the least affect by the crisis and become a stable pillar of several economies in the world. As an example we can mention the situation from USA in November 2008 when the country's overall unemployment rate climbed to 9, 4%, but unemployment in the creative industries was less than 3% (Suciu, Ivanovic, 2009, p. 382).

To develop creative economy successfully, it is necessary to know the region, and to support key creative economy factors: the leadership and participation, awareness and education, infrastructure, investments and policy (Hamilton, Arbic, Baeke, 2009).

For the deep analysis, we focus on the one of the key creative economy factors – awareness and education. Where universities and research centres play the dominant role as well as in the economic and social development of the territory based on quality human resource (see chapter Human capital). The university comprises a potential – and, in some places, actual – creative hub that sits at the center of regional development” (Florida, Gates, Knudsen, Stolarick, 2006, p. 20). It means that the most important part of the territorial potential for the creative economy has an innovation potential which include universities and research centres (Godard, Chatterton, 1999; Holland, 2001; Etkowitz, 2002; Mille, 2004; Florida, 2006; Vaňová). They should be considered as the main actors in the knowledge generation process (Castells, Hall, 1994) and their location in the region is a key presumption of the economic and social development (OECD, 1999, Godard, Chatterton, 1999, Holland 2001, Etkowitz, 2002). Universities make an economic contribution to their host territory in two ways. Firstly, there

is the direct impact of the initial investment and the effects of students and staff spending and universities operating expenditure on the surrounding economy. However, universities are also public institutions that carry out missions of higher education, training and knowledge dissemination that contribute to the local accumulation of human capital, as well as missions of research and knowledge creation that promote technological progress in the host territory (Mille, 2004, p. 2). The universities should be seen as an important stakeholder in the territorial development and development of human capital. They are not able to achieve these aims separately, only in collaboration with all other relevant stakeholders in the territory mainly with local government, entrepreneurs, non-profit organisations etc. (Petríková, 2011). Mille (2004, p. 81) identified two ways in which universities contribute to the development of economy. Firstly, education and training activities improve the level of human capital of the individuals attending universities and of society as a whole and, secondly, universities's basic and applied research activities, whether contractual or not, contribute to improving the economy's stock of scientific and technological knowledge.

Slovakia has a potential to develop the economy and industries based on quality human resources, what is also the preposition for development of creative economy. Due to this fact, in the next part of the paper we characterize on the basis of statistical data the Slovak regions from the innovation point of view and with the detailed focus on universities and colleges and their cooperation with the local municipalities as a core for the territorial development based on the human resources.

## **RESEARCH AND METHODOLOGY**

Refer to the theory; the paper presents the selected outcomes of primary and secondary research. Secondary research summarizes statistical data focusing on the data about the structure of universities in Slovakia, R&D expenditures and its comparison with EU, unemployment rate of university students, regional gross domestic product in Slovakia provided by the Statistical Office, Euro stat and data of Slovak Ministry of Education.

The primary research includes the results of two surveys. Firstly, the questionnaire survey was conducted in 100 municipalities. The aim of the research was to analyze the relationships (the level of cooperation), among the universities research centers and local municipalities in Slovakia with focusing on the activity of these stakeholders, importance and quality of the relationship and the reasons for their disruption. The representative sample was prepared in the form of quota selection. We established two basic quota - size of the municipality and

region, in which the municipality is located. The sample comprises 66% municipalities of the small size (from 0 to 999 people), 28% of medium-sized municipalities (from 1,000 to 4,999 people), and 6% of large municipalities over 5,000 people. Respondents in the selected municipalities were identified as mayors (66%) and representatives of the mayors (18% of respondents), heads of municipal offices (7% of respondents), 9% of respondents did not specify their position. Employers all of these positions in the structure of Slovak municipalities are responsible for the development of relationships with stakeholders on its territory.

Secondly, the questionnaire survey through the Delphi method among the experts from theory and practice was conducted. It dealt with issue of competitive advantage; and empirical research among the managers and employees in all Slovak regional self-governments realized through structured interviews. The results of the Delphi method were used in the formulations of theoretical presumptions in the field of identification the human resources as an important factor of the competitive advantage.

The empirical researches were done during the same election period (2009 – 2012). All collected data were processed by the programs – MS Excel and IBM PASW Statistics 18.0 with using various mathematical and statistical methods – correlations analysis, medium values etc.

In the paper we use also the methods of scientific abstraction, synthesis and analysis, description and in the processing of the research outputs mainly descriptive method, deduction, analysis, synthesis.

The end of the article concludes the possible ways to initialize the improving measurements in the cooperation of local municipalities and universities, and how to support the talented, creative and innovative human resources helping in the economic and social development in the Slovak regions.

## **UNIVERSITIES IN THE SLOVAK REPUBLIC AND THEIR ROLE IN THE REGIONAL DEVELOPMENT**

The Slovak Republic was established in 1993 as a republic. Nowadays, it belongs to the post-transitional economics as well as Poland, Czech Republic and Hungary. The overall population of the Slovak Republic is approximately 5,405 million and consists of 51% women and 49% men. In 2009 Slovakia achieved the highest natural (8304) and overall growth (12 671) of the population over the last 13 years. (<http://portal.statistics.sk/showdoc.do?docid=1686>).

The most valuable capital in Slovakia is a human capital. Its high quality and price were the main factors which have attracted the foreign investors to invest in Slovakia during last ten year. But the world economic crisis shows that the situation is not sustainable because there is a lack of sophisticated and innovative production with the high added value (Report about the current state of business environment in Slovak Republic, 2010). One of possible way how to minimize the effects of the situation and initiate the new sources of development can be the orientation on the education system and strengthening the role of universities and research centers in the economic and social development in Slovakia.

In Slovakia, there are 33 high schools with diversified orientation, including 12 universities, 11 colleges (1 College of Economics, 5 Technical Colleges, 3 Colleges of Art and 2 Military and Police Academies), 10 private colleges and 3 foreign colleges. Their structure by the regions and by the owner present table 1.

Table 1 Structure of the universities and colleges in Slovak regions

Universities and colleges in Slovak regions	public	state	private	Total
Bratislava	5	2	4	11
Trnava	2	0	2	4
Trenčín	1	0	2	3
Nitra	3	0	0	3
Žilina	2	1	0	3
Banská Bystrica	3	0	0	3
Prešov	1	0	1	2
Košice	3	0	1	4
Total	20	3	10	33

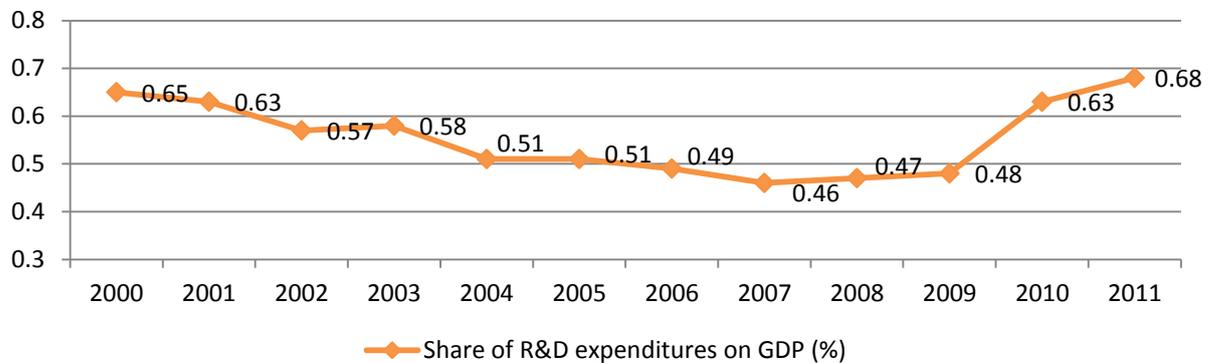
Source: Own workmanship of data from Slovak Statistical Office.

Number of higher education institutions we consider sufficient. The highest number of universities and colleges is localized in Bratislava region. The region is an administrative and economic centre of Slovakia and also the seat of capital city. There concentrates also the qualified human capital. Four universities and colleges are situated in the regions of Trnava and Žilina. The less number of universities and colleges is localized in Prešov region.

The universities and colleges are the main holders of research activities and also the key source of innovations. The position of Slovakia and the contribution of Slovak universities and colleges to the global research development are endangered by the low financial support from the national level, understood as a share of research and development expenditures on the GDP in Slovakia. It is a real weakness or competitive disadvantage connected with the

quality human resources. The development of the indicator during 11 years is illustrated in Figure 1.

Figure 1 R&D expenditures as a % of GDP in Slovakia form 2000 to 2011

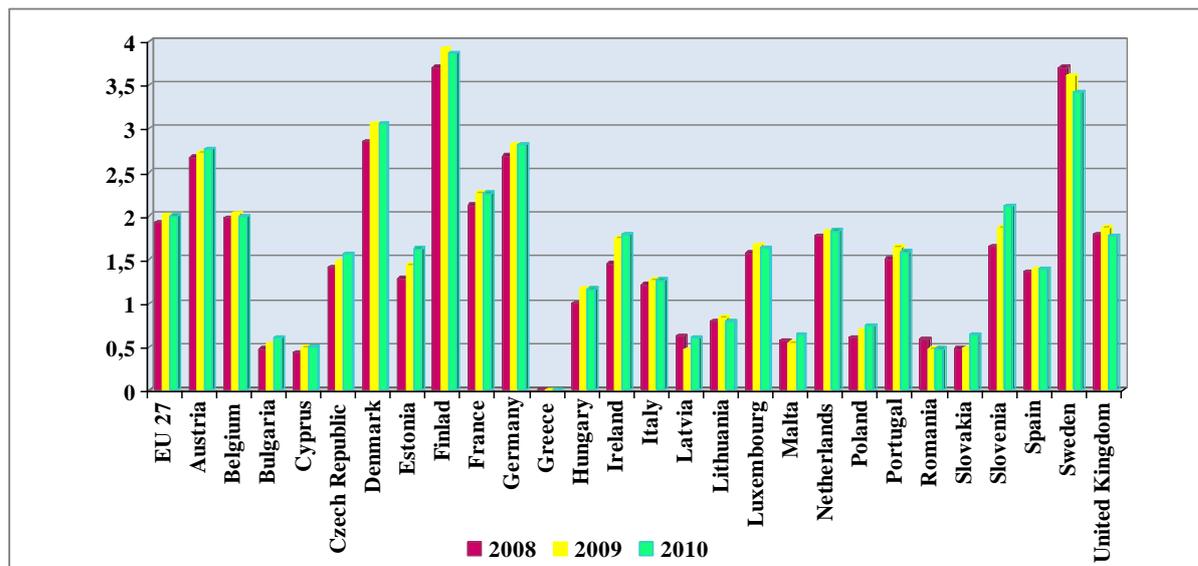


Source: own workmanship of Slovak Statistic Office data.

During the whole observed time period, the level of R&D expenditures share on GDP is less than 0.70 %. This weakness negatively affects the building of the potential competitive advantage associated with high quality human resources. In comparison with other European countries, the situation in Slovakia is alarming and the change in this area is really necessary. The following Figure 2 shows the expenditures on research and development (R & D) as a percentage of GDP of all member states of the European Union. Figure 1 shows that in 2009 Slovakia ranked the 2nd last position among all EU countries. The share of R & D expenditure was less than 0.5 % of Slovak GDP. In 2010 Slovakia was the 5th from the end before Cyprus, Bulgaria, Romania and Latvia. This position we consider as an extremely negative indicator that influences dominantly the possibilities of further development in this area.

The expenditures on R & D in Slovakia are inadequate and their share of expenditure on R & D on GDP should be increased, not only because they are committed to a number of strategic documents and plans, but mainly because the research and development, knowledge infrastructure, creative and innovative potential and related innovation activities belong among the key factors of competitive development of territory. Due to the age and educational structure of Slovak population, the support of science and research in Slovakia through the synergistic effect could contribute to emergence of innovation and increase of competitiveness in Slovakia.

Figure 2 R&amp;D expenditure as a % of GDP in all EU countries



Source: own workmanship according to <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsiir030>

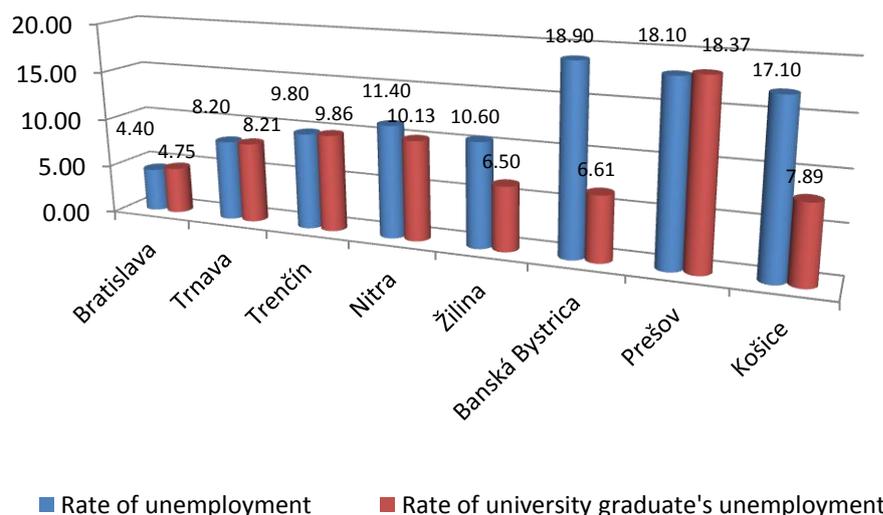
Increased spending on research and development is not sufficient solution of outstanding problems in this area. Before increasing expenses, it is necessary to review the whole system of R & D funding, which is in urgent need of restructure change. The current system is characterized by the resistance of the structure and forms of public funds invested into the science, research and innovations, not-reflecting the needs of private and public sector, lack of international cooperation within the European research area. The aim of restructuring scientific and technical infrastructure in Slovakia should be to achieve higher quality of research activities, university educations and lower depending R & D institutions on government decisions (National Strategy of Regional Development in Slovak Republic, 2008; Report about the current state of business environment in Slovak Republic, 2010).

One of the reasons why to invest more in the field of research and development is the fact, that educated people have better opportunity find the job position regardless their qualification and skills. The unemployment rate of university graduates in 2009 (data from the years 2010, 2012, are not available) presents figure 3 (see next page) in comparison with the registered rate of unemployment in Slovak regions.

The unemployment rate of university graduates is in four regions – Košice, Banská Bystrica, Žilina, Nitra lower as the registered rate of unemployment. The rate of university graduates is a little bit higher in Bratislava region, but it can be caused by the number of graduates from 11 universities and colleges. The similar situation is in Trnava region. The worst situation is in

the Prešov region. In this region, the lowest number of universities and colleges is localized, only 2, the rate of unemployment of the graduates is the highest. But the position of Prešov region influences also the economic situation (see table 3 - the share on national GDP is only 8,42% what indicates the lowest level of economic activities in comparison with the rest of Slovak regions).

Figure 3 Unemployment rate of university graduates in 2009



Source: own workmanship of data of Slovak Ministry of Education and data of Slovak Statistical Office.

These findings confirm the fact that the localization of universities and colleges in region can be a source of economic and social development, as well as the results in table 2. They illustrate the regional gross domestic product in Slovak regions.

Table 2: Regional Gross Domestic Product in EUR in 2010 at current prices

Region	Mil. Eur	Share on SR in %	GDP ratio to average of Slovakia in PPS
Bratislava	18 297	27,78	241,05
Trnava	7 666	11,64	112,39
Trenčín	6 435	9,77	88,57
Nitra	7 105	10,79	83,07
Žilina	7 500	11,39	88,59
Banská Bystrica	5 857	8,89	73,97
Prešov	5 546	8,42	56,56
Košice	7 464	11,33	78,98
Total in SR	65 869	100	100

Source: Eurostat.

Table 2 presents that the regional GDP was the highest in Bratislava region, its share on national GDP is 27.78 %. Nearly the same volume of GDP is produced in regions – Trnava, Žilina, Košice and Nitra. The lowest contribution to the national GDP brings regions Prešov, Banská Bystrica, Trenčín.

When the table 1 and table 2 is compared, there is possible to see that the regions where more universities and colleges are localized, also the regional GDP is higher – namely in Bratislava region, Košice region, Trnava region. It declares a lot of experts dealing with the human resources and its role in territorial development (Godard, Chatterton, Holland, Etkowitz, Mille, Florida, etc.). But when we compare the figure 3 and table 2, the results are more different. In spite of the fact that in Košice region, 4 universities and colleges are situated, it produces 11.33% of national GDP, the unemployment rate is the third highest in Slovak regions. This problem can be caused by various factors, as we said e. g. price of human resources, the location of Roma ethnical minority, but the important role can play also weak cooperation of stakeholders in regions.

In Slovakia, the flow of ideas, knowledge among universities and colleges, entrepreneurs and other relevant stakeholders stagnates in the regions. It creates also the barriers for development of creative environment and exploiting the creative potential as well as the lack of financial support of research (see Figure 1).

The next factor, which strength the existing barriers is a disinterest of entrepreneurs, also local and regional managers in cooperation with universities and colleges, including the underestimating its effects for territorial development. However, the local and regional management could be in a position of mediator that can support the flow of the innovations and creative ideas and develop the cooperation among the universities and entrepreneurs. They could help to keep the graduates in the regions and bring new idea to their development.

The same results were researched also by the questionnaire survey among the experts from the theory and practice. They consider the cooperation as very crucial for identification and exploitation competitive advantage, but nowadays in Slovak regions is a lack of cooperation one of the greatest barrier for building competitive advantage.

In the next chapter, we present the partial outcomes of national research aimed at the exploring the relationships between the universities and colleges and local municipalities in Slovak Republic. It provides the complex view on these relationships and identifies its development possibilities.

## COOPERATION OF UNIVERSITIES AND COLLEGES WITH THE LOCAL MUNICIPALITIES IN SLOVAK REPUBLIC

The existence of high quality human resources is closely linked, and dependent on the level of higher education that is guaranteed in the Slovak Republic, especially by colleges and universities. The primary impacts of these institutions are manifested in the closest areas – in the place of its residence, in the region where they are located. In the questionnaire survey conducted by us, we focused on examining the characteristics of the relationships between the selected local governments and colleges and universities, the reasons for their development and problematic issues that are associated with its building. Selected results are presented in the table 3 and explained in the text below.

Table 3 Selected characteristics of relationship between local government and universities, colleges

Selected characteristics of relationships between local government and universities, colleges					
Kind of relationship in %		Importance and quality of the relationship (standard deviation)		Activity in the relationships in % (100 % = 44 local governments)	
Partners	43	Importance	5.19 ( $\pm$ 2.71)	Both partners	34.09
Partners and rivals	1	Quality	2.78 ( $\pm$ 1.05)	Local governments are more active	20.45
No cooperation	48	Difference	2.42	Universities and colleges are more active	25
Without answer	8			Only the universities and colleges are active	6.82
				Without answer	13.64

Source: Own workmanship of data of questionnaire survey

Respondents of the local governments showed by their responses that the expected assumption that cooperation between municipality and university is minimal. Up to 48% of local governments do not cooperate with universities and colleges, 1% of respondents perceive them as rivals and partners; 43% of local governments see the college or university as partners, 8% of respondents did not answer.

Generally, the development of the relationship between local governments and colleges and universities should have an interest in both parties. But, according to the local governments, the relationship is developed by both parties only in 34.09 % of municipalities. 20.45% of local governments are more active in this relationship and 31.82 % of answers declared more active approach of universities and colleges.

Furthermore, all asked governments evaluated the importance (the potential level of relationship) and quality (the real level of quality) of the investigated relationship with colleges and universities. The respondents could evaluate these aspects by the scale of points from 1 to 10, where 10 meant the most important, the best and 1 the least quality and the least important. The average value of the importance of the relationship with colleges and universities was evaluated by local governments at 5.19 points (with a standard deviation of  $\pm 2.71$ ); the quality of the relationship was evaluated by 2.78 points (with a standard deviation of  $\pm 1.05$ ). Comparing these values, we find out that by the importance is the investigated relationship with colleges and universities is considered to be moderately important for local authorities and by the quality of relationships, it belongs to the low quality relationships (difference between quality and importance is 2.42 points). The presented results show a negative level of cooperation between universities, colleges and local governments, and also the fact that local governments have not yet realize the importance and potential of colleges and universities for the development of its territories.

In detail analysis of this relationship, we continued by the Spearman correlation test between quality and importance of the relationship (Table 4).

Table 4 Spearman correlation test

<b>Correlation</b>		Universities, colleges	Universities, colleges
Spearman's rho	Correlation Coefficient	1,000	0,793*
	Sig. (2-tailed)	-	0,000
	N	58	58
	Correlation Coefficient	0,793**	1,000
	Sig. (2-tailed)	0,000	-
	N	58	58

Source: Own workmanship of data of questionnaire survey

Based on the test results, we claim that there exist the correlation between the importance and quality of relationships between local government and universities, colleges. The correlation coefficient is 0,793, what means the strong interdependence. If the local governments considered the relations more important, also quality should be higher. The results of the questionnaire survey show that the local governments do not realize sufficiently important position of colleges and universities in the development of human resources, which then has an impact on the efficiency of the use of endogenous resources in the territory, which includes also human resources.

Another researched aspect of relationship with colleges and universities is the reason for its existence. The largest number of municipalities (23%) reported as a reason for the development of the relationship - increasing the educational level; 12% of municipalities develop this relationship to ensure awareness. Among the reasons for building a relationship with colleges and universities (10% and less), local governments include also promotion of municipality, education of youth, ensuring effective collaboration, ensuring satisfaction, building a good image of the municipality; support of youth activities, attractiveness of municipalities; legislative obligation; coordination of different interests; development of joint actions, and others.

Relations of local governments and colleges and universities belong to the less conflicted. Nevertheless, local governments have identified a number of problematic issues. They include mainly the unavailability of higher education institutions (28%), lack of communication (14%), lack of awareness (9%), lack of financial resources (6%) and others (e.g. different goals and priorities, disagreements in the past, favoring their own interests, lack of reliability, etc.).

To conclude the results, the situation in cooperation between local municipalities and universities and colleges is inconvenient. The local municipalities do not use the potential that these education institutions provide, what can be a source of stagnation and lower level of development.

The similar situation is also in regional self-governments. According to our previous research in Slovak regions in 2012, all respondents of structural interviews confirmed our assumption that the level of cooperation is not sufficient. None of the representatives of regional self-governments considered the localization of universities and colleges in their region as an advantage. They also do not cooperate with universities and colleges in preparation of strategic, planning and development documents and representatives of universities do not act in advisory roles. This situation is unsatisfied and requires change in minds and attitudes of stakeholders.

## CONCLUSIONS

The position of human resources as a basis for competitive advantage has been confirmed by many foreign and several domestic researches. The secondary and primary research showed that the Slovak Republic has a strong potential of human resources. However, not all

supporting tools are utilized for their development. Especially, the role of universities and colleges is underestimated.

Quality human resources are considered as the most important factor in the competitive advantage of region. If the human resources are in good quality and permanently developed, they can act as an independent competitive advantage. This is mainly due to the fact that the quality human resources can act as a catalyst for innovation, creative thoughts and ideas, which favor the territory with such high-quality resources to others, increase the competitiveness of the territory and generate new jobs.

Human capital in Slovakia, in our opinion, is in high quality and its low price create predisposition to be a strong potential competitive advantage of Slovakia. Human resources are owners of scarce capital in the form of knowledge, skills and know-how that can create, acquire or use. It is extremely important to create the conditions to human resources by the central and regional authorities in a country or region. This field is problematic in the Slovak republic as showed the empirical research. The expenditure on research and development in Slovakia are one of the lowest in the whole European Union. There absents the conceptual cooperation among universities, colleges and local municipalities which help to keep the university graduates in regions, to employ at the local entrepreneurs or investors. There is a lack of research cooperation between the stakeholders in regions, lack of networking support, connecting skills and knowledge, lack of creative employee's motivation.

To utilize the potential competitive advantages associated with human resources and create real competitive advantage based on the quality human resources, we recommend a number of measures that should be implemented by the regional and local body. The local and regional authorities in cooperation with the universities should support existing businesses in its territory, as well as start-up creative and innovative entrepreneurs, e.g. in the form of startup competitions and pilot innovative projects. For example, the authorities can help them by providing space for lower rate, through promoting, organizing business seminars. The universities can help by developing ideas and knowledge at the workshops or conferences, where the entrepreneurs can gain valuable contacts, partners, customers and potential employees. The local and regional self-government bodies should seriously consider and implement the systemic approach to improving the quality human resources, training of the population to the true market economy and build quality creative class through cooperation with colleges and universities. The emphasis should be placed on the rapid transfer of new knowledge and ideas into practice, exchange and sharing of experiences and know-how.

Implementation of these measures would contribute to increase the competitiveness of human resources of the Slovak Republic, but can be also a valuable source of Slovak regional development.

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**“THEORETICAL FRAMEWORK ON PUBLIC PRIVATE  
PARTNERSHIP AND SERVICE CONCESSION ARRANGEMENT,  
BEFORE AND AFTER IFRIC 12 ADOPTION. A RESEARCH NOTE:  
EVIDENCE IN SUBSTANCE FROM ITALY”**

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## **ABSTRACT**

The present paper aims:

- (i) to achieve a consistent systematization of business and economic literature on Public Private Partnerships (PPPs) and Service Concession Arrangements (SCAs), in favour of the implementation and management of public assets granted to contractual entities (Foldvary, 1994, 2010), falling within the discipline of IFRIC 12, before and after its adoption by scholars from different countries;
- (ii) to analyze and systematize the clarification provided by IFRIC 12 (Laghi, 2010; Campra, 2012: 2675), in relation to service concession for concession operators providing a public service or public work, especially in Italy, by means of a “literature survey ” also evaluating the bibliometric analysis from other studies (Capellaro, Cuccurullo, Marsilio, 2009, 2011).
- (iii) to determine to what extent IFRIC 12 helped to improve the order and to simplify the conceptual vagueness and chaos of definitions applying to the different forms of PPPs and SCAs. How much evidence does currently exist in the literature subsequent to the introduction of IFRIC 12. Will the analysis of the selected case studies proposed in this paper be able to get an answer to this question.

IFRIC 12 gives guidance on the accounting by operators for Service Concession Arrangements (SCAs) between a public body and a private company, it does not

specify the accounting by grantors, and provides for the concession assets, once verified some objective and subjective conditions (Laghi, 2010: 127), an alternative way to recognize them. In fact, infrastructure within the scope of this Interpretation shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator. Infrastructure shall not be recognized as material activity (highways, water supply, etc.), but as a right to charge users (intangible asset); or a right to receive consideration from the grantor for utilities paid (financial assets); or a mixed method, forked method (Campra, 2011). The proposed systematization of business literature, even in the presence of a weak and not systemic defense of the doctrine on the subject, would make it possible:

- a) to highlight in a systematic manner the weaknesses linked to the application of contractual PPPs and SCAs in Italy, detected by different scholars with regard to the adoption of IFRIC 12;
- b) to provide a starting point for future researches, identifying elements that are capable to predict crisis or scandal (Di Pietra, McLeay, Ronen, 2010; Di Pietra, Gebhardt, McLeay, Ronen, 2012), even through subsequent international comparisons by scholars from different countries (stone, 2000, 2002; Ronen, 2008; Dean, Gebhardt, 2008).

**Keywords:** *Public Private Partnership (PPP), Service Concession Agreement (SCA), public services, regulation, concession, IFRIC 12.*

## INTRODUCTION

The present paper aims:

- (i) to achieve a consistent systematization of business and economic literature on Public Private Partnerships (PPPs) and Service Concession Arrangements (SCAs), in favour of the implementation and management of public assets granted to *contractual entities* (Foldvary, 1994, 2010), falling within the discipline of IFRIC 12, before and after its adoption by scholars from different countries;
- (ii) to analyze and systematize the clarification provided by IFRIC 12 (Laghi, 2010; Campra, 2012: 2675), in relation to service concession for concession operators providing a public service or public work, especially in Italy, by means of a

"literature survey " also evaluating the bibliometric analysis from other studies (Capellaro, Cuccurullo, Marsilio, 2009, 2011).

- (iii) to determine to what extent IFRIC 12 helped to improve the order and to simplify the conceptual vagueness and chaos of definitions applying to the different forms of PPPs and SCAs. How much evidence does currently exist in the literature subsequent to the introduction of IFRIC 12. Will the analysis of the selected case studies proposed in this paper be able to get an answer to this question.

The accounting treatment to be applied to "Service Concession Arrangements" (SCA), under IFRIC 12, represents one of the most significant and emblematic cases where the principle of the prevalence of substance over form prevails (Meyer, 1976; Shere, 1986; Adwinckle, 1987, Di Pietra, 2010), as to highlight "typical light and shade" of a principle which is the basis of IAS/IFRS accounting model (Laghi, Giornetti, 2009; Laghi, 2010).

IFRIC 12 gives guidance on the accounting by operators for Service Concession Arrangements (SCAs) between a public sector body and a private sector entity, it does not specify the accounting by grantors, and provides for the concession assets, once verified some objective and subjective conditions (Laghi, 2010: 127), an alternative way to recognize them. In fact, infrastructure within the scope of this Interpretation shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator. Infrastructure shall not be recognized as material activity (highways, water supply, etc.), but as a right to charge users (intangible asset); or a right to receive consideration from the grantor for utilities paid (financial assets); or a mixed method, forked method (Campra, 2011). The proposed systematization of business literature, even in the presence of a weak and not systemic defense of the doctrine on the subject, would make it possible:

- a) to highlight in a systematic manner the weaknesses linked to the application of contractual PPPs and SCAs in Italy, detected by different scholars with regard to the adoption of IFRIC 12;
- b) to provide a starting point for future researches, identifying elements that are capable to predict crisis or scandal (Di Pietra, McLeay, Ronen, 2010; Di Pietra, Gebhardt, McLeay, Ronen, 2012), even through subsequent international comparisons by scholars from different countries (stone, 2000, 2002; Ronen, 2008; Dean, Gebhardt, 2008).

## SECTION I

### RESEARCH OBJECTIVE

The objective of the present paper is to analyze the impact and the scope of IFRIC 12 's innovative discipline on accounting , in reference to PPP, and in particular with regard to service concessions for concession operators offering public service or public works in Italy, through an organic systematization of the business literature on the topic (Laghi, 2010; Campra, 2012: 2675). The work is divided into two main sections. The first section describes the relevance of the research theme, its practical implications, the historical reconstruction and the regulatory framework referring to PPP in Italy. The second section is divided into two parts. The first part, highlights the phenomenological trend in Italian PPPs; the second part proposes a classification of literature on PPPs and the SCA (literature survey), *before and after* the adoption of IFRIC 12.

IFRIC 12, provides a set of guidelines on accounting by concessionaires for Service Concession Arrangements (SCA) between public authorities and private companies (Oricchio, 1996), it does not deal with the accounting by the grantor, and provides for the concession assets, once verified some objective and subjective conditions (Laghi, 2010: 127), an alternative way to recognize them. In fact, infrastructure within the scope of this Interpretation shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator. Infrastructure shall not be recognized as material activity (highways, water supply, etc.), but as a right to charge users (intangible asset); or a right to receive consideration from the grantor for utilities paid (financial assets); or a mixed method, forked method (Campra, 2011). The proposed systematization of business literature, even in the presence of a weak and not systemic defense of the doctrine on the subject, would make it possible:

- a) to provide a systematization of economic literature on the complex and multi-faceted discipline of Public Private Partnership (PPP) and Service Concession Arrangements (SCA), falling within the interpretation of IFRIC 12;
- b) to highlight in a systematic manner the various problems of interpretation, legislation, regulation and application of the different types and different models of Public Private Partnership (PPP) and Service Concession Agreements (SCA), before and after the application of the interpretations offered by IFRIC 12;

- c) subsequent international comparisons offer by other scholars of different countries.

## METHODOLOGY

The research methodology is both theoretical and empirical:

- Theoretical framework of Service Concession Agreements and its evolutionary path in the Italian, European and international context. Review of literature;
- Significant analysis of literature through a survey process according to the different applications of IFRIC 12 and the interpretive positions by various organizations (World Bank, Oecd, the IASB, EFRAG, Eurostat, OIC, AVLP, Court of Auditors);
- Analysis of development applicative models based on differentiating variables, highlighted by the empirical analysis (case method. Triangulation: sources, methods, results);
- Case studies (Yin, 1984, 1995), "testing", new areas of investigation.

The selected case studies, have in the first case, an atypical nature, representing an anomaly for survey and accounting treatment models of IFRIC 12 (financial model); in the second case, a typical scenery, a listed company which is representative of the whole sample of reference in the panel of analyzed and classified Italian listed companies. The first case study, is characterized by being held in a majority of capital shares by the same public body which is the grantor of functional privatization (grant) for the realization of interests and works of public interest and utility. The control upon the concessionaire is held by the grantor that corresponds to the majority shareholder of the concessionaire providing public assets or services. The selected methodological support provides an answer to the following questions: does IFRIC 12 apply in the case the private entity is essentially a public body and coincident with the grantor? Would it be a public-private partnership or, would it be appropriate to consider Public Public Partnership? And does IFRIC 12 apply?

Theoretical/deductive (Yin, 1984, 1995): systematization of theories by means of an empirical verification of the evolution of the selected business models, up to an outline of future potential circumstances. Critical reflection and proposals.

## RESEARCH QUESTIONS (RQS)

In Italy, the development of the business literature on IFRIC 12, is being merely guaranteed by some authoritative scholars in addition to a large and growing group of professionals (Campra, 2005, 2012; Laghi, 2009: 26; Giussani, 2009: 180; Delladio, Gaiani, Meneghetti, Pozzoli, 2011: 168; Giovando, 2012: 200; Rotondaro, Zambon, 2010: 2010; Leo, 2011: 164; Brescia, Muraca, 2011: 381; Cordazzo, 2008: 40), despite the strategic importance and interest expressed by international literature. Shown below are the research questions to which we will try to provide an examination in the next few paragraphs:

Is it unclear the overview on business models and on the accounting treatment of concession services linked to PPP? If Yes, why?

Is the theoretical approach by Italian scholars, on service concession, different from the theoretical approach by scholars from other countries? If Yes, why?

Do literature-identified cases find a response in the empirical evidence offered by the selected case studies?

Do publicly-owned concession companies corresponding to the grantor of functional privatization, represent further forms of PPP?

After having identified the different approaches to the research theme, we will develop evolutionary profiles and any emerging experiential practice raised in literature.

Considerations, critical reflections and proactive analysis are aimed to investigate a tenuous and weak presence of Italian corporate economic doctrine within the complex and multiform rules concerning Private Public Partnership (PPP) arrangements and concession services (SCA) falling within the application discipline offered by IFRIC 12, in spite of the robust and growing interest by scholars of international law and economists, particularly by scholars of public management in the international business economic doctrine. The systemization of literature, will detect the emerging practices in the business economic doctrine, in order to verify, in a context of growing scarcity of financial resources, the identification of new business models supporting public decision-makers in an increasingly complex financial framework, in an effort to combine the pursuit of economic balance under the respect of rules, needs and rights.

This systematization can be regarded as a starting point to develop new lines and future research on PPPs and SCAs falling within the application of IFRIC12, through international comparisons, analyzing business models and specific mostly.

## THE IMPORTANCE OF THE RESEARCH THEME AND AREA

The current economic situation is characterized by increasing scarcity of public resources that are therefore inadequate to finance investment in structural works.

Consequently, it is now remarkable the possibility for public authorities to co-operate with the private investors in order to benefit from the know-how of the private sector and to overcome public budget constraints, for a given number of years, through Public Private Partnerships (PPP), within the concession system.

IFRIC 12, has radically innovated accounting methods to record and monitor financial transaction related to this phenomenon.

The analysis of IFRIC 12 allows us to handle the issue of the interaction between public body and private sectors in the field of the construction and management of infrastructure.

The analysis of national legislation and regulation regarding concessions essentially aims to identify several business areas to which these aspects apply.

The study of IFRIC 12 – given its innovative impact in comparison with the past approach – is greatly important and interesting since it represents a starting point for an analysis aimed at determining which sectors may come under its application segment and, specifically, what business might adopt IFRIC 12 (companies, etc.) or which ones might not adopt it (public-owned companies or non-listed companies, etc).

The examination will focus on the impact analysis of the accounting change produced by IFRIC 12, in relation to service concession by concessionaires providing construction or upgrade services (or more ancillary services). Further problems resulting from international comparisons will be examined, with particular reference to budget representation and business models.

The research aims to investigate the universe of concession companies that have implemented IFRIC 12, in order:

- to offer a comprehensive evidence on IFRIC 12 distinctiveness, after its introduction;
- to provide an international comparison between different application methods of PPP and SCA, in different EU countries and non EU countries.

The logical path of research, will be broken down into five main phases (Bailey, 1982; Corbetta, 2003b; Ricolfi, 2001), such as:

- bibliographic search and theoretical study of the arguments that are object of the search;

- the formulation of hypotheses and research objectives;
- research design formulation and definition of the tool (method) to be implemented in the selected case studies;
- Organization, reworking and representation of data;
- data interpretation and formulation of conclusions.

## **PPP, PF, SCA AND IFRIC 12. THE PREVALENCE OF THE LEGAL APPROACH: A CLASSIFICATION.**

### *PPP (Public Private Partnership)*

The Public-Private Partnership (PPP) refers to contract forms, based on the cooperation between a public sector entity (grantor) and a private sector entity (operator) through which their respective expertise and resources are integrated in order to perform public works or services and related management services.

A PPP process- wholly or partly - embraces the following activities:

- design;
- funding;
- construction or renovation;
- management;
- maintenance.

### *SCA - Service Concession Arrangements*

The absence of a precise definition of service concession both in national and EU legislation was filled by Community directives no. 17 and no. 18 of 2004. They both defined the service concession as "a contract that has the same characteristics of a public service contract, except for the fact that the consideration received or receivable by the operator providing public services solely consists in the right to operate the service or in this right together with payment.

Moreover, apart from the merits of defining the provision of services, the above mentioned directives exclude service concession within the Community framework. In fact, article 18 of Directive 17/2004 states that its rules do not apply to work and service concessions as well as article 17 of Directive 18/2004 provides that, without prejudice to the application of the provisions referred to article 3, this Directive shall not apply to service concessions. The above definition of service concession was drawn from the Public Contract Code (art. 3, c. 12), which also provides, at article 30 ("service concessions") the discipline of the institution for ordinary

sectors and at article 216 ("work and service concessions")-containing a reference to article 30 – the discipline for special sectors.

This definition is based on the one referring to public procurement contract: a notion concerning the concession contract is not provided as considered necessary within the European Community. However the definition solves the thorny question concerning the delineation of service contract institution, in relation to the contiguous notion of service concession and similar figures, that have been engaging both internal and European doctrine and jurisprudence, for many years.

*PPP from Giolitti to Law no. 142/90*

The discipline concerning local public services in Italy, dates back to the early 1900, in harmony with the Giolitti law (Law No. 103 March 29, 1903) in Italy. This law, which allowed municipalities and provinces to hire and manage the services deemed essential to the local authorities, remained in force until the end of the 80s of the last century, and allowed local authorities to take from the market economy those goods and services aimed to satisfy collective needs. Municipal enterprises, were therefore public enterprises operating in a single production structure and acting within the territory reference framework.

This area was excluded from the intervention of the private sector entity, which could still get reference by the administration of a concession for the management of the service.

Municipal companies and concessions, however, were not the only way in which it was possible to manage a public service. The Giolitti law, in fact, allowed the local Government to directly manage the monopoly service. Besides providing the management of the public service on the part of the local authority, the law 103/1903 also provided a list of services to be defined as such, but did not specifically outline this notion. Through this list it was possible to identify essential services for the community, services that were to be returned to the authority. The Giolitti law remained into force until 1990, year in which the dismantling of State-owned companies began in order to ensure the free market wished by the European Union. In fact, since the European Union affirmed the primacy of competition at an European level, the Italian authorities have been establishing a process of privatization of public enterprises, thus determining a u-turn compared to what happened in the early 20th century; the State basically ceased to be an entrepreneur in order to ensure the autonomy of the market, this process met strong resistance on the part of our government. The result was a long reform process, still continuing and that found his starting point in Act No. 142. of June 8, 1990,

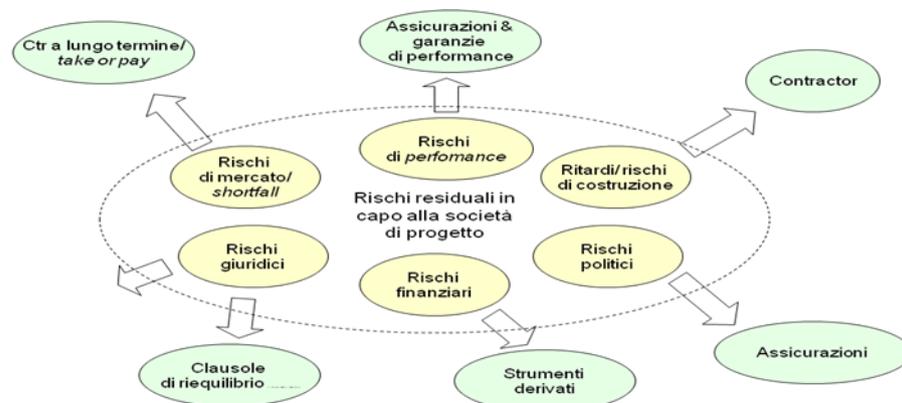
The Act, which represents the first comprehensive standard in terms of local public services and resulting from European Union law, tried to open the sector to competition according to the article 22.

## THE ITALIAN CASE: COMPLEXITY, REGULATORY CONFUSION AND STATUTORY PROFILES.

Unlike the experience of other European countries, Italy regulatory efforts have focused on the procedural aspects of the PPP, with limited attention to other relevant segments, but especially with regard to the civil rules of the relationships between the various actors involved in these operations, this also gives explanation of the scarce number of projects and little finance in relation to PPPs (Bentivoglio, Panicara, Tidu, 2008, 2010).

The term public-private partnership (PPP) refers to all forms of cooperation between public sector and private sector aiming at the design, construction, financing, operation and maintenance of public works or utilities, or the supply of goods or the provision of services.

*Subjects and risks: contractual allocation as a form of mitigation.*



In our system, the first general discipline of PPP for the realization of public works was introduced by Law no. 415 in November 18, 1998, (the so-called Merloni-ter law), which included articles from 37-bis to 37-nonies in the framework law on public works (Law no. 109 February 11, 1994, the so-called Merloni law), then merged into the legislative decree no. 163 April 12, 2006, (the Public Contract Code: articles from 153 to 160).

These articles are divided into two groups, governing both logically and chronologically distinct phases: i) the first group, whose articles are mainly focused on recent reform measures, is aimed at the selection of the private contractor as well as at the commitment of

the public works concession ; ii) the second group relates to the implementation of the contractual relationship between the public authority and the concessionaire and provides certain forms of guarantee in favour of the funding bodies.

With reference to the latter stage, the most relevant laws are related to: i) the possibility to succeed in the project company concession relationship potentially formed by the successful contractor; ii) the favour in respect of funding bodies, according to which the sums owed by the government to the concessionaire as compensation in the event of termination or withdrawal "are intended primarily to satisfy the claims of the concessionaire financiers and are unavailable on the part of the concessionaire until full satisfaction of financiers' claims"; iii) the so-called step-in right ", which grants to funding bodies the chance to appoint a substitute in the event of termination of the concession relationship for reasons resulting from the concessionaire; iv) introduction of a conventional privilege to protect claims of those financing the realization of public works or public service management.

Despite the importance of these remedial provisions for the regulation of public works, since they removed the obstacles to successful use of PPP, interpreters and professionals have showed the insufficiency and inadequacy of these guiding principles. It is possible to consider, for example, the need to introduce) a dynamic step-right up, enabling the intervention of funding bodies before the concessionaire will be in a full-blown default situation; as well as ii) more detailed rules on privilege, which ensures the PPP project "locked-in".

#### *The PPP in the Public Contract Code*

*In particular, art. 3, par. 15-ter of the Code of Public Contracts defines PPP contracts as "contracts for one or more services such as design, construction, operation or maintenance of public works or utilities, or the provision of a service, including in all cases the total or partial financing by private entities, even through different forms, of such services, with the risk allocation in accordance with the EU regulations and guidelines in force".*

#### *The PPP in the European Commission Green Paper*

*The European Commission Green Paper on Public-Private Partnerships and EU law on public contracts and concessions, issued on April 30, 2004, provides useful guidelines, explaining the institution characteristics and different forms, by making a distinction, based on different types of contract, between the institutional partnership and the contract partnership.*

*The institutional partnership entails cooperation between the public sector and the private sector within a specific entity, assuming the existence of a corporate or institutional structure, which, being held jointly by the public authority and private entities, carries out the task of ensuring the delivery of a work or a service on behalf of the community. The Government is geared to the use of this formula for primarily managing public services at local level.*

The legislation on the discipline of the PPP different application modes has been strong and growing in the last decade, as showed for example in table 1.

Table 1. Normative references

1999 DECREE No. 554 December 21, 1999, ' regulation and implementation of the framework law on public works February 11, 1994, no. 109, as amended ' (NB: in force until the publication and implementation of the regulation of the code of public contracts)

2000 supervisor of public works, regulatory Act No. 34/2000 of 18 July  
«Project financing – business plan»

2000 Legislative Decree n. 267 August 18, 2000 «Consolidated local government»

2000 European Commission, communication No. 2000/121/02 of 4/12/2000 «Commission interpretative communication on concessions under Community law»

2004 Eurostat, February 11, 2004 decision ' accounting treatment in national accounts of contracts signed by public undertakings in the framework of partnerships with private companies»

2005 European Commission, communication 2005/569 of 11/15/2005 «on public-private partnerships and Community law on public procurement and concessions»

2006 Legislative Decree No. 163 of April 12, 2006, "code of public contracts for works, services and supplies", and s.m.i.

2006 European Parliament, resolution No. 2043/2006 of October 26, 2006, on public-private partnerships and Community law on public procurement and concessions

2007 European Commission, communication 2007/616 of 10/18/2007 ' communication on a European ports policy»

2007 Finance Act for the year 2008 (L.244/07) – investor companies (Article 27, paragraphs 1-32)

2008 European Commission, communication 2007/6661 2/5/2008 's ' interpretative communication of the EU Commission on the application of Community law on public procurement and concessions to institutionalized Public-Private Partnerships (IPPP is SET UP)»

2008 The implementing regulation and implementation of the code of public contracts

The contractual partnership is based, instead, on purely formal ties between public authorities and private entities for the commitment of the public work. In this context, one of the best known models is the concession model, which is characterized by the existence of a direct link between the private entity and the final user, providing a service to the community in place of and under the control of the public authority (Gallia, 2008).

This model is also characterized by a specific mode of private remuneration, since the operator's consideration results from users of the public service (Vecchi, Amatucci, 2008, 2009).

With reference to the Italian legislation on remuneration method, the concession of public service under the Consolidated Act on municipality, R.D. No. 2578 of 1925, is ruled by article 267 of the R.D. No. 1175 of 1931. This article provides for concession contracts regarding local public services, a participation notice to be published in order to allow private sector entities to submit or enter into an agreement when advised by "special circumstances in relation to the nature of the services" subject of the commitment. This discipline, referring to special circumstances and not exceptional circumstances, has effectively legitimised an interpretation and application of article 267 which allowed the widespread use of private agreement, on the assumption of the fiduciary nature of the relationship between the grantor and the concession operator, as well as by reason of technical financial and organisational requirements-. The concession as a tool for the management of local public services was considered in the reform of local authorities provided for by Act No. 142 of 1990, as an alternative model, including the innovative reliance on mainly public partnerships. Italian law envisages both institutionalized PPP and contractual PPP.

In the Italian legal system, the institutionalized PPPs are realized through:

- mainly public capital partnerships;
- mainly private capital partnerships;
- public-private partnership established according to the civil code;
- urban transformation partnership.

The main forms of contractual PPPs are:

- concession of construction or upgrade services and operation services;
- sponsorship;
- leasing ("leasing in costruendo")

## **SECTION II**

### **TRENDS AND THEORY**

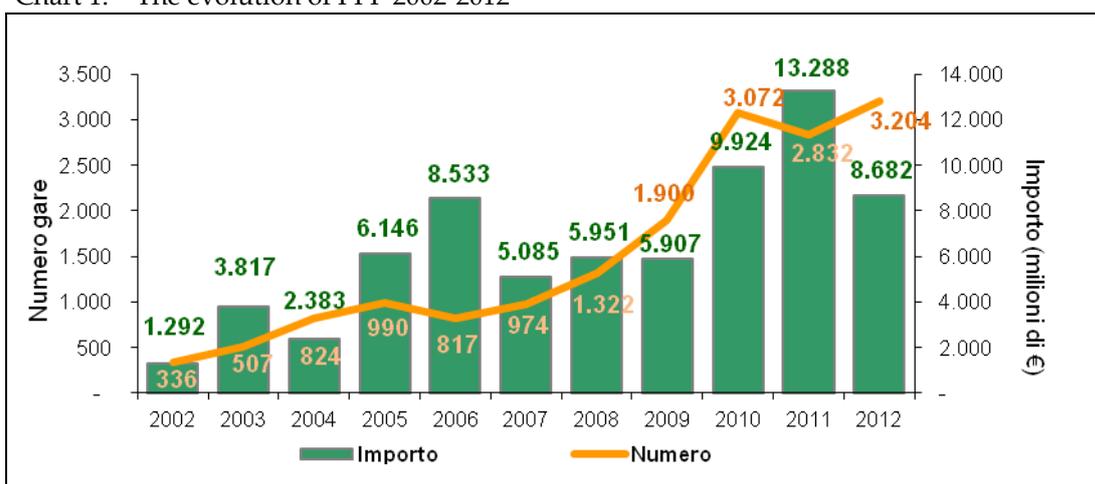
#### **THE NETWORK OF STRATEGIC INFRASTRUCTURE UNDER CONCESSION IN ITALY**

The Public and Private Partnership (PPP) demand, on the basis of available data by the National Observatory of the Public-Private Partnership, an information and monitoring

system and alerts of concession contracts within the entire landscape of the PPP, the economic and financial crisis scenario, continued to grow in 2012, but the execution path becomes increasingly difficult.

Developing analysis, assistance and technical knowledge programs become a strategic variable in this difficult market period, to delineate the possible effectiveness and synergies that may allow the growing demand for public-private partnership to play a role as a driving force for the revival of the country. *In 2012, participation notices were 3,204 for a business volume of 8,682 million. Compared to 2011 there has been a growing demand compared to a sharp decline in economic value, that was sub sequential to the general crisis which made it difficult to find financial resources through funding even for private companies. Between 2011 and 2012 the number of competitions increased by 13.15% from 3,204 tenders to 2,832 notices, while the business volume decreased by 34.7%, from 13.3 billion euros of amounts devoted to competition to 8.7 billion euros.* This remarkable decline resulted from the collapse, after an expansive period, of over 50 million large-scale works to be realized through PPP, decreasing by 39.7% in one year. Last year no exceptional amount work was realized, such as the two public work concessions, convened in the second half of 2011, for the strengthening and maintenance of the A22 Brennero-Modena motorway (3 billion euros) and for the construction of the Rome – Latin Intermodal Corridor and Cisterna-Valmontone connection (2.7 billion), in addition works exceeding 50 million significantly reduced, passing from 22 annual participation notices between 2010-2011 to 14 participation notices in 2012.

Chart 1. – The evolution of PPP 2002-2012

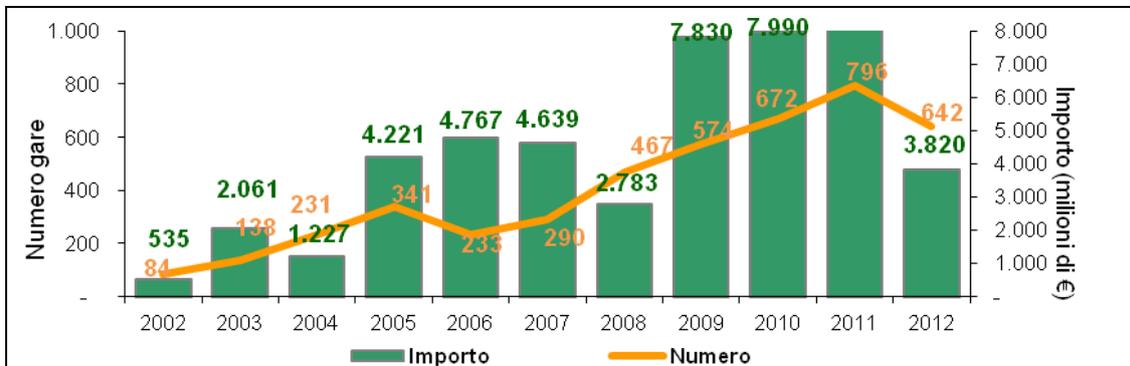


Source: Unioncamere, Dipe-Utfp and Ance and realized by CRESME.

The PPP demand continued to grow in 2012, driven mainly by the municipalities and local stakeholders, but it became increasingly difficult to materialize, not surprisingly, things went even worse for the PPP works that were adjudicated: from 796 participation notices

adjudicated in 2011 to 642 participation notices adjudicated in 2012 ( -19.3%) and from 8.3 billion euros to 3.8 ( -54%).

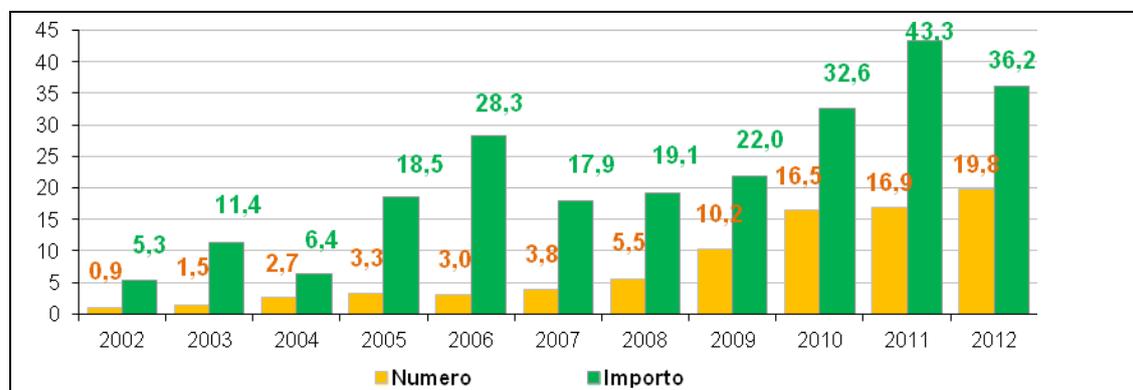
Chart 2. – The evolution of PPP contract awards 2002-2012.



Source: Unioncamere, Dipe-Utff e Ance e realizzato dal CRESME

The dynamics in progress are also highlighted by the importance of PPP in the public work market, risen from 16.9% in 2011 to 19.8% in 2012 in terms of number of opportunities – the highest level recorded since the Centre was operational, i.e. since 2002 when it represented less than 1% of the opportunities – and from 43.3% to 36.2% for economic value.

Chart 3. PPP – percentage on OOPP 2002-2012



Source: Unioncamere, Dipe-Utff and Ance and realized by CRESME

Additionally, by aggregating the identified PPP 18 sectors into three main groups of interventions, we see an increasing emphasis on urban regeneration, meaning the set of regeneration interventions on built space, functional to improve the quality of life<sup>5</sup>. It is a market sector, triggered mainly by municipalities, which approximately represented 70% of

<sup>5</sup> This group embraces the following sectors: rehabilitation of urban areas; urban planning and public parks; trade and handicrafts; directional constructions; sports facilities; leisure; tourist landings; parking.

demand and 17% of the total business volume between 2002 and 2012, and it was the only sector with a total positive balance sheet in 2012. Basic service sectors (transportation, health and education and social) and essential service sectors (water, energy, lighting, cemetery services, waste disposal) were the main sectors with reference to revenues, but during the last year these sectors registered a decline in the amounts linked to tender notices.

Compared to the size of PPPs, in 2012, works of less than 5 million euros continue to grow and investments have mainly covered initiatives of higher amount.

The initiatives of less than 5 million euros were 1,553 corresponding to a total of 974 million, that are at odds respectively in number and amount, of 92% and 11% of the PPP total market when excluding the initiatives for which we do not know the value of the contract.

The initiatives of more than 5 million euros, on the other hand, were just 127 (only 8% of demand) but their economic value exceeded the 7.7 billion equivalent to 89% of the total market of PPPS (in 2011 initiatives were 169 for 12.2 million euro equal to 92% of the market).

Table 1 – the macro fields of PPP: number and amount of races counted in 2002, 2005, 2008-2012 (amounts in millions of euros)

	2002	2005	2008	2009	2010	2011	2012	Total2002-2012
<b>Races</b>	<b>Number</b>							
Essential services	115	207	297	372	860	662	911	4.189
Basic services	33	38	131	168	175	195	212	1.150
Urban regeneration	188	745	894	1.360	2.037	1.975	2.081	11.439
<b>TOTAL</b>	<b>336</b>	<b>990</b>	<b>1.322</b>	<b>1.900</b>	<b>3.072</b>	<b>2.832</b>	<b>3.204</b>	<b>16.778</b>
	<b>%</b>							
	<b>'12/'02</b>	<b>'12/'05</b>	<b>'12/'08</b>	<b>'12/'09</b>	<b>'12/'10</b>	<b>'12/'11</b>		
Essential services	692,2	340,1	206,7	144,9	5,9	37,6		
Basic services	542,4	457,9	61,8	26,2	21,1	8,7		
Urban re generation	1.006,9	179,3	132,8	53,0	2,2	5,4		
<b>TOTAL</b>	<b>853,6</b>	<b>223,6</b>	<b>142,4</b>	<b>68,6</b>	<b>4,3</b>	<b>13,1</b>		
	<b>Amount: (mln euro)</b>							
Essential services	455	3.002	1.460	1.335	4.173	3.840	2.953	21.430
Basic services	349	1.764	3.525	3.162	4.751	8.277	4.524	37.627
Urban re generation	488	1.381	966	1.410	1.000	1.171	1.204	11.951
<b>TOTAL</b>	<b>1.292</b>	<b>6.146</b>	<b>5.951</b>	<b>5.907</b>	<b>9.924</b>	<b>13.288</b>	<b>8.682</b>	<b>71.008</b>
	<b>%</b>							

	2002	2005	2008	2009	2010	2011	2012	Total2002-2012
	'12/'02	'12/'05	'12/'08	'12/'09	'12/'10	'12/'11		
Essential services	549,2	-1,6	102,3	121,2	-29,2	-23,1		
Basic services	1.195,0	156,5	28,3	43,1	-4,8	-45,3		
Urban re generation	147,0	-12,8	24,6	-14,6	20,4	2,9		
<b>TOTAL</b>	<b>572,1</b>	<b>41,3</b>	<b>45,9</b>	<b>47,0</b>	<b>-12,5</b>	<b>-34,7</b>		

Source: Unioncamere, Dipe-Utfr and Ance and realized by CRESME

## THEORY

### ELABORATION OF THE REFERENCE THEORETICAL FRAMEWORK .

#### PPP, SCA AND IFRIC 12: A LITERATURE SURVEY

*("Before" and "After" the application of IFRIC 12)*

In some countries, infrastructure for services and public works (stadiums, kindergartens, roads, ports, airports, hospitals, cemeteries, prisons, parking lots, telecommunications networks, water distribution systems, networks for the supply of energy), is created, managed and controlled directly by the public sector taking care of the maintenance over time through direct financial allocations (Campra, 2005, 2012; Hall, 2008).

However, subsequent to the introduction of new stringent budgetary constraints, the respect of general government budgetary balances (Stability Pact in EU countries), and the increasing scarcity of resources, worsened by the financial crisis, in some countries, over the past twenty years, (Borgonovi, 2005, 2006, 2009; Amatucci, Vecchi 2009, 2011), governments have introduced (as shown in the following table), public-private partnership (PPP), through contractual service arrangements (Oricchio, 1996; Robinson 2001; Hawksworth, 2001), in order to attract private sector participation in the development, financing, operation and maintenance of works and utilities (Laghi, 2010), even to keep their rising debt under control (Broadbent, 2001; (Broadbent, 2001; Broadbent, Laughlin, 1999, 2002, 2004; Ricci, 2005; Eurostat, 2004).

The agreements regulating the different concession services in the recurring form of PPP (Parker, Gould, 1999; Pisani, 2001; Grimsey, Lewis, 2005; Guthrie, 2005), fall within the scope of IFRIC 12 (Campra, 2012: 2675) and the different accounting treatment of the operator's rights on infrastructure, depending on the different tasks of control and regulation to be provided to the public on behalf of the public sector in accordance with the terms specified in

the contract for a specified period of time (Hall, 2008), and on the identification and detection of the party on whom demand risk stays (Campra, Faraudello, Malfatti, Passarani, 2011),

The accounting treatment of "Service Concession Arrangements" (SCA), ruled by IFRIC 12, represents one of the most significant and emblematic cases of the application of the principle of the prevalence of substance over form (Meyer, 1976; Shere, 1986; Adwinckle, 1987), to highlight "typical light and shade" of a principle which is the basis of IAS/IFRS accounting model (Laghi, Giornetti, 2009; Laghi, 2010). It is a significant case because it falls within the definition perimeter of the concession services (SCA), all forms of public-private partnership and Project financing, particularly focused and copiously considered and debated in the business literature over the past fifteen years (Vecchi, Amatucci, 2008).

In the following paragraphs, business literature on different forms of PPP and SCA before and after the adoption of IFRIC 12 will be separately analyzed and reclassified, in order to determine the contribution that IFRIC 12 interpretation produced in favour of the improvement of the conceptual vagueness characterizing such instruments even under an increasing normative isomorphism (DiMaggio, Powell, 1983, 1991; Sullivan, Skelcher, 2002; Dickinson, Glasby, 2010).

## **PPP, SCA:**

### **THE THEORETICAL FRAMEWORK "BEFORE" THE APPLICATION OF IFRIC 12**

"Service Concession Arrangements" (SCAs) refer to those forms of PPP projects through which a public sector entity (grantor), entrusts to a private sector entity (operator), the concession to construct or to operate a public work or infrastructure, in order to perform a public service in the public interest, upon consideration, and resulting in deep functional privatization processes (Pivato, 1958; Amaduzzi, 1978: 227; Caramiello, 1988: 546; De Robertis, 1992; Guatri, 1992: 498; Oricchio, 1996; Kunz, 1997; Perfolini, 1999; Dell'Atti, 2001; Rijna, 2010). The operator's consideration may consist in a right to charge users of the public services (intangible asset), or in an unconditional contractual right to receive cash or another financial asset (financial asset) from or at the direction of the grantor for the construction services (Campra, 2011; Laghi, 2010).

The following table reproduces the critical success factors regarding PPP, from an international literature view, prior to the adoption of IFRIC 12.

*Reconstruction and classification of literature*  
(Critical success factors, PPP Projects)

Critical success factors	Author
<i>Strong Private consortium</i>	Jefferies et al. (2002) Tiong (1996) Birnie (1999) Savas (1987) Savas (2000)
<i>Appropriate risk allocation and risk sharing</i>	Qiao et al. (2001) Grant (1996) Bing L., Akintoye A., Edwards P. J., Hardcastle C. (2005) (2007)
<i>Competitive procurement process</i>	Jefferies et al. (2002) Kopp (1997) Gentry and Fernandez (1997)
<i>Commitment/responsibility of private/public sector</i>	Stonchouse et al. (1996) Kanter (1999) NAO (2001b)
<i>In-depth and realistic cost/benefit assessment</i>	Qiao et al. (2001) Brodic (1995) Hambros (1999)
<i>Technical feasibility project</i>	Qiao et al. (2001) Tiong (1996) Zantke and Mangels (1999)
<i>Transparency in the procurement process</i>	Jefferies et al. (2002) Kopp (1997) Gentry and Fernandez (1997)
<i>Good governante</i>	Qiao et al. (2001) Frilet (1997) Badshah (1998)
<i>Favourable legal frame work</i>	Bennett (1998) Boyfield (1992) Stein (1995) Jones et al. (1996) DiMaggio, Powell (1983,1991) Sullivan, Skelcher (2002)
<i>Available financial market</i>	Qiao et al. (2001) Jefferies et al. (2002) McCarthy e Tiong (1991) Akintoye et al. (2001b)
<i>Political support</i>	Qiao et al. (2001) Zhang et al. (1998)
<i>Multi – benefits objectives</i>	Grant (1996)
<i>Involvement of the Government providing guarantees</i>	Stonehouse et al. (1996)

	<i>Kanter (1999)</i> <i>Qiao et al. (2001)</i> <i>Zhang et al. (1998)</i>
<i>A healthy economic policy</i>	<i>EIB (2000)</i>
<i>Macroeconomic stability</i>	<i>Qiao et al. (2001)</i> <i>Dailami e Klein (1997)</i>
<i>Well organized government</i>	<i>Boyfield (1992)</i> <i>Stein (1995)</i> <i>Jones et al. (1996)</i> <i>Finnerty (1996)</i>
<i>Shared authority between the public and private sectors</i>	<i>Stonehouse at al. (1996)</i> <i>Kanter (1999)</i>
<i>Social support</i>	<i>Frilet, 1997</i>
<i>Technology transfer (please note: research is not included in this type of PPP/PFI)</i>	<i>Qiao et al. (2001)</i>

*(Adapted from Li, Akintoye, Edwards, Hardcastle, 2007)*

In the national scenario, business and economic literature on the topics of the PPP and the SCA remains weak and non-systemic, there is small evidence of PPPs and SCA application. This is partly compensated by students of industrial engineering who have tried to classify standards, dimensions, variables and recurring characteristics of a number of PPP arrangements (*Carbonara, Costantino, Pellegrino, Sciancalepore, 2012*), reclassified on the basis of the legislation on PPPs and of their division into contractual and institutional PPPS.

Dimensions	Variables	Values	
<i>PPP arrangement's structure</i>	Contract type	Based on the legal structure of the transaction	Institutional PPPs Contractual PPPs
		Based on operational aspects	Management contract Leasing model or Build-Lease-Transfer Design-Build (and Design-Build with warranty) Design-Build-Operate-Maintain Design-Build-Finance-Operate Build-Operate-Transfer Build-Own-Operate-Transfer Build-Own-Operate
	Use of private resources and expertise		Degree of involvement of the private sector in the lifecycle of the project (from design to management)
	Time horizon of contract		Long term (25-30 years)
	Revenues sources	Payments based on usage volumes or demand	By private sector By public sector By public and private sectors
		Public financial contribution	Lump sum payment by public sector
	Special purpose vehicle (SPV)		Private company Publicly- and privately-held company
	Risk allocation		Private sector Public sector Shared between public and private sectors
<i>PPP arrangement's financing</i>	Use of private finance		Financing in whole by the private sector Financing partially by the private sector Government-funded projects (no private capital)
	Type of funding options		Bank debt Equity Bonds Loan from shareholders Mezzanine finance
	Debt to equity gearing		High (debt exceeds 70%)
	Investment value		High
<i>PPP arrangement's financing</i>	Use of private finance		Financing in whole by the private sector Financing partially by the private sector Government-funded projects (no private capital)
	Type of funding options		Bank debt Equity Bonds Loan from shareholders Mezzanine finance
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	Investment value		High
<i>Public Leverage on PPP</i>	Scope	Assuring Value for Money	
	Legislation	Degree of PPP formalization by a Government legal/statutory framework	

(Carbonara, Costantino, Pellegrino, Sciancalepore,, 2012)

Dimensions	Variables	Values	
<i>PPP arrangement's structure</i>	Contract type	Based on the legal structure of the transaction	Institutional PPPs Contractual PPPs
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<i>Public Leverage on PPP</i>	Scope		Assuring Value for Money
	Legislation		Degree of PPP formalization by a Government legal/statutory framework

		do not still use tools, such as risk matrix, to best evaluate and allocate risks.
PPP arrangement's financing	Use of private finance	Generally, private funding is used for these projects, but lenders give funding only in exchange for traditional guarantees (Bentivogli et al., 2008). But PPPs are usually financed also by a quote of public funding: an example for this is the Autostrada Cispadana highway (Costantino et al., 2011)
	Type of funding options	The culture of the use of capital market, by selling bonds or shares to investors, for such projects is not spread in Italy: consequently, the financing is generally granted by banks with a deep experience of such projects (Etro, 2007). But even the access to this source of funding is characterized by disadvantageous conditions in comparison with other countries: the interest rate is about 10 - 11%, while in UK, for instance, the required spread on the risk-free rate is 0,75-1% (Iossa and Antellini Russo, 2008)
	Debt to equity gearing	Generally, Italian PPP projects are characterized by high leverage: for instance, debt to equity gearing is more than 80:20 for Vigliena port project in Naples (Micelli, 2009) and it is estimated from 75:25 and 85:15 for wind energy plant projects (Scarnati, 2007)
	Investment value	PPP projects are characterized by little or medium economical dimension (Iossa and Antellini Russo, 2008)
Public Leverage on PPP	Scope	Italian law does not prescribe the estimation of VfM before the approval of a PPP project. Thus this practice is not still sufficiently adopted (UTFP, 2010). Contrarily, they often choose PPP route on the basis of other reasons, such as their financial situation, the possibility of getting infrastructure costs off the public balance sheet while keeping investment levels up (Iossa and Antellini Russo, 2008).
	Legislation	Italian PPPs are ruled by Code of Works, Services and Supplies Public Contracts. This imposes some rules on PPP schemes, call for tenders, SPV, concessionaire default and its substitutions (Vigliano and Bicchieri, 2007). Until 2007, differently than in the other European countries, if there was a private promoter of the project, this had the pre-emption right on the awarding. This discouraged many firms entering the market (Iossa and Antellini Russo, 2008): in Lombardy, the 75% of the PPP tenders with promoter were without any other competitors (Bentivogli et al., 2008). In 2008, a substantial modification about the use of the pre-emption right was introduced, which is expected to reduce the anti-competition effect (Ricchi, 2009).

Dimensions	Variables	Values	
PPP arrangement's structure	Contract type	Based on the legal structure of the transaction	Institutional PPPs Contractual PPPs
		Based on operational aspects	Management contract Leasing model or Build-Lease-Transfer Design-Build (and Design-Build with warranty) Design-Build-Operate-Maintain Design-Build-Finance-Operate Build-Operate-Transfer Build-Own-Operate-Transfer Build-Own-Operate
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Public Leverage on PPP	Scope	Assuring Value for Money	
	Legislation	Degree of PPP formalization by a Government legal/statutory framework	

(Carbonara, Costantino, Pellegrino, Sciancalepore,, 2012)

These configurations are reproduced in various search models identified as distinct disciplinary sectors, even divided within the same sector (SECS P07), similarly to the several pieces of a puzzle to be recomposed, into fractionated subsets of specific interest depending on scholars specializations and interests (public companies and private companies), delivering to professionals and operators a confuse interpretation without any systemic and comprehensive vision of criticality, models and configurations assumed over time.

Table II: The "Mosaic" of the economic literature on Italian PPP

SECS	PPP	ASC
<b>SECS P07</b> <i>(Business economy)</i> <i>public companies</i> <i>scholars</i>	<i>(Amatucci, Vecchi, 2008, 2009; Marsilio, Cappellaro, Cuccurullo, 2009, 2011; Cappellaro, Longo, 2011; Hellowell, Vecchi, 2012)</i>	
<b>SECS P07</b> <i>(Business economy)</i> <i>private companies</i> <i>scholars</i>	<i>(Laghi, 2010, Campra, 2011, 2012)</i>	<i>(Oricchio, 1996; Laghi, 2010, Campra, 2011, 2012)</i>
<b>SECS P08</b> <i>Business management</i>	<i>(Capasso, 2002)</i>	
<b>SECS P09</b> <i>corporate finance</i>	<i>(Martiniello, 2010, 2011)</i>	<i>(Martiniello, 2010, 2011)</i>
<b>SECS P10</b> <i>business organization</i>	<i>(Grandori, 1997, 2008)</i>	
<b>SECS P06</b> <i>Applied Economics</i>	<i>(Dalla Longa, 2010, 2011)</i>	

**PPP, SCA:****THEORETICAL FRAMEWORK "AFTER" IFRIC 12 APPLICATION**

The discipline of IFRIC 12 is essential and also constitutes an "emblematic" case, even if it is partial and partially satisfactory, for the application of the principle of prevalence of the substance over form (Laghi, 2010), since all aspects determining the accounting treatment of "service concession arrangements" (SCA), starting from the same definition of the scope of IFRIC 12, ending with the accounting models to be used for the purpose from the representation of the effects of SCA are "filled" by the continuous research of the representation in the "economic substance" (Heald, Georgiou, 2011), regardless of the legal

form they are regulated the transfer of risk and responsibility for the realisation of the works or services under concession and the management of public services or in the public interest. The continuous research of the economic substance of the SCA, becomes a crucial condition for achieving the reliability of financial information and to avoid errors and distortions in relevant economic and financial communications.

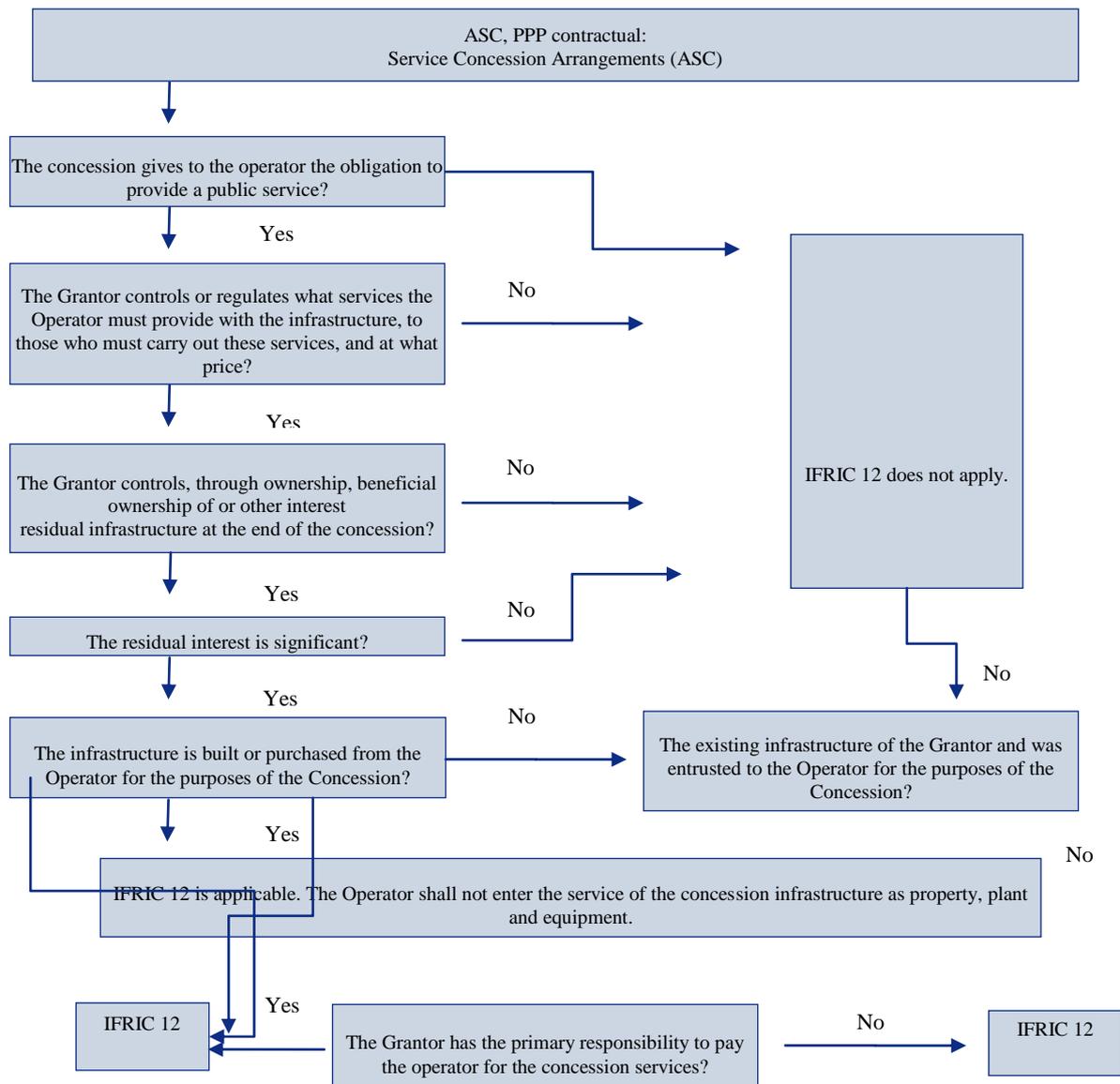
Support and expected effects of IFRIC 12, published on November 2006, are also found in literature (Laghi, 2010), and are linked to the need to frame, simplify and clarify the complexity of the accounting treatments relating to different forms of PPP and ASC, caused by a stress between orientations and operational practices and legislation hypertrophy (Capaldo, 1998; Oricchio, 1996; Pinto, 1996; Pisani, 2002; Laghi, 2010), as well as to avoid any confusion in the scope of other international accounting standards. The Regulation (CE) n°. 254/2009, regarding the SCA and IFRIC 12 interpretation, places in the introduction to the same interpretation, references to the basis of the number and complexity of the different principles:

IFRIC 12 Interpretation – Service Concession Arrangements. References

IFRS 1, IFRS 7, IAS 8, IAS 11, IAS 16, IAS 17 e IFRIC 4, IAS 18, IAS 20, IAS 23, IAS 32, IAS 36 , IAS 37, IAS 38, IAS 39
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IFRIC 12, provides guidance on the accounting by operators for public-to-private service concession arrangements, it does not deal with the accounting by grantors, and provides for the concession assets, once verified some objective and subjective conditions (Laghi, 2010: 127), an alternative recognition according to which infrastructure shall not be recognised as a material activity (highways, water supply, etc.), but as a right to charge users of the public service (intangible assets); or a right to receive a payment (Laghi, 2010), namely a consideration by the grantor for the utilities paid (financial assets); or through a mixed or forked method (Campra, 2012).

IFRIC 12 then provides an analysis to verify, for subsequent grades, which types of concession come or do not come under its scope, and when falling within the discipline of IFRIC 12, the application of Financial Asset Model or the Intangible Asset Model. The path is defined below.



Few years after the adoption of IFRIC 12 and the previous long, tiring, unclear (Frab, 2007; Nobes, 2008: 183; Martiniello, 2011) and controversial (Kaufmann, 2006), endorsement on accounting treatment of concessions (European Commission, 2008: 15; Campra, 2012), literature, especially international literature paid more attention, (Paris, Cruz, Rodriguez, Brugni, 2011), to the outline of the different evolutionary developments, applications and interpretation of IFRIC 12, in different countries (Zeff, Nobes, 2010).

International literature has carefully investigated the application of IFRIC 12, and in some EU countries (Bing L., Akintoye A., Edwards, P. J., Hardcastle C., 2005, 2007; Treasury, 2008; McQuaid, Scherrer, 2010; Heald, Georgiou, 2010; Camfferman, Zeff, 2011; Zeff, Nobes, 2010; Heald, 2011), such as Spain (Acerete, Shaoul, Stafford, 2009; Rangel, Valende, 2009; Rangel, Vassallo, Galende, 2010), France, (Schevin, 2001; Marty, 2011; Dupas, Marty, Voisin, 2011), Denmark (Petersen, 2010), Greece (Roumboutsos, Anagnostoupoulos, 2010), UK (Bringhlie, 2005; Li, Akintoye, Edwards, Hardcastle, 2005, 2007); and other non-EU countries, such as Brazil in particular (Cruz, Silva, Rodrigues, 2009; Lima, 2010; Martins, Andrade, 2009, 2010; Costa, 2010; Paris, Rodrigues, Cruz, Brugni, 2011), Japan (Uozumi, 2007) or Australia (Raisbeck, Duffield, Xu, 2010) offering comparative analysis with applications in different countries.

The following tables show the aspects characterizing the different forms of public-private partnership in the interest of their useful and systematic organization, in order to compare different countries or similar business models to better support the choices of public decision-makers and of concession companies.

The following table, offers a scheme of the selected literature and summarizes the content and variety of the current national and international debate on the topic of PPP and the SCA.

*Table III: selected Literature*

<b>Anglo-Saxon Literature</b>	(Bing L., Akintoye A., Edwards P. J., Hardcastle C., 2005, 2007; Treasury, 2008; McQuaid, Scherrer, 2010; Heald, Georgiou, 2010; Camfferman, Zeff, 2011; Zeff, Nobes, 2010; Heald, 2011)
<b>Spanish Literature</b>	(Acerete, Shaoul, Stafford, 2009; Rangel, Valende, 2009; Rangel, Vassallo, Galende, 2010)
<b>Literature of German-speaking</b>	(Budäus, B Grüb, 2008; Muller, 2008; Papenfuß, C Schaefer, 2009; Jacob, C Hilbig, D Neunzehn, T Popp, T Uhlig; Herbold, 2012; Hodges, 2013 )

<b>countries</b>	
<b>Literature of Latin American countries</b>	(Cruz, Silva, Rodrigues, 2009; Lima, 2010; Martins, Andrade, 2009, 2010; Costa, 2010; Paris, Rodrigues, Cruz, Brugni, 2011)
<b>Italian Literature</b>	(Capasso, 2002; Amatucci, Vecchi, 2008, 2009; Laghi, 2010; Campra, Faraudello, Malfatti, Passarani, 2011; Campra, 2012; Pozzoli, 2011; Martiniello, 2008, 2012; Vecchi, Hellowell, 2012; Cappellaro, Marsilio, Cuccurullo, 2009, 2011; Cappellaro, Longo, 2011)

This section aims to show, through an international literature survey, the multidisciplinary approach adopted for the study of PPP. In the table below, a reconstruction of the existing literature on the sources of PPP in developed countries and in developing countries is represented, paying attention to the various theories which are based on multi-disciplinary approaches:

- macro-economic;
- business and economic
- political science;
- public management.

Table IV: PPP, SCA determiners

Determiners and characteristics of Private public partnership (PPPs) and Services Concession Arrangements (SCAs) Literature reconstruction and classification		
Variable	Negative-Significant	Postive-Significant
<i>Economic Factors</i>		
Income		Cappellaro, Longo (2011) Marsilio, Cappellaro, Cuccurullo (2009) (2011) Treasury (2008) Bentivogli, Panicara, Tidu (2008) (2010) Bajari, Lewis (2008) Raganelli (2009) Vecchi, Hellowell, Longo (2009) Amatucci, Lecci (2006) Amatucci, Vecchi (2008) (2009) Amatucci, Hellowell, Vecchi (2008) Bing L., Akintoye A., EdwardsJ.,Hardcastle C.



		Lasthuizen, Huberts, Heres (2011)
Public Procurement		Pashev (2011)

These comparative analyses highlighted application problems and confusion in the various systems of service agreements involving public authority and private entities, in relation to creative accounting treatments asymmetries (Martiniello, 2011), produced by (immaterial and financial) unusual methods, as well as by the responsibility of the entities or parties affected by the demand risk (Campra, 2012: 2705), also through the different models of accountability adopted (Ricci, 2005, 2010).

The theoretical framework that outlines, making it useful to deepen the evolutionary trends in the application of IFRIC 12 in different countries, in the light also of new paradigms that are setting up new conceptual-logical cognitive maps in re-thinking the common goods, contractual communities (Foldvary, 2010), the collective property; the allocation and risk management; report systems and (in) dependency between ownership and control (Flick, Cearns, 2008; Ellwood, Lacalle, 2012), and control over significant residual interest of infrastructure (Campra, 2012: 2678).

In Italy, business literature on IFRIC 12, is solely developed by some authoritative scholars and a large and growing group of professionals (Campra, 2005, 2012; Laghi, 2009: 26; Giussani, 2009: 180; Delladio, Gaiani, Meneghetti, Pozzoli, 2011: 168; Giovando, 2012: 200; Rotondaro, Zambon, 2010: 2010; Leo, 2011: 164; Brescia, Muraca, 2011: 381; Cordazzo, 2008: 40; Bauer, 2007: 327), notwithstanding the strategic importance and interest manifested by the international literature on the one hand, and the continuing lack of an overview on the accounting treatment of the PPP concession services by local authorities (Ricci, 2005, 2007, 2009).

Though addressed to concession companies, and therefore private entities, IFRIC 12 is however vital for scholars of public companies and public management, since the same definition framework, pointing out and stressing the principle of the prevalence of substance over form, it focuses on the need for further reflection on some issues, and some key concepts, such as:

- the boundaries for the public and private sectors;
- the risk identification and allocation;
- infrastructures;
- public services, services of public interest and/or utility;
- important economic and social services;

- service price/value;

The interpretation of IFRIC 12 also allows researchers to avoid confusion in the classification, measurement, and detection of SCAs involving public and private entities such as outsourcing contracts, contracts of network capacity, take-or-pay contracts, ruled instead by IFRIC 4 (Treasury, 2008; Heald, Georgiou, 2010. Laghi, 2010: 6); or even errors in classification of PPP, where the prevalence of economic substance is entirely public, as in the case study, and then can be traced in the discipline of IAS 20.

Among other positive aspects of IFRIC 12, there is the attempt to improve the budgetary information for investors, clarifying the nature and risks of the ASC, object recognition and measurement.

However, several authors in literature measure that the centrality of complexity is also interpretative effect and not only because of the demands of public finance (Laghi, 2010).

The registration or cancellation of a budget, are sometimes connected and based on the model of "risk/benefit" transfer, sometimes related to the prevalence of the "control" on the activity (Laghi, 2010; Martiniello, 2011; Head, Georgiou, 2011), which leads to an absolute complexity of interpretation. Complexity that recurs like a mirror (Head, Georgiou, 2011), evaluating the adoption of IFRIC 12 compared to evaluation based on the model of "control" (control model), or to risk/benefit model "(risk and reward model), or the new information provided by institutions such as the UFP sustaining principle-related costs for implementation and management (Martiniello, 2011) and not dependent on budgetary implications of local and more generally on public finances (Internal Stability Pact).

## **NOT CONCLUSIVE REMARKS**

The construction and management of infrastructure in the framework of concession relations between public sector entities and private sector entities, presents, from the financial point of view, several critical aspects, especially with reference to cases in which the public work or infrastructure construction is entrusted to an undertaking which draws up the budget according to the IAS/IFRS accounting standards. For IAS adopter subjects operating on the basis of concession agreements, starting from the budgets relating to exercises that began after January 1, 2010, the new rules on financial representation provided by IFRIC 12, already subject of analysis by the OIC in application No. 3 of July 2010, have become compulsory rules. The new rules on financial representation provided by IFRIC 12 apply to public-to-

private service concession arrangements when: the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price;. and the grantor controls — through ownership, beneficial entitlement or otherwise — any significant residual interest in the infrastructure at the end of the term of the arrangement.. According to the new rules laid down by the IFRIC 12, the grantor who builds and manages a public work shall not list tangible assets among the goods to be transferred at the end of the concession, but grantor must include the fair value of the performance. In particular, in accordance with IAS the concessionaire/operator shall recognise (Laghi, 2010; Campra, 2011):

- a financial activity when having an unconditional contractual right to receive cash or another financial asset from or following the instructions of the grantor for construction services;
- an intangible asset when from the construction of the asset the concessionaire/operator draws the right to exploit the work in relation to third parties, acquiring the right to charge users of the public service,

The concessionaire/operator that is required to apply IFRIC 12 shall recognise in the income statement, on the one hand, the construction cost and, secondly, the amount that is determined by reference to the relative fair values of the services delivered, already incorporating an estimated contract margin. In this regard, it should be firstly noted that, by virtue of the principle of reinforced derivation art. 83 of the Tax Code, in the version in force since 2008. qualifications, charges, classifications of financial statements arising from the adoption of IFRIC 12 find direct recognition from the point of view of taxation. In particular, subsequent to the recognition of the intangible asset it will become applicable the discipline under the art. 103, paragraph 2 of the Tax Code, which, with reference to the cost of the concession rights and other rights recognized in the balance sheet provides that the accumulated depreciation charges are deductible in proportion to duration of the use specified in the contract or by law. Some doubts arise with regard to the possibility of using the so-called sinking fund provisions according to the art. 104 of the Tax Code, which allows the deduction of variable depreciation charges in lieu of ordinary depreciation.

There are, however, no good reason to exclude the application of this discipline in the case of IAS adopter entities, provided that the same art. 104, paragraph 1 of the Tax Code provides that this type of depreciation is allowed in a planned ordinary depreciation for both physical

assets and intangible assets. Another problem of a fiscal nature in respect of operations of replacement and restoration that, according to IFRIC 12, must be calculated pro rata basis taking into account the time of maturation of the bond and its deferral in time: this involves the necessity to account, in each year, a special fund, based on its current value. With reference to the above provisions, it is believed that the art. 107, paragraph 2 of the Tax Code can be applied, it allows the deduction within the limit of 5% of the cost of each item, and up to the total amount of expenses incurred for each item in the last two years. A number of systematic reasons, lead to the conclusion that it can not be accepted the argument of those who believe that the under discussion provisions concern the constructed item which does not appear in the financial statements of companies IAS adopters. Other themes of interest regard the improvements to be borne by the concessionaire without the recognition of tariff increases.

It may happen, in fact, that the concession agreements require the concessionaire the construction of real additions or additional works without additional economic benefits. In this case, according to the interpretative guidance of the OIC, the accounting practice is to be preferred to enrol at the time of incurrence of such liabilities the present value of future liabilities in return for a corresponding increase in intangible asset, which is thus subjected immediately to the amortization procedure, in full respect of the principle of correlation with revenues. This system is not dissimilar to the one provided for the costs of remediation and environmental restoration, for which the explanatory report on the Ministerial Decree of 1st April 2009 stated that the accounting rules of IAS express a qualification designed to find direct tax recognition. Therefore, it seems logical to assume that the costs for improvements to be borne by the concessionaire, capitalized on the value of the intangible asset, conform to the same treatment as the cost of remediation and environmental restoration.

IFRIC 12, although addressed to the concessionaires/operators, then to private sector entities, however, is of fundamental importance for scholars of public enterprises and public management, as the same definitional framework, stressing the principle of substance over form, highlights a central need for further reflection on some issues and some key concepts, such as:

- The boundaries for public and private entities;
- The identification and allocation of risk;
- Infrastructure;
- Public utilities, public interest services and / or benefits;

- Major economic and social;
- Price / value of the services;

The interpretative usefulness of IFRIC 12 is essential in order to avoid confusion in the activity of classification, measurement and recognition of ASCs involving public sector entities and private sector entities, such as outsourcing contracts, contracts of network capacity, take-or-pay agreements, all regulated instead by IFRIC 4 (Laghi 2010: 6), or even errors in the PPP framework, where the prevalence of economic substance is entirely public, as in the selected case study, and then having reference to the discipline of IAS 20 .

Among other positive aspects of IFRIC 12, there is an attempt to improve the financial reporting for investors, clarifying the nature and risks underlying the ASCs subject to measurement, recognition and assessment. However, several authors in the literature reveal that the centrality of the interpretative complexity is an effect and not just source of greater needs of public finance (Laghi, 2010).

In fact, the entry or cancellation of balance sheet assets, are sometimes linked and based on the "transfer risk / benefit" model, sometimes they are linked to the prevalence of the activity "control" model (Laghi, 2010; Martiniello, 2011; Head, Georgiou, 2011), this circumstance generates an undoubted complexity of interpretation. Such a complexity comes back as in a mirror (Head, Georgiou, 2011), when assessing the adoption of IFRIC 12 with respect to the choice of evaluation based on the "control" model (control model), or to the "risk / benefit" model (risk and reward model), or to the new information provided by institutions such as the UTPF related to the principle of incurring the construction and management costs (Martiniello, 2011).

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## SERBIA A RECOMMENDABLE DESTINATION: SLOVENIAN AND SERBIAN PERSPECTIVE

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### ABSTRACT

The main purpose of this study was to examine the perception of Serbia brand identity elements viewed from the stand point of Slovenian residents - external stakeholders, and Serbian citizens - internal stakeholders. The main aim of this research paper is to identify, compare and contrast different perspectives of Slovenian and Serbian residents regarding Serbia brand identity. Multiple surveying techniques consisted of on-the-filed and on-line surveys were applied. 2228 responses were collected in Slovenia and 740 responses in Serbia. Principal component analysis was used for results analysis. Research findings point that certain differences and similarities in the perception of Serbia brand identity between Slovenian and Serbian residents do exist. First difference is reflected in the number of brand identity elements identified by each of the two examined groups. Slovenians identified 4 brand identity elements which are marked as **recommendable tourist destination, development, national treasury and cultural heritage**; whilst Serbian residents identified 6 elements: **people, obsolescence, negative media bias, cultural uniqueness, tourist destination and national treasury**. Second difference, is reflected in the view point of both groups. Slovenian residents perceive Serbia as a favourable tourist and business destination, and emotions involved are mostly experiential, whilst the perception of Serbian residents is mainly shaped by emotion of national pride. A side from differences, our research suggests certain similarities in perception of both groups. Slovenian and Serbian residents both hold the view that Serbia is associated with positive attributes, such as: recommendable tourist destination, rich with national treasury and distinctive culture.

**Keywords:** country brand identity, external stakeholders, Slovenia, residents, Serbia

## 1. INTRODUCTION

Widely spread trend of globalization, rapid development of modern world, and increasing customer mobilization led to the changes in concept of destination branding. More than ever, highly competitive marketplace influences the need for destinations to create a unique brand identity in order to differentiate themselves from competitors, attract visitors, and increase foreign investments. Despite all the challenges, this opened numerous opportunities for international brand experts and marketing scholars to get involved and give contribution in the terms of destination branding and strategic destination brand identity development. Foremost goal of the destination branding is to shape future visitors' perception regarding certain destination (Sartori et. al., 2012; Murphy et al., 2007; Ekinci et al., 2006; Hankinson, 2004; Morgan & Pritchard, 2002). Many developed countries such as Canada, New Zealand, Spain, UK, Portugal, and many others, approached the issue of destination branding with great attention (Hudson & Ritchie, 2009; Morgan et. al., 2003; Gilmore, 2002; Freire, 2007; Aziz et. al., 2012). But, not only developed countries are seeking to create appropriate destination branding strategy, developing countries are also searching for a way to position in the global marketplace.

Yugoslavia once consisted of 6 countries: Serbia, Montenegro, Croatia, Bosnia and Herzegovina, Slovenia, FYROM (Former Yugoslav Republic of Macedonia), and after dissolution these newly formed countries faced a challenging task to create their new brand identities. In order for destination branding planners to begin with the process of creating a destination brand, it is necessary to assess destination brand's current position. Konecnik et al. (2010) argue that managing destination brands focusing on only one stakeholder is myopic. Therefore, examining the perception of external and internal stakeholders is essential because internal perception of destination brand image is usually not in accordance with external perception. The inconsistencies in perception are most commonly related with positive and negative elements linked with destination brand identity, attitudes toward a destination, and overall experience (Hankinson, 2007; Hudson & Ritchie, 2009). Having this in mind, our study examines Serbia destination brand perception through the spectacles of two interrelated but different audiences: Slovenian residents (external stakeholders), and Serbian residents (internal stakeholders) once part of the same country. The main aim of the study is to determine differences and similarities in the perception of these two stakeholders groups regarding Serbia as a destination brand.

At the first glance, Serbia may appear as a fertile research context for destination brand image type of study. Following arguments should justify the reasons for investigating Serbia as a brand from the perception of Slovenians. First, after Serbia became independent in 2003, country became 'new to the market'. In this way Serbia became interesting and attractive destination for ex-Yugoslav, neighbouring countries, especially Slovenia. Two countries, once part of Yugoslavia, have been bonded by strong historical, cultural, and economical ties for decades, which only emphasize the experiential component value for future visits. Second, Slovenia and Serbia always had good bilateral relations, not burdened with legacy of the past times. Also, two countries never had any conflicts, which enabled development of strong economical and business cooperation between them. Having this said, it is not surprising that Slovenia plays an important role in Serbian foreign direct investments portfolio, both in terms of number of projects and value of investments (SIEPA, 2013). Third, in past couple of years Slovenians are ranked as the most frequent visitors to Serbia. In recent years Serbia became city break destination for Slovenians, where they come to enjoy gastronomic specialties, nightlife, hospitable people, and pleasant ambient (National Tourism Organization of Serbia, 2012).

Therefore, this paper should help scholars and practitioners to better understand differences and similarities in the perception of Serbia brand identity from the stand point of closest neighbours, once part of the same country, today very influential external stakeholder. The results presented in the study will point out core competences of Serbia as a destination brand, which will allow destination branding planners to tailor appropriate branding platform for Serbia and create adequate destination branding strategy toward external stakeholders.

## **2. LITERATURE REVIEW**

First literature stream relevant for this study is general literature on destination branding, destination brand identity and destination image. The interest of scholars and practitioner for the issues surrounding these topics is steadily growing in the recent years (Qu et. al. 2011; Roy and Banerjee, 2007; Tasci and Kozak, 2006). In the period 1998-2007, 74 destination branding publications by 102 authors were identified (Pike, 2009). Gilmore (2001) provided a "diamond shaped" branding framework consisting of four factors essential for the branding of each country: macro-trends, target stakeholders, competitors and core competences. Author outlines the fundamental value of branding framework for setting adequate

destination branding strategy. Mainstream studies on brand strategy development at the national level mostly explore attitudes of external stakeholders, usually focusing on the multiple stakeholder groups. For example, Anholt (2005) explores consumer perspective on America's brand image from the viewpoint of ten different countries. Morgan et al. (2003) examine influence of public and private sector stakeholders on brand image of New Zealand. Stancioiu et al. (2011) highlight the role of visitors' perception of tourism and historic attractions in the development of a destination image of the brand Romania. Several studies (Ekinci and Baloglu, 2007; Aziz et al. 2012) explore USA visitors' opinion about brand personality of Turkey and concluded that integrated marketing communication strategy should focus on presenting Turkey as a country to discover rather as an escape alternative. Nowadays, the focus of destination branding literature is slowly shifting toward experiential component of a destination. For example, Canada has recently launched a repositioning campaign targeting domestic and international tourists under the name "Brand Canada", using experiential marketing techniques to communicate new brand identity and brand promise (Hudson & Ritchie, 2009).

Second relevant literature stream has particular focus on destination image of ex-Yugoslav republics. A respectable number of studies outlined rebranding necessity of former Yugoslavian republics that appeared as new states on the global scene burdened with their post-conflict media image. The increased interest was followed by the number of publications. For example, Hall (2002) examined Serbia brand identity and found Serbia as the meeting place of cultures, religions and languages. Furthermore, he found Serbia as multiethnic country where all the ethnicities have one thing in common - their homes are wide open to the friends. In the case of Bosnia, Duborija and Milvic (2008) recognized local people as the key element for building a distinctive brand image of Bosnia. In the case of Croatia, Martinovic (2002) analyzed poor international destination brand recognition. Author suggested Croatia to focus on geo-economic position, natural resources, human resources, tradition and social and cultural activities in positioning their destination brand. Konecnik and Go (2007) describe endeavours of Slovenia to position their small country on the fierce international destination market as one of the smallest countries in the world but a country in the heart of the Europe that has ideal opportunities for the tourism industry.

Third literature stream is studying importance of local people for a destination brand identity. In the case of Portugal (Freire, 2007), friendliness of local people was found to be important for brand building process in Portugal. In the case of Stoke-on-Trent (UK), Phillips and Schofield (2007) found that perception of residents is an important component of the

place brand identity. Sartori et al. (2012) presented evidence which confirmed strong link between the internal and external performance of destination brands caused by commitment of internal stakeholders, especially local people. Previous studies on Serbia by Hall (2002), Popesku et al. (2010) and Novčić et al. (2012) explored brand identity of Serbia, focusing exclusively on Serbia destination brand elements perception of internal stakeholders – Serbian residents and Diaspora. Novčić et al. (2012) highlight important difference in the perception of Serbian residents and Diaspora. Serbian residents recognized people as the most important element of Serbia as a brand, whilst for Diaspora people are not an important brand identity element. To the best of our knowledge, there have not been any studies examining destination brand perception from the stand point of the neighbors, EU country, not so long ago part of the same country.

Based on literature review we identified literature gap regarding the perception of country brand identity elements, from the view point of the EU country and the closest neighbours, once part of the same union. Therefore, we have chosen to investigate perception of Slovenian residents, regarding Serbia as a destination brand. Three main reasons for choosing Slovenia as an influential external stakeholder are following: 1. Serbia and Slovenia are ex-Yugoslav countries, bonded with close historical, cultural and economical ties, 2. Slovenia is one of top 10 foreign direct investors in Serbia in the period of 2001-2011 (Business Info Group, 2012), and 3. Slovenians are ranked as the most frequent visitors to Serbia (National Tourism Organization of Serbia, 2012). Stated factual reasons only emphasise the importance of investigating Slovenian perception of Serbia, as in the future Slovenians and Slovenia as EU member can play important role in advocacy of Serbia as destination brand. Building on the actual literature and identified literature gap our research has and having in mind immense economic importance of Slovenia and Slovenian residents for Serbia as a country, it would be important to examine and compare their perceptions with the perceptions of Serbian residents. The proposed research question can be framed as following: *What are the differences and similarities between Slovenian (external) and Serbian residents (internal) perception in relation to the elements of Serbian destination brand identity?*

### **3. METHODOLOGY**

The phenomenon of brand is very complex; therefore the investigation of brand image has similar characteristics (Maurya and Mishra, 2012). Having this in mind, in order to address the issue of complexity, we have used an exploratory sequential mixed research method. The

features of mixed methods were fitting for the nature of problem we explored. Mixed methods approach is good for studying complex phenomena (Salehi and Golafshani, 2010) and has a broader perspective compared to mono-method research (Azorín and Cameron, 2010; Johnson and Onwuegbuzie, 2004). In our case mixed method had two phases: phase 1: Exploratory (qualitative) and phase 2: Confirmatory (quantitative). Exploratory phase included: selection of appropriate research context, Analysis of media content and focus groups, Convenience sampling with sample size of 50 and thematic analysis using nVivo 9. The main goal of this phase was to discover elements of Serbia brand image and help building instrument for phase 2. The second phase included survey research method (N=740, Serbian residents, and N=2228 Slovenian residents) with random sampling. Principal component analysis in SPSS 17.9 was applied for results analysis. The goal of second phase was to identify and confirm structure of Serbia brand image.

The questionnaire consisted of relatively large number of attitudinal questions on a frequent stereotype attitudes shared in the discourse of everyday communication, media, history and collective conscious of Serbs. This might appear as a radical and risky approach in the research design, but in the cases when researchers do not have previous study to refer to, or the phenomena of study is new, a start from the scratch seems inevitable. Attitudinal statements were collected within a period of 12 months from national media (TV and newspapers) and 10 focus groups. 4 different researchers were independently coding frequent issues regards perception of Serbia and the lists were than compared and convergences identified. Further inspiration for the questionnaire design was found in the work of Ristiano (2005) who provided theoretical framework consisting of generic elements of a country's brand identity. Thus, our initial questionnaire consisted of 7 clusters of questions: demography, brand culture, brand personality, brand character, brand symbols, brand name, and brand slogan related questions. We undertook pilot testing to test the questions and make sure that questions are appropriate and relevant. The questionnaire was pilot tested on a group of 160 examinees. Final list of issues consisted of 38 most frequent attitudinal statements on the image of Serbia and a number of socio-demographic questions. In the phase of confirmatory research, PCA was used in order to distinguish significant from insignificant brand image elements. To measure attitudes, 5-item Likert scale was used with *Strongly Disagree* - weight of 1, and *Strongly Agree* - weight of 5, as the scale anchors. Initial research was undertaken in order to capture attitudes of internal audience: Serbs living in Serbia and Diaspora. The same questionnaire was adapted and used for the research of Slovenian, external stakeholders' attitudes toward Serbia brand identity. The difference between initial

and adapted questionnaire is reflected in three important questions. First question, regards citizenship of examinees. Second question explores frequency of visits to Serbia, and the last question captures reasons for visiting Serbia. All of these issues were not relevant when we were exploring attitudes of internal audience – Serbian residents.

Our target examinees were Slovenian citizens, permanently inhabited in Slovenia. Surveying lasted for three weeks in November 2011. People were surveyed on-line and on the field. Existing email databases were used and potential examinees were emailed to participate in the survey. In order to avoid response bias through the on-line survey, only people older than 40 years were interviewed on the field in five major Slovenian cities – Ljubljana, Maribor, Celje, Kranj and Koper. Survey was completely anonymous, and examinees were not asked for any personal data. We found the topic was interesting for our prospects and many wanted to participate. Thus, it shouldn't be surprising that examined sample was more than twice larger from the projected sample. Many of respondents felt delighted to participate in a survey about Serbia.

After expiration of the surveying period, online survey was closed. Results were coded and inserted in the SPSS 17.0 software, which was used for statistical analysis. Following good practice of Palant (2005) and Malhotra (2007), prior to the data analysis, error screening and data cleaning was undertaken. After insuring that there are no missing values or values of the variables that fall outside defined ranges, it was preceded to the data analysis. Following statistical tools were used: (1) **Descriptive statistics** tools were used to capture average values on the examined issues. These tools were very helpful to extrapolate demographic profile of participants and their general impressions. (2) **Factor analysis**. Exploratory and confirmatory factor analyses were used. The aim of this tool was to reveal underlying structure (i.e. Serbia brand identity) and determine how many reliable and interpretable brand elements can be found within both of the examined groups.

#### 4. FINDINGS

Final survey sample consisted of 2228 examinees, from which 2098 Slovenian residents permanently inhabited in Slovenia. The examinees were in average 40.56 years old (std. dev. 10.205, median 40, mode 35, range 15 to 76 years). Our research analyzed frequency of visits and main reasons for Slovenians to visit Serbia. The results showed that 42.4% of the sample visits Serbia once a year, and as the main reasons are listed: owning property in Serbia (38.5%), work (24.6%), and nightlife and fun (28.3%). In the terms of size, the group was

suitable for principal component analysis. According to the recommendation by Tabachnik and Fidell (2007) and Stevens (1996), it is comforting to have at least 300 cases or 150 cases, in the case when solutions have several high loading market variables (above .80). These conditions are met in both of our target groups (refer to the Table 1 and Table 2 for further details).

#### *4.1 Serbia brand identity - Slovenian residents' perception*

Prior to the performing of principal components analysis (PCA), the suitability of data for factor analysis was assessed. PCA was repeated 4 times with exclusion of attitudinal statements with communalities lower than .5. Finally, 15 attitudinal statements have left. Inspection of the correlation matrix revealed that all of the coefficients were equal to or higher than .3. This confirmed that dataset is suitable for the factor analysis. The Kaiser-Meyer-Olkin value was .859 exceeding minimal required value of .6 whilst Bartlett's Test of Sphericity reached statistical significance of .00, supporting factorability of the correlation matrix. Principal Component Analysis (PCA) was performed used Oblimin rotation. PCA revealed presence of 6 components with eigenvalues exceeding 1, explaining 27.48, 11.09, 8.08, 7.28, 5.53, and 5.35 percentages of variance respectively. In order to determine optimal number of factors, parallel analysis (Monte Carlo simulation) was used and eigenvalues were compared with the eigenvalues given by the PCA (Pallant. 2005). Parallel analysis showed that 4 components have eigenvalues that exceed the corresponding criterion values for a randomly generated data matrix of the same size (18 variables x 2098 responses). The 4 component solution explained a total of 56.49% of the total variance of Serbia as destination brand. To aid in the interpretation of identified components. Oblimin rotation was performed (for the detail findings of PCA please refer to Table 1). The four brand identity elements emerged:

1. **Recommendable tourist destination** – 33.38% of total variance explained and this is the strongest brand identity element. It is not surprising that Slovenians described Serbia as hospitable country, with great cuisine on which Serbs can be proud of, beautiful nation, and as a country they would recommend to every foreign visitor. The roots for this kind of perception can be found in close positive relations between two countries, dating back at the time when they were a part of Yugoslavia.
2. **Development** – 13.14% of total variance explained. Serbia was found to be perceived as a drop behind European Union country, which relates with the fact that Slovenia is the only member of EU out of all ex-Yugoslav countries. Serbia was also described as

not modern and undeveloped country with low quality products. Turbulent and unstable Serbian past still reflects the safety of country.

3. **Rich national treasury** – 9.79% of total variance explained. Slovenians perceive Serbia as a country rich in archaeological sites, monuments, monasteries and natural beauties.
4. **Cultural heritage** – 7.46% of total variance explained. Distinctive Serbian cultural heritage, Slovenians relate with strong bonds with tradition and orthodox religion, reflecting vital place of church and celebrations in lives of Serbs.

**Table 1:** Serbia brand image perceived by Slovenians - Rotated Component Matrix for PCA with Oblimin rotation for 4 factor solution.

Attitudinal statement	Pattern / Structure coefficients				Comm.
	C1	C2	C3	C4	
Serbia is country of hospitality	.836	.045	-.042	.003	.666
Serbia has great national cuisine	.779	-.161	.057	.020	.590
Serbs are beautiful nation	.675	.063	-.020	.104	.539
I would recommend every foreigner to visit Serbia	.558	.252	.173	-.092	.535
Serbia can be proud with its national cuisine	.486	-.029	.268	.240	.564
Serbia is modern and developed	-.147	-.850	.036	.066	.695
Serbia is European country	.009	-.829	-.033	-.008	.666
Serbia is country with high quality products	.027	-.703	.097	.038	.556
Serbia is safe country	.394	-.552	-.050	-.081	.537
Serbia is rich in archaeological sights	-.126	-.043	.888	-.067	.710
Serbia is rich in monuments	.046	.057	.777	.089	.716
Serbia is rich in monasteries	-.001	-.087	.758	.088	.614
Serbia is rich in natural beauties	.190	.059	.692	-.077	.605
Church plays vital role in lives of Serbian people	-.098	.092	.021	.906	.741
Celebrations play vital role in the lives of Serbians	.184	-.040	-.013	.810	.689
	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>Total</b>
<b>% of variance explained</b>	33.38	13.14	9.79	7.46	63.77
<b><math>\alpha</math></b>	0.739	0.760	0.814	0.419*	
<b>Mean</b>	24.12	10.45	14.45	12.17	
<b><math>\Sigma</math></b>	3.693	2.643	2.727	2.030	

#### 4.2 Serbia brand Identity: Residents' perspective

The surveyed residents (N=740) were in average 30.36 years old (std. dev. 9.969, median 27, mode 25, range 15 to 81 years). Prior to the performing of principal components analysis

(PCA), the suitability of data for factor analysis was assessed. PCA was repeated 3 times with exclusion of attitudinal statements with communalities lower than .5. Finally, 27 attitudinal statements have left. Inspection of the correlation matrix revealed that all of the coefficients were equal to or higher than .3. This confirmed that dataset is suitable for the factor analysis. The Kaiser-Meyer-Olkin value was .882, exceeding minimal required value of .6 whilst Bartlett's Test of Sphericity reached statistical significance of .00, supporting factorability of the correlation matrix. Initial PCA was performed used Oblimin rotation technique which suggested 8 factors/components. In order to determine optimal number of factors, parallel analysis (MonteKarlo simulation) was used and eigenvalues were compared with the eigenvalues given by the PCA (Pallant, 2005). Parallel analysis showed 6 components with eigenvalues exceeding the corresponding criterion values for a randomly generated data matrix of the same size (27 variables x 740 responses). Thus, we found that optimal factor number was 6. We facilitated another PCA and forced procedure to suggest 6 factors. The 6 component solution explained a total of 55.51% of the total variance of Serbia as destination brand. To aid in the interpretation of identified components, Oblimin rotation was performed. The 6 brand identity elements emerged (for the detail findings of PCA please refer to Table 1.):

1. **People** – 25.54% of total variance explained. It was found that people are the most significant brand identity element. Despite the life in a country burdened with problems, Serbian people enjoy and celebrate life with the sounds of Serbian folk music. They are talented for sports, curious and good looking.
2. **Obsolescence** – 8.75% of total variance explained. Serbia was found as a country that falls behind modern world and current trends. Serbia was also described as mainly rural, under-developed and non-European country.
3. **Negative media bias** – 7.01% of total variance explained. Negative media bias seems as the outcome of long years of conflict in the region and role of Serbian people in these misfortunate events. Serbia and Serbs were usually presented in foreign media as “bad guys” and initiators of civil war in Yugoslavia. Despite the fact that Balkan conflicts are more than a decade behind, Serbian media picture is still considered to be negatively biased and not authentically presented in the domestic in foreign media.

4. **Recommendable tourist destination** – 4.99% of total variance explained. Serbia was found to be hospitable country, with great cuisine and glorious history, recommendable to every foreign visitor. This is also a point of self-reference as respondents identify themselves with the role of a good host which is a part of Serbian cultural matrix.
5. **Rich national treasury** – 4.72% of total variance explained. Serbia is perceived as rich in archaeological sites, monuments, monasteries and natural beauties. Even though aware of national treasury, it would be interesting to examine how many of these places are in the reality visited by Serbian residents.
6. **Cultural uniqueness** – 4.5% of total variance explained. Serbia is described as a country with distinctive culture, where tradition, countryside and church play vital roles in the everyday life of Serbian people.

**Table 2:** Serbia brand image perceived by Serbian residents - rotated component matrix for PCA with Oblimin rotation for 6 factor solution

Attitudinal statement	Pattern / Structure coefficients						Comm.
	C1	C2	C3	C4	C5	C6	
Serbs love folk music	<b>.671</b>	-.020	.051	.178	-.141	.161	.487
Serbia is always burdened with problems	<b>.650</b>	-.217	.073	.197	-.143	-.025	.466
Serbs love to know everything	<b>.647</b>	.009	-.112	.234	-.260	-.003	.431
Celebrations play vital role in the lives of Serbians	<b>.698</b>	-.030	-.232	.408	-.387	.183	.573
Serbs are talented for sports	<b>.600</b>	.239	-.254	.523	-.443	.159	.529
Serbs are beautiful nation	<b>.491</b>	.260	-.266	.531	-.446	.282	.510
The image of Serbia in media is full of contradictions	<b>.419</b>	-.086	.033	.216	-.264	-.226	.283
Serbia is mainly urban	.039	<b>.756</b>	-.015	.123	-.207	.110	.585
Serbia is modern and developed	-.148	<b>.714</b>	-.031	.011	-.121	.357	.588
Serbia is mainly agricultural and rural	.157	-.496	-.038	.203	-.141	.364	.294
Serbia is European country	-.027	<b>.518</b>	-.020	.163	-.081	.196	.671
The image of Serbia in media is positive	-.060	.074	<b>.787</b>	-.010	.079	.045	.497
The media image of Serbia is better than reality	.135	-.074	<b>.755</b>	-.107	.083	-.221	.658
Serbia is as presented by the foreign media	-.189	-.195	<b>.615</b>	-.424	.222	.124	.656
Serbia is as presented by the domestic media	-.125	.131	<b>.502</b>	-.180	-.015	.462	.531

Attitudinal statement	Pattern / Structure coefficients						Comm.
	C1	C2	C3	C4	C5	C6	
I would recommend every foreigner to visit Serbia	.150	.148	-.123	<b>.778</b>	-.444	.086	.501
Serbia is country of hospitality	.276	.183	-.165	<b>.796</b>	-.386	.162	.651
Serbia has great national cuisine	.349	.053	-.163	<b>.782</b>	-.319	.145	.646
In Serbia people spend more than they have	.410	-.162	-.129	<b>.686</b>	-.218	-.017	.623
Serbia is a country of glorified history	.133	.198	-.186	<b>.643</b>	-.530	.339	.562
Serbia is rich in archaeological sights	.175	.086	-.074	.318	<b>-.862</b>	.088	.565
Serbia is rich in monuments	.220	.145	-.129	.342	<b>-.833</b>	.206	.762
Serbia is rich in nature beauties	.464	.109	-.201	.516	<b>-.753</b>	.168	.698
Serbia is rich in monasteries	.573	.056	-.173	.435	<b>-.727</b>	.173	.657
In Serbia, tradition is specially nurtured	.146	.278	-.014	.272	-.219	<b>.682</b>	.671
Serbs have unique and distinctive culture	.258	.308	-.141	.412	-.545	<b>.474</b>	.497
Church plays vital role in lives of Serbian people	.234	.121	-.105	.196	-.293	<b>.640</b>	.474
	<b>C1</b>	<b>C2</b>	<b>C3</b>	<b>C4</b>	<b>C5</b>	<b>C6</b>	<b>Total</b>
<b>% of variance explained</b>	25.54	8.5	7.01	4.99	4.72	4.5	55.51
<b><math>\alpha</math></b>	0.887	0.759	0.723	0.719	0.71	0.69	
<b>Mean</b>	4.09	2.43	2.44	4.19	4.04	3.39	
<b><math>\Sigma</math></b>	.59	.75	.71	.75	.78	.66	

#### 4.3 Comparison of Slovenian and Serbian perception

Thorough examination of the results gained from Principal component analysis of both external and internal stakeholders, allow us to assess the current position of Serbia as a destination brand. Several differences and similarities in the perception of both examined groups were extracted. First found difference reflects the number of brand identity elements influencing Serbia brand image. Slovenian residents outlined four elements, mostly positively associated with Serbia brand image: Recommendable tourist destination, Development, National treasury, and Cultural heritage. On the other side, Serbian residents approached this issue in more detailed manner, and depicted six elements: People, Negative Media Bias, Obsolesce, Tourism destination, National treasury, and Cultural uniqueness. According to Hankinson (2007) and Hudson & Ritchie (2009), observed inconsistencies in the perception of Slovenian and Serbian residents can be related with positive and negative elements linked with destination brand identity, attitude towards destination and previous overall experiences. Having this in mind, it is not strange that Slovenians perceive Serbia as a

favourable tourist and business destination, evoked by emotions generated during previous experiences and visits to Serbia.

Further detailed analysis of brand identity elements content was applied in order to explore key decision making criteria favouring future advocacy of Serbia as a destination. The results showed that both Serbian and Slovenian residents perceived Serbia as a recommendable tourist destination, rich with national treasury and cultural heritage, but also as an underdeveloped country. Serbian residents had more detailed approach identifying People and Negative Media Bias as influential factors affecting Serbia brand image, while Slovenians did not even recognized People as valuable Serbia brand identity element. Several authors (Phillips & Schofield, 2007; Freire, 2007) argue that perception of local people is important component of destination brand identity. Therefore, cheerful, hospitable, and successful people should be incorporated into future Serbia branding strategy.

Lastly, our research also identified certain similarities affecting Serbia brand image. Future branding planners should have in mind that Serbia was perceived by both groups as an underdeveloped, rural, and not European country. Also, both groups agreed that Serbia is a hospitable country, with great national cuisine, rich in national treasury (archaeological sites, monasteries, monuments, and natural beauties), see Exhibit 1. Therefore, stated elements should be used as points of difference when creating destination branding platform, formulating strategy, and shaping external perception of Serbia as a brand.

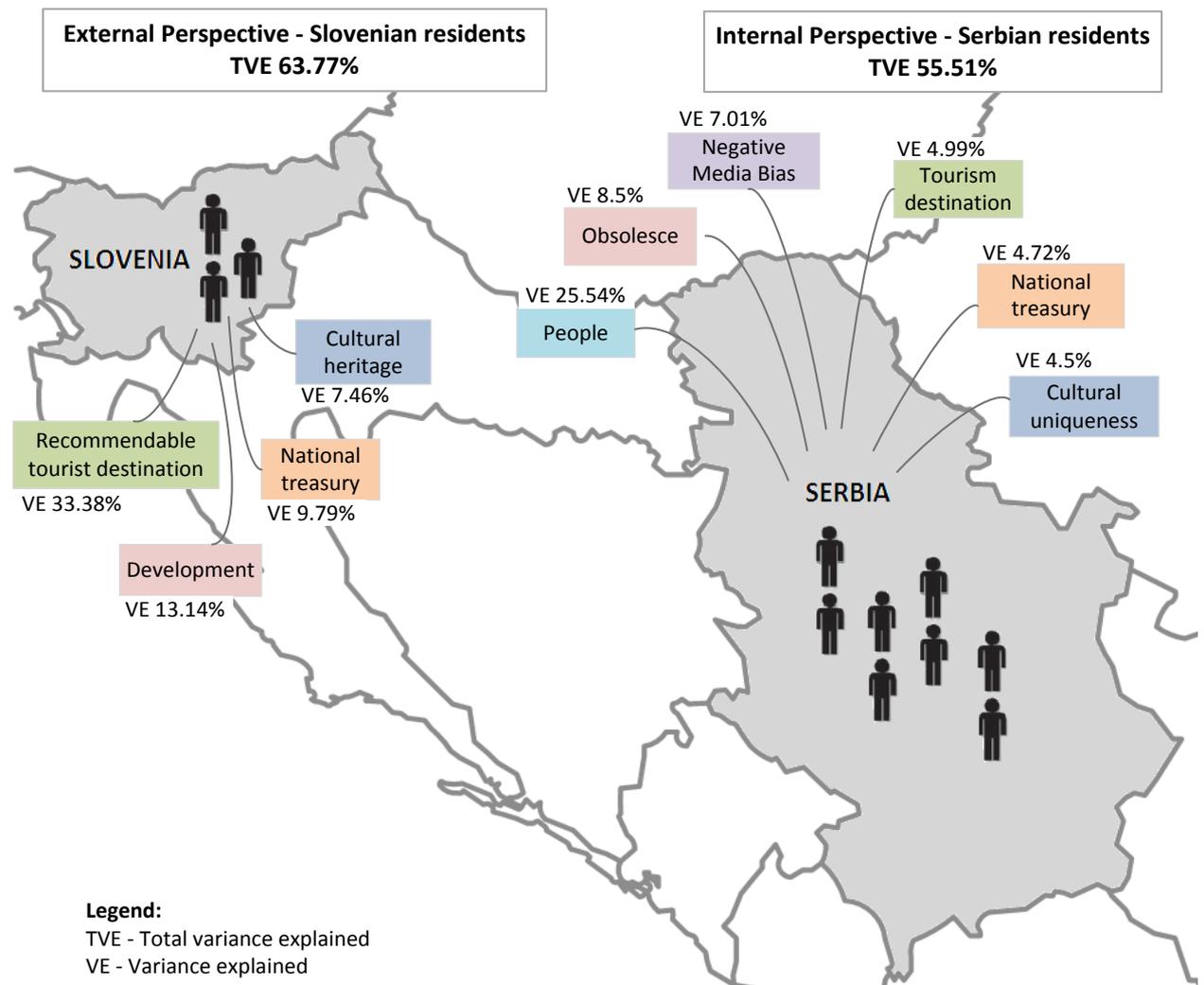
## 5. CONCLUSION

Addressing the research question stated at the beginning of the paper and in accordance with findings of our research, important differences and similarities in the perception of Slovenian residents (external) and Serbian residents (internal) exist. Slovenian residents identified four elements of Serbia brand identity: Recommendable tourist destination, Development, National treasury, and Cultural heritage. Whilst, Serbian residents approached stated issue in more detailed way, outlining six elements of Serbia brand identity: People, Negative Media Bias, Obsolesce, Tourism destination, National treasury, and Cultural uniqueness. Onwards, both groups created their perception based on different points of view. Though not so long ago Slovenian residents have been a part of a same country with Serbia, today are playing an important role as investors, economic partners and visitors to Serbia. Therefore, Slovenian mostly positive perception of Serbia as a brand is driven by previous experiences and visits to Serbia. Never the less, close relations between two countries and past without conflict led to

the absence of negative media bias influence on perception creation. All stated facts are essential for development of future branding platform of Serbia, because Slovenia should be considered as valuable stakeholder in advocacy of Serbia as a destination brand. Finally, both groups match opinion that Serbia is a great place to visit, recommendable tourist destination, rich with national treasury and unique cultural heritage. Results of previous studies (Hall 2002; Popesku et al., 2010; Novcic et al., 2012) are in accordance with findings gained from our research, confirming Serbia as a meeting place of cultures, hospitable country, with great national cuisine, rich in national treasures, featuring hospitable, cheerful and successful people. Stated elements should be integrated into future Serbia branding strategy. Besides, branding planners should have in mind another valuable fact extracted from our study. Serbia was perceived by both groups as an underdeveloped, rural and not European country. Also, presented results could be effectively incorporated in Gilomre's (2001) diamond shaped branding framework, revealing core competences of Serbia as a brand.

Our study has several limitations that need to be highlighted. Firstly, sample in Slovenia is much larger than sample in Serbia, which is in contrast to population in examined countries. On the other hand sample size of both groups satisfies necessary statistical criteria set for exploration of a like phenomenon. Secondly, results analysis did not consider separately perception of Slovenians that have visited Serbia and those that have not. Thirdly, in order to get realistic external perception of Serbia as a brand, future research should explore attitudes of other stakeholders important for Serbia.

Having in mind that Slovenia is one of the most important direct foreign investors in Serbia, and that Slovenians are ranked as most frequent visitors to Serbia, future direction of the research should focus on identifying specific needs and touch points interesting to this group, in order to create specially tailored branding strategy in order to shape image of Serbia as a brand. Following this premise branding planners at national level would be able to create a destination brand platform, consisted of unique brand identity elements, which will differentiate country of Serbia from competitors in the Balkans and Europe.

**Exhibit 1:** Slovenian and Serbian residents' perception of Serbia as a brand

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## FACING A FINANCIAL CRISIS – THE CASE OF SPANISH RESTAURANTS

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### ABSTRACT

The research is situated in the field of crisis management in the tourism industry. The purpose of the study is to detect crisis readiness of Spanish restaurants. Restaurants feature rarely as object of analysis in crisis management studies. In 2008, shortly after the beginning of the current financial crisis, a survey was conducted among 291 Madrid restaurants with a response rate of 62 %. Results indicate that restaurant owners / managers fear financial crisis more than other forms of crisis. A financial crisis is considered to be more damaging for the business since it lasts longer and impacts the business more than other types of crisis. Furthermore, it could be confirmed that size is a good predictor of crisis readiness. Larger restaurants did engage in formal crisis planning. Age did not prove to be a predictor of formal crisis planning. However, older restaurants are likely to have lived through a crisis and adjusted accordingly by adapting their internal organization.

**Keywords:** Restaurant; Crisis; Financial Crisis; Hospitality Industry; Crisis Readiness; Crisis Preparedness; Anti-Crisis Planning; Crisis Management; Spain.

### INTRODUCTION

The study looks at the Spanish restaurant industry in 2009, one year after the beginning of the financial crisis. Bars and restaurants form an important part of the Spanish culture and are abundant. Due to the mild climate in winter and the hot long summer periods, social life in Spain often takes place outside, either in bars or restaurants or on the

streets since homes are often small and considered part of family life and thus not for outsiders (Graf-Riemann, 2011).

The study encompasses two different lines of research: Crisis management and services industries, especially tourism. References are also made to literature focusing on crisis management in small businesses. During the last years many studies in the tourism sector have focused on crisis management given that the amount of critical events increases (disasters, health threats, terrorist attacks, and economic crisis) and proper management becomes important. Examples for studies focusing on crisis management in the tourism industry are: Henderson (2007), Huang and Min (2002), Enz et al. (2011), Cooper (2005), Alonso-Almeida and Bremser (2013). Crisis management in the tourism industry focuses mostly on hotels. Restaurants feature mainly as object of analysis for performance or marketing related studies (Kim and Kim, 2004, Yuksel, 2002).

The study contributes to literature in the two fields of crisis management and analysis of restaurant business. Whereas crisis management literature has analysed the situations of hotels extensively, restaurants have been neglected. Thus, the paper can also help restaurant owner or managers to gain valuable insights. The remaining research is structured as follows: the next section presents the literature review and develops three hypotheses. Section three introduces the research methodology. In section four the findings will be discussed. In addition, section four develops insights for restaurant managers and shows the limitations of the study as well as giving indications for future lines of research.

## LITERATURE REVIEW

In order to install crisis management, businesses have to show a certain degree of crisis readiness. (Faulkner, 2001), p. 137 has analysed the work of several authors and indicated that the key elements of a crisis are:

- "a triggering event, ...
- high threat, short decision time and an element of surprise and urgency;
- a perception of an inability to cope among those directly affected;
- a turning point, when decisive change, ..., is imminent. ...;
- characterized by 'fluid, unstable, dynamic' situations."

Although they cannot be stopped, their impacts can be limited by effective crisis management. Since a crisis is so broadly defined it is no longer a question if a business is hit by a crisis, but rather when it will happen and how well the company is prepared in order to cope with the crisis (Kash and Darling, 1998). Often, tourism is affected due to the side effects of a crisis. Terrorist attacks aimed to disrupt public life (e.g. Madrid Metro bombings) will stop travellers from visiting the spot if the reaction of the authorities is considered to be inadequate (Pizam and Fleischer, 2002). Health threats (e.g. SARS) force governments to close their country to visitor groups from entire regions (Messe Basel, 2003). Natural disasters can destroy tourism facilities and the negative media coverage afterwards might keep tourists from travelling to the destination (Henderson, 2005). Economic crisis reduce spending power and force tourists and locals to stay at home in order to save money (Sausmarez, 2004). Even though the root cause of the event differs, similar measures have to be taken in order to combat it. Companies are especially aware of recessions because their financial advisors (banks, investors) demand provisions for "lean" years. In addition, natural disasters, terrorist attacks or health threats are considered to be difficult to prepare for. Especially small businesses define crises as something that affects cash-flow and therefore fear a financial crisis (Herbane, 2010). Given that the fall of Lehman Brothers led to global contagion and thus increased awareness of an upcoming crisis, the first hypothesis is postulated:

H1: Restaurants, that fear an economic crisis most, are less worried about other forms of crisis.

There is scant research available on restaurants in crisis times. However, some researchers have in general looked upon success factors for restaurants. Thus, as Parsa et al. (2005, p. 306) conclude from their literature review and subsequent analysis of US restaurants: "The longer a company is in business, the less likely it is to fail". Age and experience do have an important influence on the survival rates of restaurants (Camillo et al., 2008). An economic crisis is to some extent comparable to a start-up situation. Financing has to be found, demand calculated, reactions from the competition are unknown, the personal situation of the managers / owners changes (very often restaurants are independent businesses including family members of the owner working there). In order to survive a crisis, crisis planning is essential. However, research has shown that companies only start planning, after they have already survived a previous crisis.

The literature researching the relationship between crisis preparedness / crisis readiness and age / prior crisis experience starts out with Reilly (1987). Crisis readiness in her

definition encompasses the existences of crisis plans in the organization. She finds weak support for her hypothesis that prior crisis experience is positively related to subsequent crisis planning. Her study was not restricted to the tourism industry but contained a large number of significantly different industries. Restaurants were not included. Thus, it remains untested if the statement holds true for restaurants as well. Later, another study by Carmeli and Schaubroeck (2008) that also covered a variety of industries and sizes confirmed her results.

Failure rate is highest during the first year of existence. Subsequently, failure rates fall since businesses become accustomed to the ups and downs of the economic cycle, the action of the competition and manage to establish a successful value proposition to their customers. As Herbane (2010) notes, this situation is applicable for British SME. Approximately 30 % fail within their first three years of existence, the first year being the hardest. These observations hold also true for Spain. According to the national statistics institute INE (Instituto Nacional de Estadística, 2012), of all companies founded between 2001 and 2009 approximately 20 % failed during their first year of existence. Failure rates declined to ca. ten percent in the second and third year respectively. They fell significantly afterwards. However, between four and five years after their foundation, only about half of all companies survived. Here, small businesses were especially hard hit. More than 99% of all failed companies had less than ten employees, 63 % had no employees at all. Unfortunately the INE does not disclose information for sectors. Henceforth, it will be concluded that the situation in the restaurant sector is comparable to the national average. These numbers clearly show the necessity of crisis plans or crisis management in all types of businesses. Given that crises are frequent and survival cannot only be based on luck, a second hypothesis is postulated:

H2: Older restaurants are more ready for a financial crisis than younger ones.

Apart from age which is a sign of experience (either in the form of general business experience or specific crisis experience), size is also expected to be a predictor for the existence of crisis plans. Spillan and Hough (2003, p. 406) state: "[...] small businesses with their limited resources are especially vulnerable to the catastrophic consequences of crisis events." Herbane (2010) also confirms the low degree of crisis preparation among small businesses compared to larger one. Generally speaking, larger companies have more resources (financial as well as manpower) available that can be directed at foreseeing critical events and plan accordingly. In addition, larger corporations that are organized as chain restaurants can provide central crisis planning to the benefit of the individual restaurant

manager. The correlation between size and crisis preparedness has already been tested in the tourism industry, but not for Spanish restaurants. Reilly (1987) investigated 79 different companies of different industries in the US, however, did not include restaurants. Rousaki and Alcott (2006) surveyed hotel managers in the UK and Pennington-Gray et al. (2011) questioned managers from three different segments of the tourism industry (lodging, attractions, and promotions). They all detected differing degrees of positive correlations between size and crisis preparedness. Hence, size should be a predictor of crisis planning in the Spanish sample:

H3: Larger restaurants are more ready for a financial crisis than smaller ones.

## METHODOLOGY

The survey was conducted in 2008. In total 291 Madrid restaurants were surveyed and 180 valid responses collected (response rate 62%) which represents a high response rate for this type of study (Malhotra, and Grover, 1998). Data were collected by the use of student interviewers who contacted restaurant owners or managers. Madrid was chosen as a location because being the capital of Spain it benefits from leisure as well as business travel. Thus, results of the study will be comparable to other Southern European capitals that share the same characteristics (e.g. Lisbon, Rome). This research is conducted as a descriptive analysis. The 180 restaurants in the sample are, on average, 18.3 years old and have a seating capacity of approximately 114 places which is considerably larger than the national average of 60.8 places (Fundación Hostelería de España, 2013).

In order to test hypothesis 1 (Restaurants, that fear an economic crisis most, are less worried about other forms of crisis), interviewees were asked to judge which of the following four threats they considered to be worst for their business: natural disaster, health threat, terrorist attack or economic crisis. Results can be found in table 1.

Table 1: Crisis events judged to be most damaging for the business

<i>Recession</i>	150	83
<i>Terrorist attack</i>	13	7
<i>Health threat</i>	21	12
<i>Natural disaster</i>	21	12
<i>Critical event</i>	<i>Frequency*</i>	<i>Percent*</i>

\*Several answers possible

As can be seen from table 1, by far the majority of respondents judged recessions as most damaging for their business. Subsequently, a descriptive analysis using Pearson's correlation coefficient was conducted in order to see how the considerations about different critical events are related to each other. The results are displayed in table 2.

Table 2: Correlation between economic crisis and other critical events

Terrorist Attack	-0.336**
Health threat	-0.348**
Natural Disaster	-0.441**
<i>Critical event</i>	<i>Pearson's correlation coefficient</i>

\*\*Statistically significant at the 0.01 level

As can be seen from table 2, a statistically significant, negative correlation exists between economic crisis and other critical events. In addition, those restaurant managers and owners also stated that economic crises are larger than other critical events and affect the business most.

In order to test hypothesis 2 (Older restaurants are more ready for a financial crisis than younger ones), the interviewees were asked to give their opinion on several statements concerning crisis planning and crisis experience. Answers could be given on a five point Likert scale. Responses were correlated with age of the restaurants. All significant results can be seen in table 3.

Table 3: Correlation age / size of restaurants and crisis planning

The company disposes of an anti-crisis plan	0.135	0.229**
The company prepared for the crisis by taking internal measures	0.070	0.242**
The company has lived through other financial crisis and survived	0.178*	0.161*
The company learned from	0.161*	0.204*

other crisis and made adjustments within the organization		
<i>Statement</i>	<i>Pearson's correlation coefficient (Age)</i>	<i>Pearson's correlation coefficient (Size)</i>

\*\*Statistically significant at the 0.01 level \*statistically significant at the 0.05 level

The results from table 3 show that no correlation exists between an anti-crisis plan and age. However, it shows clearly that older restaurants are more likely to have experienced another crisis in the past and therefore adjusted their organization accordingly. Thus, hypothesis 2 can be supported partially. Whereas no formal plan exists, some actions have been undertaken due to previous experience.

Last, hypothesis 3 (Larger restaurants are more ready for a financial crisis than smaller ones) was tested using the same method as hypothesis 2. The results are displayed in table 3 as well. Here, strong support is found for the hypothesis. Larger restaurants do have crisis plans and prepare for a crisis by taking internal measures. Additionally, the results show clearly that larger restaurants dispose of crisis experience and learned from that experience. This leads to the acceptance of hypothesis 3.

## DISCUSSION OF RESULTS AND CONCLUSIONS

As the statistical analysis of the previous section showed, hypothesis 1 (Restaurants, that fear an economic crisis most, are less worried about other forms of crisis) can be supported. Literature has so far not researched this phenomenon. However, the result is not surprising. Recessions are part of the economic cycle and recur frequently with varying intensity and duration. They only change in severity. Thus, companies are prepared to make adjustments. Other forms of crisis come suddenly as a singular event and occur with a lesser frequency. Moreover, literature shows that the impact of a recession is longer lasting than of other types of crisis (Enz et al., 2011).

Contrary to literature, the study found only partial support for hypothesis 2 (Older restaurants are more ready for a financial crisis than younger ones). Whereas the restaurants did not dispose of formal plans, they had experienced previous crises and adjusted their organization accordingly. It seems that age in the restaurant business is not a good predictor

of formal crisis planning. It remains to be tested if this is a general characteristic of the restaurant industry or a specific characteristic of the sample. Reilly (1987) investigated the relationship between crisis preparedness and prior crisis experience. Her construct of crisis preparedness includes "Organization's quick response ability" (Reilly, 1987, p. 81). It seems as if older restaurants do have a certain degree of crisis readiness without writing down specific crisis plans. Crisis plans seem to reside within the personal knowledge of the restaurant's manager, a situation quite common for small businesses or family-owned establishments. Future research will have to test if crisis experience is a better predictor for crisis plans than age.

Hypothesis 3 (Larger restaurants are more ready for a financial crisis than smaller ones) could be supported. This finding is in line with literature. Larger restaurants are able to free resources and establish tools like strategic management or crisis management. If they belong to a chain, they can also rely on headquarters' resources in order to support their own planning processes. They are therefore better equipped to deal with the current financial crisis. Here, for the future it could be interesting to differentiate between large independent restaurants and chain restaurants.

Restaurant owners and managers can draw important conclusions from this study. The results show, that older restaurants are more likely to have experienced a crisis before. Among entrepreneurs and owner-managers of small businesses there exists a tendency not to prepare for critical situations since it is expected that the own business will not be hit (Herbane, 2010). However, results show that financial crisis or recessions are abundant and have to be mastered during the years in existence. Thus, restaurants owners or managers should from the beginning include crisis management in their business plan. In this context, managers will have to be creative to include not only foreseeable events in their planning (computer failures, power failures) but also larger threats (recession, terrorist attack).

In addition, entrepreneurs wanting to open a restaurant business can also learn from this study. The results show that size is a predictor of crisis readiness. Thus it might be helpful to open a franchise business or join an existing restaurant marketing association in order to benefit from the knowledge of the group instead of opening an independent restaurant.

Given the limited geographic area in which this study is performed, the study does have some limitations. The results might not be applicable to restaurants in other locations within Spain. The Spanish restaurant industry differs considerably among the regions. Whereas in

the coastal areas large restaurants directed at foreign tourists prevail, the restaurants of the interior regions are generally smaller and directed at local tourism (Fundación Hostelería de Espana, 2013). Thus, the financial crisis will most likely affect restaurants catering to domestic tourists more than those offering their services to foreigners. An increase in the geographical coverage of the study to the entire country or capitals of other countries could offer further valuable insight.

The survey study method only gives a snapshot of a restaurant's situation during the crisis. Larger data series are required to detect the long-term effects of a crisis. Surely, the prolonged duration of the financial crisis in Spain (2008 – present) will magnify some of the results. Already today, bankruptcies and foreclosures in Spain are high; unemployment rates are at record height and influence consumer spending negatively. Domestic spending is at extremely low levels which affect restaurants severely. Especially small businesses throughout the country are hit hard.

This study focuses entirely on restaurants in Madrid. Research has included hotels to a large degree, travel agencies or tour operators that also belong to the tourism industry are not included covered as much. Surely, interesting findings would result from an analysis of those sectors of the tourism industry during crisis periods.

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## THE APPROACH OF FAMILY BUSINESSES IN THE LUXURY INDUSTRY

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### ABSTRACT

In the actual scenario characterized by new and ever-changing dynamics of the global market, firms need to quickly and timely anticipate competitors' next moves, monitor market tastes, adapt their products and properly communicate their positioning. The history of many luxury brands is linked to a family, though they may have changed ownership over time. The products often remain faithful to the style impressed by the family and when it does not happen, the risk is to lose enamel. Since this phenomenon has not been thoroughly investigated, this research aims at investigate the relationship between family and products in the luxury sector, in order to understand if and how, the family affects the success of the company. We have interviewed 19 family businesses operating in the luxury sector discovering that the involvement of the family and its essence are deeply anchored in the core business of the company.

**Keywords:** luxury; family firms; product; new product development; entrepreneurial approach

### INTRODUCTION

Family businesses operating in the luxury segment compete in a particular context, in which the advantages and disadvantages of the family model clash and face particular challenges. In this framework the competitive advantage resides not so much in the price as in the quality of product, the ability to innovate, the adherence to the trends of the moment and, also, the time to market (Mosca, 2010). All of these variables create a reputation that becomes more important in family businesses because product's brand is not only linked to the company, but also to the family and its people, becoming part of a larger system (Ferda, 2010;

Montemaggi and Severino, 2007). Moreover, the commitment of family members in the business is very high and also their level of involvement in the decision making process with regards to new products: a single error in introducing a product in the market could ruin forever the brand reputation and the family image (Saviolo and Corbellini, 2009).

The main difference between companies that successfully survive for decades or even centuries and those who fail often lies in the ability to seize opportunities and changes taking place in the market, and to correctly manage company and family dynamics: ownership, business and family, in order to create a competitive advantage hard to imitate (Pearson et al., 2008; Bresciani et al., 2013).

## LITERATURE REVIEW

Define family businesses is a hard task. However, the European Commission has put forward a unique definition (2007), in order to ease the process of data gathering and comparison, both within the same country and among different sectors. At the same time, the analysis of the different definitions proposed by different authors over the years has lead Aiello and Donvito (2006) to identify a number of common elements that characterize luxury goods. According to the authors, luxury is described mainly by the following attributes: Status (the superior status that an object confers to the owner/user), Emotion (self-realization with the property of the good), Qualitative Excellence (in materials or innovation), Aesthetic refinement (design), Exclusive (very few customers in number), Rarity (reduced availability of the product), High Price (sacrifice made for purchase), Tradition (craftsmanship or style), Investment (durability).

In addition, further three types of effects that luxury goods exercise on consumers were proposed by Vigneron and Johnson (1999) and Brioschi (2000). They are based on consumers' buying motivation and are: a) the Veblen effect (see Veblen, 1899), b) the "snob" effect and, c) the "bandwagon" effect. Summarizing these effect it is possible to affirm that three main reasons pushing consumers to buy luxury goods and they are: publicly display their wealth, feel unique and be part of an exclusive community.

Moreover, the concepts of "Veblen", "Snob" and "Bandwagon" were further described by Vigneron and Johnson (1999) believing that there are motivations and behaviours of an alternative "personal" nature, from within the consumer.

However, luxury products typically refer to tangible product categories such as transportation, real estate, household items, artwork, clothing accessories, food, healthcare products as well as intangible services such as a private club membership, sports leisure projects, or professional services (Kaufman et al., 2012).

*The family business luxury industry, the entrepreneurial orientation and the role of new product development*

Worldwide spending in luxury product rose by 13% in 2010, 10% in 2011 led by Emerging Markets (PwC, 2012) pushing total luxury goods revenues to an estimated € 212 billion (Bain and Company, 2012). This is the third year in a row of double-digit growth for the personal luxury goods market over the € 200 billion.

In Italy, more than 90% of the firms are family ones (Pratesi, 2008) and some recent research (e.g. CERIF, 2011) estimated that family businesses produce nearly 70% of the total GDP of the country. More specifically, according to the “Osservatorio AIdAF-Unicredit-Bocconi” (2011), among medium and large enterprises operating in the luxury segment in Italy, around 80% are controlled by an entrepreneurial family. The peculiar features of most of family-owned fit almost perfectly with the competitive logic of hard and soft luxury approaches; so, the unique bundle of resources family firms own implies the potential to provide an advantage over non family firms in luxury-related industries.

Italian family firms have a very strong culture of good standing, quality and brand (Attanzio, 2011). They have some key characteristics: they are managed by a limited group of people, their decisions are made quickly (Miller and LeBreton-Miller, 2005), the final approval on a new product is often given by the family members who is leading the company (Bertoldi et al., 2011) and so in a more rapid and effective way than that of new product development committees in public companies (Mussati, 2008).

Recent literature has shown that entrepreneurial orientation is positively related to innovation (Rhee et al, 2010; Pérez-Luno et al., 2011) and to firm performance (Rauch et al., 2009).

According to the literature, the entrepreneurial orientation is mainly characterized by three dimensions (Kreiser et al., 2002; Matsuno et al., 2002; Rauch et al., 2009): proactiveness

(Kreiser et al., 2002; Lumpkin Dess, 1996), innovativeness (Lumpkin and Dess, 1996; Wang, 2008), and risk taking (Miller and Friesen, 1978; Clausen and Korneliusen; 2012).

In fact, an entrepreneurial firm has been defined as a firm that “engages in product market innovation, undertakes somewhat risky ventures and is the first to come up with proactive innovations, beating competitors to the punch” (Miller, 1983). This leads to higher product innovativeness, product development speed, customer-focused performance and financial performance (Chen, Li and Evans, 2012).

As previously mentioned, in the luxury world the product brings with itself a number of intrinsic messages that its owner wants to communicate to the others. At the same time, the values of the family are often embodied in products since the company and the brand represent a single entity in the consumer’s mind. Thus, the product is filled with symbolic meanings and this is why the new product development process is fundamental to the growth and longevity for the company’s success, family business or not, over time (Crawford and Di Benedetto, 2006). The launch of a product which turns out into a success creates several advantages for the company, more than anything else that can happen (Tardivo et al., 2011).

Within the company, the product development process is managed by product development experts. In small companies or in family businesses, mainly, the inputs for the creation of a new product come from the entrepreneur's personal vision of the market (Calabrese et al., 2002). The entrepreneur considers him/herself to be a manager with transversal competence and wants to be the protagonist of all the fundamental moments of the process, from the first step to final authorization.

## **RESEARCH QUESTIONS**

The luxury sector is dominated – in Italy – by family businesses. Being a family business means to have some competitive advantages but also critical dynamics to manage. There is a growing interest in studying the product development process in family businesses: some researchers studied the role of the family in the new product development (NPD) process of small family businesses (De Massis et al., 2011), while others focused the attention on the process that lead family businesses to choice new products and how to maintain the entrepreneurial vision inside the company (Bertoldi et al., 2011). But few researchers

investigate the role of family businesses and their entrepreneurs in the luxury market: for this reason authors decided to study the relationship between family members, luxury and products.

In particular, the research questions that authors try to answer are the following:

- “In which way families are involved in the product development process in the luxury sector?”
- “Which are the key success factors for family businesses operating in the luxury sector?”

Authors try to understand the degree of involvement of families in the most important process of the business, in order to observe the differences and to extrapolate common elements that can represent sources of competitive advantage. Secondly, authors want to understand the key success factors that family businesses operating in the luxury market apply in order to thrive in a hypercompetitive and global market, by being always in step with the times and entering the market with successful products.

## **RESEARCH METHODOLOGY AND DESCRIPTION OF THE SAMPLE**

The methodology adopted in this paper is qualitative; in fact, the phenomenon investigated is linked with a complex social context. Family businesses are companies in which the interaction between the three spheres – family, business and ownership – creates special dynamics among family and non-family members involved in the company. So, in order to study and understand these dynamics the most suitable approach, as suggested by Yin (1984), is the qualitative one. Starting from the fact that our objective was to deeply understand the factors that facilitate entrepreneurs and families in having success in the luxury market and, how they manage the product development process, we started to collect data through interviews.

TABLE 1. Description of the sample

Firm	Year of establishment	Production	Number of employees	Number of family members involved	Turnover category
a	1911	Mosaics	5	2	0-1 M€
b	1988	Cat and dog food and supplies	5	3	0-1 M€
c	1993	Artistic Ceramics	6	2	0-1 M€
d	2009	Clothing	1	1	0-1 M€
e	1995	Clothing	1	1	0-1 M€
f	2000	Majolica stoves	1	1	0-1 M€
g	1969	Jewelry	NA	2	0-1 M€
h	1985	Jewelry	2	2	0-1 M€
i	2002	Jewelry	12	2	0-1 M€
l	1890	Furniture	30	5	1-10 M€
m	1982	Jewelry	10	2	1-10 M€
n	1989	Jewelry	5	3	1-10 M€
o	1961	Silverwork	27	4	1-10 M€
p	1963	Chandeliers	100	4	10-50 M€
q	1966	Elevators	220	2	10-50 M€
r	1969	Yachts	2500	3	>100 M€
s	1975	Doors	750	15	>100 M€
t	1938	Billiards	15	2	NA
u	1959	Carpets	8	3	NA

Source: personal elaboration

In conducting the interviews we used a questionnaire divided in three sections: 1. General questions on the family and the firm; 2. Family and firm values; 3. Product development process. More or less ten questions in each section were proposed.

The sample identified was composed by 19 Italian family firms interviewed during a special conference on Family and Luxury Business held in Verona. Data collected were processed, analyzed and combined with available bibliography, companies' documents and internet websites; the data-triangulation is useful to validate and integrated all the information coming from different sources (Olsen, 2004).

The sample seems to be heterogeneous but thanks to the most general question of the interview guide's first section was possible to collect a number of interesting information about four aspects: geographical area, intergenerational transfer, generation at the head of the company and turnover; more information on the sample are described in table 1.

## RESULTS

Information and data obtained have been collected in a single database in order to put light on common features and dichotomies. The results often varied from firm to firm, this is due to the heterogeneity of the sample considered.

The most part of the sample is composed by family businesses at the first generation (9 out of 19), while the others reached the second (6 out of 19) and third generation (4 out 19) experiencing the trans-generational process. These results can have an influence on the dynamics between the three spheres -family, business and ownership- and, in part, they can justify the way in which relationships between relatives are regulated. In fact, from interviews emerged that the relationships between family members are regulated by formal family agreements only in three companies. In the other cases, tasks and succession processes are managed through oral agreements and/or practices rooted.

The first common results observed was the leadership role of family members inside the company: in all the companies the CEO is a family member and only in two cases he is supported by external managers. In these two cases the relationship between the family and the external management were formal: everyone played his role with accountability, consistency and correctness.

The second common trend with regard to our first research question, and the most interesting one, is that the majority of the companies performed internally all the phases of the product development process. The phases in which family members are mostly involved are the idea generation and the product design, while the level of commitment is lower in market research and production. These data suggest that family members are placed where the core competencies of the company reside. The final decision on the launch of a product into the market lies always in the hands of the family.

On average, 35% of the companies think that the contribution of the entrepreneurial orientation of the family in the development phase of the product accounts for the 90%; the 29% of respondents think that the family contribution accounts for the 100%, while the 24% believe that accounts for the 50%, while a smaller percentages think that the family is influential by 70-80%.

Finally, from the analysis of these results it is possible to underline the higher degree of involvement of family members in the product development process and, the level of power in the hand of the family: it has always the final approval on products. It seems that just the family has the necessary competences and the right intuition, the instinct to recognize successful products.

The second part of the interview was used in order to understand the key success factors for family businesses operating in the luxury sector.

Through a deep analysis of the interviews was possible to identify common features and, in particular, were identified three main factors:

- Pursuing high product quality and other shared values: all the entrepreneurs stated that the quality is an essential characteristic of luxury products but, they also underlined that quality has to be paired up with other values. The first value is the *product prestige*: a set of features such as design, cost, fashion, etc.; secondly, the *innovation inherent in the good*: not only in the product but also in the manufacturing process. Often due to the different academic education successors have shown an impetus toward innovation. The innovation in the family businesses is mixed up with the essence of the family tradition. The third value, *the quality of finished products* of design and manufacturing that is never left up to fate, but is based on a careful choice repeated overtime. Suppliers are often kept by the new generation thanks to personal relationships based on mutual trust. Finally, the fourth is the *tradition*: the second or third generations have never subverted the company's soul but have only introduced incremental improvements. Oftentimes, even after the intergenerational process, the past generations remained present to support new managers and make sure that tradition is respected.
- Maintain an high level of control (by the family) on the product development process: owners are the ones who design products, and the final approval is always left to family members. This trend is even stronger when the firm is at the first generation: the companies operating in the clothing sector were the most recently established. Within them, family control is very powerful because the entrepreneurial activities stem from the founder's idea<sup>6</sup> and in the first operating years with the family are the ones with the necessary know-how, creativity, knowledge. Therefore they have the absolute power on deciding products to be launched on the market. As the company grows, both in terms of experience and size, more and more people possess the necessary know-how to create new products. However, the final green light on every project is always given by a family member.
- Preserve the family tradition as a competitive advantage on the market. All the family businesses interviewed deemed the family and their entrepreneurial orientation of the family members as fundamental to the business success. First of all, family members are living the company since the childhood; moreover, the family component is highly

important for clients, in fact family members put themselves in first line every time they place a new product on the market. So customers believe that, being fully responsible for every success or failure of their own brand, they strive to create quality products in line with market expectations.

## CONCLUSIONS

The analysis of the data collected allows authors to state that the level of involvement of family members in the product development process is very high. In fact, from the interviews emerged that the family is always involved in the process and, above all, is the final decider on the launch of new products into the market. Moreover, in the majority of the companies is recognized that the contribution of the entrepreneurial orientation of the family is fundamental in the product development phase and, probably, is one of the key factors for having success in the luxury market.

From the point of view of the entrepreneurs and/or family members seems clear that in order to have success there are three main factors to remember and to transmit to the company. These three common features, regardless of the companies' sectors, are: pursuing high product quality and other shared values, maintaining a high level of control on the production process with the involvement of the family and, finally, keep alive the family tradition as an added value in order to have a competitive advantage in the market.

In particular, with regards to the first common feature, the ethical dimension in luxury family businesses is extremely important, and should be implemented in daily operating activities and in relations with all stakeholders. This sense of ethics and fairness toward the market must be translated in the quality and prestige of the products as a fundamental component in order to maintain reputation and family tradition. Interviews clearly show that family ownership reach excellence for special care in product quality and focus a strong attention in details. Family businesses continue to accumulate and transfer knowledge through the "continuity of his legacy through time and generations" and develop talent with passion for the product.

This research presents, therefore, some managerial implication. In fact, it clearly shows that entrepreneurial orientation of family members promote the successful marketing of new products and, in line with part of the existent literature, highlights that the high degree of involvement of family members in the new products development process is a key factor for maintain the success. In addition, the research provides to luxury family firms some common guidelines in order to achieve success. The common guidelines emerged could help firms to

take the right managerial decisions in a growing business that, however, could lead firms to quickly lose their competitive advantage.

This research shows some common trends and opens the way for more extensive research, both nationally and internationally, to confirm the results identified and/or to add new insights to identifying characteristics of luxury family businesses, in order to achieve definitive results. In particular, it would be interesting to interview a larger panel of companies in order to identifying peculiar characteristics of each sector of luxury especially in those sectors that in this research were mentioned only marginally. Thus, it would be interesting to examine whether and how the values identified in this work may find a different effect in the different areas and why. Moreover, from a quantitative point of view, it would be interesting to analyze the performance of family businesses in which the family owns the product development process and the ones in which external managers own the process.

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## THE INTERNATIONALIZATION OF R&D ACTIVITIES TO ASIAN DEVELOPING COUNTRIES

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### ABSTRACT

In the actual scenario firms not only produce and sell, but increasingly also develop goods and services outside their home countries. Moreover today, it seems to be the rule, not the exception, that these firms have R&D activities at different locations inside and outside their home country. In the recent years the interest in the developing Asian countries has grown a lot and firms from almost all over the world have considerably extended their R&D activities in the developing Asia.

The goal of this paper is to show R&D internationalization activities of firms from Italy in Asian developing countries. We use a dataset of 500 Italian firms with international R&D units in order to understand whether companies follow a knowledge augmenting or knowledge sourcing strategy.

The results show a positive relation between the choice to settle R&D units in Asia and the sale of innovative products in Asia; in this sense the conclusion is that these firms follow a knowledge exploiting strategy, establishing their whole innovation value chain to developing Asian countries.

**Keywords:** R&D, R&D internationalisation, knowledge augmenting strategy, knowledge sourcing strategy

### INTRODUCTION

The quick growth in international R&D since the last decade of the last century has attracted the attention of researchers, policy makers and managers.

In the actual scenario firms not only sell and produce, but also develop services and goods outside their own countries of origin. So, it is normal, and commonly accepted, to think that firms, especially multinational enterprises (MNEs) have R&D activities at different location both in their home countries and in foreign countries (Bresciani and Ferraris, 2012).

Moreover, enterprises from different continentals have extended a lot their R&D activities abroad, and they are emerging new players from emerging economies i.e. China, India, and other Asian countries, which are becoming year by year more attractive for MNEs.

Due to numerous factors internationalization of R&D has become more important year by year; it is possible to think to the innovation in information and communication technology, to the globalization, to the iper-competition, all factors which affect a global spread of R&D units across the world (Friedman, 2006; Karlsson, 2006; UNCTAD, 2005).

The most cross border R&D units are settled between developed countries. In the last years, however, the internationalization of R&D units has characterized also new geographical areas of developing countries, especially East Asia (Edler, 2008; von Zedtwitz and Gassmann, 2002).

The structure of the paper follows this methodological approach. The next section undertakes a literature review towards defining the terminological context of innovation, R&D and drivers of R&D internationalization. The following section develops the hypotheses. Subsequently, the research methodology is presented, followed, finally, by the research results and conclusions, along with some discussion and directions towards further research.

## **R&D AND DRIVERS OF R&D INTERNATIONALIZATION: THE CONCEPTUAL FRAMEWORK**

Nowadays, the world is characterised by innovation, globalization, iper-competition, the shortening of technology products life cycles, and the rapid generation and commercialisation of new technologies (Tardivo et al., 2011).

Generally speaking, MNEs develop their own R&D activities following a process of three different phases (Hakanson, 1990): (a) establishment of a centralised hub of laboratories, i.e. a central unit which produces all the most important innovations; (b) a polycentric stage of a decentralised federation of laboratories, i.e. a group of R&D units performing different task; (3) R&D in the parent company, with more autonomy.

Florida (1997) found evidence that R&D was a heterogeneous process. He means that the sources of innovation changed from sector to sector, so that laboratories tended to emulate and learn from US approaches to R&D organisation and management.

As a consequence, from a specific point of the normal evolution of the developing of R&D activities it is possible to speak about “internationalisation of R&D activities”.

According to Kuemmerle (1999) R&D can be classified into (i) the Home-Base Exploiting R&D (HBE) and (ii) Home-Base Augmenting R&D (HBA), according to the objectives of the different strategies. In the first case, affiliates are established in the host country in order to use the specific advantages of that environment, and in the second affiliates’ activities are used to gather new abilities in knowledge and capacities. The latter kind of R&D activity is usually developed near universities and the former is generally developed near firms or significative markets.

HBE facilities usually have a closer proximity to their objective than HBA affiliates. HBE activities, in fact, need to interact actively with clients and other firms and are concentrated on specific knowledge which exists inside firms. On the contrary, HBA requires specific know-how usually located beyond the firms’ frontiers.

## **DEVELOPING HYPOTHESIS**

Both innovation and internationalisation of R&D in developing countries are still a new but increasing phenomenon. Empirical studies based on company surveys show different results regarding firms’ R&D strategy in developing Asian economies, whereas case study evidence points to the increasing importance of knowledge augmenting strategies. As we know, in the Home-Base Exploiting R&D (HBE) affiliates are established in the host country in order to use the specific advantages of that environment, while in the Home-Base Augmenting R&D (HBA), affiliates’ activities are used to gather new abilities in knowledge and capacities.

So, the aim of our research is to evidence whether firms with international R&D follow a knowledge augmenting or knowledge exploiting strategy.

Following Mangelsdorf and Schmiele (2009), we did not ask firms for the strategy of their R&D units; we decided to use the relationship between the sales of innovative products and establishing R&D units in Asia. Firms with HBA, in fact, use the knowledge from developing

countries to develop new products in the headquarters; then they will sell this new products in the developing countries (with or without the development of selling activities in the developing countries). For these reasons, it is possible to formulate the following hypotheses:

Hp 1: Italian firms conducting R&D activities in Asia following a HBA strategy sell new products in developing countries.

On the contrary, firms adopting a HBE strategy customize products to local demand using the foreign R&D units abroad. The main consequence is that the firms sell this products in the local market, but not in other countries. For these reasons, it is possible to formulate the following hypotheses:

Hp2: Italian firms conducting international R&D activities following a HBE strategy sell new product in Asian countries but not in developed markets.

Moreover, in order to better analyze the propensity to have international R&D activities we add other variables which follow the models from Dunning (1981), Hollenstein (2005), Rammer and Schmiele (2008), and Mangelsdorf and Schmiele (2009). In this sense:

- we consider innovation activities in developing Asia countries. The presence of innovation activities, in fact, may mean that firms establish their whole value chain in developing Asia, while on the contrary the absence of innovation activities may suggest just independent R&D units transferring knowledge to the head quarters.

- we consider export intensity in developing Asia countries. The presence of high level of exports, in fact, may mean the attempt to reduce the risk of international R&D (Rammer and Schmiele, 2008); of course we expect a positive influence.

- we consider the number of R&D in other countries. As firms internationalize R&D first to developed countries and later to developing ones, the propensity to establish R&D units in Asia increases with experience; of course we expect a positive relation.

- we consider innovation activities in developed countries. As firms raise their international activities with experience, we expect that firms establish R&D units in developing Asia if they have still develop innovation activities in developed countries.

- we consider company size (employees per firm in logarithm) because the propensity to internationalize R&D activities increases with the number of employees per firm.

- we check for industry dummies considering low-tech, medium-tech and high-tech manufacturing as well as services which are developed (Mangelsdorf and Schmiele, 2009) on the base of NACE codes.

## PRIMARY RESEARCH METHODOLOGY

The research was conducted on 500 Italian firms selected from AIDA, a database of company accounts, ratios, activities of more than 700,000 Italian companies; moreover, the research employs data from the last Italian Innovation Survey (2010), which covers innovation activities of the Italian enterprises with at least ten employees operative in industry and services. In particular, the survey collects information about new or significantly improved goods or services (product innovations) and new or significantly improved processes, logistics or distribution methods (process innovations), as well as about organizational and marketing innovation. Most questions refer to product and process innovations: to this regard, the survey provides a wide and articulated set of indicators on innovation activities, innovation expenditure, public funding, sources of information for innovation, innovation co-operation and innovation objectives.

The survey is part of the EU Community Innovation Survey (CIS), carried out on a two-year basis (from 2004 onwards) by all EU Member States and candidate countries, plus Norway and Iceland.

**Table 1: Dependent and Independent Variables**

Variable	Indicator
<b>Dependent Variable</b>	
International R&D in developing Asia	1 if a firm plans (in 2009/2010) or already

	conducts (in 2008) R&D activities in the following countries: China, India, Indonesia, Malaysia, Singapore, South Korea, Taiwan, Thailand; 0 otherwise
<b>Independent Variables</b>	
<i>R&amp;D Strategy</i>	
Selling of innovative products in developing Asia	1 if a firm sells innovative products in developing Asian economies; 0 otherwise
Selling of innovative products in developed countries	1 if a firm sells innovative products in developed economies (North America, Europe); 0 otherwise
<i>Absorptive Capacity</i>	
R&D intensity	Share of R&D expenditure from sales
Continuous in-house R&D	1 if a firm conducted in-house R&D continuously in 2009-2010; 0 otherwise
<i>Innovation value chain</i>	
Innovation activities in developing Asia	1 if a firm successfully introduced innovations in Asia (construction/ conception of new products, manufacturing of new products, implementation of new processes)
<i>Experience</i>	
Export intensity	Share of exports from sales
Number of R&D activities in other countries	Number of R&D locations abroad per firm
Innovation activities in developed countries	1 if a firm successfully introduced innovations in developed countries (construction/ conception of new products, manufacturing of new products, implementation of new processes) by 2008; 0 otherwise
<i>Firm Size</i>	
Firm size	Log. No. employees in 2008
<i>Industry Dummies</i>	
Industry dummy 1	Low-tech manufacturing
Industry dummy 2	Medium-tech manufacturing
Industry dummy 3	High-tech manufacturing
Industry dummy 4	Services

The model of analysis applied by this research is the one used by Mangelsdorf and Schmiele (2009).

The sample has been restricted to all the innovative firms with the head quarter in Italy which carry out R&D activities in foreign countries. In this way it is possible to compare the effects of internationalisation drivers of different countries.

#### *Dependent and Independent Variables*

The information of the dependant variables derives from the last Italian Innovation Survey (2010), which asked firms for their innovation activities outside Italy. So, the survey contributes to the variables to test our hypotheses as well as the control variables described above. Table 1 puts in evidence the description of our dependent and independent variables.

## PRIMARY RESEARCH RESULTS

This section presents the results of the analysis. Using a probit model estimation in order to estimate the probability that the observation falls into a specific one of the categories (in our case the impact of a change in the independent variable on the firms' probability to locate R&D units in developing Asian economies) it is possible to show the results as in Table 2. The pseudo R-square (0.59) confirms that the model is acceptable. These results are in line with those of Mangelsdorf and Schmiele (2009), so we can affirm that Italian firms strategically act in the same way of the German ones.

Regarding our main hypotheses, we can now affirm that HBE firms sell innovative products in Asia but not in developed countries and that HBA firms do not sell innovative products in developed countries. So, we have to reject the hypotheses 1 and confirm the hypotheses 2. Those firms selling innovative products in developed countries, in fact, have a lower propensity to settle R&D units in Asia; at the same time, firms with international R&D activities in Asia sell innovative products on that market. The conclusion is that firms with international R&D activities in developing countries follow a HBE strategy. A possible explanation is that the competition of developing countries is often the result of the relocation of MNEs production more than the consequence of a domestic innovativeness strategy; in other words, the foreign R&D in developing countries is often the result of an adaptation of the existing products to the foreign local market (Kumar, 2001).

**Table 2: Result of probit model**

Variables	Marginal effects	z-value
<i>Probit Estimation: Dependent Variable: International R&amp;D in developing Asia</i>		
<b><i>R&amp;D Strategy</i></b>		
Selling of innovative products in developing Asia	0.443*	1.69
Selling of innovative products in developed countries	-0.571***	-2.65
<b><i>Absorptive Capacity</i></b>		
R&D intensity	0.00159	0.33

Continuous in-house R&D	0.286	1.28
<i>Innovation value chain</i>		
Innovation activities in developing Asia	1.346***	4.54
<i>Experience</i>		
Export intensity	-0.00365	-0.76
Number of R&D activities in other countries	0.466***	5.46
Innovation activities in developed countries	-0.0675	-0.23
<i>Firm Size</i>		
Firm size	-0.0139	-0.35
<i>Industry Dummies</i>		
Industry dummy 1	0.244	0.76
Industry dummy 2	0.578**	2.38
Industry dummy 3	0.562**	2.23
Industry dummy 4	-2.451***	-6.67
No. of Observations	500	
Pseudo R Square	0.59	

Level of significance: \*\*\*<0.01, \*\*<0.05, \*<0.10.

Although we can not affirm that the presence of R&D activities in Asia depends on the absorptive capacity of the firms (both the variables R&D intensity and Continuous in-house R&D are not significant), another interesting result is that firms settle their innovation value chain in developing Asia countries. This means that the higher is the firms R&D activities the higher is the propensity to have research activities in Asia.

In a certain sense this result is also confirmed by the necessity of experience with international R&D; firms with an high number of R&D activities in other countries, in fact, rise the propensity to settle R&D in Asia.

Moreover, we did not find any evidence about the influence of firm size – employees per firm on the propensity to settle R&D activities in developing Asia. This is a very interesting result because it means that the internationalization of R&D represents an opportunity for all the different dimension scale of enterprises.

Finally, for industry dummies we found a positive influence by both medium-tech and high tech manufacturing firms.

## CONCLUSION

The goal of this paper was to investigate R&D internationalization activities of firms from Italy in Asian developing countries using a dataset of 500 Italian firms with international R&D units in order to understand whether companies follow a knowledge augmenting or knowledge sourcing strategy.

In particular, as innovation and internationalisation of R&D in developing countries are still a new but increasing phenomenon, we decided to investigate the case of firms which set up R&D units in developing Asia from advanced countries.

Empirical studies based on company surveys show different results regarding firms' R&D strategy in developing Asian economies, whereas case study evidence points to the increasing importance of knowledge augmenting strategies. So, the aim of our research was to evidence whether firms with international R&D follow a knowledge augmenting or knowledge exploiting strategy.

The results of the probit model put in evidence that HBE firms sell innovative products in Asia but not in developed countries and that HBA firms do not sell innovative products in developed countries. As we stated before, in fact, those firms selling innovative products in developed countries have a lower propensity to establish R&D units in Asia; at the same time, firms with international R&D activities in Asia sell innovative products on that market. The conclusion is that firms with international R&D activities in developing countries follow a HBE strategy.

From an operational point of view this means that firms with international R&D activities in developing countries customize their products and services to the local markets.

Our findings, moreover, are in line with the most empirical literature. For example, we agree with Mangelsdorf and Schmiele (2009), who found that the investigated German firms followed a knowledge exploiting strategy and were attracted by market opportunities. At the same time, in the same way by Rammer and Schmiele (2008), we found that Italian firms internationalize R&D as the consequence of a process which permit them to move their products from the domestic market to the foreign markets. Finally, we agree with Belitz (2006), as we evidenced that Italian firms internationalize R&D activities in order to adapt their product to the foreign markets.

The findings are by extrapolation universal for developing markets, but especially valid for the Italian firms which are internationalizing their R&D activities in developing countries.

Italy, in fact, is characterized by clusters based on the flexible specialisation between a large number of SMEs sharing a complementary technological specialisation in a territorial network of common norms and values. This competitive framework has been, until recently, a source of advantages both for the firms belonging to this network and for the foreign countries where these networks have emerged (Rossi et al., 2012). However, the main source of this competitive advantage, the possibility to share the costs of learning and innovation in a territorial network, is close to being exhausted. The main reason is that the extension of the network is insufficient to metabolise the degree of complexity generated by the global process of interaction between people, institutions and firms. The local network of shared norms and values has become a barrier to local knowledge creation because it constrains interaction rather than leveraging it across geographical boundaries (Bresciani et al., 2013).

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## COST OF EQUITY CAPITAL IN PRIVATE COMPANIES

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### ABSTRACT

**Purpose:** The appropriate calculation of the cost of equity capital remains the central pain point in modern finance, management accounting and value-based management. This problem is especially emphasized in privately held companies, where dominating capital market oriented methods (e.g. CAPM, APT) don't apply. The paper aims to summarize and present solutions and methods to calculate the cost of equity capital for private companies.

**Design/methodology/approach:** The paper is mainly based on literature review. Authors' deductions are provided by arguing or criticizing existing literature. Furthermore, an attempt is made, where possible to propose solutions and give practical solutions to those issues, where literature shows deficits or gaps.

**Findings:** Results of literature review indicate that cost of equity capital can be derived either by deploying appropriate adjustments in methods applied for listed firms or by implementing other subjective approaches. When making adjustments for private companies, already complex methods (e.g. CAPM) become even more complicated and time-consuming. Thus simple subjective judgments of financial analysts, the management or the entrepreneurs in private firms can deliver much more reliable results than series of doubtful formulas.

**Research limitations/implications:** Authors' suggestions and deductions are yet to be proven in practice or by further studies regarding implementation of cost of equity capital calculation alternative methods in private companies.

**Originality/value:** The paper addresses the obstacle of calculating cost of equity capital for private companies. It proposes a summary of existing methods, practical calculation guidelines as well as their shortcomings.

**Keywords:** literature review, cost of capital, private companies, cost of equity capital, WACC, CAPM validity, value-based management.

## INTRODUCTION

In company valuation as well as in value-based management (VBM) the cost of capital (COC) is one of the key elements (AIR 2010, p. 800) and in the meantime it is one of the central problems in the value-enhancement analysis (Herter 1994, p. 89). COC is the profit that investors have to give up instead of investing elsewhere. It has two elements in it: a) the timing of the expected returns and b) the risk of alternative investments (Young and O'Byrne 2001, p. 162). That is why it is used as the discount rate for projecting present values of the future cash flows in valuation theory, for calculations in value-based management metrics (e.g. Economic Value Added, Shareholder Value) as well as a hurdle rate for accepting new investments (Stewart 1991, p. 431). The effectiveness of VBM measures highly depends on the accuracy of the calculation of the capital costs (Männel 2006, p. 83). Studies show that the difficulty of calculating the COC is in determining the requirement of return of the equity holders – cost of equity capital (CEC) (Geginat et al. 2006, p. 7). The estimation of the cost of equity is difficult because there are many uncertainties to consider (Britzelmaier 2009, p. 73). This is true for all companies, but is highly emphasized for private companies. The reason is that the calculation of CEC for publicly listed companies is possible with established mathematical models such as Capital Asset Pricing Model (CAPM) or Arbitrage Pricing Theory (APT), which however base on the condition of stock market listing. This is a condition, which naturally is absent for private companies.

Existing literature on cost of equity capital focuses on calculation methods for large companies, which also still demand further research. In individual cases the CEC is addressed for SMEs or private companies, but existing literature lacks in overview which calculation methods are valid for private companies. Moreover, a practical link is often absent in the literature. The objective of this paper is to summarize and present solutions and methods to calculate the cost of equity capital for private companies. In doing this, this paper will critically analyze the validity of the most common CEC calculation method, namely CAPM for private companies. As the CAPM-derived methods for private companies are highly questioned, other methods are analyzed and presented. Although this paper does not include specific cases and is based on literature review, it is the intention of the authors to

provide a practical guide for financial analysts and controllers to have an overview and a guideline in order to be able to calculate the cost of equity capital for private companies.

## FUNDAMENTAL PRINCIPLES OF COST OF CAPITAL

### *Background and Weighted Average Cost of Capital*

There are basically two approaches to the cost of capital – subjective and objective estimation. According to the decision oriented valuation principles, the COC is derived from the subjective decision making of individual investors (Pape 2010, p. 107 and Pereiro 2002, p. 101). In finance theory, however, an attempt is made to objectify the COC, thereby the COC represents the opportunity cost of a particular investment under the consideration of risk aspects (Ballwieser 1994, p. 1380 ff. as cited in AIR 2010, p. 801 and Bühner and Sulzbach 1999, p. 239). The capital providers expect a certain compensation – a minimum rate of return – for the opportunity cost of investing their capital in a particular company instead of others with an equivalent risk (Khadjavi 2005, p. 85, Pereiro 2002, p. 100, Pape 2010, p. 107 and Copeland et al. 2000, p. 201).

The capital costs are represented by the expectations of debt holders regarding interest payments and expectations of equity providers regarding dividend payments or stock price profits (Britzelmaier 2009, p. 69). In the classical finance theory the COC represents the business risk. However besides the business risk in COC, the financial risk also plays a major role, mostly through the capital structure component in the most common cost of capital formula – the Weighted Average Cost of Capital (WACC) (Coenenberg and Salfeld 2007, pp. 74-75).

Studies show that most companies (83%) use WACC for the calculation of the cost of capital (Britzelmaier 2013)(Geginat et al. 2006, p. 13).

Formula 1: Weighted Average Cost of Capital

$$WACC = \frac{Equity}{Equity + Debt} \times C_{Equity} + \frac{Debt}{Equity + Debt} \times C_{Debt} \times (1 - Tax Rate)$$

where  $C_{Equity}$  and  $C_{Debt}$  are the costs of Equity and Debt Capital, respectively.

Whereas all components of WACC can be calculated relatively easily and don not prepare complications in the practice, the cost of equity capital is the pain point of the formula.

The determination of the capital structure follows either a) by calculating the actual capital structure with market or book values of debt and equity or b) by applying the target capital structure. In general the actual market values of debt and equity are recommended to be used and not the actual book values, as the market values show how much it would cost to raise the same capital today – opportunity approach of raising capital (Young and O’Byrne 2001, p. 163, Vishwanath and Krishnamurti 2009, p. 230). Applying the market value of equity is clearly better because of the increasing meaning of the intangible assets which are referred to as hidden reserves. Many intangible assets are not activated under the existing Generally Accepted Accounting Principles (GAAP), thus resulting in divergence of the market and book values of the equity. As the book value of the debt usually does not vary so much from its market value, it can be used instead of the market value (Tappe 2009, p. 112). Whereas the market value of equity for publicly listed companies can be calculated by multiplying the number of outstanding shares with the stock price on the date of calculation, the market value of equity for unlisted companies is quite difficult to calculate (Hostettler 2002, p. 24).

Instead of using actual values of debt and equity (regardless book or market) to determine the weighting ratios, the target capital structure can also be deployed in the WACC calculation. This recommendation is made mainly for the valuations for long-term periods in order to avoid short-term changes in the market value of the securities or other short-term financing activities and mainly for private firms (Copeland et al. 2000, pp. 203-204, Britzelmaier 2009, p. 69). The implicit assumption under this approach is that even though the current capital structure differs from the target, future financing decisions will bring the capital structure closer to the target (Young and O’Byrne 2001, pp. 163-164). The target capital structure method is also recommended because of its calculation easiness, especially for not listed companies. This also solves the so called circularity problem for private companies, which arises due to the need of cost of capital as a discount rate during the calculation the market value of equity (Tappe 2009, p. 112). In theory the circularity problem can be solved with iterations methods, where mathematically all possible scenes are played until the relevant capital structure is found (Pape 2010, p. 111). In practice it is not easily applicable, so that the target capital structure can be used instead (Pape 2010, p. 111).

Furthermore, the determination of the cost of debt and the tax rate can follow relatively easily. The cost of debt can be derived either a) by dividing actual debt interest payments over the average debt (Dörschel et al. 2009, p. 228 ff.) ; b) by using the contractually agreed interest rate or c) implementing the actual market rate of return in the case of bonds (Töpfer

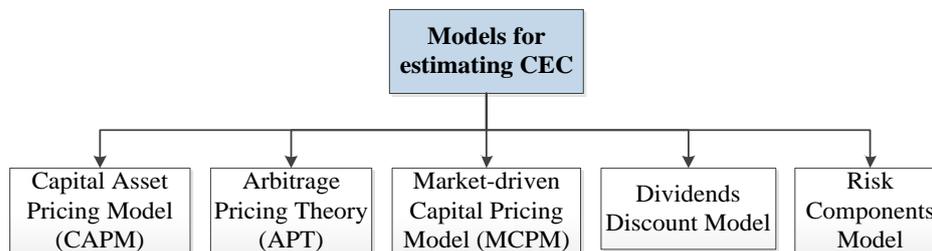
and Duchmann, 2006). The tax rate is considered in the WACC formula because of the so called tax shield effect. The tax shield effect occurs because the interest payments for debt are tax-deductible, i.e. the more interest payments the company has, the less tax it pays on the income (Young and O'Byrne 2001, p. 164). Therefore, the more the company is leveraged (more debt), the more effect has the tax shield on the WACC. The tax shield in WACC formula is considered under the assumption of a fictive only with equity financed firm (Hostettler 2002, p. 50). Usually a normalized country specific company tax rate is used.

The remaining component, the cost of equity capital is the main focus of this paper so it will be discussed separately in the next section.

#### *Alternative Approaches of Cost of Equity*

The following figure illustrates the different models which have established in the literature and practice for calculations of cost of equity capital:

Figure 1: Possible Models for Estimating Cost of Equity Capital



Source: Based on Britzelmaier (2009), p. 73

In general from all the presented methods, only CAPM (with further model enhancement), the Risk Components Model can be considered for private companies. This is due to the lack of existence of stock prices as required for CAPM, APT, MCPM and DDM Models. Being the most widely used method for CEC calculation CAPM builds and therefore a separate section is devoted to this method.

*Capital Asset Pricing Model (CAPM)*

The most common used method<sup>7</sup> of estimating the CEC is the CAPM, a capital market and portfolio theory model developed by Sharpe, Lintner and Mossin based on Tobin's and Markowitz's models (Tappe 2009, p. 105, Pratt and Grabowski 2010, p. 103). This model has been developed especially to determine the CEC for publicly listed companies because there are normally numerous investors and it is complicated to calculate a single expected rate of return for unknown investors. The solution has found in observing the capital market behavior through this model (Young and O'Byrne 2001, p. 165). It considers the return from a risk free investment and a market premium. With the help of the Beta factor the systematic risk of each security relative to the market portfolio is brought into calculation.

Formula 2: CAPM Model Formula

$$r_{(Equity)} = r_{(Risk-free)} + (r_m - r_{risk-free}) \times \beta$$

where  $r_m$  is the rate of return of the market portfolio and therefore  $(r_m - r_f)$  is the market risk premium of the equity;  $\beta$  is called market Beta or Beta factor

A number of assumptions are laid under the CAPM model which brings some limitations (Pratt and Grabowski 2010, p. 113 and Perridon and Steiner 2007, p. 255). Normally the yields of long-term government bonds with "best credit rating" are considered for  $r_{(risk-free)}$  (Bark 2011, p. 10). The 30-year and 10-year government bonds are mostly recommended in the literature as they are relatively easily determinable in the practice. For the calculation of the market premium  $(r_m - r_f)$  the required return of the market portfolio can be calculated ex-ante or ex-post by trying to estimate the future or by extrapolating historical development to the future, respectively. Both approaches have their proponents and critics (Copeland et al. 2000, p. 216 ff.). Usually a market index, such as EuroStoxx, DAX, S&P 500 is considered.

The bottom line is that except for company-specific  $\beta$  factor, all other components of CAPM can be calculated regardless whether the company is publicly traded or not.

The Beta factor is normally calculated using historical market data by regressing the stock's return against the return of a stock index (e.g. DAX Index) (AEU 2002 p. 2338). Mathematically it can be also calculated by dividing the covariance of the stock in subject and the market portfolio to the variance of the market portfolio as shown in the formula below (Dörschel et al., 2009).

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<sup>7</sup> About 2/3 of the firms examined determine their CEC with CAPM (Geginat et al. 2006, p. 14).

Formula 3: Beta Factor

$$\beta = \frac{Cov(r_e; r_m)}{Var(r_m)}$$

where  $Cov(r_e; r_m)$  is the covariance between the return of the equity and the market and  $Var(r_m)$  is the variance of the return of the market.

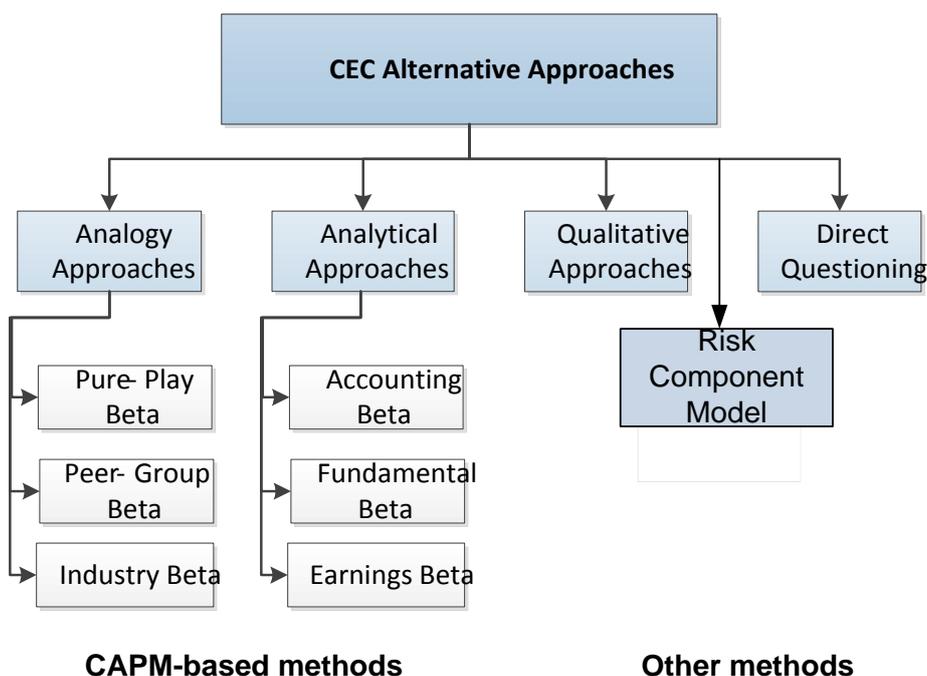
For companies that are not publicly traded, the decisive factor  $\beta$  becomes a problem as the relevant capital market figures cannot be derived (Günther 1997, pp. 166 ff.). Hence CAPM is not valid for private of companies without further adjustments or by using other alternatives (Vélez-Pareja 2005).

## **COST OF EQUITY CAPITAL FOR PRIVATE COMPANIES**

### *Overview of Alternative Approaches*

Being the most common method of calculating the CEC, CAPM is supposed to objectively estimate the CEC from the market. However, many scholars heavily criticize the model regarding its anticipated objectivity and claim that discount rate is a completely subjective parameter and that no formula can yield to better results than a simple subjective judgment (Pereiro 2002, p. 101). This is especially true for privately held companies where the direct calculation of CAPM does not apply anyway due to lack of historical stock prices for the computation of the Beta factor and the not fulfillment of the CAPM assumptions. Especially the SMEs or even large family owned companies are often publicly not listed and the estimation of risk-adequate capital costs is the largest critic of VBM concepts in such companies (Tappe 2009, p. 108). Nevertheless, financial analysts and practitioners have developed methods which allow the estimation of the CEC for such cases which are summarized in the following figure (Geginat et al. 2006, p. 20, Bufka et al. 1999, p. 118 and Britzelmaier 2009, p. 80):

Figure 2: CEC Calculation Methods for Private Companies



Source: Own Illustration based on Geginat et al. (2006, p. 21), Michels (2008), p. 81

These methods are not only useful for privately held companies, but also for company divisions of publicly listed companies. Often the risk of divisions is not the same as the overall group risk and the individual cost of capitals need to be calculated.

#### *Analogy Methods (Comparable Company Approach)*

The first and in practice most commonly used cluster of CAPM-derived CEC is referred to as the Analogy Methods, which was initially suggested by Van Harde and then tested by Fuller and Kerr to estimate the divisional CEC. The Analogy Methods or also referred to as comparable companies' approach (CCA) are the most common methods of calculating Betas for private companies. Here the Beta for the company in subject is approximated from that of a single listed comparable firm (Pure-Play Beta), or alternatively from several comparable firms (Peer-Group Beta) or from the industrial average (Industry Beta) (Geginat et al. 2006, p. 21 and AWFMU 2004, p. 250). The implicit assumption is that the risk of the unlisted company is the same as that of the comparable listed ones and therefore the risk can be derived from the market (Bühner and Sulzbach 1999, p. 239). The Betas calculated from Analogy Approaches are sometimes referred to as bottom-up Betas (Damodaran 2002, p. 933).

### Pure Play Beta

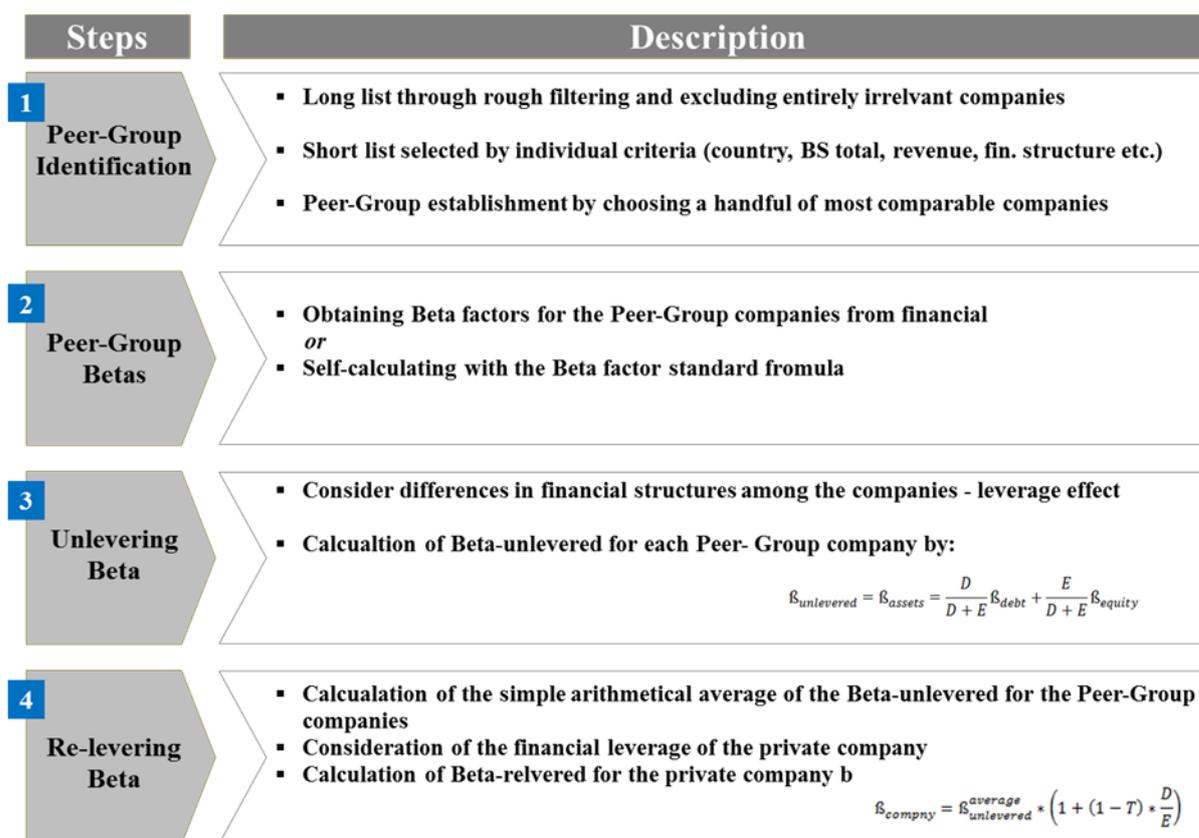
The original model of Van Herde suggested to proxy the unlisted company to a single comparable listed company. However due to special statistical effects this method is not recommended (Bark 2011, p. 127). The estimation error for a single company is higher than for a portfolio of companies. This why the method was expanded to include more than just a single company. By using Peer-Group or the Industry Beta the standard estimation error decreases (Bowman and Rush 2004, p. 3). Moreover, finding a very similar company can often be problematic (Erhardt and Bhagwat 1991, p. 62). Thus for practice the pure play method is not recommended.

### Peer-Group Beta

So by using Peer-Group the standard estimation error decreases meanwhile decreases the comparability among the proxy companies to the private company (Bowman and Rush 2004, p. 3), but meanwhile the comparability among the proxy companies to the private decreases (Bowman and Rush 2004, p. 3).

As the Peer-Group approach is the most widely used here the standard approach of the Peer-Group calculation is demonstrated:

Figure 3: Calculation Steps for Peer-Group Beta



#### Peer-Group Identification (Step 1)

One approach of determining the Peer-Group is to establish what is called a long list of the listed comparable companies through rough filtering criteria. The long list excludes entirely irrelevant companies (Geginat et al. 2006, p. 22). Then through individual selection criteria the relevant short list is created. The possible criteria might include the country, BS Total, financing structure, asset intensity and structure, sales revenue, sales growth, EBITDA, number of employees, product portfolio, composition of the sales (Geginat et al. 2006, p. 22 and Herter 1994, p. 117). Then the Peer-Group of the most comparable companies is established.

This step is the most crucial as it requires subjective judgment as to which companies should be included and which excluded from the Peer-Group and this will affect the outcome of the Cost of Equity. In the first step it should be attempted to find comparable publicly listed firms having similar operating activities as the firm in subject. However, occasionally private companies have very specific business models and the number of similar companies can be very limited so that finding such companies might be much harder as thought at first sight. In

this case, financial analysts can rely on the experience and knowledge of the management. The management can be asked to name comparable publicly listed companies, which are influenced from the same market forces as the valuated private company. This approach is beneficial especially for those private companies, which are family owned and the founders have been highly active in the management since decades and so their knowledge and expertise is first-hand and should be profited from.

In the selection of the Peer-Group the companies should be thoroughly chosen. Companies which had their IPO earlier as 1 year ago are generally not recommended to be included as it will affect the Beta calculation by statistically distorting the results. Internet source such as Yahoo Finance can be a very helpful practical tool to find comparable companies as they offer such information at hand. Additionally short profiles for each company can be obtained from Finance internet sources in order to examine their core competencies and to compare it with the private company. Generally, the more companies are included the better are the statistical properties of the estimated (Bowman and Rush 2006, p. 2). When the private company has a very specific business the number of comparable companies is limited anyways, further selection criteria cannot be implemented (e.g. company size, revenue, country etc.). Normally the more the size of the private company approximates the size of the comparable companies, the less biased is the method. Therefore it is recommended to consider the size effect in CCA method for Beta calculation (Bowman and Rush 2006). Normally if the private company is smaller as the peers, this will result in underestimating the Betas. Gross revenue is usually used to compare the companies.

The geographical area is also essential for determining the Peer-Group (Geginat et al., p. 27). Even if the operating activities of the firms are the same, the presence in different geographical areas might result in different unsystematic risks (Erhardt and Bhagwat 1991, p. 62). A further limitation in Peer-Group composed from companies from different countries as that of the private company represent effects from foreign exchange rates, which are not considered in this model. Here a further assumption must be made that foreign exchange rates don't have an essential influence. This can in fact be true for those companies which are globally active and anyhow affected by the same currency effects.

#### Peer-Group Betas (Step 2)

After the relevant companies have been identified, the Betas of these companies are required. Beta factors can be obtained from different financial sources such as Bloomberg or Yahoo Finance. Otherwise the Beta factors for the selected companies are calculated with the

standard formula. The problem of obtaining the data from financial sources is that the Betas of all the selected companies need to be found in one source; otherwise they will not be comparable. This is because the CAPM model does not give any calculation specification in. Even though the Beta factor has established to be a benchmark financial measure, Betas from different sources might alter depending on the time period chosen for the calculation, the market index as well as the frequency of the returns in the regression model. Here it is to point out once more, that there is no right or wrong, it is just a matter of subjective input of the required data by the financial analyst carrying out the valuation.

### Unlevering Betas (Step 3)

When using the Analogy Approaches, normally the capital structure of the private company will be different from the comparable ones (Bark 2011, p. 127). As the financial risk significantly effects the Beta, i.e. the more leveraged the company is the higher will be the Beta, the leverage effect has to be eliminated for calculating the company Beta (Süchting 1989, pp. 367-369 as cited in Herter 1994, p. 102).

Despite which Analogy Method is chosen (Pure Play, Peer-Group or Industry) the Beta taken has to be unlevered and then re-levered using the debt to equity ratio and the tax rate for the company subject for calculation.

The most common formula for unlevering is the following (Michels 2008, p. 82 and Herter 1994, p. 103):

#### Formula 4: Unlevering Beta

$$\beta_{unlevered} = \beta_{assets} = \frac{D}{D + E} \beta_{debt} + \frac{E}{D + E} \beta_{equity}$$

In the practice however, this relation is complemented with two further assumptions: 1) the  $\beta_{debt}$  is zero, i.e. the debt is risk-free and 2) tax rate is not affected from the capital structure (Serfling and Marx 1990, p. 426 ff. and Copeland 1990, p. 264 as cited in Herter 1994, p. 103). Under these assumptions the following equation for the equity Beta can be derived for a company, which is fully financed with equity<sup>8</sup>:

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<sup>8</sup> When a “no-debt” company is assumed, then the tax shield effect has to be considered as well. The logic is the same as with tax shield consideration in WACC.

Formula 5: Unlevering Betas of the Peer-Group<sup>9</sup>

$$\beta_{unlevered} = \frac{\beta_{equity}}{1 + \frac{D}{E}(1 - T)}$$

After the unlevered Betas for the Peer-Group have been calculated it is necessary to calculate the average Beta of the Peer-Group. Generally geometrical, arithmetical or median averages can be used (Geginat et al. 2006, p. 22), however mostly simple arithmetical average is calculated. This is done to obtain one single unlevered Beta in order to be able to in the re-levering formula.

Re-levering and Beta Calculation (Step 4)

After determining one single unlevered Beta for the Peer-Group (Step 3), the final step is to calculate and re-lever the Beta for the valuated company considering its financial leverage using the following formula:

Formula 6: Re-levering of the Beta for the Company

$$\beta_{company} = \beta_{unlevered}^{average} * \left(1 + (1 - T) * \frac{D}{E}\right)$$

However, the consideration of the leverage effect can lead to over- or underestimation of the CEC (Fuller and Kerr 1981, p. 1002, Schlegel 2011, p. 108 and Bowman and Rush 2004, p. 2). Thus one should be cautious when using the Analogies Method and the plausibility of the CEC should be proven with other calculation methods.

Another problem in CAPM-derived CCA calculation can arise when the company in subject is in a country, where market capitalization is relatively low. This is the case for many European countries, which compared to Anglo-Saxon countries are mainly bank financed. This prepares the difficulty of finding Peer-Group companies in the same country. In this case data from e.g. USA can be employed (Herter 1994, p. 117). However this challenges the comparability of the companies in terms of exchange rates and business environment.

Industry Beta

Although the Industry Beta improves the statistical method, an additional assumption is implicitly made that the systematic risk within the same industry is the same (Herter 1994, p.

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<sup>9</sup> There are several formulas for re-levering the Betas, mainly depending on the financing structure (fixed book value or market driven value of debt) (Fernandez 2006). However, the most common approach is here presented (fixed book value).

104). Moreover, in specific cases it might also be difficult to place the company in one particular industry. Thus the Peer-Group Method from the Analogy Approaches is considered more plausible and unless it is impossible to calculate, then it is recommended to use the Industry Beta (Pape 2010, p. 201). The Industry Betas can be obtained from various financial sources. Once the Beta is available, the methodology of transforming Industry Beta into the company's Beta is the same as in the case of the Peer-Group Beta starting however with the 3<sup>rd</sup> step – unlevering of Industry Beta.

#### *Analytical Approaches*

In these approaches it is attempted to find a relationship between accounting-based measures of systematic risk and the market-based systematic risk measures (Erhardt and Bhagwat 1991, p. 61 and Bufka, et al. 1999, p. 116). It is thereby assumed that the accounting data are influenced from the same events and information as the market price data (AF 1996, p. 552). The underlying approaches are the Earnings Beta, the Accounting Beta and the Fundamental Beta.

In Earnings Beta, the changes in quarterly earnings of the private firm are regressed against changes in quarterly earnings for an equity index (S&P 500, DAX etc.) to estimate the Beta factor (Damodaran 2002, p. 930).

Formula 7: Earnings Beta

$$\Delta Earnings_{Private Firm} = a + b\Delta Earnings_{Equity Index}$$

The slope of the regression – the parameter b – is the Beta for the firm. The limitation of this approach is that the private firm's earnings are usually available only on one year basis, which will result in limited statistical power. Moreover, the mismatches resulting from accounting principles among firms might lead to wrong Betas (Damodaran, 2002, p. 930). In the case of the Accounting Beta approach more than one accounting measure is taken into consideration. The principle is however the same as that of the Earnings Beta. The Fundamental Beta approach tries to find specific characteristics of the firm, which have a relation with the systematic risk. Many researchers have tried to find a relation of various measures of publicly listed firms to that of private firms in the attempt to estimate Betas for private firms. Such measures can be earnings growth, debt ratio, company size, foreign income or dividend payout. The weakness of this approach is that it is assumed that the Beta

factors of different companies would react the same way on the changes of these fundamental factors (Damodaran, 2002, p. 933 and AF 1996, p. 552 and references there).

The Analytical Approaches are generally plausible models, but the calculations are complex and not easily applicable in practice. However, the main issue in these models can occur when the company in subject has experienced a great external growth through acquisition in the prior years. Often the acquisitions are done gradually and the consolidation decisions have a legal or tax background. This can significantly distort the regression results of the analytical methods as these models require a large amount historical data, preferably quarterly financial measures, which can be statistically biased.

#### *Validity of CAPM-derived Methods for Private Companies*

As discussed in the previous chapter, the most common way of estimating CEC for private companies is by using Analogy Approaches. This methods allow to calculate the Beta of a private company and thus also the CAPM. But can this CEC be applied to private firms without hesitation? In this part the plausibility of market derived calculation of CEC is proven. As it was emphasized before, the Betas calculated with these methods can be under- or overestimated. But here the overall model of CAPM for the purposes of private companies is questioned. In order to prove the plausibility of CAPM, in the first place the model's underlying assumptions are proven and the question is raised whether or not CAPM can be applied when these assumptions diverge greatly for privately held companies. The deviation of the CAPM assumptions for private companies is summarized in the Table below:

Table 1: Divergence of CAPM Assumptions for Private Companies

CAPM Assumption	Divergence from CAPM	Effect on CEC
<b>Risk-aversion of the investors</b>	Entrepreneurs are generally considered more risk taking	-
<b>Perfect diversification</b>	Entrepreneurs are underdiversified	+
<b>Investors are price takers (minority interest holders)</b>	Entrepreneurs hold the controlling packet of their company	-

CAPM Assumption	Divergence from CAPM	Effect on CEC
<b>Perfect marketability and divisibility</b>	Entrepreneurs cannot sell their equity at any given time to a certain price	+
<b>Systematic and complete information</b>	Information is symmetric compared to publicly listed firms	0/-
<b>Neither transaction and information costs nor taxes</b>	For private firms the information costs are high	+

Source: Based on Khadjavi (2005), p. 202. Michels (2008), p. 29 and Balz and Bordemann (2007)

#### Risk-aversion

Usually the entrepreneurs behave all but rational and risk averse on behalf of their investment decisions regarding their choices of the tradeoffs between risk and return (Young and O'Byrne 2001, p. 167 and Khadjavi 2005, p. 2). CAPM neglects the individual risk appetite of the entrepreneurs and thus a CAPM-derived CEC for private companies is to be critically seen (Behringer 1999, p. 94 as cited in Tappe 2009, p. 108). Not the expected return of the market is of relevance but rather that of the entrepreneurs. It can be assumed that the entrepreneurs are less risk-averse (Tappe 2009, p. 108-109). This would mean that they are ready to take more risk without compensation of adequate return. Consequently the assumption of CAPM that for higher risk investors require higher return is not fulfilled. This results in having a lower expected rate of return from the side of the entrepreneurs as it would have been with same risk for normal market investors.

#### Perfect diversification

The major assumption under the CAPM model is that the investors are diversified. For closely held companies such as family owned companies with limited shareholders, the owners are normally underdiversified, i.e. they don't or cannot invest in any desired

portfolio. As the diversification is not achievable, market-derived CAPM for unlisted companies is heavily criticized (Herter 1994, p. 116). Furthermore, especially the family owners have all their assets in the company and it is highly unlikely that they have invested in other not to the family business related projects (Balz and Bordemann 2007, p. 8, Damodaran 2002, p. 930 and Herter 1994, p. 116). This results in requiring higher risk due to the additional unsystematic risks, which the entrepreneurs are undergoing (Balz und Bordemann 2007, p. 2 and Khadjavi 2005, p. 154). The owners are exposed not only to the market risk, but to the whole risk in the firm. As a result it can be argued that the capital market driven CEC for underdiversified companies should be neglected as they are underestimated (Herter 1994, p. 116).

If the investors are not diversified, it's necessary to consider and evaluate a specific risk and the individual risk preference of the entrepreneurs. However, the definition and foremost the quantification of such specific risk and its differentiation from the systematic risk is neither clear nor easy to determine. Thus, in many cases the costs of trying to do such measurements will exceed its benefits. To avoid further complication, the determination of the expected CEC for a not diversified shareholder can ultimately follow by the entrepreneur or his financial analyst. In this case, the market-derived CAPM can serve as the starting information basis with the help of which the investor decided how strong he wants to adjust for specific risk he is undergoing (Herter 1994, pp. 118-119).

However, the diversification problem can be solved when the market Beta is adjusted. After this adjustment the Beta is called *Total Beta*. If used in the same concept the standard and not adjusted Beta is referred to as *Raw Betas*. The formula of the adjustments is as follows (Damodaran 2002, p. 671):

Formula 8: Total Beta

$$\beta_{Total} = \frac{\beta_{Asset}}{\rho_{jm}}$$

where  $\beta_{total}$  is the Beta unadjusted for diversification and  $\rho_{jm}$  is the correlation of the asset to the market.

In the case of unlisted companies, the correlation coefficient of the comparable companies is taken into the calculation (Damodaran 2002, p. 671). However, one should consider this adjustment very carefully.

In the first place, the higher risk resulting from underdiversification can be compensated by more active and committed management of the family owners<sup>10</sup>. However, it should be also mentioned that in the case of family owned businesses, the owners might be risk-averse in the sense of being afraid to lose the business. In such cases careful risk management, diversification through financial instruments (hedging) and avoidance of high risk projects can even result in lower risk for such families (Khadjavi 2005, p. 180). Thus, a clear conclusion regarding the diversification and risk averseness of family owned firms cannot be drawn and case-specific information is to be considered. Nevertheless, in most of the literature entrepreneurs are generally considered not to be fully diversified and being risk sympathetic compared to capital market investors (Kratz and Wangler 2005, p. 171).

#### Price takers

Entrepreneurs are not price takers in the sense of CAPM (Tappe 2009, p. 109). They hold the controlling packet in the company and therefore manage the company the way they wish. Therefore the assumption that the investors are price takers is also not fulfilled. It is assumed that this somewhat reduces the risk (Bucher and Schwendener 2007, p. 345). It is often argued that these reductions are balanced out with the absence of marketability of privately held shares (Khadjavi 2005, p. 200).

#### Marketability and illiquidity

Private companies lack marketability and illiquidity. Moreover, compared with public companies private companies have more difficulty to raise additional debt or equity capital from organized capital markets (Pratt and Grabowski 2010, p. 587). Therefore, it is assumed that the cost of equity would normally be higher for the private company and an adjustment to the CEC should be made. Due to the lack of fungibility, i.e. the impossibility of withdrawing the invested capital from the company again at any time, the CEC has to be increased. However, the relevance of the fungibility adjustment is only justified in the case of possible intention to sell the company. The illiquidity adjustments are also to be neglected when this is not expected. The underlying principle to this approach is that only the expected risks are to be taken into calculation (Dörschell et al. 2009, p. 258). Moreover, even if such a general adjustment were to be made, it is almost impossible to determine a justified amount

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<sup>10</sup> A correlation has been found between higher risk and higher return of such companies which can be attributed to 1) High dependency of the equity holders makes them work harder on the company success and 2) Owners require higher returns on the investment projects because of the higher risk (Khadjavi 2005, p. 180).

of adjustment. Empirical studies have tried to find some approximation, nevertheless studies are partially very controversial and the fixed adjustment is to be rejected.

#### Systematic and Complete Information

In CAPM it is assumed that the investors will require additional returns due to the principal agent information asymmetry. In case of private and family owned companies the principal and the agent are one person, so that this reduces the capital costs (Khadjavi 2005, p. 201). Nevertheless, in case of integration of third-party managers, the information asymmetry can also occur in private companies (Tappe 2009, p. 109).

#### Transaction costs and taxes

This assumption is not realistic neither for publicly listed nor for unlisted companies. In the real world there are transactions costs as well as taxes which will bring to requiring higher capital costs. Especially for privately held companies the transaction costs are high (Michels 2008, p. 29).

#### *Other Methods*

Besides the above discussed issues regarding lack of fulfillment of CAPM assumptions for private companies, there are further specific characteristics which encourage the other methods of CEC. First of the entrepreneurs of private companies are usually described to be following not only monetary goals. The so called meta- or personal goals, e.g. the consciousness to family business tradition, reputation, prestige, social recognition and etc., also have an impact on the valuation. This is sometimes referred to as emotional or family value (Bucher and Schwendener 2007, p. 345). Whereas market derived models assume purely monetary oriented investors, entrepreneurs' other preferences might result in sacrifice of short-term returns in order to secure long term business existence. This can even result in a negative cost for equity in the short-term, which under the market driven models would be nonsense (Khadjavi 2005, pp. 180-181).

The models (e.g. CAPM, APT) for calculating the cost of equity were introduced in order to calculate the cost of equity for publicly listed companies, where the number or the identities of the investors are normally vast. From capital market observations driven calculation cannot be completely left out from consideration. Sometimes even if the entrepreneurs are to be asked their expectations, their answers might be partially too vague (e.g. "we want as

much return as possible”) (Young and O’Byrne 2001, p. 165). Therefore other methods should be applied when calculating the cost of equity for private companies. Three methods are here presented and discussed, which are not based on capital market estimations. This can be quite plausible in practice especially when the above addressed problems with the commonly used mathematical methods (esp. CAPM) are taken into consideration. Moreover, many authors claim that formula cannot deliver better results than just a simple subjective estimation of the CEC (Pereiro 2002, p. 101).

### Risk Components Model

In this model the cost of equity is calculated by adding different company specific risk components to the risk-free rate of return. Thus, in contrast to CAPM, unsystematic risk is also considered by taking different factors into the calculation. Hereby the basic risk free rate is increased or decreased with subjective estimations. Gleißner has developed a model for determining the adjustment to the risk free rate, which is based on the subjective evaluations from the company and not the investors from the market. Various risks are determined and with the budgeted date of the company through simulation (e.g. Monte-Carlo-Simulation) the risks are aggregated and added (Gleißner 2005 (a), pp. 27-37 and Gleißner 2005 (b), pp. 217-229).

This method is considered to be a quite plausible method especially for closely-held companies, for which due to the underdiversification the unsystematic risk is relatively high. Although this model is suitable for not listed companies sound planning data and high qualified analysts within the company will be required to be able to conduct a reasonable assessment of the CEC. The latter conditions are not always given and can be a further challenge for smaller companies.

### Qualitative Approaches

In contrast to CAPM-derived models, these approaches are not based on estimating CEC based on objective comparable data, but rather attempt to subjectively estimate the relevant risk indicators (Bufka et al. 1999, p. 118).

There are various scoring models, the most famous of which are the BCG and the Fuquana Inst. Method.

Figure 4: Cost of Equity Capital Estimation with BCG Matrix

Criteria	Characteristics					High Risk	
	Low Risk	1	2	3	4		5
Controllability of the profits	Low external influences						Strong external influences
Market	Stale, without cycles						Dynamic, cyclical
Competitors	Few, constant market shares						Many, variable market shares
Products/Concepts	Long lifecycle, not substitutable						Short lifecycle, substitutable
Market entry barriers	High						Low
Cost Structure	Low fix costs						High fix costs

**Legends:** 1=not so important  
5=very important

Source: Own illustration based on Bufka et al. (1999)

In the BCG method the CEC for unlisted firms or divisions is derived by comparing and adjusting the CEC of the whole company, which is listed and the CEC can be calculated with CAPM. With the help of 6 criteria, the subjective judgment of the managers is required to estimate the divisional CEC (Lewis and Stelter 1994, p. 81 ff. as cited in Bufka, et al. 1999, p. 118). The Fuqua Ind. method is similar to the BCG Method and uses 14 instead of 6 criteria. The BCG method is considered as a better approach because the criteria used in BCG are more general. The study of Bufka et al. (1999) indicated that the estimation of the CEC with the BCG method has a better explanation relation with the Beta factor as the Fuqua Ind. method, especially for homogenous companies.

If the BCG method is used of unlisted companies, a starting CEC can be applied, which can for example be the average CEC of the industry and then through scoring and normalization, company specific CEC can be calculated. Alternatively, the Beta can be estimated with the help of the scoring model, by assuming the mean value of the scoring the Beta=1 and then by adjusting it according to the respective risk (Herter 1994, p. 109).

For the Qualitative Approaches the management of the company in subject can be questioned and their subjective judgments of the company's risks are taken into consideration. The main problem of scoring models is the starting point of the adjustment. In scoring models the criteria are used to compare the risk, i.e. cost of equity with another company. These models are more adequate for determining the divisional/ or subsidiary cost of equity in case the overall cost of equity for the parent company is already determined. In this case with the help of scoring, one can determine whether the divisions have a higher or lower risk compared to the parent, and adjustments can be carried out. On the contrary, for estimation of the CEC for the private company a very similar company's CEC has to be found. In practice this can be

difficult, as it is the case with the Pure-Play method in terms of finding a company similar with the risk portfolio, having the same regional activities and being public.

A further problem of the qualitative approaches is the weighting proportion of each risk criteria. It's questionable that each of the risk categories would lead to the same change in the CEC. Existing literature recommends using the same weighting for each of the category. Here it is proposed to ask the managers also to evaluate the importance of each of the category and through scaling this can be normalized and the weighting proportions of each of the category can be adjusted.

Figure 5: Determination of Weighting each Criteria of the BCG Matrix

How important do you consider each of the categories for the development of your business?					
	1	2	3	4	5
Controllability of the profits					
Market					
Competitors					
Products/Concepts					
Market entry barriers					
Cost Structure					

**Legends:** 1=not so important  
5=very important

A further challenge of scoring models is the determination of the deduction and the increase of the basis value and determination of the basis value itself. Therefore, often this is done in approximation and is therefore very subjective (AF 1996, pp. 556–557).

### Direct Questioning

Besides capital market derived approaches the cost of equity can be estimated with the help of so called “Individual Approach” or “Direct Questioning” (Weber et al. 2004, p. 52). Analogy Approaches can serve as an orientation tool. According to this model direct questioning of the entrepreneurs, independent from capital markets is applied in all the cases where it is possible. Important for this approach is the consideration of the risk-aversion of the entrepreneurs and their underdiversification (Tappe 2009, p. 110). It can be generally assumed that the entrepreneurs are more risk-friendly, thus require fewer premiums for the higher risk. Here the opportunity cost of capital does not play any role (Tappe 2009, p. 206). If there is more than one owner, the expected return of each owner can be weighted according to their equity share to arrive at an overall cost of equity capital (Khadjavi 2005, p. 195).

Table 2: Cost of Equity by Direct Questioning (Example)

Shareholders	Part in Equity	Expected Return	Weighted
Shareholder 1	55%	7,5%	4,1%
Shareholder 2	24%	9,2%	2,2%
Shareholder 3	16%	5,0%	0,8%
Shareholder 4	5%	7,5%	0,4%
<b>Total expected return on equity</b>			<b>7,51%</b>

The company owners can be asked to give their expected return on the invested capital. In order to better explain the plausibility of their answer additional questions can be prepared to proof their risk appetite.

In the classical finance theory the cost of equity is higher than the cost of debt, as the equity holders are liable in case of bankruptcy. This is not the case for family owners, as the equity is seen as a controllable capital. Therefore the equity cost can be even lower as the debt costs (Bühler 2005, p. 9). As risk is a very subjective measure, there is no universal understanding how the risk appetite could be precisely measured. Nevertheless, to compare the risk appetite of private company owners, the shareholders can be asked to choose one out of three investment alternatives. The investment alternatives with different probabilities of occurrence and returns can be suggested. An example of such questioning is presented below:

Table 3: Investment Alternatives

Investment alternatives			Answers			
	Return	Prob.	Shareholder 1	Shareholder 2	Shareholder 3	Shareholder 4
Alternative 1	15%	10%		X		
Alternative 2	10%	60%	X			
Alternative 3	5%	90%			X	X
Expected Return			1,5%	6,0%	4,5%	6,0%

## CONCLUSION

This paper contributes to the literature, which argues that capital market derived methods though rooted for calculation of cost of equity capital in listed companies, may not be the best approach for private companies. Subjective approaches of cost of equity capital can be applied in case of private companies saving further assumptions and complexity in already doubtful and assumption flooded finance formulas, the most common of which is the CAPM. Whereas the Beta factor can be adjusted in numerous ways in order to be applicable for

private companies, the authors challenge such approaches. Whereas it can be argued that the suggested subjective methods will be biased and therefore are useless in finance calculations, we argue that CAPM either does not deliver unbiased and objective calculation methodology and far most not for private companies. If the financial analysts are able to make the notion of cost of equity understandable and transparent to the company owners and the management, together a reasonable cost of equity capital and thus cost of capital can be agreed upon. Most importantly, CEC should consider the business and finance risk of the company and represent the expected return on the invested equity by the entrepreneurs.

Further related research topics can be empirical studies of private companies and their perception, acceptance and use of cost of equity capital. Furthermore, case studies of hands-on calculation of CEC for companies from broad business spectrum would help this research field.

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## MECHANISMS OF (DE)CERTIFICATION: UNDERSTANDING HOW CONFLICTS UNFOLD IN ORGANIZATIONS

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### ABSTRACT

This research proposes an exploration of the making and unmaking of legitimacy by the means of a qualitative case study of an extreme case of contention between a challenging student union (SU) and an incumbent administration (MU) of a large research-intensive university (Patton, 2002; Eisenhard, 1989) based on a wide range of documents such as minutes from meetings, strategic plans, newspaper articles, reports and six extensive semi-directed interviews. In the nine month episode over 80 significant events were registered and shown to uncover mechanism. From a recurrent set of similar events, we identify the mechanism of (de)certification as the “validation of actors, their performance, and their claims by external parties, especially authorities” (McAdam et al., 2001:316), while decertification is the withdrawal of validation. We first find that this mechanism is central in the making and unmaking of legitimacy in an episode of contention. Second, we observe a transfer from an initial position where an incumbent’s legitimacy emanates from external sources to an internal source of legitimacy. Finally, we hypothesise that *legitimacy equilibrium* is a heuristically fruitful concept, making sense of this transfer from external to internal legitimacy.

**Keywords:** social movements, contention, legitimacy, mechanism, certification, process

### INTRODUCTION

A few years ago, a Montreal student union organized a campaign against the administration of their university to protest a fee hike. Disruptive actions followed firm statements, bitter discussions, threats and accusations. In itself, this is not an unusual story. Comparable

protests have occurred regularly in many higher education organizations such as Cambridge, NYU, and UC Santa Barbara, and many others have experienced similar turmoil. What makes this case special and worthy of research is its conclusion: after a fierce campaign, the administration and the student union leaders negotiated and came to an agreement that would end the struggle.

This conflict, we argue, was about much more than finances. It was also about something much more intangible than budgets. The legitimacy enjoyed through a set of relationships by the administration and the student union was at stake. The importance of legitimacy for institutions is not new (Deephouse & Suchman, 2008; Meyer & Rowan, 1977; Singh, Tucker, & House, 1986; Suchman, 1995). Neo-institutional theory asserts that “[o]rganizations that incorporate societally legitimated rationalized elements in their formal structures maximize their legitimacy and increase their resources and survival capabilities” (Meyer & Rowan, 1977, p. 352). Legitimacy is particularly important for the institutional sector, comprising, among others, schools and higher education organizations, because of their hazy technology and intangible goals. Traditionally, legitimacy is acquired through an alignment of organizational- and field-level culture. It “is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (Suchman, 1995, p. 574).

The research question guiding this project is: “What are the mechanisms surrounding the making and unmaking of legitimacy in the midst of contention?” To go deeper into the workings of legitimacy, that is to provide a rich and grounded understanding that moves beyond the proverbial organizational black box, this project adopts a constructionist perspective (in that construction is a social and collective activity) on legitimacy (Patton, 2002). It focuses on how it is constructed by actors inside and outside higher education organizations. This research project is coherent with appeals from the practice perspective to focus on research in organizations “explaining social phenomena in a processual way without losing touch with the mundane nature of everyday life and the concrete and material nature of the activities with which we are all involved.” (Niccolini, 2012, p. 9). It is also congenial with an “‘inhabited institutions approach’ that focuses on (1) local and extra-local embeddedness, (2) local and extra-local meaning, and (3) a skeptical, inquiring attitude.” (Tim Hallett & Ventresca, 2006, p. 214).

The conflict between the student union and the administration of Metropolitan University (MU) over a new fee raised important issues around legitimacy in a highly institutionalized

context: parties disturbed relations with different stakeholders, appealed to their membership and mobilized to discredit the adverse party. The focus on an intense conflict instructs us on institutional mechanisms that guide the making and unmaking of legitimacy in similar organizations, experiencing lower levels of conflict. The epistemic logic of the case study is that an intense case of conflict will render "clearly observable" a phenomenon that would have been more difficult to perceive in normal situations (Patton, 2002; Eisenhard, 1989). Concretely, I present an intra-organizational retrospective qualitative case study of a nine-month conflict between a student union (SU) and the administration of Metropolitan University (MU), a large Canadian research-intensive higher education organization, over the imposition of a new fee to students. As a new principal was taking office, a decade of government austerity had put a strain on MU's finances and the new administration was confronted with a sizable deficit. Yet, the administration still considered it crucial to develop information technologies and implemented a fee on students in order to finance technological improvements. The trigger for this conflict was the unilateral decision of the administration to implement the fee. In reaction, the SU led a political campaign comprising a vast array of tactics up until the adoption of a negotiated agreement between the administration and SU over the fee. More than 80 events, some of which were instigated by the MU administration and others by the SU, are related to this conflict. These events ranged from meetings and negotiation sessions to disruptive actions and public relations strategies. This case represents a "rich oppourtunit[y] for exploring the role of movements within existing institutions and organizations" (Schneiberg and Lounsbury in Sage: p. 657).

Below, I first present a review of institutional theory and how recent research has approached the making and unmaking of legitimacy. The method section is also rooted in the notion of mechanism. I will follow with the presentation of the case study organized around the concepts of certification and decertification and I will draw conclusions in the discussion.

## **LR: INSTITUTIONAL RESEARCH ON CONFLICT**

This institutional analysis research is anchored in the sociology of contention (McAdam et al., 2001). The foundational idea of institutional analysis is to find explanations for lower order phenomena in higher order elements (Schneiberg & Clemens, 2006). In this sense, the sociology of contention's aim is to uncover the mechanisms structuring episodes of contention (Tsoukas, 1994). The socio-political understanding of contention points toward phenomena of "(1) claim making and (2) strategic interaction involving (3) the deployment of

commitment, coercion, and compensation as incentives for supporters, allies, rivals, and objects of claims" (Charles Tilly & Tilly, 1998: 232). Understanding conflict as processes of organizational contention means studying organizational conflicts as "simply politics by other means" (McAdam, 2003: 282).

The introduction of social movements concepts in organizational theory has been used to make sense of a growing number of phenomena: the concept of free space explains the adoption of new practices in hospitals (Kellogg, 2009); identity movement helps explain the diffusion of new cuisine (Rao, Monin, & Durand, 2003); external challenges to organizations can be used to explain the transformation of the biotech industry in Germany (Weber, Rao, & Thomas, 2009); contestation helps to explain the variation of stock market (King & Soule, 2007; Soule & King, 2007); dialectic process can be used to explain innovation in the information technology sector (Hargrave & Van De Ven, 2006) and how activism influences corporate social activities (den Hond & de Bakker, 2007). Yet, social movements' blind spot seems to be conflict within organizations (Arthur, Mariel, & Arthur, 2008; Clemens & Minkoff, 2004; Davis, McAdam, Scott, & Zald, 2005; Schneiberg & Lounsbury, n.d.; Scott, 2010). Moreover, while anchored in an institutional perspective, the issue of legitimacy is rarely addressed directly.

Some classics of institutional theory have approached the issue of management of legitimacy. Oliver (1991) addresses issues of legitimacy as an independent variable. The dependant variable in the study of organizational response to environmental pressures is the likeliness of adoption of specific strategies. Oliver makes two contradictory hypotheses which are relevant to our research projects. First, he proposes that organizations in search of legitimacy are likely to acquiesce more than to compromise, avoid, defy or manipulate the environment. Second, he proposes that organizations having multiple constituents, such as universities, are less prone to acquiesce than to mobilize any other strategy. This hypothesis on organization with multiple constituents seeking legitimacy is unclear. A second contribution in the field is Suchman's (1995) seminal piece, where he offered advice to organizations looking to restore legitimacy. He asserts that they have three courses of action: "(an) offer normalizing accounts, (b) restructure, and (c) don't panic." (Suchman, 1995, p. 598). While very actionable, these suggestions do not explain the phenomenon at stake.

Literature on certification provides another entry point on issues of legitimations. Graffin & Ward model certification as a "third-party quality signal". One such signal was tested in the voting on admission of players to the baseball Hall of Fame (Graffin & Ward, 2009; Rao,

1994). A similar approach can be found in Rao's research, where certification is acquired through contest in the automobile industry. He defines certification contests as: "credentialing mechanisms that invest organizations with cognitive validity, create a status hierarchy, and build the reputations of organizations." (Rao, 1994). In both cases, certification takes place through a competitive process, that to say that the winner of a contest, either by vote or by merit, acquires legitimacy.

Finally, Hallett (2010) has studied how recoupling school policy and practices with board expectations in order to maintain legitimacy has created turmoil and delegitimation from the internal constituency. The author does so by "bringing work activity, social interaction, and local meaning-making back into the picture" (ibid. 2010, p. 66), contributing to an inhabited understanding of the *ugly* effect of recoupling processes on legitimacy. Following his lead, we intend to adopt an inhabited perspective on the making and unmaking of legitimacy during a contention episode inside a higher education organization.

At the organizational level, we know that legitimacy is a matter of concordance with wide social expectations (Deephouse & Suchman, 2008; Meyer & Rowan, 1977). Even if this is so, we know that organizations have the opportunity to act strategically in reaction to different types of pressures (Oliver, 1991) and that once they have lost legitimacy, it is possible for them to regain it (Suchman, 1995). We also are aware that different social processes such as contests distribute legitimacy through the mechanism of certification. Finally, an ethnographic account informs us on how recoupling can cause turmoil which, in turns, affects legitimacy (T. Hallett, 2010). What still remains to be explored is the concrete making and unmaking of legitimacy during an episode of contention inspired by an inhabited perspective on institutions.

## **THEORETICAL FRAMEWORK : MECHANISM OF CERTIFICATION AND DECERTIFICATION**

To follow this research agenda on the making and unmaking of legitimacy, we borrow from a socio-political perspective and capitalize on research in the sociology of contention (McAdam, Tarrow, & Tilly, 2001). This perspective does not understand conflict as the result of structural strains or inadequate individuals. Earlier research often analyzed similar events in a cognitive lens as the product of anomy, abnormal individuals, episode of collective madness or in a sociological perspective as the results of conflicting norms, structure or institutions (Clemens & Minkoff, 2004). "Roughly translated, [sociology of contention

understands conflicts] as collective political struggles” (McAdam et al., 2001:5). This distinction is crucial as we recognize strategic actions and agency. In a nutshell, we argue that contention is best understood as equipped with the notion of mechanisms of certification and decertification. Certification and decertification are mechanisms that help explain contentious episodes. Certification is the “validation of actors, their performance, and their claims by external parties, especially authorities” (McAdam et al., 2001:316), while decertification is the withdrawal of validation. Following Stinchcomb’s definition of mechanism, these are explanatory devices that operate as modest pieces of theoretical understanding and that contribute to institutional theory. Mechanisms of decertification and certification at the individual and group level are applied to institutional theory at the organizational and field level.

## METHODS

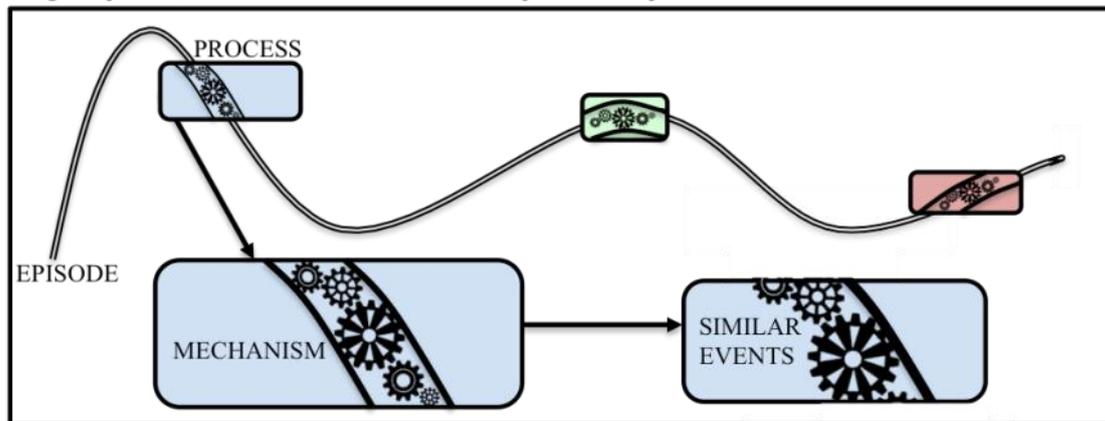
I opted for a qualitative research design to explore contention in a university because it provides rich insights into a phenomenon previously neglected by researchers (Yin, 2012) and because it provides opportunities for theory-building (Eisenhardt, 1989; Eisenhardt, 2007). The point of this research is to “go beyond simply documenting that variables are statistically related to explain the underlying process that make it so: not just finding that a watch runs when you wind it, but prying off the back to display the cogs and wheels that make it happen (G. F. Davis & Marquis, 2005)” (Davis, 2010: 17). This qualitative research takes the form of a retrospective case study of one episode of contention inside a higher education organization. The episode of contention between the administration of MU and the student union represents an extreme example of conflict (Patton, 2002; Eisenhard, 1989). Focusing on an extreme event enables one to perceive with richness and clarity a phenomenon that appears with less intensity in daily organizational life.

### *Mechanisms as units of analysis*

The sociology of contention contains a research agenda centered on the notions of episodes, mechanisms and processes. This approach asserts that understanding episodes requires a look at smaller units: mechanisms and processes. Mechanisms are: “1) independently verifiable and independently give rise to theoretical reasoning, 2) they give knowledge about a analysis at a “lower level” of another theory, 3) they increase the suppleness, precision, complexity, elegance, or piece of scientific reasoning which is an independently verifiable component process [...] 4) while respecting the social reality” (Stinchcombe, 1991).

Ontologically, this entity produces and orders social reality (Tsoukas, 1994). More concretely, *episodes* are discrete collective claims making action. Crucial portions of these episodes are mechanisms and processes. *Mechanisms* refers to types of recurrent sets of *events* “that alter relations in similar ways” (McAdam et al., 2001:24). *Processes* are linked *mechanisms* acting together with certain regularity. To borrow a musical analogy, events are like notes drawn on a piece of paper. Mechanisms are like motifs or phrases: a grouping of notes/events repeated with some resemblance and regularity. Processes are like movements and episodes are like symphonies.

Fig. 1 Episodes, mechanisms and events in the explanation of processes



Epistemologically, this perspective acknowledges the contingency of the social world and promotes an interrogative attitude toward what we can know. Knowing mechanism does not signify predictive capability. Mechanisms are not laws and do not make the same universal claim to validity. Unveiling a new mechanism is like “add[ing] a new item to our repertoire of ways in which things happen” (Elster, 1989: 10). Predictability in social matters is constrained by cognitive capability and the contingent aspect of social affairs. To pursue the musical metaphor, from just a few notes or a few phrases, one cannot extrapolate a whole symphony. Yet, this does not mean that we can have no knowledge of the world; a motif is music just as uncovering a mechanism is a theoretical contribution.

#### *Collection of data*

The choice of terrain was motivated by some prior knowledge of the organization, the accessibility of the data and the intense conflict that occurred. The main steps of the research process were as follows. The first step was to gather the archival data from the SU and the publicly available data from the MU administration. I then proceeded to 6 one-hour interviews to provide more detailed information on the episode. The informants were key players in the episode, had intimate knowledge of the events and were willing to share behind

the scenes information not available in documents and public records. I focused on a large question and then on probes (Patton, 2002). The knowledge of the unfolding of events from the documents was used to probe and orient the interview with the informants and help the recollection of events. I also took the opportunity to test my understanding of the events. The interviews lasted around one hour and were recorded, then transcribed. Early in the planning of this study, it appeared important to provide a balanced view of the episode. To do so, I assured the participation of individuals from the MU and from the SU. The same balanced view has served as a guide while collecting data. This, in our view, mitigates the possibility of a special bias in the rendering of the episode.

#### *Collected data*

More precisely, the data from the SU include minutes from meetings, strategic plans, budgets, student newspaper articles, etc. I was granted privileged access to the archive of the SU and the help of an archivist. The minutes from meetings comprised very rich details of events since they included detailed accounts of every meeting for every elected official of the SU and its purpose. Indeed, student representatives provided a detailed report of their actions every three weeks. Also, the strategic plans (3) included calendars of actions that, when cross-referenced with discussions and other data such as budgets, provided a reliable catalogue of events. Internal documents from the MU administration were more difficult to obtain, but information was available through organizational newspapers, websites, official minutes from meetings, official registries and reports. For a detailed list of collected documents, refer to the table 2. This list of documents only includes the relevant data subsequently analyzed. The relevant document data collected comprised more than 200 pages and required exploring more than 1000 pages from archived documents and numerous web pages. This study is complemented by six one-hour semi-structured interviews. The interviews included main actors who negotiated the agreements and their political advisors from both sides of the conflict. Everyone was closely associated with strategizing activity and present for critical decisions (see appendix 2).

As any qualitative study, one would hope for more data and richer details. Yet, this research provides authentic and valuable insight on a difficultly accessible, under-researched phenomenon. First, informants' willingness to participate should be underlined. As key players in the conflict, they share detailed information. This level of access and of franchise was only possible because of prior relations of trust with the informants. While the number of interviews might appear limited, it should be noted that the very large access to

documentation and the restricted number of strategists puts this limitation into perspective. This is even more true since our focus was on events, not perceptions, and that there was strong inter-reliability among the informants even if they were from opposing parties in the contention.

#### *Analysis of data*

The analysis of data followed multiple steps. First, I produced an event catalogue for the episode from this rich data, organized chronologically (Tilly, 2008). An event catalogue is “a set of descriptions of multiple social interactions collected from a delimited set of sources according to relative uniform procedure” (Tilly 2008: 47). The identification of these events in a catalogue is the first step in identifying mechanism. More than 80 events were identified as crucial to the unfolding of the episode. From the event catalogue, I proceeded to reconstruct the episodes and identify its main actors using a narrative strategy (Langley, 1999). The catalogue of events and the narrative reconstruction of the episode were therefore used as guides to conduct the interviews, helping informants' recollection and guiding probes. The interviews were recorded, transcribed and helped provide a more detailed narrative of the episode. From a recursive and iterative analysis of the catalogue of events, I identified a subset of central events as either certification or decertification. From the 80 relevant events constituting the event catalogue, 38 were characterized as either decertification or certification. These are central events from the narrative presented in this paper. I used visual mapping (Langley, 1995) to make sense of this analysis in a process perspective.

### **CASE: AN EPISODE OF CONTENTION AT METROPOLITAN UNIVERSITY**

The contention pitted a student union against the administration of a large research university, Metropolitan University (MU). On the part of the administration, the object of the claim was to collect additional fees to implement information technologies. On the part of the student union (SU), the claim was to withdraw the new fee imposed by the administration.

The administration's claim, championed by the vice-principal, proposed to the executive committee and endorsed by the board of governors, was strongly rejected by student representatives. During a meeting with the administration, the president of the student union warned that they would fight the fee until the administration would reconsider its decision. As SD, who was present at the meeting, recalled: “They wanted it [the conflict], they

understood what was going on. They wanted to see what we were able to do.” (SD/SU) From this meeting, which occurred in February, up until the signature of an agreement, almost a year later, an important contention opposed the two parties. This conflict's leitmotiv is a battle over the validations of different actors throughout the episode. The making and unmaking of legitimacy by mechanisms of certification and decertification by challenger (SU) and incumbent (MU) characterized the episode.

*Metropolitan University's strategic actions of decertification*

During the contention, the MU administration was more reactive than active. As one informant from the administration recalled, it was not very important to them, while “for the students, it was a big issue and they were right. For the university... we were talking about 10 million, on a budget of 500 million... we didn't talk about it every week. It wasn't... we didn't wake up in the morning thinking ‘the fee...’..and for no one... not even for [the vice-principal in charge of the project]. So it was like the gadfly... it was tiring” (AC). Consequently, the involvement of MU at first was not very strong and SU wanted to come to an agreement. The refusal to negotiate and to find common ground greatly affected SU: “I was always worried that MU would stop being an interlocutor or stop talking to us... because in a campaign, what's most difficult... We always had the idea to reach a common ground...so we couldn't [burn] bridges. We had to maintain an open channel of communication” (SD/SU). But at some point, this common ground appeared to be slipping away: “There was a difficult period where you had the impression [that you have] had [little] impact on the institutions, few ears at the media level... sure it was a difficult time, a lot of questioning...” (SD/SU). This affected the relations between the SU and its members, the students. The administration's refusal affected the SU's credibility.

As the issue became more important, the MU's administration decided to make an appeal to expertise and referred to a special committee to evaluate the fee. In one sense, it was answering one claim by the SU to justify to the MU community the imposition of the fee. The SU had argued that economies could be made by rationalization of the inefficient direction of technology. The administration hired outside experts to evaluate the efficiency of the direction in question. Once again, appealing to experts denied the SU the status of an actor with the same legitimacy. The SU was aware of this tactic. Collegial meetings were the occasion for the administration to exclude the SU from participating as relevant stakeholders, affecting the relations between the SU and the community. But the relations between the SU and the community, including students, were also affected by opinion pieces published by

members of the administration. In response to the claims of the SU for the abolition of the fee, articles were featured in MU newspapers with titles such as “The fees are absolutely necessary” (in the organizational newspaper), authored by a vice-principal. There, it was argued rationally to the community that there was a need to update pedagogical material for the 21<sup>st</sup> century: “Thirty years ago, when I was a student we learned using books. Today, the modes of transmissions of knowledge changed and we are in the multimedia era,” said one vice-principal.

Finally, twice during the episode, the MU administration threatened to sue the SU, potentially affecting the relations between the SU and its members, the community and the society at large. Both times, the threats occurred in reaction to strategic actions perpetrated by the SU. One in particular put a strain on SU: “I remember a meeting with the head of security, the vice-principal to students affairs et the principal’s cabinet chief... and there were some actions committed [that were] on the verge of legality... and I felt it was important to... that in this meeting I had the opportunity to maintain an image of partner, of collaboration” (JP/SU).

#### *Student Union’s strategic actions of decertification*

Confronting a mostly silent opponent, the SU multiplied the actions against the MU administration, targeting some of its multiple relationships: to the MU community’s, to the students, to donators and to the outside community in general. Initially, the strategic actions aimed the relations between the administration and the students or the community comprised of professors and employees aimed to inform and gather support: “September was to inform our students, make sure they were on board, adopt a strategic plan, advertise outside, make the issue known... but it was also a phase to get the support from other groups with whom we shared multiple committee that we could use as lever.” (SD/MU)

Not satisfied with the community, the SU would also target the outside community and the prospective students. Every year, a recruitment team from the administration would visit colleges to promote MU to future students. Students from MU would follow the team in charge of recruitment as they travelled to colleges across the province and inform the prospective students about what MU was doing: “this irritated the rectorship....not to the point to show a sign of openness to negotiation... but we knew it disturbed them...” (SD/SU). This was also acknowledged by the administration. Public actions in general had a strong effect on the administration: “it disturbed a lot... because people were saying... “now it’s too much.. as long as is it’s between us, a demonstration or at the collegial assembly... articles in

the local newspaper, it's in the normal order of things... prospective students, that could have long terms consequences" (AC/MU).

The SU always maintained political relationships with the government. Lobbying the government was very effective in this situation. One informant from MU shared that: "When you receive a call from [the] minister's office because they met with the students and the minister wants answers, some clarifications... and the minister.... she held her ship tight!" (AC/MU). At this point, the MU administration could not really act as if nothing was happening.

Among the multitude of actions, two stood out as particularly disrupting and led to threats to sue from the MU administration: a direct action in the administrative offices and an advertisement in a national newspaper. The SU never claimed responsibility for the disruptive action, yet it was interpreted by the MU administration as coming from them. Incognito, a small group of students drove next to the IT department, opened the back-door of a white van and ran toward the IT direction with small cardboard boxes. Once the doors of the offices opened, they threw the content of the boxes inside quickly and fled the scene. The day's work was interrupted in the IT department when they realized that the masked students had thrown live mice inside the offices. The mice were used as a computer analogy in order to direct appeal to the IT department and to draw attention to the fee that the administration wished to levy. This action had unforeseen consequences. Indeed, the use of animals in research-intensive organizations is strictly regulated. Such use of animals on MU's property provoked reaction from a granting agency, which requires strict norms to be upheld when experimenting on animals.

The agency threatened to withdraw their permission to use live animals for experimenting at MU. This led to a meeting between the MU administration and the SU where the prospect of legal action was put on the table. The SU's representative, while denying any involvement, guaranteed not to repeat any similar action. Knowledge of this action made its way to members of the SU. A heated debate between the SU and its members led to the adoption of a proposition to never use or condone actions involving live animals.

At the end of the campaign, the SU published an advertisement in a national newspaper that denounced the fee. One of the particularities of the advertisement was that it borrowed aspects of the MU administration's public relations campaign. The colours were the same, the disposition and graphics were almost identical and the motto followed the same patterns as the MU administration's campaign. If the two-page advertisement was read quickly, one

could have mistaken it for the MU administration's own ad. The threat to sue was grounded in intellectual property provisions. "The publicity in the newspaper, we were shocked because they took, if I remember correctly, I don't know how they did it, but they took MU's logo and they distorted it... this is legally protected...it was during recruitment period and we were particularly [sensitive] to... how to say... the publicity, that hurt" (JF/MU). The advertisement put forward the claim that going to MU would cost more than anywhere else.

The reaction to both these actions was strong. One informant from the MU administration said: "we started to take care of it when students really raised their voice and took actions. [...] This is when people started to talk about it and say "we can't let this get ugly like this... we have to take action. We have to take care of it" (AC/MU). "[Before] we had no time to lose [with SU]. But then that... the symbolic action on campus.... The animals... the animals, that's what we found the most difficult" (JF/MU). This was enough to bring them back to the negotiation table.

#### *Certification*

Everybody knew that it could not continue this way and that it had to end. SD recalled saying to the administration: "We must find a way out...You must find a way out and I know that you have one. You have pressure from the board of governors...Lets find a solution that reassures everyone" (SD/SU). This echoed the administration's worries. But until the very end, nothing was certain: "He [AC] candidly told me: 'We are wondering if we didn't already pay the political price for the fee'" (JP/SU). Maybe that late in the conflict, no deal was better than a deal.

The objective was to come up with a negotiated agreement that both parties agreed upon, that would be proposed to the SU members and voted on and approved by the MU's executive committee and board of governors. JF and AC were present at the table for the administration and JP and SD for the SU. The agreement in itself was to be a mid-way compromise or, as actors within the contention from both sides called it: an "honourable agreement" (JP/SU, SD/SU, JF/MU). It answered both the worries of the SU regarding the mandatory fee and those of the administration looking for a way to finance technological improvements. Moreover, it was conceived as a way to establish a framework for dealing with future issues regarding fees. The principal aspect of the deal was that the fee would be voluntary rather than mandatory, it would be slightly less than initially proposed, and there would be a collaboration between the administration and the union and a promise of closer collaboration between the administration and the SU

After a few sessions of negotiation, the SU agreed to present and to recommend the negotiated agreement to their members. Following the SU's approval, the administration would present it to the board. For the SU, this meant discussing the agreement in their executive council, comprised of nine student representatives. As informants from the SU shared, they were mainly happy to have a negotiated agreement to present to their members. They had been looking for an exit strategy for some time now. This was one, and, in their opinion, a good one.

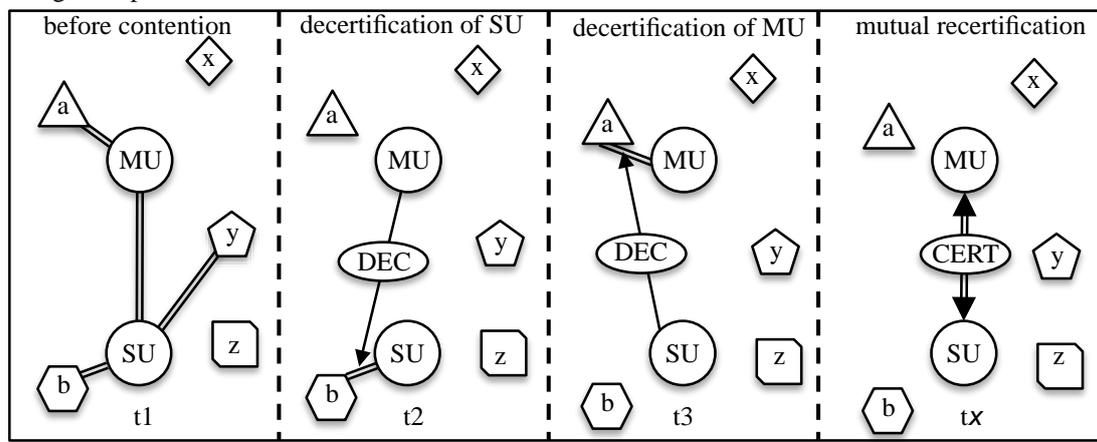
The next step for the SU was to present the negotiated agreement to the members in the assembly. The members were representative of more than 80 student associations present on campus. This also went well. There were a few discussions, but the students finally ratified it. In the end, "People were just happy to have an exit strategy... everybody was happy... we knew that it was vital for the organization... otherwise it was hard seeing any future with the rectorship" (SD/SU). Among elements in favour of the ratification, the opportunity to opt out of the fee for individual students and the presence of a 50/50 student administration committee to manage was looked upon favourably. For the administration, "the idea of the committee [...] instituted a legitimization process by which students put their hand on the wheel, politically that's what I was interested in. We had a place where we could talk about things and put forward [ideas] and convince the students of the necessity of these fees" (JF/MU). A similar process occurred on the side of the administration: the negotiated agreement was presented to the executive council, adopted and presented to the board of governors. This went quickly and without trouble. The administration expected a low number of students to opt out in the end as the agreement prevented the SU from promoting opting out. Therefore, MU would be able to finance its technological projects.

The signature of the agreement signalled the end of the conflict. It reinstated both parties as legitimate interlocutors. By accepting the bargained agreement, the board of governors provided legitimacy to the relations between the administration and the student union, reinstating the administration as a legitimate actor. The same is true on the other side of the contention. The adoption by students of the agreement certified the relations between the SU and the administration, reinstating the SU as a legitimate actor. As such, it was a form of certification. Looking back on this episode, one informant recalled: "All in all, it was a good campaign... just as there were others and just as there will be others and there will be some in the future and there was some before" (AC/MU).

*Analytical presentation of events*

This description of the contentious episode is the product of a narrative strategy (Langley, 1999). It was necessary to help us provide meaning to a large number of actions, but the bulk of the data was in the form of documents and the research strategy mobilized a catalogue of events (Tilly, 2002, 2008) to provide a process and practice-oriented, -situated and -inhabited perspective. Using catalogues of events is a form of synthetic strategy taking the form of a table, making explicit “who” has done “what” affecting “which relation” (see appendix 3 and 4). From the rich account of the episode provided by the narrative strategy and the detailed account of the synthetic strategy, we constructed a visual mapping of the episode (Fig 2).

Fig.2: Representation of decertification and certification in contention



The representation identifies three specific moments: before the contention, during the contention and after the contention. The first one is characterized by taken-for-granted relations between actors. The contention, the second moment, includes decertification efforts from the SU and the MU administration and problematizes relations between actors through actions of decertification. The administration took for granted its relations with prospective students, financing bodies and the society at large, yet these were hindered, respectively by following the MU recruitment team in colleges, the action involving mice and the publication of advertisement in journals. Finally, the conclusion of the episode is symbolized by the signature of an agreement between the MU administration and the SU and by the presentation of the agreement to the members of the SU and to the board of governors of the university.

## DISCUSSION

Two issues appear particularly relevant in this case study. The first one relates to the central position of mechanisms of (de)certification in contentious episode. Second, the unfolding of

this event shows how legitimacy is gained from internal and external sources and how this can be explained through the notion of legitimacy equilibrium.

#### *Centrality of (de)certification*

Mechanisms of certification and decertification are central to understanding the conflict opposing the SU and the MU administration. These mechanisms enabled the interpretation of 38 out of the 80 events constituting the conflict. But more than a numerical importance, the mechanism of (de)certification points toward important moments when legitimacy was at play and to specific events characterizing the making and the unmaking of legitimacy, when actors aimed at relations providing legitimacy to the other party. It was the case when the SU disrupted public events or organized symbolic actions on campus. It was also the case when both parties looked for an *honourable agreement*, meaning one that had value beyond the simply ending the conflict. This agreement had to provide legitimacy to both parties. Analytically, these mechanisms uncovered a link between a set of strategic actions undertaken by the parties in the conflict and legitimacy. The links between what people do in organizations and the making and unmaking of legitimacy opens the organizational black box and is the virtue of an inhabited perspective on legitimacy. Not only does our focus on mechanism of certification and decertification illustrate episodes of intense conflict, but in organizations experiencing less intense forms of conflict such as resistance, tension or disagreements, mechanisms of (de)certification might provide some analytical clarity. Indeed, even in more benign forms of conflict, legitimacy is at stake because (de)certification is likely to be a central mechanism.

Are certification and decertification the only mechanisms in the making and unmaking of legitimacy in contention? If that would be so, their identification would not be as valuable a contribution; contention would simply be another label for decertification. We believe different types of mechanisms are available in contentious episodes. While this research only focused on the most prominent, we can imagine other mechanisms such as "making pay the price", where the actions are directed toward an economic goal. In such cases, tactics such as work-to-rule, boycott or even vandalism could become the base of action and their aim would be not to decertify but to affect the organizational bottom-line. We can also think of a mechanism such as "making an example" at play in conflict where one promotes his points of view by acting as he wishes the other party would act. Respecting a strict ethical rule in decision-making or helping particular charities could be an example of such a mechanism. The number of such mechanisms is not finite as they most likely vary between groups and in

time. What is central here is how (de)certification is a key mechanism in the making and unmaking of legitimacy in contention.

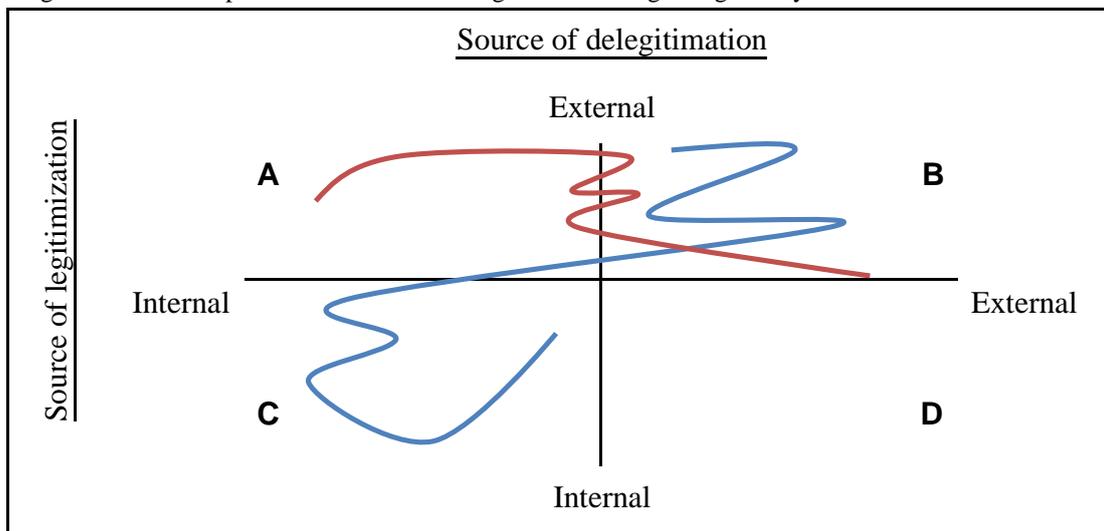
*From external to internal legitimacy*

Legitimacy is not something like capital or material resources, it is the product of relations (Deepphouse & Suchman, 2008, p. 54). Mechanisms of (de)certification targeting relations are central features to understanding how legitimacy is lost and gained during contentious episodes. In the contention, the MU administration and the SU targeted relations providing legitimacy to the other party. The student union, for example, enjoyed legitimacy from the wider social system by conforming to laws and from the wider academic community by convincing them of the value of their cause. Both relations were the subject of attacks during the episode, first by threatening the SU with litigation for actions committed by the students and second by the vice-principal addressing the issue in the organizational newspaper explaining the new fee in the hope of convincing the community that it was a good idea. Yet, these two events of decertification can be differentiated by the source of their threat to legitimacy. In the first case, the legitimacy is external and in the second case it is internal. External legitimacy is enjoyed when “organizations hav[e their] actions endorsed by powerful external collective actors (Stinchcombe, 1968) and develop [...] strong relationships with external constituencies” (Singh et al., 1986, p. 174). Internal legitimacy stems from the fact that some organizations (some might say all organizations) are not unitary. Some organizations at least might be considered plural in the sense that they are composed of different groups with sometimes divergent goals (Denis, Langley, & Rouleau, 2007; Hardy, 1991, 1996). By the fact of their pluralism, relations between the different actors inside the organization are possible. It is therefore possible to think of an internal constituency providing internal legitimacy, and not only of the coordination process (Singh et al., 1986) or the technical core (Meyer & Rowan, 1977) traditional to the institutional literature. In sum, this research takes Deepphouse & Suchman’s affirmation that “[s]ources of legitimacy’ are the internal and external audiences who observe organizations and make legitimacy assessments (Ruef & Scott, 1998: 880)” very seriously (2008, p. 55).

These distinctions between internal and external sources of legitimacy make it possible to adopt a process perspective and to observe the variation of the source of legitimacy during the episode of contention. So far we have posed two variants, internal and external, and two mechanisms linked to legitimation processes, certification and decertification. In this case, it is possible to observe two movements. The first one is the passage from an external source of

threat to an internal one, in the development of the contentious episode. It is also possible to observe a change from an external to an internal source of legitimacy. This translates very approximately in blue for the MU administration and red for the SU into figure 3: a movement starting in the B quadrant and finishing in the C quadrant for MU and a movement starting in the A quadrant and moving to the B quadrant.

Fig.3: Processual representation of the making and unmaking of legitimacy



A process perspective on the event illustrates how the incumbent relied initially on external legitimacy and, following the threat, how it converted it into internal legitimacy. Indeed, decertification was used at the outset of the conflict by the SU and the MU administration, getting more and more intense, while certification was used to end the conflict. Decertification affected the legitimacy enjoyed by both organizations and certification, which took the form of the signature of a negotiated agreement between the parties, provided legitimacy. This translates into a very actionable recommendation for incumbent organizations experiencing conflict or tension. The tension will affect the external relations providing legitimacy to the organization. To regain legitimacy, incumbents need to turn towards their constituency and focus on the relations between the different groups in the plural organization.

This leads us to a working hypothesis regarding the relationship between legitimacy and organizations. By the transfer from external legitimacy to internal legitimacy by the incumbent resulting from a contentious episode, it is *as if* internal legitimacy came to replace external legitimacy lost during the episode of contention. It is, I hypothesize, *as if* the incumbent required a certain amount of legitimacy to function properly and in the event that it loses legitimacy, the incumbent needs to find the equilibrium of legitimacy. In the case of a

pluralist organization, since internal actors can also be a source of legitimacy, it is possible to turn inward to these relations instead of trying to repair affected outside relations.

## CONCLUSION

Is this legitimacy we are speaking of or some proximate concept? In a recent assessment on legitimacy in organizational institutionalism, the authors assert “that legitimacy is fundamentally a property of forms or populations, rather than of self-defined groups (à la status) or individual firms (à la reputation)” (Deephouse & Suchman, 2008, p. 62). Abiding to this definition strictly, one could dismiss it as not being about legitimacy because it focuses on incumbents and challengers and their relations providing legitimacy through mechanisms of (de)certification. In between organizations and the fields lays individuals, groups and other organizations. Going into the making and unmaking of legitimacy involves taking these into account. This level of detail is an integral part of the story on how legitimacy is managed. The case explored is neither about status (it is not a question of agreement, of ranking or of membership) nor reputation (it is not a history of expectation). It is truly a question of legitimacy in an inhabited perspective (T. Hallett, 2010; Tim Hallett & Ventresca, 2006).

While this research is still preliminary, it points towards interesting research avenues, notably in the exploration of the different processes and trajectories of legitimacy as well as other mechanisms that help explain the making and the unmaking of legitimacy. More research is needed to expand our understanding of these mechanisms and confirm the working hypothesis of the transfer from external to internal legitimacy in incumbent organizations and the proposition of a *legitimacy equilibrium* for organizations.

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## APPENDIX 1

Table 2. Table of documents

Type	Date	Description	Source	Availability
Strategic plan	23/08/XX 04/10//XX 06/12/XX	Report and planning of actions presented to member's meeting	SU	Restricted to members
Report of the campaign	23- 25/03/XX	Report of students representative to members	SU	Restricted to members
Minutes from annual congress	23- 25/03/XX	Annual meeting where elections are held and report to members made	SU	Restricted to members
Minutes from member meetings	415-421	Meeting with members to discuss political issues	SU	Restricted to members
Campaign balance sheet	07/03/XX	Campaign budget are presented to members	SU	Closed session Restricted to members
Organizational newspaper	29/08/XX	Bi-weekly student financed newspaper	SU	Public
Newspaper	08/09/XX 08/09/XX 15/09/XX	National newspaper	Public	Public
Institutional newspaper	Vol. 41 # 01-31	Official newspaper of the community	MU	Public
SU newspaper	29/08/XX	Official newspaper of the SU	SU	Public
Newspaper advertisement	11/12/XX	Advertisement in national newspaper	MU	Public
Campaign material: sticker, posters, leaflets, etc.		Material used by SU to inform and mobilize students and prospective students	SU	Public
Institutional presentation	06/02/XX	General presentation of MU	MU	Public
Report to the government	02/09/XX	Annual report to the government on activities and spending of MU	MU	Public
Annual report	2007	Report of student representative (9) to members	SU	Restricted to members
Principal's declaration to the community	16/10/XX	Annual statement of intention of the principal	MU	Public
Official executive committee minutes	2006-2007	Resolutions adopted by the executive council	MU	Public
Correspondence		Correspondence between different actors during the conflict	Informants	Private

**APPENDIX 2**

Table 1. Table of informants

CODE	Title	Organization	Position at the time of the interview	Time
AD	Political advisor	SU	Political advisor	73 min.
JP	President	SU	Human resource management professional	84 min.
SD	Responsible for institutional affairs	SU	Ph D student in education	75 min.
AC	Advisor to the principal/vice-principal adjunct to students affairs	MU	Vice-principal adjunct to students affairs	55 min.
JF	Graduate dean and vice-principal to international affairs / provost	MU	Vice-president to an international organization	68 min.
LB	Dean of faculty	MU	vice-principal to students affairs	50 min.

**APPENDIX 3**

Table 3. Mechanism of decertification employed by MU

Date	Action	Targeted relation	
		Actor A	Actor B
10/03/XX	Announce of the fee to the community	MU community	SU
04/05/XX	Creation of a sub-committee in a collegial meeting	MU community	SU
04/05/XX	Mandate to an expert by collegial meeting	MU community	SU
15/08/XX	Negotiation meeting with no advance	Students	SU
11/09/XX	Opinion piece in the MU newspaper	MU community	SU
16/10/XX	Negotiation meeting with no advance	Students	SU
25/10/XX	Negotiation meeting with no advance	Students	SU
06/11/XX	Opinion piece in the MU newspaper	MU community	SU
11/11/XX	Threat to sue regarding specific actions	MU Community	SU
09/11/XX	Negotiation meeting with no advance	Students	SU
04/12/XX	Negotiation meeting with no advance	Students	SU
06/12/XX	Threat to sue regarding publicity in newspaper	MU community	SU
11/12/XX	Collegial meeting	MU Community	SU
11/12/XX	Collegial meeting	Students	SU

**APPENDIX 4**

Table 4. Mechanism of decertification employed by SU

Date	Action	Targeted relation	
		Actor A	Actor B
10/03/XX	Ask for a committee to examine	Community	Administration
25/08/XX 14/09/XX	to Distribution of campaign material during freshmen week	Students	Administration
25/08/XX 14/10/XX	to Massive display of poster on campus	Students	Administration
01/09/XX	Giving a speech to students in front of the principal	Students	Administration
12/09/XX	Participation to a campus radio show	MU Community	Administration
14/09/XX	Disrupting of the collegial assembly	MU Community	Administration
26/09/XX	Symbolic action on campus	Students	Administration
14/10/XX 14/12/XX	to Frequent distribution of flyers	Students	Administration
10/10/XX	Symbolic action on campus	Students	Administration
10/10/XX	Disrupting of prospective student fair	Prospective students	MU
10/10/XX	Distribution of flyers / New campaign image	Students	Principal
14/10/XX 14/12/XX	to New poster on campus	Students	Principal
16/10/XX	Disruption of a public event	Outside community	Administration
20/10/XX	Letters to the board of governor	Board of governor	Administration
20/10/XX	Letters to the board the donators	donators	MU
25/10/XX	Symbolic action on campus	Students	Principal
21/11/XX	Disruptive action in the administration	Directory Research council	Administration
25/10/XX 16/11/XX	to Presence at the recruitment tour of MU in many colleges	Prospective students	Administration
5//11/XX	Demonstration on campus	MU community	Administration
23/10/XX	Symbolic action on campus	MU Community	Administration
01/12/XX	Occupation of main hall	MU Community	Administration
04/120XX	Publicity in a national newspaper	Community	Administration
11/12/06	Petition to the principal	MU Community	Administration
011/120XX	Publicity in a national newspaper	Community	Administration

## INTEGRATION OF FASTER PLATFORM INTO EDUCATION PROCESS OF ECONOMIC INFORMATION SYSTEMS

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### ABSTRACT

Digitalization and modern trends nowadays in the business increase requirements on the information skills and knowledge of workers. Effective use of information technology plays a key role in a successful business. In our opinion the main role of the universities is education of students in this area. Thanks to combination of theory and practical skills to work with IT in enterprising, students have better opportunity to apply themselves successfully in the labor market. The part of the process of education at the Faculty of Economics of the Technical University is the education of subject Economical Information Systems. In this subject students learn how to establish the small virtual firm and to do the business by using electronic communication, e-shop and e-banking. Weakness of the course is the absence of e-accounting. The main goal of project FASTER (Financial and Accounting Seminars Targeting European Regions) founded by EU is to develop an innovative on-line educational platform in order to facilitate the flow of existing practical knowledge produced in the daily routine of financial services of enterprises, banks & public sector. The aim of our paper is to show the possibility and the importance of integrating the FASTER platform into the educational process of the course Economic Information Systems at our faculty.

**Keywords:** ICT, e-Laboratory, virtual firm, accounting, e-learning, FASTER

### INTRODUCTION

Digitizing everyday reality is modern current trend. The amount of information and the increasing demands of their fast processing lay greater demands on the introduction of advanced information and communication technologies (ICTs) and their effective utilization.

This trend is fully reflected in particular in business where information and its quick processing delivers competitive advantage and cost savings (Bucko, Delina et al., 2005). Keeping the growing trend of ICT use increases the demand for employees, their information literacy, the ability to adapt to new processes and procedures misleading in society and practical skills to work with the new complex and demanding software and information systems (Bucko et al., 2003).

In the flood of new information and procedures for employees are forced to study the new rules and to learn new skills and knowledge. In the process of learning plays an important role the administration of new knowledge and efficiency of learning, when we remember 10% of what we read, 20% of what we hear, 30% of what we see, 50% of what we see and hear, 70% of what we discuss with others, 80% of what we experience personally and 95% or what we teach others (Dale, 1969). In the process of gaining the new knowledge is the most effective in a virtual environment, which is trying to emulate the real environment. In such a training environment it is possible to acquire skills based on own experience by trying new software, processes and activities, use of new technology and so on.

Such an environment is also e-Laboratory (or virtual laboratory) of electronic business in which we teach the subject Electronic Information Systems (EIS) at the Faculty of Economics since 2006. The main objective of this course is to prepare our faculty students for electronic business environment in the Slovak Republic. The development of e-Laboratory was supported by several national projects and the construction lasted several years (Bucko, 2005). The accounting module of the e-Laboratory has undergone many changes during development and is still in development. Its further development can be influenced FASTER project, in which our faculty participates as a researching partner.

The FASTER (Financial and Accounting Seminars Targeting European Regions) project develops an innovative on-line educational platform in order to facilitate the flow of existing practical knowledge produced in the daily routine of financial services of enterprises, banks and public sector. Interactive web-based educational applications and case studies on real accounting situations provide accumulated knowledge in forms suitable to non-formal, practical learning, serving both Erasmus and Leonardo Da Vinci strategic objectives (FASTER consortium, 2012). The courses are in 5 languages, while accounting, taxing, legislative differentiations between nations are spotted. FASTER is a two year project (2011-2013) funded by the EU. During the first year the requirement analysis was completed with the participation of 133 academics, 1030 graduates and undergraduate students, 176 people

interested in vocational training and 97 employers who replied to the FASTER interviews and online questionnaires. In total, requirement analysis gathered 1528 online replies to questionnaires and 64 replies to interviews. Participants in the requirement analysis considered as very important:

- The usefulness of an on line platform in teaching accounting and analyzing accounting information.
- The use of new technology in developing accounting skills.
- The help of new technology to streamline processes.
- The innovative idea of having an on line job seeking environment and mechanism that can match employers and job seekers in the accounting profession.

The FASTER project is in its second year. The end product of the project is the development of the web-based FASTER platform in five languages. The FASTER platform consists of Educational material, Resources (bibliographical sources and glossary) and Job seeker part (Pařová, 2012). Participation in the FASTER project is a good opportunity to push further the development of electronic laboratory, particularly it could support accounting module, which is currently in the e-Laboratory least developed.

## **THE EDUCATION OF ECONOMIC INFORMATION SYSTEMS**

The development of learning environments e-Laboratory was based on initiatives eEurope and eEurope+ reflected in the strategic objectives of the company in the country. Mainly the aim to provide flexible and competitive labor force, respectively potential business staff able to succeed in the global economy, to enable people to benefit from that computer science and ICT brings. Especially high-quality education in this area is very important in Europe to ensure the permanent knowledge innovation of the population. The main objective of our e-Laboratory trainer was to support on-line learning of modern forms of electronic business and its management. E-Laboratory facilitates students and future potential managers of small and medium-sized businesses the understanding the economic linkage of business information system with e-commerce solutions, electronic payment systems and electronic banking.

E-Laboratory presents how to effectively integrate management information systems, e-commerce and electronic payment systems used in a market environment. The laboratory

provides students with access to databases, the possibility of work in analyzing the efficiency of business and gradually other areas of e-business, trade, investment and risk management.

The main objectives of e-Laboratory can be summarized as follows:

Practical demonstrations and presentation of the possibilities of information and communication technologies support development and deployment of information systems in small and medium-sized businesses.

Simulate real conditions of business life cycle in a competitive environment.

Present the benefits of e-commerce and its ties to traditional commerce.

Demonstrate the benefits of the use of electronic payments and e-commerce links and electronic banking with economic information system of the company.

Through learning simulation allow management, monitoring and evaluation of own firms in the market environment.

Explain the benefits of a joint database and electronic data interchange.

Improve the ability of managers of small and medium-sized companies to formulate the requirements for an information system to understand, monitor and effectively change the business and work processes, evaluate the effectiveness of changes.

Emphasize and explain the basic assumptions of the safety of electronic forms of doing business with a particular focus on electronic signature and corresponding legislation.

The e-Laboratory is used in education process of subject of the Economic Information Systems (EIS). This subject is an optional course for undergraduates in third year of their studies at our university. It is intended for students in fields of Business Informatics and Finance, Banking and Investment.

The main asset of the EIS in educational process at faculty is the practical experience with doing business gained by students during course completion. The course consists from founding and managing of a small trade company. Students must pass through all stages of setting up of their firm and the first year of its existence. The course lectures tend to have consultation character with aim to clarify some details of necessary processes. All basic information is provided via LMS Moodle and students do not need to be present at school in the time of the courses. All tasks can be done through the Internet distantly, but still students welcome direct cooperation with the teachers. Lecturers specializing in given areas provide lectures about the completion of the tasks.

The education process of the course Economic Information Systems is supported and realized by using the multiple information systems. The most of information systems necessary for education in EIS (excluding only LMS Moodle) are components of e-Laboratory of electronic business (see following Σφάλμα! Το αρχείο προέλευσης της αναφοράς δεν βρέθηκε.).

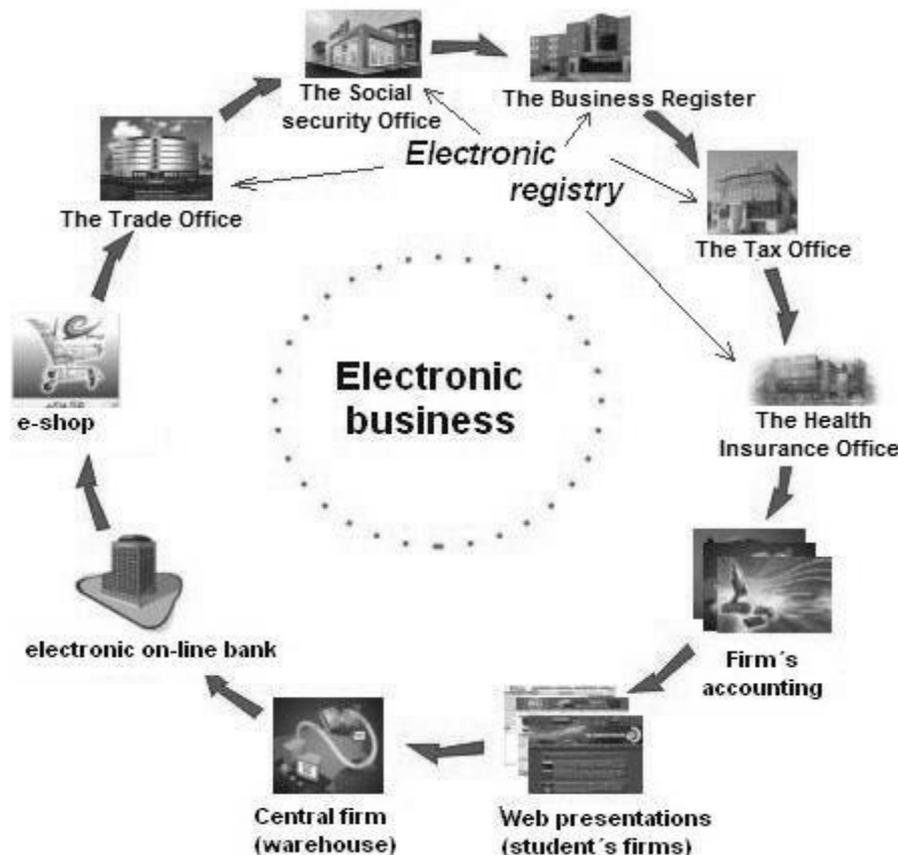


Figure 6: Scheme of e-Laboratory of electronic business

The e-Laboratory is comprising from following systems:

- Online banking system - donated to the Faculty of Economics for the educational purposes by firm UNICOM. Solution of virtual bank was originally developed for use in praxis in real bank, so it provides full functionality, even with support of digital signature for purposes of authentication.
- Accounting system – various accounting software solutions were used during recent years (own web accounting solution, Stormware Pohoda), but currently is used only MS Excel as medium for recording of bookkeeping information. Main reasons for

frequent changes of accounting software are expensive licenses, objectionable functionality of educational versions and problems with usage by students from home.

- Electronic registry – represents virtual public administration offices and supports electronic communication with them.
- Certification authority – used for management of certificates of digital signatures used in electronic communication with virtual public administration offices.
- Electronic shop system – own system for setting up and management e-shops for providing possibility of trade between virtual firms (students' and central wholesale firm managed by lecturers).

The Learning Management System (LMS) Moodle contains all information and materials necessary for course completion, but it is not part of e-Laboratory. The realization of the EIS is based on the students' knowledge from multiple already completed courses (e.g. Marketing, Management, Civil and Industrial Law, Accounting, Informatics, Taxes and Taxation Policy, Electronic Services in Banking). During the completion of EIS course students acquire practical experience in following cases:

- Establishing a virtual firm – each student of EIS course have to establish own virtual trading firm according to Slovak legislation. They must send applications to virtual public administration authorities (see e-Laboratory scheme on Figure 6) via electronic registry. Applications must be signed by their digital signatures acquired at faculty's certification authority. Lecturer in the role of public administration authority replies in form of electronic confirmation of registration in case of correct application was sent. Knowledge from subjects Civil and Industrial Law and Taxes and Taxation Policy is useful students in this part of course.
- Preparing a business plan – during establishing firm students should prepare business plan of their company with regard of future actions in their business including management and marketing strategy and trade plans. Business plan has to be uploaded by student into LMS Moodle. Students use skills gained in courses of Management and Marketing.
- Creating the company's website – students create website representing their firms and place it on the Internet (space on webserver is provided by e-Laboratory). It should contain basic information about firm, its legislative documentation and e-shop. Students in this case need knowledge from Marketing and Informatics.

- Creating an e-shop and its continual management – students sell their goods through e-shop between themselves. E-shop is only trade channel in this course and its basic solution is provided by virtual laboratory. Students can personalize it and manage all attributes (e.g. connection to their bank accounts). Student's e-shop can be filled only by buying in central e-shop managed by lecturers. Students could use their skills gained from Informatics, Management and Marketing courses.
- Opening an account in the virtual e-bank – students by electronic application demand creation of accounts in virtual bank provided with virtual credit of 200 000 EUR. They must continually repay first several installments of credit provided during course. Virtual money serves for buying goods for further trading at e-shops and students must use Internet banking interface. Knowledge from Banking and Electronic Services in Banking courses is useful in this part.
- Trading the virtual goods – is main activity of students' firms. Trades are conducted between the students' firms and faculty firm or between students' firms only. Main aim is to create a profit at the end of accounting year thanks to right pricing of goods. Knowledge from courses of Marketing, Management and Electronic Services in Banking is useful in this part.
- Recording all events into accounting – students have to record properly all relevant operations into the accounting including end-of-year operations. MS Excel is used for these purposes currently. Students need skills gained in courses of Accounting and Taxes and Taxation Policy.
- Strategic study and evaluations of their business – students evaluate their business actions and prepare strategic study about future plans of their firms. Skills from Management and Marketing courses are necessary in this part.
- Analysis of the information system – is final task in EIS course where students choose one of the systems used, analyze it, summarize the users' requirements and provide the suggestions for the changes and improvements. Knowledge from Informatics is necessary in this part.

Final feedback is provided by students on the Economic Information Systems course after its completion to gain information for course improvements. These feedbacks together with average points acquired by students in each task are valuable for inspiration of course enhancement.

## ASSESSMENT OF THE ECONOMIC INFORMATION SYSTEMS COURSE

The course of Economic Information Systems is taught in the third year of bachelor's degree field of study Finance, Banking and Investment (FBI). Teaching process is supported with above described e-Laboratory since 2006. Given course is optional to study and the number of students differs. Its study involves several arduous tasks, so students who chose this subject are among the better students in third grade of their studies. Since 2010 the subject is also taught in the study field of Business Informatics (BI) at Faculty of Electrical Engineering and Informatics, where students are more experienced in informatics, but they lack the basics of accounting.

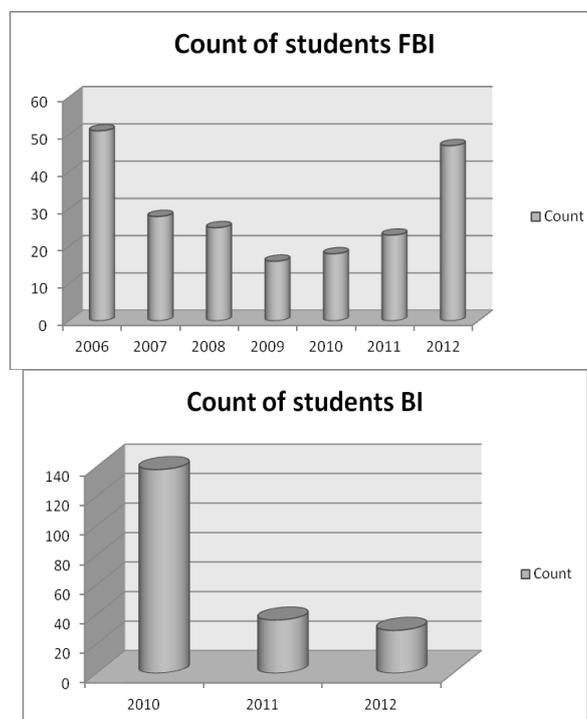


Figure 7: Counts of students in both fields of study: Finance, Banking and Investment (FBI) and Business Informatics (BI)

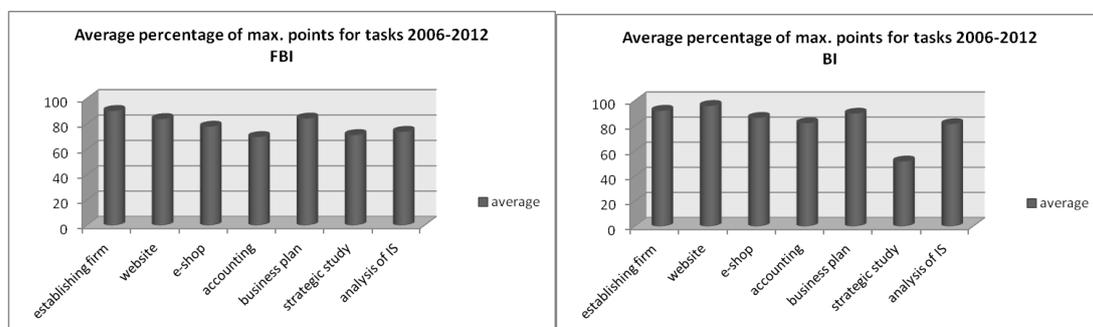
Together students might gain evaluation in sum of 100 points, but evaluation and range of some task differs according to their field of study (see following table).

Tasks	Finance, Banking and	Business Informatics

	Investment	
Website	10 points	10 points
E-shop	15 points	15 points
Establishing the firm according to legislation	10 points	20 points
Business plan	15 points	15 points
Accounting	25 points	20 points
Evaluation and strategic study	15 points	10 points
Analysis of the information system	10 points	10 points
Total	100 points	100 points

*Tab. 1: Maximum evaluation of each task according to field of study*

In the task of establishing the firm students in Business Informatics field of study have to use electronic signature for signing the necessary electronic documents. Students of Finance, Banking and Investment do not sign documents electronically. In contrast, when recording all events into accounting Finance, Banking and Investment students should demonstrate greater proficiency and also evaluation of this task has higher weight than in case of Business Informatics students.



*Figure 8: Average percentage of acquired points from maximum points in each task in both fields of study: Finance, Banking and Investment (FBI) and Business Informatics (BI)*

During the teaching of this course in several years e-Laboratory has evolved and this fact mirrored even in evaluation of students and their points acquired.

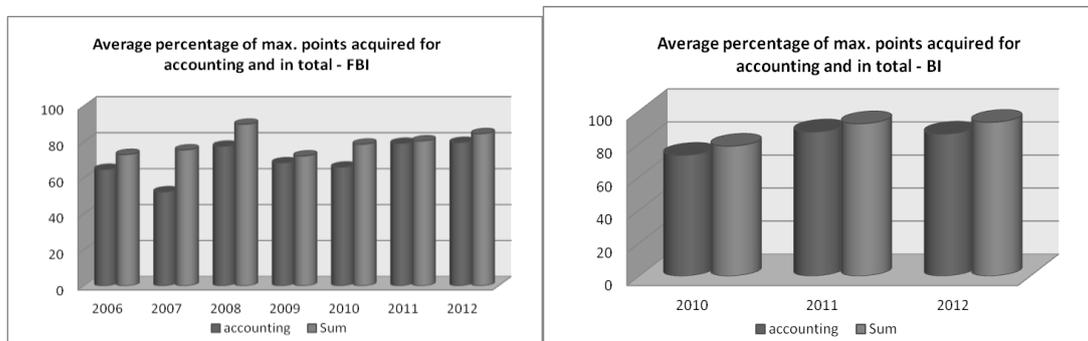


Figure 9: Average percentage of points acquired for accounting task from maximum points in both fields of study: Finance, Banking and Investment (FBI) and Business Informatics (BI)

The above charts show, that in 2007 students were less successful in the accounting task because there was implemented a new and imperfect accounting module in e-Laboratory, which allowed simple bookkeeping of small firm by web application created by lecturers team. In 2008, the total points total acquired increased, while the use of web accounting application was abandoned and bookkeeping was realized only through MS Excel. The decrease in acquired points occurred again in 2010, when the students had to process the virtual business accounting with software "Pohoda" from local software developer STORMWARE. The move proved to be problematic, so next year we reduced complexity of this task since the year 2011 and virtual accounting is again realized through MS Excel.

All evaluations show that points acquired for accounting tasks was lower than average of all tasks. The reason is the lower level of knowledge and preparedness of students to keep in a particular practice area of virtual company. Despite the fact that the students completed the accounting course before EIS course, their knowledge is more theoretical and cannot be practically applied to their tasks in a specific software (Mihók et al., 2000), as it is necessary in virtual company in course of EIS.

This result can be partially attributed to the number of tasks that students must accomplish during the course and the fact that the course is more focused on a demonstration of modern

electronic systems such as e-banking and electronic payment systems, e-commerce, as well as the use of electronic communication and electronic signature.

Ensuring the achievement of better results in the field of accounting is possible integration of the on-line platform of FASTER project, which is devoted to accounting and its objective is to educate users in the field. The FASTER platform is designed directly to support education in accounting and provides practical examples and self-testing in the field of accounting to help students better prepare to manage the accounting of a real small firm.

## CONCLUSION

Digitalization process has penetrated all sectors of human activity. Implementation of a full transition to electronic communication, accounting in electronic form, e-commerce and other routine business processes is not possible without adequate knowledge of the users. A range of innovative and successful practices was not introduced into practice just because of their refusal by users (Révészová, 2012). The solution to these problems is to introduce a virtual learning environment, similar to e-Laboratory described in the article that allows students to apply their learned theory in practical training activities. The results of the evaluation of the course and points acquired by students for tasks in course of Economic Information Systems during the years 2006 to 2012 show need of improvement in the field of accounting. It will be implemented in the future integration of online FASTER platform. We expect that the students' results in accounting task will improve in the following academic years and also increase students' success in labor market and entrepreneurship.

## ACKNOWLEDGEMENT

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## THE EMERGENCE OF HRM TOOLS IN R&D PROJECTS AT COMPETITIVENESS CLUSTERS: ANALYSIS AND INSIGHTS IN THE LIGHT OF ACTOR-NETWORK THEORY

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### ABSTRACT

French competitiveness clusters have existed officially for about seven years. In these competitiveness clusters, employees from different organizations work together, often through collaborative R&D projects. This new system raises questions for HRM at several levels, including what types of HRM tools are introduced and used. In joint projects in particular, several questions arise: What tools are being developed and what purposes they are used for, who is driving their introduction and how is this being done?

The research presented here was conducted longitudinally over three years on two collaborative projects running at a global competitiveness cluster located in France. Our paper presents an analysis of these collaborative projects in the light of Actor-Network Theory (ANT) (Callon, 1986a; Latour, 2005, 2006). The aim is threefold: to provide analytical insights on the interactions between actors and "translation" operations, identify HRM tools used in collaborative projects and finally point out the contributions of the analytical framework used.

**Keywords:** HRM tools, competitiveness clusters, actor-network theory

### INTRODUCTION

French competitiveness clusters have now been in existence for a little over seven years (Chabault, 2010). They are similar to traditional cluster-type networks, the difference being that the Central Government has a hand in developing them (Defélix et al, 2006), while traditional clusters are formed by local actors. Competitiveness clusters bring together various actors outside their own organizational structure (Culié, 2009; Pichault, 2002). The originality of this new form of organized regional network is to bring together all actors present locally, in a purposeful system supported by the Central Government, along an

industrial value chain to ensure competitiveness through innovation (Bories-Azeau et al., 2011; Mendez and Mercier, 2006). In reality, a competitiveness cluster combines within a single geographic area, businesses, research centres, training organizations and government agencies *"engaged in a partnership designed to create synergies around innovative projects conducted jointly, targeting one or more given markets"*.<sup>11</sup> In competitiveness clusters, employees from different organizations work together on joint R&D projects. These employees all have very different statuses, pay scales, work schedules, tasks and cultures (Calamel et al, 2012). Joint R&D projects have a paradoxical form of management: on the one hand, they are the obvious and natural mode of operation in this type of strategic partnership, but on the other, the actors who are involved often find along the way that the working context is highly specific, and the traditional levers and incentives do not really serve. Whatever the type of partnerships, they require very specific managerial techniques (Segrestin, 2004).

Twelve of the 71 competitiveness clusters accredited by the French Government are in the Rhône-Alpes region, one of the most dynamic economic areas in France. Micronano, one of them, currently has more than 200 members from industry, research and higher education and local and regional governments, focusing on micro-nanotechnologies and embedded software intelligence.

It seems difficult and rather ambitious to conduct concerted human resource management (HRM) actions within competitiveness clusters. How can HRM tools structurally located in the context of a single employment relationship be adapted to share configurations between multiple partners? How can joint HRM tools be developed for a collaborative R&D project?

This paper attempts to answer these questions based on a longitudinal study conducted between late 2008 and early 2012 in the Rhône-Alpes region, on two collaborative projects at the Micronano competitiveness cluster. This research aimed primarily to identify and capitalize on HRM tools present within the R&D projects.

After presenting how the human dimension is addressed within competitiveness clusters (1), we discuss the contribution of Actor-Network Theory, (2) we briefly present the methodology used (3), and then we use the Actor-Network Theory framework to analyse two collaborative R&D projects in which shared HRM tools have been used. (4) In conclusion, we point out the contributions of the analytical framework used for HRM.

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<sup>11</sup> Official website of the French competitiveness clusters: <http://www.competitivite.gouv.fr>, 2011

## **1. COMPETITIVENESS CLUSTERS AND HRM: AN ESSENTIAL ALLIANCE**

Competitiveness clusters present a clear managerial challenge (1.1). However, the specific nature of the human resource problems is difficult to identify in collaborative R&D projects (1.2).

### **1.1. Competitiveness clusters: a clear managerial challenge**

The purpose of competitiveness clusters is to promote the emergence of collaborative R&D projects among the members (industry, universities, etc.). Each member must be positioned on one or more collaborative projects, contributing its technological expertise. The cluster leadership must provide administrative support to these inter-organizational project teams, by creating management systems.

The first studies available on competitiveness clusters examine different dimensions, including their organizational structures, governance and conditions of formation (Gomez, 2009; Chabault, 2010); their territorial roots (Fen-Chong, 2006; Barabel et al., 2009; Gosse et al, 2010); and the reality of their innovation potential (Mendez and Mercier, 2006; Fallon et al, 2009). Other researchers explore their economic efficiency (Duranton et al., 2008), as well as their impact on innovation and employment (Pichault, 2002; BCG & CM International, 2008, Calamel et al, 2013).

From a more managerial perspective, Mendez and Bardet (2009) raise the question of the role of governance practices in the development of cooperation capacities, saying it involves combining differentiation and integration (Holmqvist, 2003). Gomez (2009) indicates the theoretical reasons that make this type of governance difficult, pointing out two major problems: 1) the difficulty of establishing property rights on the joint output of a competitiveness cluster; 2) the objectives of the stakeholders that cannot be achieved by pursuing joint profits. These challenges demonstrate the value, pointed out by Ferrary (2009), of inter-organizational coordination as a factor for success (Bouty et al. 2012). Managing collaboration in clusters is also a topic studied by various researchers (Calamel et al, 2012; Wannemacher et al, 2012) who observed the first HRM systems or tools seeking to make partnerships between different organizations coexist peacefully and to facilitate the joint work of people not covered by the same employment relationship. They try to shed light on organizational learning issues in hybrid, cluster-type organizations, especially within collaborative R&D projects involving multiple actors.

## 1.2. HRM within clusters: challenging questions

By their very nature, competitiveness clusters pose a series of questions on how to engage the employees as stakeholders in collaborative projects. *"Human resources management in a cluster is not simple: the people involved have widely differing statuses and cultures (researchers, entrepreneurs, employees), and most of the people associated with the cluster are not managed or paid by the cluster"* (CM International et al., 2008, p. 105). The employees belong to completely different organizations, ranging from start-ups, to SMEs, large corporations, public laboratories, universities and government agencies. They are engaged in projects for periods varying from a few months to several years. Their contribution may be full-time or part-time, while continuing to work on other programs within their 'home' organization. They may work physically in their home organizations, be moved into a unit of one of the project partners or brought together into a single technology platform. Beyond these objective differences, the actors' perceptions of their career prospects within clusters are also very different (Culié, 2009). How is it possible to motivate people with such different positions, when they continue to be paid under the compensation system of their home organization? Could inter-organizational group bonuses be one solution?

The question raises the possibility of human resources management tools shared across several organizations, which, though they work together, nonetheless have their own specific interests and strategies. In this perspective, Tixier (2009) examines the skills management methods developed within competitiveness clusters, and raises this question: what are the challenges and risks of their institutionalization? Some collaborative projects have considered but not yet implemented it. Similarly, the professional evaluation procedures remain those of the home organizations, although in this case, the opinion of the employee's project manager may also be sought. And what about the value systems specific to each organization, which the project members convey? Private sector employees and civil servants from different organizations working together do not have the same work schedule, or the same paid holidays, or the same pay for the same job. This non-exhaustive list of differences shows the magnitude of the HRM challenges to be addressed in competitiveness clusters and joint R&D projects. The specific nature of the HRM problems in competitiveness clusters and collaborative R&D projects is difficult to identify.

## 2. ANALYTICAL FRAMEWORK: ACTOR-NETWORK THEORY

Actor-network theory offers a fresh positioning, initiated in the field of social sciences. Callon and Latour were the first to delve into how science is produced and specifically the construction of scientific facts in the laboratory (Latour and Woolgar 1979, Latour, 1987). The premise was to analyse science in action or "science in the making" rather than science already done. In "science done" the facts are considered as black boxes that are not open. The fact is clear to all and is a foundation that one can build on without risk. In contrast, in "science in the making", the emphasis is placed on the construction of the essential facts leading to the emergence of a new theory or concept. One considers through the "fact" that which is constructed in the laboratory in the interactions and exchanges between human and non-human actors.

In this posture of "science in the making," relationships are placed at the heart of the construction process of scientific knowledge. This process is not seen as a purely technical, cognitive process, but as a process of *interessement* in which the actors are encouraged to interact with others in an attempt to convince them of their vision and their definition of the situation. The individual or collective actors position themselves as spokespeople; they "translate" their intentions and try to enrol new actors. Relations between actors are built through successive translations operations. Innovations can be seen as the result of translation operations (Callon, 1981.1986, Latour, 1987).

Actor-network theory is widely used in the fields of social sciences (Latour, 1987; Callon, 1986 a, b), anthropology (Strathern, 2004), organizational theory (Gheradi & Nicolini, 2005, Fox 2005), information systems (Cho et al., 2008; Mitev, 2009), and management sciences (Lowe and Koh, 2007; Alcouffe et al., 2008; Dreveton and Rocher, 2010; Weppe, 2011).

Actor-network theory or sociology of translation aims to analyse the phenomenon of change, how change is managed and any inherent difficulties (Delvaux et al., 2011). However, according to (Latour, 1988) it is important to be present during the construction of a management tool in order to experience its changes through the interactions between actors and tools, or as appropriate, to understand, through their reconstruction, the mechanisms and issues that led to this construction. This translation process can be performed in four main steps: *problematization*, *interessement*, *enrolment*, *mobilisation of allies* (Callon, 1986 a, b; Latour, 1987, 2005).

### 3. RESEARCH METHODOLOGY: ETHNOGRAPHIC IMMERSION IN TWO R&D PROJECTS AT A COMPETITIVENESS CLUSTER

Our present research is part of a research project conducted by a team of researchers funded by the Rhône-Alpes region. This project aimed to identify emerging HRM tools in the twelve competitiveness clusters in the region, and within two collaborative projects at the Micronano cluster.

As support for this research, we conducted an extensive study on two specific collaborative projects carried out at Micronano. Three series of interviews were conducted between 2008 and 2012. The purpose of these interviews was learn more about the emerging and existing HRM tools in the clusters, or lack thereof, and to study changes in how the human dimension was addressed in two R&D projects.

These two projects were officially launched in 2007, with a planned duration of at least 4 years. The teams were formed by the leaders of each project and the HR departments at the lead organizations with the agreement of the partners.

Box 1: Brief description of the R&D projects studied

<p><b>Project A</b></p> <p><b>Objective:</b> Improve energy efficiency by creating a smart electrical panel</p> <p><b>Duration:</b> 48 months</p> <p><b>Total effort:</b> 127 people/year</p>	<p><b>Project B</b></p> <p><b>Objective:</b> Developing new generations of electronic components used for embedded software</p> <p><b>Duration:</b> 60 months</p>
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To study the first months of operation of these two projects, initial research was conducted in late 2008 and early 2009 through semi-structured interviews, fourteen on Project A and six on Project B. These twenty interviews focused on the launch of the projects, their evolution, and the management practices throughout their first year.

The interviews were conducted with a diverse sample of employees involved in the project, representing different partners at different levels of responsibilities, in order to get different points of view: the project manager, sub-project leaders, and simple participants. A second series of interviews was conducted in 2010 and the last one in 2011/2012. The people we met and the questions we asked were essentially the same, with some variations depending on the progress of the projects.

#### 4. ANALYSIS IN THE LIGHT OF ACTOR-NETWORK THEORY

This section aims to analyse two collaborative R&D projects using Actor-Network Theory. Using this analytical framework, the idea was to identify, through the four main stages, namely problematisation, interessement, enrolment and mobilization of allies, the roles of the different actants and determine whether these two projects could be considered successful or not (Callon, 1986 a, b; Latour, 1987, 2005). This analysis also aims to identify the HRM tools used to facilitate or strengthen the project, if any.

##### 4.1 Project A, or how to create meaning for a multi-partner team with widely varying interests

Joint R&D projects are the keystone of competitiveness clusters. Through these joint projects, french organizations are expected to innovate and be more competitive on the global market. The first project discussed here is called Project A. The main objective of this project, carried out at the Micronano competitiveness cluster, was to improve energy efficiency by developing and creating a smart electrical panel.

###### 1. Problematisation, or how to understand the interests of each party

Within this collaborative R&D project, various actors from completely different organizations and worlds coexist.

- The partners, who are represented by all the organizations working on the project, whether private or public. The organizations can be start-ups, very small entities, SMEs, large corporations, public research centres, university research laboratories, etc. The project partners have a common goal: make the project a success in order to benefit from it, depending on their orientation: this may be in number of products sold on the market, number of publications in recognized journals, etc.
- The project manager, who must strive to make this rather disparate microcosm coexist and must see the project through to completion, that is to say, produce the deliverables expected and defined by the funders.
- The competitiveness cluster leadership team, who accredited the collaborative project. This team plays an important role since it is the link between the project manager and the funders. It also helps to form the full team of partners for the project.
- French and European funders, who provide the funds and who check the progress of the project regularly.

- An outside consultant, present at the launch of the last sub-project, to create and strengthen the sense of belonging to a team with a common vision.
- Finally, the project itself is identified as an actor. The issue of energy efficiency is central in a context of a latent economic crisis and a shortage of fossil fuels within a few decades.

The central question that the project manager must address from the outset is the following: how to ensure that the twelve partners coexist and work together, given that they have diverse origins, different and sometimes conflicting organizational and research cultures, and with potentially different objectives with respect to their participation in the competitiveness cluster and project A in particular.

## 2. Interessement schemes

In the case studied, one entity, represented by the manager of the collaborative project, tries to rally the other units in order to move the project forward in the same direction. He is responsible for the project divided into six sub-projects. He has already launched the first 5 and must implement the last one. Having received some feedback about a lack of common vision from the group of researchers who observed the launch of the first 5 sub-projects, the manager is considering putting together an event (a kind of team-building day), with the help of the competitiveness cluster leadership team, as well as the HRM from the company where he is employed.

By setting up an event to launch the last sub-project, he would potentially bring together the actors involved in the project, and even beyond. The goal is to show the partners that an action is being taken to unite and make them stronger and more able to move quickly on the project. Thus, the manager of the collaborative project is positioned as a "translator" and earns the recognition of the others. The proposed interessement scheme is supposed to lead to alliance building and enrolment.

## 3. Defining the roles

The goal is to create a sense of cohesion in order to move the project forward quickly so that the products (smart electrical panels) can be introduced on the global markets and French innovation can be showcased. However, team cohesion is not so easy to obtain. The project manager must negotiate with the partners themselves and convince them of the value of a team-building event. He must prove to the partners the real value of participating.

It is interesting to note that it was at this time that the presence of the researchers who studied the collaborative project and reported the lack of a common vision to the project manager was taken into account. Initially, the role played by the researchers was not taken into account, especially because it was supposed to be non-existent. However, along the way, the researchers studying the project and meeting with key actors (project manager, leadership team, partners, etc.) were assigned a role. It was no longer just the role of observer, but also a role of co-structor.

#### 4. The mobilisation of allies, or how to create a common vision.

Interviewed just before this team building day took place, the manager responsible for this new sub-project (2010) had high hopes for the event: *"In accordance with the overall project manager, during this session, the goal is to work and define the criteria for success of the project, to get to know one another, learn how to work together and create a climate of trust, learn how to handle the arrival and departure of partners, have common goals, etc."* What really happened? Did the partners participate in the event? What do the funders who accredited and funded the global R&D project think?

It would appear that this team-building day was a success. The feedback we got during interviews with various actors was very positive. It would appear that this action helped to unite the team: *"I am very pleased to have participated in the day, I'm less afraid."* (Engineer, 2010). The consultant had the partners work on their skills and the transversality of their skills with respect to the project. They were able to discuss their ways of working and identify the skills they lacked for the project. When the partners presented their skills and knowledge of the subject, they realized that they had complementary capacities. Because the partners knew each other better at the launch of the project, they were able to express themselves and share openly about sensitive topics during the project. One partner (2010) stated that *"this day was very welcome, because we realized that even if we work together for several half-days, we don't really know each other, and this was an opportunity to get to know aspects other than professional, it's much easier to work together afterwards, we dare to tell each other things straight out"*.

In the end, it appeared that the team building day was a great success according to the actors in this project, whom we met a few days after the event, and then again a year later. An engineer (2011) explained to us: *"I'm sure we worked faster thanks to this day, because we know each other."* It enabled them to share and communicate more quickly, which saved time in the implementation of the project. They understood what was at stake and each partner became

aware of the skills of all the other partners. The actors didn't wait for several weeks before speaking to one another, because they already knew each other. Tools were created to optimize their discussions. They were able to share values and a global vision of the project and the team.

In addition, the actor who played the role of translator was the project manager. He played a key role, namely to build trust and unite the team of the last sub-project through the team-building event. The event helped infuse a spirit of shared vision among the various partners from very different backgrounds and orientations. This very positive situation enabled them to meet the deadlines imposed by the funders of the project. All the project deliverables were delivered on time.

#### **4.2 Project B, or how to try to create meaning through the idea of a group bonus**

The objective of Project B was to develop new generations of electronic components used for embedded software.

##### **1. Problematisation**

Because of equipment requirements and because the work was carried out in a cleanroom, project B had only two partners: a small micro-electronics firm and a large public research centre.

The public research centre has a very strong orientation towards research, development and further consideration of what is developed in the laboratory, whereas the SME's objective is clearly to sell an effective new product recognized by customers. According to the project manager (2008), the research centre *"has a culture of customer satisfaction but which corresponds to a 'best effort' commitment, its objective is to try to understand things. [The SME, however] has a must stronger performance commitment. I think that their understanding of the competitive environment is the same but the concepts of time and results are not."*

This project has only two partners, yet the differences between them seem to be fairly significant. The major problem of project B is the disparity in corporate cultures and HR management systems between the two organizations. The central question that arises is the following: how do we move forward and develop a project together even though our origins and activities are so different?

The challenge is to make clear from the outset the purpose of the product, regardless of the type of organization, whether business or research. One participant of this project (2011), from the public research centre, agrees, saying: *"If we had assessed the final applications of the product, that might have helped bring the people together in a stronger way. (...) The absence of a considered approach hinders collaboration"*.

And not only do the two partners have different orientations and objectives, but their corporate cultures and HR actions also are different. They do not have the same recruitment process, or the same career development and management system, or the same compensation system, or the same work organization or schedule. And yet, they know perfectly well that they must go through an 'obligatory passage point': their collaboration and cultural rapprochement is necessary for the project to succeed.

## 2. Interessement and roles

Each partner is aware of the magnitude of the challenge facing them. But ultimately, given the gulf separating them, few actors enter into action. The actor who is the most motivated to decompartmentalise the partners, oriented "business" vs. "research" respectively, is the Director of Human Resources of the private enterprise. He first attempted to convince his counterpart at the public research centre of the value of establishing a group bonus common to both organizations, to unite the actors and make them feel as if they belonged to a project and a common entity.

But the proposal ran into several obstacles. According to the project manager, there were cross-cultural difficulties, compounded by another more institutional problem involving forms of payment (2009): *"There is a problem when [the company] gives out project bonuses to its employees. They exist [at the research centre] but it is very rare: one or two every ten years!"* During the project, and in the course of our interviews, the project partners spoke bitterly about the differences in working hours and paid holidays for some, compensation and working conditions for others. The HRD of the company realized this, and tried to initiate a movement to bring the partners' systems more into line. He ran up against too much bureaucracy and complicated paperwork at the public research centre. His counterpart had no discretionary powers and had to comply with the culture of the organization.

## 3. Enrolment and mobilisation of allies

Enrolment was not able to work. The main lever designed and proposed for the enrolment of the actors, namely the creation of a group bonus to motivate and reward the project partners,

was unsuccessful. Still, the project was a resounding success at the scientific and commercial level. Despite a few months' delay, the deliverables were produced correctly and the product was introduced on the market. Several papers were published. Neither of the orientations favoured by partners (business vs. research) was abandoned. The difficulty was to bring together actors around a common project, even though they did not have the same compensation or the same working hours, etc. However, it is interesting to note that most of the actors interviewed said they did not want to take part in another collaborative R&D project, mainly because of these cultural differences.

## CONCLUSION

This paper has provided insight into the process of "translation" of two collaborative R&D projects. We have seen that the translation phases differed greatly from one project to another, the actors took different paths, and the principal translators in the two cases studied faced a number of pitfalls and obstacles.

We can draw several lessons from this analysis in the light of Actor-Network Theory:

- It is interesting to note that the actors, both in project A and B, were aware of the challenges and agreed on the "obligatory passage points." This first step in the translation process was critical because it enabled the two projects to get off the ground despite the obstacles and challenges, be they organizational, strategic or technical. Another important dimension was the emergence in both projects of a "translator" recognized by the other actors, who focused on the progress of the project and sought out multiple solutions to the problems inherent in the project. Without a principal translator, intersement and enrolment do not seem possible, and the project is nipped in the bud.
- This theory allows us to consider all project actors, and the project itself is an actor and simply a medium or an objective. Far from focusing only on power plays and the stages of an organizational situation, Actor-Network Theory provides a very enlightening vision of the situation. Thus we see that in Project 2, the project itself becomes a central actor/actant that overcomes the failure of the intersement and the type of translation that could have ensued. The critical importance of the project turned the tide in a situation that was compromised, and probably "forced" the actors to set aside the cultural and organizational gulf separating them.

- In the case of technical projects such as projects A and B, attempts at intersement emerged largely around the field of HRM between actors and tools. As regards actors, the HRD, Project Managers and HR consultant spearheaded the initiatives and action. As regards tools, communication techniques and processes focusing on personal interactions and compensation schemes were used. Again, Actor-Network Theory provides insight into the families of actors/actants in action, and the processes and steps that emerge during the life of a project. In both cases studied, the field of HR played a prominent role and showed its strong potential in the field of organizational analysis. Moreover, it was clear from the outset that these two collaborative projects raised HRM issues that would have to be addressed sooner or later. As regards partners, they should be recruited based on a consensus between project leaders (regardless of their home organizations). As regards human resource incentives, it was difficult in the short term to harmonize these practices. In collaborative R&D projects, it is important to create conditions where diverse practices can coexist peacefully without causing antagonism or bringing the project to a standstill. Other research conducted in this area concurs, in particular (Calamel et al, 2012).
- HRM tools do not seem to be prevalent in joint R&D projects. And yet they appear to be critical for processes carried out at the beginning and end of such projects, such as recruitment, skills development, career management, etc. Further research is being carried out in French competitiveness clusters on these aspects and will in the medium term confirm or refute these findings.

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## CARBON DISCLOSURE SCORE AS A PROXY OF CORPORATE ENVIRONMENTAL PROACTIVITY: A CROSS-CULTURAL ANALYSIS

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### ABSTRACT

The aim of the paper is to analyze if and how national culture impacts on corporate's environmental strategies. The Organizations and the Natural Environment literature recognizes the introduction of environmental protection as a driver of corporates' competitive advantage, and identifies several drivers of corporate environmental proactivity.

While most of literature focuses the analysis on the broader issue of Corporate Social Responsibility and analyses the effect of national culture on Corporate Social Performance, only a few studies focus on the relationship between national culture and environmental proactivity, employing national environmental indicator rather than firms' performance scores. In addition, these studies – based on Hofstede's framework – do not analyse culture's impact on company's environmental behaviour, but only the relationship between national culture and the overall national environmental performances.

Our paper aims at missing this gap, investigating the linkage between national culture and

Corporate environmental proactivity, by using a specific index: the carbon disclosure score (CDS). In order to consider the effects of national culture on organizations, we base our analysis on the GLOBE's cultural dimensions, which give us the possibility to consider more up-to date measures, and also to consider a wider range of values with respect to Hofstede's model.

**Keywords:** Environmental Performance, National Culture values, GLOBE's cultural dimensions, CDS.

## 1. INTRODUCTION

The trade-off existing between achieving an high and sustainable economic growth, and keeping an high environmental standard is nothing new. At the organization level, the environmental protection has become an important issue since pollution and natural resources' depletion represent a wide source of costs. Companies may play a significant role in the reduction of man activities' impact on natural environment also promoting a more ecologically sustainable world.

During the last years the Organizations and Natural Environment (ONE) stream of research has focused the attention on the linkage existing among environmental protection, business management and strategy. One of the main topics of interest indeed is the corporate development of proactive environmental strategy, which ideally represents the last stage of convergence between firms' environmental effort and management practices (Hunt and Aster, 1990). It is defined as a strategy aimed at reducing the environmental impact of firms' activities, and at managing the interface between business and the nature beyond imposed compliance (Sharma, 2000; Aragon - Correa and Sharma, 2003).

A proactive environmental strategy is characterised by the presence of four basic elements (Delmas *et al.*, 2011): a) environmental reporting; b) operational improvements; c) organisational changes; d) regulatory proactivity, all factors connected to a higher attention towards Environmental protection. Some researcher have particularly underlined that the introduction of environmental protection at firm level could be used to reach a competitive advantage. The reduction of inefficiencies and the rationalization in the use of natural resources are important sources of cost reduction, and the environmental attributes of products and services (Orsato, 2006; Porter and Van der Linde, 1995) are used for marketing differentiation.

Across countries, firms do not show the same inclination towards environmental protection, neither towards proactive environmental strategies. Firms are actually conditioned by the different environmental regulations of their home and host (Ambec and Barla, 2006; Majumdar and Marcus, 2001; Rugman and Verbeke, 1998), and by the stakeholders' pressure that they face (Gonzales-Benito and Gonzales-Benito, 2006; Buysse and Verbake, 2003; Madsen and Ulhøi, 2006; Garcés-Ayerbe *et al.*, 2012).

Connected to the last driver, the level of firms' ethical attitude seems to be one of the most important factor of corporate environmental proactivity (Paulraj, 2000; Bansal and Roth, 2000). In presence of strong ethical motivations, related with the 'right thing to do', environmental protection becomes an important matter into organisations. Ethics is related to

values, strictly embedded with both national and organizational culture. National culture has been defined as "...patterns, explicit and implicit, of and for behaviour acquired and transmitted by symbols, constituting the distinctive achievements of human groups" (Kroeber and Kluckhohn 1952, p. 13). It shapes the orientation of individuals to take sustainable initiatives and to translate them into strategic goals and managerial practices.

The most of literature focuses on the effects of cultural values on the broader issue of Corporate Social Responsibility (Ho *et al.*,2012; Parboteeah, 2012; Ringov and Zollo, 2007), while only few studies have specifically analyzed the relationship that occurs between the national culture and the corporate environmental proactivity. In particular, these studies (Park *et al.*, 2007, Husted 2005) employ national environmental indicators, without focus on this connection at organization level.

In order to cover the gap of existing literature, we formulate the following research question:

RQ: Does national culture impacts on corporate environmental proactivity?

The paper is articulated as follows: the first section presents the theoretical background highlighting the main literature on the topic, and develops the hypotheses; section 2 describes the dataset and variables; section 3 presents the result of the analysis, while the last section explores the implications and limitation of the analysis.

## **2. THE IMPACT OF NATIONAL CULTURE ON CORPORATE ENVIRONMENTAL PROACTIVITY**

Cross-cultural studies have analyzed the influence of national culture on company's social responsibility from different viewpoints, employing as their basis Hofstede's (Husted, 2005; Park *et al.* 2007; Ho *et al.* 2012) or GLOBE's ( Ringov and Zollo, 2007; Parboteeah *et al.*,2012) cultural dimensions.

Despite previous analysis used different models, they assumed that the different sets of values, beliefs, attitude and moral, rooted in the national culture drive individuals on their choices and actions. Therefore, national culture is strictly embedded at the corporate social or environmental behaviours and some cultural dimensions are more likely to support these initiatives than the others.

In order to understand how the national culture affects corporate environmental proactivity and, consequently, firms' inclination to implement a proactive environmental strategy, this paper considers GLOBE's cultural dimensions.

The Global Leadership and Organizational Behavior Effectiveness Research Project (GLOBE project) is a multi-phase, multi-method project, involving 62 countries, grouped into ten cultural clusters, in order to analyze in depth their different cultures. Cultural contexts are examined through nine dimensions: power distance, uncertainty avoidance, in-group and institutional collectivism, performance orientation, assertiveness, future orientation, and humane orientation, which explain the different perception and acceptance of leadership within each context (House *et al.*, 2002):

Each dimension is studied at two levels considering both 'as is scores' – that is what middle manager think about their culture in a certain moment – and 'should be scores' – that is what middle managers think about how their culture should change to improve.

We considered GLOBE's dimensions, instead of Hofstede's ones (Husted, 2004) for several reasons. Hofstede includes a more limited number of dimensions, and his model is less up-to-date than the GLOBE project. Having a higher number of dimensions helps to investigate the relationship between culture and corporate environmental proactivity, because of the possibility to include cultural values, which are much related to the inclination towards a proactive environmental strategy. In addition, the GLOBE project has been already used in other similar analysis, even if the investigated variable was not the Carbon Disclosure Score – considered as a proxy of corporates' proactive environmental strategies – but other factors, such as the inclination to support sustainability initiatives (Parboteeah *et al.*, 2012) or sustainability values and performances (Rinkov and Zollo, 2007).

Ringov and Zollo (2007) explore the effects of national culture on environmental performance and use both Hofstede's and GLOBE's cultural dimensions. With regards to Hofstede's dimensions, they hypothesize a negative effect of power distance, individualism, masculinity, and uncertainty avoidance. They found out that power distance and masculinity are significantly negatively associated with firms' social and environmental performance. But they didn't find support for their other hypotheses. In order to verify their hypotheses, the authors repeated the analyses by considering four of the nine GLOBE's dimensions: power distance, uncertainty avoidance, gender egalitarianism (as a proxy of countries' inclination towards femininity), and in-group collectivism (as a proxy of countries' low inclination towards individualism). Once again, they got to similar results: a) Power distance has a negative and significant effect on firm social and environmental performance; b) gender egalitarianism (a proxy for a lack of masculinity) has a positive and significant effect; c) collectivism (an inverse measure of individualism) and uncertainty avoidance do not have any effect on environmental performances.

Parboteeah *et al.* (2012) decided to consider different cultural dimensions and excluded three of the nine GLOBE's dimensions: power distance, in-group collectivism, and gender egalitarianism. According to them, these three dimensions are not relevant to understand sustainability: a) Power distance refers to hierarchical expectation of distribution of power within a society and is not seem relevant to understand sustainability. b) In-group collectivism is also not relevant to understand sustainability as it refers to the degree to which people show loyalty in their family. c) Gender egalitarianism reflects preference for gender roles and is not necessarily relevant to understanding sustainability.

The authors consequently focus on performance orientation, assertiveness, institutional collectivism, uncertainty avoidance, and future orientation. They hypothesize that performance orientation and assertiveness should be negatively related to the inclination towards sustainability initiatives, and that institutional collectivism, uncertainty avoidance, future orientation, and humane orientation should be positively related to it. They thought that the other GLOBE's cultural dimensions did not have any relationship with sustainability. Although Parboteeah *et al.* (2012) decided to focus on specific dimensions, we think that all of them are useful to explain specific values of national culture. Therefore, we decided to consider all the nine dimensions, and to focus on "should be" scores. 'Should be' scores measure how the culture should be according to individuals' wishes. They refers to the future and are consequently useful to understand which kind of relationship exist between culture – meant in terms of values more than behaviours – and specific phenomena, such as corporate environmental proactivity.

Our main hypothesis is therefore:

*H1: Cultural values impact on corporate environmental proactivity, and particularly on carbon disclosure score.*

More specifically, relying on the main literature, we suppose the existence of a linkage between Carbon Disclosure Score and each of GLOBE's cultural dimensions.

Given that high levels of power distance are associated with polarization and low employee involvement in decision-making processes, we expect that power distance do not push towards a stakeholder-oriented approach and is consequently negative related to CDS. On the same hand, Cohen *et al.* (1996) highlight that people from a high power-distance culture are more likely to view a questionable business practice as ethical than people from a low power-distance culture.

Performance- oriented cultures value results, competition, and materialism (House *et al.* 2004), while low-performance-oriented societies focus on harmony with the environment (House *et al.* 2004). We consequently expect that performance orientation is negatively related to propensity to support sustainability initiatives.

Regarding assertiveness, House *et al.* (2004) underline that in assertive societies, people tend to be competitive, value success, and think of others as necessarily an opportunistic way. Such values and beliefs may also encourage individuals to behave in a self-interested and unethical manner to succeed, and consequently expect assertiveness to be negatively related to CDS.

In collectivistic cultures, people rely on membership in groups (e.g., social class, community, religion, and/or family) for identity and status. People's actions are concerned with what is the best for the goals of the group through sharing, cooperation, and group harmony. In this sense, in collectivist society people should be more likely to perceive sustainability as an important societal goal. We consequently expect a positive relationship between institutional and in-group collectivism, on one side, and CDS, on the other.

Future orientation is defined as "the degree to which individuals in organizations or societies engage in future oriented behaviours such as planning, investing in the future, and delaying gratification" (House *et al.* 2002, p. 6). According to the authors future-oriented people are more inclined to strategic planning and long-term strategies and should consequently be positively related to support sustainability initiatives.

Humane orientation is the degree to which individuals in organizations or societies encourage and reward individuals for being altruistic, generous, caring, and kind to others (House *et al.* 2004). In societies with higher humane orientation, people tend to consider others important, and it seems reasonable to expect this dimensions to be positively related to CDS.

Gender egalitarianism refers to women's role within society, and to a society's inclination to accept that women have position of powers and same rights as men. Given the strong influence of different social constructs on this dimensions and also the difficulty to relate it with corporate environmental proactivity, we expect gender egalitarianism to have no influence on CDS. In same way, given the results of both Parboteeah *et al* (2012) and Ringov and Zollo (2007), we expect that uncertainty avoidance is not significantly related to CDS. Actually the possibility to implement environmental proactive strategies requires an inclination towards change which can not be natural in uncertainty-avoidant societies. At the same time, however, the possibility to preserve the environment is a way to preserve

harmony, which is something strongly related to uncertainty avoidance. That is, even from a conceptual point of view, uncertainty avoidance does not seem to have a unilateral effect on firms' inclination towards environmental proactive strategy neither on CDS.

Therefore, consistent with these consideration we hypothesize that:

*H1a: Power distance, performance orientation, and assertiveness are negatively related to CDS.*

*H1b: Humane Orientation and Collectivism are positively related to CDS.*

### 3. DATA AND MEASURES

#### 3.1. Dependent variable

The analysis is concentrated on the evaluation of national culture's effect on environmental proactivity rather than environmental performance.

Considering the complexity of the definition of environmental proactivity, finding an effective indicator is not easy. Christmann (2000) has already revealed that data on firms' environmental practices and the cost reduction due to the implementation of green practices are not available from public and global database.

Previous researches used qualitative measures based on mail surveys of a specific samples of companies or environmental indicators provided by institutional agencies. Others used the presence of EMS as a measures of proactivity.

Consistent with the definition provided by Delmas *et al.* (2011), the measure of environmental disclosure is a proxy of environmental proactivity.

Following these considerations, the paper employs the company's carbon disclosure score (CDS), measured by Carbon Disclosure project (CDP) as dependent variable.

Every year, CDP asks to the Global 500 companies to measure and report what climate change means for their business. During the 2011, 81% (404) of corporations answered to the CDP questionnaire. A score (from 0 to 100) is applied to most of the company responses to CDP, which are assessed for disclosure and performance.

Low CDS (< 50) indicates limited or restricted ability to measure and disclose risks and opportunities that came from carbon emissions. The companies which gain this score show a compliance attitude towards environmental -or more precisely carbon- problems. It does not

indicate poor performance but a low score is assigned to companies that provide insufficient information to evaluate performance and could be considered inactive to climate change. Vice-versa high CDS (>70) indicates a more deep involvement into climate change issue: companies identify into climate change management a tool to reach a strategic advantage.

In this companies “senior management understand the business issues related to climate change and are building climate related risks and opportunities into core business” (CDP,2011 pp.22).

### 3.2. Explanatory variables

This research focalizes the attention on the role of national culture into shape corporate environmental proactivity using the GLOBE project cultural dimensions.

As already highlighted by House et al. (2002), a high correlation exists among the nine cultural dimensions. In order to overcome contradictions, we made indeed a Principal component analysis considering all the cultural dimensions. We got three main components explaining the 73,443% of the variance (Table 1).

*Table 1: Results of PCA: Total Variance Explained*

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2,834	31,491	31,491	2,834	31,491	31,491
2	2,214	24,595	56,087	2,214	24,595	56,087
3	1,562	17,357	73,443	1,562	17,357	73,443
4	,803	8,918	82,362			
5	,585	6,503	88,865			
6	,448	4,978	93,842			
7	,258	2,862	96,704			
8	,160	1,781	98,485			
9	,136	1,515	100,000			

Table 2: Results of PCA: Component Matrix

	Component		
	1	2	3
PD	-,327	,792	,021
UA	-,551	-,402	,591
FO	-,006	-,190	,929
COLLI	,622	,470	,436
COLLII	,241	-,775	,014
PO	,841	,156	,229
ASS	-,466	,563	,323
HO	,578	-,356	,039
GE	,849	,315	-,001

As table 2 shows, each main component is differently correlated with the nine dimensions, and each component is more significantly correlated with some dimensions than others. The first principal component (COMP1) is negatively correlated with Power Distance (PD), Uncertainty Avoidance (UA), Future Orientation (FO) and Assertiveness (ASS), and positively correlated with Institutional Collectivism (COLL I), In-group Collectivism (COLL II), Performance Orientation (PO), Humane Orientation (HO), and Gender Egalitarianism (GE). The most significant correlations are those with GE (+), PO (+), COLL I (+). The three cultural components revealed by PCA are the explanatory variables of the study.

As a result, we formulated our second hypothesis:

*H2: COMP 1 is positively related to CDS*

The second principal component (COMP2) is positively correlated with PD, COLL I, PO, ASS and GE and negatively correlated with UA, FO, COLL II and HO. The most significant correlation are those with PD (+) and COLL II (-). As a result, we formulated the following hypothesis:

*H3: COMP 2 is negatively related to CDS.*

The third component (COMP3) is negatively correlated with GE, and positively correlated to the others. However, it is significantly correlated only with FO (+). As a result, we formulated the following hypothesis:

*H4: COMP 3 is negatively related to CDS.*

We tested our hypotheses through a statistical analysis developed using IBM SPSS 19 Statistic software. The raw sample included 500 companies contacted by CDP report. A screen of the sample has been developed, in order to evaluate the presence and the availability of the necessary data. The final sample includes only those companies that responded to CDP's questionnaire and that distinctly belong to a specific country, which is included in the GLOBE project. It is composed by 362 companies from 28 different countries: Australia, Brazil, Canada, China, Colombia, Denmark, Finland, France, Hong Kong, Germany, India, Israel, Italy, Japan, Malaysia, Netherland, Russia, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, United Kingdom, USA.

### 3.3. Control variables

In order to confirm the relationship between national cultural dimension and company's environmental proactivity, we introduced two control variables: revenues and longevity. The selected two variables had been identified by the extant literature as relevant drivers for firms' environmental proactivity. These are: company's revenues as proxies of firm's dimension (Benito and Benito, 2006); company's age (Hass, 1996; Kolk and Mauser, 2002).

Data have been collected from Businessweek (2011).

## 4. ANALYSIS

To test our hypotheses, we calculated the bivariate correlations between the principal components derived from the GLOBE's dimensions, Companies' Carbon Disclosure Scores, Revenues and firms' longevity (Table 3).

According to our results, the Carbon Disclosure Score is positively but insignificantly correlated with COMP1 (0,081) and negatively correlated with COMP2 (-0,106 *p-value* < 0,05) and COMP3 (-0,220; *p-value* < 0,01). Moreover there is a positive significant correlation between the score and the logarithm of Revenues at 2011 ( 0,206; *p-value* < 0,01) and firms' longevity (0,086; *p-value* < 1,01). As a result H2 is not confirmed.

Table 3: Correlations and descriptive statistics

	Mean	Std. Deviation
CDS	69,65	18,430
REVENUES	23,8472	1,10375
LONGEVITY	87,36	115,214

	COMP1	COMP2	COMP3	CDS	REVENUE S	LONGEVIT Y
COMP1	1					
COMP2	0	1				
COMP3	0	0	1			
CDS	0,081	-0,106**	-0,220***	1		
REVENUES	-0,033	-0,055	-0,123**	0,206***	1	
LONGEVIT Y	0,104**	0,017	-0,092*	0,086*	0,109**	1

Notes: \*\*\*. Significant at 0,01 (2-tails); \*\*. Significant at 0,05 (2-tails) ; \* Significant at 0,1 (2-tails)

In addition, we developed two regression functions (Table 4). The first function considers the impact of cultural principal components on Carbon Disclosure Score, while the second model considers also the effect of the control variables (logarithm of revenues at 2011 and firms' longevity). Results of model 1 show that COMP2 and COMP3 have a negative impact on CDS, with a good level of significance. In model 2, with the inclusion of the control variables, the significance of the analysis increases (R-square=0,100). As a result, H3 and H4 are confirmed. In addition, both company's longevity coefficient (LONGEVITY= 0.07) and Revenues (REVENUES= 2,925) positively affect firms' proactivity score even if the introduction of control variables reduces the effect of principal components on CDS. Thus, statistical analysis demonstrates the effect of national culture on firms' proactivity score, but this effect is moderated by firms' size and longevity.

Table 4: Regression results

Variable	Model	
	1	2
COMP1	1,489 (0,941)	1,517 (0,933)
COMP2	-1,961** (0,941)	-1,795* (0,929)
COMP3	-4,060*** (0,941)	-3,592*** (0,937)
REVENUES		2,925*** (0,851)
LONGEVITY		0,007 (0,008)
Constant	, (0,940)	-0,706 (20,264)
Observations	362	362
R-Squared	0,066	0,100
F-Statistics	8,485**	11,504**

Robust standard errors in brackets  
 \*\*\*. Significant at 0,01 (2-tails); \*\*. Significant at 0,05 (2-tails); \* Significant at 0,1 (2-tails)

## 5. DISCUSSION

The analysis provides evidence that national culture exerts an important role on companies' environmental proactivity.

In particular, COMP 2 is negatively related with CDS, thus in particular is negatively linked to PD, ASS, and less to Institutional Collectivism. In addition, it is positively and significantly dependent on In-group collectivism.

COMP 3 is significantly and positively dependent on FO, UA, and less on Institutional Collectivism. As a consequence, these dimensions have a negative impact on CDS. However, the effect of UA is still difficult to understand, given that it has an inverse effect on COMP 2 and COMP 3, which are both negative related to CDS.

Therefore, hypothesis 2 and hypothesis 3 are confirmed, while hypothesis 4 is not supported because the coefficient is not significant even if is correctly signed.

As a result, according to our analysis, hypotheses H1a and H1b are only partially confirmed. Power Distance and Assertiveness are negatively related to CDS, while Performance orientation impacts only on COMP1, which does not show a significant correlation with CDS. For what concerns H1b, Humane orientation is positively related to CDS, but the weight of

HO on COMP 2 is not high. Collectivism's effects on CDS depend on the contrary on the kind of collectivism. Institutional collectivism has a negative but low impact on CDS, while In-group collectivism has a high positive impact on CDS. That is norms and rules have only a limited impact on firms' inclination to environmental proactivity, while the feeling of belonging to the group and individuals' inclination to consider the group's interests behind the individual ones play a big role.

## 6. CONCLUSION AND LIMITATIONS

Nowadays, environmental problems are receiving more and more attention at firm level. The environmental proactivity is considered an important tool for gaining a competitive advantage by helping to reduce costs or increase differentiation. Although the interest towards firms' environmental proactivity and the drivers of this attitude, only a few contributions are given on the effects of national culture on corporates' environmental proactive strategies. Most of literature focuses on Corporate Social Responsibility, and on Corporate Social Performance. On the contrary, our paper aims at investigating to what extent national culture impacts on Corporate environmental proactivity, by using a specific index: the carbon disclosure score (CDS).

We investigated the effects of national culture, by focusing on cultural values and particularly on GLOBE's 'should be' scores. We decided to use the GLOBE project because it's the most up-to-date model and because it includes many cultural dimensions, offering the possibility to investigate different cultural factors.

We found out a linkage between culture and CDS, but according to our analyses only a few cultural values strongly impact on corporate environmental proactivity: power distance, assertiveness, and in-group collectivism. The statistical analysis partially confirms indeed our main hypothesis about the influence of cultural values on environmental proactivity.

Our analysis contributes to understand the influence of national culture on CDS, and gives several contributions: on the theoretical side, the results open to a deep analysis of the predicted relationship among variables, since different results are presented. It can provide fertile areas for future research as it offers a number of points of departure for deeper considerations.

From a managerial standpoint, the study of the cross-cultural differences could affect the effectiveness of environmental practices at both intra and inter organization levels.

While interesting, our results suffer of important limitations, too. The analysis should consider the industry of firms, in order to verify if the kind of activities affects the linkage

between culture and corporate environmental proactivity. In additions, some dark shapes on cultural dimensions impel the necessity to consider other measure of cultural values.

Nevertheless, the lack of environmental indicators to measure corporate environmental proactivity constitutes the main limitation of this kind of study. The lack of synthetic measure of proactivity can be the cause of the different outcomes within these researches.

Future steps of research will consequently focus on the influence of industries and on further analysis on more reliable cultural and environmental indicators.

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## THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND BUSINESS MODEL CHOICE IN FAMILY FIRMS: IS THERE A MISSING LINK IN FAMILY BUSINESS STUDIES?

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### ABSTRACT.

Although the great attention given to business model in the last years, no contribution has been found with respect to the effects of family corporate governance components (namely, ownership & control, management, family interests & values) on business model choice. This paper provides a theoretical framework aimed at investigating whether any relationship exists between family corporate governance and business model choice. Henceforth, it analyses some preliminary case studies on Tuscan (Italy) wineries in order to test the conceptual model proposed. The empirical cases show that different business model choices are available to family firms. Future studies are needed to generalize results.

**Keywords:** *Family business, Business model, Corporate governance, Family involvement*

### INTRODUCTION

Is there a missing link between business model choice and corporate governance in family firms? In the last decades, scholars have increasingly focused their attention on business model (Lambert and Davidson, 2012) and family business topics (De Massis *et al.*, 2012). Nevertheless, to our knowledge, no contribution so far has coupled the interests belonging to

the two streams of research, neglecting the influence that different family corporate governance components (namely, ownership & control, management, family interests & values) may have on business model choice.

In the literature on business models many definitions have emerged, all sharing the basic idea that a business model (BM) represents the way a firm can create and capture value (Zott *et al.*, 2011). Several authors have explored how BM can allow the firm to better exploit technologies or to obtain superior performance. More recently, researchers are focusing on BM evolution, investigating how firms can reach competitive advantage by innovating and changing their BM (Demil and Lecocq 2010). In explaining firm performance, BM designs have been used with respect to certain industries, but research on them is only at its early stages (Lambert and Davidson, 2012).

On the other hand, family business literature has focused its attention on several strategic management topics such as “*goals and objectives, strategy formulation and content, strategy implementation and control, management and ownership, organization performance*” (De Massis *et al.*, 2012: 8), often comparing these elements with respect to family vs. non-family firms (Zahra *et al.*, 2004).

Although the large number of contributions generated in each field (i.e. the BM and the family business literature), no research has investigated so far the relationships among them. This can be due to the fact that, when speaking about family businesses, scholars often imply the coincidence of the family firm with a specific type of business model, the “family business model”, ruling out *de facto* the possibility that family firms may apply different business models.

This paper wants to address this point and look at possible linkages between the two literatures above mentioned. First, we carry out a literature review both on the streams of business models and family business corporate governance. This helps us to identify the relevant variables to build our theoretical framework. In order to test our conceptual framework, we present our preliminary empirical results derived from a case study research conducted on some Tuscan (Italy) family wine firms. Finally, results, limits and further research are discussed in the last section.

## LITERATURE REVIEW

*Business model*

Academics and practitioners have mainly focused business model's conceptualisation (Teece 2010; Chesbrough 2010). Although a general accepted definition does not exist (George and Bock 2011), it is widely acknowledged that a BM explains how value is created and captured by firms (Amit and Zott 2001; Davey *et al.* 2011; Johnson *et al.*, 2008). The recent literature review by Zott *et al.* (2011) has stressed the need to consider the BM as a unit of analysis, distinguishing it from other related concepts such as 'strategy' and 'tactics' (Magretta 2002; Zott and Amit 2008). Moreover the analysis of BM's dynamics is still scant (Willemstein, Van der Valk and Meeus, 2007; Demil and Lecocq 2010; Johnson *et al.*, 2008). For our purpose, we adopt Pucci *et al.* (2013)'s definition: "*a business model is a systemic representation of the combination of strategic, organizational and technological firm's activities, of the way they shape firm's relationships within its reference context and of the relating financial structure, with the scope of explaining how the firm is able to create and capture value*". This definition allows us to define the three activities and decision blocks, namely business strategy, business organization and technology management constituting a BM. Lately, attention has been given to BM designs. Amit and Zott distinguish four business model designs, namely the 'efficiency, aimed at achieving transaction efficiency, 'complementarities', based on the bundling of goods, activities, resources, or technologies, 'lock-in', aimed at retaining stakeholders, and 'novelty', referred at new ways of conducting exchanges, ones (Amit and Zott, 2001; Zott and Amit, 2007). In the same vein, but using Porter's generic strategy and two variants, Chatterjee (2013) distinguishes 'efficiency-based', 'perceived-value based', 'network value, or loyalty-based", and 'network efficiency based' types of BM designs. Pucci *et al.* (2013) also suggest three ideal types<sup>12</sup> of BM, namely 'new product development oriented' BM, 'organizational processes efficiency oriented' BM, and 'marketing management oriented' BM, that result from the intersection of the three different activities and decision blocks of a firm.

Moreover exogenous (e.g. social and institutional environment, type of sector where the firm operates, market trends), as well as endogenous factors to the firm (e.g. firm's

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<sup>12</sup> Baden-Fuller and Morgan (2010) suggest that, when referring at business model concept, researchers should not use neither the terms 'types' (and consequently, 'typology') or kinds (and consequently, 'taxonomy'). They argue that a more appropriate term is that of Weber's 'ideal type'. In fact, "*the ideal type concept will help to develop our skill in imputation in research: it is no 'hypothesis' but it offers guidance to the construction of hypotheses. It is not a description of reality but it aims to give unambiguous means of expression to such a description*" (Baden-Fuller and Morgan, 2010: 161).

dimension, degree of district or cluster embeddedness, firm life cycle) have been identified as influencing the BM ideal type adopted (Osterwalder *et al.*, 2005; Pucci *et al.*, 2013).

A separate focus concerns the relation between corporate governance and BM. As anticipated, the majority of studies on BM have focused on strategic management aspects (Zott *et al.*, 2011). Only sporadically, the proprietary level (ownership and control) is considered as one of the BM components (Donath, 1999; Morris *et al.*, 2005, Tikkanen *et al.*, 2005). Coherently with most of the literature and the definition here adopted (Pucci *et al.*, 2013), in this paper the corporate governance is considered as a factor endogenous to the firm which could influence the business model choice, but is not integral part of the BM structure.

#### *Corporate governance in family firms*

Many definitions of *family business* can be found in literature (Carr and Sequeira, 2007; Miller *et al.*, 2007; Dematté and Corbetta, 1993; Corbetta 1995; Songini 2006). In this paper, we adopt Chua *et al.* (1999)'s definition where "*the family business is a business governed and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families*" (Chua *et al.*, 1999:25). Moreover, we suggest that family involvement should be taken into consideration during family businesses analysis, family involvement being one of the factors that mainly differentiate among family firms (Astrachan, Klein and Smyrniotis, 2002).

Astrachan and Shanker (2003) use three levels of family involvement to develop as much operational definitions of family firms: 1) a broad definition includes firms with some family participation in the business and control over its strategic direction; 2) a mid-range definition includes those cases in which the founder or descendant of the founder is involved in the day-to-day operations and intends for the business to remain in the family; 3) the narrowest definition includes only those businesses in which multiple generations of family members are directly involved in the day-to-day operations.

In the family business literature, corporate governance has been studied from different perspectives. Four theories are the most referred (Gubitta and Giannecchini 2002; Siebels *et al.* 2012): the agency costs theory, the stewardship theory, the resource based view and the new theory of property rights.

According to the agency (costs) theory (Jensen and Meckling, 1976), there are opportunistic behaviors between the agent, which represents the management and the principal, who coincide with the ownership. The separation of the management from the ownership causes agency costs such as free-riding and shirking costs and creates information asymmetries. Principals can reduce these problems controlling and monitoring agent's conduct or through incentivizing mechanisms. Jensen and Meckling (1976) suggest that agency problems can be reduced by making the owners directly participating in the management of the firm, that is owner-managed firms have lower agency costs. A study conducted by Schulze et al. (2001) shows that privately held, owner-managed firms are exposed to agency threats, originated by personal rivalries and self-control problems. Applied to the family firms this translates into asymmetric altruisms and self-control problems of the parents which make family managers behave as agents. Agency problems might not exist in the case of a sole family owner-manager, but they can exist in the presence of many family managers and a principal owner (Chrisman et al., 2007). In order to overcome these agency problems, Chrisman et al. (2007) suggest family managers should be monitored and given incentives through compensation.

Alternative to agency theory, the stewardship theory suggests that *"family managers, regardless of ownership, will generally behave in the organization's best interest... [due to] subordinate personal goals to family goals"* (Chrisman et al., 2007: 1030). Supporters of this perspective argue that, in a firm with a stewardship culture, competitive advantage can arise from collectivistic attitudes, psychological commitment, and trustworthy behaviors (Eddleston et al., 2012). Agency and stewardship theories refer to the role of managers in achieving firm goals, but differ in their assumptions about the motivations of managers (Chrisman et al., 2007). According to the agency theory, owners and managers have conflicting goals, while from a stewardship perspective, family managers are intrinsically inclined to value owners' interests as much as their own (Chrisman et al., 2005). To sum up, if on the one hand agency theory focuses on the importance of monitoring and control, on the other the stewardship perspective relies on participation, long-term orientation and the importance of building a skilled human capital (Eddleston et al., 2012).

Another relevant theoretical reference is the resource based view, which stresses how family business owns a unique bundle of resources, referred as the *"familiness"* (Habbershon and Williams, 1999), deriving from the interaction between the family and the business. Family business resources alone are not able to build a competitive advantage: they need to

be strategically managed. Sirmon and Hitt (2003) identified four family business resources, namely 'human capital', 'patient capital', 'social capital' and 'survivability capital'. The authors add to these latter the governance structure as a further resource that can lead to competitive advantage.

Finally, the new theory of property rights (Gubitta and Giannecchini, 2012) is a new perspective applied to family business literature and defines a governance model on the basis of three main factors. First of all, the managerial team is selected on the basis of managerial skills and identity; then, it is important to involve non-family members in strategic decisions and governing boards; finally, the contractual incompleteness deriving from the inability to define beforehand all the duties and actions, is filled by trust. Gubitta and Giannecchini (2002) assert that *"in family business, governance receives the family imprinting and becomes a synthesis (sometimes a compromise) between the family values and the business rules, reflecting all of the critical steps in organizational development: the delegation process of managerial activities and the creation of a managerial style, the involvement of the family members in the management bodies, the entrepreneurial succession process, and the opening of equity capital to third parties"* (p. 278).

As suggested by the aforementioned considerations, family corporate governance is a multidimensional concept, whose analysis is influenced by different theories and perspectives. Since we recognize that each one gives a specific contribution to a deeper understanding of the topic, this paper integrates all these perspectives in defining the family corporate governance components.

## **THEORETICAL FRAMEWORK**

From the literature reviewed two main considerations emerge. On the one hand, business model literature is shifting its attention from definitional problems to a "taxonomy\typology" of business models designs (Amit and Zott, 2001; Chatterjee, 2013; Pucci et al., 2013; Zott and Amit, 2007). Despite that and to the best of authors' knowledge, a classification of BM has not been applied yet to family firms whose BM has been considered so far as a "black-box" and "homogenous" across firms. On the other hand, despite the many theoretical perspectives, an holistic framework is missing in family business literature, which defines a clear typology of corporate governance and their related determinants. This article develops a theoretical framework aimed at "connecting the dots", that is we look at whether different family corporate governances, influenced by the different level of involvement and participation shown by the family, affect the BM choice.

We adopt the three more general business model ideal types developed by Pucci et al. (2013):

1) New Product Development-oriented BM (NPDo): this configuration results from the firm's knowledge application and its capacity of accessing and exploiting new external knowledge (Gilsing, Lemmens and Duysters 2007; Markard and Truffer 2008) in a continuous counterbalance between technological activities of exploitation and exploration (March 1991), coherent with the firm's strategic vision. This ideal type stresses a diversification strategy through the introduction of new products \ services;

2) Market Management-oriented BM (MMo): this results from the combination of firm's own assets and resources, activities configuration and supply chain management in order to better satisfy its customers, exploit better existing markets or enter new markets, establishing more innovative and efficient relationships with them (Kohli and Jaworski 1990). Firm focuses on strengthening internationalization processes, on researching distribution channels or retail efficiency or on enhancing communications strategies;

3) Organizational Processes-oriented BM(OPo): this ideal type results from the focus of the firm in exploiting internal (complementary) resources and competences or implementing relationships with partners in order to improve efficiency in terms of both technology applied to processes and transaction costs savings due to the synergies that arise from coordination/integration, learning and reconfiguration of firm's processes (Teece, Pisano and Shuen 1997; Williamson 1981).

The aim of this paper is to understand whether the family corporate governance can have an influence on the business model choice. On the basis of the literature reviewed, and specifically integrating the agency (cost) theory, the stewardship theory, the resource-based view and the new theory of property rights, we defined family corporate governance as made by three components: the "ownership & control", the "family interests & values" and the "management". These components derive from the main theories behind corporate governance depicted by the literature reviewed.

*Ownership & Control.* The ownership & control dimension refers to who owns and controls the firm. Ownership is defined as "voting shares or voting power over a trust" and "when the parent or parents own 50% or more, they are considered in control" (Ward and Dolan, 1998:305-306). In literature several ownership configurations exist, but one of the most popular describes the three stages of the ownership evolution: the owner managed, sibling

partnership, and cousin consortium (Gersick et al., 1997). As generations inherit the business, the ownership can be further divided and this can lead to a more difficult control of the family business. Moreover, it can happen that during the succession process, an heir sells its share. This component is affected by both the RBV and the new theory of property rights.

*Family interests & values.* The family interests & values are derived from the stewardship theory.. Miller et al. (2008) suggest that stewardship manifests itself in three forms in the family-owned business: assuring continuity, creating a community and creating a strong connection. Continuity refers to the willingness to assure longevity of the firm (Siebels et al., 2012), and it is revealed by an emphasis on research and development of new offerings, attention to the business reputation and emphasis on increasing the market share (Miller and Le Breton Miller, 2005; Miller et al., 2008). Community relates to the creation of a collective corporate culture through employee training, giving to employees broader jobs and more responsibilities, creating a flexible, inclusive structure. This leads to the fact that people will be more motivated to stay in the firm for longer. Connection refers to the building of strong connection with external stakeholders that can help the firm. It is disclosed by a personal oriented approach to marketing and a narrowly targeted group of customers.

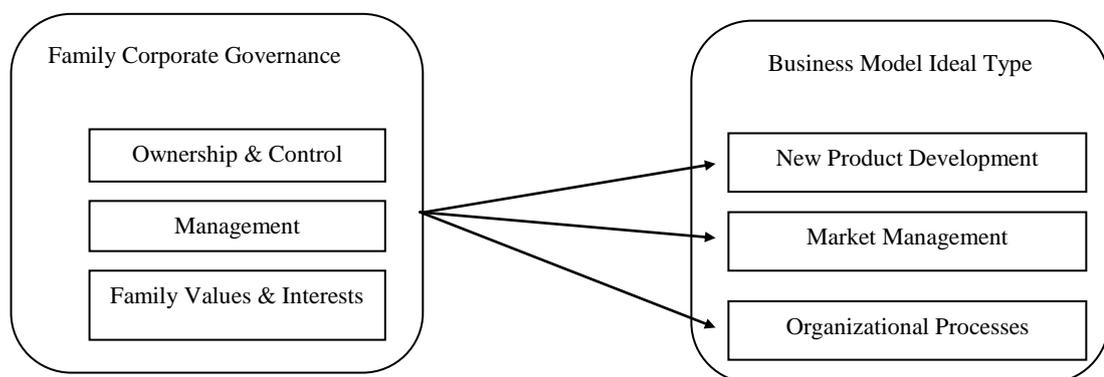
*Management.* The management dimension is particularly linked to the agency theory. According to the agency theory, in family firms the owner is the principal, and the manager is the agent. If the family firm has a sole family owner-manager, no agency costs exist: there is an alignment between principal-agent goals. Once the management is not on the sole owner, two situations can be drawn: the management is given at and \or shared with another family member; the management is given at and \or shared with non-family members. In the first case, if high trust and shared values exist among family members, unlikely create problems. On the other hand, agency costs arise in case of conflicting goals in the family, or from opportunisms or self-control problems. In the case of non-family members, agency costs exist, but can be mitigated by monitoring and incentives. We propose three main structures of the management dimension: a close structure when only family members manage the family business; a mixed structure when both family and non-family members are involved in the management; an open structure when only non-family members manage the family business. These three structures are quantitatively measurable through the percentage of the family members over non-family members.

Increasing attention has been given by literature on the so called “professionalization” of management phenomenon (Chua et al., 2012; Dekker et al., 2013;

Kline and Bell, 2007; Perren et al., 1999; Songini, 2006; Stewart and Hitt, 2012). The adoption of a professional style of management can depend on: (1) the generation in charge (Beck et al., 2011; Klein and Bell, 2007); (2) the absence of qualified family members who want to be involved in the management (Chua et al., 2003); (3) the occurrence of a critical event, such as marriage, divorce, childbirth, employment, retirement and death (Aldrich and Cliff, 2003).

Literature distinguishes three main ways for professionalizing family firms (Dyer, 1989): (i) by professionalizing the members of the owning family; (ii) by professionalizing the non-family employees currently working in the business; (iii) by bringing in outside professional management talent. Due to the evolutionary and incremental changes of the first two types, literature has more focused on the last one: employing one (or more) non-family manager(s) is considered in fact a revolutionary and disruptive change in doing business (Dyer, 1989).

In line with these contributions, in this paper we consider the “outside-in” professionalization of management. We suggest that family corporate governance influence the choice of a business model ideal type (figure 1).



**Figure 1:** *Conceptual framework*

## EMPIRICAL FINDINGS

The sector studied is that of wine. This choice relies on two main motives. First, the wine sector is largely considered a low tech-, traditional sector. Business models have been usually studied in high tech sectors. Second, the majority of wineries are family businesses, often long lasting family businesses. In table 1 the wine family businesses interviewed are depicted. Due to difficulties in finding completely open managed family business, and this is one of the limitations of the study, we present here only close and mixed management structures.

		Management	
		Closed	Mixed
Business Model	NPD	DarComp	PonComp
	MM	TempComp	PriComp
	OP	BerComp	FreComp

**Table 1:** *Family Business analyzed in Tuscany*

“DarComp” is a start-up company. The owner, Angela Dar, is a young family entrepreneur who is developing a NPD-oriented BM, overcoming the old type of production mainly focused on bulk wine and cost efficiency. The production is going to change, increasingly focusing on bottling of high quality wine through a new organic production and on the construction of a new winery. The firm is trying to improve the innovation process in two ways: by using her father’s companies’ complementary assets (Dar family owns many firms) and by creating synergies with local actors (other firms and the Chianti Classico Consortium; connection with a university to develop new agronomic and productive knowledge). “DarComp” is at its early stage, but the owner knows the company’s strengths will rely on product differentiation and diversification, looking at new wines, such as rosé or sparkling Chianti Classico. This company is a synthesis of tradition and modernity. Tradition since the family values and interests have been transmitted from the first- to the second-generation. Modernity since the first generation has recognized the need of leaving part of its control and ownership to the next-generation, so that the younger family member can become an entrepreneur and build her own company.

“TempComp” is a small company completely family managed. The owner, Leo, began to run the firm in 1992, succeeding to his father. To date, the firm is run by Leo, his wife and an employee who is sitting-by-Leo in order to learn the secrets of wine making. Family values and interests rely on the importance of maintaining the property, but overall

Leo wants to be useful in boosting local development and he is responsible of a local wineries' association. Leo has constantly invested in both production efficiency and research, but today his main concern is about marketing. In 2004 Leo funded a research which made him discovering the characteristics of a unique winegrape, the tempranillo, available since centuries only in the small municipality of San Miniato, a small town near Pisa. but at those times not officially recognized by the Chianti's Production Regulation: Leo uses the tempranillo vine variety in implementing the yield of his vineyard. Tempranillo is suitable for certain types of soil where Sangiovese, the main wine grape used in producing Chianti, yields worst. The main resource in the family business is Leo's wife, the marketing manager. According to Leo, although the quality of wine is important, communication and promotion are to date the most important and fundamental strengths of the family firm: *"In this moment, the most important thing is the communication [...]. To sell directly wine to final consumer is difficult and limited to those living near the winery. However, it is important to know the importers outside Italy and we travel a lot going with them to their clients. Moreover, the web through its social networks, is disruptively changing how to sell "*.

"BerComp" is one of the family companies owned by Dar family. Dar are two brothers and possess three companies: a digger company, the core family company, a green-service company that focuses on providing services to local wineries such as planting vineyards, and "BerComp", a winery. The business model applied by "BerComp" is the OP-oriented BM. In fact, the family business focuses on reaching organizational process efficiency by using the other family companies' complementary assets. The company's value offering has by far consisted in cask wine and bottled wine. The family interests pursued are linked to the willingness to grow and make synergies among proprietary assets. In particular, as the "DarComp" case has shown, the first-generation entrepreneurs are willing to make second-generation responsible for their own business, leaving it the control of part of the assets owned.

At the end of 2011 the brand "PonComp" and the main factory in Tuscany were bought by a US corporation, while the vineyards remained under the control of LMN family. This brand, founded at the end of XIXth century, represents part of the history of the Italian oenology. The firm has been controlled since 1910s by LMN family which has been the pioneer in the export of Chianti wine in the world. The family interests rely on maintaining the ownership on the estates, but at the same time to preserve the family values of attention to traditions and to social environment. Recognized its limits, the family gradually left the

management to non-family members and, at the end, decided to sell the brand. In doing this, however, it made sure of sharing its values, founded on continuous innovation in the respect of tradition, with the new management.

“PriComp” belongs to DEF family, an Italian aristocratic family. The estate “PriComp” belongs to DEF since XV century but until 1980s, the family did not manage the firm, since DEF family had numerous estates and was not able to be physically present in each of them. Since 1981, due to succession motives, Pri DEF became the owner and the manager of “PriComp”. In early 1990s, Pri made process innovation investments in order to minimizing risks and costs. Although wine remains the core product, more recently, “PriComp” has diversified its activity through farm holidays services. Moreover, since the end of 2011, a non-family export manager has been responsible for marketing activities and management. To date the company is present on more than 60 countries and it is mainly pursuing a market management oriented business model. This is well expressed in Pri’s words: *“Today the strength is in the export. [...] The priority is to reach the North Star. Once the organization has been stabilized, goals and priorities are focused on the promotion and the extension of the selling network and countries”*. The values and interests of the family rely on the preservation of the estate and on giving the family imprinting to the products. What is important is the way the owner is able to find new products rooted in the tradition. It is the owner who decided, although he is helped by external managers. Managers are like football players. The owner is their coach.

GHI is one of the oldest Italian aristocratic families. GHI’s winery “FreComp” story began in 1950s when Pluto, second-born of Sempronius, became the family leader and manager of the agricultural and wine production. The decision of dividing the managerial part from the property has been done in light of future succession. Two separated entities were created: “GreComp” ed “FreComp” (totally owned by “GreComp”). GHI family still owns and controls the wine family business. A mixed participation of family and non-family professional members in the management of the company is in course. The business model pursued by the family business is a OP-oriented BM. “FreComp”, in fact, diversifies its value offering providing both multiple wines and also services (several restaurants and wine bar has been open around the world), but its main concern is to assure a guaranteed income for the family shareholders. This is pursued with the effort in consolidating the company’s position. GHI family is interested in shared comparison and evaluation among all family members. Its values rely on the willingness to maintain separated the real estate used by the

industry from the individual personal properties. These motives lead the owner to introduce succession pacts.

The cases presented show that different family corporate governance structures exist for each business model ideal type, but a deeper investigation is required in order to understand possible patterns among them.

## **DISCUSSIONS AND CONCLUSION**

This paper proposes to investigate whether a missing link exists between business model choice and corporate governance structure in family firms' studies. The connection has been neglected on the one hand by the business model literature, which considers the corporate governance as integral part of the firm's business model; family business literature, on the other hand, has completely bypassed business models conceptualization, identifying the family firm as a business model in itself and focusing its attention on ways to capture and create value depending on intrinsic characteristics of the family business.

We draw on evidences emerged in the two streams of literature, i.e. the business model and the family business fields of research, and integrate them with the different types of governance structures that can characterize a family firm. In this way we provide two main contributions. On the one hand, at the theoretical level we conceptualise that different business models can be linked to different family corporate governance structures. On the other hand, the empirical cases, although not complete since we have not been able to find open management, provide a first qualitative support of the model proposed, in view of a wider international comparative analysis. Moreover, to our knowledge, this is the first study applying business models concepts to the wine sector. As suggested by the case studies provided, different business model choices are available to family firms. However this work represents the first step of a wider research project and further evidences must be provided in order to validate our proposal. Future research shall be able to look at patterns between business model choice and family corporate governance, and possibly to link them to family business performance. The theme merits further developments, as it should be of interest for both academics and practitioners.

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## THE ROLE OF ART IN LUXURY MANAGEMENT

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### ABSTRACT

Our overall goal is to examine the nature of this relationship between art and luxury brands, particularly the similarities, differences, complementarities or conflicts between the different modes de liaison linking art and luxury brands. By mode de liaison we refer to the type and nature of the relationship between an artist or an artistic event and a luxury brand.

The data come from the study of publicly available data from companies who are members of the Comité Colbert in France and the Altgamma Association in Italy. . It is considered that both countries represent up to 55% of worldwide luxury goods sales, and it was therefore logical and reasonable to focus on luxury brands from these two countries.

A careful study of the artistic initiatives of each member brand in the two associations allowed for the identification of four modes de liaison between luxury brands and arts. These four modes de liaison are: artistic mentoring, business collaboration, foundations, and patronage.

The research demonstrates that luxury brands are seeking to transfer the distinctions they convey towards a set of inimitable values by migrating to a more sophisticated and more elitist ensemble of codes, and that art is ideally suited to this migration, because its access is complex and its understanding difficult for outsiders. Art de facto moves the exclusivity associated with luxury to a higher, more inaccessible level and more difficult for competitors to copy.

**Keywords:** Arts, Brand management, Luxury goods and services, Art and Luxury

### 1. INTRODUCTION

Over the last twenty years the market for luxury products and services has grown dramatically with an estimated sales of more than 200 billion Euros in 2012 representing an increase of +7% over 2011, and forecasts of 250 billion Euros in 2015 (Kapferer and Bastien, 2009; Altgamma, 2012). The evolution of some companies is even more impressive: For instance, in 1977 Louis Vuitton was a family business with sales of 10 million Euros but nowadays invoices €6 billion per year.

During the same timeframe art has become a major component to this evolution because art allows being out of the ordinary (Fillis, 2010) at a time when the proliferation of signs, commoditization and massification of luxury (Nueno and Quelch, 1998; Thomas, 2007) require luxury brands to distinguish themselves from and beyond the mere product. As stated by Patrick Thomas CEO of Hermès<sup>13</sup>: "*... I am wary of the paradox of luxury: The more one is desired, the more one grows, but the more one grows, the less desirable*".

While the worlds of art, fashion and luxury are growing closer together every day, a key question which thus arises is the need to better understand the links between art and luxury brands.

Within this context of mutual enrichment between art and luxury brands, we examined the diversity of the relationships which can exist between luxury brands and art because a clarification of these relationships could expand knowledge in luxury brand management including its strategic dimension (Riezebos, 2003; Berthon *et al.*, 2007).

## 2. ANALYSIS

We have chosen to study the links between art and some of the main French and Italian luxury brands. For historical reasons, these two countries represent the largest portion of the world's luxury goods. The data come from the study of publicly available data from companies who are members of the Comité Colbert in France and the Altgamma Association in Italy. These two associations unite most of the key players in the luxury field in each country, with very strict membership criteria. Moreover, membership is by co-op nomination, providing a guarantee for brands who are already members that any new members will uphold the standards in place. Alone, the 75 luxury houses of the Comité Colbert hold a quarter of the global luxury goods market with a turnover of 39 billion dollars and 115,000 employees in France.

We have identified a total of 152 luxury brands, either product- or service-oriented, of which 76 are members of the Comité Colbert while 76 are Altgamma Association members<. Then, for each of the remaining brand we researched if they were engaged in any initiatives connected to the arts. Table 1 summarizes the data resulting from this analysis.

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<sup>13</sup> Feb. 2011

**Table 1: Analysis of the number of luxury brand members from Altagama or Comité Colbert and their involvement in artistic initiatives.**

	<b>ALTAGAMMA</b> in number of companies	In %	<b>COMITÉ COLBERT</b> in number of companies	In %
Total number of brands who are members of the association	76	100%	76	100%
Of which are not luxury goods or services-oriented or are redundant	14	18%	13	17%
Total number of luxury brands	62	82%	63	83%
<i>Of which have no specific arts-oriented linkages</i>	26	34%	32	42%
<b>Total number of luxury brands with arts-related actions</b>	<b>36</b>	<b>47%</b>	<b>31</b>	<b>41%</b>

67 luxury brands representing 44% of all the brands member of both organizations are engaged in an action related to the arts. This percentage rises to an average of 55% (58% for members of Altagama marks and 49% marks for the members of the Comité Colbert) of all the luxury brands which are member of the two associations, i.e. more than a luxury brand has developed some systemically institutionalized link with art.

In a second phase, we looked at which brands were connected to which arts-related initiatives.

A total of 106 links between luxury brands and art have been identified (52 for Altagama members and 54 for Colbert members). This figure is higher than the number of luxury brands involved in arts because one brand may intervene in one or more artistic fields. For instance Gucci is offering some patronage, artistic collaboration too and also created a foundation. In the same vein Cartier has a foundation and is also patronising some artists.

A careful study of the artistic initiatives of each member brand in the two associations allowed for the identification of four modes de liaison between luxury brands and arts. These four modes de liaison are: artistic mentoring, business collaboration, foundations, and patronage. Table 2 synthesises this information:

**Table 2: Categorisation of the links between luxury brands and art**

	<b>ALTAGAMMA</b> <i>in number of companies</i>	<i>In %</i>	<b>COMITÉ COLBERT</b> <i>in number of companies</i>	<i>In %</i>
<b>Number of arts-related initiatives made by these luxury brands</b>	<b>52</b>	<b>100%</b>	<b>54</b>	<b>100%</b>
<i>Of which:</i>				
<b>Artistic collaboration and commercial creations by artists</b>	25	48%	18	33%
<b>Patronage</b>	18	35%	21	39%
<b>Foundations</b>	7	13%	8	15%
<b>Support to creation and artistic mentoring</b>	2	4%	7	13%

### **3. INTERPRETATION: : ABOUT THE CONSUBSTANTIALITY BETWEEN ART AND LUXURY**

From a traditional perspective, luxury is made even more luxurious because it is unavailable to everybody else (Wetlaufer, 2001; Silverstein and Fiske, 2003).

However, this traditional vision clashes with significant evolution in the luxury universe (Wiedeman *et al.*, 2007) over the course of the past fifteen years, characterized by two complementary factors.

The first factor is the growing potential of an upper-middle class who is achieving a certain level of financial comfort, particularly in developing countries. This upper-middle class now possesses resources and can tap into a financial surplus which may easily be reutilised in purchasing products with strong symbolic value – luxury products – thus permitting them to move from financial comfort to true social recognition.

The second factor is the recent emergence of true multi-national luxury companies – such as LVMH, Kering, Richemont – which due to their size and their economic visibility (stock value for example) self-generate their own need for steady sales and profitability growth; even if they are not willing to recognize it as such.

The conjunction of these two factors in some ways makes the traditional luxury model (based on rather drastic management of rarity with price as a major adjustment variable) obsolete.

For this reason, luxury brands seek to transfer the distinctions they convey towards a set of inimitable values by migrating to a more sophisticated and more elitist ensemble of codes, more difficult to understand by external stakeholders.

Art is ideally suited to this migration, because its access is complex and its understanding difficult for outsiders. Art de facto moves the exclusivity associated with luxury to a higher, more inaccessible level and more difficult for competitors to copy.

As stated by Fillis (2011), *“Today’s business realities have impacted heavily on the arts”* and a large number of companies in the luxury sector use art to increase their brand’s notoriety at the international level. The more luxury brands democratise themselves, the more they need art so as to preserve a certain distance with the non-luxury world, and thus maintain a distinct image and thereby source of creating value and margin.

Art is less an object for advertising communication than luxury brand’s vehicle for luxury itself. Its introduction brings about interference within borders and hierarchies resulting in luxury consumers seeing themselves elevated to the ranks of art amateurs. As such art introduces a contribution of symbolic and aesthetic values destined to neutralise risks from the industrialisation of luxury. Using art to create a dramatic setting at the heart of a luxury brand contributes to the metamorphosis of the merchandise’s profane character into sacred value.

The relationship between art and luxury is thus proportional to the increasing ease of access to luxury products and services, as the essence of the luxury brand exists much more by the distancing environment and experience it creates, promotes, and maintain.

In this manner, the juxtaposition of a luxury brand with arts allows a company to generate a long-lasting sustainable competitive advantage and make the luxury brand model difficult to copy due to its idiosyncratic nature, and because it is a powerful generator of causal ambiguity (Weick, 1976; Orton and Weick, 1990). When the bonds between arts and a luxury brand are so intense, it becomes impossible to determine if art is in and of itself a source of competitive advantage, or if the results it generates are not themselves the origin of the luxury brand’s perceived values.

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## THE GOVERNANCE OF 'COLLECTIVE' STRATEGIES FOR INTERNATIONALIZATION: SMALL BUSINESSES IN THE ITALIAN WINE SECTOR\*

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### ABSTRACT

The Italian wine sector is dominated by small businesses, which due to reduced demand for domestic consumption, are required to access international markets for survival and growth. By virtue of their limited size and the consequent scarcity of resources, inevitably, the feasibility of collaborative strategies on the part of the various manufacturers - not always facilitated by profound differences - has to be evaluated.

Our study therefore proposes to investigate in the first instance whether it is possible to successfully activate 'collective' strategies of internationalization for small wineries and, secondly, to define what the main factors of cohesion in such collaborations might be. The research, in particular, has focused on the case study of the 'Enoteca Provinciale di Salerno', chosen because it works as a relationship facilitator in a territory which has at the same time both much in common with many other areas (as concerns the fragmentary nature of wine production) and differences compared to many other areas (in terms of wealth of tourism, sightseeing, history, and culture in general).

The study attempts to demonstrate that collective strategies of internationalization for small wineries are not only possible, but also far-sighted, as in the case of the 'Enoteca Provinciale di Salerno'; in addition, one of the most important factors of cohesion is the promotion of the territory in general, with relevant implications, both scientific and managerial. The research, of an exploratory nature, provides interesting insights for further contributions as a follow-up to empirical research, already in progress, on the population of the wineries, members of the Enoteca.

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\* This paper is the result of a collaborative study on the part of the authors. More specifically, the paragraphs "Introduction", "Networks of Relations in the Internationalization of Small Businesses", "The Connector in Internationalization Networks" and "Research Objectives and Methodology" are the work of Maria V. Ciasullo; while the paragraphs "The Case Study of Enoteca Provinciale di Salerno", "Research Results, Implications and Developments" and 'Conclusion' are the work of Giuseppe Festa.

**Keywords:** Wine sector - Small business - Internationalization - Wine marketing - Terroir - Collective strategies - Network - Support services.

## INTRODUCTION

In wine markets, if on the one hand increasing sales (at least for Italian wineries) on foreign markets (Mele and Russo Spina, 2008) is inevitable, on the other, it is of paramount importance to define collaborative forms of cooperation in order to survive and compete within the scenario of international dynamics of wine production (Chetty and Wilson, 2003; Green et al., 2003; Dana and Winstone, 2008; Muecke, 2008).

The steady reduction in domestic consumption of wine, in fact, has pushed Italian wineries to take into account the internationalization of their products. Exporting, is no longer considered an opportunity, but a real necessity (Italy, in fact, exports more than 50% of its production - Ismea, 2013). This state of affairs however is not immune to problems, both in quantitative and qualitative terms.

As concerns *quantity*, Italy remains the first exporting country in the world for quantities (millions of hectoliters) while for values (millions of euros), Italy is second only to France (Ismea, 2013). However, in recent years the country has had to face a more aggressive policy on the part of other countries, especially those of the New World, and continental Europe (Spain in particular). As regards *quality*, Italy is historically linked to its numerous *ampelographic* varieties, declined in infinite combinations with each *terroir*, making it extremely complicated to recognize Italian wines abroad.

With international competition in mind however, it is as well to remember that continental Europe (Italy in particular; perhaps with the exception of France) has never shone for marketing capabilities on the wine markets, contrary to the New World, which is much more proficient in the promotion of its products (Resnick, 2008). The delay, in the case of Italy, can most probably be traced to the infinite variety above mentioned, together with the poor – often completely absent – capacity for aggregation between companies (Raimondi, 2004; Cesaretti et al., 2007).

On the other hand, the New World, in order to overcome the lack of a solid albeit antique winemaking tradition (at least compared to Italy and France for example) has imposed on

international markets, thanks to decisive marketing capacities, a taste defined as 'international', based mainly on the 'drinkability', often of good quality, of the *allochthonous* grape varieties (now also defined 'international'), such as Merlot, Cabernet Franc, Cabernet Sauvignon, Syrah, Pinot, Chardonnay, Sauvignon Blanc, often not contextualized within a specific *terroir*.

Therefore, the strategic opportunity of success of Italian wines on international markets would seem to depend on the following trade-off: a focus on the aggregation of wineries, dropping the identity of often unique products, both in terms of quality and personality, achieving scale and / or experience economies; a focus on the extraordinary wealth of the *ampelography* (varieties and clones) and the geography (denominations and *terroir*) of the national wine heritage (Rea & D'Antone, 2010) difficult to communicate because hyper-fragmented but at the same time fundamental. Investing in the enhancement of national wines inevitably means managing complex micro-productions characterized by the following structural constraints:

- small size of most firms, which leads to the necessity for reflection on the specific features of small businesses, particularly with regard to the lack of adequate financial resources and managerial skills;
- consequent fragmentation of the sector;
- intrinsic differentiation of the offer, at the same time both strength and weakness of small wineries (Corrado & Odorici, 2009);
- consequent poor control of distribution channels, due to lack of strong bargaining power in the hands of producers in the light of such limited dimensions;
- entrepreneurial individualism, result of short-sighted pride, characterized by mistrust and the reluctance to establish strong relationships with a collaborative working valence (Rossi, 2008). Some authors believe that the main element of competitive discrimination resides particularly in cognitive and cultural aspects (Zanni, 2004): in Italy, as often happens, an entrepreneurial structure, characterized by a generalized overlap between proprietary and managerial functions, together with the highly centralized and autocratic character of the entrepreneur, is oriented towards production rather than towards strategic, managerial and commercial components and therefore often unable to acquire the knowledge, skills and experiences, necessary to support adequately the dynamics of company development.

Given the relative scarcity of resources and the physiological aversion to engage in collaborative strategies of development, wineries often find themselves in difficulty as concerns planning, on the sole basis of internal forces, their lines of expansion into foreign markets. Internationalization in the strict sense of Italian wineries is generally limited (Pomarici and Boccia, 2007), while other authors (Mastroberardino, 2002; Zanni, 2004; Zaghi and Troilo, 2006) believe that the competitiveness of Italian wine in the world is crippled by the lack of a truly international strategy for growth and development, especially considering the managerial shortcomings of the sector.

Therefore, the opportunity of outlining a theoretical framework on the subject would be justified, not only to analyze and interpret the strategic behavior of wineries in the processes of international development, but also and above all, to identify potential organizational structures, suitable for sustaining and supporting commercial proposals on foreign markets. One possible solution might be merely to invest in aggregation operations: the question however posits on the way to retain product identity (or rather, the identity of the wine producer) within such relations of cooperation.

In this sense, cooperation (or what we could call '*coopetition*') would seem to have a huge potential in terms of enhancing local specialties, to gain a satisfactory economic-commercial positioning on international markets. In terms of method, a solution can be found in the aggregation of enterprises for promotion of the territory, as our analysis of the 'Enoteca Provinciale di Salerno' case study clearly reveals.

## **NETWORKS OF RELATIONS IN THE INTERNATIONALIZATION OF SMALL BUSINESSES**

In the context of internationalization strategies, the literature has identified 'new forms of internationalization' or relative 'relational methods', highlighting on the one hand their more structured rather than commercial status and on the other, their flexibility compared to hierarchical organizational scenarios. For instance, the reticular perspective (Johanson and Mattson, 1988) interprets markets as networks of relationships among enterprises.

In perceiving the lack of resources and information as a key constraint in the various stages of internationalization, this theory proposes a phased approach, although not deterministic, especially for small businesses with a limited knowledge of foreign markets (Jolly et al., 1992; Knight and Cavusgil, 1996; Oviatt and McDougall, 1997). Therefore, interesting implications

emerge relative to the analysis of 'networks', a crucial factor for better understanding and addressing the issue of internationalization strategies for small businesses.

One strategic option in this sense, can be identified in the collaborative relations among businesses (Hagedoorn and Dysters, 2002; Eisenhardt, 2002; Lawrence et al., 2002). The minimum common denominator of potential strategies of cooperation is the centrality of the relational dimension among the different actors involved that encourage synergies not only in terms of scale, experience and scope economies, but also in terms of exploitation of other resources, shared via reticular configurations with a collaborative, cooperative and/or *coopetitive* nature.

The progressive loss of company viability, in a highly complex and globalized world, has led to consolidated, competitive cooperation, achieved through the establishment of close relations relative to more extensive chains, even of competitors, capable of initiating processes of international development characterized by high flexibility and reversibility. Some authors believe, more specifically, that a network-oriented approach represents one of the entrepreneurial ways that small businesses should be run with major efforts to compete on international markets, by minimizing the limits related to their size and favoring the process of internal learning (Håkansson and Snehota, 1995; Madhok, 1997; Rutashobya and Jaensson, 2003).

In this perspective, the ability of businesses does not reside exclusively in the internal resources, knowledge and capabilities, but particularly in the identification and exploitation of synergic opportunities with partners (Achrol, 1997; Doz and Hamel, 1997 Sarkar et al., 2001). The evolutionary trajectories taken by such small businesses should therefore be interpreted to the effect that through the construction of vertical (suppliers and customers) and horizontal networks (with competitors), they have benefited from access to resources not available internally, by getting, at the same time, a critical mass of skills, that are relevant to international competitive positioning (Zucchella and Maccarini, 1999; Lipparini, 2002).

However, the logics of the network, to be truly multiplicative, requires that among the nodes of the network, knowledge exchange and resource sharing are activated, if possible even in terms of sensitive information about research, production, marketing and so on, which, because characterized by a high distinctive potential, often result as jealously protected by firms (Rullani, 2009). Sharing knowledge, however, can become an incentive for further

development and innovation, with significant effects in terms of value generated by the continuity of relationships.

Consequently, networks are a source of competitive advantage if they assume a strategic (Gilmor et al., 2000; Carson et al., 2004) and proactive (Achrol, 1997; Sarkar, 2001) dimension, in particular in the operating environment of small businesses. As concerns the strategic element, openness to relationships of trust, more extensive collaborations (in / between / among sectors), allow businesses to access to important cognitive resources in a stable way, with the possibility of activating more structured processes of international growth in terms of market orientation, distribution channels, communication, and organizational assets. The pro-activity of the networks, however, depends on the greater or lesser awareness of the actors of their 'belonging' (Pellicano and Ciasullo, 2010) to a system of relations and on the consequent ability to activate specific connections in considering the company not as an isolated entity, but as an interactive and flexible component of a system.

In the field of entrepreneurship studies, how connections (as formal and / or informal links) evolve during the life of the business is also shown (Falemo, 1989). In particular, the ability to develop structured relationships with other organizations, characterized by strong strategic importance, seems to be manifest in the phase of growth and development of the enterprise life cycle, while in the start up phase networking activities are reactive and personal for the most part (Granovetter, 1985).

The way in which a small winery, necessarily oriented to some forms of internationalization, can take advantage of the opportunities of collaboration (and in particular of 'networks') with competitor wineries would be interesting to study and how, although in *coopetition*, each firm retains its own identity in terms of varieties, clones, denominations and *terroir*. Before achieving an 'institutional' functioning of such collaborations, in an n-tuple form, it might be useful, especially in the early stages (on the basis of the previous consideration, almost assimilating in a certain sense networks to enterprises), to count on a sort of 'guarantee' effect, often of a personal (or, consequently, associative) nature.

## THE CONNECTOR IN INTERNATIONALIZATION NETWORKS

The adequacy of the relational and reticular perspective in interpreting the processes of internationalization of wineries must be analyzed taking into account above all, the territorial component, as a factor that can facilitate or otherwise, the structural or cultural attitudes to

internationalization on the part of businesses. Facing the complexity of the competitive environment (and in particular the social, economic and institutional constraints of the international context in which enterprises of the fragmented and sometimes pulverized wine industry operate), the ability to create a system of relationships with public and private institutions of the territorial system plays a fundamental role to enable the enterprises in the supply chain to access a wider range of resources, so as to facilitate the processes of international development.

Research conducted on a national basis (Pomarici et al., 2007; Migliaccio et al., 2008) suggests that the network can be used as a privileged instrument for establishing, maintaining and developing stable relationships over time, making it possible to start joint projects, up to the point of sharing, in some cases, business risks. A significant example in this sense, is the 'collaboration' (or '*coopetition*') between the Italian cooperative firm Caviro (the first Italian group for basic wines) and the French firm Val d'Orbieau (the fifth wine group in France), based on the exchange of know-how for the optimization of organizational processes, joint purchases and actions in common for the development both of marketing intelligence and to contrast the competition from New World countries (Ismea, 2005).

Therefore, partnerships can aggregate for access to new markets, gaining real forms of joint internationalization of production or distribution. This phenomenon is still limited quantitatively speaking, but very significant in qualitative terms: consequentially, we have on the one hand the need for innovative business strategies and on the other, the necessity for new forms of governance designed to achieve them concretely.

In this perspective, a particularly important role is played by entities that vehicle liaisons and coordination in terms of connections to networks of relationships (Burt, 2005). Such entities, normally public /private, by facilitating the circulation of information flows and knowledge, encourage cooperative action thanks to the activation of fiduciary mechanisms. These reside primarily in their guarantee function relative to the effective working of the network, by avoiding 'particular' positions and stimulating ongoing planning and guidance in the decision-making processes for each components of the network. Entities in their function of facilitators and connectors of large relational and reticular systems to support within broader internationalization strategies, need to possess specific characteristics:

- stable, durable and 'reliable' participation in the local-foreign relations system; an active part of a dense social network (Granovetter, 2004);

- components of local networks, but possessing the appropriate communication codes to enable them to interact with facilitators / connectors of other countries;
- a functional 'open' system of relations, establishing not only durable, but also permeable connections to enhance the strength of 'weak' bonds, by means of which new information, new knowledge, new skills, new experiences, new contacts and further new relationships can be acquired;
- capacity for interconnecting strictly economic initiatives with others of a non-economic nature, to help strengthen the social roots of an economic system (mainly, but not only, territorial) to increase the opportunities for relationships in order to enhance the value of the connections to favor the development of new knowledge. Such an approach could be easily adapted to a 'collective' strategy (Astley and Fombrun, 1983) consisting in a network, the objective of which would be mainly to develop initiatives for promotion and for territory marketing, capable therefore of enhancing a given territory and projecting the same in the international competitive arena. In other words, devising business paths capable of binding a winery's image to territories and local systems, well defined and characterized by traits that highlight the will to work on a idea of territory, active and identity-laden, as a result of co-evolution and sedimentation processes (Magnaghi, 2010), on the one hand by strengthening the local roots of the winery and on the other by rendering the territory globally visible.

From the point of view of individual wineries, such a configuration could provoke the renouncing of a portion of decision-making autonomy, to achieve a potential harmonization of interests with those of other actors in the network. According to this view, enhancement projects require governance mechanisms to foster synergistic collaborations and coordination processes through project management for the harmonious development of enterprises and territory.

In a customer-based perspective (Busacca, 1994; Cantone, 1996), enterprises in the network can be considered beneficiaries of a commercial system with a solid image, based on shared values and characterized by a precise competitive positioning (Franch, 2002). Such distinctiveness, represented in a symbolic, experiential and cultural perspective, can act as an undoubted amplifier of attractiveness in the global consumer behavior.

Therefore, in the context of the wine sector, the need emerges to establish connectors capable from an integrated and systemic logics perspective, on the one hand of encouraging forms of networking among local businesses and other categories of stakeholders, both public and

private, operating in the domestic and international field, and, on the other, of supporting appropriate coordination mechanisms including support for services that represent a point of reference for the realization of investments. In this direction, therefore, we argue that interesting opportunities for study are emerging.

## RESEARCH OBJECTIVES AND METHODOLOGY

Evidently, the internationalization of small wineries becomes the only obvious choice not simply one of the potential strategic options. Inevitably this leads to 'collective' strategies, characterized by strong collaboration, given the evident inability of a small winery to cope with the challenges of internationalization – which, however, seems inescapable – on its own.

Our research focuses on the issue (widely debated in the literature, but not practiced in real business and especially difficult to apply in the wine sector) of collective strategies of internationalization. We reason about the need for small wineries to become consolidated in foreign markets, together with the opportunity to differentiate themselves from their competitors, i.e. other producers in the wine industry belonging to the same territory. This implies at least two research questions.

*Can small wineries, limited as to production quantities and profoundly different in the individual expression of the offer, collaborate in promotion on foreign markets without losing their specific corporate identity? (first research question).*

*If so, what factors of cohesion can such companies invest in for a 'coopetition' relationship, addressed not only to the generic 'foreign' market, but in particular to single and specific foreign markets? (second research question).*

As to the research methodology, having a mainly exploratory intent, we attempt to verify how the literature has identified in the 'network' the critical point for better understanding and addressing the internationalization strategies of small businesses. At the same time, the fundamental role played by entities engaging and supporting businesses in cohesive processes of growth and consolidation on the international markets is highlighted. Subsequently, by means of a case study methodology, an empirical investigation is put in place with the object of analysis the 'Enoteca Provinciale di Salerno'. By means of the case study approach, starting from the two research questions, as a preliminary step, we attempt to verify from the perspective of the collective reference organism, whether there is the

disposition of small winemakers towards internationalization and collective strategies, rendering visible at a subsequent stage, the enablers or impediments to their implementation.

Inevitably, the results of the study are limited to the context of the survey ('Enoteca Provinciale di Salerno') with the relative disadvantages in terms of extension of applicability while advantages concern a better understanding of the problematic issues and / or perspectives of a specific territorial context (Yin, 2005). As emerges, however, the territory of Salerno, when compared with other Italian wine regions presents at the same time, particular traits and traits in common which characteristics are both significant in the analysis of any case study.

### **THE CASE STUDY OF 'ENOTECA PROVINCIALE DI SALERNO'**

After an initial trial period starting in 2003, on the 15<sup>th</sup> of December, 2008 the 'Enoteca Provinciale di Salerno' was officially founded; operations started in 2009 and to date (2013) it numbers 37 members of which 35 are wineries (other members are the Provincial Administration of Salerno and since the end of 2011, the Chamber of Commerce of Salerno). The Enoteca is a public-private association, whose mission is the promotion and enhancement of the wines of the province of Salerno, by virtue of "... actions aimed at communicating the excellences of the territory and the development of tourism promotion in the territory" (we thank Mr. Ferdinando Cappuccio, President of the 'Enoteca Provinciale di Salerno', for his kind cooperation given).

In the province of Salerno, in particular, there are actually only wineries characterized by small production: Bruno De Conciliis (about 250,000 bottles), followed by Raffaele Marino (about 120,000), Marisa Cuomo (just over 100,000 ) and Luigi Maffini (100,000) (data from 'Enoteca Provinciale of Salerno', 2013). Also because of the limited business dimensions, virtually all of the wineries in the area (except for very few businesses waiting to join) have found it useful to aggregate within the Enoteca, in order to share experiences, projects and resources, in terms of internationalization, the latter aspect being of particular interest in the context of this work.

Although we have described internationalization as a necessity for survival and development for the wine industry, going abroad evidently, is not easy, because costs – at best in 'investments' – are higher than those needed to operate on the domestic market. This scenario affects above all small businesses, distressed from a financial point of view, especially in

times of recession and credit crunch. Costs are even more incisive when management of the investment is on an ongoing basis (in terms of strategies, programs, processes, etc.) as opposed to one-off initiatives).

***Internationalization - Third Countries: Canada, Brazil, Shanghai, Qatar, Argentina, China, Russia and Countries of the Former USSR.***

So far, internationalization actions developed by the Enoteca (and therefore in a broader sense 'collective' for member wineries) have focused on the 'Programs for the promotion of Italian wine in Third Countries', governed by AGEA, for promoting abroad not individual brands and products, but in general wine of the Salerno area (whose main and most characteristic grape varieties are Aglianico, Piediroso and Tintore for the reds, and Fiano, Biancuzita and Biancolella for the whites). In particular, in these programs the Ministry of Agriculture and Forestry Policies (MIPAF) has funded 50% of the total expenditure and the Regional Administration of Campania 20%, with the remaining 30% paid by the promoter (i.e., the Enoteca, along with the wineries participating in the project).

It should be noted that AGEA is an acronym for 'Agenzia per le Erogazioni in Agricoltura - Agricultural Payments Agency' (see [www.agea.gov.it](http://www.agea.gov.it)), that is the Organism for Coordination and Payment in Italy of funding for producers, in terms of aids, grants and awards, made available by the EAGF (European Agricultural Guarantee Fund) and EAFRD (European Agricultural Fund for Rural Development). For 'third countries', we intend nations not part of the European Union.

The initiatives of 2011 and 2012 (both leveraging on the 2010 Call) were aimed in particular at two countries, Canada (2011) and Brazil (2012) respectively. The choice was made in consideration of two fundamental aspects: the growth rate of the economies in question (in the macroeconomic sense) and the rate of growth of exports of the Italian wine sector to these countries.

The actions, more specifically, were aimed at affirming the image, and attraction on the market of wine from Salerno, from an institutional perspective to promote wine coming from the territory in general (through print ads and TV production of multilingual promotional material, development of incoming / outgoing service activities and wine casting) rather than to promote its sale on an individual or collective basis.

Of the two countries covered by the action of internationalization, Brazil has definitely proved itself the most interesting. Firstly, because it is a rising economic nation, with evident ongoing development of disposable wealth and consequent demand for goods with a high added-value, Canada on the other hand is administratively based, as regards the import of wines, on a monopoly which certainly does not facilitate the smooth entry of the wine flow to the country.

In addition, wineries from Salerno generally have an average quality / price ratio, which normally is an attractive proposition for wine consumers. In Brazil, in the Italian wines segment there is very aggressive price-based competition, especially with Lambrusco; in terms of benefits for the wine from Salerno, however, the Brazilian market, as a consumption system, is changing fast: if until the recent past any Italian wines, merely because 'Italian', were absorbed indiscriminately, now the Brazilian market is beginning to be more selective, thus benefiting offers of higher quality and distinctiveness.

In Canada and Brazil institutional relations were held respectively by the Italian Chambers of Commerce of Ontario and Sao Paulo, with home based support in Italy for planning and implementing from the Provincial Administration of Salerno and in particular, from the Offices dealing with Production Activities. In both cases it was possible to establish relations with many buyers, while in Canada there were buyers interested in orders relating both to quantity and quality, in the case of Brazil, thanks to the Canadian experience, meetings were held with buyers especially interested in the quality of the product for trading in particular through two main distribution channels: restaurants (mostly Italian) and wine-shops (most of all, 'gourmet').

Since 2011, moreover, there has been official collaboration with Intertrade, a Special Agency (for internationalization) belonging to the Chamber of Commerce of Salerno, which has proved fruitful for at least two reasons: its undoubted competence and skills in organizational / administrative terms and greater (if compared to the Enoteca) availability of financial resources to respond to potential opportunities deriving from Calls. In particular, by virtue of Intertrade it has been possible to activate 1) the AGEA 2011 fund (in 2012) for Switzerland and Shanghai; and 2) the AGEA 2012 fund (to be carried out in 2013 and 2014) for Qatar (because of its elitist tourism system), Argentina (because of the large Italian community), Russia and other countries of the former USSR.

Again in 2013 / 2014, in addition, the Enoteca, due to the action of the Provincial Administration of Salerno, will have access to the AGEA 2012 fund for Brazil and China.

*Other projects abroad: Denmark.*

In 2010 and 2011, pursuant to specific collaboration with Coldiretti and Intertrade, the Enoteca participated in a multiple project, which aimed to enhance various food products of the Salerno area, including in particular, wine, cheese, tomatoes, anchovies, tuna and coffee. Denmark was chosen as the foreign market for this promotion campaign because several businesses (associated with Enoteca or otherwise) had had previous experience with Denmark, working and investing in that market: therefore, it was natural to return for a follow up of the promotion action, at the same time involving other producers of the territory in the initiative.

*Results and implications of the actions of internationalization.*

Even for small wineries, like all those affiliated to the Enoteca, it is essential to work in foreign markets. In fact, even though volumes, sales and margins might be limited, in any case proportionately, important results have been achieved for small business, which necessarily have to compete on several fronts (commercial, organizational, administrative, and so on). Other benefits arising from internationalization affect the image building of the territory (which leads to the image building of wines and brands), the acquisition of experience in international contexts and processes, without neglecting more 'cynical' benefits: in fact, the payments from abroad, almost paradoxically, are often safer than Italian payments, that nowadays are at rather unsustainable levels of sufferance.

The collective actions of marketing, in the specific case of the 'Enoteca Provinciale di Salerno', has worked primarily as a 'battering ram', i.e., to facilitate entry to international markets, in order to raise product awareness, enriching, especially in the case of wine, the contribution of the *terroir*. These initiatives, were mainly limited to an initial phase, postponing to a later stage fundamental individual commitment on the part of individual businesses.

As regards the governance of the collective action of internationalization, it should be specified that Enoteca, even though providing coordination facilities, offers only a service of

temporary support for participating wineries, its role being that of 'facilitator / connector'. Downstream, as mentioned previously the drive of individual wineries is necessary. In any event this is possible above all by virtue of the ongoing improvement of entrepreneurial and managerial skills.

In short, the mission of Enoteca is the promotion of wine and wineries of the province of Salerno and the organism intervenes only when no specific business role in the strictest sense is involved. Accordingly, it works as an 'institutional' organism, in the broadest sense of the term, for all the businesses in the wine sector of the territory of Salerno.

Moreover, this initial task, concerning the promotion of the territory at international level, has already encountered considerable difficulty in the communication of the brand 'Salerno', which suffers greatly in terms of visibility, although it is a strong tourist attraction on the domestic market (this is, in fact, a very common problem abroad for a large number of Italian territories, above all in the South of Italy). Fortunately, for the territory of Salerno in general, brands such as 'Amalfi Coast', Amalfi, Positano and Paestum are more likely to do well, their geographic and symbolic appeal are important factors for territorial development, in addition, meta-elements are also competitive: for example, the reference to Campania (and therefore also to the territory of Salerno) as 'Vigna Felix' (from the Latin 'Campania Felix') and the Mediterranean Diet, historically identified with the territory of Cilento in the famous Seven Studies by Ancel Keys and in which the contribution of wine, especially red wine, in small quantities, is crucial.

In this 'ideal' apposition there is the rationale for the selection of the 'Enoteca Provinciale di Salerno' as a case study. The territory of Salerno, in fact, is populated by small wineries (a characteristic common – 'typical' – for many other Italian regions of wine), but fortunately also very attractive, thanks to its rich heritage in terms of landscape, art and culture in general (feature not so common – even 'unusual' – for many other Italian wine territories) and, thus can be considered an 'extreme case' (Eisenhardt, 1989).

Also in terms of collective strategies, in this case concerning trade in a narrow sense, the potential of the *bundle of products*, on which the Enoteca is at present working by means of which foreign buyers can obtain a simplified 'offer'. The bundle would in fact, consist of an intelligent mix of the wine produced by the wineries belonging to Enoteca, with their particular quantitative and qualitative characteristics.

Finally, it is worthwhile pointing out that at present, in the specific case of the 'Enoteca Provinciale di Salerno', there does not seem to exist other forms of aggregation for wineries in the territory. The Provincial Administration was the entity that proposed the creation of Enoteca (and continues, as a member, to play an important supporting role) and Intertrade, the Special Agency of the Chamber of Commerce of Salerno, works closely with Enoteca as the Chamber of Commerce is also a member. The only other form of aggregation planned is the Consortium, at present still in a start-up phase.

## **RESEARCH RESULTS, IMPLICATIONS AND DEVELOPMENTS**

The study has highlighted that collaboration between small businesses in the strategies of internationalization is not only possible (as in the case of the 'Enoteca Provinciale of Salerno'), but also profitable, as long as it leverages on a factor of cohesion that would be clearly beneficial, consisting, in this case, in the promotion of the territory on international markets. The Enoteca, in effect, considers itself a facilitator / connector of collaborative relationships between member wineries, when their purpose is merely the promotion of the territory, having a role in this sense of planning, coordination and guarantee towards the collaborating parties.

The analysis, in terms of scientific implications, highlights the importance of networks among small businesses in the wine sector, with subsequent auspices, in this particular case study, of further project developments. It seems very beneficial, in fact, that the network can collaborate with other institutions and enterprises of the territorial system (with reference to other typical food products, but also to tourism, environment, culture, as already happens naturally), considering promotion of the territory from a wider vision in terms of the wine supply chain.

In addition, a follow up to our research, which is already in progress, focuses on the proactive collaboration among wineries, investigating in particular the perception of the small entrepreneur in the wine sector on the importance and feasibility of collective strategies of internationalization, highlighting also the factors, needing correction or encouragement to enable a greater degree of receptivity on the part of the governing body towards paths of internationalization, in which, as mentioned previously, there is automatically a loss of some decisional autonomy, but at the same time, also a clear business opportunity. This study aspires to having a positive effect with respect to actions of more effective territorial governance, and in this context, the collective bodies of reference for the wine sector

(Chambers of Commerce, Consortia, 'Enoteche Provinciali', etc.) could further legitimize their natural role as meta-organizers, in order to better project and implement collective actions of international marketing, for the creation, obviously each within its own field of competence, of a network of specialized services for internationalization (Cafaggi & Iamiceli, 2008), especially as regards knowledge-intensive business services, extremely critical success factors for international networks.

In fact, penetration, consolidation and establishing of firms on foreign markets are instrumental goals constantly at the center of territorial development policies. The latter require implementing through coordinated actions in support of an integrated communication system and underpinned by studies on the peculiarities of consumer segments in different countries, as well as on the offer of the most aggressive competitors at national and international level; by encouraging relationships with appropriate operators of the distribution sector; and so on. Moreover, several studies have already demonstrated the importance of country reputation as a competitive advantage in the internationalization processes of communication and distribution of wine (Zen & Fensterseifer, 2011), indicating interesting trends for development in terms of reputation building of a territory (Ciasullo & Festa, 2012), or 'region', intended as an area with a particular vocation for wine.

In managerial terms, in the same way, although from a quite different perspective, the opportunity / necessity emerges for small wineries to develop a greater awareness of the evaluation and adoption of collective strategies of internationalization, in order to benefit from the evident advantages deriving from their relative economies. In commercial terms, in fact, thanks to scale and experience economies, productions from the same territory can be aggregated to deal with bulk orders, to increase negotiating power versus the large-scale retail trade or to cut the cost per business of communication campaigns abroad; in relational terms, in addition, the benefits of scope economies can also be enjoyed where the sharing of information, knowledge and relationships can enable management to deal with risky or profitable scenarios with greater awareness (and lesser cost).

## CONCLUSION

The research attempts to investigate the opportunity / necessity of internationalization for small businesses in the Italian wine sector (principally because of a decrease in domestic consumption of wine), together with the supposed difficulty of reconciling both highly fragmented and very specific productions, when aggregated in any form of cooperation,

rendered necessary because of the limited size of individual wineries. In this sense, we believe that the study, using a methodology structured on a literature review applied to a case study, can respond to two research questions, providing evidence that 1) it is possible to activate effective collective actions of internationalization even when the aggregation process concerns very different producers and / or productions, and 2) the main factor of cohesion in such actions that would bring together small wineries (very different one from the other) and not alienate them is territorial identity, especially with regard to territory communication.

In this sense, a significant role can be played by 'third party' organizations, especially when they have an associative nature (in this case study, the 'Enoteca Provinciale di Salerno') clarifying that the interest pursued by collective actions (of internationalization, specifically) is not restricted to the specific interest of individuals but to all the members involved. In a later stage of territory promotion, however, the internationalization strategies of the wineries will need to be supported by adequate services in order to encourage a commercial follow-up to the communication actions on territorial identity.

The study, in short, proposes to provide a potential contribution to the identification of an organizational strategy solution (in this case, collaboration agreements, implemented by networks) to support the internationalization of small businesses in the Italian wine sector, finding in territory promotion a valuable asset. In actual fact, together with the ongoing search for quality, the propulsive engine of the Wine Renaissance of the late 1980s in Italy; the planning of a convenient quality / price ratio, inevitable on international markets; constant dialogue with the distribution system, too often overlooked and / or endured with resignation by small wineries; for foreign markets wine communication above all is becoming increasingly strategic which at the end of the day, by its very nature, is mainly communication expressing the *terroir* of the wine, a fundamental common resource for wineries.

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## THE IMPACT OF FACEBOOK PRESENCE ON BRAND IMAGE

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### ABSTRACT

Although the study does not indicate a significant relationship between the brand use of Facebook pages and consumer purchase intention, it seems there is an impact of Facebook presence on brand image which is an important factor relating to increased sales and brand survival in a competitive international environment. The study indicates that there is a correlation between respondents who frequently visit their Facebook account and those who often visit company brand pages on Facebook. The study investigated the impact that social networks have on developing and maintaining company brands. Two similar questionnaires were developed, one for consumers (269 respondents) and another administered to companies (42 respondents) to study a firm's social network site from their and the consumer's perspective. When asked about other social network sites where they had profiles/brand pages consumers' and company's responses were similar. It was interesting to note that both consumers and companies responded that the content of the Facebook brand page is the most valuable feature indicating that companies recognize the importance of content and are responding to consumer's needs in the network.

**Keywords:** brand image, company image, social networks, Facebook

### INTRODUCTION

Social networking site (SNS) is the term used to describe sites such as Facebook, MySpace or Twitter (Taylor, Lewin, and Strutton, 2011). Boyd and Ellison (2007) define SNS as web-based services that allow three main functions to individuals: the construction of a public or semi-public profile within a bounded system; the articulation of a list of other users with whom they share a connection; and viewing and traversing their list of connections and those made by others within the system. Boyd and Ellison (2007), Joinson (2008) and Ellison, Steinfield, and Lampe (2007) argue that Facebook users are registered in the social network looking

for people with whom they have an offline connection and not looking for new friends. According to OberCom (2012) 97,3% of respondents that use social networking sites have a Facebook profile and 59,2% of respondents believe that company interaction and brand association in social networking sites are important to them.

Keller (1993) states that consumer's knowledge of brands is defined through brand awareness and brand image. Thus, it is important to clarify the concept of brand equity. The American Marketing Association defines brand as "a name, a term, a design, symbol or any other features that identifies one seller's good or service as distinct from those of other sellers". Keller (1993) defines brand equity based on consumer as the differential effect of brand knowledge on consumer response to the marketing of a brand. Word-of-mouth (WOM) is important aspect of social networking sites as it is what gives the site its power through the viral nature of WOM. Kozinets, Valck, Wojnicki, and Wilner (2010) define WOM as an intentional influencer of consumer to consumer communication through professional marketing strategies. Reece (2010) defends that consumer generated media, as social network communication, has a great popularity level, due to the emotional need that people have of being heard. However, Treadaway, and Smith (2010) argue that Facebook marketing is not a quick process, because developing and convincing followers, fans and friends to convert into consumers and brand ambassadors takes time.

Carter and Levy (2011) argue that companies are beginning to integrate social networks as a part of their marketing strategies, communication and consumer service. Pempek, Yermolayeva, and Calvert (2009) compare Facebook communication to traditional media communication, where the presented information reaches a lot of viewers at the same time. Social networks (SN) have the opportunity to effect the branding paradigm in a broad way as a brand can be created or adapted through SN consumer generated content (Lim, Chung, and Weaver, 2012). Edelman (2010) defends that relationships created in the social environment are determinant in consumers purchase decision. Although there has been no standard procedure to measure a brand fan importance there is agreement that a brand fan has intrinsic value (Millard Brown and Dynamic Logic, 2011). This study is focused on the social network site (SNS) Facebook and its relationship with the development, and maintenance, of brand image as well as its impact on consumer purchase decisions.

## CONCEPTUAL MODEL AND HYPOTHESES OF STUDY

Facebook has approximately one billion users (Dinheiro Vivo, 2012), and 23% of its users access their account five or more times a day (State of Search, 2012). A Netsonda study (2011) about company presence on Facebook indicates that 56% of respondents like company brand or product pages and the results indicate this number is increasing. State of Search (2012) statistics indicates that 47% of North-Americans considered that

social networks are a major impact on purchase behavior. Treadaway and Smith (2010) consider that social media have a great power when it comes to influencing their users. Lim, Chung, and Weaver (2012), however, believe that it is consumer WOM to be the major influence effecting consumer SNS behavior and not the company postings. Edelman (2010) also believes that it is the relationships which are created in a social environment that are determinant in the purchase decision.

Lim, Chung, and Weaver (2012) found that social media sites could influence a consumer depending on whether the individual had a positive or negative reaction to a company's social networks site. Individuals who had a positive experience report being pleased with the brand. However when the site experience was negative consumers reported a negative reaction to the firm's brand.

The results of these studies lead to the following consumer (c) hypothesis which related to the consumer questionnaire sample:

**cH1:** Consumers visits to a firm's Facebook are directly related to visits to the company brand page site.

**cH2:** Consumers that have a positive perception of the company brand pages on Facebook tend to increase their purchasing volume.

Company social network sites can be considered to be company/brand communities (Keller and Kotler, 2012). In these communities consumers are brands "friends" and interact with others who share similar beliefs about the brand image (Harden and Heyman, 2009). This provides the opportunity for a firm to manage its brand image, encourage and foster supportive dialog and in doing so, increase consumer loyalty (Carter and Levy, 2011). These observations led to three company/brand (b) hypotheses which related to the company/brand sample:

**bH1:** Company/Brand sites that interact more with consumers are those that update Facebook page more often.

**bH2.1:** Consumers that have a more positive perception of a firm's Facebook pages will tend to increase their purchase volume.

**bH2.2:** Consumers that have a more negative perception of a firm's Facebook pages will tend to decrease their purchase volume.

## METHODOLOGY

To test the hypotheses cH1, bH1, bH2.1, and bH2.2, four Spearman's correlation coefficients were calculated; and to test Hypothesis cH2 a qui-square test was performed. Correlation analyses and a qui-square test were performed were conducted on a sample of 269 consumers and 42 mass marketing brands. The hypotheses was considered significant when a statistical level of  $p$  equal to or less than 0.05 was obtained. A non-probabilistic sample based on convenience was used for consumers. Brands were chosen according to the rankings: (1) Socialbakers – Facebook brand pages with more fans in Portugal - and (2) FbRankPt – Facebook Portuguese brand pages ranking.

## BRAND SELECTION AND PARTICIPANTS

The study featured 42 mass marketing brands in the Portuguese market. A message was sent to all brands that had at least 50 thousand fans on their Facebook pages. A total of 170 brands were contacted, 129 via a post on their Facebook wall and 41 via private message. Private messages were only sent to brands who didn't allow consumers to publish on their wall. Ninety seven brands responded to the wall post or the private message, but only 42 responded the questionnaire.

A Facebook event was created so that consumers' sample were able to answer the questionnaire. Three thousand and fifty three invitations were sent to Facebook users and 269 Facebook users responded to the questionnaire. The respondents' age ranged from "less than 18 to 45" to "54 years old".

## SURVEY INSTRUMENT DEVELOPMENT

Two questionnaires were developed: one for brands and other for consumers. The questionnaires were built using mainly closed answers, even though there were some open-ended answers. Consumer respondents rated items using a four-point Likert scale, while brand respondents rated items using a five-point Likert scale. The data results were treated on IBM SPSS 17.0 and Microsoft Excel 2010.

## DATA PROFILE

Consumers sample (N=269) included 181 (67,3%) females and 88 (32,7%) males and Facebook users were mainly under the age of 18 to 24 (73,6%) and 25 to 34 years old (20,4%). Most of the individuals had an undergraduate degree (44.2%) or were in college (32,7%). Table 1 provides a general result of consumers sample profile:

**Table 1. Consumers Profile**

Demographic Variables	Sample Profile
Sex	Female (67.3%) Male (32.7%)
Age	Less than 18 years old (1.1%) 18 to 24 years old (73.6%) 25 to 34 years old (20.4%) 35 to 44 years old (3.3%) 45 to 53 years old (1.5%)
Table 1 continued:	6 <sup>th</sup> grade (0.4%)
Academic Qualifications	9 <sup>th</sup> grade (0.4%) 12 <sup>th</sup> grade (5.6%) At college (32.7%) Undergraduate Degree (44.2%) Postgraduate Degree (16.7%)

Brands sample (N=42) included 42 mass marketing brands. Table 2 presents each brand and its business sector.

**Table 2. Brands Sample**

Brand Name	Business Sector
A Vaca que ri	Food industry
B!	Soft Drinks

Brand Name	Business Sector
Braga 2012: CEJ	Cultural Sector
Cão Azul	Retailing
Casa da Música	Cultural Sector
Ericeira Surf Shop	Retailing
Ford Lusitana	Automobiles
Fox Life Portugal	Media
Fox Portugal	Media
Gorila	Retailing
Hiper FM	Media
Lanidor	Apparel
Licor Beirão	Alcoholic drinks
Mega Hits	Media
Meo	Telecommunications
Merrell Portugal	Apparel
Mini Portugal	Automobiles
Moviflor	Furniture /Decoration
Nat Geo Portugal	Media
Netviagens	Travel Agency
Odisseias	Retailing – experiences packages
Peugeot Portugal	Automobiles
Pousadas da Juventude	Hotels
Renascença	Media
Renault Portugal	Automobiles
Revista SuperInteressante	Press
Rotas do Vento	Travel Agency
Swatch	Watches

Brand Name	Business Sector
Tamariz	Nightlife
TAP	Airline transportation
Telepizza	Food Industry
The Phone House	Retailing
Tiffosi	Apparel
TSF	Media
Um Bongo	Soft Drinks
Vaqueiro	Food Industry
Vila Galé	Hotels
Vodafone	Telecommunications
Volkswagen	Automobiles
Volvo Car Portugal	Automobiles
Westrags	Apparel
Zon Lusomundo Cinemas	Entertainment

## RESULTS

### CORRELATIONS

A Spearman's correlation coefficient was calculated to test the first hypothesis of the consumer sample (cH1). Not all respondents were included in this analysis (N=249). The correlation found between "consumers visit to their account on Facebook" and "the accompaniment consumers do to brand pages" was  $-0.129$ ,  $p=0.042$ , resulting in a correlation between the two variables and cH1 was confirmed.

A qui-square test was calculated for the second hypothesis for consumer's sample (cH2).  $\chi^2(269)=6.7, p>0.879$ , with 12 degrees of freedom. cH2 was rejected ( $p>0.05$ ). As such, it is indicated that

consumers who develop positive perceptions regarding brand pages on Facebook tend to increase their purchase volume.

Table 3 provides the general results for these two correlation analyses.

**Table 3. Hypothesis Testing Results for Consumers Sample**

Hypothesis	Statistical Test	Associated Probability	Results
<b>HC1</b> -Consumers visits to a firm's Facebook site is related to the accompaniment they do on brand pages.	Spearman's Correlation Coefficient	$p=0.042$	$p \leq 0.05$ H1 accepted
<b>HC2</b> - Consumers that have a positive perception of brand pages on Facebook tend to increase their purchasing volume.	Qui-square Test	$p=0.879$	$p > 0.05$ H2 rejected H0 accepted

Three additional Spearman's correlation coefficients were calculated to test the three hypothesis of the brands sample. Not all respondents were included in bH1 analysis (N=40). The correlation found between "brands interaction level with consumers" and "how often brands update their Facebook page" was -.214 with an associated probability of  $p=0.186$ . The result was no correlation between the two variables was determined ( $p > 0.05$ ) and bH1 1 was rejected, This suggests that brands that interact more with consumers are not necessarily those who update their Facebook page more often.

Not all respondents were included in bH2.1 analysis (N=36). The correlation found between "brand purchase volume increase" and "the increase of positive brand image/associations by consumers" was 0,245

with an associated probability of ( $p=0.150$ ). The result is that no correlation was found between the two variables ( $p>0.05$ ) and b H2.1 was rejected suggesting that, from brands point of view, there is not a relationship between a consumer's positive perception of Facebook brand pages and consumer's intention of increasing purchase volume.

Not all respondents were included in bH2.2 analysis ( $N=34$ ). The correlation found between "the decrease of brand purchase volume" and "the increase of negative brand image/associations by consumers" was  $-0.2$  with an associated probability of  $p=0.257$  so bH 2.2 was rejected. The study indicates that from brand's point of view consumers that have a more negative perception of brand pages on Facebook do not tend to decrease their purchase volume. Table 4 provides the general results for these three correlation analyses.

**Table 4. Hypothesis Testing Results for Brands Sample**

Hypothesis	Statistical Test	Associated Probability	Results
<b>bH1</b> - Brands that interact more with consumers are those that update more often their page.	Spearman's correlation coefficient	$p=0.186$	$p>0.05$ H1 rejected H0 accepted
<b>bH2.1</b> - From the brands' point of view consumers that have a more positive perception of Facebook pages tend to increase their purchase volume.	Spearman's correlation coefficient	$p=0.150$	$p>0.05$ H2 <sub>1</sub> rejected H0 accepted
<b>HB2.2</b> - From the brands' point of view consumers that have a more negative perception of Facebook pages tend to decrease their purchase volume.	Spearman's correlation coefficient	$p=0.257$	$p>0.05$ H2 <sub>x</sub> rejected H0 accepted

## DESCRIPTIVE STATISTICS

In addition to the formal hypothesis testing a descriptive statistical analysis was performed which provided information about consumer and brand habits on Facebook, consumer buying behavior, and brand image. Both questionnaires had similar questions which made comparisons between samples possible. Consumers and brands habits on the social network Facebook, consumer buying behavior and brand image and associations were analyzed.

## CONSUMERS AND BRANDS HABITS ON FACEBOOK

To better understand Facebook consumer and brands habits questions about the date of creation of the profile/brand page, the frequency of profile/brand page visit/update, the existence of profiles in other SNS and the most valuable features on a Facebook brand page were asked. Results were similar for the first three questions. Although brands are aware that the most valuable feature for consumers on a Facebook brand page is its content, they seem to believe prizes, contests or hobbies promoted by them are very important to consumers which was not confirmed by the consumer's questionnaires results. Table 5 provides results of the comparison between consumers and brands habits on Facebook. Only the highest results obtained through the questionnaires were considered.

**Table 5. Comparison Between Consumers and Brands Habits on Facebook**

	Consumers	Brands
Profile Page creation on Facebook	3 years (35.7%)	3 years (45.2%)
Frequency of profile/brand visit/update	Daily (96%)	Daily (92.9%)
Other SNS used	Youtube (26.7%)	Youtube (33%)
	Twitter (17.5%)	Twitter (33%)

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	Google+ (16.5%)	Google+ (8%)
Most valuable features on a Facebook brand page	Page content (33.8%)	Page content (33.8%)
	Interacting with consumers (27.5%)	Prizes, contests or hobbies promoted by the brand (23.8%)
	Refresh rate of the page (26.4%)	Interacting with consumers (21.4%)
	Prizes, contests or hobbies promoted by the brand (10.4%)	Refresh rate of the page (2.4%)

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*Consumer Buying Behavior*

Consumers were asked about changes in their consumer buying behavior after starting to follow a brand page on Facebook. Brands were asked about the perception they had about changes in the consumer buying behavior after they started to follow a brand page on Facebook. Consumers questionnaire results showed that most of them had no changes in their purchasing behavior (84.8%). However, brands seem to believe consumers increase their purchase behavior after following brands on Facebook (88.1%). The results are in Table 6:

**Table 6. Consumer Buying Behavior**

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	Consumers	Brands
Changes in consumer buying behavior	No changes in purchasing behavior (84.8%)	Increase in purchase behavior (88.1%)

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**BRAND IMAGE/ASSOCIATIONS**

Consumers were asked about changes in their brand image/associations after starting to follow a brand page on Facebook. Brands were asked about the perception they had about changes in the consumers' brand image/associations after they started to follow a brand page on Facebook. Consumer's questionnaire results showed that most of consumers discovered unknown brand features that have a positive influence in their brand/image perceptions of the brand (70.6%). Brands questionnaire results were similar to consumers and showed that brands think their brand page on Facebook has a very positive impact on consumers brand image/association (31.7%). The results are in Table 7:

**Table 7. Brand Image/Associations**

	Consumers	Brands
Changes in brand image/associations	Discovered unknown brand features that had a positive influence (70.6%)	Very positive influence (31.7%)

## CONCLUSIONS

Five hypotheses were tested through a Hypotheses Test measuring correlations between variables and chi-square test. Two of those hypotheses were calculated through the consumer's sample and the other three using brands sample. The only hypothesis that was valid was cH1 as the other four hypotheses were rejected. cH1 was confirmed indicating that there is a correlation between respondents who frequently visit their Facebook account and those who often visit company brand pages on Facebook.

cH2 for consumers and bH2.1 and bH2.2 for brands were similar in format but cH2 was designed to investigate the consumers' perspective and bH2.1 and bH2.e were designed to investigate the information from the company's viewpoint. The objective of cH2 was to understand if there was a correlation between

respondent's positive perceptions after visiting company product brand pages and the if there was an increase in the purchase of that brand after becoming brand fans on Facebook. bH2.1 and bH2.2 questioned if there was a relation between consumers' perception and their purchase behavior from the company product brand perspective. As these hypotheses were rejected there was no demonstrated relationship between the variables. bH1 for brands sought to establish a relation between the update frequency of a company brand page on Facebook and the level of interaction between brands and consumers on that page. bH1 was rejected further indicating that no relationship was demonstrated between the companies that more frequently update their specific Facebook brand and those that interact the most with their consumers on their pages.

Most of the questions in the consumer and company brand questionnaires were similar which permitted a direct comparison of these questions. For example, the response to how long a firm had had a Facebook profile/brand page most companies and consumers responded three years. This data corresponds to the social network movement in Portugal as according to data a Marktest study (2010) in 2009 the most used SNS among the Portuguese was Hi5 however in 2010 Facebook became first in popularity among Portuguese users.

Consumers and brands responses were also similar when asked about the frequency of profile/brand page visit/update as

Both samples had a majority of responses stating "daily". This corresponds to a Netsonda study (2011) about Facebook and brands in Portugal which showed that 80% of respondents were always connected, or connected more than once a day, on Facebook.

When asked about other social network sites where they had profiles/brand pages consumers' and company's responses were similar. YouTube, Twitter and Google+ were the most popular alternatives which indicated that companies locate social network sites in those networks most used by consumers. This result, however, does not correspond to data presented by OberCom (2012) where most of respondents answered Hi5 and Google+ after Facebook and not YouTube or Twitter.

Pempek, Yermolayeva, and Calvert (2009) note that young adults spend most of their time on Facebook observing its content instead of creating it. In line with this finding was that both consumers and companies responded that the content of the Facebook brand page is the most valuable feature. This indicates that companies are noting the importance of content and are responding to consumer's needs in the network.

Edelman (2010) argues that the purchase decision process has been changing along the years and that the relationships established with the brand can have an important role in the product or service acquisition moment. This was not consistent with the data in the study as there were differences between the results of

the company and consumer responses relating to changes in consumer buying behavior. Consumer's stated they had no changes in their purchasing behavior after being a Facebook company brand fan. Companies, however, stated that they believed that consumers had an increase in their purchase behavior after viewing the company brand site. In 2011, most of North-American citizens (88%) argued that SNS had no impact in their purchase behavior and, after a year, 47% of the consumers stated that SNS had the major impact in the purchase behavior (State of Search, 2012). A Nielsen study (2012) asked respondents of four regions in the world (Asia/Pacific, Europe, Middle East/Africa and Latin America ) the probability of making a purchase choice within the next year based on products comments in social media sites on a list of 14 products/services categories. In all categories the Europeans registered less purchase probability.

Lim, Chung, and Weaver (2012) argued about SNS positive influence on consumers if they were satisfied customers and the negative influence if they are unsatisfied. In a Netsonda study (2011) results showed the consumer's opinion about a brand had improved after following it on Facebook. This was consistent with study findings as both consumers and companies agreed that Facebook pages influence the firm's brand image/associations in a positive way.

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## BRANDING OF SUSTAINABLE CLOTHING

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### ABSTRACT

To address sustainability and its conceptual foundations which are taken as self-evident; issues such as production, overall economic activity, materialism, distribution or technology highlight a need for environmental consumption. Firms need to innovate their thinking from a strategic level by offering sustainable products. The purpose of this study is to investigate the extent to which sustainable brands affects generation Y consumer's intention to purchase. The research investigate a sample of over 200 responses. The hypothesis: *There is a direct and positive relationship between sustainable branding and generation Y's intention to purchase sustainable clothing* was tested. Chi Square analysis was used to analyse the data. The study generates empirical evidence which suggests that generation Y while they are not aware of sustainable brands would purchase sustainable brands for clothing. Finally, managerial inferences are drawn that concern strategic brand management.

**Keywords:** sustainable clothing, generation Y, brands, intention to purchase

### INTRODUCTION:

In light of environmental degradation, global warming, over consumption and increases in pollution rates, there has been call for an increase in sustainable activities and behaviours. This results in demands for both micro and macroeconomic policy decisions (D'Souza & Taghian, 2010). In addition, the solution to environmental degradation and over consumption not only calls for drastic changes in consumer behaviour to offset high consumption levels, but a need for cleaner and more efficient technologies is called for as the amount of consumption will always be prevalent within society as a whole (Oskamp, 2000). The literature demonstrates that while the growing population wil consume and pollute, innovative technology in green products can bring about a change. To address sustainability and its conceptual foundations which are taken as self-evident; issues such as

production, overall economic activity, materialism, distribution or technology highlight a need for environmental consumption. Thereby putting pressure on Firms to innovate their thinking to a sound environmental based offerings.

There is substantial amount of literature covering environmental consumption (Schlegelmilch et al, 1996; Van dam & Apeldoorn, 199; Heiskanen & Pantzar, 1997; Schaefer & Crane, 2005; D'Souza and Taghian 2010). Although sustainability with regard to consumer products has been extensively researched throughout past and current literature, the development of the literature within sustainable clothing is an emergent topic in marketing and fashion research. Green purchases have not yet extended to this category of industry (Gam, 2011). Against this backdrop, the purpose of this study is to investigate the extent to which sustainable brands affects generation Y consumer's intention to purchase. There is limited research undertaken on sustainable brands. Within marketing literature, the majority of sustainable research (Karp, 1996; Schlegelmilch, Bohlen & Diamantopoulos, 1996; Follows & Jobber, 2000; D'Souza & Taghian, 2010) has studied the overall effect of environmental concern and purchase intentions in the context of household cleaning products, the recycling of paper, glass and plastic and energy consumption. However, there has been little empirical research addressing the use of textiles such as sustainable clothing (Domina & Koch, 1999; Morgan & Birtwistle, 2009). With a high demand for cheap fashion, the fast fashion clothing market has significantly grown. The research identifies an increase in purchase behaviour, with tendencies to keep clothing for a shorter period of time (Morgan & Birtwistle, 2009). The fashion cycle is relatively short and with each season new fashions emerge. According to Mintel (2007), there has been an excessive growth within fast fashion retailers worldwide, and these stores are recognized to create impulse buying, this increase in fast fashion has led to consumer's purchasing and disposing of large quantities of clothing toward landfills. In Australia, data obtained by the Australian Bureau of Statistics in 2010 suggest that the growth of waste generated per person has increased dramatically as a result of Australia's fast growing, materialist intensive society. With a strong dependence on landfill since 2007, Australia's rate of waste deposit increased by 12 percent with 21.3 million tonnes of waste deposited to landfill (Australian Bureau of Statistics, 2010).

*. The phenomenon of fast fashion has grown, the literature projects that this concept will continue to remain as an environmental impediment in the foreseeable future (Mintel, 2007). The lifecycle analysis of clothing is harmful to the environment due to the synthetic nature of the materials*

used in most clothing garments, they are not easily recyclable and consumes far more energy resources (Morgan & Birtwistle, 2009). Studies in the area of sustainably produced fashion show there is still a lack of knowledge in terms of consumer's wants and needs, resulting in low levels of sustainable consumption as consumers are more interested in their personal fashion needs than the environmental effect the garment poses on the environment (Joergens, 2006; Niinimaki, 2010). According to Meyer (2001) and Gam (2011) there is a lack of sustainable purchases within the apparel industry due to higher costs and decreased purchasing choices, with aesthetic and functional disadvantages. Many consumers lack knowledge of sustainable clothing and are uncertain about the actual environmental benefits.

## **SUSTAINABLE FASHION**

Encompassing a wide variety of branding literature ( Aaker, 1996 ; de Chernatony & Riley, 1998; Grace & O'Cass, 2002; Hartmann, Ibanez, & Sainz, 2005), is the notion of brand identity and brand value. The process of delivering a clear brand identity to consumers holds a high strategic importance within marketing strategy, in order to successfully create a high brand value (de Chernatony & Riley, 1998; Hartmann et al, 2005). In the view of Aaker & Joachimsthaler (2000), brand identity uses associations through the product to connect and create relationships with target consumers, generating value through emotional, functional and self-expressive benefits. Developing as a business and marketing imperative, brand equity has also emerged displaying the need to understand brand associations (Grace & O'Cass, 2002). To achieve this Keller (1993) suggests the use of a customer based brand equity strategy, which allows marketers to understand how their marketing strategies improve the value of their brand, emphasizing the importance of creating a differentiated effect, generating brand knowledge, awareness and consumer responses.

Sustainable clothing can be defined as clothing designed and produced for long term usage, causing little environmental impact and manufactured within ethically stable production systems, sustainable clothing makes use of eco-labeled and recycled materials (Joergens, 2006; Niinimaki, 2010). Sustainable fashion targets only a niche market, as garments do not always reflect the broad styles and lifestyles of consumers. McCracken (1988) states that clothing is a high involvement product as consumers buy clothing to create an identity and take possession of a style that best suits themselves. Clothes satisfy a wide range of consumer needs as they work to protect, define personal roles and help individuals express themselves

displaying a certain lifestyle (Meyer, 2001). It has been found that there are only minor differences in clothing preferences between males and females, where preferences are guided by an individual's fashion orientation (Meyer, 2001). According to Belleau, Nowlin, Summers & Xu (2001) an individual's fashion orientation is explained through attitudes, interest and opinions toward fashion products. Gutman & Mills (1982) suggested four factors that influence a consumer's fashion orientation are as follows: (1) Fashion leadership; (2) Fashion interest ; (3) Importance of being well dressed; and (4) Anti-fashion attitudes

Having an understanding of consumer's clothing preferences and purchase behaviours is imperative when effectively marketing sustainable brands in a retail fashion environment. As seen above there are vast differences in the way consumers treat fashion. Those fashion oriented consumers are more likely to seek further information about the garments; they have an increased curiosity of sustainably labeled apparel, and may ultimately have a greater propensity to purchase sustainable clothing (Gam, 2011).

Price sensitive consumers respond differently to purchasing environmental products. Despite the environmental concern of many consumers within the apparel industry, consumers are faced with a large volume of low cost clothing tempting consumers to purchase unsustainably (Niinimaki, 2010). According to Joergens (2006) sustainable purchases will only occur within the market if there is no added cost for the consumer, this includes higher prices and loss of quality and sacrifice to their ideal self. Sustainable clothing is generally sold at a higher price than mainstream garments due to the production process that is associated with the brands (Niinimaki, 2010). If consumers are price sensitive, it can pose a limitation on their decisions. As stated above, price is a dominant factor when consumers make purchasing decisions, and if this is the case then with low-cost, low- quality clothes in the market, it is hard to encourage consumers to purchase sustainably, if they would trade off on price. Secondly, sustainable fashion also faces low levels of awareness within society and although consumers are aware of the environmental issues being faced, sustainable clothing is a relatively new concept (Gam,2011), though. ethical and sustainable brands had emerged in the retail industry for several years and implemented by organisations such as People Tree, Gorman and Levi's. These sustainable brand leaders hope to bring new attitudinal changes toward sustainable fashion, gaining interest and awareness within fashionable consumers (Joergens, 2006). Thus the research hypothesis can be stated as follows:

*H1 -There is a direct and positive relationship between sustainable branding and generation Y's intention to purchase sustainable clothing*

Individuals categorized as generation Y are consumers born between the years of 1977 – 1994, making the age of respondents falling between 17 – 34 years (Martin & Turley, 2004; Foscht, Schloffer, Maloles & Chia, 2009; Noble et al, 2009). Due to the heterogeneity of the segment, the study explores a sub-section of generation Y consumers: participants between the ages of 18 - 30. Recent studies exploring generation Y purchase decisions have tended to divide generation Y into two subsections, with the majority of research taking high priority toward the older sub -section of generation Y (Martin & Turley, 2004; Noble et al, 2009). It is the purpose of this study to gain an understanding of the purchase decisions within sustainable clothing on generation Y consumers. Individuals selected to participate in this study have been chosen based on qualifying characteristics of generation Y. Respondents asked to complete the survey are between the ages of 18 – 30 years are enrolled in university or beginning their full time working careers. Several generation Y consumers are currently completing their tertiary education or have started their primary working life (Heaney, 2007). Those attending University are widely accessible through scheduled lecture and tutorial sessions and being the most technologically savvy generation, Y consumers are those who have begun working careers and are widely reachable through internet specific techniques.

## **DATA COLLECTION STRATEGY**

Due to the exploratory nature of this research within consumption of sustainable clothing, a quantitative based methodology is used to gain statistically significant relationships between the psychological variables and product attributes affecting intentions to purchase sustainable clothing. A self-administered questionnaire (paper based and online copy) is used for the data collection method. This allows the respondent to complete the questionnaire without the aid of an interviewer (Bryman, 2008). Survey research works well to collect primary data, specifically for the project at hand and is typically used to describe and identify target markets, customer attitudes, purchasing patterns and decisions (Zikmund, Babin, Carr & Griffin, 2000).

A self-administered survey is used as this technique provides a quick, inexpensive, efficient and accurate means of assessing information about a population (Zikmund et al, 2000). The use of questionnaires is one of the most popular methods for data collection in academic

research as many advantages are displayed through this process. Mann (1988) states, when employing a large sample size, surveys work as a very efficient tool when addressing a wide variety of topic areas, displaying information in a standardized and meaningful way when evaluating the findings. However, due to the high reliance on the actions and participation of respondents in the completion of a survey, issues with response rates and response bias can occur (Zikmund et al, 2000). This can present a disadvantage when generalizing findings, as data may not display a valid or accurate representation of the population. Notably, response bias is an issue as environmental concern and environmental behaviour questions may be answered in a false manner. As participants often answer with what they believe to be the most socially acceptable response (Zikmund et al, 2000), response bias was accounted for during questionnaire development, ensuring questions were not worded in a leading manner.

Based on previous studies the questionnaire has been established using appropriate scales all of which display adequate cronbach's alpha to ensure high validity and generalizability of findings (Maloney, Ward & Braucht, 1975; Schwepker & Cornwell, 1991; Stern, Dietz & Kalof, 1993; Schlegelmilch, Bohlen & Diamantopoulos, 1996; D'Souza, Taghian & Khosla, 2007; Kilbourne & Picket, 2008; Niinimaki, 2010). This research forms a part of a larger survey. Using a 5 point likert scale, respondents are asked to answer questions in a format of; (1) strongly disagree, (2) disagree, (3) neutral, (4) agree, (5) disagree. This was then collapsed into three: disagree, neutral and agree.

Prior to administering the questionnaire to students, a pilot test was conducted to ensure that the questionnaire instructions were adequate for the respondents and easily understood (Bryman, 2008). The pilot test identified how well the questions flowed and if any questions were not necessary or adding value to the survey (Bryman, 2008). The questionnaire was given to students prior to scheduled tutorial sessions commencing. Before students were asked to complete the questionnaire, the purpose of the study and applicable conditions were explained to students ensuring they were aware that by completing the questionnaire they were giving consent to be involved in the research. To gain the sample size required for the study, the process was done within numerous sessions. In the online survey, an exact copy of the paper-based questionnaire was created in an online format using Qualtrics; an industry leading provider of online survey software. Using social media as a communication tool, the online survey was sent out to individuals between the ages of 18- 30 who are currently completing a university degree, or have commenced their working careers. Once students

completed the questionnaire, paper based questionnaires were personally collected and filed, and online questionnaires were filed within the Qualtrics software program to adhere to confidentiality and privacy principles. A total of 210 completed surveys were collected within the current study, 199 surveys paper based copies of the questionnaire were completed while 90 surveys were completed via the online survey software; Qualtrics.

Cronbach Alpha test shows the reliability of a scale and specifies how free the scale is from random error (Pallant, 2010). According to Hair et al (1987) the statistics should have a minimum level of 0.6. However dependent on the number of items within a scale, a small number of items in a scale (less than 10) can provide quite a small Cronbach alpha value. The Cronbach alpha value for the variables tested was .616. In turn, Babbie (2005) states that validity refers to the extent to which the empirical measures adequately reflect the real meaning of the concept under consideration. Three types of validity exist; Convergent, Discriminant and Nomological (Hair, Anderson & Tatham 2006). This study assessed evidence for nomological validity of the scale. Several scales used within the questionnaire were adapted and are consistent with those previously used by other researchers, therefore ensuring nomological validity.

Chi square tests are non-parametric and it is used to establish whether the variables are statistically independent or if they are associated (Coakes and Steed, 2001). Coakes and Steed (2001) provide three assumptions: one is that observations should be randomly sampled, each observation should be independent and none of the expected frequency should be less than 1 and no more than 20% of the expected frequencies should be less than 5. The sample size of over 200 is considered large for a chi square test. If the sample size is small, chi square would give inaccurate results.

## **BRANDING AND INTENTION TO PURCHASE**

To understand the significance of branding alongside the intention to purchase sustainable clothing, a Chi Square Analysis was conducted. The data was analysed through SPSS. The original data was transformed to coded data. The three variables that were tested were also coded as 1= disagree, 2= neutral and 3= agree. The three variables were based on branding attributes: preference of sustainable brands over conventional brands, the extent to which

consumers switch between brands, and the last variable awareness of sustainable brands to purchase. These were used to answer the following hypothesis:

Three hypotheses have been formulated

- a. There is a significant association between the intention to purchase sustainable clothing and the preference to stay with a sustainable brand over a conventional brand
- b. There is a significant association between the intention to purchase sustainable clothing and brand switching
- c. There is a significant association between the intention to purchase sustainable clothing and awareness of sustainable brands

A cross tabulation table with a contingency coefficient was developed. The statistical significance ( $p$  value) of a result shows the probability that the observed relationship occurred by chance. The required level of significance for all analyses identified was  $p < .05$ . The magnitude of the associations and differences were also examined and reported using Cramer's  $V$  (Gall, Gall, & Borg, 2003). The data was analyzed using the chi-square test. The use of the cross tabulation chi-square test was used, as it makes no assumptions about the underlying distribution of the data (George & Mallery, 2007). Chi-Square is calculated by collecting the observed values for each and examining the differences between the observed and expected values. The main assumption of the chi-square test was not violated, as all cells had an expected frequency of more than 5. Notably, since the  $df= 4$ , anything above 0.35 has a large effect size (Cohen 1988, pp.75-107). It can be seen that all the other variables show little if any effect size. Thus the strength of the correlation between the two variables at hand are weak. The required level of significance for all analyses identified was  $p < 0.05$  (Gravetter and Wallnau, 2004).

The survey also yielded personal information regarding participant gender, age and Australian annual income. Demographic variables have been separated into categories, discussing the data in reference to their associated frequencies tables and histograms. From the 210 questionnaires completed, 41% of the participants were male, consequently 58% participants were female. A Chi Square Test was performed to analysis the association

between gender and intention to purchase sustainable clothing. Associations are deemed significant if the Pearson Chi – Square p value are between 0.00 and 0.05. The relationship was deemed insignificant  $\chi^2 = 2$ ,  $p = 0.429 > 0.05$ . Therefore, no significance was found between male’s intention to purchase sustainable clothing and female intention to purchase sustainable clothing

**Table 1:**

<b>Hypotheses</b>	<b>Pearson Chi -Square</b>	<b>Effect size – Cramer’s V</b>
a. There is a significant association between the intention to purchase sustainable clothing and the preference to stay with a sustainable brand over a conventional brand	$\chi^2 (4, N=210) = 10.182$ , $p = .037$	0.156
b. There is a significant association between the intention to purchase sustainable clothing and the extent to which consumers switch from a brand to try something new	$\chi^2 (4, N=210) = 13.510$ , $p = .009$ .	0.180
c. There is a significant association between the intention to purchase sustainable clothing and awareness of sustainable brands	$\chi^2 (4, N=210) = 9.560$ , $p = .049$ .	0.152

**Ha** is supported as there was a significant positive association between the intention to purchase sustainable clothing and the preference to stay with a sustainable brand  $\chi^2 (4, N=210) = 10.182$ ,  $p = .037$ . The Effect size of 0.156 shows a weak association between variables.

**Hb** is supported. There was a significant positive association between the intention to purchase sustainable clothing and the extent to which consumers switch from a brand to try something new  $\chi^2 (4, N=210) = 13.510$ ,  $p = .009$ . Effect size of 0.180 shows there a weak association between variables.

**Hc** is supported. There is a significant association between the intention to purchase sustainable clothing and awareness of sustainable brands  $\chi^2 (4, N=210) = 9.560$ ,  $p = .049$ . With an effect size of 0.152 the association displays a weak strength between the two variables

## **DISCUSSIONS**

As such, findings of this study can be beneficial to managers and sustainable strategy development by providing a deeper insight into the underlying psychological variables of generation Y consumers. An enhanced representation is provided of generation Y consumers and the level of environmental concern, allowing sustainable communication strategies to effectively target those younger consumers who are more inclined and willing to purchase sustainable clothing, by strongly focusing on their environmental concerns.

This prediction was confirmed displaying a significant relationship between the two variables. Findings of this thesis support the results of Pickett- Baker & Ozaki (2008), who showed how branding strategies can transform rational reasoning into emotional preferences, shifting consumer attitudes toward more sustainable purchases. Hartmann et al (2005) also stated that sustainable branding had a significant effect on an individual's emotional dimension. When linking back to the current research, this concept can be accepted, as a majority of respondents agreed with the statement "I believe a sustainable brand is a socially acceptable clothing brand". This shows the effect branding can have on purchase behaviour. If positioned correctly, a sustainable brand can be extremely successful within the segment of generation Y consumers, if quality is not compromised and is sold at a price affordable to generation Y consumers.

Although a significant relationship was present between sustainable branding and the intention to purchase sustainable clothing, this relationship was only weak, displaying a small effect on intentions and therefore actual purchase. This can be attributed to generation Y's knowledge of sustainable brand. A large proportion of the sample was not aware of sustainable clothing brands available to them and the overall concept of sustainable clothing. Hence, further research is needed in the field of sustainable branding, consumer knowledge and awareness of sustainable brands. This places further implications on marketers to create a higher awareness of sustainable clothing brands and the benefits associated with sustainable purchases. Effective branding strategies can have a dramatic effect on consumer's affective domain, transforming rational reasoning into emotional preferences, hence shifting consumer attitudes toward more sustainable purchases (Pickett-Baker & Ozaki, 2008). A sustainable brand has specific product attributes and related benefits to the environment holding perceptions of an environmentally sound purchase (Hartmann et al, 2005). Displaying environmentally sound product benefits, a sustainable brand should be positioned in a strategic manner to ensure the brand identity and value are actively communicated toward the target market (Aaker & Joachimsthaler, 2000). To be commercially successful within the retail market it is imperative for marketers to communicate sustainable brand attributes,

creating a differentiated brand through can develop a competitive edge through strategic marketing (Hartmann et al, 2005).

## **IMPLICATIONS TO PRACTITIONERS**

This places implications on manufacturing procedures and marketing communications. For generation Y consumers to actively purchase sustainable clothing, a high level of quality needs to be ensured. Manufacturing processes need to guarantee that quality garments are being produced; this may come at a higher cost but is likely to result in increased purchases of sustainable clothing in the long run thus resulting in diminishing cost of returns.

Findings of this study provide marketers with an understanding of the effect branding attributes play in the purchasing decisions of generation Y consumers. Marketing strategies can appropriately target the generation Y segment, and communicate sustainable clothing to suit their psychological values and the way they perceive product attributes. From this study it can be seen that an importance is placed on sustainable branding. Therefore, this allows for sustainable clothing companies to create garment's corresponding to the needs of the segment ensuring that appropriate characteristics are met. These findings provide marketers with the opportunity to create communication strategies that appeal to those who have a tendency to have environmental attitudes and values.

In addition, sustainable brands could create value for businesses. These brands also enhance social responsibility thus creating competitive advantage. The only issue that would arise is brand loyalty as loyal customers may not prefer to shift to alternate brands. It would serve a niche market.

## **LIMITATIONS**

Throughout the study conducted, a number of limitations were identified. These are useful when identifying recommendations for future research. Although all was done to obtain accurate and valid findings, the use of a convenience sample provided an imbalance of age and gender. From an analysis of the results it can be seen that an uneven variation of age was obtained. Prior to research a sample consisting of respondents aged 18 – 30 was anticipated. However, majority of the respondents included were aged between the years, 18 – 20 and 21 – 23, this displays a positive skew in participant age. This is due to the large sample of university students used. Although this poses limitations in terms of generalizability, the study gives a good representation of the younger subsection of generation Y consumers.

Therefore for future reference, research should use university students as a small segment within their sample to gain a larger variation of participant age. The concept of representation also applies to gender as the study had more female respondents than males.

Response bias also poses limitations toward the current study as participants can often answer a question in a false manner or in a way in which they think is preferred. This is an issue to take note of as environmental concern and environmental behaviours questions tend to suffer from bias with participants responding with the most socially acceptable option. Although, this issue of leading questions was accounted in questionnaire development, whether response bias occurred within in the study cannot be known.

## CONCLUSIONS

The results contribute to sustainability and fashion literature in a marketing context, proving marketers with an understanding of the sustainable branding for clothing affecting generation Y consumer's intention to purchase. Several conclusions can be made based on the results of this study, one being that generation Y consumer's psychological variables, such as environmental concern are very influential in their purchasing decisions. Secondly, this study identified generation Y consumers holding significant environmental and sustainable values. By identifying the driving forces influencing the sustainable purchases of generation Y consumers, marketing managers and key stakeholders are able to better predict consumer intentions. Although further refinement and research is required, to identify if this intention leads to actual sustainable purchase behaviours, marketers now have a platform, stating the underlying themes in sustainable consumption providing a clear insight into the decisions of generation Y consumers. This can contribute to the development of successful marketing strategies ensuring the transformation of sustainable clothing into a mainstream retail market of sustainable fashion.

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## EXPLORING THE DETERMINANTS OF MARKETING INNOVATIVE BEHAVIOURS IN WINE SMES: AN EXPLORATIVE CASE STUDY IN THE APULIAN WINE BUSINESS.

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### ABSTRACT

*Research on innovation is continuously improving and the academic debate on innovation is hugely wide and alive. Following the work of some eminent scholars (see among others Hauser et al., 2006), we will focus on the issue of marketing innovation conceived as an incremental innovation in marketing that upgrade the benefits (substantial price or functional) to users. This paper means to perform and analyze the determinants of marketing innovative behaviours in wine SMEs by performing an explorative study of the Apulia region, in southern Italy. The paper wants to answer the following research questions: which drivers promote marketing innovative behaviours among SMEs? A mixed approach has been adopted in research designing (Yin, 1998) and particular attention has been paid to research strategy triangulation and multiple data source selection when building the case. A web based survey has been submitted to a sample of 100 wineries and 63 responses have been collected. Data once collected have been analysed and integrated with secondary data previously collected. The paper is structured as follows: in the first part a literature review on marketing innovation and innovation in general and in the wine industry is provided; secondly methodology and hypothesis are presented. Then the case study is introduced. After the data analysis section implications and conclusions are drawn.*

**Keywords:** Marketing innovation, Wine business, Strategy triangulation, Innovation, Customer orientation, Market orientation, Competitive advantage, Web Survey

### INTRODUCTION

The wine industry is facing global challenges that are shaping the competitive environment. Italy has seen a changing competitive scenario: new competitors from non EU states (Chile,

Australia, South Africa, etc..) are threatening the Old World's relative market share and new trends in consumption and demands are transforming the business. A new hedonistic lifestyles led to an increase in consumption of other types of beverages and the simultaneous shift in demand towards the Protected Designation of Origin (PDO)/Denomination of Controlled and Guaranteed Origin (DCGO) wines. This demand is favoured by an increase in the consumption outside the home and the accentuation of the hedonistic function of prestigious wines. Furthermore as the demand for convenience foods increases, consequently the quality of such products becomes more important (Buckley et al., 2005). Through the food-related lifestyle (FRL) instrument authors have demonstrated both rural and urban consumers are more responsive toward new food products and show a preference toward the same salient factors: price, quality, taste, health issues, and nutritional composition (Cullen and Kingston, 2009). Somewhat hedonistic goes to do with the experimental creation of wine label too; furthermore new wine consumers in the 19 to 22 year-old segment are much more likely to choose wine based on package features than based on product features, such as producer and country-of-origin (Elliot and Barth, 2012). Nevertheless, Italy must face a high fragmentation on the productive side that does not facilitate small scale wineries to emerge. Apulia, a region in the Southern Italy, has a long history as a wine producer, but the local wine industry has to face serious market challenges in order to compete with emerging countries. Since the first efforts paid for upgrading wine quality and for promoting the local food and wine production at a national and international level, this region has adopted a policy oriented to support local wines and to create new appellations. Apulia is trying to move from a low quality positioning to a higher quality production. Marketing innovation could help wineries to market themselves. Generally innovations to diversify wine farm production are less frequent (Borsellino et al. 2012) and background research on marketing innovation in wine is very limited. This paper aims at filling this gap. It investigates the determinants of marketing innovation and intends to highlight the relationships between marketing innovation and market orientation, consumer orientation, customer orientation, strategic intent and market positioning. Understanding under what conditions marketing innovation is more likely to happen would provide important insights for evaluating which are the optimal conditions for the successful adoption of marketing innovations; consequently marketing innovation can play a key role in the wine business development and can be a useful tool to help winery to adapt to evolving needs and demands. The present paper has been designed and carried out within the following Integrated Projects of Food Chain (IPFs), measure 124 of the Rural Development Program of Apulia Region (EAFRD), in the wine

sector: Vitis, Nord Wine, Sud Wine. An explorative case study based on multiple observations is therefore presented. Our case focuses on a specific area of Apulia, since the wineries interviewed produce wines with the appellations of origin Locorotondo, Castel del Monte and Nero di Troia. Background research is provided in order to support the hypothesis to test. Therefore an explorative case study is presented. Findings and implications are drawn. Conclusions close the paper.

## **BACKGROUND RESEARCH**

### *Marketing Innovation*

Research on innovation is extremely wide and explores different aspects of the issue by adopting various approaches and perspectives. One of the challenges scholars must face is the availability of studies and the wide range of approaches that have been adopted: a scholar who move towards this research issue must deal with an impressive number of definitions available in the literature (Garcia and Calantone, 2001), an inner dichotomy (Wang et al., 2005) and a variety of categorizations (i.e: technical/administrative; product/process; radical/incremental) that underline that this field of study is so deeply permeated by an evolving dynamism and a high complexity. As we have already observed, the complexity of the issue is reflected in the measurement of the adopted methods: if at the earliest stages of the research in the field, innovation was measured by considering a few variables, today, as pointed out by some scholars (Wang et al., 2005) research designs take into account a wide number of variables. In this paper we will explore a specific issue of innovation, that is marketing innovation. Although it is recognised the importance that marketing innovation plays in the achievement of firm's competitive advantage, scholars (Chen, 2006; Augusto and Cohelo, 2009) underline that there is a limited research in this specific issue. From the literature it emerges how marketing innovation has been often examined as an issue related to other research issues and it has been rarely investigated as an isolated concept: the lack of specific studies and the difficulty in isolating marketing innovation from the other variables under investigation have fostered a sort of confusion on the research issue. Marketing innovations represent "ways in which companies can develop new ways of marketing themselves to potential or existing customers. Marketing innovations should not be confused with market innovations that, according to John and Davies (2000), are concerned with activities such as the entry into new markets (Halpern, 2010). Marketing Innovation has been classified as a type of incremental innovation (Grewal and Tansuhaj, 2001); other authors

consider marketing innovation as part of business methods innovation (Chen, 2006). By recovering the aspect of perceived novelty (Rogers, 1998) and users' benefits (see among the others Dosi, 1982; Henderson and Clark, 1990), we can define Marketing Innovation as an incremental innovation in marketing that upgrades the benefits (substantial price or functional) to users. Nevertheless, marketing innovation has too often been misunderstood with market orientation (Halpern, 2010). Market orientation mainly focuses on the ability of the firm to understand consumer's needs and to respond to market pressures. Market orientation has been considered as a general strategic orientation that might facilitate new product development (Augusto and Cohelo, 2009). Thus market innovation is influenced by market orientation, but, although linked, the two concepts are slightly different. Insights emerging from background empirical research on marketing innovation are limited and hard to be generalised. Nevertheless background research provides some useful inputs for our study and more specifically for defining which are the determinants of marketing innovation within the wine industry and which variables should be observed. From the literature it emerges the relationships between Marketing Innovation, Marketing Orientation and Competitive Advantage Creation: marketing orientation influences marketing innovation that has a primary role in the building of competitive advantage (Naidoo, 2010). Empirical researches have been carried in the field of SMEs to highlight how variables are related (Naidoo, 2010). Other scholars in their empirical studies have outlined the conditions under which Marketing Innovation is more likely to happen: size and position of the company influence the type and the strength (or the ability to resist to imitation) of Marketing innovation (Chen, 2006). Following the definition of marketing innovation previously provided, marketing innovation should be considered as an effective tool for emerging in a market. Due to the intrinsic ties that marketing innovation has with marketing orientation we should suppose that there is a linkage between the type of strategy chosen for achieving competitive advantage, the segment of customer served and marketing innovation. There has been an extensive academic debate about the importance of business orientation and firms' capability for the achievement of superior performances (see among the others, Jaworski and Kohli, 1993; Lumpkin and Dess, 1996). Empirical researches have shown the linkages between innovation and marketing and firm's competitiveness (O'Cass and Viet Ngo, 2011), and market orientation and firm's performance (Hult and Ketchen, 2001). Thus there is no doubt about the role that innovation plays in firms competitive positioning and, more specifically, about the importance of marketing in achieving a superior competitive advantage. An

element of novelty to investigate is the linkage between the type of competitive advantage sought by firms and the willingness to introduce marketing innovation

*Innovation and Marketing Innovation in wine*

As some authors have observed (Voelpel et al., 2006), many wineries owe their industry leader positioning to a savvy mix of knowledge and innovation: the growth of some companies and the reshape of the wine industry (with the emerging of *negotiants* and New World business models) is much more explained by innovation and knowledge rather than by physical resources. Thus the importance of innovation for the development of the business, the wine business has to face some constraints and resistance to innovation and marketing innovations. First of all the characteristics of the business must be taken into account when exploring innovation. Researcher who approach the issue of innovation and marketing innovation in wine can't leave out of consideration the inner features of the business, since it has been demonstrated that innovation is influenced by sector dynamics (Malerba, 2007). This perspective is supported and reinforced by the studies carried in the field of agricultural innovation that bestow a primary role to business features (see among the others the works by García-Martinez and Briz, 2000; Grunert et al., 1997). The wine business is heavily regulated: local and European codes control inputs and processes; wineries are not free to mix grapes or blend wines as they prefer, if they want to use appellation of origin on their labels. Also packaging is settled by appellation standards. As it can be guessed it is extremely difficult to find out some radical examples of innovation in wine. Furthermore, we are talking about an agricultural business (Jenster et al., 2008) that is facing a "seismic shift" (Aylward, 2003) in global consumption and production. Wineries have tried to find new ways to reach new consumers and increasing sales, especially in times where new competitors are just around the corner and market pressure gets higher. Wineries perceive the importance of pursuing product differentiation by improving the so called augmented product dimension (Jennings and Wood, 1994). Marketing innovation could be a useful tool for achieving an effective differentiation strategy. Background research on marketing innovation in wine is limited. Some insights may come from researches that explore how companies have improved changes in marketing and packaging for meeting customers' expectations (Santini et al., 2006). From a preliminary analysis of the literature it emerges that research on innovation is focused on a few topics: some studies investigate the dynamics of innovative behaviours among wineries by exploring the role that location might have on firms' orientation towards innovation (Gilinsky et al. 2008); other researches provide insights about consumers perception of innovations (see the study on packaging by Atkin et al., 2006; Marin

et al. 2007); much research focuses on the role that clusters and networks have on the adoption and the development of innovative behaviours (Giuliani et al., 2008; Giuliani and Arza, 2009). The literature suggests that Marketing Innovations have progressively found a diffusion among wineries, in order to be able to adapt to the evolving market or consumers' needs or to pursue a differentiation strategy (Santini et al., 2006). Besides the importance covered by marketing innovation in wine, there is a research gap about this issue. In order to understand the main features of marketing innovations in wine, we have performed an analysis on the main professionals websites (WineBusiness.com; Vines and Vine; Harpers) with the aim of creating a list of the tools implemented by marketing and sales departments in the industry for marketing wines. **Σφάλμα! Το αρχείο προέλευσης της αναφοράς δεν βρέθηκε.** represents the main marketing tools adopted by wineries over the last decade. A brief description of some selected packaging innovations is also provided by 2. With an introduction of minor packaging innovations, sustainable too (Conte et Al., 2013), companies can be facilitated in marketing themselves and can be able to: improve the info provided to consumers; make people feel much more comfortable with wine; help wineries to reach new segments of consumers or new markets that pay a particular attention to some specific aspect of consumption, production or packaging.

## METHODOLOGY AND HYPOTHESIS

The complexity of strategy as a research issue requires researchers to deal with mixed approaches and hybrid research designs (Harrigan, 1983). From the debate on the methodological approach to investigate strategy it emerges the need of a "customization" or adaptation of existing research methods (see among the others, Harrigan, 1983). This paper is an explorative case study. The research design has been structured in order to follow the principles outlined by eminent scholars (Eisenhardt, 1989). In particular we have been extremely careful to ensure research triangulation (Eisenhardt, 1989; 2007); in order to preserve the explorative feature of the case, we have combined multiple data sources (Gersick,

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**Marketing and Sales Tools**

Type	Brief Description	Resource Requirements
Website	Websites that host company info. The Web is a great tool for achieving notoriety among consumers and visitors.	The company has to make an initial investment for buying the web domain; the amount of money required for managing a website depends on the degree of outsourcing of the website and to the type of website that the company wants to realise.
Newsletter	Newsletters are sent by email to a list of customers or professionals that agreed to receive information and news from the company. Usually contain info about the winery and its products, the vintage, events, etc..	The company has to invest time and HR for building a database of customers that agree to receive the newsletter, and for writing news.
Wine Club	A winery wine club ships wine to customers' door once/twice (or more) per year according to the type of service selected by the customer. As a reward the customer can have free access to wine tasting or events in the winery or discount; rewards vary according to the type of membership selected. Payment is in advance	Winery wine clubs are used by wineries for enhancing customers' loyalty and developing direct sales (Santini and Faraoni, 2008). Winery Wine Clubs need a high initial investment in terms of development of a proper offer and an adequate promotion of the new marketing tool.
Wine Events	Events hosted in the cellar. Wine Events are events that take place at the winery; this category includes tasting, concerts, art exhibitions, conferences, book presentations, etc...Also special sales, could be considered as wine events.	The cost of this marketing tool depends on the aims the company wants to pursue.
Wine Education	Wine training organized by the company on a regular basis, in order to make consumer more comfortable with wine. Consumers who take part can gain info about: how wine is made; how wine should be tasted and stored; the area or the country where wine is produced; food and wine	The target and quantity of internal resources that the company aims to reach influences the amount of financial resources that might be employed.

pairing.

Telemarketing	Telemarketing sales. In the countries where there has been a development of commercial TV it can represent an interesting way for marketing products.	The initial investment is high. The impact on finance depends on the type of broadcast the company wants and on the geographical coverage.
Brokers /agents	Agents or Brokers selling wine. A network of brokers or agents represent an effective tool for selling wine abroad, especially for small companies who don't have resource for visiting personally foreign countries.	Through brokers and agents companies can operate in the Ho.Re.Ca. channel. The investment is relatively low and in general the company pays a percentage to the agent according to the volume sold.
Mobile App	Application for mobile phone. Mobile Apps have been released on the market for facilitating knowledge circulation and extending the relationship between wineries and final consumers.	The wine has seen an impressive quantity of mobile apps that can provide info about wine tourism, wine purchase, wine pairing, etc..
Social network and web 2.0	Employment of Social Network and web 2.0 for reducing the distance company - consumer. Facebook and other social networks are often used for cultivating customer relationships	This tool is not a universal remedy for establishing a profitable relationship with final users. A professional management should ensure a profitable growth.

## INNOVATIVE PACKAGING

**Screw caps:** this type of closure not only helps to reduce the risk of a bad storage of wine, but also makes wine tasting easier, since no other tools are required for opening a bottle and the act of drinking is released from the ritual of uncorking. Screw caps are sought by a consumers because they make wine easier and help in maintaining wine after it has been opened.

**Bag in Box:** as well as screw caps Bag in Box help to maintain wine longer. This package is particularly appreciated in some Northern Europe countries that tend to import wines whose package is eco friendly; some market segments are particularly interested in Boxed wines, as they represent an answer to some of their needs (see Santini et al., 2006).

**Glass Top:** glass top is useful for reducing the risk of damaging the quality of wine during storage; it represents – as well as cork with silicon, silicon cork and screw cap- an alternative to the traditional cork. Glass top is also eco friendly and it represents an incentive for those

consumers that seek for green oriented products when they buy wine.

Can and aluminum bottles: They are 100% recyclable. Wine in a can is slowing getting a diffusion outside US; aluminum is seen as a novelty in wine. Pros are the lower weight of the aluminum bottle if compared to the classical glass bottle and the waste disposal process. Cons are the unit cost and the aversion of consumers towards this kind of package.

RFID: RFID can be employed for monitoring sales and storage. A large employment of RFID has been done for logistic purposes; companies are also employing RFID for monitoring traceability.

QR Code: Qr Code are finding a diffusion also in Europe and are extremely useful for providing extra info about the company or the wine to consumers. Qr Code can be easily placed on the label.

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*Table 4 - Marketing and Sales Tools and Innovative Packaging*

1988) that have also been proven to reinforce substantiation of constructs and hypothesis (Eisenhardt, 1989). In particular we have been extremely careful to ensure research triangulation (Eisenhardt, 1989; 2007); in order to preserve the explorative feature of the case, we have combined multiple data sources (Gersick, 1988) that have also been proven to reinforce substantiation of constructs and hypothesis (Eisenhardt, 1989). Background research have shown the importance of combining qualitative and quantitative approaches in case study research (Yin, 1998); this paper has been designed to combine secondary data to the primary ones collected through a survey. The survey has been carried by using tested items scales that have emerged from the literature review. More specifically, the workflow has followed the following steps: firstly a desk research has been carried in order to provide evidences and insights for defining variables to investigate. Then, secondary data have been collected according to the specificities emerging from the academic literature, in order to illustrate business features and context characteristics that have been proven to influence firm's innovative behaviours. In particular, for describing the business context we have followed the insights emerging from Zeithaml and Fry (1984). The next step was to submit a survey. A web-based survey has been employed: given its accessibility, web based survey have been frequently used in field research (see among others, Gilinsky et al., 2008). Before submission the survey has been tested. On the basis of insights emerging from background research the following Hypothesis have been formulated:

*Hp1: Companies where management is actively involved in seeking for innovative marketing ideas have a strong Market Orientation.*

*Hp2: The degree of management willingness to introduce Marketing Innovation varies according to the way strategy is crafted.*

*Hp3: Companies that show a high customer orientation are those where managers are strongly committed to seek for innovative marketing ideas.*

*Hp4: High degree of managerial attitude towards Marketing Innovation is more likely to be found in companies with a strong Competitor Orientation.*

As well as for innovation (Ravichandran, 1999) it is widely recognised the difficulty in achieving a widely employed method for measuring marketing innovation. Empirical researches carried in the field of marketing innovation (Naidoo, 2010) have provided us with some insights for selecting variables to observe and item to test in the survey. The variables observed and the related scales are displayed in Table 22.

Variable	Item	Scale
Marketing Innovation [MI]	Management actively seeks innovative marketing ideas.	Agreement (1-7)
	Improvements in product design are readily accepted.	Agreement (1-7)
	Improvements in product promotional activities are readily accepted.	Agreement (1-7)
	Improvements in product pricing are readily accepted.	Agreement (1-7)
	Staff are penalized for new marketing ideas that do not work	Agreement (1-7); R
Competitive Strategy [CS]	New marketing ideas are perceived as too risky and are resisted	Agreement (1-7); R
	With regard to competition, my firm is always ahead in the use of innovative promotional strategies (Differentiation)	Agreement (1-7)
	With regard to competition, my firm is always ahead in the use of innovative pricing strategies (Differentiation).	Agreement (1-7)
	My firm distinguishes itself from competition by means of the quality of its products(Differentiation)	Agreement (1-7)

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	My firm emphasises cost reduction in all its business activities (Cost Leadership)	Agreement (1-7)
	In my firm, the production process changes all the time with the goal of constantly reducing production costs (Cost Leadership)	Agreement (1-7)
	My firm invests mainly in large projects to realise economies of scale (Cost Leadership)	Agreement (1-7)
	In my firm, cost is the most important consideration in the choice of a distribution system (Cost Leadership)	Agreement (1-7)
	In my firm, cost is the most important consideration in the choice of a distribution system (Cost Leadership)	Agreement (1-7)
	My firm tries to force competitors out of the market by good cost control (Cost Leadership)	Agreement (1-7)
	My firm produces one single unique product (Focus)	Agreement (1-7)
	My firm targets a specific, limited part of the market with its products (Focus)	Agreement (1-7)
	My firm's strategies are driven primarily by customer satisfaction.	Agreement (1-7)
	My firm's strategies are based on understanding customer needs.	Agreement (1-7)
	My firm's strategies are driven by its beliefs about how it can create greater value for its customers.	Agreement (1-7)
Customer orientation [CO]	The customers' interests are one of the key priorities of my firm.	Agreement (1-7)
	My firm carries market research with customers at least once a year to assess the quality of its products.	Agreement (1-7)
	My firm incorporates the extent to which its customers are satisfied with its products as part of its quality assessment.	Agreement (1-7)
	If my firm finds that its customers are	Agreement (1-7)

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	dissatisfied with the quality of its products, it immediately takes corrective actions.	
	My firm rapidly responds to competitive actions that threaten it in its industry.	Agreement (1-7)
	My firm is very well aware of its competitors.	Agreement (1-7)
	My firm is more customer-oriented than its competitors.	Agreement (1-7)
	My firm competes primarily by adopting a strategy of product differentiation.	Agreement (1-7)
Competitor Orientation [Co.O]	My firm's product(s) are the best in the business.	Agreement (1-7)
	My firm is quick to respond to significant changes in its competitors' pricing.	Agreement (1-7)
	My firm regularly monitors its competitors' marketing efforts.	Agreement (1-7)
	If a major competitor were to launch an intensive campaign targeted at export markets, my firm would implement a response immediately.	Agreement (1-7)

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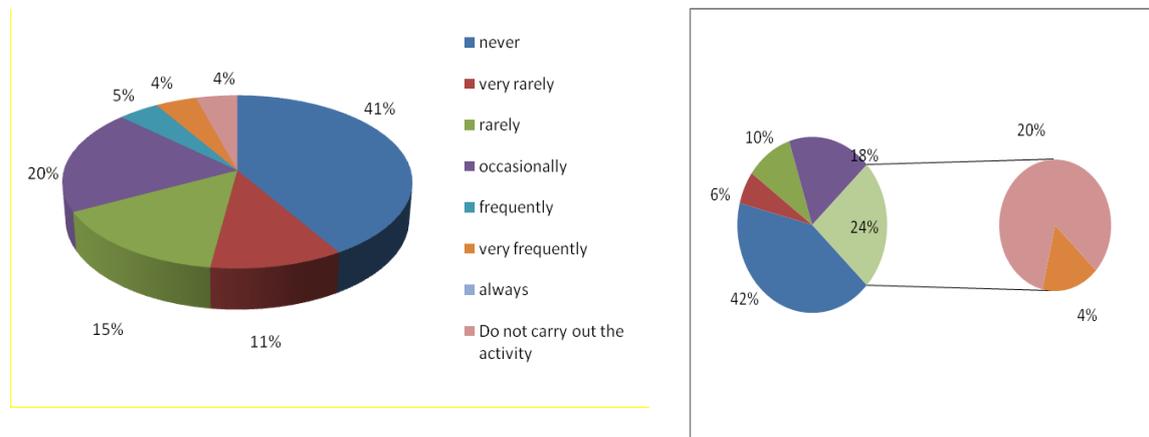
Table 2, *The variables selected (note: R stands for Reverse Scale)*

## THE CASE STUDY

Apulia is located in Southern Italy and has a long history as a wine producer, but the local wine industry has to face many challenges for emerging in the competitive scenario (Costa et al., 2013). In 2012 the total Apulian wine production represented the 13.6% of the total wine produced in Italy (ISTAT). Apulian wine production dramatically fell down (according to ISTAT -8% in the period 2011 – 2012) together with a impressive reduction of hectares of Vineyards. Local producers are experimenting difficulties in selling their wines and this is confirmed also by the growth of must sales (Contò et al., 2011; 2013). According to MIPAF, Apulia is getting through a transition phase, trying to move from a low quality positioning to a higher quality production (Baiano et al., 2013): in Italy Apulian bulk wines are known because they were used for blending and reinforcing wines with lower alcohol content. Many efforts for supporting and improving the local food and wine production have been spent

over the last years in order to upgrade Apulian products image; policy makers and institutions, together with producers and other stakeholders are committed to promote local productions both on the domestic and international markets. New appellations have been introduced in order to control wine quality and to improve sales through the potential benefits arising from appellations. Nevertheless the challenges that Apulian wineries must face are various: first of all they must be able to face a fierce competition happening both at a national and international scale that is fostered by the global economic and financial crisis. European policy has dejected smaller wine producers (Confagricoltura) whose only lifeline is to find a rescue in niche strategy. Thus niches are getting overcrowded and it becomes challenging to emerge in a competitive landscape where there is a mass of good quality wines available on the market released by small scale wine producers. In this scenario marketing innovation would help. Apulian wine industry represents for all the reasons above described an interesting case to observe. An explorative case study based on multiple observations is therefore presented. Our case focuses on a specific area of Apulia. The explorative study have been designed and carried out within the following Integrated Projects of Food Chain (IPFs), measure 124 of the Rural Development Program of Apulia Region (EAFRD), in the wine sector: Vitis, Nord Wine, Sud Wine. These wineries sells their brands under the following appellations of origin: Locorotondo, Castel del Monte, Nero di Troia. Therefore, the criteria used for identifying the sample of firms to be interviewed are: 1. certified quality wine production (DOP); 2. wine produced by indigenous grape variety that are Nero di Troia, Aglianico, Bombino Bianco e Nero, Verdeca, Fiano, Pampanuto. We have collected data through a web based survey and then analysed the inputs of 63 respondents whose in majority were owners (39.4%), followed by Sales Managers (24.2%), General Manager (10.6%) and then winemaker (10.61%). The 63 wine companies examined are l.t.d. companies (42,6%) and another relevant percentage (27,9%) are '*aziende agricole*' that according to the Italian law are in general relatively small and whose main trait is agricultural production. Many companies are family businesses (17 out of 63) and 6 companies are in the third generation of family business and other 6 are older. As regards the production's dimension of the firms, most of them (24%) produced more than 1 million of bottles in 2012 (these firms export their wine in the most important global markets) and 17% of the interviewed wineries produced less than 50.000 bottles, mainly for the domestic market and so on. The wineries interviewed do not tend to outsource: the majority manages the vineyard by itself (77,2%) and is in charge of other activities such as pressing (80,7%), bottling (84,7%), logistic (90,7%). Outsourcing is more frequent in marketing activities: the 42% of the companies interviewed manages direct

marketing activities by their own or are in charge of social media marketing (39,5%). 40% of respondents entrust never to external experts promotional marketing activities; 4% does not carry out the latter activities and 20% does not carry out even direct marketing activities (graph. 1-2).



*Graph. 1 and 2 - Outsourcing to external experts of promotional marketing activities (on the left) and direct marketing activities (on the right)*

It should also be underlined that 47,2% do not employ ecommerce for selling their products, 15% does not use social media and 10 % does not have a developed direct sale channel. These data are crucial in order to investigate the issue of marketing innovation. Companies compete in different market segments, but none of respondents offers icon wines; as expected, inc. firms focus production only on upper price segments: Premium (5-7 €), Super Premium (7-14 €), Ultra Premium (14-150 €) whose percentage value (33%) is higher than the others juridical forms. Cooperative winery produce in majority wine in Popular Premium (3-5 €) segment. Companies give more importance to customers segments such as traditionalists and baby boomers; the 76% of the companies consider the latter as the most important segment for their sales today and almost 80% of the companies estimate baby boomers as the most important market segment for future sales). Companies in general don't show some tendency to change their preferences towards the market segments they have chosen. In order to outline the diffusion of marketing and sales tools and packaging innovations we have asked wineries info about what they do and how they market their products. Results are shown in Figure and a synthetic overview of marketing and sales tools is provided in Fig. 2.

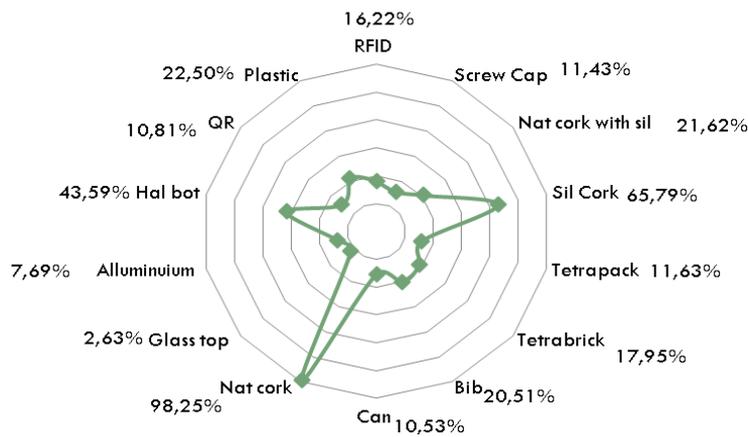


Figure 1 - Diffusion of package innovation within the population examined (% is calculated on the number of valid responses )

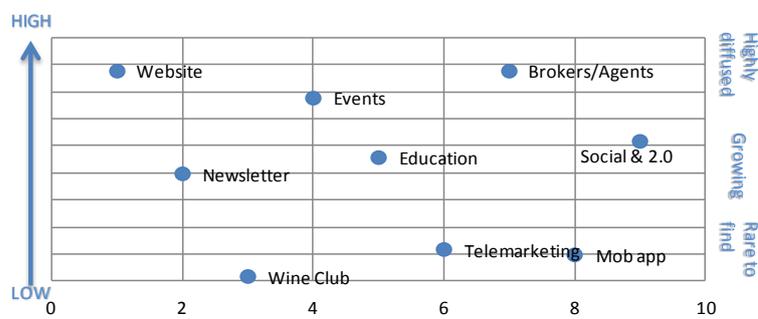


Fig. 2 - Diffusion of Marketing and sales tools in the population of wineries observed (on the Y axis the number of wineries that adopt the marketing solution proposed)

## FINDINGS AND IMPLICATIONS

Data analysis has been performed by using SPSS software. The small size of the sample has not allowed to carry out PCA analysis. Nevertheless, we have been able to perform a correlation analysis with the aim of highlighting significant relationships between the variables selected. Correlation matrix shows most of Pearson's Correlation values among different items of the variables (see Table 2) that are significant at the 0.01 level (2-tailed). Generally, from the data it emerges that the companies where management is much more involved in seeking for innovative marketing ideas are those whose strategy is crafted on competitors (Pearson's Correlation values equal to 0.533 and 0.635 at the 0.01 level). Thus, in our analysis competitor orientation in strategy making plays a key role in defining managerial attitude towards marketing innovation (with a Pearson's Correlation value equal to 0.558 at the 0.01 level). Although data show a positive and significant relationship between

customer orientation and managerial attitude towards marketing innovation, customer orientation plays only a secondary role in the formulation process of innovative marketing ideas by managers. A Pearson's Correlation value equal to 0.772, significant at the 0.01 level, highlight the strong relation between Marketing Innovation and Customer Orientation; in particular, those companies that are more likely to accept changes in product designing are those where management is highly involved in seeking for new marketing ideas. In other words marketing innovation finds a breeding ground in those companies who perceive the importance of product designing as part of the innovative process. Thus all the five hypothesis are confirmed.

Findings cannot be discussed in relation to existing literature, as background research on marketing innovation in wine is very limited; in fact this paper aims at filling this gap. We can underline that this work fits with the insights by other researchers that have explored firms' improved changes in marketing and packaging for meeting customers' expectations (Santini et al., 2006). Academic and practical implications are related to the advantage for wine marketers to understand the competitive environment for identifying who are the true competitors (Vrontis et Al., 2011a). Further changes suggested to wine practitioners includes concentrating on native grapes which offer optimum results, developing quality, using better marketing and promotional techniques (Vrontis and Thrassou, 2011) and savvy mix of innovation to reach industry leader positioning (Voelpel et al., 2006). In conclusion, marketing innovation could help wineries to market themselves if the way strategy is crafted.

## CONCLUSIONS

Over the past few years, the wine business have been changing at a pace that has left many wine firms unable to adapt to a constantly modified environment (Vrontis et al., 2011a). The first important conclusion is evident from past researches: quality (Hejmalová and Šperková, 2011), and innovation (Garcia et al., 2000) conceived in several ways and concepts, are the new watchwords of agriculture and so wine sector. This insight has been reinforced through the explorative case study of this research. Marketing innovation could be a crucial driver to face the new challenges of the wine business being an useful tool to help winery to adapt to evolving needs and demands. A management seeking innovative marketing ideas has a key role in strengthening this driver. This paper has several limits; firstly the relative small sample has limited the statistical analysis to be performed. Secondly, the number of variables

selected doesn't provide a full overview of marketing innovation, but focuses on the role of management in the innovation process. Besides the limits, that are those typical of explorative research papers, this paper has the merit to provide some insights about marketing innovation and to inputs for further researches.

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## THE INTERNATIONALIZATION STRATEGIES OF ITALIAN COMPANIES IN INDIA

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### ABSTRACT

This study explores the characteristics of Italian foreign direct investment (FDI) in India and aims at filling the gap identified in the literature (i.e. a lack of empirical studies on Italian MNCs internationalizing in India) by providing an exploratory study on this issue. By the end of the Eighties most internationally oriented companies had realized the urgency of moving into the Far East. Italian MNCs are part of this trend. It is therefore important to fill the above mentioned gap for the possible implication both under the managerial and under the theoretical perspective. In particular, different questions need basically to be asked and answered, such as “Why do Italian firms invest in India (motives of FDI)”, “Role of the subsidiary in the international network of the Italian MNC” and “Its value chain configuration”. In order to investigate the research questions, a unique database of Italian firms that invested in India was created. The first empirical confirmation we collected was about the low number of Italian companies with subsidiaries in India. In terms of internationalization goals it emerges clearly from the research that the main target is market seeking. In order to acquire that market share Italian companies have organized their subsidiaries as partially independent companies, adopting a typical “multidomestic” approach customizing products and services to the local needs and demands. Moreover, the industry fragmentation suggests that so far only the best in each class have approached India.

**Keywords:** India, internationalization, FDI, MNC.

## INTRODUCTION

By the end of the Eighties most internationally oriented companies had realized the urgency of moving into the Far East. Italian MNCs are part of this trend. The growth and potential of Asia have been obvious for a while, but what changed were the barriers to foreign companies: Asia as a whole was opening up to the outside. Of all the Asian countries China has made the strongest effort to entice Western companies to invest in their country, while at the same time providing the largest market (in terms of population) in the world. By the end of the Nineties every company that wanted to be a serious global player had some sort of presence in China. In 1996 developing countries received inflows of 130bn USD in direct investment, China received 42bn (the largest share), and India only got 2.5bn (Athreye and Kapur, 1999). For a number of reasons, India was overlooked until a few years ago, however it still is – especially by Italian companies – when compared to any other BRIC nation.

This aim of this paper is to analyze the extent and the characteristics of the internationalization process of Italian companies going to India. More specifically, we try to understand the reasons behind internationalization decisions in India, the strategic goals associated with them (i.e. manufacturing vs. commercial), the role played by the Indian subsidiary and its value chain configuration. In particular we try to understand whether the value chain reflects closely that of the parent company or if it is influenced by the local needs. Therefore the decisions that impact the business model configuration (Onetti et. al., 2012) are investigated: make vs. buy, and international value chain configuration (longer vs. shorter).

The purpose of this topic seems to be extremely relevant for different reasons:

- The relevance of Indian market among relatively large emerging economies;
- Lack of literature on Italian companies that internationalize to India;
- The choice to focus the attention on the FDI.

With respect to the first aspect, India represent an interesting case of rapid growth and internationalization witnessed during the past two decades (Pradhan, 2011; Zheng, 2009). India-EU relations have grown substantially in both quality and depth in the last few years. India's engagement with the EU in trade grew steadily up until the economic crisis of 2008/2009. Looking at data from Ministry of Commerce & Industry (2009-2010) it is easy to see how EU represents a 20% share in India's total exports, followed by the United Arab Emirates (13%), USA (11%) and China (7%). However, analyzing the country wise cumulative FDI inflow in India (data from Ministry of Commerce & Industry, period 2000-2011), while EU (27) represent 20% of the overall amount the Italian share is about 1%.

With respect to the second aspect, the literature background analysis presented in the second part of the literature review, shows a substantial gap of empirical studies on Italian MNCs internationalizing in India. While many scholars have carried out several empirical studies on Italian MNCs operating in foreign markets, we find out only two studies dealing with Italian MNCs in India.

As regards the choice to focus the attention on the FDI – disregarding other important methods of internationalization – is based on the following evaluations: Foreign Direct Investments represent, by their own nature, irreversible choices in the short term and can therefore be considered as a good proxy of the companies employing such medium to long term strategies; FDIs are traditionally mentioned in literature (Caves 1971; Dunning 1981; Johanson and Vahlne, 1977) as an evolved and mature form of internationalization, indeed they show a strong commitment towards the company's international strategy.

For all the above reasons, studying the FDIs can help understanding the trends and strategies in companies' internationalization.

This paper is structured in three main sections. The first one contains a comprehensive literature review on internationalization process and highlights a substantial gap of empirical studies on Italian MNCs internationalizing in India. In the second paragraph, the methodology is discussed and the main features of the sample are presented. In the third section, results are pointed out. Some managerial and research implication complete the paper.

## **I. LITERATURE REVIEW**

Internationalization of firms has been a key issue in international business studies for a long time. Internationalization has been defined as the process of increasing involvement in international operations across borders (Welch and Luostarinen, 1988). Calof and Beamish (1995) defined internationalization as "the process of adapting firms' operations (strategy, structure and resources, etc.) to environments" (p. 116). According to Cavusgil (1984), internationalization is an ongoing process determining the ongoing development and change in international firms in terms of scope, business idea, nature and extent of activities and organization principles.

As regards to the first question we posed "Why do Italian firms invest in India (motives of FDI)", the literature examining the motivations for FDI is considerable. Several theories and

models has been developed in the field of international business in the years that have had a fundamental impact on researches and writings/academic contributions. Starting from the pioneer studies of Dunning (1958) and Vernon (1966) and proceeding to analyze more recent studies, it is possible to notice how the research object has shifted from foreign investments to the internationalization process and multinational firm organization/management. The early studies carried out in the Sixties and in the Seventies analyzed the environmental factors and institutions that could provide a proper context within which MNEs can operate. This is considered as a macro approach to internationalization where the research focus is represented by countries and industries rather than firms (Kindleberger, 1969). On the opposite, the micro-economic/industrial organization theory, suggests that foreign direct investments are made to further capitalize on the ownership of some of the firm's unique assets (Hymer, 1960/1976; Caves, 1971). Later on, during the Seventies and Eighties, scholars research's interest shifted to the managerial and strategic issues related to MNCs' management. With the firm as the primary unit of analysis and management decisions as the key variable, these studies provide further insights on management challenges associated to international business. First of all, the Eclectic Paradigm Theory proposed by Dunning (1976) offers an holistic framework that identifies the important factors influencing the decision to carry on production in a foreign country. Referring to Dunning (1993), it is possible to identify market seeking FDI's; resource/asset seeking FDI's and efficiency seeking FDI's. The first one relates to the size and potential growth (also in terms of opportunities offered by neighbor countries) of the FDI's hosting country. Resource factors mainly refer to possibility for the MNC entering the hosting country to access to specific raw materials and/or to skilled and educated workers and/or to local technology. Efficiency seeking motives, on the contrary, leverage on advantages related to access to low cost workforce and/or materials or, more in general, to the opportunity to increase firm's profitability by reducing operative costs.

As regards subsidiary's role, after the seminal work of White and Poynter (1984) subsequent research has been conducted on subsidiary's role and strategy. The literature referring to this issue often used the terms "subsidiary's role" and "subsidiary's strategy" as interchangeably (Birkinshaw and Morrison, 1995). Studies related to this issue often comprise also the analysis of the activities performed by the subsidiary and therefore its value chain. Focusing on the roles that subsidiary can play within the MNC's overall strategy, it is possible to identify different typologies. According to Birkinshaw and Morrison's classification (1995), which integrates most prior studies, it is possible to identify three different types of subsidiaries taking into consideration the geographic scope, the range of value adding activities

performed, the level of autonomy in taking decisions. The first type refers to “the local implementer”, which is a subsidiary mainly servicing the hosting country’s market performing the entire range of value adding activities of the headquarters (according to Whyte and Poynter’s definition, 1984, this subsidiary can also be defined as a “miniature replica”). This type of subsidiary mainly adapt global products of the MNC to local market needs (typically a multidomestic strategy). The second one is “the specialized contributor”. Some of the activities performed by this type of subsidiary are of particular specialization. We can say that they specialize on a narrow set of value activities that are tightly coordinated/interdependent with the activities performed by other subsidiaries belonging to the MNC’s international network. Whyte and Poynter (1984) also define this subsidiary as “product specialist” depending on the range of value added activities performed. Moreover, Porter (1986) define their strategy as “pure global”. The third type, “the world mandate” characterizes a subsidiary working with the HQ to develop and implement strategy (Roth and Morrison, 1992). The subsidiary’s activities are integrated at worldwide level, but personally managed by the subsidiary. Jarillo and Martinez (1990) define this subsidiary as characterized by global integration and local responsiveness.

Referring to the configuration of the activities of the value chain, Porter, in his seminal work of 1985, identifies four well known different international strategies according to the coordination/interrelation of those activities within the MNC and among the different subsidiaries. According to such a framework, he proposed four types of strategies: “high foreign investment with extensive coordination among subsidiaries”, “simple global strategy”, “export based strategy with decentralized marketing” and “country centered strategy by multinational or domestic firms operating in only one county”. Bartlett (1986) proposed a slightly different approach taking into consideration coordination among subsidiaries and degree of adaptation to each national context. He identifies therefore three types of organization, each implementing a different strategy: global organization, multinational and transnational organization. While Porter’s framework analyzes strategic characteristics of industries, the approach of Bartlett is more firm specific. According to the latter, in fact, a company can implement different strategies in each subsidiary that best fit MNC’s overall strategy. Moreover, Jarillo and Martinez’s study on Spanish MNCs (1990) concentrate on two dimensions of analysis, i.e. geographical localization of activities (if activities such as R&D, purchasing, manufacturing, marketing are performed in the country) and the degree of integration of those activities performed at overall group/MNC level. According to this approach, a subsidiary can follow an “autonomous” strategy (if it carries

out, independently, most of the value chain activities), a “receptive” strategy (if it carries out in the hosting county few value chain activities, i.e., only marketing&sales or only manufacturing) or an “active” strategy (if it acts as a “node” of an integrated network of subsidiaries performing different activities within the group they belong to).

Concluding, nowadays, the choice of methods of doing business abroad is now much wider than in the past and such a choice can be customized to the specific needs of the internationalizing firm. Under this point of view Born Globals (McDougall and Oviatt, 1994) are to be considered as an emerging important phenomenon that should not however obviate/underestimate the importance of incremental learning through stages, even for the most experienced MNCs.

#### *Identified gap in literature*

To clearly show the identified substantial gap of empirical studies on Italian MNCs internationalizing in India, we performed a literature background analysis on the most relevant literature in international business. The results are wrapped-up in this paragraph. While many scholars have analyzed the process of internationalization of Italian firms in several areas, just two up-to-date studies deal with Italian MNCs in India. The first one is an exploratory study made between 2004 and 2005 that analyzes the internationalization process of a sample of Italian companies to India (Friso and Gattai, 2005). The second one, more recent, is a business case analysis of an Italian software SME off-shoring its R&D activities in Bangalore (Angeli and Grimaldi, 2010).

Analyzing researches performed on FDIs and foreign companies located in India, we found different kind of studies that can be categorized as follows:

- Internationalization, to India from other countries (considering both exploratory generic studies and researches on specific MNCs management related aspects) mainly from: Germany (Welge, 1994; Becker-Ritterspach, 2005, 2009), Sweden (Jansson, 1982), Denmark (Baark, 1985; Hansen et al., 2011), Netherlands (Lieten, 1987), Korea (Pant, 2003; Park, 2004, 2011) and Japan (Horn et al., 2010). Moreover, it is possible to find in-depth business case analysis on US, Japanese, Danish, British, Swedish and Korean MNCs located in India (see among the others: Singh, 1979; Singh Rathore, 2008; Sinha, 2004);
- Comparison between FDIs in emerging countries: India FDIs vs China or Brazil (see, among the others: Asakawa and Som, 2008; Zheng, 2009; Vivoda, 2011);
- Localization of FDIs in India and factors influencing such choices (see, among the others: Chalapati Rao and Murthy, 2011; Megha and Nunnenkamp, 2010).

Moreover, recently, scholars have been starting to investigate issues related to FDI from India to other countries (for example, see the recent study of Jain (2011) on operation of Indian firms in the U.S).

The present research work aims at contributing to fill this gap in the literature, providing an exploratory research on the internationalization of Italian companies to India.

## II. OBJECTIVES DATA AND METHODOLOGY

On the basis of the theoretical framework previously described, we focused the analysis on a sample of Italian MNCs that carried out investments in India. In particular we try to provide evidence of the strategic goals associated with the investment in India (i.e. manufacturing vs. commercial), of the role played by the Indian subsidiary and its value chain configuration.

### *Population*

In order to investigate the research questions, a unique database of Italian firms that invested in India was created. Data was sourced from the Italian Institute for Foreign Trade (ICE), branches of Italian and International Chambers of Commerce operating in India, Embassy and Consulates, and several foreign and Italian entrepreneur associations. The total amount of presumably existing Italian firms from the mentioned sources was 141<sup>14</sup>. The database has then been checked and validated to keep out of the analysis the companies no longer active. The survey was conducted in 2011. Over the course of two months all the companies (141) with a reported phone number were called to ascertain if they were still in existence and their current address. The result was a database of 60 active Italian enterprises.

A questionnaire was developed with the goal of eliciting answers from the managers of the Indian subsidiaries. In order to verify and test the questionnaire's suitability for the task a number of professionals working in related fields were contacted: a) an Indian full Professor working in International Marketing; b) an Italian lawyer who has worked and lived in New

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<sup>14</sup> The number of Italian companies in India is indeed far from clear. One critical variable in evaluating the overall number of companies is how a company with multiple subsidiaries in India is counted. It is not always clear from the sources what is their methodology. We have opted to count a single legal entity with multiple locations as one company only. This is most likely why some sources report a higher number of companies. Among the latter, the largest database found in the research was of Pantheon, a financial consulting company working in Italy and India: according to Pantheon 400 Italian companies working in India were reported. This database however is not public and no way was found to verify its content and validity. The Italian Trade Commission and the Indo-Italian Chamber of Commerce were however available to provide their database, the total amount of presumably existing Italian firms from the mentioned sources was 141.

Delhi and has extensive knowledge of Italian companies going to India, c) an Italian consultant, CEO of the Indian subsidiary, who has lived in Mumbai for over four years. With their help two companies were identified to which we initially submitted the questionnaire in order to ascertain its validity. The two companies were then excluded from the sample. Some questions were modified, some deleted and some added. The resulting final questionnaire was subsequently sent to the identified companies along with a cover letter in which an appointment for a personal interview was asked for with the local branch manager. All the questionnaires and interviews were eventually conducted with either the local General Manager or a Board Director or a top manager (in larger companies).

Forty seven large, medium, small and micro companies out of the previously identified firms replied to the questionnaire. An additional 18 were discarded for one of the following reasons:

- the company had changed ownership and was no longer held by Italian shareholders. Either the Italian parent company had changed ownership and become part of a larger multinational non-Italian group or the local Indian partners bought out the subsidiary entirely, in such cases when a Joint Venture was in place;
- the replies were not meaningful;
- the company was a representative office or was just engaged in consultancy services with no manufacturing or distribution.

An answer rate of about 19% was obtained, which is quite similar to the average of the best international surveys (Harzing, 1997). Considering the large number of questions in the questionnaire and the complexity of some of them, the achieved result may be considered satisfactory. All the findings on the 27 remaining companies are reported and any relevant findings analyzed with regard to the size and the industry of the companies. The most relevant features of the responding companies are summarized in the following paragraph.

#### *Sample description*

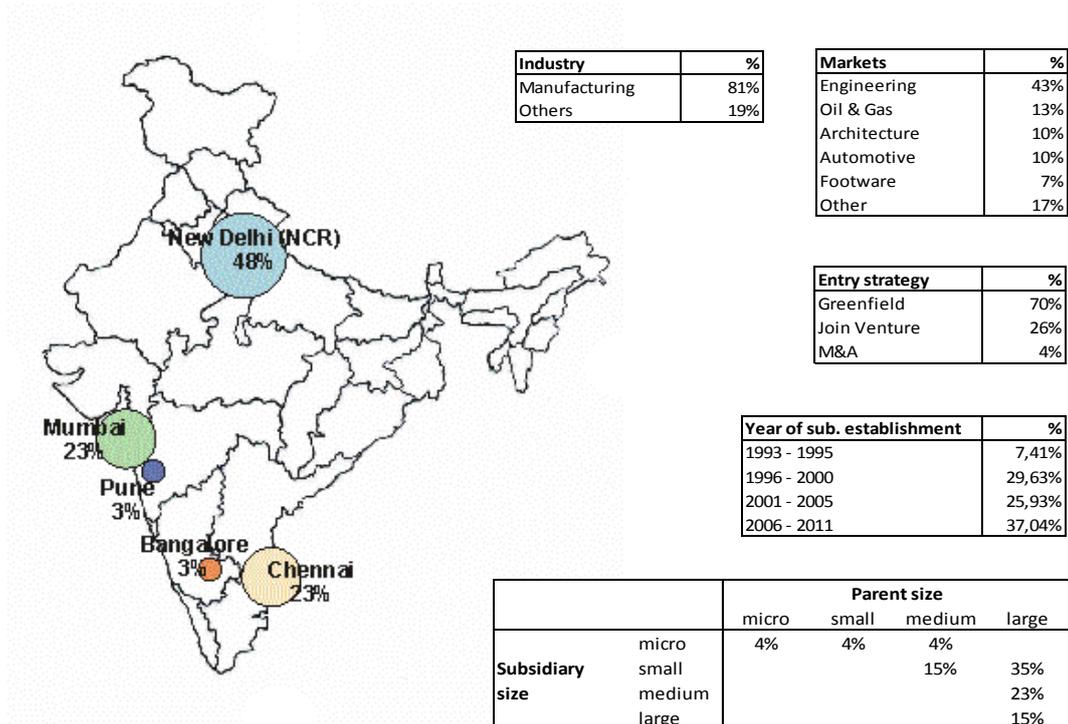
There is apparently no peak in Italian companies deciding to move to India. Starting from 1993, almost every year one company of the validated sample was established. The only slight exception being 2008. However what stands out is that all of the companies found were established after the 1991 liberalization laws.

Most of the companies in the sample are manufacturing companies (81%), some of them, the largest ones, are also providing services to their clients. The Engineering market (43%) is by far the most represented. Looking at the size of the parent companies, the large ones are the

absolute majority of the sample. However, looking at the size of the Indian subsidiary, there is a clear prevalence of small companies. And only 15% of the sample has reached a large size. The geographic distribution of the sample companies was entirely around the main Indian cities. An analysis conducted on the original database of 141 companies revealed that the sample is very consistent with the supposed addresses of the initial database.

The most relevant features of the investigated sample are summarized in figure 1.

**Figure 1:** Sample description



### III. RESULTS DISCUSSION

#### *Strategic goal*

One legitimate expectation when the research started was to find companies outsourcing the manufacturing process to India – due to the very low cost of labor (in 2005 the hourly compensation in USD was 0.63\$ for “production workers” and 0.91\$ for “all Employees”, see Sincavage et al., 2010) – and shipping the manufactured goods to the target markets of the parent companies, without necessarily targeting the Indian market. As it is the typical case for many Italian companies that have been internationalized in Eastern Europe (Onetti and Majocchi, 2002). On the contrary it was discovered that all the companies in the samples

moved to India with – among others – a “market seeking” approach, i.e. with the specific goal of getting a slice of the growing Indian market. This approach is also consistent with the “pull view” (Reid, 1981) since the choice of the target market is not only driven by the current size of the target market, but more specifically by its growth potential.

This could be interpreted as a shift from the previous trend of moving to low cost countries only in order to exploit the lower labor costs. Internationalization decisions seem therefore to follow a “looking for the market” strategy. A question to be further addressed is whether the target market for Italian companies going to India is represented only by India or by the other growing Far East economies.

Our research shows how no respondent specifically indicated the rest of APAC as a target. There are several reasons behind the focus on India that have emerged, once again, more during interviews with the Italian managers than with the Indian subsidiaries:

- The Indian market is huge and most companies try first to consolidate the local market before considering a move to the neighboring countries (Vernon, 1966; Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977);
- As previously mentioned, India is not part of the China-Asean agreement (ACFTA) and that is still an important obstacle when exporting from India to most of the Eastern countries;
- In some cases the local Indian manager was not aware of the future plans for the subsidiary or not willing to share them with us.

#### *International network*

One of the variable that cannot be left aside is the international experience and the extension of the Italian MNC international presence (Vernon, 1966; Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977; Bartlett and Ghoshal, 1989 and 1991; Doz, Santos and Williamson, 2001). This could help in better understand the other objective of the research i.e. the role of the subsidiary in the MNC.

Following the analysis of the findings the respondents have been classified into three groups:

- A) in this group companies were categorized whose only international experience so far is represented by India: India represents their first experiment at internationalization;
- B) in this group companies with 2 - 8 foreign subsidiaries were placed;
- C) which is composed by companies that have over 15 subsidiaries worldwide.

All the groups are represented in the sample, but the global companies belonging to group C are not the majority. As shows in table 1, it appears that Italian companies, although with

some delay, have recognized the importance of the Indian market and have started moving to India regardless of their international experience and size. This represents an interesting result. In fact, the challenges posed by a difficult environment, such as India, may be too much for companies with no international experience. Similarly small corporate size could represent an additional obstacle. As highlighted by Johanson and Vahlne (1977) entering foreign markets (particularly “geographically” and “culturally” far from the domestic one) requires fixed investments that might be prohibitive for small companies. Therefore, these results seem to partially contradict the gradual approach to internationalization à la Johanson and Vahlne (1977) and confirm the most recent theories about born global companies (Oviatt and McDougall, 1994; Knight and Cavusgil, 1996).

**Table 1: International experience per Parent size**

Network	Parent size			
	Micro	Small	Medium	Large
A	4%	4%	4%	8%
B	-	-	15%	27%
C	-	-	-	38%

Source: own calculations.

Notes: The percentage is calculated as follows: No. of companies of a specific size belonging to a specific group /total number of companies.

It is quite clear that large international networks belong only to large Italian companies. It is not however true of the opposite. Not all the large Italian companies of the sample have an extended network. As a matter of fact 45% of the large Italian parent companies belong to group A or B.

#### *Role and Value Chain structure of the subsidiaries*

Following the results of the strategic goals it appears that 100% of the sample perform sales in India, while “only” 85% have a manufacturing activity in the country. Once again this is quite uncharacteristic of Italian internationalization into low labor cost countries (Cotta Ramusino and Onetti, 2006). As shown by Berra et al. (1995), Majocchi and Zucchella (2003), typically the opposite is more common situation (cost saving).

**Table 2: Subsidiary’s role per subsidiary size**

	Micro	Small	Medium	Large
Manufacturing	75%	77%	100%	100%

Sales	100%	100%	100%	100%
Other	25%	-	-	25%

Source: own calculations

Notes: *The percentage is calculated as follows: No. of companies of a given size reporting a specific role/total number of companies of that size.*

**Table 3: Subsidiary's role per parent size**

	Micro	Small	Medium	Large
Manufacturing	100%	-	100%	84%
Sales	100%	100%	100%	100%
Other	-	100%	-	5%

Source: own calculations.

Notes: *The percentage is calculated as follows: No. of companies of a given size reporting a specific role/total number of companies of that size.*

Only a few of the smaller Indian subsidiaries do not perform any manufacturing activity, but only sales. In some cases (approximately 5 companies) the manufacturing was performed in order to export to neighboring countries as well. However the findings from the data collected were not clear enough to allow for a certain classification of the phenomenon.

Looking at the distribution over the dimension variable, it can be noticed that the only companies not doing manufacturing in India belong to large parent companies. The explanation might reside in the fact that these companies already have an important and established international manufacturing network in place. Referring to Jarillo and Martinez (1990) this results can indicate that the subsidiary is following a "receptive" strategy.

Also as expected, in most cases the subsidiaries have a shorter (67%) and sometimes different value chain (37%). In some instances the value chain is as long as the parent company (19%) but different in content (i.e. activities performed). The "different" value chain stems frequently from the need to adapt and customize to the local market. For instance, the parent and subsidiary might both be involved in R&D and manufacturing (i.e. shoe soles as it is the case of a company belonging to our sample). While the Italian headquarters design and manufacture type A and type B soles, the Indian subsidiary manufactures type B but designs and manufactures a type C, customized for the local market. The same company reports the need to adapt to the local availability of rubber components and additives. Such example shows a strong orientation towards a "multinational" or "multidomestic" approach (Bartlett and Goshal, 1989), with local customization and independence. Additionally, materials and technical specifications can influence the local content as well. For instance a metal profiles

manufacturer, while using the same technology as the parent company, needs to work with different sizes and thickness. Therefore, part of the manufacturing process is different as the size and thickness of the metal sheet influences the working procedure, Quality Assurance and shipping and handling. Another company belonging to the Telecom business has had to adapt to local materials and costs. While the design of many (not all) of the products is the same, the materials had to be changed for sourcing and cost reasons. The typical high-grade industrial stainless steel used in Europe is AISI 304, however in India the AISI 202 is much more common (with a slightly different/lower content of nickel). While their performance is very similar, the cost of supplying 304 in India would make it more expensive than it is in Italy (due to the low volumes consumed in India), placing the resulting product completely out of the acceptable price range. Hence the need to adapt the technical specification to the local materials.

Size distribution shows that smaller subsidiaries are the ones reporting most frequently a shorter value chain (table 4). Which can probably be explained by their size compared to that of their parent company (always bigger).

**Table 4: Subsidiary's value chain per subsidiary size**

	Micro	Small	Medium	Large
Same	25%	8%	33%	25%
Shorter	50%	85%	33%	75%
Different	50%	23%	83%	-

Source: own calculations.

Notes: *The percentage is calculated as follows: No. of companies of a given size reporting a specific value chain/total number of companies of that size.*

Medium subsidiaries report most frequently a "different" value chain. This could be explained by the fact that medium subsidiaries are already established enough to have the same value chain as their parent companies, however they are also still small and flexible enough to be able to adapt to the local market needs. This data seems to confirm an evolutionary path for the subsidiary over time (consistently with the theoretical theories on the life cycle of the subsidiaries that were mentioned above): the longer the presence in the market, the wider the spectrum of activity and the bigger the autonomy of the subsidiary.

## CONCLUSIONS

The objective of this research was to investigate the characteristics of Italian companies in India. Specifically we explored the reasons behind the internationalization choices and the role played by the Indian subsidiary and its value chain configuration.

The first empirical confirmation we collected was about the low number of Italian companies with subsidiaries in India. Based on official statistics the overall population of Italian companies in India ranges from 141 (source: ICE) to 400 companies (source: Pantheon). The empirical validation of the population that we performed during the research shows that the actual number of active subsidiaries of Italian companies is likely to be lower. This result contrasts with the strong growth of the Indian economy and therefore the huge opportunity that the country represents.

In terms of internationalization goals it emerges clearly from the research that the main target is market seeking. This approach is also consistent with the “pull view” (Reid, 1981) since the choice of the target market is not only driven by the current size of the target market, but more specifically by its growth potential. The entire group of respondents mentioned it as the main objective of their presence in India. Not a single company has moved to India simply to outsource the manufacturing to a low labor cost region. In order to acquire that market share Italian companies have organized their subsidiaries as partially independent companies, adopting a typical “multidomestic” approach customizing products and services to the local needs and demands. Following the results of the strategic goals it appears that 100% of the sample perform sales in India, while “only” 85% have a manufacturing activity in the country. Once again this is quite uncharacteristic of Italian internationalization into low labor cost countries. As shown by other scholars (Berra et al., 1995; Majocchi and Zucchella, 2003) typically the opposite is more common situation (cost saving). The analysis of the subsidiary’s value chain brings out that, in most cases, the subsidiaries have a shorter (67%) and sometimes different value chain (37%). In some instances the value chain is as long as the parent company (19%) but different in content (i.e. activities performed). The “different” value chain arises frequently from the need to adapt and customize to the local market. This data seems to confirm an evolutionary path for the subsidiary over time (consistently with the theoretical theories on the life cycle of the subsidiaries that were previously mentioned): the longer the presence in the market, the wider the spectrum of activity and the bigger the autonomy of the subsidiary.

Future research has to monitor the evolution of the internationalization process of Italian companies in India. If the process is going to grow more analysis can be developed: both quantitative (increasing the size of the sample) and qualitative (performing a longitudinal

analysis of the firms composing the sample). This would help both home and host countries/governments to understand what MNCs are doing in their countries, why and how they decide for such an investment/strategy. Of particular interest could be the analysis of the evolution of the autonomy level and role - along the life - of the subsidiaries, to be done performing a longitudinal analysis of the firms that compose the sample.

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## HEALTH LEAN MANAGEMENT AND CLINICAL RISK MANAGEMENT: A SYSTEMATIC LITERATURE REVIEW

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### ABSTRACT

Nowadays healthcare context needs to afford increasing costs due to aging population, more advanced technologies, inefficiencies and medical errors. These costs cannot be afford any more by the government, considering the international crisis and the pressure to the spending review, that have caused a reduction of the public health care resources. On the other hand, quality must be guaranteed, not only because patients are even more exigent and they claim high quality, but also because of quality accreditation standards required and basic ethical principles. A central problem is to assure high efficiency and high quality level at the same time, and therefore it is crucial to control and reduce wastes and errors in healthcare environment, as they increase costs and decrease health quality. In medicine, errors management is still in developing and managerial tools and practices are needed to identify, analyze, treat and monitor clinical risks. The intention of this paper is to conduct a systematic literature review in order to investigate connections and overlaps between health lean management, focused on performance improvement through waste reduction, and clinical risk management, to understand if and how these two approaches can be combined together to pursue efficiency and quality simultaneously.

Results highlight an emerging research stream, highly understudied, with many useful theoretical and practical implications also for the whole society.

**Keywords:** clinical risk management, clinical process, health lean management, hospital management

## INTRODUCTION

During the last decade, the healthcare sector has been characterized by two contradictions. First of all, the costs of medical care have been increasing due to an aging population and more use of advanced technologies in healthcare, but also to inefficiencies and medical errors that occur in hospitals (Pocha, 2010; Printezis & Gopalakrishnan, 2007; OECD, 2012). On the other hand, the need of governments to reduce the public spending has forced public hospitals to reduce wastes in order to cut costs (Stuckler et al., 2010). Moreover, nowadays customers are more exigent, and the quality levels have to be guaranteed following the quality accreditations standards; thus, researchers and physicians are interested in understanding how to reduce healthcare costs without impacting negatively on patient safety.

Quality in healthcare can be defined as 'the degree to which health services for individuals and populations increase the likelihood of desired healthcare outcomes and are consistent with current professional knowledge' (Rowell, 2004); however, a more recent definition from another point of view defines quality as 'doing the right thing at the right time, in the right way, for the right person and having the best possible results' (Agency for Healthcare Research and Quality, 2001).

In order to achieve a high level of quality, according to a Clinical Risk Management (CRM) perspective, all the risks should be identified, analysed, treated and monitored (Verbano & Turra, 2010) to avoid the 'dark side of quality' (Vicent, 1997).

Many studies have focused on the implementation of CRM (e.g. Kavalier & Spiegel, 2003; Kumar & Steinebach, 2008; Trucco and Cavallin, 2006; Verbano & Venturini, 2011), which can be defined as an approach to improving quality in healthcare that places special emphasis on identifying circumstances which put patients at risk of harm, and on acting to prevent or control those risks. The aim is to both improve safety and quality of care for patients and to reduce the costs of such risks for healthcare providers (Walshe & Dineen, 1998). According to Floreani (2005, p. 227), from a more practical point of view, CRM can be defined as the system of guidelines, protocols, steps, organizational and clinical procedures adopted by a hospital to reduce the probability that events and actions, that might potentially produce negative or unexpected effects on the health of patients, occur.

However, CRM is not the only approach implemented to improve the quality level of health care; in fact, from manufacturing industries, other practices are proposed with the aim of achieving high quality. These are quality methodologies such as PDSA (plan, do, study, act), lean management, six sigma, Quality function Deployment Matrix, ISO 9000, Total quality

management and various other business management strategies (Varkey et al., 2007; Benitez et al., 2007; Kruskal et al., 2012; Joint Commission on Accreditation of Healthcare Organizations, 2006). In particular, six sigma is a methodology that provides businesses with the tools to improve the capability of their business processes (Yang & El-Haik, 2003), aiming at perfection in order to reduce clinical errors (Vanker, 2010; Johnstone et al., 2003). The other quality methodology that is receiving increased interest both in academic and in management is health lean management (HLM), which can be defined as a managerial approach, to identifying and eliminate waste while improving flow of activities to maximize value to the customer. This methodology considers standardization and specification of work processes, organization of work in such a way that unexpected events are easy to spot, and deployment of activities that find and fix mistakes (Ohno, 1988; Womack & Jones, 2003). With the intent of combining the advantages of six sigma and lean management, some hospitals have implemented 'lean six sigma', aiming to achieve speed and efficiency improvements and reduction of variation (Veluswamy & Price, 2010; Martin, 2007; De Koning et al., 2006; Yeh et al., 2011).

Although all these research efforts are aimed at increasing the quality and the safety of patients in hospitals, the number of errors that are reported for the hospitals are still high (National Priorities Partnership, 2008; Schwappach, 2011).

During the past, errors were attributed to physicians, but most of the authors (e.g. Kohn et al., 2000; Reason, 2000; Institute of Medicine, 2001; Novis, 2008; Berte, 2004) stated that errors are due to failures of the processes (inefficiencies/problems in the system and process organization) that should be improved.

In order to avoid medical errors, people should work in better conditions where the right barriers (procedures, protocols, process control, controls at the points of risk and administrative controls) should be erected in order to implement more reliable systems (Reason, 2000; Kohn et al., 2000). For achieving this aim, the clinical processes have to be analysed using methodologies of business process analysis to detect high risk situations. Lean management, as a business management strategy, comprehend a set of principles, practices and methods for analysing, designing and managing processes (Schweikhart & Dembe, 2009); thus, it can be considered for the purpose of medical error avoidance.

In particular, since 2002, lean management has been adopted in an increasing number of health contexts (De Sousa, 2009; Laursen, 2003; Mazzocato et al., 2010) as a solution to achieve productivity, cost, quality, and timely delivery objectives, reducing any wastes of overproduction, over-processing, transportation, inventory, movement, waiting and defective

products, that are the typical wastes of hospitals (IHI, 2005; Bush, 2007; Jimmerson et al., 2005). Nonetheless, Holden (2011) underlined that further research seems necessary in order to study this issue, in particular regarding the assessment of lean management's effects on patient safety and quality outcomes. Moreover, Pawlickj et al. (2008) claimed the need to clarify the concepts of quality, errors and how to report errors. More researches are requested also to better understand how a process can be performed without making it prone to errors and the effects of lean on patient safety (Pawlickj et al., 2008; Holden, 2011). Also Vincent (2001) stated CRM is just one facet of quality improvement and in future the connections between CRM and other quality improvement systems need to be made more explicit and meaningful.

Considering the definition of HLM provided, some connections with CRM emerged just from it. Lean management facilitates reduction in health care costs, while its main benefit is that it supports the clinical process analysis and it could provide an approach that contributes to clinical error reduction, achieving the CRM objectives. To investigate this extent, the aim of this paper is to systematically review the academic literature.

## METHODOLOGY

In order to analyze rigorously the existent literature, a systematic literature review has been conducted, following the indications of Denyer & Tranfield (2009), Pawson (2006), Denyer et al. (2008) and Brereton et al., (2007). The literature review questions were formulated based on CIMO (context, interventions, mechanisms and outcomes) approach, as follows:

- Are there any connections/overlaps between health lean care management and clinical risk management in hospital environment? If yes, which are the connections and the outcomes?
- Can lean healthcare management help/support CRM in hospital environment? If yes, how?

Next, the protocol for the systematic literature review has been generated including the following steps: a) Conceptual discussion of the problem; b) Literature review questions; c) Search strategy; d) Paper selection criteria; e) Single paper analysis; f) Descriptive analysis of the extracted database; g) Synthesis and content analysis.

The third step has been carried out using academic databases: Business Source Premier (EBSCO), Compendex (Ei Village 2), Inspec (Ei Village 2), Web of Science (ISI) and PubMed. The keywords employed for this searching phase are reported in the second column of table 1, where also the results of the search strategy are synthesised.

Search strategy	KEYWORDS	Web of Science (ISI)	PubMed	Business Source Premier (EBSCO)	Compendex (Ei Village 2)	Inspec (Ei Village 2)
	CRM "AND" lean health care	9	16	0	1	0
	lean management "AND" CRM	49	96	0	2	0
	lean organization "AND" CRM	5	11	0	0	0
	lean management "AND" health RM	50	123	19	18	4
	lean organization "AND" health RM	14	36	4	4	1
	RM "AND" lean health care	17	47	3	3	4
	lean hospital "AND" CRM	9	35	0	1	0
	six sigma "AND" CRM	8	11	1	0	0
	six sigma "AND" medical error	23	55	7	2	1
	six sigma "AND" clinical error	27	14	0	0	1
	lean "AND" clinical error	72	65	0	8	4
	lean patient safety "WITHOUT" obesity weight	161	48	16	7	4
	lean patient safety "WITHOUT" obesity body	156	49	16	7	4
TOTAL	600	606	66	53	23	

Tab. 1 – Results of search strategy.

For the paper selection phase the following criteria have been adopted: exclusion of duplications and papers that from the title and the abstract were not useful to answer to literature review questions (obtaining 157 papers), exclusion of conferences proceedings, opinion papers, lecture notes and papers with only 1–3 pages, papers with no references (as they are not sufficiently authoritative), and non-English language papers, as they lack international impact (obtaining 116 papers).

Reading full text, papers were selected based on CIMO, cutting the papers whose context was not that of health care providers, such as hospitals (C) and including papers which consider lean health care and its relationship with clinical errors (even if they are only mentioned in the results or in the objectives) (I-M-O).

The resulting database (47 papers) has been studied.

For the single paper analysis the aspects recorded are: Citation, Authors, Title of the paper, Year, Keywords, Principal theme, the name of the Journal, Impact Factor and H index of the journal, Research methodology, Aim of the paper, Results, Author background, Context of applicability, Notes about key concepts, Number of authors and the Country.

A descriptive analysis and than a content analysis have been conducted on the papers obtained.

## DESCRIPTIVE ANALYSIS OF THE EXTRACTED DATABASE

For the descriptive analysis journals, authors, countries, time trend and research methodology have been investigated and the results are presented in fig. 1 and fig. 2.

For journal evaluation four main databases have been used (ISI, SCOPUS, ABS - Association of Business Schools, CNRS - Comité National de la Recherche Scientifique) and other three databases (SCIENTOMETRIC, ERA - Excellence in Research for Australia, ABDC -Australian Business Dean Council) have been considered to evaluate journals that were not listed in all the four main databases. On the base of the four rankings so obtained for each journal, final journal evaluation have been obtained using 5 quality levels defined in fig.1: Gold\*, Gold, Silver, Bronze, Copper.

Fig. 1 illustrates the distribution of the papers based on the quality level of the journal in which they are published, and also the authors evaluation, obtained summing up the journal evaluation of each paper written by an author divided by the number of authors.

Moreover, descriptive analysis reveals that papers are distributed in many journals, authors are mostly physicians and only few scholars have written more than one paper.

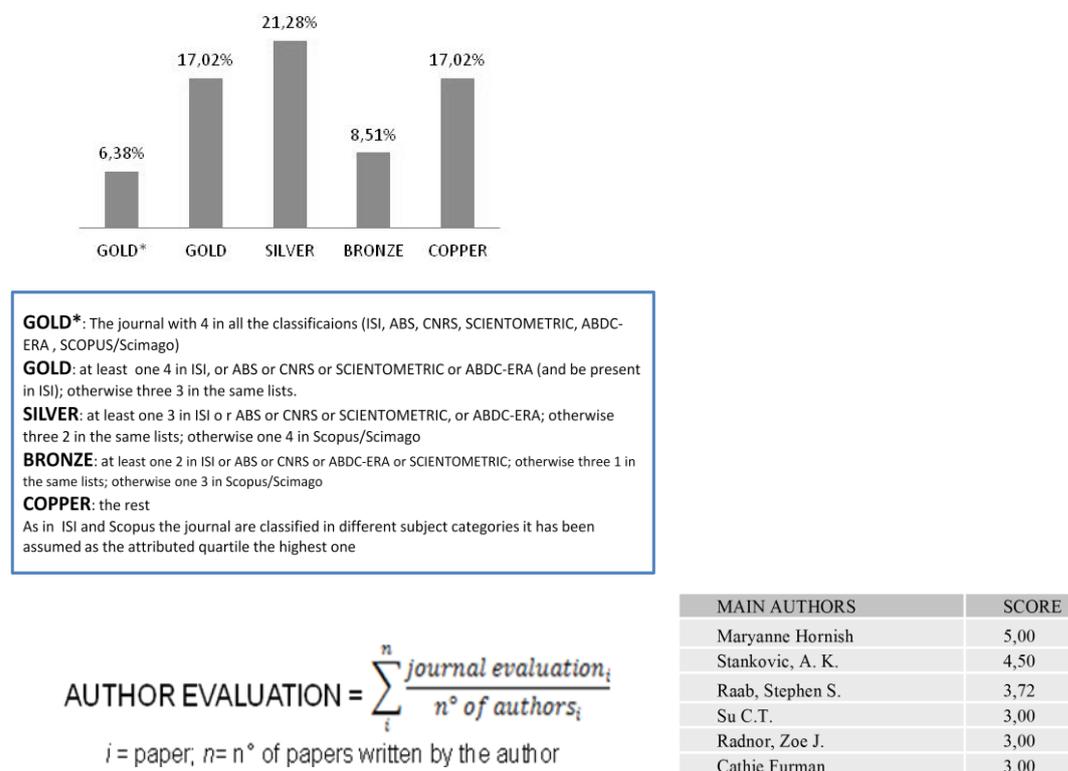


Fig. 1 – Journal and author evaluation

In fig. 2 time distribution of the papers demonstrates a positive trend from 2004 and 2012 for this young research theme.

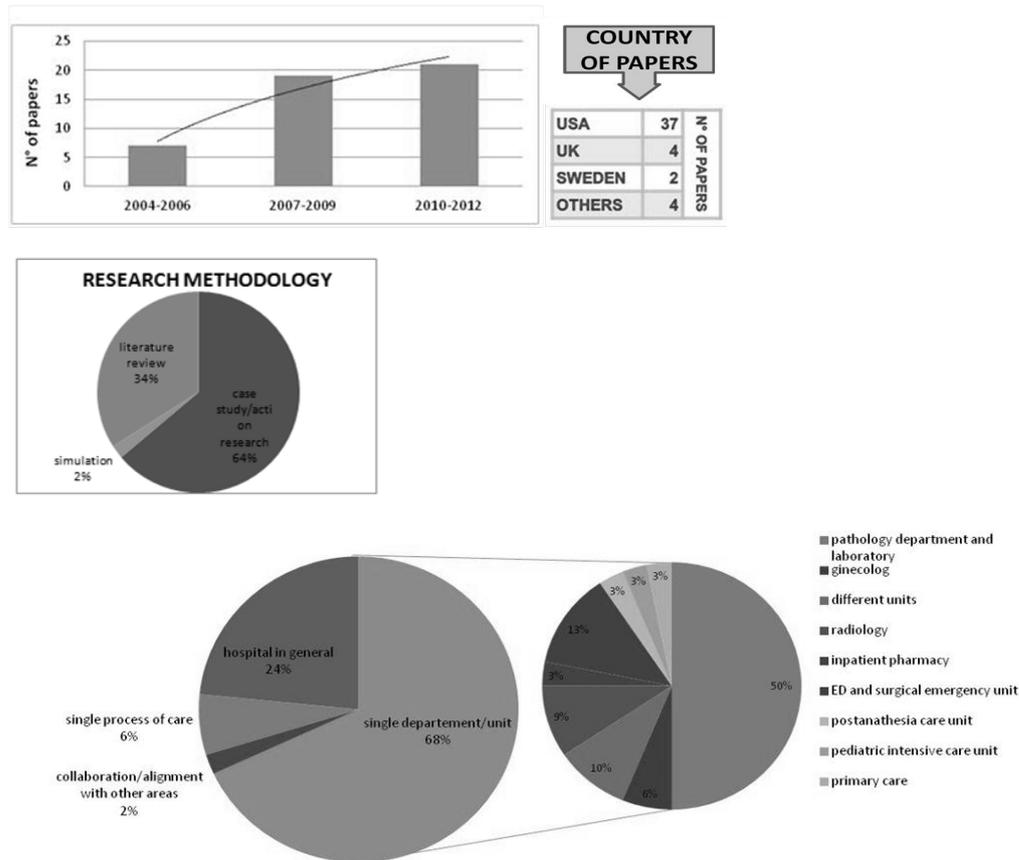


Fig. 2 – Time and country distribution, research methodologies and context of applicability

This is confirmed also by the absence of survey research methodology in the papers analyzed, while case studies and action research are preferred.

Researches come mostly from USA, UK and Sweden and, as the context of applicability is concerned, most of the papers consider single areas (department or unit), overall pathology Department and laboratory and Emergency Department.

## CONTENT ANALYSIS AND RESULTS

In order to answer to the literature review questions a content analysis has been carried out. In tab. 2 papers are classified inserting in the central column papers with at least one objective of HLM and one of CRM (first row), at least one methodologies of HLM and one of CRM (second row) and that achieve at least one result of HLM and one of CRM (third row); in this column also papers with respectively common objectives, methodologies and results are included. Therefore, it can be observed that most of the papers adopt at least one method of HLM and one of CRM to pursue at least one objective of HLM and one of CRM, even if the

entire CRM process is never adopted, considering just some CRM phases and only to pursue partial objectives of CRM.

	HLM	HLM U CRM		CRM	
OBJECTIVES	Radnor et al. (2012)	Holden (2011)	Benitez et al. (2007)	Berte (2004)	Biffl et al. (2011) Kim et al. (2010)
	Pocha (2010)	Zarbo et al. (2009)	Becich et al. (2004)	Buesa (2009)	
	Serrano et al. (2010)	Naik et al. (2011)	Hurley et al. (2008)	Condel et al. (2004)	
		Niemeijer et al. (2011)	Johnson et al. (2010)	Das (2011)	
		Novis (2008)	McCulloch et al. (2010)	Esimai (2005)	
		Printezins & Gopalakrishnan (2007)	Schweikhart & Dembe (2009)	Furman & Caplan (2007)	
		Raab et al. (2006)	Mazzocato et al. (2010)	Hintzen et al. (2009)	
		Raab et al. (2008)	Pantanowitz et al. (2008)	Kruskal et al. (2012)	
		Kumar & Steinebach (2008)	Smith et al. (2012)	Martin (2007)	
		Sloane & Gehlot (2007)	Veluswamy & Price (2010)	Raab et al. (2008)	
		Stankovic & DiLauri (2008)	Hummel et al. (2010)	Stankovic (2004)	
		Varkey & Kollengode (2011)	Sunyog (2004)	Yeh et al. (2011)	
		Vats et al. (2012)	Herring (2009)	Pawlickj & Mundt (2007)	
	Wilson (2009)	LaRocco & Brient (2010)	Varkey et al. (2007)		
METHODOLOGY	Radnor et al. (2012)	Holden (2011)	Benitez et al. (2007)	Smith et al. (2012)	
	Sunyog (2004)	Naik et al. (2011)	Hurley et al. (2008)	Becich et al. (2004)	
	Herring (2009)	Novis (2008)	Johnson et al. (2010)	Berte (2004)	
	Hummel et al. (2010)	Pawlickj & Mundt (2007)	Schweikhart & Dembe (2009)	Biffl et al. (2011)	
		Raab et al. (2006)	McCulloch et al. (2010)	Kim et al. (2010)	
		Raab et al. (2008)	Mazzocato et al. (2010)	Condel et al. (2004)	
		Buesa (2009)	Kuo et al. (2011)	Das (2011)	
		Sloane & Gehlot (2007)	Niemeijer et al. (2011)	Esimai (2005)	
		Stankovic (2004)	Pantanowitz et al. (2008)	Furman & Caplan (2007)	
		Varkey & Kollengode (2011)	Printezins & Gopalakrishnan	Hintzen et al. (2009)	
		Vats et al. (2012)	Serrano et al. (2010)	Kruskal et al. (2012)	
		Wilson (2009)	Pocha (2010)	Kumar & Steinebach (2008)	
		Yeh et al. (2011)	Stankovic & DiLauri (2008)	Martin (2007)	
	Zarbo et al. (2009)	Veluswamy & Price (2010)	Varkey et al. (2007)		
RESULTS	Johnson et al. (2010)	Holden (2011)	Pantanowitz et al. (2008)	Buesa (2009)	
	McCulloch et al. (2010)	Benitez et al. (2007)	Becich et al. (2004)	Condel et al. (2004)	
	Schweikhart & Dembe (2009)	Niemeijer et al. (2011)	Biffl et al. (2011)	Das (2011)	
		Novis (2008)	Kim et al. (2010)	Esimai (2005)	
		Mazzocato et al. (2010)	Hurley et al. (2008)	Furman & Caplan (2007)	
		Printezins & Gopalakrishnan (2007)	Kumar & Steinebach (2008)	Gras & Philippe (2007)	
		Raab et al. (2006)	Kuo et al. (2011)	Hintzen et al. (2009)	
		Radnor et al. (2012)	Varkey et al. (2007)	Naik et al. (2011)	
		Stankovic & DiLauri (2008)	Pocha (2010)	Raab et al. (2008)	
		Vats et al. (2012)	Serrano et al. (2010)	LaRocco & Brient (2010)	
		Wilson (2009)	Smith et al. (2012)	Sunyog (2004)	
		Yeh et al. (2011)	Stankovic (2004)	Herring (2009)	
		Zarbo et al. (2009)	Veluswamy & Price (2010)		

Tab. 2 – Papers classification based on objectives, methodologies and results.

In the right column there are two papers pursuing only CRM objectives. In particular the first (Biffl et al., 2012) aims to define and implement risk assessment (central phase of CRM process) and the second (Kim et al., 2010) intends to improve and understand error analysis and reporting. Both of them, implementing lean and CRM methodologies achieve also results of HLM.

Papers on the left column (first row) focus only on HLM objectives, such as reducing waste, increasing productivity and reducing costs. Using just HLM methodologies, or both HLM and CRM methodologies, they obtain also partial results of CRM (quality of care improvement and safety).

Finally, among papers pursuing HLM and CRM objectives, three papers (left column, second row) achieved partial CRM results using only HLM methodologies, and other three papers (left column, third row) achieved just HLM results, failing in CRM or common objectives.

This first analysis demonstrates there is a two way arrow between HLM and CRM, meaning that HLM methodologies support CRM and some methodologies that are typical of CRM contribute to achieve also some HLM results.

A further analysis regards only the papers in the central column of table 2:

- Most of them (55%) pursue efficiency objectives: time, costs and waste reduction, productivity enhancement, workflow/process improvement, processes streamlining, work environment improvement, scheduling improvement, better use of resources/capacity.
- Few papers aim to improve the management of demand peaks (differentiation of demand) or of volume peaks (2% and 5% respectively).
- The majority of the papers pursue common HLM and CRM objectives, such as quality improvement (48%), safety enhancement, error detection and reduction (90%). Among objectives, length of stay and customer satisfaction are low considered (2% and 5% respectively).
- As CRM objectives is concerned, 10% of these paper focus on effective personalized care, patient centered care and improved patient care and only 5% focus on compliance with healthcare standards.

Content analysis demonstrates that the objectives of papers are fragmented; only few of them pursue three or four objectives, while none of them pursue all HLM or all CRM objectives.

Nevertheless, it should be noted that there are first partial attempts to take advantages from the synergies between HLM and CRM.

Papers analyzed adopt jointly different methodologies, belonging to both HLM and CRM approaches, even if CRM methodologies are less used and only single and separate activities of CRM process are performed.

## CONCLUSION

Papers in literature focus mainly on analysing how lean management can be implemented in order to save money and increase the efficiency of the processes. However, these objectives should be achieved ensuring an improvement, or the same level of healthcare quality and safety, compared to what was reported before lean interventions.

The systematic literature review carried out confirms that no studies focus on the relationship between HLM and CRM .

The results of the conducted analysis permit to answer the two systematic literature review questions. Solving the first question (Are there any connections/overlaps between HLM and

CRM in hospital environment? If yes, which are the connections and the outcomes?), it should be observed that in most of the papers there are objectives, methodologies and results that are related to both HLM and CRM approaches. In particular, a lot of papers pursue common objectives, apply common methodologies and obtain common results of both approaches, in most cases regarding quality and safety improvements. These “double-sided” results are usually achieved accidentally, without a declared intention, adopting only methods that mostly belong to one approach, even if some common methodologies are considered.

To answer the second literature review question (Can HLM help/support CRM in hospital environment? If yes, how?), it has to be noted that pursuing only HLM objectives and/or adopting HLM methodologies, some partial results of CRM are achieved, but also CRM objectives and methodologies of both approaches can lead to partial HLM results, such as efficiency improvement. Therefore, a two way arrow between HLM and CRM emerged; in particular, there are HLM methodologies that can be used to support CRM, mostly in risk identification and risk treatment phases.

From content analysis the following gaps emerged from literature review:

- Few studies focused on a whole process of care instead of a single unit/department.
- No studies consider the entire CRM process, even if partial objectives of CRM are pursued and some CRM methodologies are adopted, considering often only specific phases of CRM process.
- Understudied objectives are: improvement of demand management and customer satisfaction, reducing the length of stay, achieving other CRM objectives besides safety and quality improvement.
- Fragmented objectives are pursued one by one, instead of following an integrated approach.

In synthesis, this research has demonstrated that literature not properly investigates how the key concepts of HLM and CRM are linked, and how lean management can be used to achieve objectives of the CRM, and the implementation of CRM process. The contribution of this paper is the introduction of a new research stream that studies how to improve health care management combining HLM and CRM approaches. From a practical point of view, based on the results of this research, physicians should consider the possibility to adopt HLM also as an approach to enhance quality, in addition to reduce costs. The opportunity to develop an integrated methodology that include both HLM and CRM tools and practices could be considered in order to stop adopting the two approaches separately and to start discussing how

to manage clinical processes obtaining at the same time all possible benefits in terms of costs, quality and safety.

Possible future research could map the experiences on the field (not published and therefore not analyzed in this paper), in order to deeply understand how lean methodologies can be applied to prevent medical errors of clinical processes and, finally, to grasp lessons on how to exploit synergies emerged. Many useful implications can be derived from this emerging research stream, especially in this period of economic recession, in which improving the performance of healthcare organization becomes necessary in a context of decreasing resources. Moreover, the implementation of managerial tools and practices belonged to HLM and CRM combining these two approaches could concentrate the efforts into an improved clinical process management with the final aim to increase patient safety and guarantee continuous quality improvement, soaring patient satisfaction and hospital reputation, contributing to create a better society in terms of healthcare.

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## CAN COOPETITION BE A WINNING STRATEGY FOR SMALL FRUITS PRODUCTION COMPANIES IN SICILY?

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### ABSTRACT:

In the last few years the agriculture sector has shown a significant slowdown due to economic crisis. On the one hand, the reduction in the purchasing power of households has determined a decrease in the demand for food and agricultural products, on the other hand, there has been a reduction in the income of the farmers. This has inevitably led to implement business strategies to counter the exponential reduction in profitability required to survive in an increasingly competitive environment. The literature on corporate strategies is particularly large, however, the majority of authors identify competition and cooperation as “the driving forces” for economic and social progress (Hurta and Hilda, 2007).

The aim of this paper is to verify if a co-opetition can represent a strategy for the success of small fruits companies operating in Sicily. The study carried out through a two step framework showed, on the one hand, that the co-opetition is an opportunity for the entrepreneurs in the start-up and in the distribution phases, and on the other hand, that the low propensity to invest in the small fruits sector by horticultural producers in the region, leads consequently to a non-profitable market.

**Keywords:** Co-opetition, Small fruits sector, Sicily.

### INTRODUCTION

The present scenario, strongly characterized by unstable and uncompetitive markets, has implications for an increasingly negative impact on the enterprise system and alliances could certainly represent, in this context, a valuable tool in order to give companies a strong

competitive position. Generally, alliances are accepted by managers as "*modus operandi*" but "*ob torto collo*" as they see in them the appearance of a "loss of leadership".

The existing literature on co-opetition is fairly recent, Ray Noorda, in fact, introduced in 1980, this new strategic approach, adopted, then by enterprises which is expressed through a collaboration between competitors. Conceptually, this relationship, may be seen as a "bizarre strategy" because joining two diametrically opposed concepts: cooperation and competition, two terms that, perhaps, they can hardly get married. In fact, Coy (2006) defines this relationship like "sleeping with the enemy". The paradigm of co-opetition then pushes companies to collaborate and to be simultaneously competing with the aim of improving the economic performance (Bengtsson and Kock, 2000; Brandenburger and Nalebuff, 1996; Gnyawali and Madhavan, 2001; Lado et al. 1997 ). The co-opetition has found application in many areas such as health care (Barretta, 2008 Le Tourneau, 2004; Peng and Bourne, 2009), air transport (Garrette, et al., 2009, Oum et al. 2004), automotive (Gwynne, 2009; Segrestin, 2005), tourism (Kylanen and Rusko, 2011; Kylanen and Mariani, 2012). The agro-food industry has not remained free from this "*modus operandi*" where such cooperative behaviors may be of interest both in horizontal and vertical relationships both at company level and at the level of the organizational structures over business (Walley, 2007; Walley and Custance, 2010) . The types of co-opetition described in the literature appear heterogeneous and strongly influenced by the intrinsic characteristics of the product and the target market. In the food sector, however, the available literature seems strongly directed to the analysis of different forms of organization and governance of markets rather than to the development of themes aimed at identifying behaviors and strategies intra or inter companies (Frisio et al., 2012). The co-opetition could be seen as a tool to internationalize small businesses, having as result the possibility to win large markets (Dana et al. 2011). The existing literature also provides a summary of the results of the competition that appears in contrast, in fact there are some unsuccessful experiences (Park and Russo, 1996), that's why some consider this strategy potentially harmful (Hamel, 1991), others see it as detrimental to alliances (Kim and Parkhe, 2009). In contrast, other studies suggest this co-opetition can have a positive effect on the performance of the market (Luo et al. 2007) and on innovation (Belderbos et al., 2004; Quintana-Garcia and Benavides-Velasco, 2004; Tether, 2002) .

The aim of this study is to verify the presence, within the meager segment of small fruits in Sicily, of cooperative behaviours considering, at the same time, the propensity of farmers to invest in the sector of small fruits and the willingness of adoption of cooperative business strategies between companies under study. In addition, it will be identified and assessed the

role of institutions, particularly the Region of Sicily, in the definition of strategies for the organization of agricultural offer addressed to the realization of nets to corporate autonomy rather than towards the constitution of "unique" subjects, strong and with hierarchical structure (Frisio et al, 2012).

The work contributes to the knowledge of the sector of small fruits in Sicily in relation to the attention that has recently been addressed by the Regional Government and to check whether a cooperative strategy, already established in other sectors, can also represent an opportunities for growth for this sector.

The paper is organized as follows. After a description of the importance of the sector of small fruits in Italy and in Sicily, we describe the methodological approach used to achieve the aims of the research. Below it is a description of the results and the discussion of the same. The work closes with some brief considerations.

## THE ITALIAN SCENARIO OF SMALL FRUITS

In the last decade, in Italy, the interest in the sector of small fruits has taken an increasingly significant role as the official statistics FAO show. In fact, as shown in Table 1, the amount of recorded land, in the period (2001-2011), has had an increase of about twenty-three times, from 431 hectares in 2001 to 9.926 hectares in 2011

*Tab. 1- Small-fruited Area (hectares) in Italy (2001-2011)*

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Blueberries	194	183	200	108	173	200	199	202	206	202	192
Currants	58	58	54	69	74	100	100	100	102	104	100
Raspberries	179	167	172	181	178	200	239	300	283	287	300
Berries Nes*			8.800	8.700	8.800	8.300	7.400	9.200	10.000	9.797	9.334
<b>Total</b>	<b>431</b>	<b>408</b>	<b>9.226</b>	<b>9.058</b>	<b>9.225</b>	<b>8.800</b>	<b>7.938</b>	<b>9.802</b>	<b>10.591</b>	<b>10.390</b>	<b>9.926</b>

*Source: our processing of FAO data*

*\* Other berries not classified*

In particular, the species that has the greatest impact is represented by the Raspberries, the surface of which passes from 179 hectares in 2001 to 300 hectares in 2011. The other species, show, over the decade, an increase of the planted areas where, specifically, the species Currant shows an increase in fact it has doubled from 58 hectares in 2001 to 100 hectares in 2011. In terms of production, there has been, over the decade, the same trend, with a produced volume, in 2011, of about twenty-two times greater than in 2003. We move, in fact, from 3,938 tons in 2001 to 89,141 tons in 2011 (Table 2). As for the surfaces, even the

productions, excluding always the category "Berries Nes", that's the Raspberries species that has the most of volume, in fact, with 2,000 tons in 2011, it intercepts the 48,30% of the total product, showing an increasing trend during the whole considered period. In tail in order of importance, the Blueberries, for which, although over the decade there has been a decreasing trend and it intercepts, in 2011, con 1.441 tons, 34.80% of the total product

*Tab. 2- Small-fruited production (tons) in Italy (2001-2011)*

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Blueberries	1.88	1.81	1.400	1.507	1.489	1.500	1.440	1.435	1.526	1.405	1.441
Currants	0	1	615	694	723	800	700	800	760	716	700
Raspberries	1.45	1.38	1.391	1.657	1.421	1.700	1.647	1.700	1.956	1.990	2.000
Berries Nes*	5	0	72.80	71.50	82.20	67.50	71.00	87.20	92.00	84.70	85.00
			0	0	0	0	0	0	0	0	0
<b>Totale</b>	<b>3.93</b>	<b>3.77</b>	<b>76.20</b>	<b>75.35</b>	<b>85.83</b>	<b>71.50</b>	<b>74.78</b>	<b>91.13</b>	<b>96.24</b>	<b>88.81</b>	<b>89.14</b>
<b>Totale</b>	<b>8</b>	<b>7</b>	<b>6</b>	<b>8</b>	<b>3</b>	<b>0</b>	<b>7</b>	<b>5</b>	<b>2</b>	<b>1</b>	<b>1</b>

*Source: our processing of FAO data*

*\* Other berries not classified*

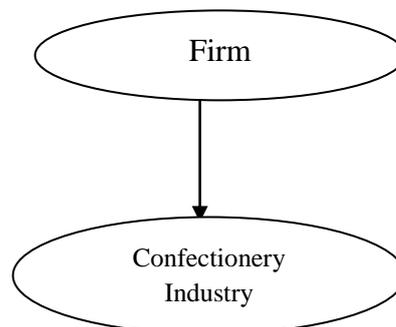
The picture just described gives a glimpse of significant room for growth in the sector. From official national statistics (ISTAT), the distribution of Italian areas and production for regions, reveals a higher concentration in the regions of northern Italy, primarily the Trentino Alto Adige followed by Lombardy and Piedmont, while for the scenario of Sicily, in spite of the climatic conditions in some particularly favorable area, there are no statistical data on area and production. This aspect is related to the lack of significance that currently the sector plays in Sicily. However, by surveys conducted by the research team, there were recognized ten companies producing small fruits, mainly located in Eastern Sicily, which represent the statistical universe of reference in this study.

## THE SICILIAN SCENARIO OF SMALL FRUITS

The universe under study is composed of ten companies located in the western and eastern Sicily, two are in the town of Campobello di Mazara, in the province of Trapani, and they are cultivated in a protected environment, the remaining eight companies, cultivated in the open field, fall within the territory of the Nebrodis, a mountainous area in the province of Messina,

which represents the ideal distribution area for growing these fruits in terms of soil and climate. For these distribution areas, located at about 800 meters above sea level, the cultivation of small fruits is an important opportunity income. By the investigations carried out, it emerges, a value of PLV, for 1,000 square meters, in soilless cultivation, amounting to € 9,000 and, in the field, a PLV equal to 1,900 euro per 1000 square meter. The sample investigated is characterized by small production companies that, together, will inform a total area of 4.7 hectares for a total production in 2012, amounting to about 185 tons. The cultivated species are raspberries, currants, blueberries and blackberries. These companies are run by entrepreneurs with an average age of 37 years who have undertaken the cultivation of small fruits due to the push by the Region of Sicily, who intended to pursue the development of this sector in Sicily through a loan that guaranteed an aid able to support the initial investment costs and ensuring technical advice during the entire production cycle. The sales market of products thus obtained, follows a system of short chain ,in fact, they are sold directly to local confectionery industries business (Fig 1).

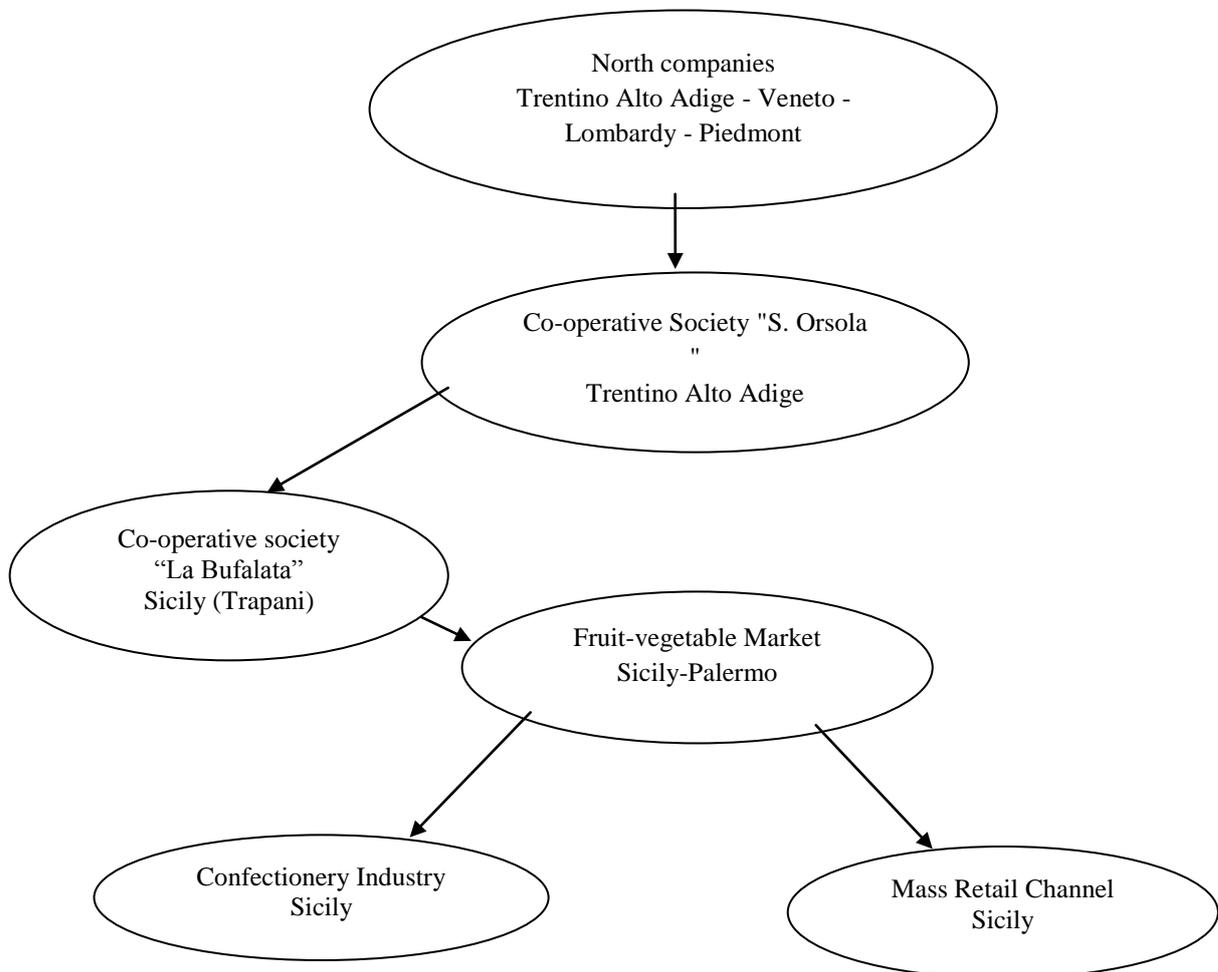
*Fig.1 Small fruits chain in Sicily*



It is, unfortunately, a volume of production unable to meet the demand of the regional market, as the reality of small fruits in Sicily is still in initial phases. The main Sicilian market supply, is represented, in fact, by the productions from the regions of Northern Italy and the countries of South America that are intercepted, specifically, by the cooperative society "S. Orsola ", located in Trentino Alto Adige, which channels the productions in different regions of Italy, and then follows the path of fruit marketing to various confectionery industries or regional supermarkets (Fig 2), satisfying the market demand for ' entire year. This is an aspect which is of particular importance in an era in which the culture of seasonality, it is significantly different than that of the past. In particular, in Sicily, there is a cooperative that

serves as a link between the cooperative "S. Orsola " and the fruit and vegetable market of Palermo which is the main regional platform for small fruits.

Fig 2 organization scheme of the small fruits sector

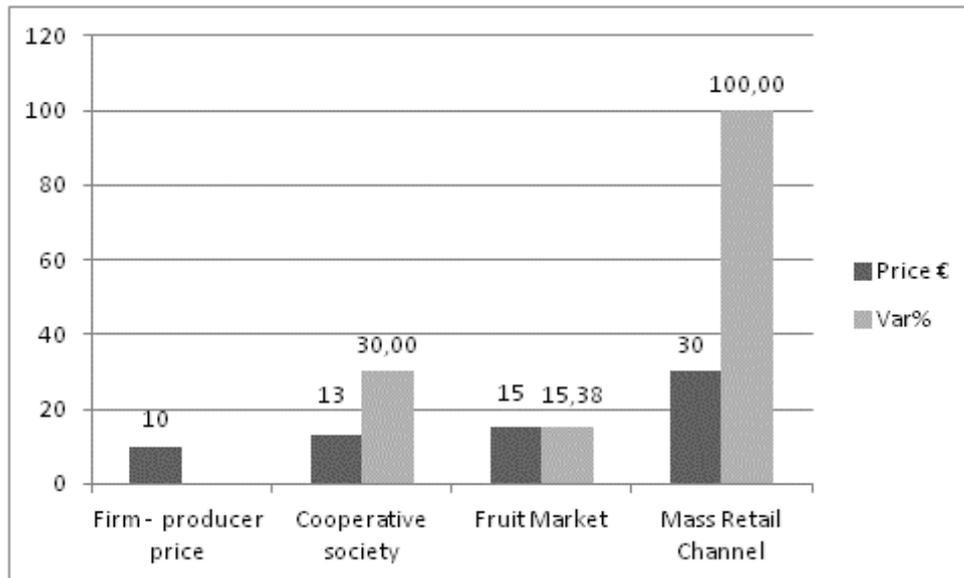


It's clear, however, as the wide structure of the supply chain, involving many actors has as consequence, the formation of particularly prohibitive price especially on the fresh market of the product (Fig. 3).

In fact, the changes of the prices are significant along the production chain. Specifically, the selling price popped by employers amounts to about 10 €/ Kg The product is sold in boxes mixed (blackberries, currants, raspberries and blueberries) 1 kg, consisting of 8 trays of 125 g each, and they are sold to cooperative society engaged in a rise of about 30% at the time of sale of the product to the fruit and vegetable market which, in turn, it sells at a price of 15 euro/kg (+15.40%) in pastry shops and department stores, the latter , specifically, increasing

customs sales prices in an amount equal to 100% with a price of about 30 euro/Kg, addressing a small number of target consumers.

Fig 3. Percentage change of small fruits price in the production chain Sicilian



Source: our processing based on direct interviews

## METHODOLOGY

In order to reach the research's aim we have contacted all the 10 Sicilian firms that make the production of small fruits the core business of their activity.

The interview was conducted using a questionnaire containing 12 open-ended questions addressed to capture qualitative information relating to the forms of horizontal integration, relationships upstream and downstream of the production phase and the main problems of the sector.

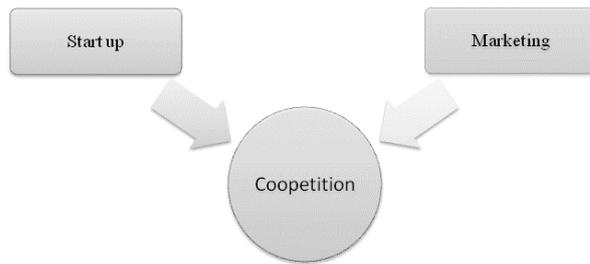
In addition, in order to assess the propensity to invest in this product segment, we have carried out a telephone interview through a semi-structured questionnaire to 30 fruit growers in Sicily, not employed, at the moment, in the production of small fruits and operating in areas where the soil and climatic conditions are suitable for the cultivation of small fruits. We have chosen the 30 most important companies of wild strawberries, in relation to the strong similarity with the agro-technical of the small fruits. To these entrepreneurs were asked, first, if they knew the specific production characteristics of the market and the health of the sector and, based on the response, the questionnaire followed two different routes. Specifically, in the case of knowledge of the sector, the questionnaire wanted to estimate the propensity to orient production towards the berries and then to establish competitive strategies with other

businesses. For those who were not aware of the peculiarities of the sector, after a brief presentation of the most significant segment of small fruits, it was estimated the will to invest and to cooperate in the fund. Finally, it was also asked what could be the role of institutions in supporting the development of cultivation. In particular, the questionnaire consists of a first part aiming to highlight the strengths and weaknesses of the sector (SWOT Analysis), in order to shed light on at the same time, opportunities and possible threats of the sector under study, that could serve as an incentive for entrepreneurs to start this productive activity, followed by a second part to assess the propensity of farmers, working and not in the industry, to invest in the sector of small fruits and to adopt business strategies by identifying cooperative production phases where such a strategy might be more efficient. This will allow you to understand the future direction of entrepreneurs operating in the region.

## RESULTS AND DISCUSSION

From the interviews carried out with small fruits farmers it has been possible to deduce in time of production that the cooperation may represent an interesting strategy to overcome some obstacles. The group of entrepreneur interviewed claims to be willing to cooperate in the stages of the purchase of seedlings and the marketing phase (Fig. 5). Indeed, as emerge in other studies carried out in the Sicilian fruits and vegetables sector, the main constraints for the enterprises success is linked to the high level of the provision costs of nursery materials and the complex distribution system (Schimmenti et al., 2011). Also the co-operation through common marketing strategies, often too expensive for small fruits companies, could contribute to increasing the competitiveness of them. Therefore, to cooperate in the purchasing phase of seedlings can be an opportunity to reduce the high costs of initial investment which involves the cultivation of small fruits. One possible solution, according to the interviewees, could be the creation of a common nursery from which we could supply, without the need to resort to nurseries in Northern Italy and in Northern Europe. Other solution could be a strategy that allows entrepreneurs to create a regional productive reality and a commercial hub that could have a greater impact on the main markets to which to allocate the production.

*Figure 5 – Phases diagram identified for an effective co-operative strategy*

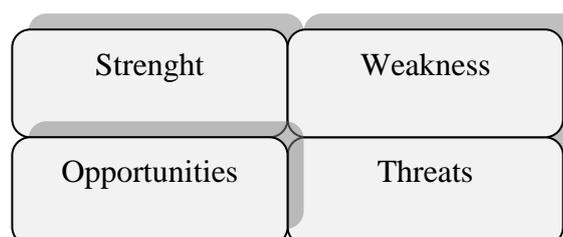


In reference to the group of thirty Sicilian fruit entrepreneurs, it was estimated the propensity to invest in small fruits sector in order to understand the future production scenarios. By the conducted interviews we can see the majority will not to invest in this area, regardless if it is supported by a possible support of public institutions. Specifically, only one out of thirty entrepreneur said he had filed in the past for funding aimed at supporting the initial investment for the cultivation of small fruits. The rationale for this categorical attitude is due, in almost all cases, to market problems. According to the respondents, in fact, it does not exist, in Sicily, a significant market of small fruits for the reasons already explained above. Some of the entrepreneurs surveyed also said they had had previous experience in the cultivation of these fruits and not to be more willing to invest in this sector because of the difficulty in placing the productions in the regional market for the high perishability of fruits.

## SWOT ANALYSIS

From the survey results it has been possible to develop a SWOT analysis (Fig. 4), which is essential to highlight the strengths and weaknesses of the sector of small fruits in Sicily. The same analysis is been important to identify the stages of production where co-opetition can be an interesting strategy, and finally evaluate the propensity to invest by Sicilian fruit entrepreneurs.

*Figure 4 - SWOT Analysis*



In particular, the SWOT analysis shows that the most interesting trait of this sector is represented by the nutraceutical properties and health benefits of the product, accompanied by a market demand growing, high profitability of crops both in protected cultivation and in open field. Between the weaknesses emerges a strong entrepreneurial individualism, a cultural factor that does not allow to appreciate the fresh product, the purchase price of the seedlings that represents the voice of the more expensive of production, for which most entrepreneurs have expressed their willingness to collaborate with other businesses, high perishability of the product, and finally the problems of marketing.

The opportunities foreseeable for the future, are based on the important potential of development of the sector, on the new market opportunities both domestically (center-south) and abroad. The international market competition is considered, among the possible critical (Threats) for the future, so that the imported products may steal some market share.

## CONCLUSIONS

The main contribution of this study has been, first, to know the strengths and limitations that characterize the sector of small fruits and to inquire about the existence of cooperative strategies within the same market, using, in particular, empirical data between agricultural producer groups operating in Sicily.

Although the investigations have not emerged, at present, the cooperative attitudes, in a future perspective, this study has highlighted the willingness, by the entrepreneurs to adopt business cooperative strategies aimed at the reduction of production costs, identifying, specifically, the phases of the production process more expensive. Specifically, it has emerged from the survey carried out, that the purchase of propagation material and the marketing phase of the product are the steps that fit best to such business strategies although, to date, the structure of the industry in terms of area and production, is such as to prevent the implementation of these strategies.

The low propensity to invest by the interviewed entrepreneurs, can be attributed mainly to market problems, a solution to this problem might be to invest in marketing efforts using, for example, the specific nutraceutical features and health benefits that these fruits have, educating the consumer, and step by step you may catch a glimpse at the growing in the sector, where the cooperative strategies could represent an interesting opportunity for Sicilian farmers.

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## COMPETITIVENESS OF ITALIAN WINES ON THE INTERNATIONAL MARKET

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### ABSTRACT

In the last few years the wine market has been affected by a deep structural transformation due to the entry in the world productive scenario of new competitors and for changing of the demand not only at geographical level but also for more and more orientation of consumers towards the quality wines. This transformation has involved even the Italian wine sector, that takes in the international wine scenario a significant importance, both in terms of supply and of the weight on the world wine export. The competitiveness analysis of Italian wine in the main partner countries, carried out through the application of the Vollrath index, show different scenario depending on the wine categories considered. In general results reveal an increasing competitiveness in some markets, such as Asiatic (especially for bottled wine and sparkling wine), East Europe (mainly for sparkling wine and cask wine) and North European countries (especially for cask wine), which do not have a viticulture tradition and where the acknowledgement of the health characteristics of wine and of the product as an expression of an Italian lifestyle are strategic factors for the success of Italian wine. Contextually, emerges a disadvantage in traditional markets (France) and in new producing markets (USA). In this context is necessary to consider the peculiarities of each market that differ in terms of dimension, culture, purchasing power, through the adoption of focused strategies.

**Keywords:** Wine industry; Competitiveness; International trade; Italy

### INTRODUCTION

Over the last few decades the wine market has been affected by a deep structural transformation due to globalization and mounting international competition (Bernetti et al., 2006). On the one hand, the entrance of new countries on the world productive scenario, whose role is continually strengthening, set beside the traditional wine producing countries

of the “Old World”, such as France, Italy and Spain, has led to an overall geographical reconfiguration of the productive scenario. On the other hand, the demand for wine has also registered a geographical change with a fall in the traditional market, in line with social changes that have occurred through time, and an increase in new consumer markets. Contextually, preferences and customs associated with wine consumption have changed with a general decline in the quantity of wine sold and an increasing orientation of consumers towards quality wines apt to satisfy more complex needs than purely gastronomic ones, the function of which is enriched with experiential, symbolic and hedonistic elements (Nosi, 2012). In 2007, a deep economic and financial crisis was added to this changing process of the world wine market; a crisis that involved indiscriminately all economic sectors and, among them, that of agriculture and food, until then characterized by a strong resilience ability compared with other sectors. In the international and European scenario, Italy is the undisputed leader in the wine market, both in terms of supply, increasingly oriented towards designation productions (ISMEA, 2012), and export, absorbing in 2011 about  $\frac{1}{4}$  of world export (OIV, 2012). Furthermore, Italy has one of the longest and most important traditions, producing a great variety of wines from a number of geographically different regions (Bernetti et al., 2006). Wine is, in fact, one of the most representative products of the ‘Made in Italy’ food productions, that, thanks to its high quality and marked distinction, has contributed to the strengthening of the reputation of Italian products in the world as an offer of excellence, strongly tied to the territory (Carbone and Henke, 2012).

The aim of this paper is to analyze the competitiveness of Italian wine on the international market, with specific reference to sparkling wine, bottled wines and cask wine of less value, in relation to their weight in the more general context of agri-food trade. In particular, we intend to verify the changes in Italy’s competitive position during the period 2000-2012, related not only to structural changes of the sector, but also to the entrance into force in 2009 of the new common organization of the market in wine, and to the deep economic and financial crisis in Italy and in the world.

After outlining the reference frame of the Italian wine sector as seen on the wider international scenario, this work will illustrate the working method used to respond to the aims of the research. Then, the results of the analysis of the competitiveness will be described and discussed. The paper ends with some final remarks by the Authors’.

## LITERATURE REVIEW

The deep structural changes that have characterized the world wine market in the last few decades have fomented a growing research interests in exploring the dynamics of the competitive position of individual countries in the world market and their main determinants. In that sense, Cusmano et al. (2010), through a comparative analysis of two emerging countries, such as Chile and South Africa, and a long established Italian wine region, such as Piedmont, highlight that the success of new world producers is linked both to investments in process of technological modernization and in their ability to adapt quickly to global demand changes. Ewert (2012) and Van Rooyen et al. (2011) observe, respect to the South African wine sector, the strong influence of regulation and support of government policy on the sector' competitiveness. A Similar result is achieved by Doloreux and Lord-Tarte (2012) in their study on the Canadian wine market.

Other studies, carried out through a competitiveness analysis using specific indicators based on the principle of comparative advantage, show the main factors contributing to the failure of the sector. These, can be depend, as for Portuguese wine (Fortuna sets per., 2007), from bottlenecks in the phases of production, processing, bottling/labelling and distribution, or as emerges for Bosnia and Herzegovina wine sector, from a low consumption of wine (Ivankovič et al., 2005). The same authors emphasize the importance of investment in critical phases of the supply chain, in order, as assert Ivankovič et al. (2005), to improve production efficiency, wine quality and marketing.

On the other hand, several Authors, focus on the role of innovation strategies in enhancing the companies competitiveness on the market. In that sense, Fernandez et al. (2011) reveal, in their analysis on the Spanish wine market, a positive relationship between a formal technological innovation strategy and the competitive advantage. Also Leenders and Chandra (2013) found that a green innovation strategy has a positive impact in terms of business performance mainly when firms use more direct sales channels.

With regards to the Italian sector, Corsi et al. (2013) analyse the positioning of the Italian wines in Asian markets and show that China and South Korea are two potentially interesting markets due to the perception of Italian wine as a status symbol, showing, however, the need to investment especially in the promotion phase. In fact, as assert Bernetti et al. (2006), differentiation strategies and the combination of tradition and innovation are the keys to the success of Italian wine in the world.

## **THE ITALIAN WINE SECTOR IN THE INTERNATIONAL SCENARIO**

Italy takes on a role of relevant importance on the international wine scenario, with a concentration in 2011 of 10.2% of surface under vineyard, and 15.7% of the world wine supply, preceded only by Spain and the United States, and 24.4% of the world export, proving itself as the main exporter (OIV, 2012) (Table 1).

Countries	Vineyards surface (mha)		Wine production (mhl)		Wine consumption (mhl)		Wine exporters (mhl)	
	2000	2011	2000	2011	2000	2011	2000	2011
Argentina	2.6	2.9	4.5	5.8	5.5	4.0	1.4	3.1
Australia	1.8	2.3	2.9	4.2	3.6	4.8*	5.2	7.1
Chile	2.2	2.7	2.4	3.9	3.0	4.1*	4.4	6.7
China	3.8	7.4	3.8	4.9	4.7	7.0	0,1	0.1*
France	11.6	10.6	20.6	18.7	15.3	12.3	24.9	14.2
Italy	11.6	10.2	18.4	15.7	13.6	9.4	24.3	24.4
South Africa	1.6	1.7	2.5	3.6	3.1	4.1*	2.3	3.6
Spain	15.7	13.6	14.9	12.6	6.2	4.2	14.3	22.4
USA	5.3	5.3	7,7	7.1	9.4	11.7	4.6	4.2
World	7,847	7,585	280,000	265,000	225,665	244,306	60,300	99,400

Table 1 - World vitiviniculture scenario (value in %)

\* 2009 data

Source: Own calculation on International Organisation of Vine and Wine (OIV) data.

The dynamics registered in the period 2000-2011 confirm the change of the world competitive scenario which had begun some decades earlier, marked by a reduction in the market shares held by the main European producers who, nevertheless, continued to maintain leadership in the world market, in favour of emergent producers, particularly China, Chile, Australia and the USA, who have appeared more recently on the global competitive market, but where there are lots of large size firms which have achieved good performances and high market shares, while applying targeted marketing policies (Vrontis et al., 2011).

In Italy, according to the VI General Census of Agriculture (ISTAT, 2011), the sector counts 383.6 thousand companies stand on a surface of 632.1 thousand hectares; compared to the census data of 2000, there is, on the one hand, a decrease of 52% in the number of productive units and of 11.9% of surfaces under vineyard, and, on the other hand, an increase of average investment per company, which went from 0.9 to 1.6 hectares. This data show an important process of transformation more and more oriented towards the aggregation and specialization of companies which operate in the sector.

On the basis of annual data on cultivation (ISTAT, 2013), viticulture in Italy in 2011 covered a surface of 762.1 thousand hectares, of which well 88.7% (675.8 thousand hectares) addressed to the production of wine grapes, registering in the period studied a contraction of 7.9% of the wine grape production investments (Table 2). A central role in reshaping the productive surface has been played by the regime of grubbing-up, introduced in 2008, with EU Regulation No 479/2008, relating to the reform of the common organization of the market in wine. The latest data given out by the Ministry of Agriculture, Food and Forest Policy, led to the grubbing-up of more than 20.5 thousand hectares, with the 2008/09 and 2009/2010 period (MiPAAF, 2013). The new regulation, apart from tending towards a greater equilibrium between supply and demand, also through other measures such as the application of quotas to grape production or the disposal for wine which is distilled into potable alcohol, also intends to increase European producers' competitiveness in foreign markets and preserve the relationship between product and territory in a perspective of safeguarding the environmental, cultural and social patrimony of rural areas.

	u.m.	2000	2011	Var. %
Area under Vineyard	m ha	805.6	762,1	-5.4
Area under vineyard for wine	m ha	733.6	675.8	-7.9
Grapes production	m t	8,869.5	7,282.9	-17.9
Grapes for wine production	m t	7,345.8	6,034.2	-17.9
Wine production	m t	5,408.8	4,218.5	-22.0
Value of wine production	M €	2,055.60	1,881.00	-8.5
Wine export	M €	2,446.90	4,368.00	78.5
Wine import	M €	204.50	289.20	41.4
Trade balance	M €	2,2242.4	4,079.0	81.9
Wine consumption	m liters	30,800	23,052	-25.2
Wine consumption per capita	Liters	54.05	38.17	-29.4

Table 2 - Market balance for the wine sector in Italy (2000-2011 period)

Source: Own calculation on ISTAT and OIV dat

In relation to supply, wine production in 2011 reached 4.2 million tons (48.4% red wine, 47.4% white wine and 4.2% must), registering a contraction of 22% compared to 2000, to the value of 1.9 billion euros, equal to 3.7% of the value of agricultural production at basic prices, marking a contraction in the same period of 8.5%. Wine supply concerns significantly all the Italian regions in which viticulture extends over deeply diversified environments, from coastal plains to high altitudes (Malorgio et al., 2011). The multiplicity of plantation environments, and also varietal differences on a regional basis, find their widest expression in 521

designation, of which 330 Protected designation of origin (PDO), 73 Controlled and guaranteed designation of origin (DOCG) and 118 Indication of geographical origin (IGT) (INEA, 2012). The strong orientation towards quality improvement, both of the basic raw material and of the finished product, but also of some intangible characteristics, attributable in particular to the *terroir*, has in many ways been a forced choice for many productive realities in Italy, especially as far as international competitiveness is concerned.

As regards to consumption, in Italy the trend registered on the international market is confirmed, with a contraction of purchases which decreased from 30,800 hl in 2000 (45.05 litres per capita) to 23,000 hl in 2011 (38.17 litres per capita) (OIV, 2013). In fact, the part of population consuming wine has decreased, but, above all, styles of wine consumption have changed, from wine as an energetic product to a product for occasional consumption linked to special situations, or cultural consumption for connoisseurs (ISMEA, 2012). This tendency is also highlighted by the increasing amount that Italian families spend for this product categories.

Referring to trade, which will be discussed in detail in the next chapters, Italy showed a positive trade balance in 2011 that attested at more than 4 billion euros, in particular, due to the exportation of bottled wine, recording in the period in question an increase of 81.9%.

The process of the change of the Italian wine sector has also involved distribution channels, in which the increasingly centralized role of the large scale distribution (LSD) is confirmed. On the basis of the latest data diffused by Mediobanca, there is a progressive weakening of market shares held by LSD, which represent the main selling means, above all, for basic wines, from Ho.Re.Ca. channels and wine shops and bars, mostly oriented towards the sale of “icon wine”, in view of a strengthening of sales through wholesalers and other channels which include on-line selling (I numeri del vino, 2012).

## **MATERIAL AND METHODS**

In the economic literature, several approaches have been developed to measures of international competitiveness based on trade data. The advantage of using the trade data is that, as suggest Frohberg and Hartman (1997), demand and supply responses are considered simultaneously and that costs of marketing and transport are taken into account.

In this paper, Italy's competitive performance is assessed for the wine products on the international market, by analysing bilateral trade flows and market shares and making use of specific indicators based on the principle of comparative advantage. Although these indices are not dynamic, as suggest Trail and da Silva (1996), their trend it is more important for explain the competitive advantage.

The first two indices used are the Export market share (EMS) and the Import market share (IMS), for outline the structure and geography of trade in wine products, that are expressed as:

$$EMS = 100 (X_{ij}/X_{iw}) \quad IMS = 100 (M_{ij}/M_{iw})$$

In the formula,  $X$  and  $M$  stand for exports and imports,  $j$  and  $w$  for the region, whilst  $i$  is the product. Market shares are expressed as values from 0 to 100; thus, a value of zero indicates that the exports (or imports) of a given product  $i$  from a given country  $j$  are nil; whilst a value of 100 indicates that the entirety of export (or import) of product  $i$  is carried out by country  $j$ .

The third index used in this paper, is the Relative Trade Advantage (RTA) proposed by Vollrath (1991) as alternative specification of revealed comparative advantage and which is derived by Balassa's index, from which differs for the removal of the double-counting of country and product, for which it has been much criticised. The RTA, obtained from the difference between the Relative Export Advantage (RXA) and the Relative Import Advantage (RMP), shows positive (or negative) values if the country in question has an advantage (or disadvantage) in its competitive position for trading in product  $i$ .

$$RTA = RXA - RMP$$

Specifically, the RXA expresses the export share for product  $i$  of a given country in the market  $j$  compared to the share held for other products; the index has a higher (or lower) unit value if the country's has an advantage (or disadvantage) in its competitive position for exporting product  $i$ . In the formula,  $X$  stands for exports and  $M$  stands for imports. The indices  $i$  and  $n$  relate to categories of products, whilst  $j$  and  $r$  relate to region.

$$RXA = \left( \frac{X_{ij}/X_{ir \neq j}}{X_{nj \neq i}/X_{nr \neq i}} \right)$$

There is a similar index for imports, the RMP, which expresses the import share for product  $i$  of a given country in the market  $j$  compared to the same share held for the remaining products; this indicator is greater (or less) than 1 if the country in question has an advantage (or disadvantage) in its competitive position for importing product  $i$ .

$$RMP = \left( \frac{M_{ij}/M_{ir \neq j}}{M_{nj \neq i}/M_{nr \neq i}} \right)$$

Vollrath, in addition, proposes a new version of the index (RC) in which the Relative Export Advantage (RXA) and Relative Import Advantage (RMP) are expressed in logarithmic form, but this of limited use where trade flux is limited or nil (Havrila and Gunawardana, op.cit.).

The RTA index has been applied in a number of studies to analyse revealed competitive advantage of various sectors of different countries (Traill and Da Silva, 1996; Frohberg and Hartmann, 1997; Havrila and Gunawardana, 2003; Fertő and Hubbard, 2003; Bavororà, 2003; Ascuito et al., 2008; Crescimanno and Galati, 2012). Regarding the wine sector, the Vollrath index was applied also to analyze the international competitiveness of wine production in Bosnia and Herzegovina (Ivanković et al, 2005) and in the Slovak Republic (Hambalková, 2006). In particular, as opposed to the traditional approach, in this paper the RTA index is used to capture Italy's competitive advantage with respect to the individual world partners and the trade intensity ties between the partners.

For the competitiveness analysis of Italian wine we have analyzed the trade on the basis of the data concerning export and import money flow taken from the data base of Italian National Institute of Statistics (ISTAT, 2013) and in the 2000-2012 periods. More in detail, the analysis of the Italian wine competitive performance has been carried out taking into consideration, on the one hand, the trade flows concerning the 6-digit classification of the harmonized nomenclature (HS6), relative to the three commercialized typologies of wine - sparkling, grape wine in pack  $\leq 2$  liters (bottled wines) and grape wine in pack  $> 2$  liters (cask wines, of less value, although it is not possible to establish a unique relationship in this sense), and, on the other hand, the agri-food trade concerning the 2 digit classification of the nomenclature Ateco 2007, relating both the products of agriculture, forestry and fishing and food, beverages and tobacco products.

## RESULTS AND DISCUSSION

### Structure and dynamics of Italian wine trade

Wine is one of the main products of Italian agri-food export. It covered 14.2% of foreign sales on average 3 year period of 2009-2011, which has not changed significantly with respect to the first 3-year period of reference. On the contrary, it has little weight on agri-food importation (0.7%).

In the triennium 2009-2011, wine export reached on average a value of 3.9 billion euros, registering, compared to the triennium 2000-2002, an average annual increase of 4.2%, partly ascribable to a large spread of wine consumption also in those Countries not associated with viticulture traditions (Gerolimetto and Mauracher 2009). In the same period, imports increased but at a less dynamic rate (+2,8%) with an average value of 264.8 million euros. The registered trend, therefore, have determined an increase in trade balance, which is attested at 3.649.3 million euros, and an increasing of trade specialization, as emerges from the analysis of normalized trade balance, which moved from 85.8% to 87.3% between the two triennium of reference.

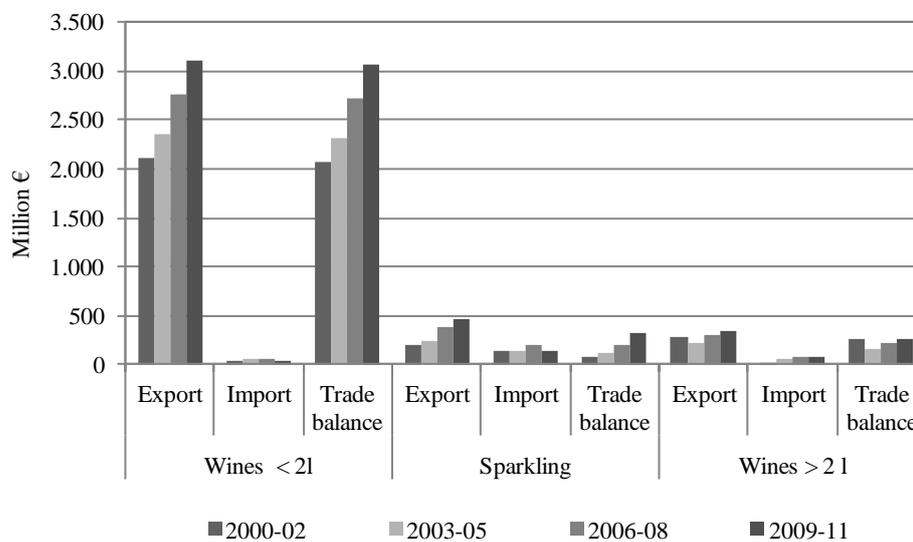


Figure 1: Dynamics of Italian wine trade

Source: Own calculation on ISTAT data

Sales abroad concern mainly bottled wines (79.4%), followed by sparkling wines (11.8%) and cask wines (8.8%). Among these three categories of wine, sparkling wine registers the best performance (+10.7%). However, as far as imports are concerned, the purchase of sparkling wine prevails (51.5%), even though cask wines have a considerable weight (30.4%), the purchase of which registers an average annual increase rate of 19.2%. Imports of bottled wine are more reasonable (18.1%).

The analysis of the Export and Import market shares trend (EMS and IMS), referring both to wine on the whole and to the three categories considered in this paper, has allowed to highlight the change in the trade structure.

Analysis of EMS shows how, in the triennium 2009-2011, three markets absorbed more than half the value of Italian wine exportation, particularly Germany (21.9%), which is the biggest wine importing market in the world (Nosi, 2012), the United States (21.2%) and the United Kingdom (12.1%), even though there are some differences in the types of product. In fact, while the USA and United Kingdom are more oriented towards the purchase of bottled wine and sparkling wine, Germany is the main purchaser of cask wine (Table 3). Other important target markets are: Switzerland (6.4%), which purchases all three categories of wine, and Canada (5.9%), interested mainly in cask wine. The evolution of market shares in our reference period highlights a progressive reduction of German shares in bottled wine and sparkling wine, compared to an increasing bearing of the cask wine category, and the United States in the three types of wine (even though there is a rise in the export value in both countries). The presence of wine in the United Kingdom is increasing, especially the sparkling wine category, ever more appreciated in spite of the financial crisis that in the last few years has led to a reshaping of purchases (Baccaglio, 2011). Moreover, positive dynamics are recorded in the bottled wine category in Russia, thanks to the 2006 closure of the Russian border to Georgian and Moldavian wines, and also in Canada, Denmark and China, which represent the new consumer markets, and for cask wines in the Czech Republic. The increasing demand of wine above all from the Chinese market is due to a change in the way Chinese consumers approach foreign products. They see wine as a convincing substitute of the traditional alcoholic drinks such as rice wine or sorghum and maize drinks (Mitry et al., 2009), for its benefits to health which have also contributed to the increase in consumption and to the culture of wine in the Asiatic Country (Corsi et al., 2013). On the other hand, shares held by Japan have decreased, where Italy is the second supplier, after France, of bottled wines (16.0% in 2011) and the third supplier of sparkling wine (9.0%) (Centro Interdipartimentale per la Ricerca in Viticoltura ed Enologia, 2013).

Countries	Wine				Sparkling		Wines ≤ 2 l		Wines > 2 l	
	2000-02		2009-11		00-02	09-11	00-02	09-11	00-02	09-11
	M€	%	M€	%	%	%	%	%	%	%
Argentina	0.4	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Australia	11.1	0.4	19.8	0.5	2.0	1.4	0.3	0.4	0.3	0.2
Austria	63.6	2.4	84.8	2.2	1.0	4.2	2.7	1.8	1.9	2.8
Belgium	38.7	1.5	72.2	1.8	1.2	2.8	1.6	1.8	0.7	0.7
Brazil	20.8	0.8	28.5	0.7	1.6	1.1	0.8	0.7	0.2	0.3
Canada	115.1	4.4	229.6	5.9	1.7	2.2	5.2	6.8	0.8	2.0
Czech R.	8.4	0.3	36.3	0.9	0.1	0.6	0.1	0.6	2.3	4.6
Chile	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0

China	3.6	0.1	41.5	1.1	0.0	0.7	0.0	1.1	0.9	1.0
Denmark	52.4	2.0	126.2	3.2	0.6	1.6	2.3	3.6	0.8	1.7
France	112.2	4.3	94.9	2.4	3.9	2.6	1.8	1.9	23.0	6.7
Germany	753.9	29.0	857.2	21.9	27.8	19.6	28.6	20.5	32.4	37.9
Japan	109.4	4.2	105.0	2.7	7.4	3.8	4.3	2.7	1.2	1.0
Greece	14.3	0.5	9.0	0.2	0.6	0.6	0.1	0.1	3.7	0.6
Ireland	9.2	0.4	22.9	0.6	0.0	0.3	0.4	0.7	0.0	0.0
Norway	19.5	0.7	61.1	1.6	0.6	0.5	0.8	1.6	0.7	2.3
Netherlan ds	51.5	2.0	102.2	2.6	2.1	2.0	2.2	2.9	0.4	0.7
Portugal	12.8	0.5	9.2	0.2	4.0	1.4	0.0	0.1	1.5	0.0
UK	249.7	9.6	475.3	12.1	7.8	11.4	10.8	12.9	1.8	6.0
Romania	0.3	0.0	6.1	0.2	0.1	0.2	0.0	0.1	0.0	0.9
Russia	8.9	0.3	95.7	2.4	1.9	8.3	0.2	1.5	0.4	3.6
Spain	18.9	0.7	35.5	0.9	1.0	0.7	0.5	1.0	2.5	0.6
USA	623.9	24.0	830.0	21.2	21.4	17.2	26.7	23.8	6.0	3.0
Switzerlan d	158.7	6.1	250.5	6.4	5.6	6.5	5.6	6.4	10.4	6.6
Hungary	3.0	0.1	17.8	0.5	0.7	0.4	0.0	0.1	0.4	4.0
Other Countries	140.3	5.4	302.6	7.7	7.0	9.7	4.9	6.9	7.7	12.4
	2,600.	100.	3,914.	100.	100.	100.	100.	100.	100.	100.
World	7	0	2	0	0	0	0	0	0	0
% category	100.0		100.0		7.7	11.8	81.2	79.4	11.1	8.8

Table 3: Export market share (EMS)

Source: Own calculation on ISTAT data

As far as imports are concerned, France is the main supplier market (61.7%), especially for sparkling wine (96.5% of the value of sparkling wine bought by Italy) and of bottled wine (48.9%), followed by American (17.8%) and Spanish (10.4%) markets for the purchase of, above all, cask wines (Table 4). Among the other markets, the German and Portuguese ones have great importance as suppliers of bottled wine.

The evolution of IMS shows a contraction of French market shares, which has decreased by 18.1% because of the sudden reduction of purchases of cask wines from it, and of Portuguese shares, a consequence of the reduction of the weight of bottled wines. Conversely, an increasing importance of the USA (17.1%) and Spain (+5.2%) is recorded among supplier markets, mainly for the cask wines category. In our period of reference, there is a market diversification which rose from 39 in 2000 to 50 in 2011.

Countries	Wine				Sparkling		Wines ≤ 2 l		Wines > 2 l	
	2000-02		2009-11		00-02	09-11	00-02	09-11	00-02	09-11
	M€	%	M€	%	%	%	%	%	%	%
Argentina	0.4	0.2	0.8	0.3	0.0	0.0	0.5	1.2	0.5	0.3
Australia	0.6	0.3	0.5	0.2	0.0	0.0	1.1	0.9	0.6	0.1

Austria	0.7	0.4	1.6	0.6	0.0	0.1	1.1	2.4	0.8	0.3
Belgium	0.3	0.2	0.2	0.1	0.0	0.0	0.6	0.3	0.1	0.0
Brazil	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Canada	0.1	0.1	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0
Czech R.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Chile	1.6	0.8	1.5	0.6	0.0	0.0	3.4	2.3	0.3	0.5
China	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Denmark	0.1	0.0	0.2	0.1	0.0	0.0	0.2	0.2	0.0	0.0
	158.		163.							
France	6	79.8	3	61.7	95.8	96.5	47.5	48.9	54.5	10.2
Germany	3.0	1.5	6.6	2.5	0.4	0.8	3.9	9.7	3.0	1.0
Japan	0.4	0.2	0.2	0.1	0.0	0.0	0.7	0.4	0.0	0.0
Greece	0.9	0.5	0.8	0.3	0.0	0.0	2.0	0.6	0.1	0.7
Ireland	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Norway	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.0
Netherland										
s	0.5	0.2	1.2	0.5	0.1	0.5	0.7	1.1	0.0	0.0
Portugal	10.6	5.4	6.0	2.3	0.0	0.0	21.8	12.5	3.7	0.0
UK	4.1	2.1	1.6	0.6	1.8	0.3	3.1	2.0	1.6	0.2
Romania	0.4	0.2	0.8	0.3	0.0	0.0	0.0	1.4	1.7	0.1
Russia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Spain	10.3	5.2	27.5	10.4	1.7	1.1	5.1	9.7	23.9	26.5
USA	1.4	0.7	47.1	17.8	0.0	0.0	2.6	1.1	0.5	57.8
Switzerlan										
d	0.9	0.4	0.8	0.3	0.0	0.0	1.7	1.5	0.2	0.0
Hungary	0.8	0.4	1.1	0.4	0.0	0.0	0.7	0.9	1.8	0.8
Other										
Countries	2.9	1.5	2.9	1.1	0.0	0.4	2.9	2.8	6.4	1.3
	198.	100.	264.	100.	100.	100.	100.	100.	100.	100.
World	6	0	8	0	0	0	0	0	0	0
	100.		100.							
% category	0		0		65.3	51.1	22.5	18.1	13.2	30.4

Table 4: Import market share (IMS)

Source: Own calculation on ISTAT data

#### Competitiveness of Italian wine in the main partner countries

The Relative Trade Advantage index has been determined for the three items which make up the wine category, in order to evaluate the competitive advantage or disadvantage of Italy with respect to its main commercial partners and its relative evolution during the reference period.

Taking into account the multitude of information, and in order to make the reading of the results and of the trend registered easier, the countries were classified into 8 groups in relation to the evolution of the index value between the two triennium of reference, according to the following proposed in the table 5.

As for sparkling wine, relative to the main trade partners, a positive high index value with Russia (5.2) was seen, considering that 8.0% of the Italian agri-food export value in this

market is made up of sparkling wine and that the same market absorbs 8.3% of Italian sales of sparkling wine in third country markets, with Brazil (2.4), whose high index value is due to the net specialization of Italy in the export of this product, and with the United States (2.3), in which the Italian advantage is, rather, due to a higher grade of penetration of the Italian product on the market. Values above the unit are also shown in Portugal (2.1), due to the net exportation benefit, and in Switzerland (1.5).

Group	Definition	Indices combination
I	Increase of the competitive advantage	$+RTA_{2009-11} > +RTA_{2000-02}$
II	Decrease of the competitive advantage	$+RTA_{2009-11} < +RTA_{2000-02}$
III and IV	Transition from competitive advantage to competitive disadvantage	$-RTA_{2009-11} < +RTA_{2000-02}$
V	Increase of the competitive disadvantage	$-RTA_{2009-11} > -RTA_{2000-02}$
VI	Decrease of the competitive disadvantage	$-RTA_{2009-11} > -RTA_{2000-02}$
VII and VIII	Transition from competitive disadvantage to competitive advantage	$+RTA_{2009-11} > -RTA_{2000-02}$

Table 5: Adopted classification

Other markets where values are above the unit are Canada, Australia and China, for the net advantage of Italian exportation, and United Kingdom and Austria, as a consequence of the high shares of sparkling wine absorbed by such markets compared to Italian exportation on the whole. The competitive advantage with Germany is more moderate, in spite of the fact that it is the main target market of sparkling wine in terms of value, considering that the same product absorbs a relatively modest share of Italian agri-food export. In the reference period, as figure 2 shows, the competitive advantage with Russia increased -where the Italian product is increasingly appreciated even though only by wealthy consumers who associate its consumption to an Italian lifestyle-, but also with the United Kingdom -where Italian

sparkling wine signals a continuous growth in the last few years in spite of the effects of the financial crisis on the English wine market-, China, Denmark and, to a lesser extent, Switzerland and Canada (Group 1). Among these, the Chinese market offers remarkable opportunities. In fact, in spite of a fast growth of local wine production in the last few years, the per capita production of wine remains relatively low and is not enough to satisfy domestic supply, thus making the importation of wine necessary in the light of the expected rapid growth of per capita consumption (Mitry et al., 2009). Moreover, while local wines tend to satisfy daily wine consumption, more demanding consumers see wine as a status symbol and hence tend to buy imported wines (Corsi et al., 2013). However, the competitive advantage over Portugal and Brazil, has diminished (Group 2), as a consequence of a contraction in the Italian exportation market share which has been absorbed by the two markets, both with reference to sparkling wine and the agri-food as a whole, but also over the United States, Australia and Japan. There are negative index values with France (-6.3), considering that it is the main if not the only supplier market, being the undisputable leader in the world market of the product at issue (Carbone and Henke, 2010), disadvantage which has increased as a consequence of an growing dependence on the part of Italy.

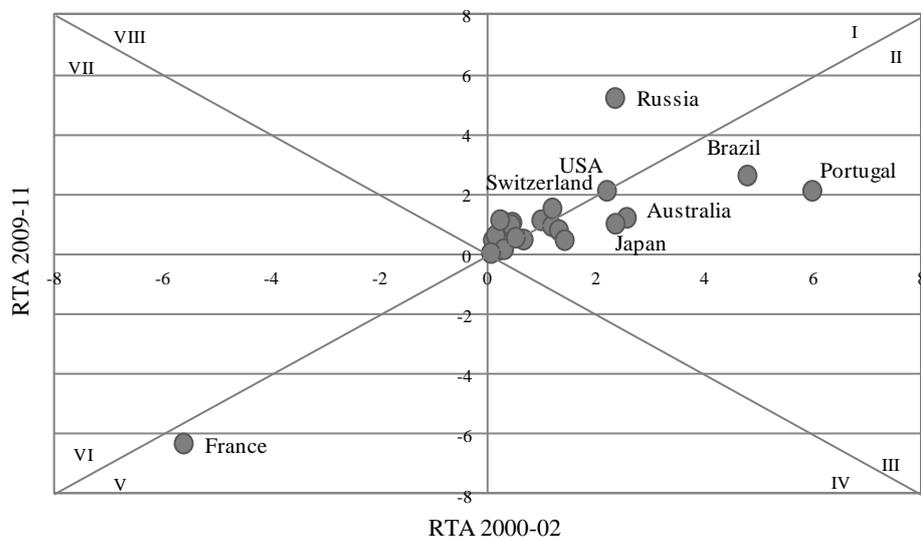


Figure 2: RTA of sparkling (2000-02 and 2009-11)

Source: Own calculation on ISTAT data

For bottled wines the calculated results of indicator of RTA show a high index value with a competitive advantage for Italy in Canada (5.1), United States (3.3), Denmark (2.6), Brazil (2.0), Ireland (1.9) and China (1.7), as a consequence of the high weight of these categories of wine on Italian agri-food exportat in these markets, with shares that reach 39.4% in Canada

and 18.4% in China. In our reference period, Italy strengthened its competitive advantage on all these countries, except Brazil which belongs to Group II, due to an increasing weight of these products on Italian agri-food export destined to satisfy the demand of these markets (Figure 3). The increasing competition in the Asiatic markets, and in particular China for bottled wines, is tied to a sustained growth in the consumption of premium and super premium wines in the same markets, thanks to consumers who have worked abroad or a foreign workers resident in China (Corsi et al., 2013). However, high negative index values with Portugal (-19.7), Japan (-11.7), Chile (-4.8) and France (-3.1) are seen. The result in Japan is linked to the higher weight that these categories of wine take on within agri-food import compared to that assumed in the context of exportations. As has already emerged from the analysis of the market shares, Japan is a privileged partner for Italian wine exportation, which finds consensus among local consumers, thanks to a sound wine culture and a growing curiosity on the part of Japanese consumers towards Italian quality products (Corsi et al., 2013). During the 2000-02 and 2009-11 period, as Figure 3 shows, the Italian competitive disadvantage with Portugal, Chile and Japan decreased as a consequence of a lesser degree of penetration of this category of wine by the above-mentioned markets and a lesser weight of the same product on agri-food import. On the contrary, the competitive disadvantage with France (Group 5) increased for the growth Italian demand for French wines.

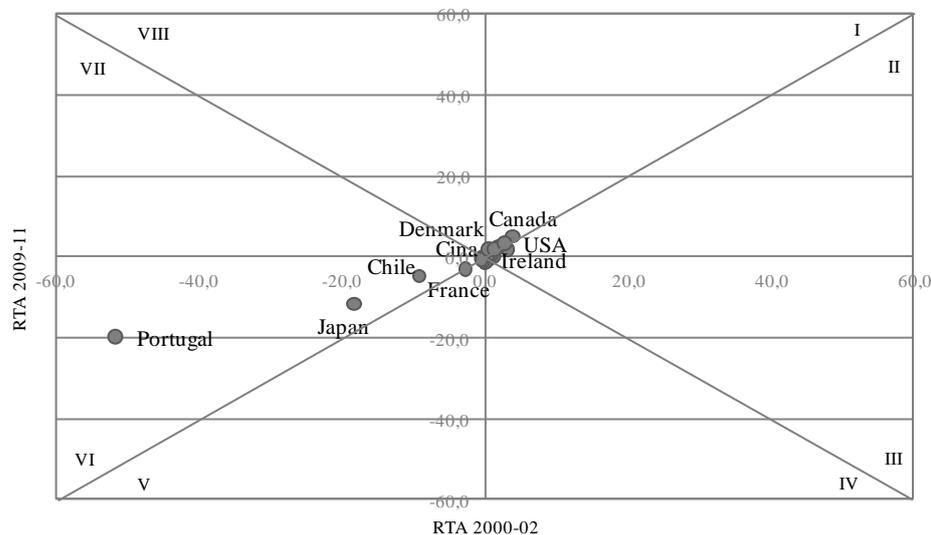


Figure 3: RTA of Wines in bottles  $\leq 2$  l (2000-02 and 2009-11)

Source: Own calculation on ISTAT data

Finally, regarding the value of the RTA index for cask wines and compared to the main trade partners, Italy shows a competitive advantage with Hungary (4.4), the Czech Republic (4.2)

and Norway (3.9), although they are markets which absorb relatively modest exportation shares of this type of wine, but assume a heavier weight for agri-food exports. Positive index values are recorded also with Germany (1.9), considering that the German market absorbs 37.9% of Italian exportation of this category of wine, Switzerland (1.6) and China (1.5), as a consequence of a net advantage in the exportation of cask wine in these markets. The dynamics registered during the reference period highlight countries such as Romania, Norway and Hungary (Group VII and VIII) with whom Italy improved its competitive position as a result of a greater degree of penetration of the Italian product on such markets, whereas in the first triennium it presented a competitive disadvantage (Figure 4). The competitive advantage with Germany and the Czech Republic (1 Group) increased, while the same advantage decreased with Switzerland and China, as a result of a reduction of the weight of this typology of product within agri-food production. The analysis highlights a marked competitive disadvantage with the United States (-34.0), with whom Italy worsens its position, turning from a weak competitive advantage in the first triennium to a marked disadvantage in the triennium 2009-2011, linked to the weight of these products in the import value of agri-food products. The trend observed could be linked on the one hand to the growth of surface under vineyard and of wine production in North America (Nosi, 2012), and on the other hand, to a recent tendency which links stronger flows of cask wines to greater economic and environmental sustainability (ISMEA, 2013). To a lesser extent, a competitive disadvantage with Spain (-2.7) is observed as a result of a growing penetration in the Italian market. The Iberian country, together with Australia, in fact, showed greater dynamism at an international level with considerably growing flows in this sector of the market (Carbone and Henke, 2010) thanks to increased production in the last few years, tied to the coming into production of recently planted vineyards.

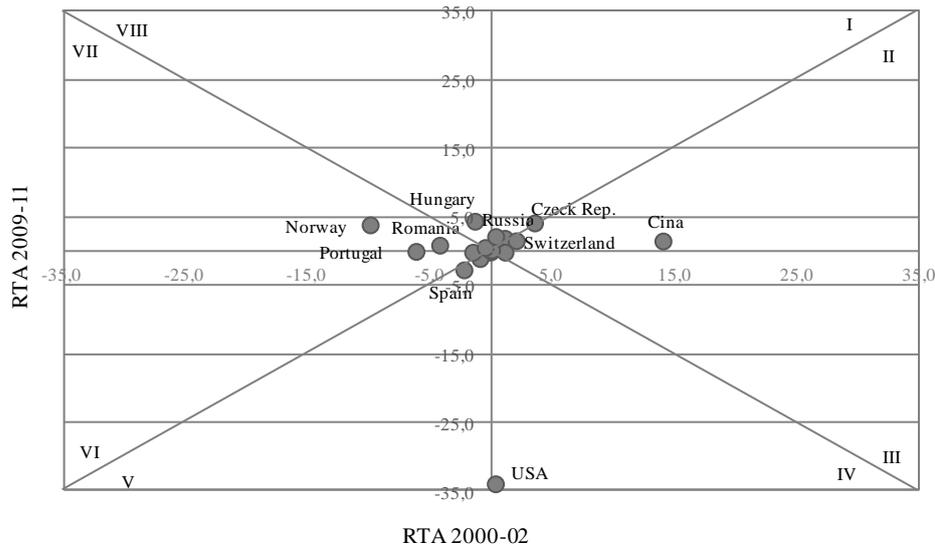


Figure 4: RTA of wines in conts > 2 l (2000-02 and 2009-11)

Source: Own calculation on ISTAT data

## CONCLUDING REMARKS

The results of the present study show how Italy seems to have managed to seize the opportunities offered by the recent change of the international wine market, progressively opening itself to foreign countries, not only in the traditional consumer markets but also in the emerging ones, thanks to its ability to satisfy a diversified demand more and more oriented towards quality products also in the recent period of crisis.

In particular, the analysis carried out via the application of the Vollrath index to the bilateral trade of Italy with its main trade partners, as well as evaluating Italian competitiveness, it has highlighted, indirectly, the degree of appreciation for Italian wine with respect to the agri-food industry as a whole. More specifically, an increasing competitiveness has been identified in some markets which do not have a viticulture tradition, where there is inadequacy of local production to satisfy domestic demand, and where the acknowledgement of the health characteristics of wine as an expression of an Italian lifestyle are strategic factors for the success of Italian wine.

The competitive challenge can act on two sides: on the one hand, the achieve of new consumer markets that represent  $\frac{1}{3}$  of total world consumption, and, on the other hand, the maintenance of traditional partners through the offer of better quality wines. Consequently, it is necessary to consider the peculiarities of each market of reference that are different for dimension, culture, and purchasing power. It is important the adoption of focused strategies

and without disregarding obstacles linked to promotion and distribution and also to the knowledge of the complex system which regulates the commerce.

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## MANAGEMENT ACCOUNTING CHANGES TOWARD RISK MANAGEMENT. IMPLICATIONS FOR MANAGEMENT ACCOUNTANTS

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### ABSTRACT

During the past few years, changes in competitiveness have generated new and variable risks. These risks have considerably impacted companies' aptitudes to create value. Consequently, management accounting and management professionals, particularly management accountants, are stressed by these environmental changes.

The *main goals* of this research are: i) to understand if a further change in management accounting and in the role of management accountant is required, and ii) to highlight the main direction of this change, with particular attention to risk management as a new variable.

The *method* used in this research is an empirical and comparative analysis based on explorative case studies. These case studies included seven companies listed in the Italian "public utilities" market sector, which represents the third sector in terms of capitalization in the Italian Stock Market Exchange. The analysed companies represent the 78,7% of the Italian "public utilities" sector, in terms of capitalization (*datum* referred to 2011). The choice of the companies is due to the fact that they have undergone extensive changes in response to their political, legislative and economic environments and are now subject to regulations, which have significant effects on both their strategic planning and management control systems, as well as on their risk management systems.

In our *discussion* of the results, we designed an explorative theoretical model, which considers the expected change in management accounting and in tasks and functions, skills, competencies, knowledge and abilities of management accountants. In particular, by adopting institutional theory, we researched the development of the

evolving roles for management accountants from performance controller to performance and risk controller.

**Keywords:** Management Accountants, Management Accounting Change, Risk Management, Key Risk Indicators, Critical Risk Factors, Performance Measurement Systems

## 1. INTRODUCTION

The environmental trends of the last decade have been characterised by features that are difficult to identify from previous times. The process of market liberalisation, especially between developed and developing countries, began in the second half of the 1970s and it has recently completed its first major milestone as globalisation has become a recognised event. Companies now operate in an economic environment that spans the globe. The process of technological innovation, begun in the 1990s and mainly due to developments in Information and Communication Technology (ICT), has supported this unstoppable phenomenon.

Market globalisation, however, has quickly turned into a “global crisis” that has affected consumption, industrial production and, consequently, social welfare. In the current framework, value creation *has become* much more difficult, especially for those companies in developed countries. In particular, companies must now face the new and changing risks generated by this competitive environment. Environmental variables such as decreasing consumption, high unemployment, well-informed customers, high competition and continuous changes are difficult to manage. In this context, it is inevitable that managers must make quick decisions in situations of high uncertainty and risk.

Our main hypothesis (*HP1*) is that this external context is creating conditions for institutional changes in management accounting that follow several often-interrelated directions. The least explored, in both the literature and practice, is likely also the most urgent: *the integration of management accounting with risk management*. Consequently, we hypothesised (*HP2*) an *evolving role of the management accountant*, who would accept the challenge of enriching the traditional role with new intra-organisational relations, functions, tasks, skills and knowledge, even as they maintain the role’s most fundamental traits.

Therefore, the *aims* of our research are:

- to understand if a further change in management accounting and in the role of management accountant is required;
- to highlight the main direction of this change, with particular attention to risk management as a new variable.

Our analysis contributes to the extant literature as it reveals a further specific direction of change for management accounting and, consequently, for management accountants, which goes toward the integration between performance and risk planning and monitoring. In particular, we explored the new tasks and skills that should enrich the management accountant's traditional role. Only if management accountants are able to accept and impose a new role for themselves by integrating performance controlling with risk monitoring will the change be successful for the organisation and improve the decision-making process beyond simple legitimisation and institutional isomorphism.

In the following section of the article, we firstly analysed the literature on changes in management accounting and the challenges for management accountants, with particular attention to the key tenets of *institutional theory* that inform our research. In this section there is also an analysis about the main literature concerning the Enterprise Risk Management (ERM), as this system represents the hypothesised direction of change for management accounting. Then, in the third paragraph we illustrated the research methodology. The results of our research are presented in the fourth paragraph, followed by the fifth one in which we engaged in a discussion of our findings. In the last paragraph we concluded and underlined the limits and the possible implications of our research.

## **2. THEORETICAL BACKGROUND**

### *2.1. Management Accounting Change*

The majority of the literature from the last twenty years has described management accounting systems as essential tools for business strategy formulation and implementation (Shank, 1989, 1996). These tools must be able to measure a wide range of strategic variables on a long time horizon and integrate economic and financial indicators with non-financial indicators by following the logic of cause-and-effect links (Bhimani and Langfield-Smith, 2007; Bromwich and Bhimani, 1994). Management accounting systems have taken the form of a mechanism to monitor management's long-term strategic decisions. With this assumption

about the function of management accounting systems, there is an awareness of the difficulties of implementing a strategy and independently translating it into operational terms based on the effectiveness of the strategy itself (Kaplan and Norton, 1996, 2001, 2004). Indeed, even if a company's top managers formulate excellent long-term strategies, they often have serious difficulties in implementing them, as the organisation struggles to translate strategic objectives into daily operations. To develop a strategy that creates value is an art that can hardly be realised through rigid conceptual schemes. After the formulation of a strategy, the real difficulty lies in implementing it and communicating it to the whole organisation (Brusa, 2007; Kaplan and Norton, 2006, 2008).

The difficulty is not in describing the "tangible" elements of a strategy that are measurable by financial parameters (e.g., capital requirements for planned investments), but rather, it is in describing the "intangible" elements such as knowledge management, which grows with human resources, experience, skills and capabilities; information technology that supports the enterprise and connects it with its customers and suppliers; and the organisational culture that encourages innovation, problem solving and continuous improvement (Argyris, 1993; Davenport and Glaser, 2002; Edvinsson and Malone, 1997; Kaplan and Norton, 2004; Nonaka, 1991; Nonaka and Takeuchi, 1995; Nonaka and Toyama; 2003; Nonaka et al., 2000; Sveiby, 1997).

These elements are essential to creating value, but it is difficult to measure their contributions with traditional management control system methods (financial control), because their impact on financial results is indirect rather than direct and operates along a chain of causal links that is more or less long and complex. Moreover, the value of these factors depends on the strategic context in which they are used. In this case, they have only potential because there is no related trading market. In addition, the intangibles create value only when they are combined with the tangible elements of a company.

The role of a managerial system should therefore be that of an instrument to implement strategy and the system should translate the conceptual roles of the strategy's tangible and intangible elements into operational terms. It is important to expand the boundaries of traditional control systems to create a strategic management system (or strategic control), that is, an advanced control system that oversees the real achievement of strategic objectives in the short term.

Most studies on the changing role of management accounting (Cooper, 1996; Kaplan and Norton, 1996) have focused on more technical aspects of new control practices, such as strategy maps, business models and cost accounting systems (e.g., BSC and ABC). Through the identification of a map for each strategy – a so-called *strategy map* – top management defines a logical structure that highlights the expected results in the short and long term and the critical success factors necessary to achieve these results (Kaplan and Norton, 2001, 2004). After the map for a strategy is identified, it has to be translated into a set of financial and non-financial *balanced* performance indicators that are causally interrelated. The company indicators are then discussed, translated and adapted within the appropriate parameters, including the specific targets for each responsibility centre and taking into consideration the peculiarities of the organisational structure. The strategy is then pursued by employees operating at the various levels of the organisation on a day-to-day basis. This means that the balanced system of objectives and parameters must be communicated and translated into operational terms that establish specific goals for all areas of the company. In addition, the overall company results and the results of the responsibility centres should be consistently monitored with an appropriate evaluation system and rewarded in an incentive system (Kaplan and Norton, 2006, 2008).

Strategic initiatives and related projects should be identified and their financial and human requirements should be specified to achieve the approved target for each indicator. The financial and human requirements for strategic projects should be authorised and embedded into a company's annual budget. To do this, the budgeting process should be split into two different elements: the *strategic budget*, aimed at managing *strategic objectives* in both the long and short term (discretionary programs), and the *operational budget*, aimed at managing the *efficiency objectives* of the different responsibility centres and the various control objects (Kaplan and Norton, 2001).

Several studies show that change in strategic control systems should be adequately supported by the use of business information systems (Scapens and Jazayeri, 2003; Scapens et al., 1998). These studies underline the benefits of improving these systems, but they also highlight the possible limitations of using these tools, which are primarily defined by the conceptual reliability of data and the potential disconnection between functional areas (Culasso, 2004).

Other researches have considered the effect that the change in management accounting has had on the role of the management accountant and observed how the role should evolve from *bean counter* to consultant on all aspects of corporate business, as a so-called *business analyst* or

*business partner*, while maintaining the most traditional tasks and traits of the *pessimistic scorekeeper* that characterised the role of controllers in past decades (Baldvinsdottir et al., 2009a, 2009b, 2009c, 2009d; Bhimani and Keshtvarz, 1999; Johnson, 1992; Johnson and Kaplan, 1987; Parker, 2001; Roslender, 1995; Roslender and Hart, 2003; Scapens et al., 2003). This focus has led, at least in theory, to a redefinition of the management accountant's and CFO's roles, so that they require a greater engagement in business processes management, a strong attention to strategic and historical information, a decentralisation and dissemination of accounting knowledge (economic and financial) to operational managers, with a re-characterisation of the efficiency control of their activities (Burch, 1994, 2000; Kaplan and Norton, 2004).

There are also studies, that were inspired both by the New Institutional Sociology (new institutionalism) and the Old Institutional Economics (old institutionalism) (Di Maggio and Powell, 1991), which have focused on the social and institutional aspects of the change in management accounting. These studies investigated the importance of internal and external organisational and business context analysis and the conflict and resistance that often threaten the success of the on-going changes to techniques and processes of strategic planning and management control (Burns and Baldvinsdottir, 2005; Burns and Scapens, 2000; Burns and Vaivio, 2001; Coad and Cullen, 2006; Collier, 2001; Covalski et al., 1996; Di Maggio and Powell, 1983, 1991; Granlund and Lukka, 1998; Hussain and Hoque, 2002; Lukka, 2007; Ma and Tayles, 2009; Modell, 2001; Scapens and Jazayeri, 2003; Seo and Creed, 2002; Tsamenyi et al., 2006; Yazdifar et al., 2008).

There are few academic authors who have dealt with management accounting change, especially regarding the integration of management accounting, corporate governance and risk management (Busco et al., 2005, 2007a, 2007b; Collier and Berry, 2002; Kaplan, 2009; Kaplan et al., 2009; Kaplan and Mikes, 2011a, 2011b; Paladino et al., 2009; Parker, 2001; Power, 2009; Scholey, 2006). Indeed, despite the fact that all businesses are forced to communicate their strategic intentions about risk and efforts necessary to increase business efficiency, there has not been enough attention paid to how planning and control systems should be integrated with those of risk management and corporate governance in the creation of the "new" management accountant role (Bhimani, 2009).

## 2.2. *Institutional theory in management accounting research*

Recently, many researchers have adopted institutional theory in order to analyse management accounting change. These researchers consider accounting structure and processes as social practices. Even if they adopted different analytic perspectives, it would be possible to define their approaches as *institutional management accounting research* (Burns and Baldvinsdottir, 2005). Institutional management accounting research includes research inspired by new institutionalism, or New Institutional Sociology (NIS), and by old institutionalism, or Old Institutional Economics (OIE) (Burns and Scapens, 2000; Burns and Vaivio, 2001; Covaleski et al., 1996; Granlund, 2001; Granlund and Lukka, 1998; Hussain and Hoque, 2002; Lukka, 2007; Seo and Creed, 2002).

In particular, management accounting research inspired by NIS illustrates how, in addition to internal efficiency and effectiveness needs, changes in planning and control systems are often motivated by changes in the general environment (e.g., political, legal, economic, cultural, technological and social changes) and changes in institutions and phenomena (e.g., rules, habits, routines, norms and culture). When applied in management accounting research, the new institutional theory considers management accounting change to be an instance of *institutional change* (Burns and Baldvinsdottir, 2005). An organisation embodies institutional requirements and becomes isomorphic with a set of norms, practices and routines. The isomorphism can be (Di Maggio and Powell, 1983):

- coercive, when an organisation accepts that it has to change in response to formal and informal political and regulatory pressures (legitimation);
- mimetic, when an organisation accepts that it has to change to improve its success and it copies more successful organisations;
- normative, when an organisation accepts that it has to change to conform to rules and practices developed by professional groups.

In contrast to criticisms that NIS is excessively deterministic, OIE instead considers the above factors as related to intra-organisational relationships between actors or to cultural and political processes concerning the legitimacy, power and interests of private actors involved in the change (Burns and Scapens, 2000; Burns and Vaivio, 2001; Granlund, 2001; Granlund and Lukka, 1998; Lukka, 2007; Seo and Creed, 2002).

In previous literature, there have also been some efforts to integrate themes suggested both by old and new institutionalism (Collier, 2001; Ma and Tayles, 2009; Modell, 2001; Yazdifar et al., 2008) and the consequential adoption of *hybrid* frameworks (Di Maggio and Powell, 1991),

which represent a fusion between old and new institutionalism and use a double lens in order to explain organisational change:

- at the macro level, considering political, regulatory, cultural and market pressures;
- at the micro level, considering underlying, intra-organisational power relations.

Indeed, hybrid frameworks consider external changes and organisational actions, as well as the different interests and capacities of the human actors, as though they are important drivers of organisational change. In this article, we adopt a *hybrid institutional theory* because we intend to argue that a successful organisational change - a change that improves the value creation of a company and its durability across a long time horizon - is the result of interplays between institutional forces and intra-organisational power relations. We propose that complying with the political and regulatory environment (coercive pressures and legitimation), following the influence of professionals (normative pressure and professionalisation), or acting according to market forces probably will not generate a successful change if there is not an adequate mobilisation of power inside the company. In other words, institutional pressures create the need for organisational change (Tsamenyi et al., 2006), but endogenous forces are required to adequately implement it.

### 2.3. *Enterprise Risk Management*

At the beginning of the new millennium, the global economic environment, which had already begun to change radically as a result of market globalisation, was the driving force behind the surfacing of new risks to companies; the global environment promoted the development of a new doctrinal approach to manage risk (a *proactive* approach) with the goal of improving business performance and creating value. Therefore, many of the factors that drive the diffusion of more "modern" risk management tools are exogenous in origin. This means that these factors derived from the economic environment (due to the globalisation and relocation of production) and the political-legal environment (as a result of the legislative evolution and codes of corporate governance).

In recent years, a new methodology for risk management called Enterprise Risk Management (ERM) has emerged in literature and in practice (COSO, 2004). This approach promotes the integration of business areas and transversal risk management and it places the control

activity of the uncertainty factors within the strategic planning phase (Liebenberg and Hoyt, 2003).

Despite the declared goals of ERM, some researchers and managers keep describing risk management as a *costly compliance exercise* (Collier et al., 2006, 2007), because this model, usually implemented to satisfy the legislation on corporate governance and internal control systems (which has mainly affected companies listed on regulated markets), has still difficulty in improving long term value for companies. Consequently, some researchers and managers deny that the benefits of risk management exceed the costs.

Certainly, the adoption of a model of risk management is initially financed to ensure the following (Culasso, 2009):

- greater respect of rules and regulations in the entire company structure and, therefore, a fuller application of the principles and values at the heart of the economic activity;
- dissemination of true information outside of the company structure, avoiding the risk of transmitting to the market false or incoherent information.

These two elements, however, are not necessarily antithetical to value creation. It is important to note that risk management is not only useful to "get by", without contributing to value creation, and that it does not necessarily compromise value creation because of the cost of implementation. Quite the opposite is true: when management is responsive to effectiveness and efficiency criteria in the short term, but its actions are based on unethical behaviour, the company's ability to survive over time and to safeguard its own value is compromised. In the absence of rules and laws, firm durability could be compromised. For the same reasons, in the long term, the environment rewards those companies that, using good information, have been shown to have strong ethical values and an effective system of risk management. Therefore, the compliance exercise should be translated over time into a reduction of the specific risk factor of the firm assigned by the market (Sharpe, 1964) and an increase in firm value.

Therefore, it is useful to recognise some important limitations of the use of the ERM model, rather than intrinsic ones, because the limitations may be harbingers of failure. Indeed, because the main existing framework for risk management begins with the important consideration about the need to integrate risk management policy with strategy formulation and strategic planning, it seems to be reasonable that this requirement is not fully

implemented, even if managers have understood the potential of risk management in generating and protecting value (Culasso, 2009). Essentially, the risks are initially conceived of as part of some strategy; then, however, the risk is rarely continuously verified, even in the short term with the evolution of binomial strategy–risk. The missing link is the continuous updating of the strategy's validity and, at the same time, of its associated risks.

This is mainly attributable to two facts related to the intra-organisational power relations (Collier et al., 2007):

- on the one hand, the risk manager or, in general, the person responsible for the determination of risk, too often acts like a bureaucrat, in accordance with rules and procedures, without worrying about managerial and organisational issues;
- on the other hand, the role of the management accountant is quite marginal to the risk management process. It is assumed that the controller plays support functions, but s/he is not involved in the logics underlying the measurement and control of risk.

Reports prepared by the risk manager usually do not include reference to the parameters of company performance and at the same time, there is no trace of integration of strategic planning (e.g., business performance measurement and models such as *Balanced Scorecard*) and management control (budgeting and reporting) with the risk factors and risk indicators elaborated during the risk management process (Berry et al., 2005).

The controllers are the first to admit their "forced exclusion" from the risk measurement process while recognising a potentially significant role in risk management. Instead, the other employees with leading roles in the risk management process (such as the risk manager and the internal auditor) believe that risk and risk management should not to be included in the tasks and responsibilities of the management accountant (Collier et al., 2007). This means that risk management, without the support of management systems to make it operate effectively, does not always go beyond the tasks of ensuring compliance and information transparency.

Despite the new approach to risk management, therefore, many problems must still be faced to undertake this "holistic" method. In particular, an issue that should be considered relevant both in theory and practice is the organisational structure of a firm and its operational mechanisms that guard against general economic risk. Specifically, addressing this issue means trying to clarify how to measure the particular risks faced by a company and how to balance target performances with these risks. In particular, the problem is how to integrate

risk management with management accounting, or how to include risk indicators within the system of strategic planning and management control (Culasso, 2009; Kaplan, 2009; Kaplan et al., 2009; Kaplan and Mikes, 2011a, 2011b). The tools of strategic planning and management control should embrace the logic and techniques of risk management to ensure that all of the responsibility centres in the firm follow a systematic pattern in their decision-making process. This procedure should affect the analysis and evaluation of potential risks related to strategy implementation initiatives, with the knowledge that all organisational units of the company also have responsibilities with regard to this effort. The strategic planning systems and the management control systems should introduce not only performance indicators but also risk indicators to better understand risks and opportunities continuously and with constant updating. At the same time, however, risk management should be able to balance the natural need of the management to understand new opportunities and the related risks. This requires the risk manager to devote attention managerial and organisational issues.

If management accounting does not evolve in this direction, it encounters two possible problems (Berry et al., 2005):

- the so-called "risk of control";
- the so-called "illusion of control".

With regard to the "risk of control", too often the implementation of a risk management model is driven more by the need for compliance and good relationships with various stakeholders than by a genuine belief in the need to monitor risks to protect company value. This is partly attributable to the complex national and international regulatory framework with laws, regulations and conduct codes. Even if this environment has allowed the diffusion of risk management and its logic to companies and in the literature, it has complicated the possibility of having a true system to manage the risk.

Thus, risk management could be only a bureaucratic answer to a rules-based need. It could be that the introduced models of control are excessive because they impose compliance with certain requirements that become "mandatory" for managers. The different decision makers may have little space to manage the company properly, especially in dynamic environments, and this could cause an increase in risk rather than a decrease, due to the lack of flexibility in the plans and budgets to seize new opportunities. The risk is to overemphasise *hyper-control*, or the fact that the person who controls is in turn controlled, without considering the effective functionality of the system itself. This is called "risk of control".

Regarding the phenomenon of the "illusion of control", the controls implemented during the risk management process could lead to an unjustified "belief" that all the uncertain events are well managed. In this way, hazardous and unanticipated conditions may arise, or opportunities could be missed.

### 3. RESEARCH METHODOLOGY

#### 3.1 *The research method*

As indicated in the Introduction section, in our research we formulated two correlated hypotheses:

- *HP1*: the external context created conditions for *changes in management accounting* and the most urgent direction of change is the *integration of management accounting with risk management*;
- *HP2*: the change in management accounting could be successful only if *the management accountant role evolves*, accepting the challenge of enriching the traditional tasks and skills.

In order to verify our hypotheses, we expressed the following research questions (RQs):

- *RQ1*: is it required a new *management accounting change*? Is it correct to affirm that the most urgent direction of change is the integration between management accounting and risk management?
- *RQ2*: should *management accountant's role* be considered as an intra-organisational condition, which will enable the successful management accounting change? And what are the necessary functions and features of this role considering the main direction of change of management accounting?

The *research method* used is a qualitative mixed method, as it integrates deductive and inductive perspectives. In particular, we firstly used the case studies method to answer to *RQ1* and *RQ2*. This method, although it is in part affected by subjectivity and it is often criticized for lack of statistical reliability and validity, excels especially when it is necessary to understand a complex issue (Yin, 1984) and it can develop expertise and strengthen what is already known through previous research. The analysed case studies can be defined as explorative (Ryan et al., 2002), because our research didn't aim to assume some generalizations or definitive conclusions, but to verify our hypotheses concerning the need

of change in management accounting and in management accountants' role and the main direction of change.

The tool adopted in the case studies is the interview. This tool has advantages such as flexibility, environmental control, the order of questions, the completeness, the response from the interviewees definitely concerned, but it has also disadvantages such as time, the influence of the less standardized and the formulation of the questions. The interviews were semi-structured to be kept within the main question area but still open the possibility to get the interviewees own ideas and feelings. The interviews included also some questions to verify the good quality of answers. We interviewed selected respondents, to verify the opinion of management accountants regarding:

- the *status quo* of management accounting systems in their companies;
- the expected or potential change in management accounting systems in their companies;
- the expected or potential changes and challenges to the management accountants' role in their companies.

Secondly, our research adopts *institutional theory*, in particular to answer to the RQ2, not with the intention of formally testing it, but rather to support our theoretical model of the successful directions of change for management accountants' role. The key tenets of institutional theory that inform our research are that management accounting is more than a technical system and that change in management accounting is embedded in institutional change. Particularly, institutional theory is adopted in our article to explain the hypothetical dynamics of change in management accountants' roles, considering the dynamics in terms of power relations as they are created by the intra-organisational condition and as they complement the exogenous drivers that create successful change and generate, preserve, improve and deliver value. Change in management accounting toward risk management is a response to the effectiveness and efficiency needs required by the new competitive market, the regulatory environment (coercive pressures) and the professional and normative pressures that characterise today's economy in developed countries (Di Maggio and Powell, 1983). However, we also consider that, in addition to exogenous drivers of change, endogenous organisational power relations are significant components in the effective improvement of management accounting. It is imperative to examine the interaction between institutional forces, market forces and intra-organisational power relations in order to understand the dynamics of change. This implies that top management should mobilise

power to implement effective and integrated management accounting tools, making changes to the management team and to the management accountant's role in the process. Top management should appoint powerful and influential management accountants to promote the use of the new management accounting systems and the management accountant's role should be enriched by new functions and tasks. To achieve successful organisational change and, in particular, successful management accounting change, it is necessary for coercive and normative pressures, as well as market forces, to interplay with intra-organisational power relations.

### 3.2 *The sample*

The case studies that constituted our sample included seven leading companies listed in the Italian "public utilities" market sector, which represents the third sector in terms of capitalization in the Italian Stock Market Exchange (the 18% of the global capitalization of Borsa Italiana in 2011), after Banks (21,6%) and Energy<sup>15</sup> (19,5%). Furthermore, the seven companies analysed represent the 78,7% of the Italian "public utilities" sector, in terms of capitalization. The choice of the seven companies is supported also by the Eisenhardt's approach to case study research, which argues for the use of more than a single case. She concludes that "between 4 and 10 cases usually works well. With fewer than 4 cases, it is often difficult to generate theory with much complexity, and its empirical grounding is likely to be unconvincing, unless the case has several mini-cases within it" (Eisenhardt, 1989).

The public utilities sector—which is different from posts and telecommunications and from public transport—was composed of the following sub-sectors:

- Energy
- Water
- Gas
- Renewable Energy
- Environmental Hygiene (wastes, maintenance of public areas, purification and sanitation, etc.)
- District heating.

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(<sup>15</sup>) The name of the sector has subsequently changed in Petrol and Gas, that better represents the composition.

The selection of the case studies was made concentrating on all the companies in the *FTSE sector: Italian Public Utilities Services*, that is, eighteen companies and groups were chosen in this first round of selection. However, the list has subsequently changed due to new listings, de-listings, or mergers between companies.

Successively, we eliminated the following companies from the original sample:

- subsidiaries of a holding company listed in the same sector, because firm policies relating to planning, control systems and risk management (which constitute the primary objects of the research) are set by the holding company;
- private companies, because we chose to focus on state-owned companies, for reasons of sample homogeneity (the vast majority of privately-owned utility companies operate in the Renewable Energy sub-sector because of the high investments required for infrastructure in Energy, Water, etc.) and because of the significant effect that the nature of government control has on them.

Therefore, ten companies were included in the final sample.

As a first step we contacted the investor relations directors to explain them the aims of our work, to identify the most appropriate respondents at each company and to obtain their contact information. Subsequently, a letter of introduction that contained an explanation of the research and a brief explorative questionnaire was sent to the potential respondents identified by the director of investor relations.

Seven state-owned companies declared to be interested in our research and accepted to be interviewed, and seven interviews were conducted in 2011. A large percentage of the respondents were leaders of strategic planning and management accounting or CFO at their company, with the exception of one risk manager, and all of them reported to have relatively short tenure with their company or experience that did not exceed five years.

The companies have from 800 to approximately 6,500 employees and, in five cases, are *multi-business* or *multi-utilities* (energy, water, gas, renewable energy, waste cycle, heating, lighting, maintenance of public areas, etc.).

The *choice of the public utilities sector* was motivated by the fact that, in the last decade of the last century, companies in this sector were impacted by a deep change in institutional (political and regulatory) environment and market competition, including the introduction of liberalisation and privatisation. Tsamenyi et al. (2006, p. 410) observe that, "...Perhaps no

industry has attracted as much attention in terms of change in recent years as the utility sector". Several Western public utilities sectors have undergone an important reform process to make them more efficient, and this process has introduced new competition rules. In Italy, the first round of reforms was introduced in the 1990s with the specific goal of cutting costs and reducing state deficits. Although free-market competition has not been completely established in this sector, liberalisation and privatisation have had a significant effect on efficiency and on organisational change aimed at more proactive management systems.

In addition to having to comply with national and EU laws, the companies operating in this sector are particularly subject to the regulations on internal control systems and corporate governance, which were first introduced in USA at the end of the 1980s<sup>16</sup> and subsequently developed around the world (in 2004 the so-called *Transparency Directive* was approved by the EU), to guarantee more transparency to the market and investors, greater compliance with laws and regulations and increased strategic success for the listed companies. Due to the fact that the purpose of the Internal Control is to support managers and monitor risks, these regulations have introduced the ERM methodology and have forced listed companies to implement the risk management process and structure in order to improve the assessment and the control of new risks. Therefore, regulatory, political, cultural and environmental pressures have caused significant changes in the public utility sector, exerting effects on both the strategic planning and management control systems, as well as on risk management systems.

#### 4. RESULTS

As we explained in the Research Methodology section, in case studies we investigated the opinion of management accountants regarding: i) the *status quo* of management accounting systems in their companies; ii) the expected or potential change in management accounting systems in their companies; iii) the expected or potential changes and challenges to the management accountants' role in their companies.

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<sup>(16)</sup> In 1987, driven by corporate scandals and failures in USA, the Treadway Commission published the Report on Fraudulent Financial Reporting, which contained a policy concerning corporate governance.

The results from the interviews showed that among the companies there were advanced management accounting systems, supported by integrated enterprise information systems, even if these systems were not completely integrated with the risk management tools.

We observed that in all companies there was a specific office of management accounting (in five cases, this person was directly below the CFO); in three cases, this office had more than ten employees and in two cases it had more than twenty employees.

In all cases, there were company objectives (both long-term and short-term) that were compared with company performance monthly and management control had its own formalised procedures and prepared monthly reports. Reports were issued to the following offices (Chart 1):

**Chart 1: Responsibilities Centres**

Top management	7/7	100.00%
SBU Managers (*)	7/7	100.00%
Functional Managers	5/7	71.43%
CFO	7/7	100.00%

Source: own elaboration

(\*) SBU stays for Strategic Business Unit.

Managers were charged with specific goals and were evaluated and rewarded on the annual achievement of results. The reports were characterised by a certain complexity because they were articulated with regard to different business dimensions or objectives (Centres of Responsibility, Services, Projects, Customers, Distribution channels, Geographic areas, Activities and processes, Business areas). The reports contained both financial parameters and non-financial indicators (quantitative and qualitative). This demonstrates that the analysis conducted by the management accountant and addressed to operational managers was characterised by multidimensionality and complexity, even though the reports included measures of business risk in only in two cases.

In six companies, in addition to traditional instruments of management control (budgeting and cost accounting), innovative tools for performance measurement and strategy implementation (activity based management, process management and balanced scorecard) were used. In all of the cases the tools allowed managers to monitor the current operations in

order to achieve strategic goals. Even though the balanced scorecard approaches were used in only four cases, all of the companies were aware of the cause-and-effect relations that connect the short-term financial perspective with the other, long-term perspectives (customer satisfaction, business processes and intangibles).

We also asked if companies had implemented "integrated" operating information systems (such as enterprise resource planning or ERP) and management decisions support systems. The answers demonstrated that the level of advanced computerisation was high with regard to both operational transactions and business intelligence tools.

Then, we analysed the structure (organisational and technical), the activities and the process of risk management to understand how this was undertaken and whether it was integrated with the strategic planning and management accounting tools and processes. In six companies there was a specific risk management office, which had more than ten employees in one case. In one company, risk management activities were executed directly by the CFO. The locations of the risk management office in the organisational structure were as follows (Chart 2):

**Chart 2: Risk Management Office**

Below the CFO	1/6	16.67%
Below the CEO	1/6	16.67%
Below the SP and/or MA Director (*)	1/6	16.67%
Below the health and safety responsible	1/6	16.67%
Below the operational managers	1/6	16.67%
Below the directors' staff	1/6	16.67%

Source: own elaboration

(\*) SP stays for Strategic Planning and MA stays for Management Accounting

We found that in four cases, the risks associated with the processes were mapped, estimated, evaluated, treated and their trends were monitored and communicated to the market; however, there was not a strict correlation between these activities and performance. Indeed, risk parameters were measured in connection with the performance parameters only in one case. It seems that although risk factors were often considered at the beginning of the planning phase, only some companies continued paying attention to risks and continuously

verified, in the short-term, the evolution of the binomial strategy-risk during and at the end of control processes.

Risk management was considered by five companies to be among the managerial systems that should be formally and substantially integrated with management accounting. In other words, the respondents affirmed that it would be very important that management accounting changes toward the full integration with risk management processes, structures and tools, in order to improve the companies' durability. To the direct question about the main expected or potential direction of change for risk management, all of the respondents confirmed that the integration with risk management could be this direction.

Most respondents considered critical events (six respondents), board and top management (six respondents) and laws and regulations (five respondents) to be the strongest drivers for the introduction of risk management in their companies. This means that the implementation of risk management is usually top management's response to extraordinary and negative events or regulatory calls to improve corporate governance. For this reason, there is still resistance at the operational level against exploiting the full benefits of risk management, not only in terms of compliance and transparency but also in terms of value creation.

In five cases the strategic planning and management accounting directors were involved in risk estimation and evaluation activity and in three companies they were involved in risk reporting and communication. However, each respondent (also in the case in which the respondent was the risk manager) underlined the importance of improving the involvement of management accountants in risk management activities, especially in the definition of risk management goals and in the risk monitoring and reporting activities.

Though companies used different approaches, in all companies the respondents affirmed that in their company there was coordination between the strategic planning and management accounting directors and employees involved in risk management. However, in only three cases was that coordination adequately formalised and not "ad hoc"; in only two companies risk parameters were identified in planning and control reports. However, in only one case there was an effective integration of performance and risk parameters.

Next, we asked whether managers believed that it would be useful to create a corporate board (top management, management accountant and risk manager) to share information about performance and risk and whether they thought that risk management could, from the strategic and managerial perspectives, be better used. The answers are shown in Chart 3:

**Chart 3: Integration by corporate board**

Yes, it is necessary to achieve common goals and then ensure better monitoring of performance, and to predict, evaluate and enable risk management actions	2/7	28.57%
Yes, it is necessary to have a more integrated view of risks and to have a more structured exchange of information	1/7	14.29%
Yes (not justified)	1/7	14.29%
No answer	1/7	14.29%
<i>Presence of a similar unit in the company:</i>		
Top management participates in risk commissions for specific types of risk and in risk management committees	1/7	14.29%
The corporate board sets out to monitor market risks and define the hedging strategy. It is being launched in the energy risk management project, which involves several managers in addition to CEO, including the director of finance, the director of planning and control, the director of administration, the director of management control, the director of risk management, the director of internal auditing and the director of legal services	1/7	14.29%

Source: own elaboration

At the end, the majority of respondents affirmed that top management had an important responsibility in sponsoring new power relations in their companies, characterised by a higher involvement of management accountants in the risk management activities, and considered as a *conditio sine qua non* to achieving a successful organisational change.

The management accountants' role, in the opinion of the majority of respondents, is seen as a *business analysts'* role, with a proactive involvement in the main operational processes of the company. In any case, they are favourable for a greater participation of controllers in risk management activities, in particular in the planning and reporting phase of risks and performances.

For this reason, the main characteristics that a management accountant should have are, in the opinion of all respondents:

- the ability to analyse management decisions, identifying and highlighting both *strategic variables* and *risks*. To achieve this goal, it is necessary that management accountants gain a high level of knowledge and familiarity regarding company processes, activities and internal resources. In particular, this familiarity is necessary with regard to the processes of business

development, the supply chain processes, the sales and customer service processes, the human resources processes, etc.;

- the skills in relationship and diplomacy, which would fulfil the coordination task, an essential ingredient for integration between management accounting and risk management;
- the knowledge of the main technical and logical mechanisms of ICT and information systems, as they generate and manage different information flows, that are at the basis of the management accounting and risk management tools.

## 5. DISCUSSION

The results of the empirical analysis confirmed our research questions (*RQ1* and *RQ2*), underlining the need of a further change in management accounting and in the role of management accountants.

Indeed, in the analysed case studies, institutional change and new regulatory requirements motivated organisational change. Subsequently, organisational change influenced the change in management accounting and in risk management systems. Advanced management accounting systems have been implemented, integrated ERP and business intelligence tools now support the decision making process and enterprise risk management processes and tools have been adopted. At the same time, the findings suggest that more change is possible, especially efforts to integrate management accounting and risk management systems (*RQ1*). As Collier et al. (2007) observe, "...risk has shift from being considered tacitly to being considered more formally and ...(there is) expectation that this trend will shift markedly to a more holistic approach with risk being used to aid decision-making". In addition, the results confirmed that the role of management accountants should acquire new tasks and skills and that the management accountants' role seems to be from *performance* controller to *performance and risk* controller (*RQ2*).

Consequently, we proposed an evolution model for management accounting toward risk management and, drawing on institutional theory, we identified a new role for management accountants. With particular reference to *RQ1*, to overcome the limits of risk management it is necessary to start a new from the operative mechanism of strategic control, ensuring that this system and the person who manages it are also effective "drivers" of risk management in the company. Risk management and strategic control should be a "unique system" in practice, referred to as the "Integrated Model of Risk Management and Strategic

Control" (Culasso, 2009). Essentially, the "Integrated Model of Risk Management and Strategic Control" implies the following:

- integrated and balanced performance and risk measurement systems (technical structure);
- integrated responsibilities among risk managers, internal auditors and management accountants (organisational structure) and integrated risk management and strategic control processes (phases and time).

In particular, focusing our attention on the first point, which represents the most tangible management accounting change, the tools of strategic control should integrate with risk and its parameters, implementing an "integrated" performance measurement system that includes the output contained in the reports from risk management process. These results should be achieved through three different actions:

1. The first action is including some indicators about risks that were considered extremely dangerous in the evaluation phase of risk management, but not properly transferrable or financially coverable, in the tools of performance measurement to attract the attention of managers. This first level of indicators should allow for "balancing" performance with the possible risks associated with pursuing a critical success factor. This could be a first approach to validate the goodness of a deliberate strategy, weighted by its internal and external risks.
2. The second action is including in performance measurement systems parameters related to the emerging or "bottom-up" critical success factors, which are often unknown to the top managers but well-known by operative employees in the firms and their related risks. Often, during the risk self-assessment phase of the risk management process, those bottom-up new opportunities and risks become known and it is very important to communicate them to the top management in a formalised manner. In this way, the transfer of knowledge would create the opportunity to evaluate the goodness of a strategy over time while considering organisational learning (Mintzberg, 1989, 1994), new opportunities and new risks.
3. The third action is the inclusion of some indicators in the tools of performance measurement that monitor the effectiveness of the "Integrated Model of Risk Management and Strategic Control".

The first and second categories of actions have mainly *facilitating* and *informational purposes* because they should allow those responsible to capture, using the indicators and the measures of risk, that which we could define as key risk indicators (KRI's) (Gilad, 2004; Martelli, 2005; Scandizzo, 2005), which are analogous to the key performance indicators (KPI's) (Johnson and Kaplan, 1987), any internal or external changes that promote strategic reformulation and the consequent tactics and operational choices. Of course, subordinate to this aim is also an *evaluation* and *influencing purpose* because managers should be evaluated on the degree achievement with regard to these indicators and subsequently rewarded. The third category of action focuses on *evaluating* the risk management approach in an "integrated" way.

With particular reference to *RQ2*, drawing on institutional theory, integrating risk management and strategic control tools requires sponsorship by top management and coordination among the different subjects involved. For management accountants, this means that they should adopt a broader function, enriched by some of risk management tasks:

- supporting the top management in identifying the critical success factors and designing the strategy map, taking into consideration the *risks* identified during the risk management process;
- supporting the top management to identify the performance and *risk indicators* for each critical success factor, implementing a measurement system of comprehensive and integrated parameters, and understanding and exploring the information about firm risks and new opportunities identified during the risk management process;
- preparing and disseminating guidelines for the whole structure about the design of the different performance and *risk* measurement systems for each organisational unit, operational plans and budgets and coordinating the design of these systems;
- monitoring the actual results in terms of performance and *risk* indicators, both of the firm and of the various organisational units, analysing the causes of possible deviations and proposing corrective actions and updates;
- producing and disseminating the global corporate reporting and managing the communication of performance and *risk*.

Similarly, risk managers and internal auditors should be responsible for carrying out the fundamental phases of identification, description, estimation and evaluation of risks and new

business opportunities, in addition to more technical consulting for risk treatment. In particular, risk managers and internal auditors should work continuously with top management and management accountants to build the integrated model of *performance* and *risk* measurement, identifying the related KRI for each KPI. This means that risk managers and auditors should abandon their traditional bureaucratic approaches to risk and enrich their knowledge of the critical success drivers of their company.

Finally, the integration can be achieved only if there is coordination between the process of risk management and the process of strategic control. That is, considering the time axis, it is necessary that the different phases of the two processes are strictly correlated, and the output of the first phase becomes the input of the following and *vice versa*.

The changing role of the management accountant is moving towards the consolidation of several important competencies (knowledge, skills, abilities and commitment), such as at least the following:

- the ability to logically analyse management decisions and a high level of knowledge and familiarity regarding company processes, activities and internal resources;
- the skills in relationship and diplomacy;
- the knowledge of the main technical and logical mechanisms of ICT and information systems.

This means that management accountants should increase their intra-organisational power and that top management should influence and support this empowerment process. The intra-organisational power relations are interplayed with the institutional pressures (political, regulatory, cultural) and the market forces (new competition and new risks) to understand the organisational change and, in particular, the change in management accounting.

## 6. CONCLUSIONS

In conclusion, the empirical analysis seems to confirm our beginning hypotheses and answer to the previous research questions:

- *management accounting systems* should be enriched by new functions and features, necessary to survive in the new competitive environment. Indeed, a further change in management accounting is required, especially for those companies

that are operating on listed market. The most urgent direction of change is the integration between management accounting and risk management (RQ1), especially regarding the integration between *key performance indicators* and *key risk indicators*;

- *management accountant's role* can be considered as an intra-organisational condition, which will enable the successful management accounting change. Without the involvement of management accountants in risk management activities, indeed, risk management is often only a costly compliance exercise. The necessary features of this role are a high level of knowledge and familiarity regarding company processes and internal resources, skills in relationship and diplomacy and the knowledge of the main technical and logical mechanisms of ICT and information systems (RQ2).

Our analysis contributes to an understanding of the potential management accounting change and of the changing role of management accountants, with regard to the interplay between managerial systems, as it reveals a further specific direction of change which goes toward the integration between performance and risk planning and monitoring. In particular, we identified new functions and abilities that should be integrated in the management accountant's traditional role.

Our work, however, is limited, as the empirical analysis concerns only one sector with few companies. Future development of this line of inquiry would include a broad survey and longitudinal empirical case study analyses. Furthermore, it could be interesting to analyse in deep details the tools and the processes of the Integrated Model of Management Accounting and Risk Management.

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## FAMILY ITALIAN LISTED FIRMS: COMPARISON IN PERFORMANCES AND IDENTIFICATION OF TWO MAIN CONFIGURATIONS

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### ABSTRACT

Our article compares the performances of the Family Firms (FF) with the ones achieved by the Not Family Firms (NFF), considering the family as a relevant variable in managing the efficiency and the effectiveness of the business. In particular, after distinguishing Italian listed FF on one side and Italian listed NFF on the other, having considered the board composition and the ownership articulation, we compared the economic and financial results achieved by the two groups, in order to understand if there was a relevant difference and which were the causes. Consequently, the main goal of this study is underling the importance of the family variable in the effects on performance (Miller, Le Breton-Miller, Lester and Cannella, 2007).

Furthermore, another goal of the article, strictly correlated to the previous one, is to verify if there is a distinction within the FF, in terms of organizational and institutional features, considering the different economic and financial performances. In particular, we were interested in understanding if the size of the companies, expressed in terms of i) number of employees, ii) assets quantified in the balance sheet and iii) revenues measured in the income statement, was a proxy variable of the complexity of the firm, and for this reason a significant element to be considered in addition to the presence of the family in the board.

**Keywords:** family firms performance, family firms size, family firms capitalization

## 1. INTRODUCTION

As someone affirms, the economy of the countries around the world keeps to be dominated by family firms, especially in Europe, Asia and Latin America and for this reason the importance of family firms in the economic and social environment and, consequently, in the literature is duly recognized (Astrachan and Shanker, 2003; Claessens, Djankov and Lang, 2000; Faccio and Lang, 2002; La Porta, Lopez-de-Silanes and Shleifer, 1999; Morck & Yeung, 2004).

In the studies about family firms, a relevant issue of the last twenty years concerns the corporate governance, with a particular focus on the relationship between the owners, the board of directors, and the CEOs (Keasey et al., 2005; Monks and Minow, 2004) and on the confluence between family and business (Neubauer & Alden, 1998). Different theories are usually adopted, as the Agency Theory, the Contingent Approach, the Life-cycle Approach, the Stewardship Theory and the Social Capital, in order to investigate the relation between the corporate governance and the performances (Vighneswara, 2011). In particular, the attention is focused on the composition of the board of directors and its influence on performances, even if it is not sufficiently clear how board composition affects firm performances.

Our article compares the performances of the Family Firms (FF) with the ones achieved by the Not Family Firms (NFF), considering the family as a relevant variable in managing the efficiency and the effectiveness of the business. Dyer (2006) refers to the family as “the missing variable in organizational research” and he warns that “failing to use the family as a variable in organizational research can lead to incomplete or misleading findings” (Speckbacher and Wentges, 2007). In particular, after distinguishing Italian listed FF on one side and Italian listed NFF on the other, having considered the board composition and the ownership articulation, we compared the economic and financial results achieved by the two groups, in order to understand if there was a relevant difference and which were the causes.

Consequently, the main goal of this study is underling the importance of the family variable in the effects on performance (Miller, Le Breton-Miller, Lester and Cannella, 2007). This topic is particularly significant in Italy, because the family firms phenomenon is widespread in our Country, as well in Europe, in which “the context is characterized by high ownership concentration and the presence of family groups that remain in control of a significant number of firms, in contrast to the less amenable American and Anglo-Saxon markets” (García-Ramos, García-Olalla, 2011).

Furthermore, another goal of the article, strictly correlated to the previous one, is to verify if there is a distinction within the FF, in terms of organizational and institutional features, considering the different economic and financial performances. In particular, we were interested in understanding if the size of the companies, expressed in terms of i) number of employees, ii) assets quantified in the balance sheet and iii) revenues measured in the income statement, was a proxy variable of the complexity of the firm, and for this reason a significant element to be considered in addition to the presence of the family in the board. This is due to the fact that we observed how in the Italian stock market the FF listed in the FTSE MIB index (large capitalized companies) achieved different financial performances than the ones listed in the STAR index (medium capitalized companies).

This article has the following structure. In the second paragraph the theoretical background about the FF is analyzed, with particular attention to the main issues of our paper. In the third paragraph the research method is outlined, as well as a description of the sample. In the fourth paragraph the findings and the discussion of the results are presented. Finally, in the fifth paragraph, conclusions and implications of the study are given with the limitations of the research.

## **2. THEORETICAL BACKGROUND**

### *2.1 Defining family firms*

Family firms play an important role in economic activities worldwide and contribute to creating wealth and jobs, with reference to both narrow and broad definitions of family business (Astrachan and Shanker, 2003). The quantification of family businesses in the United States and Europe is the subject of several studies (Colli, Perez and Rose, 2003; Corbetta, 1995; Larner, 1970; Neubauer and Lank, 1998; Shanker and Astrachan, 1996; Sluyterman and Winkelman, 1993) and in the last years increasing attention have been given to family businesses. Several recent studies have reported and stressed that in Continental Europe, Asia, and Latin America the vast majority of publicly traded businesses are family controlled (Claessens, Djankov and Lang, 2000; Faccio and Lang, 2002; García-Ramos, García-Olalla, 2011; La Porta, Lopez-de-Silanes and Shleifer, 1999).

A family business is often defined as the initial phase of the process of constitution of a company, that involves about one or two generations before becoming a public company. However, it is not that easy to find a definition for the expression “family business”, and

ambiguities persist in the literature. The editorial note of the first issue of *Family Business Review* asks: "What is a family business?" (Lansberg, Perrow and Rogolsky, 1988). People seem to understand which is meant by these words, but when they try to give a precise definition, they quickly discover that the phenomenon is indeed very complex (Hoy and Verser, 1994). The question continues to be asked because in the literature several different definitions are given for family business, also because different criteria were used to classify family firms. In particular, following the criterion about ownership and control, these are the possible definitions:

- a family business is a "firm in which significant voting rights or ownership is controlled by a member or members of a single family" (Barnes and Herson, 1976);
- it is possible to define a firm like family when the share of capital is owned by a single family (Alcon, 1982; Lansberg, Perrow and Rogolsky, 1988);
- in a family business, one or more families having kinship or similar ties are the owners of the full risk contributed capital (Ferrero, 1980);
- in a family business, one or more families linked by kinship or similar ties or by strong alliances contribute with full or limited risk capital, personal or collateral guarantees or managerial skills; these families own a full risk capital share that entitles it to controlling the business even without the absolute majority of the capital (Corbetta and Dematté, 1993).

If the criterion used to define the family business is the number of family members involved in its management, criterion emphasised even in recent times (Di Mascio, 2008), these are the possible definition:

- a family business must be owned and managed by members belonging to one or more families (Stern, 1986);
- in a family firm there must be at least two family's generations involved in its management (Ward, 1988), also with the aim of conveying managerial skills to the next generation (Churchill and Hatten, 1987).

In recent years, the definitions for family business have been based on a mix of criteria related to the ownership and control (Smyrniotis, Romano and Tanewski, 1998).

According to other authors, an enterprise is classified as a family business if (Chua, Chrisman and Sharma, 1999): i) at least 50 per cent of the shares are owned by the family, and the family is responsible for the management of the company, ii) or at least 50 per cent of the shares are owned by the family, the enterprise is not family-run, but the CEO perceives it as a

family business, iii) or family ownership is less than 50 per cent, the company is family-run, the CEO perceives it as a family business and a venture capital or investment company owns at least 50 per cent of the shares.

In our work we used a mix criterion in order to identify the family business sample, that is:

- a control participation in the capital by the family/ies;
- the presence in the Board of at least one family member.

Our criterion well reflects the Italian context.

Independently by the criteria chosen, in all definitions there is an evident interaction between the family, considered as an entity, its members and the activities performed by the business (Miglietta, 2009).

The relations between family and enterprise are determinant for the firm survival and to the value creation: the family has as its main goal the maintenance and support of its members, and this is the reason the family invests its own resources in the business activities, based on entrepreneurial values (Bertini, 1995; Catturi, 1995; Coda, 1988; Sorci, 1986; Vergara, 1986), which are also inspired by tradition, unity and affection (Salvato, 2002; Ward, 1997). Both the family and the business are motivated by a series of shared values, among which there are the continuity of the economic activity (Coda, 1988; Giannessi, 1960; Onida, 1954; Zappa, 1957) and the value creation (Catuogno, 2006; Cuccurullo, 2006; Tiscini, 2006).

## *2.2 Family firms performance*

The literature also focused on the analysis of the performance achieved by the family businesses.

Relevant studies conducted in the US show that publicly traded FF have higher Tobin's q values and higher return on assets than comparable NFF (Anderson and Reeb, 2003; Villalonga and Amit, 2004), demonstrating also that family ownership reduces the classical agency problem between managers and shareholders.

In addition, Anderson and Reeb (2003) find a positive effect associated with family ownership that starts to taper off at around 30% of ownership, and Villalonga and Amit

(2004) find higher valuation of FF when the founder serves as CEO or as Chairman of the board.

Analysing the results obtained by Anderson and Reeb (2003), it emerges that FF outperform than NFF in the ROA, in particular the economic performance of large listed family businesses is higher than the economic performance of public non-family companies; in addition, the performance achieved by medium sized family businesses, both listed and non-listed, are higher if compared with non-family companies of the same size (Culasso, Broccardo, Giacosa and Mazzoleni, 2012).

Anderson and Reeb (2003) underline also that the relation between family ownership in large public firms and firm performance is not uniform across all levels of family ownership, in particular when families have the greatest control of the firm, the potential for entrenchment and poor performance is the greatest.

In contrast with the previous theory other studies have shown that the presence of a family in the ownership affects negatively business performance (Faccio, Lang and Young, 2001; Volpin, 2002). In particular Faccio et al. suggest that the problems of the firms analysed, East Asian firms, are related to corporate governance and to the political-regulatory environment.

In addition, some authors have asserted the neutrality of family ownership to economic performance, in absolute terms or in terms related to the share of capital held by the family (Sciascia and Mazzola, 2008).

In the literature it is possible to find also some studies that have focused the attention on the differences among performances between family companies led by their founders and FF not led by their founders (Adams, Almeida and Ferriera, 2003; Barontini and Caprio, 2006; Cucculelli and Micucci, 2008; García-Ramos, García-Olalla, 2011; Villalonga and Amit, 2006), while other researches focused on the analysis of the performance achieved by family businesses being in their second or third generation, observing a destruction of value (Pérez-González, 2001; Villalonga and Amit, 2006).

Another aspect analysed in some studies about family firms and performance is the size. A study conducted in Taiwan examining 786 public family firms (Chu Wenyi, 2011), besides to underline that family ownership is positively associated with firm performance and that this positive association is strong particularly when family members serve as CEOs,

shows that the association between family ownership and firm performance is stronger in small- and medium-sized enterprises (SMEs) than in large companies.

In this direction another study (Gonzalez, Guzman, Pombo, Trujillo, 2012) examined 523 listed and non – listed Colombian firms. This research shows that FF exhibit better financial performance on average than NFF when the founder is still involved in operations, although this effect decreases with firm size, suggesting that some kinds of family involvement appear to make firm growth expensive.

### 3. METHODOLOGY

#### 3.1. *The sample*

We considered a sample of companies listed on the Italian stock market, included in the FTSE MIB and STAR indexes. FTSE MIB is the main benchmark index of the Italian stock market and it captures about 80% of the domestic market capitalization. FTSE MIB measures the performance of 40 large capitalized Italian primary and with high liquidity companies and it seeks to replicate the broad sector weights of the Italian stock market. STAR index, instead, is dedicated to 67 medium capitalized companies of the Italian stock market, having market capitalization between 40 million and 1 billion of Euro and respecting the followings features: i) high transparency and communicativeness, ii) high liquidity (no less than 35% of float), iii) Corporate Governance aligned to the international standards.

Our aim, in considering this sample, was to test the following research questions in companies that represent the Italian excellence, both large capitalized companies (FTSE MIB) and medium ones (STAR). We also analyzed separately the first sample (FTSE MIB) and the second one (STAR), in order to verify if there was a relation between the capitalization and the performances.

Considering the sample of listed Italian firms of the FTSE MIB and STAR indexes, we excluded banks, insurance and other financial companies, as we wanted focusing on the industrial sector in order to achieve a satisfactory homogeneity. We also eliminated foreign industrial listed companies, as we focused our attention on Italian firms. The number of companies finally selected is equal to 80.

In our work we used a mix criterion with the purpose of distinguishing FF and NFF. Our criterion well reflects the Italian context. In particular, a FF is a company that has:

- a control participation in the capital by the family/ies;
- the presence in the Board of at least one family member.

In order to distinguish FF and NFF, we used data included in the “Corporate Governance Report” of each company published on the “Borsa Italiana” website.

Using this criterion, it emerges that the 80 companies of the sample are articulated in 55 FF and in 25 NFF, as shown in the following chart (Chart 1).

**Chart 1. The sample**

	Family Firms	Not Family Firms		FTSE MIB Family Firms	FTSE MIB Not Family Firms		STAR Family Firms	STAR Not Family Firms
<b>Companies (No)</b>	<b>55</b>	<b>25</b>		<b>13</b>	<b>14</b>		<b>42</b>	<b>11</b>
<b>Companies (%)</b>	<b>68,75%</b>	<b>31,25%</b>		<b>48,15%</b>	<b>51,85%</b>		<b>79,25%</b>	<b>20,75%</b>

Source: personal elaboration

It is interesting to observe as in the Italian Stock Exchange about 68,75% of FTSE MIB and STAR companies are FF. In the FTSE MIB index, that comprises large-capitalized companies, is about 48,15%, while in the STAR index, that comprises medium-capitalized companies, the FF are the 79,25%.

### 3.2. The research method

The main goal of this study is to analyze the relationship between the presence of a family in the board of a firm and its performances, distinguishing the listed Italian FF and the listed Italian NFF. Indeed, our hypothesis (H1) was that the presence of a family is an important factor in the effects on performances of a company.

*H1: the family is a relevant variable that influences the firm performances*

To reach the declared goal and to verify H1, a first research question was formulated (RQ1).

*RQ1: Do the FF outperform in comparison with NFF? Are there some relevant differences between FTSE MIB companies and STAR ones?*

To answer the RQ1, the mean of each financial and economic ratio achieved by the companies of the sample, considered for every financial year covered by the research, was

determined. The source of the data was AIDA database. The last 6 years (2006-2011) were the period considered by the analysis. Subsequently, we calculated:

- the 2006-2011 mean for each ratio;
- the 2006-2011 median for each ratio;
- the 2006-2011 standard deviation for each ratio.

Then, economic and financial performances were compared between FF and NFF. In particular, we first considered all the companies listed in the FTSE MIB and in the STAR indexes. Subsequently, the analysis compared the FF with the NFF respectively in the FTSE MIB and in the STAR index.

Considering the findings collected by answering to the RQ1, and in particular the information concerning the economic indicators, we observed that in the FTSE MIB index the NFF outperform than the FF, whilst in the STAR index it happens exactly the opposite. This element suggested us to formulate an important assumption and a correlated new hypothesis that was proud to be verified.

The *main assumption* was that there are two kinds of FF, the ones listed on the high capitalization index (FTSE MIB) and the others listed on the medium capitalized index (STAR), to which correspond two different organizational configurations.

The hypothesis (H2) was that, if the capitalization is positively correlated with the size, expressed in terms of i) number of employees, ii) assets quantified in the balance sheet and iii) revenues measured in the income statement, the presence of a family in the business is a relevant variable to achieve higher *economic performances* than NFF, *only* when the *size* of the company is not large. Indeed, the size of a company could be considered as a proxy of the complexity/diversification of the business, and influences the effects of the actions of the family in the company. If this H2 is verified, we'll be able to affirm that, when the FF have a not-large size, they outperform in economic results than the NFF with the same size, whilst, when the FF have a large size, they underperform in comparison with NFF with the same size.

In addition, about *financial performances*, the presence of a family in the business is a relevant variable to achieve higher results than NFF, *independently* by the *size* of the company (always positively correlated with the capitalization). Indeed, FF outperform than NFF in all financial ratios, both in FTSE MIB and in STAR index, with the exception of the debt ratio in the FTSE index. In any case, this exception could confirm our main assumption about the

existence of two configurations of FF and, in particular, it seems that FTSE MIB FF have specific financial requirements related to their business, covered by financial debts more than STAR FF and FTSE MIB NFF. At the same time, the size of the company seems to be a relevant variable, which influences FF *financial performance*. Indeed, STAR FF outperform then FTSE MIB FF, while this evidence is not true for NFF (all financial ratios of FTSE MIB NFF are better than STAR NFF, with the exception of fixed assets coverage ratio, and the specificity of the debt ratio that is equal in the two indexes).

*H2: the size is a relevant variable in distinguishing the FF in two main configurations, with different economic and financial performances (debt ratio) in comparison to NFF with the same size and to FF of other size.*

In order to demonstrate this hypothesis, we expressed RQ2.

*RQ2: Is there a correlation between the capitalization of a firm and its size expressed in terms of i) number of employees, ii) assets quantified in the balance sheet and iii) revenues measured in the income statement ? If yes, how does the size influence the economic and financial performances of FF?*

The aim of this question was to verify the existence of a positive correlation between capitalization and size, that permits us to understand the findings of the RQ1 as caused by the size and not only by the belonging of the companies to a specific index, with a particular capitalization (FTSE MIB with large capitalized companies and STAR with medium capitalized ones), also supported by the studies conducted in Taiwan (2011) and Colombia (2012), that reveal a stronger relationship between family ownership and firm performance in small and medium size enterprises than in large FF.

In particular, the Pearson correlation ratio was used to identify a positive or a negative correlation between capitalization and size. The source of the capitalization data was "Borsa Italiana" website and the source of the size parameters was AIDA database.

Due to the fact that we have adopted the Pearson correlation ratio ( $p$ ) to verify our hypotheses, it is important to underline that:

- if  $p > 0$  there is a direct correlation;
- if  $p = 0$  there is no correlation;
- if  $p < 0$  there is a indirect correlation;
- if  $0 < p < 0,3$  the correlation is weak;

- if  $0,3 < p < 0,7$  the correlation is moderate;
- if  $p > 0,7$  the correlation is strong.

#### 4. 4. FINDINGS

##### 4.1. RQ1

About the RQ1 “Do the FF outperform in comparison with NFF? Are there some relevant differences between FTSE MIB companies and STAR ones?”, we compared the most significant economic and financial parameters between FF and NFF, in general and within each index (FTSE MIB and STAR), as showed in the following.

##### 4.1.1 Economic results

Considering the economic indicators, the following ratios supported by literature (Baginski and Hassel, 2004; Ferrero, Dezzani, Pisoni and Puddu, 2003; Foster, 1986; Giroux, 2003; Helfert, 1997; Higgins, 2007; Ingram, Albright and Baldwin, 2002; Meigs, Williams, Haka and Bettner, 2001; Value, 2001) were adopted:

- ROA (Return on Assets);
- ROI (Return on Investment);
- ROS (Return on Sales);
- ROE (Return on Equity).

In the following chart, the economic performances between FF and NFF were compared (Chart 2).

Chart 2. Economic performance in FF and NFF

	Family Firms	Not Family Firms
<b>Companies (No)</b>	<b>55</b>	<b>25</b>
<b>Companies (%)</b>	<b>68,75%</b>	<b>31,25%</b>
Roa 2006	9,52	7,09
Roa 2007	9,50	7,24
Roa 2008	7,74	5,88
Roa 2009	3,87	5,74
Roa 2010	5,80	6,11
Roa 2011	5,56	5,20
<b>Roa - mean (2006-2011)</b>	<b>7,00</b>	<b>6,21</b>
<b>Roa - median (2006-2011)</b>	<b>6,77</b>	<b>5,99</b>
<b>Roa - standard deviation (2006-2011)</b>	<b>2,30</b>	<b>0,80</b>
Roi 2006	12,60	7,39
Roi 2007	13,43	9,45
Roi 2008	11,33	10,21
Roi 2009	6,04	6,99
Roi 2010	8,75	8,02
Roi 2011	7,54	9,37
<b>Roi - mean (2006-2011)</b>	<b>9,95</b>	<b>8,57</b>
<b>Roi - median (2006-2011)</b>	<b>10,04</b>	<b>8,70</b>
<b>Roi - standard deviation (2006-2011)</b>	<b>2,95</b>	<b>1,29</b>
Ros 2006	10,53	7,38
Ros 2007	10,44	9,14
Ros 2008	8,67	5,84
Ros 2009	4,63	6,23
Ros 2010	7,57	8,30
Ros 2011	7,01	6,46
<b>Ros - mean (2006-2011)</b>	<b>8,14</b>	<b>7,23</b>
<b>Ros - median (2006-2011)</b>	<b>8,12</b>	<b>6,92</b>
<b>Ros - standard deviation (2006-2011)</b>	<b>2,25</b>	<b>1,29</b>
Roe 2006	11,06	12,91
Roe 2007	12,38	12,63
Roe 2008	9,51	10,14
Roe 2009	2,39	8,62
Roe 2010	7,06	7,64
Roe 2011	8,48	2,99
<b>Roe - mean (2006-2011)</b>	<b>8,48</b>	<b>9,15</b>
<b>Roe - median (2006-2011)</b>	<b>8,99</b>	<b>9,38</b>
<b>Roe - standard deviation (2006-2011)</b>	<b>3,52</b>	<b>3,68</b>

Source: own elaboration based on AIDA database.

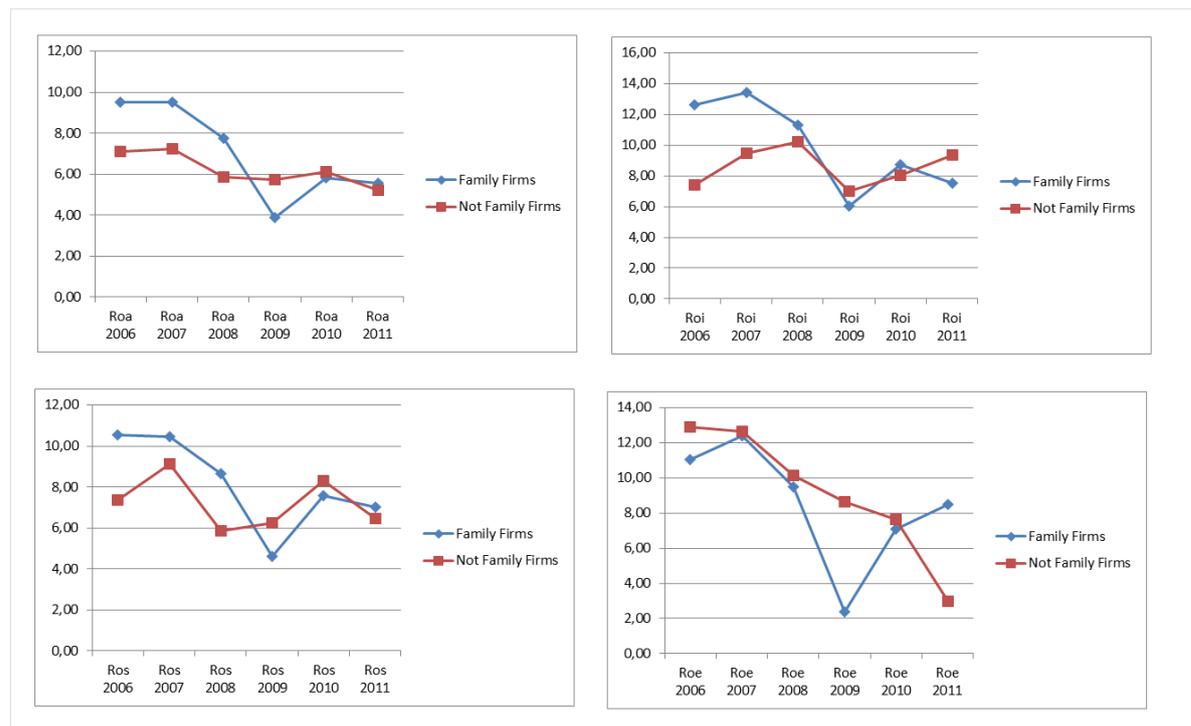
Evaluating the *economic performance*, and in particular considering the mean of each ratio (whose trend is confirmed by the median), it's clear that:

- NFF outperform in the ROE (9,15%) compared with FF (8,48%), due to the leverage effect of debt ratio, as it is confirmed in the following financial analysis;

- FF outperform in the core business, how ROI shows (9,95%), compared with NFF (8,57%). In addition, FF excel in ROS (8,14%) compared with NFF (7,23%), and in ROA (7,00%) compared with NFF (6,21%).

The following graph (Graph 1) underlines the behavior of the different parameters.

**Graph 1 - Economic ratios trends in FF and NFF**



Source: own elaboration based on AIDA database.

In particular, a decreasing trend during the 2007-2009 period for FF can be observed, more evident in 2008. If we analyse the average of the six years, ROE is higher in NFF, even if there has been a reduction in 2011. ROA, ROI and ROS are better in FF, in particular these companies excel in ROI ratio, despite the evident drop in 2009.

The median along the six years is aligned to the mean, even if the difference between FF and NFF is always greater.

We also calculated the standard deviation and verified it is much greater for FF in the case of ROA, ROI and ROS: therefore, it demonstrates a not steady trend in comparison with NFF.

We also compared in terms of economic performance FF and NFF included in the two different indexes taken into consideration, the FTSE MIB and the STAR index, how the following chart shows (Chart 3).

**Chart 3. Economic performance in FF and NFF within FTSE MIB and STAR**

	FTSE MIB Family Firms	FTSE MIB Not Family Firms	STAR Family Firms	STAR Not Family Firms
<b>Companies (No)</b>	<b>13</b>	<b>14</b>	<b>42</b>	<b>11</b>
<b>Companies (%)</b>	<b>48,15%</b>	<b>51,85%</b>	<b>79,25%</b>	<b>20,75%</b>
Roa 2006	10,46	10,00	9,33	4,63
Roa 2007	10,69	10,58	9,23	4,41
Roa 2008	9,18	10,64	7,39	1,46
Roa 2009	6,36	9,95	3,24	1,84
Roa 2010	6,51	8,96	5,62	3,25
Roa 2011	8,06	6,32	4,78	3,78
<b>Roa - mean (2006-2011)</b>	<b>8,54</b>	<b>9,41</b>	<b>6,60</b>	<b>3,23</b>
<b>Roa - median (2006-2011)</b>	<b>8,62</b>	<b>9,98</b>	<b>6,51</b>	<b>3,52</b>
<b>Roa - standard deviation (2006-2011)</b>	<b>1,89</b>	<b>1,63</b>	<b>2,47</b>	<b>1,32</b>
Roi 2006	15,93	11,69	11,82	4,26
Roi 2007	16,67	16,31	12,59	3,83
Roi 2008	13,26	16,34	10,90	4,59
Roi 2009	8,80	12,82	5,32	2,06
Roi 2010	9,30	12,26	8,60	4,44
Roi 2011	9,93	10,96	6,82	7,36
<b>Roi - mean (2006-2011)</b>	<b>12,32</b>	<b>13,40</b>	<b>9,34</b>	<b>4,42</b>
<b>Roi - median (2006-2011)</b>	<b>11,60</b>	<b>12,54</b>	<b>9,75</b>	<b>4,35</b>
<b>Roi - standard deviation (2006-2011)</b>	<b>3,47</b>	<b>2,35</b>	<b>2,91</b>	<b>1,71</b>
Ros 2006	14,92	15,42	9,60	0,80
Ros 2007	13,94	16,25	9,68	3,81
Ros 2008	12,70	14,64	7,78	-1,60
Ros 2009	9,36	13,27	3,53	0,81
Ros 2010	11,08	13,67	6,61	3,75
Ros 2011	11,87	8,55	5,43	4,17
<b>Ros - mean (2006-2011)</b>	<b>12,31</b>	<b>13,63</b>	<b>7,10</b>	<b>1,96</b>
<b>Ros - median (2006-2011)</b>	<b>12,28</b>	<b>14,15</b>	<b>7,20</b>	<b>2,28</b>
<b>Ros - standard deviation (2006-2011)</b>	<b>2,00</b>	<b>2,72</b>	<b>2,42</b>	<b>2,32</b>
Roe 2006	12,07	17,55	10,85	8,98
Roe 2007	16,58	20,07	11,38	6,33
Roe 2008	14,54	20,93	8,28	0,11
Roe 2009	6,67	17,55	1,30	0,32
Roe 2010	9,89	14,15	6,32	1,12
Roe 2011	15,50	2,04	6,25	4,20
<b>Roe - mean (2006-2011)</b>	<b>12,54</b>	<b>15,38</b>	<b>7,40</b>	<b>3,51</b>
<b>Roe - median (2006-2011)</b>	<b>13,31</b>	<b>17,55</b>	<b>7,30</b>	<b>2,66</b>
<b>Roe - standard deviation (2006-2011)</b>	<b>3,76</b>	<b>6,95</b>	<b>3,70</b>	<b>3,63</b>

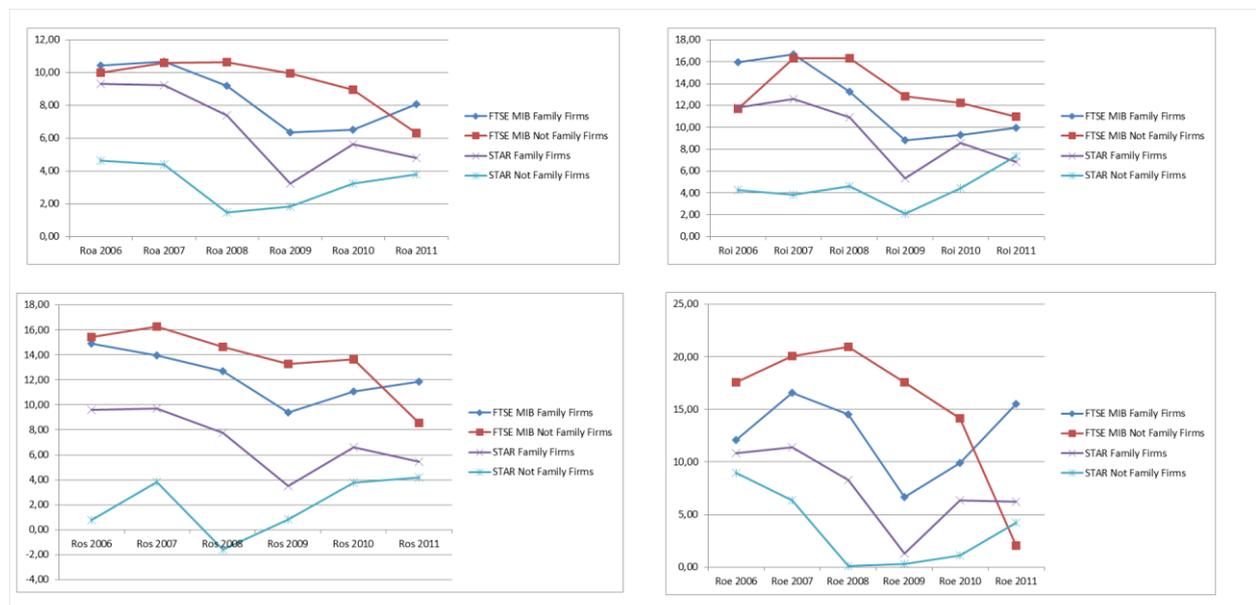
Source: own elaboration based on AIDA database.

Focusing the attention on the mean of each indicator of the previous chart (whose trend is confirmed by the median), it is evident that:

- on one side, NFF in FTSE MIB outperform in the ROE (15,38%), ROI (13,40%), ROA (9,41%) and ROS (13,63%) compared with FF, that is, the economic indicators of NFF are better than the FF;
- on the other side, FF in STAR outperform in the ROE (7,40%), ROA (6,60%), ROI (9,34%) and ROS (7,10%) compared with NFF, that is, the economic indicators of FF are better than the NFF.

It can be useful to observe the behaviors of the economic parameters, comparing FTSE MIB and STAR, looking at the following graph (Graph 2).

**Graph 2 - Economic ratios trends in FF and NFF: FTSE MIB and STAR companies comparison**



Source: own elaboration based on AIDA database.

Synthesizing, it is possible to observe an outperformance of the FTSE MIB firms in comparison with the STAR ones, in all the economic ratios, also if the trend is decreasing, both for FF and for NFF. This is a confirmation of the existence of the relation between the economic fundamentals and the capitalization of the company, that is, the higher the capitalization the higher the profitability.

Furthermore, we observed that in the STAR index the FF outperform in the economic ratios than the NFF, whilst in the FTSE MIB NFF outperform than the FF.

Concluding about economic performance, it is possible to affirm that:

- FF outperform in the core business (ROI and ROS) and in the return on assets (ROA), whilst the NFF outperform in the return of equity (ROE);
- FTSE MIB companies outperform than STAR ones;
- FTSE MIB NFF outperform than FTSE MIB FF;
- STAR FF outperform than STAR NFF.

It's also interesting to underline the performances variation into the considered period: in general, in 2009 the effects of companies' crisis situation are more evident in all economic ratios.

#### *4.1.2. Financial results*

Considering the financial ratios, the following parameters supported by literature (Baginski and Hassel, 2004; Ferrero, Dezzani, Pisoni and Puddu, 2003; Giroux, 2003; Foster, 1986; Helfert, 1997; Higgins, 2007; Ingram, Albright and Baldwin, 2002; Meigs, Williams, Haka and Bettner, 2001; Value, 2001) were analyzed:

- liquidity ratio;
- current ratio;
- debt ratio;
- fixed asset coverage ratio.

We compared financial performance between FF and NFF (Chart 4).

Chart 4. Financial performance in FF and NFF

	Family Firms	Not Family Firms
<b>Companies (No)</b>	<b>55</b>	<b>25</b>
<b>Companies (%)</b>	<b>68,75%</b>	<b>31,25%</b>
Liquidity ratio 2006	1,37	1,24
Liquidity ratio 2007	1,33	1,15
Liquidity ratio 2008	1,19	0,99
Liquidity ratio 2009	1,21	1,03
Liquidity ratio 2010	1,17	1,01
Liquidity ratio 2011	1,22	1,10
<b>Liquidity ratio - mean (2006-2011)</b>	<b>1,25</b>	<b>1,09</b>
<b>Liquidity ratio - median (2006-2011)</b>	<b>1,21</b>	<b>1,07</b>
<b>Liquidity ratio - standard deviation (2006-2011)</b>	<b>0,08</b>	<b>0,10</b>
Current ratio 2006	1,81	1,52
Current ratio 2007	1,75	1,40
Current ratio 2008	1,64	1,25
Current ratio 2009	1,65	1,28
Current ratio 2010	1,63	1,27
Current ratio 2011	1,72	1,43
<b>Current ratio - mean (2006-2011)</b>	<b>1,70</b>	<b>1,36</b>
<b>Current ratio - median (2006-2011)</b>	<b>1,69</b>	<b>1,34</b>
<b>Current ratio - standard deviation (2006-2011)</b>	<b>0,07</b>	<b>0,11</b>
Debt ratio 2006	2,73	3,48
Debt ratio 2007	2,83	3,32
Debt ratio 2008	3,07	3,58
Debt ratio 2009	3,07	3,16
Debt ratio 2010	3,12	3,05
Debt ratio 2011	3,11	3,16
<b>Debt ratio - mean (2006-2011)</b>	<b>2,99</b>	<b>3,29</b>
<b>Debt ratio - median (2006-2011)</b>	<b>3,07</b>	<b>3,24</b>
<b>Debt ratio - standard deviation (2006-2011)</b>	<b>0,17</b>	<b>0,21</b>
Fixed Asset Coverage ratio 2006	1,78	1,42
Fixed Asset Coverage ratio 2007	1,91	1,15
Fixed Asset Coverage ratio 2008	1,71	1,13
Fixed Asset Coverage ratio 2009	1,68	1,29
Fixed Asset Coverage ratio 2010	1,79	1,18
Fixed Asset Coverage ratio 2011	1,80	1,22
<b>Fixed Asset Coverage ratio - mean (2006-2011)</b>	<b>1,78</b>	<b>1,23</b>
<b>Fixed Asset Coverage ratio - median (2006-2011)</b>	<b>1,78</b>	<b>1,20</b>
<b>Fixed Asset Coverage ratio - standard deviation (2006-2011)</b>	<b>0,08</b>	<b>0,11</b>

Source: own elaboration based on AIDA database.

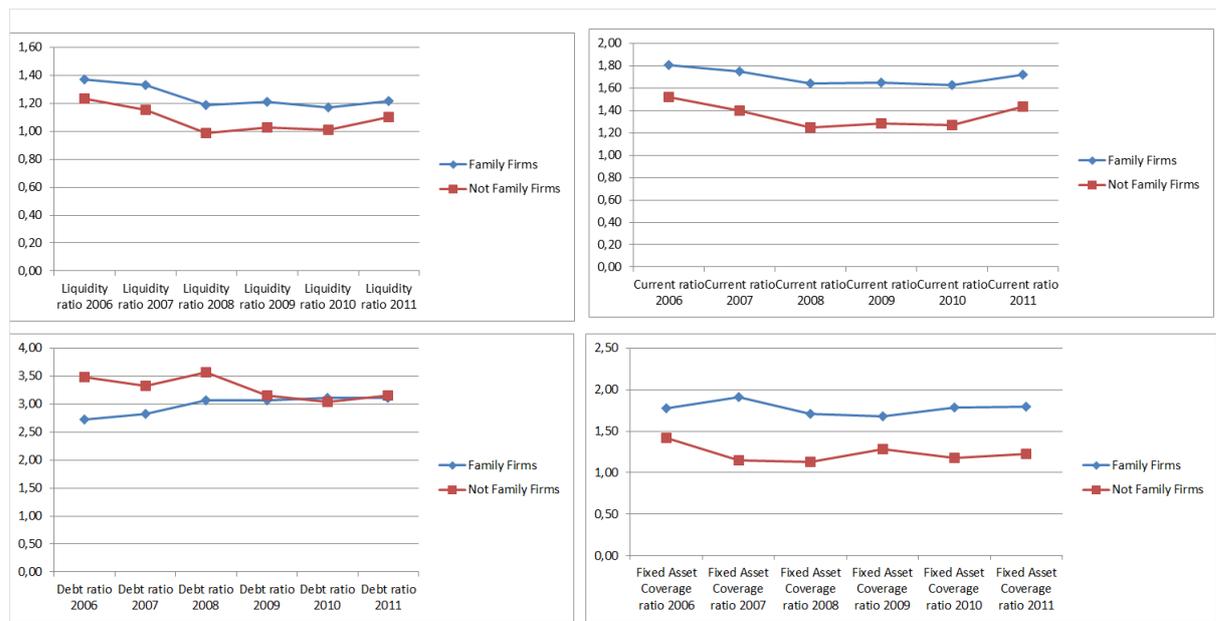
*Financial performance* is analyzed as following, focusing the attention on the mean of each indicator (whose trend is confirmed by the median), and in particular FF outperform in:

- liquidity ratio (1,25) compared with NFF (1,09);
- current ratio (1,70) compared with NFF (1,36);

- debt ratio (2,99) compared with NFF (3,29);
- fixed asset coverage ratio (1,78) compared with NFF (1,23).

The following graph shows the trend of the financial ratios (Graph 3).

**Graph 3 - Financial ratios trend in FF and NFF**



Source: own elaboration based on AIDA database.

The underlined trends by the graphs point out that FF outperform in all ratios than NFF.

Financial performances between FF and NFF are analyzed, in the following chart, also considering the differences between FTSE MIB and STAR indexes (Chart 5).

**Chart 5. Financial performance in FF and NFF: FTSE MIB and STAR companies comparison**

	FTSE MIB Family Firms	FTSE MIB Not Family Firms	STAR Family Firms	STAR Not Family Firms
<b>Companies (No)</b>	<b>13</b>	<b>14</b>	<b>42</b>	<b>11</b>
<b>Companies (%)</b>	<b>48,15%</b>	<b>51,85%</b>	<b>79,25%</b>	<b>20,75%</b>
Liquidity ratio 2006	1,11	0,96	1,43	1,46
Liquidity ratio 2007	1,09	0,98	1,39	1,30
Liquidity ratio 2008	1,21	1,10	1,18	0,88
Liquidity ratio 2009	1,38	1,23	1,17	0,84
Liquidity ratio 2010	1,23	1,17	1,15	0,85
Liquidity ratio 2011	1,19	1,23	1,22	0,94
<b>Liquidity ratio - mean (2006-2011)</b>	<b>1,20</b>	<b>1,11</b>	<b>1,26</b>	<b>1,04</b>
<b>Liquidity ratio - median (2006-2011)</b>	<b>1,20</b>	<b>1,14</b>	<b>1,20</b>	<b>0,91</b>
<b>Liquidity ratio - standard deviation (2006-2011)</b>	<b>0,10</b>	<b>0,12</b>	<b>0,12</b>	<b>0,27</b>
Current ratio 2006	1,49	1,21	1,88	1,78
Current ratio 2007	1,39	1,20	1,84	1,57
Current ratio 2008	1,57	1,34	1,66	1,17
Current ratio 2009	1,77	1,51	1,62	1,07
Current ratio 2010	1,61	1,44	1,63	1,10
Current ratio 2011	1,61	1,51	1,76	1,34
<b>Current ratio - mean (2006-2011)</b>	<b>1,57</b>	<b>1,37</b>	<b>1,73</b>	<b>1,34</b>
<b>Current ratio - median (2006-2011)</b>	<b>1,59</b>	<b>1,39</b>	<b>1,71</b>	<b>1,25</b>
<b>Current ratio - standard deviation (2006-2011)</b>	<b>0,13</b>	<b>0,14</b>	<b>0,11</b>	<b>0,28</b>
Debt ratio 2006	2,99	3,37	2,67	3,37
Debt ratio 2007	3,33	3,08	2,69	3,08
Debt ratio 2008	3,52	3,41	2,95	3,41
Debt ratio 2009	3,44	3,04	2,97	3,04
Debt ratio 2010	3,69	3,06	2,97	3,06
Debt ratio 2011	3,82	3,02	2,89	3,02
<b>Debt ratio - mean (2006-2011)</b>	<b>3,46</b>	<b>3,16</b>	<b>2,86</b>	<b>3,16</b>
<b>Debt ratio - median (2006-2011)</b>	<b>3,48</b>	<b>3,07</b>	<b>2,92</b>	<b>3,07</b>
<b>Debt ratio - standard deviation (2006-2011)</b>	<b>0,29</b>	<b>0,18</b>	<b>0,14</b>	<b>0,18</b>
Fixed Asset Coverage ratio 2006	1,24	0,96	1,90	1,82
Fixed Asset Coverage ratio 2007	1,26	0,98	2,08	1,29
Fixed Asset Coverage ratio 2008	1,05	1,09	1,89	1,17
Fixed Asset Coverage ratio 2009	1,14	1,16	1,82	1,41
Fixed Asset Coverage ratio 2010	1,24	1,16	1,93	1,20
Fixed Asset Coverage ratio 2011	1,31	1,15	1,95	1,32
<b>Fixed Asset Coverage ratio - mean (2006-2011)</b>	<b>1,21</b>	<b>1,08</b>	<b>1,93</b>	<b>1,37</b>
<b>Fixed Asset Coverage ratio - median (2006-2011)</b>	<b>1,24</b>	<b>1,12</b>	<b>1,91</b>	<b>1,30</b>
<b>Fixed Asset Coverage ratio - standard deviation (2006-2011)</b>	<b>0,09</b>	<b>0,09</b>	<b>0,09</b>	<b>0,24</b>

Source: own elaboration based on AIDA database.

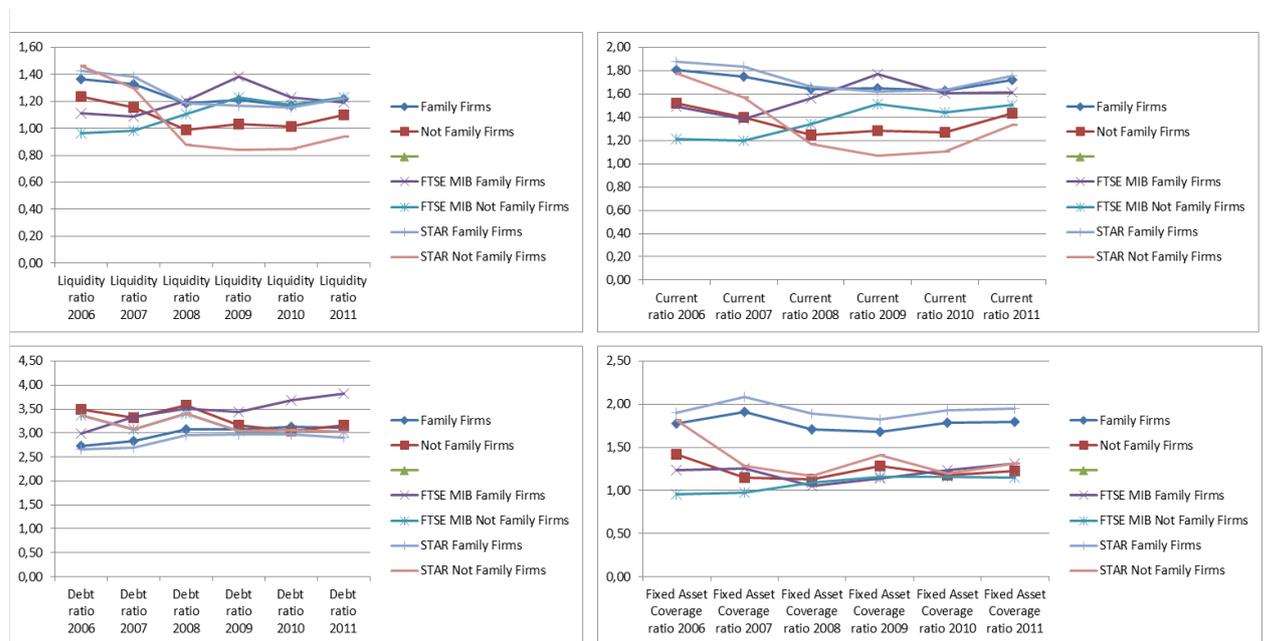
Some evidences in financial performance about FF and NFF are underlined comparing FTSE MIB and STAR indexes:

- FF in FTSE MIB outperform in the liquidity ratio (1,20) compared with NFF (1,11), current ratio (1,57) compared with NFF (1,37), and fixed asset coverage ratio (1,21) compared with NFF (1,08);
- NFF in FTSE MIB outperform in the debt ratio (3,16) compared with FF (3,46);

- FF in STAR index outperform in the liquidity ratio (1,26) compared with NFF (1,04), current ratio (1,73) compared with NFF (1,34), debt ratio (2,86) compared with NFF (3,16) and fixed asset coverage ratio (1,93) compared with NFF (1,37).

The trend behaviours of the financial ratios, comparing FTSE MIB and STAR, is shown in the following graph (Graph 4).

**Graph 4 - Financial ratios trend in FF and NFF: FTSE MIB and STAR companies comparison**



Source: own elaboration based on AIDA database.

By the analysis conducted, it is evident that:

- FF outperform in the financial ratios compared with NFF;
- STAR FF are the best companies of the sample in financial ratios, both comparing STAR FF with FTSE MIB FF and STAR FF with STAR NFF;
- FTSE MIB FF outperform in all ratios than FTSE MIB NFF, with the exception of the debt ratio.

#### 4.1.3 Discussion RQ1

In answering RQ1, it emerged that:

- FF outperform in ROA, ROI, ROS, and in the financial ratios compared with NFF, while NFF outperform in ROE;
- FTSE MIB NFF outperform than FTSE MIB FF in all economic ratios, while FTSE MIB FF outperform in all financial ratios than FTSE MIB NFF, with the exception of the debt ratio;
- STAR FF outperform than STAR NFF in all ratios.

*H1 was partially confirmed.*

Considering the results achieved, and in particular the *economic performances*, we observed that in the FTSE MIB index the NFF outperform than the FF, whilst in the STAR index it happens exactly the opposite. At the same time, considering the *financial performances*, the STAR FF outperform both in comparison with FTSE MIB FF and with STAR NFF, while FTSE MIB FF outperform in all *financial ratios* than FTSE MIB NFF, with the exception of the debt ratio. This evidence suggested us to affirm that there are two groups of FF to which correspond two different organizational configurations:

- the FF listed on the large capitalized companies index (FTSE MIB);
- the FF listed on the medium capitalized companies index (STAR).

Adopting the theory that performances in FF are higher when family members serve as CEOs or as Chairman of the board and that the association between family ownership and firm performance is stronger in small-medium-companies than in large ones (Chu Wenyi, 2011), the FF listed on the FTSE MIB index are more oriented to act as family holdings and they are interested in the diversification of the activities to gain high profitability. The family in these firms generally is not involved in directly managing the business, and there is normally a duality between CEO (a manager) and chairman (a member of the family). These FTSE MIB FF underperform in economic ratios than FTSE MIB NFF. Vice versa, the FF listed on the STAR index, more focused on the traditional core business, in which the family is directly involved in managing the company, with executive members in the board and interested to push the innovation, outperform than STAR NFF.

Therefore, we expressed a new hypothesis (H2), that, if the capitalization is positively correlated with the size of the companies, the size of a FF will be a relevant variable that influences performances. In particular, we distinguished not-large (medium) FF from large FF and we considered the size as a proxy variable of organizational complexity and diversification, which contributes to justify the different economic and financial (to be precise,

only the debt ratio) performances achieved by the FF in comparison with NFF of the same size or with FF of other size.

*H2: the size is a relevant variable in distinguishing the FF in two main configurations, with different economic and financial performances (debt ratio) in comparison to NFF with the same size and to FF of other size.*

In order to demonstrate this hypothesis, we expressed RQ2.

## 4.2. RQ2

### 4.2.1. Results

About the RQ2 *“Is there a correlation between the capitalization of a firm and its size expressed in terms of i) number of employees, ii) assets quantified in the balance sheet and iii) revenues measured in the income statement? If yes, how does the size influence the economic and financial performances of FF?”*, the aim of this question was to verify the existence of a positive correlation, that permits us to interpret the findings of the RQ1 as caused also by the size and not only by the belonging of the companies to a specific index, with a different capitalization (FTSE MIB with large capitalized companies, and STAR with medium capitalized ones).

We correlated the capitalization of each firm, distinguished in FF and NFF, considered the mean of the period 2006-2011, with its size, expressed in terms of i) number of employees, ii) assets quantified in the balance sheet, and iii) revenues measured in the income statement (mean 2006-2011). Subsequently, we analyzed the same correlation within each index (FTSE MIB and STAR), distinguishing FF and NFF.

How the following table shows, it is possible to affirm that there is a positive correlation between capitalization and size, expressed in terms of i) number of employees, ii) assets quantified in the balance sheet and iii) revenues measured in the income statement.

If we look at the global sample (FF on one side and NFF on the other), the positive correlation is strong, independently by the presence of the family in the company.

The correlation is strong also in the FTSE MIB NFF and in the STAR NFF, and it is moderate/strong in the FTSE MIB FF and in the STAR FF companies (Chart 6).

**Chart 6. Correlation between capitalization and size**

	Capitalization (mean 2006-2011) (family firms)	Capitalization (mean 2006-2011) (not family firms)	Capitalization (mean 2006-2011) FTSE MIB (family firms)	Capitalization (mean 2006-2011) FTSE MIB (not family firms)	Capitalization (mean 2006-2011) STAR (family firms)	Capitalization (mean 2006-2011) STAR (not family firms)
Number of employees (mean 2006-2011)	0,79	0,78	0,60	0,73	0,67	0,72
Total assets (mean 2006-2011)	0,81	0,90	0,71	0,87	0,71	0,78
Revenues (mean 2006-2011)	0,75	0,98	0,64	0,98	0,63	0,79

Source: own elaboration based on AIDA and Bloomberg database.

#### 4.2.1. Discussion RQ2

Concluding, we can affirm that the capitalization and the size of a company are positively and strongly correlated. Consequently:

- the *size* (as a proxy of the complexity/diversification of the business) is a relevant variable, which influences the FF *economic performance* (indeed, STAR FF, which are medium size and capitalized companies, outperform than STAR NFF, while FTSE MIB FF, which are large size and capitalized companies, underperform than FTSE MIB NFF);
- the *size* of the company seems not to be a relevant variable, which influences FF *financial performance* in comparison with NFF. Indeed, FF outperform than NFF, both in FTSE MIB and in the STAR index, in all financial ratios, with the exception of the debt ratio in the FTSE index (this evidence confirms our main hypothesis about the existence of two configurations of FF and, in particular, that the FTSE MIB FF have higher debt ratio than both the FTSE MIB NFF and the STAR FF, due to the specific financial requirements related to their business);
- the *size* of the company seems to be a relevant variable, which influences FF *financial performance*. Indeed, STAR FF outperform then FTSE MIB FF, while this evidence is not true for NFF (all financial ratios of FTSE MIB NFF are better than STAR NFF, with the exception of fixed asset coverage ratio, and the specificity of the debt ratio that is equal in the two indexes).

*H2 was partially confirmed.*

Indeed, referring to H2 and, indirectly, to our main assumption, we can conclude affirming that there are effectively two configurations of FF, in which the size is a relevant variable in achieving performances, and they are:

- the FTSE MIB FF, which are *large-size* companies;

- the STAR FF, which are *not-large size (medium)* companies.

The not-large (medium) FF outperform in *economic results* than not-large (medium) NFF, while large FF underperform than large NFF.

The not-large (medium) FF outperform in *financial results*, both comparing not-large (medium) FF with large FF and not-large (medium) FF with not-large (medium) NFF.

Large FF outperform in all *financial ratios* than large NFF, with the exception of the debt ratio.

Our H2 is partially confirmed and, in particular:

- the presence of a family is a relevant variable in *economic results* of a company, only if the size of the firm is not-large (medium);
- the presence of a family is a relevant variable in *financial results* of a company, *independently by the size*, with the exception of the debts ratio, for which the large-size FF underperform than medium FF.

How affirmed before, performances in FF are higher when family members act in a not large company as analysing the large FF (Chu Wenyi, 2011) it is noticed that:

- the family generally is not involved in directly managing the business;
- there is normally a duality between CEO (a manager) and chairman (a member of the family);
- the firm acts as family holdings, which aims to a diversification of their traditional business to gain high return on equity (ROE), using the financial leverage.

Due to these factors the return on the core business (ROI) is lower than in the NFF in which the family is directly involved (medium size companies).

On the contrary, the medium FF are more interested in the return of the traditional core business, through the development and the innovation of products and services. In these companies, the family is usually directly involved in managing the company, with executive members in the board. This consideration is confirmed, on one side, by an higher return of the investments (ROI) of medium FF than medium NFF and, on the other side, by a lower debt ratio of medium FF than medium NFF.

For this reason, the aim of the listing for large FF seems to be a money collection to improve the diversification of the business activities, in addition to the banks financings. On the contrary, the aim of the listing for not-large FF is usually a money collection to improve the traditional business through innovation, maintaining a low debt ratio.

## 5. CONCLUSION, IMPLICATIONS AND LIMITATIONS

The first research question (*RQ1*) of this study was to analyze the impact on performances caused by the presence of the family in the listed Italian companies (FTSE MIB and STAR indexes), in particular comparing the economic and financial results achieved by FF and NFF in the period 2006-2011.

Referring to *RQ1*, our analysis revealed that:

- FF outperform in ROA, ROI, ROS, and in all financial ratios (liquidity, current, fixed asset coverage and debt ratios) compared with NFF, while NFF outperform only in ROE;
- FTSE MIB NFF outperform than FTSE MIB FF in all economic ratios, while FTSE MIB FF outperform in all financial ratios than FTSE MIB NFF, with the exception of the debt ratio;
- STAR FF outperform than STAR NFF in all economic and financial ratios.

Subsequently, we formulated a new research question (*RQ2*), strictly correlated to the previous one, that was to verify if the size of the companies could be considered as a relevant variable in distinguishing the FF in two main configurations, with different economic (with particular attention to ROA, ROI, ROS and ROE ratios) and financial performances (with particular attention to debt ratio), in comparison to NFF with the same size and to FF of other size.

Referring to *RQ2*, we affirmed that:

- the presence of a family is a relevant variable in *economic results* of a company, *only* if the *size* of the firm is *not-large* (medium size FF or STAR FF);
- the presence of a family is a relevant variable in *financial results* of a company, *independently* by the *size*, *with the exception of the debts ratio*, for which the large size FF (FTSE MIB FF) underperform than medium FF (STAR FF).

Concluding, we sustained that there are two main configurations of FF, and that the distinction between them is essentially based on their size, expressed in terms of i) number of employees, ii) assets quantified in the balance sheet and iii) revenues measured in the income statement, that is always positively correlated with the capitalization. Each kind of FF (large size FF and not-large size FF) has specific effects on economic and financial performances, which can be generalized:

1. if a company has a *not-large size* (STAR index), the presence of a *family* is a *relevant variable* in achieving better economic and financial performances than NFF with the same size;
2. if the company becomes a *large-size* one (FTSE MIB index), the *family* presence becomes an *irrelevant* variable both on the *economic performances*, as the NFF economic results are better than FF, and on the financial leverage (*debt ratio*), as the FF have an higher debt ratio in comparison with large NFF and with medium FF;
3. the *family* presence is a *relevant* variable, *independently by the size*, on the *financial performances*, with the exception of the financial leverage (*debt ratio*).

This study, even considering other similar articles on the FF performances issue (Chu Wenyi, 2011; Gonzalez, Guzman, Pombo, Trujillo, 2012; Villalonga and Amit 2004), contributes to the literature on FF as it shows the effects on companies' performances caused by the presence of the family in the board, in strictly correlation with the size of the company as a proxy variable of organizational complexity.

Furthermore, the concerns of this research are pertinent for FF owners and for the regulatory bodies in order to understand and manage the effects caused by the size and the governance of the company on the financial and operative structure of the firms. We believe that considering our assumptions i) family owners can formulate more conscious and rational strategic intentions and initiatives, especially regarding the diversification and the growth of the business, even considering the risks correlated with these decisions and the effects on performances and ii) regulatory bodies can support, in a more concrete manner, the listed companies in their value creation process, especially looking at the need of integration between risks and strategic planning and control.

In addition, our article contributes also to investors' decisions making process, as it elaborates significant generalizations in order to identify which are the outperforming companies on the Italian listed stock exchange market.

This research presents some limits that can be summarized as follows:

- other external and internal causes with effects on performance trends are not considered (as, for example, the presence of executive members of the family in the board; the dividends policy chosen; the innovation and development strategy adopted; etc.);
- only listed companies (FF and NFF) are considered (we did not focus our attention on unlisted companies, even if it is very important to underline that the listed companies represent a sample, in which a certain homogeneity in terms of organizational and financial features can be observed);
- the selected firms belong to different industrial sectors, and consequently economic and financial ratios could be influenced by external and internal variables typical of the sector;
- the method adopted could be integrated with some econometrical models.

Further research will have the aim of eliminating these limits, in particular analysing the behaviour of the FF (large and not-large) in the dividends policy and in the innovation strategy, taking into consideration the existence of a correlation between the dividends policy and the innovation strategy on one side with the performances on the other.

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## RELATIONSHIP QUALITY DRIVES AND OUTCOMES: A SYSTEMATIC LITERATURE REVIEW APPROACH

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### ABSTRACT

In this study the main goals are the identification of the relational constructs related with the analyses of the inter-organizational relationship quality, the contexts more used in the researches regarding the type of market, relationships, and perspectives; the main findings of the researches in this century and the new avenues to explore in futures researches. The systematic literature review allowed us to select the most relevant articles analysed considering theory, methodology, key results, context, implications and future research. We also provide a framework representing the main constructs and dimensions used to measure the relationship quality, drivers and outcomes.

**Key words:** relationship quality, commitment, trust, long-term relationship, interdependence, cooperation, attachment, satisfaction, systematic approach

### 1. INTRODUCTION

What might be unthinkable a few decades ago is now a critical need for business competitiveness. Nowadays, the market promotes a global offer which ensures the goods and/or service quality, and also requires from all players in the supplier chain a faster, efficient and differentiated response. This reality stresses the awareness for the reciprocal and symmetric interdependence of the organizations to have access to expert knowledge and resources, which allow to complement its internal competences and increase its competitive performance (e.g., Hennig-Thurau and Klee, 1997; Dyer and Singh, 1998; Wulf et al., 2001; Walter et al., 2003; Kim, 2010; Zacharia, 2011; Hammervoll, 2012). Indeed, exchange relationship management is regarded as one of the most important strategic resources that is critical for business company success (Smith, 1998; Wulf et al., 2001; Powers and Reagan,

2007; Hammervoll, 2012; Johnson, 1999). Hence, it is not a surprise that producers, distributors, retailers, customers and even competitors join forces to co-create value solutions. Establishing, and retaining appropriate exchange relationships, and developing quality relationships results in superior and distinct advantages to both partners (e.g., Gummesson, 1997; Jap et al., 1999; Johnson, 1999; Vargo and Lusch, 2004; Cannon et al., 2010; Zacharia, 2011; Hammervoll, 2012; Rauyruen and Miller, 2007; Wagner, 2010; Nyaga, 2011).

Day by day, with the business environment becoming more competitive, a dyadic perspective of buyer-seller relations, or in another point of view supplier-customer relations, is increasing, which raises the awareness that for each partner to be successful, both should be concerned in sharing forces and working together in order to improve their joint performance and add value to their offers (Cannon et al., 2010). This means that the management practices implemented for one partner should be also perceived as effective and fair for the other partner (Kumar et al., 1995; Buzzell and Ortmeier, 1995; Gruen and Shah, 2000; Wulf et al., 2001; Wagner, 2010; Cook et al., 2011; Zacharia, 2011; Arranz and Fdez de Arroyabe, 2012; Terpend and Ashenbaum, 2012).

Despite the existence of several studies that address various aspects of the relationship between two partners in a business context, for example the work of Athanasopoulou (2009), there is still a lack of an understanding of the major constructs related to relationship quality in business to business and business to consumer research. Therefore, we intend to contribute to fulfil this gap using a systematic review, where the most relevant literature about this topic was analysed. The research goals are to:

- Identify the performance outcomes considered by a strategic RQ (Relationship Quality) management;
- Identify the key constructs used to measure the relationship and their positioning as RQ drivers, RQ core constructs or RQ outcomes;
- Identify the main findings of the research in this century and the new avenues to explore in futures researches;
- Differentiate the perspectives and the contexts used more in previous studies taking into consideration: type of market, relationships, and perspectives.

The value and originality of this study are related with the development of a framework showing the main constructs used to study RQ in different contexts as mentioned below in point 2.3. In fact, previous research already tends to focus on a partial perspective. In this manner, we are contributing with a new RQ framework of the existing literature, which could help future research and also influence management decisions.

The structure of this article is as follows: After the introduction of our topic research, a background of relationship and relationship quality concepts are presented, the methodology is described and the key results of the systematic review are provided. Finally, the conclusion and new avenues for future research are proposed.

## 2. BACKGROUND

### 2.1. *Relationship concept*

What is a relationship? Clearly it is not an occasional and singular transaction (Fournier, 1989), which means a discrete transaction or a simple vehicle for the exchange of goods, services or currency (e.g., Dwyer et al 1987; Jap 1999; Hammervoll, Trond 2012). A relationship can be defined as a unique set of practices and routines that support a relation exchange among organizations (Dwyer et al., 1987; Johnson, 1999; Rauyrueen and Miller, 2007; Adams, 2012). Fournier (1989) highlights that this concept is understood in the interpersonal domain, in which interdependence between people is established, for whom the relation has some meaning. A relationship is constituted by a recurrent and reciprocal exchange established between parts that know each other, and that are in a continuous learning and adaptation of each other's context. The author also refers that the relationship developed is shaped by the context reinforced by three sources of meaning: the psychological, the socio-cultural and the relational evolvement. Hence, a joint response to an event affects and is also affected by a particular context in which they are embedded (Fournier, 1989; Dyer and Singh, 1998; Hammervoll, 2012).

Relational management represents the orientation or behavioural predisposition to promote and preserve close relationships (Crosby et al. 1990; Smith, 1998), and it could be developed in five different stages of a supplier-buyer relationship: Partner selection; Defining relationship purpose; Setting relationship boundaries; Creating relationship value; Relationship maintenance. Each stage is affected by different factors that influence RQ (Powers and Reagan, 2007). This requires a higher degree of attention by the managers to ensure the success and the long-term relationship of the partnership.

### 2.2. *Relationship Quality Concept*

Relationship quality (RQ) has been a topic developed in several researches. In the last decades, a few definitions emerged (e.g., Crosby et al., 1990; Kumar et al., 1995; Hennig-Thurau and Klee, 1997; Smith, 1998; Johnson, 1999; Jap et al., 1999; Bejou et al., 1996;

Palmatier, 2008; Nyaga and Whipple, 2011) (see Table 1). RQ focuses on the core essence of relationship marketing (Jap, 1999) and promotes a global measure to describe and assess the nature, climate, depth, health and wellbeing of the inter-organizational relationship, between buyer-supplier.

Table 1. Relationship Quality concepts

(Crosby et al., 1990, p. 76)	RQ is "an indicator of the health and wellbeing" of relationships.
(Johnson, 1999, p. 6)	More than characterize relations that are interdependent, the RQ "describes the overall depth and climate of inter-firm relationships."
(Jap et al., 1999, p.304)	"RQ as consisting of evaluations of various aspects of relationship – attitudinal, process, and future expectations."
(Kumar et al., 1995, p. 55)	"RQ as a higher order concept, implying that a better quality relationship results in a lower level of conflict as well as greater trust, commitment, expectation of continuity, and willingness to invest.
(Bejou et al. 1996, p.137)	RQ is defined as when "the customer is able to rely on the salesperson's integrity and has confidence in the salesperson's future performance because the level of past performance has been consistently satisfactory."
(Hennig-Thurau and Klee, 1997, p. 751)	RQ "can be seen as the degree of appropriateness of a relationship to fulfil the needs of the customer associated with that relationship."
(Smith, 1998, p. 4)	RQ "is a higher-order construct comprised of a variety of positive relationship outcomes that reflect the overall strength of a relationship and the extent to which it meets the needs and expectations of the parties. "
(Palmatier, 2008, p. 77, 85)	RQ " is a higher-order, holistic view of a relational exchange composed of multiple facets." RQ "capture the overall caliber of relationship ties and their overall impact on outcomes".
(Nyaga and Whipple, 2011, p. 356)	RQ "as a higher order construct that can be used to represent the overall value of a relationship, be it collaborative or arm's length."

Despite different proposes of RQ concept, we can view some common paths which raise a higher-order construct comprising of several distinctive, although related, constructs or dimensions (e.g., Dorsch et al., 1998; Wulf et al., 2001; Walters et al., 2003; Lages et al., 2005; Rauyruen and Miller, 2007).

### 2.3. Contexts

The literature review reveals studies in different market contexts with distinct approaches that stress different relationship dimensions (e.g., Lages et al., 2005; Rauyruen and Miller, 2007; Athanasopoulou, 2009). The more common and studied contexts are:

- First, the company is offering goods or a service;

- Second, in the channel distribution the participant could be a producer, manufacture/supplier, distributor/resellers or retailer;
- Similarly, a company could be working directly in a market place or in an industrial environment;
- Fourthly, the firms may work in a domestic market or in the export market, with importers;
- Fifth, working in a business-to-business market (b-to-b), business-to-consumer (b-to-c), both, or in a business network;
- Sixth, the study could promote the perspective of the seller, buyer or the dyadic relationship.
- Seventh, the relation could be on an interpersonal level, with employees or on an inter-firm level, between organizations.
- Finally, the relation can be analysed in a salespeople and/or customer perspective.

#### *2.4. Systematic Literature review of RQ concept*

Our study conducted a systematic literature review regarding high ranking journals and studies carried out mainly since 2000, focusing on dimensions and constructs connected with RQ constructs established between each two organizations of the distribution channel. The systematic literature review allows us to:

1. Carry out an exhaustive analysis of the existing literature that allows a holistic understanding of RQ concept.
2. Highlight, interpret and understand the differences and similarities among the studies in terms of context, content, theories and dimensions.
3. Identify and document the key RQ dimensions and/or constructs used in management practices.

### **3. METHODOLOGY**

#### *3.1. Search Strategy and Specification of the search terms/topics*

This study applies a systematic literature review process, using an automated search, to collect information and identify, document, and conceptualize of all key analyses in those themes. The Web of Knowledge is the electronic data base used.

Using a combination of several keywords, which had in common the word “relationship”, the selection process of relevant research articles followed these steps:

- First, after the global results promoted by the topic search results, several filters were applied which allowed us to extract article titles that were irrelevant to the study.
- Second, after analysing titles of the selected group of the literature search, some were excluded as a result of not having any relevance to the focus of this study.
- Thirdly, to ensure the best-quality evidence and credibility, articles that were not published in journals classified with a superior rating in the Journal Quality List - Anne-Wil Harzing 2013, especially regarding the WU Wien Journal Rating, were excluded.
- Fourth, by analysing the abstract of the cited articles selected in the previous stage, a new group with significant topics to this study, was selected.
- Fifth, after a global analysis of each of the articles selected in the prior stage, a more restricted group with relevant literature emerged.
- Finally, as a consequence of the cross-references studies analysed, a few relevant and less recent studies were added.

In sum, the final selected studies are directly related with RQ. The construct could be presented, or not, in the title, but certainly it is developed in the abstract or content of the article. It is paramount that its findings propose at least one dimension/construct categorized in any of the three categories of variables, as drivers, outcomes or core constructs of RQ.

### *3.2. Quality Selection Criteria and Data Extraction*

The collection of selected articles was an impartial cross-referencing. The quality selection criteria included: validity (how accurate is the study and information presented in articles to measure what we intend to investigate); reliability (the consistency and the degree of replication of the results and the possibility to generalize); credibility (with regards to articles published in well reputed journals worldwide); integrity (which can be regarded as how robust the research is and if it adopts, or not, rigor in the selected research process) (Collis and Hussey, 2003).

Due the fact that this study intends to identify the main RQ constructs, its drivers and outcomes, most of the literature on this topic has been developed since 2000, which represents 65% of all the articles. Regarding the selection criteria, Table 2 shows the various filters used as selection criteria in the screening process in order to define the more relevant literature.

Table 2. Selection criteria for the keyword search

Criteria	Filters - Screening Process	Articles identified
<b>Selection Criteria</b>		
Electronic data base	Web of Knowledge.	2170
Topic	Relationship distributor retailer Relationship distributor producer Relationship supplier retailer Relationship distributor retail Relationship buyer-supplier Relationship Quality	
General categories	Management Business Operations research management science Economics Social sciences interdisciplinary Agricultural economics policy Psychology applied Sociology International relations Communication Ethics	
Source type	Article	
Language	English	
Research área	Business economics Operations research management science Social sciences other topics Psychology Communication International relations Sociology	
Year	2007-2012	
Year	2010-2012	849
<b>Quality and credibility assesement</b>		
Quality Journal List	WU-Journal-Rating (Stand: 3.6.2009) – Ranking: A+ or A	42

To ensure the quality of the selection, the articles extracted and analysed were published in the best worldwide journals classified in the first two ratings (A+ or A) of one of the main rating journal WIE 2008 – WU Wien Journal Rating May 2008, in its Stand: 3.6.2009. This journal rating is included in the Journal Quality List (JQL) (Harzing 2013).

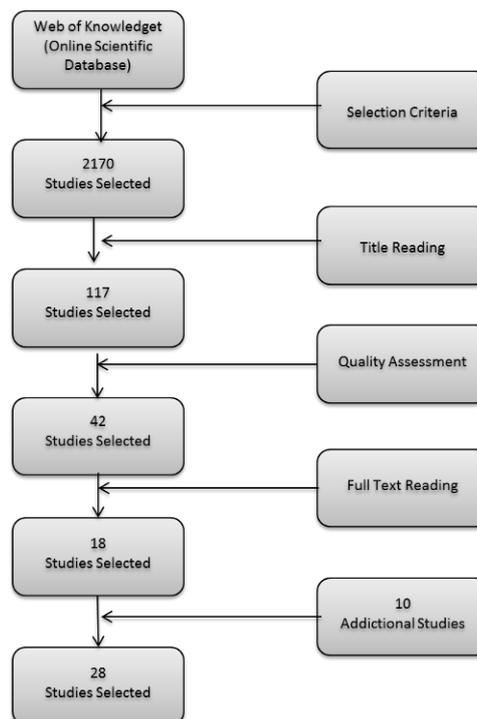
Table 3 shows the results for the keywords in the first stages of the screening process. As we can see, following the major keywords “Relationship Quality”, the second group of keywords with more results is “Relationship buyer-supplier”. This fact is related with the significant number of studies concerning the supply-chain topic. In the third place, the keywords “Relationship supplier retailer” appears in a significant number of studies, but less used in the more prestigious journals. The other keywords appear less in the main rating journals of the JQL.

Table 3. Results for the keyword search

key words	n° of refers/all dates	n° of refers 2007-2012	n° of refers 2010-2012	WU WIEN JR2009 A+	WU WIEN JR2009 A
Relationship distributor retailer	19	16	10	0	0
Relationship distributor producer	15	9	5	0	1
Relationship supplier retailer	116	75	48	3	10
Relationship distributor retail	5	4	2	0	0
Relationship buyer-supplier	488	306	180	1	17
Relationship Quality	1527	992	604	4	6
TOTAL	2170	1402	849	8	34

Despite the criteria used, the list of references in the articles selected was also checked, which allowed us to identify other studies outside the initially period of time (from 2007 until 2012). Figure 1 shows the different stages of the screening process and each result until the final group.

Figure 1. Screening Process



In this study, a developed data extraction form was used to extract the data from the selected studies and to document the data extraction process. After the last screening, a group of 46 articles emerged that were organised by its chronological development (from 1987 to 2012) for a deep examination. All the final studies selected, were analysed through a rigorous

comparison method. In order to systematize and document the data which resulted from the deconstruction of the selected articles, a data extraction form/comparative table was used (see Table 4 in appendix), which permits us to: document the selected process; reduce the possibility of human error; reduce the use of subjectively-driven selection criteria; reflect the differences and compare the similarities of the main lines of thought within the literature review; and help other researches that are interested in this field of study (Magarey, 2001; Tranfield et al., 2003; White and Schmidt, 2005; Athanasopoulou, 2009).

The extract form/comparative table is organized in several categories by the identification of the key elements produced by the study articles: authorship and journal identification; theory (based on the developed study); methodology; context of participants; key results; and future researches (see table 4 in appendix). Looking for archive consistency and reducing to the minimum the subjectivity, the results of the tables were rechecked, individually by the authors of this paper, against the selected articles.

Figure 2 shows a framework representing the main constructs used in the articles analysed as the core of relationship quality and also acting as drives and outcomes of RQ. Several constructs were analysed in different articles playing different roles in the flow drivers, the core concept and outcomes: commitment, trust, long-term orientation, cooperation, attachment and interdependence.

In a relational marketing view, the use of the partner-specific knowledge and the relational attributions are critical to forming high-quality relationships. The idiosyncrasy of this inter-organizational linkage produces mutual benefits for creating and appropriating value which sustain distinctive competitive advantages in the marketplace (e.g., Weiner, 1990; Moorman et al., 1994; Gummesson, 1997; Dyer and Singh, 1998; Jap, 1999; Johnson, 1999; Corsten and Kumar, 2005; Rauyruen and Miller, 2007; Payne et al., 2008; Bejou et al., 2008; Chatain, 2010; Wagner, 2010; Eberly et al., 2011; Zacharia, 2011; Nyaga, 2011; Hammervoll, 2012).

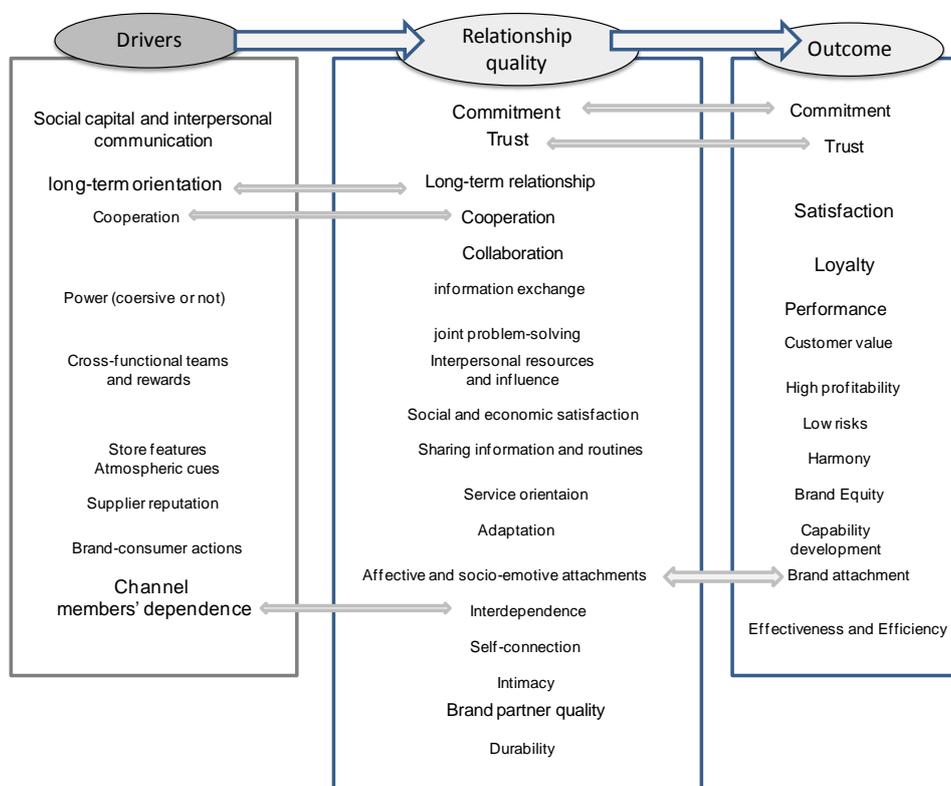
To ensure a valuable, strong and long-term relationship it is necessary to sacrifice short-term profits and bind the members to reap benefits accruing to the relation over the long run (Jap 1999; Cannon et al., 2010). Similarly, it is important that the outcomes provided by one part meets or exceeds the expectations of the other part (comparison level). Furthermore, in a global evaluation, those are considered better than alternatives offered in the market (Anderson and Narus, 1984; Hennig-Thurau and Klee, 1997; Adams, 2012)

According to Cruz and Liu (2011), the earlier the partners invest in their relationship, the more it increases the possibility to turn it more profitable. The value of a relationship transcends the economic asset (profit margins, cost reduction in production, logistic and

administrative), and also in another two fields: technical (sharing resources, reengineer process; innovation; goods inventory; reducing process cycle time ) and social (reduction of risk and uncertainty, among others) (e.g., Buzzell and Ortmeyer, 1995; Cruz and Liu, 2011; Walter et al., 2003; Gummesson, 2008; Ballantyne and Varey, 2008; Zacharia, Nix and Lusch, 2011; Arranz and Fdez de Arroyabe, 2012; Mooi and Frambach, 2012; Lui and Ngo, 2012).

In conclusion, in a context where there is a paradigm change from transactional marketing to relational marketing, there is an increase in interest for the topic related with the management, development and evaluation of relationships (e.g., Gummesson, 1997; Hennig-Thurau and Klee, 1997; Wulf et al., 2001; Lages et al., 2005). The research literature raises three distinct concepts: Discrete Transactions (DT); Relationship Exchange (RE) and Relationship Quality (RQ). Yet, few present a clear distinction between the last two. DT refers to short-term exchange actions which are market drivers; RE characterizes exchange mechanisms that are close and are driven by the context of the interaction, its interdependence and norms (Dwyer and Oh, 1987; Lages et al., 2005; Ballantyne and Varey, 2008). RQ goes further and promotes a more profound overall assessment (Johnson, 1999). Based on a more recent service-dominant logic of marketing, both concepts coexist and demand collaboration practices with a new approach to developing business (Ballantyne and Varey, 2008).

Figure 2. Relationship quality framework



#### 4. REMARKABLE CONCLUSIONS

In the present study, a thorough review of the existing literature on relationship quality drivers and outcomes has been conducted in order to identify the key constructs/dimensions to measure and analyze, used in previous research. Therefore, the main core key constructs/dimensions for RQ are: commitment, trust, long-term relationship, cooperation, collaboration, information and routine exchange, joint-problem solving, interpersonal resources and influence, social and economic satisfaction, service orientation, adaptation, attraction, interdependence, self-connection, intimacy, brand partner quality and durability.

In previous studies, we did not find a consensus concerning this topic. The dimensions and constructs depend on the context and tend to change over time. Nevertheless, the mentioned construct/dimensions seem to emerge as the most analyzed and applied.

Further research on this topic should go further in understanding the multi-relationships; how they evolve in time; how the dynamic of the process works (establishing and maintaining); how it could change depending on firm size; comparing profit and non-profit organizations; and how relationships depend on culture (county, region and organization) and leadership. In fact, most of the times the relationships are not only dyadic, instead they are triadic or in a word multiple.

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Table 4. Data extracted from selected studies (appendix)

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A	Psychological Bulletin	Ajzen, I. and Fishbein, 1977	Social psychology	Theoretical study; Literature Review	Na	Na	A strong attitude-behaviour relationship is obtained only under high correspondence between at least the target and action elements of the attitudinal and behavioural entities.	Na	Na
A+	Journal of Marketing	Anderson, J. C and Narus, J. A, 1984.	Theory of interpersonal relations, that has come to be known as social exchange theory	Empirical study with quantitative data collect by questionnaires	Distributors of electronics components were selected as the respondent group for this study.	153 distributors	Relationships can be developed and maintained when a manufacturer provides outcomes that meet or exceed distributor expectations (CL), and that are superior to those available from alterative suppliers (CLait); Manufacturers can also improve benefits received by distributors through fostering meaningful communication with distributors ; When the outcomes from a given working relationship meet or surpass expectations, better distributor cooperation and satisfaction (from the distributor's perspective) results.	This research suggests that manufacturers need to consider in their strategy a channel positioning, that is, their offering with respect to the perceptions and needs of distributors.  A basic delineation of study and research between industrial product and consumer product channels of distribution, and a basic delineation among the types of channel working relationships.	b-to-b Distributor- Manufacturer, from distributor/buyer perceptive  Industrial context
A+	Journal of Marketing	Anderson, J.C. and J.A. Narus, 1990	Social exchange theory  Inter-organizational exchange behavior	Empirical study with quantitative data collect by questionnaires	Manufacturer firm and distributor firm managers.	249 distributor firms and 213 manufacturer firms.	Relative dependence is found to be a significant antecedent of influence in the working partnership; The important consideration of the two social exchange constructs, which can be expressed managerially as out-comes compared with expectations and outcomes compared with	Longitudinal research could be directed at sets of "core" constructs, making possible better inferences about both their development over time and their causal sequence.	b-to-b Buyer and supplier/manufac turer perspective  Industrial context

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
							alternatives.		
A+	Journal of Marketing	Crosby, L.A., Evans, K.R. and Cowles, D., 1990	Interpersonal relationship theory or relational theory	Empirical study with quantitative data collect by questionnaires	U.S. households between the ages of 25 and 44, who owned one or more whole life policies, and who were the household's primary insurance decider.	151 households	Sales opportunities depend mostly on relationship quality; Relational selling behaviours, and intensive follow-up contact generally produce a strong buyer-seller bond.	How does the seller's perception of relationship quality with the customer influence the nature of the dyad and relationship development?  How is the domain of behavioural expectations pertaining to relationship quality established by dyadic participants?	b-to-c Salespeople in service contexts
A	Journal of Marketing Research	Kumar, N., Scheer, L.K. and Steenkamp, J.E., 1995	Interpersonal relationship perspective/theory or relational theory	Empirical study with quantitative data collect by questionnaires	Auto- mobile dealers in two countries— United States and Netherlands.	US; 417auto-dealers Netherlands; 289 auto-mobile dealers	The authors find strong evidence that vulnerable resellers' perceptions of both distributive and procedural fairness enhance their relationship quality, although these effects are moderated by the level of outcomes and environmental uncertainty. Furthermore, procedural fairness has relatively stronger effects on relationship quality than distributive fairness	Explore whether channel partners base distributive fairness evaluations on equity, equality, or some other non(s); Examine when channel partners' fairness perceptions differ, under what circumstances criteria for the assessment of procedural and distributive fairness are shared by the channel partners, and whether such unanimity of perspectives is possible or important.	b-to-b Reseller's/buyer perspective Cross-cultural equivalence between countries: USA and Netherlands

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A+	Journal of consumer research	Fournier, Susan, 1998	Interpersonal theory  Brand Personality Theory	Empirical study with qualitative interviews	Women consumer brands	3 consumers	The present analysis suggests an alternative to the construct of brand loyalty in the notion of brand relationship quality. Brand relationship quality is similar in spirit to brand loyalty: both constructs attempt to capture the strength of the connection formed between the consumer and the brand toward a prediction of relationship stability over time.	Research dedicated to an exposition of the alternate relationship forms uncovered here, particularly in terms of the rules and expectations implied in their contracts, and the dynamic processes through which these are managed over time, would advance theory along needed lines; A related question concerns the actuality of the brand relationship: that is, to what degree is the relationship manifest in concrete encounters between partners known personally to each other.	b-to-c  Consumer-brand context  Brand relationship quality construct  Consumer/buyer perspective
A	Psychology and Marketing	Smith, J.B., 1998	Social exchange theory	Empirical study with quantitative data collect by questionnaires	Members of the Purchasing Management Association of Canada	185 male and 181 female purchasing managers	The study was successful in demonstrating that similarity, particularly in terms of work attitudes, sex, and life stage play some role in facilitating relationship management behaviours and thus, indirectly, the quality of buyer-seller relationships.	Future research might fruitfully identify which work attitudes need to be shared to promote particular relationship management activities; Examine potential differences in male-male, male-female, female-male, and female-female buyer-seller relationships.	b-to-b Relationships between purchasing professionals and sales representatives.  Buyer perspective
A	Journal of Business Research	Jap, S.D., Manolis, C. Weitz, B.A. 1999	Relationship Marketing	Empirical study with qualitative analysis	Retail buyers	7 buyer-seller interactions (meetings) involving the 4 key buyer-informants were observed and audio-taped.	The results suggest that relatively higher-quality relationships tend to exhibit more friendliness, less question asking, disagreement, and compliance behaviour as compared with lower-quality relationships	Examining the dynamic ordering or timing of some of the behavioural variables examined herein; Identifying various moderating and mediating variables in the communication/interaction process. ; Verify some of the extant conceptualizations of buyer-	b-to-b Buyers and sellers involved  Retail buyer perspective  Retailing context

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
								seller interactions empirically	
A+	Journal of marketing	Homburg, C; Hoyer, WD; Fassnacht, M, 2002	Contingency theory	Empirical study with quantitative data collect by questionnaires	Clothing and furniture retailers in both the United States and Germany	411 retailers Of these, 245 were from Germany, and 166 were from the USA.	In terms of managerial implications, our results support the view that a service-oriented business strategy has a positive impact on performance in the market and profitability.	Whether a service-oriented business strategy increases the service orientation of individual employees. In addition, the authors conceptualization of a service-oriented business strategy can be applied to other strategic orientations, such as the innovation orientation of a business strategy.	b-to-b Retail channel perspective Service context
A+	Journal of marketing	Corsten, D; Kumar, N, 2005	Relational Marketing theory  Efficient consumer response (ECR)	Empirical study with quantitative data collect by questionnaires	Suppliers of major retailers	226 key accounts from a retailer suppliers.	Suppliers achieve greater economic performance and develop their capabilities in collaborative ECR relationships. Suppliers should be realistic about the sharing of benefits from ECR adoption if they want to avoid negative feelings associated with inequity.	Examine the retailer's perceptions of ECR adoption and the outcomes from ECR; This scale requires subsequent replication and refinement; The role of antecedents, focal construct, and moderating variables (trust and retailer capabilities) and their impact on outcomes would benefit from more stringent longitudinal studies.	b-to-b Supplier-retailer relationship perspective ERC

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A	Journal of management information systems	Son, JY; Narasimhan, S; Riggins, FJ, 2005	Social exchange Transaction cost theories	Empirical study with quantitative data collect by questionnaires	Suppliers with electronic linkages via EDI with a USA recognized retailer of home improvement supplies and materials	233 suppliers	Suppliers' cooperation with the customer, which is influenced by perceived uncertainty, trust, and transaction-specific investments, is found to have strong effects on EDI volume and diversity. Finally, the reciprocal investments are found to be an even more effective strategy when suppliers desire to keep a more cooperative relationship with the customer.	Seek to understand the underlying dynamics of a firm's participation in emerging forms of multilateral IOS (inter-organizational systems) networks such as Internet-based B2B markets. Develop a better understanding of firms' motivation for participating in the new forms of IOS networks and the strategic benefits of joining those networks. Replicate this study in other channel contexts or non-U.S. contexts	b-to-b Customer-Supplier Relationship Electronic trading perspective
A	Journal Business Research	Lages C, Lages CR, Lages LF., 2005	Relationship Marketing	Empirical study with quantitative data collect by questionnaires  A scale development was adopted. The scale resulted from a combination of exploratory qualitative in-depth interviews, a review of the export marketing literature and survey pre-tests.	British exporting firms	111 firms	A better quality of the relationship results in a greater (1) amount of information sharing, (2) communication quality, (3) long-term orientation, as well as (4) satisfaction with the relationship.  Relationship quality is positively and significantly associated with export performance.	Test the RELQUAL scale in other international settings to assess its stability across different samples and contexts. It is worth studying other types of relationship as a franchiser-franchisee. Develop a performance scale for the other side of the dyad—the importer.	b-to-b Relationship between the exporter and importer  Supplier/seller perspective

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A	Journal of retailing	Ramaseshan, B; Yip, LSC; Pae, JH, 2006	Resource-based theory	Qualitative data and survey instrument	Department stores' relationship with their tenants	A random sample of 295 sub-tenants was drawn	The established power-satisfaction-commitment-performance framework is applicable to China, provided the firms exercise power with caution by taking into consideration of the collectivistic cultural context.	Test the external validity of the current study by replicating it in similar settings; Test the model in horizontal channel settings in the context of symmetrical store-tenant relationships, as cosmetic and store brands that are very strong and more equal in power.	b-to-b Department stores' relationship with their tenants; China's distributional channel context
A	Journal of retailing	Chung, Jae-Eun; Sternquist, Brenda; Chen, Zhengyi, 2006	Relation Marketing Theory	Qualitative data and survey instrument	Department store managers who have a title of Shiire (buying) or Shokin (merchandise)	250 department store managers who have a title of Shiire (buying) or Shokin (merchandise)	This study implies that Japanese retailers are expected to look out for the best interests of their partners, rather than continuously seek new partners, and, further, partners learn to negotiate differences rather than seek dissolution of the relationship.	Help to understand the next generation of strategic partnerships being formed in Western cultures.	b-to-b Japanese retailer-supplier relationships reflect the Japanese cultural trend
A	Journal of Business Research	Rauyruen, P. and Miller, K.E., 2007	Relationship Marketing	Empirical study with quantitative data collect by questionnaires	Australian Small to Medium Enterprises (SMEs).	306 buyers	Results show that all four dimensions of relationship quality influence attitudinal loyalty, however, only satisfaction and perceived service quality influence behavioural loyalty (purchase intentions). Most remarkably, results indicate that only the organizational level of relationship quality influences customer loyalty.	Future research design should consider including details of the customer contact point to clarify the nature of the relationship, for example, whether business customers have constant contact with account managers, sales persons, or even call-centre staff.	b-to-b Buyer-Supplier (employees/organization) Buyer perspective Service context.

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A	Journal of Business Research	Thomas Powers, William Reagan, 2007	L. Relationship Marketing	Empirical study with quantitative data collect by questionnaires	Purchasing managers within the United States	300 company buyers.	There was a significant difference in the importance of the factors across stages for the majority of the relationship factors investigated; Of the relationship factors that were found to have a significant difference across relationship stages: mutual goals, adaptation, trust, performance satisfaction, cooperation, commitment, and structural bonds	Examining suppliers evaluating buyers; Link the factors that influence buyer-seller relationships to a broader construct such as relationship quality as well as relationship dissolution; Various buying contexts; Factors that might contribute to restoring those relationships.	b-to-b Supplier/buyer relationship Buyer perspective Industrial context
A	Journal of international business studies	Su, Chenting; Yang, Zhilin; Zhuang, Guijun; et al. 2009	Embeddedness theory	Qualitative data and survey instrument	Suppliers and retailers of Chinese channel	395 matched supplier-retailer dyads	Interpersonal influence is an alternative channel communication mode. Managing channel relationships in emerging markets requires consideration of the intricacy of the economic and socio-cultural environments.	Replicate the findings of this study in other relationship-oriented cultures or countries; Additional research therefore should develop a dyadic model, calibrated on dyadic measures, to examine channel dyads' communication behaviours.	b-to-b Chinese marketing channel Supplier-retailer dyads perspective

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
- add	European Journal of Marketing	Athanasopoulou, Pinelopi, 2009	Relationship Quality	Theoretical study; Literature Review	N.a.	N.a.	The framework provides firms with a guide to the factors that may affect the quality of their relationships with customers and helps them in developing effective relationship marketing strategies.	Focus future research more on services (both professional and retail) and on retail relationships (both in goods and services); It is a need for more multi-country studies in order to test whether cultural and other environmental or exogenous factors affect RQ; The nature of online relationships needs further studying; It is need more qualitative studies (case studies, interviews etc); Use this framework in the development of appropriate scales for future RQ related studies.	b-to-b
A+	Strategic management journal	Chatain, Olivier, 2010	RBV - resource-based view of the firm	Empirical study with qualitative data collect by observations	United Kingdom legal market using data on client-law firm relationships and law firm profitability for the period 2002-2005.	128 lawyer firms.	Added value, measured at the level of each buyer-supplier relationship, is a driver of relationship stability and supplier profitability. This suggests that suppliers with similar capabilities might enjoy different economic returns depending on the composition of their set of relevant competitors.	Further work could explicitly account for the endogeneity of the matching between buyers and suppliers.	b-to-b Buyer-supplier law services  Service context

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A	Journal of business research	Kim, Kyung Kyu; Park, Seung-Hoon; Ryoo, Sung Yul; et al., 2010	Resource Dependence Theory (RDT) Transaction Cost Economics (TCE) Social capital theory	Empirical study with quantitative data collect by questionnaires	Buyers that were in the purchasing division of one buyer organization; Suppliers which provide the telecommunication devices to the buyer.	100 Buyers 98 Supplier	The results show that switching costs and inter-organizational trust are significant determinants of cooperation for buyers; technological uncertainty and the reciprocity of the relationship are significant determinants for the suppliers. Also, goal consistency significantly affects inter-firm cooperation.	Explore the extent to which the interdependence structure influences the behaviours of firms; Future research needs to look into various control mechanisms with or without equity ownership; Incorporating a sample from multiple companies in non-monopolistic situations is needed.	b-to-b The perspectives of both the buyer and supplier in a dyad. Telecommunication industry
A	European journal of operational research	Cruz, Jose M.; Liu, Zugang, 2011	Embeddedness theory	Theoretical study	Suppliers, manufacturers, and retailers of a supply chain network	The supply chain model consists of 2 suppliers; 2 manufacturers; 2 retailers; and 5 time periods.	The results show that high levels of relationship can lead to lower supply chain overall cost, lower risk, lower prices, higher product transaction and therefore higher profit.	Extension of this framework to the international arena and the incorporation of other criteria; The relationships between elements in supply chain differ depending on the stage of the alliance and on aspects of the costs and benefits of the relationship. How does the combination of these elements play in each time period and stage of the supply chain?	b-to-b b-to-c Supply chain network with a multiple decision-makers (suppliers, manufacturers, and retailers) associated

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A	Journal of world business	Leonidou, Leonidas C.; Palihawadana, Dayananda; Chari, Simos; et al., 2011	Transactional view  Relational perspective	Empirical study with quantitative data collect by questionnaires	British importers, focusing on the factors that drive their adaptation in the working relationship with Western European or U.S. export manufacturer s.	167 importers	It was revealed that trust positively affects commitment and cooperation, while communication positively influences cooperation but has no effect on commitment; Both commitment and cooperation subsequently lead to importer adaptation; It was also found that adaptive importers tend to be more conducive to effective and efficient relationship outcomes.; Finally, the study confirmed that both the links between adaptation and relationship effectiveness and adaptation and relationship efficiency are moderated by both the level of dependence on and distance from the exporter.	Test the applicability of the model in other regions, such as from the perspective of importers located in developing (e.g., Nigeria) and/or emerging (e.g., India) markets; Test this model from the standpoint of importers based in countries with a large stake in import trade, such as the U.S.A, Germany, and Japan; In addition, the model should be replicated to cover working relationships between importers and foreign suppliers from industrialized versus less-developed countries.	b-to-b Buyer–seller relationships  Standpoint of the importer  Relationship between British importers and Western European or U.S. export manufacturers,
A	International business review	Tsai, Shu-Pe, 2011	Brand relationship quality (BRQ); Brand attachment (BA); Brand commitment (BC)	Adopting a multi-phase methodology. It is divided into the research stages of pilot investigation and empirical model validation	Brand consumers	519 consumers.	Committed and attached relationships built upon the relationship foundation mirroring the holistic essentiality of holistic consumer experience are convertible into powerful driver of international brand loyalty.	Longitudinal data help to see if the model remains valid throughout the international brand's life cycle.	b-to-c Brand-to-consumer relationships  Marketplace

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A	Journal of business logistics	Nyaga, Gilbert N.; Whipple, Judith M., 2011	The resource-based view (RBV) and the relational view (RV) theory	Empirical study with quantitative data collect by questionnaires; A quantitative survey instrument was developed based on a thorough literature review	Supply chain buyers and suppliers	453 buyers 255 suppliers	This research illustrates the importance of relationship quality and its impact on supply chain operational and strategic performance using both buyer and supplier samples; Relationship quality represents the combined perceptions of commitment, trust, satisfaction and relationship-specific investments exhibited within the relationship firms	Specifically examine dyadic data would allow the comparison of perceptions between partners in the same relationship; Examine the conceptual model using additional control and/ or moderator variables. For example, firm size (and comparison of firm size between buyers and suppliers).	b-to-b Both buyer and supplier perspectives The latter form of transactional relationships
A+	Academy of management review	Eberly, Marion B.; Holley, Erica C.; Johnson, Michael D.; et al. 2011	Attribution Theory Dyadic theory of relational attributions	Theoretical study	Na	Na	This article pushes the boundaries of attribution theory by modelling how relational attributions can predict behaviours that are essential in forming high-quality relationships.	Researchers could manipulate the attribution or provide attributions in scenarios to measure study participants' attitudinal and behavioural responses.	b-to-b Intra-organizations

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A	Journal of supply chain management	Wagner, Stephan M.; Coley, Linda Silver; Lindemann, Eckhard, 2011	Relationship theory, signalling and social ex-change theory supply chain management theory	Empirical study with a literature review and eight in-depth interviews	Key informants (one purchasing manager from each customer firm) in industrial firms in Germany and Switzerland.	183 buyers	Trust during the project collaboration has a stronger influence on the future of buyer-supplier relationships than fair economic rewards or reputation.	The intangible factors such as the antecedent reputation and mediators such as outcome fairness and trust in this study should be tested in other models with tangible buyer-supplier relationship performance measures, such as cost, delivery reliability or responsiveness on the customer's future intentions with their suppliers; Applying the study models in different business settings; The relationship between a reputation for fairness and business performance would be an interesting hypothesis for future research. Finally, to test the effects from the supplier's perspective and to conduct dyadic analysis.	b-to-b buyer-supplier relationships buyer's perspective industrial context
A+	Information systems research	Venkatesh, Viswanath; Bala, Hillol, 2012	In this paper, building on the technological, organizational, and environmental (TOE) framework and inter-organizational theories	Model in a high-tech industry studied with high-tech industry Rosetta Net-based IBPS	High-tech industry	124 dyads	Three TOE factors (i.e., process compatibility, standards uncertainty, and technology readiness) had synergistic effects and two factors (i.e., expected benefits and relational trust) had direct effects on IBPS adoption; IBPS adoption led to greater relationship quality (i.e., partnering satisfaction) and operational efficiency (i.e., cycle time); IBPS adoption mediated the effect of TOE factors on partnering satisfaction and cycle time.		b-to-b Inter-organizational business

QL J	Journal Brand	Author	Theory	Methodology adopted	Population features	Sample Size	Contribution - Key results	Implications for further research	Context
A	Journal of retailing	Hofer, Christian; Jin, Henry; Swanson, R. David; et al., 2012	Resource dependency theory	The empirical analysis using a robust data set drawn from the financial statements of major retailers suppliers.	Suppliers that generate at least ten percent of their total revenues from sales to either Wal-Mart or Target	242 suppliers	This study provides evidence of collaborative supplier–key retail accounts (KRAs) relationships, such that a supplier’s dependency on KRAs may positively affect supplier performance.	A study will require measuring specific KRA–supplier relationship characteristics; Would be worthwhile to examine whether affirmatively attempts to engage all its partners to facilitate supply chain management; Investigating the effects of retailer dependencies on suppliers.	b-to-b The perspective of the supplier Relation between retail accounts (KRAs), and supplier’s

## MEASURING CUSTOMER PERCEPTION AND SATISFACTION IN INTERNET BANKING, SCALE DEVELOPMENT AND VALIDATION

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### ABSTRACT

Application of technology in various service sectors is providing convenience in product delivery, access, increased productivity and performance. Public sector banks in India have implemented Internet banking so that their customers can avail retail banking services anytime and anywhere. However, it is also necessary for the service providers to know what customers perceive about their services. In this research paper a scale has been developed to measure perceived service of Internet banking. Further it has been judged whether perceived service is affecting customer satisfaction. Data from 499 customers of 5 leading public sector banks have been collected and analysed. Privacy has been found to be the most important factor in determining how customers will perceive the Internet banking service. Customers have shown a high preference for timely availability of the banking website also. Interestingly, customer satisfaction has been found to be affected by perceived services positively and significantly. The study identifies the areas where banking service providers should focus on to have more satisfied customers and to attract more customers towards Internet banking.

**Keywords :** *perceived service, customer satisfaction, Internet banking*

### INTRODUCTION

Constructive uses of new technologies have always contributed positively towards improving standards of human life and the economy of a country. In today's business environment, organizations are well aware that to be competitive, they need to be highly responsive to the growing expectations of their customers. The proliferation and rapid advances in technology-based systems, especially those related to the Internet, are leading to fundamental changes in

how companies interact with customers (Ibrahim et al, 2006; Bauer et al., 2005; Parasuraman and Zinkhan, 2002). Application of technology is providing convenience in product delivery, access, increased productivity and performance. It is being used as the most powerful tool to augment the operational performance in terms of timeliness, accuracy, ease of operation etc. Technology, in particular, has been increasingly employed in service organizations to enhance customer service quality and delivery, reduce costs, and standardize core service offerings (Ibrahim et al, 2006; Lee and Lin, 2005; Bauer et al, 2005; Gounaris et al, 2005). Customers are frequently on move nowadays and expect a certain level of quality of service regardless of where and how they accessing the service. Many companies in the financial services sector have been quick to implement Internet capabilities, and electronic service is becoming a viable option for interaction between financial service providers and their customers (Rotchanakitumnuai, S and Speece, M 2003).

The challenging business process in the financial services forced the banks to introduce alternate delivery channel to attract customers and improve customers' perception and thereby customer satisfaction. Banks implemented Internet banking to offer their customers a variety of online services with more convenience for accessing information and making transactions. Customer satisfaction and customer retention are increasingly developing into key success factors in e-banking (Bauer et al, 2005).

Satisfaction is a person's feelings of pleasure or disappointment resulting from comparing a product's perceived performance (or outcome) in relation to his or her expectations (Kotler 2000). The proposition of Kotler (2000) is similar to Gronroos's (1982, 1984) conceptualization of service quality that 'puts the perceived service against the expected service'. In addition to the mediated impact of perceived performance via a comparison process, a number of studies have shown a strong direct link from perceived performance to satisfaction (Anderson & Sullivan, 1993; Oliver, 1993, 1994; Patterson, 1993).

This article, proposes to develop a scale to measure perceived service of Internet banking and to find the relationship between perceived service and customer satisfaction.

## **LITERATURE REVIEW**

While defining Internet banking De Young (2001) states with the exception of cash withdrawals, Internet banking gives customers access to almost any type of banking transaction at the click of a mouse. Pikkarainen, Pikkarainen, Karjaluoto, and Pahnla (2004) defines Internet banking as an 'Internet portal, through which customers can use different kinds of banking services ranging from bill payment to making investments'. The use of the

Internet as a new alternative channel for the distribution of financial services has become a competitive necessity instead of just a way to achieve competitive advantage with the advent of globalization and fiercer competition (Flavián, Torres, & Guinalú, 2004; Gan, Clemes, Limsombunchai, & Weng, 2006). All banks using the Internet as an additional channel or a bank using only the Internet as delivery channel are now on equal footing to offer their banking services on the Internet and to compete for customers around the world. As Karjaluoto, Mattila, and Pento (2002) put it 'this could be the reason why the Internet is widely seen as the most important delivery channel in the era'.

Various research works have been carried out on electronic service (e-service) quality and customer satisfaction. Some researches relating e-service quality and customer satisfaction can also be found in Indian context.

Garvin (1987) introduced "aesthetics" as a quality dimension that addresses the consumer's subjective evaluation of how a product looks, feels, sounds, tastes or smells.

Zeithaml, Parasuraman, and Malhotra (2000) analysed web site features at the perceptual attribute level and categorized them into 11 e-SQ dimensions :

Reliability: Correct technical functioning of the site and the accuracy of service promises (having items in stock, delivering what is ordered, delivering when promised), billing, and product information.

Responsiveness: Quick response and the ability to get help if there is a problem or question.

Access: Ability to get on the site quickly and to reach the company when needed.

Flexibility: Choice of ways to pay, ship, buy, search for, and return items.

Ease of navigation: Site contains functions that help customers find what they need without difficulty, has good search functionality, and allows the customer to maneuver easily and quickly back and forth through the pages.

Efficiency: Site is simple to use, structured properly, and requires a minimum of information to be input by the customer.

Assurance/trust: Confidence the customer feels in dealing with the site and is due to the reputation of the site and the products or services it sells, as well as clear and truthful information presented.

Security/privacy: Degree to which the customer believes the site is safe from intrusion and personal information is protected.

Price knowledge: Extent to which the customer can determine shipping price, total price, and comparative prices during the shopping process.

Site aesthetics: Appearance of the site.

Customization/personalization: How much and how easily the site can be tailored to individual customers' preferences, histories, and ways of shopping

Loiacono, Watson, and Goodhue (2000) created WebQual, a scale for rating web sites on 12 dimensions: informational fit to task, interaction, trust, response time, design, intuitiveness, visual appeal, innovativeness, flow-emotional appeal, integrated communication, business processes, and substitutability. However, this scale's primary purpose is to generate information for Web site designers rather than to measure service quality as experienced by customers.

Using an online survey, Szymanski and Hise (2000) studied the role that customer perceptions of online convenience, merchandising (product offerings and product information), site design, and financial security play in e-satisfaction assessments. This study did not include aspects of customer service or fulfillment; rather, it dealt only with aspects of the web site. Furthermore, it measured satisfaction rather than service quality.

Yoo and Donthu (2001) developed a nine-item SITEQUAL scale for measuring site quality on four dimensions: ease of use, aesthetic design, processing speed, and security. As in the case of Barnes and Vidgen's (2002) WebQual scale, data for developing and testing SITEQUAL were gathered from convenience samples. Specifically, students enrolled in marketing classes were asked to visit and interact with three Internet shopping sites of their own choice and then evaluate each site. Like WebQual, SITEQUAL does not capture all aspects of the purchasing process and therefore does not constitute a comprehensive assessment of a site's service quality.

Wang and Huarng (2002) identified nine service quality factors that affect e-satisfaction through content analysis of online customer comments in their research. The identified factors are : (i) website design, (ii) competitive price of the product, (iii) merchandise availability, (iv) merchandise condition, (v) on-time delivery, (vi) merchandise return policy, (vii) customer support, (viii) e-mail confirmation on customer order and (ix) promotion activities. On the basis of these nine factors.

Wang (2003) assessed e-service quality via e-satisfaction in e-commerce globalization. The conclusion reached was e-service quality and e-satisfaction are the critical components in globalization of e-commerce. The study based on certain e-tailors of United States revealed a relatively low level of e-service quality.

Barnes and Vidgen (2002) developed a completely different scale to measure an organization's e-commerce offering, which they also call WebQual. This scale provides an index of a site's quality (customer perceptions weighted by importance) and has five factors:

usability, design, information, trust, and empathy. The scale is designed to be answered without a respondent needing to complete the purchasing process and is therefore a transaction-specific assessment of a site rather than a comprehensive evaluation of the service quality of a site.

Wolfenbarger and Gilly (2003) used online and offline focus groups, a sorting task, and an online-customer-panel survey to develop a 14-item scale called eTailQ. The scale contains four factors: Web site design (involving some attributes associated with design as well as an item dealing with personalization and another dealing with product selection), reliability/fulfillment (involving accurate representation of the product, on-time delivery, and accurate orders), privacy/security (feeling safe and trusting of the site), and customer service (combining interest in solving problems, willingness of personnel to help, and prompt answers to inquiries). Although two of their dimensions—security/privacy and reliability/fulfillment—show strong face validity and are highly descriptive of the items they represent, the other two dimensions appear less internally consistent and distinct. Web site design, for example, embraces aspects of in-depth information, level of personalization, selection, and speed of completing transactions. The factor called customer service contains items relating to the company's willingness to respond to customer needs, the company's interest in solving problems, and the promptness with which inquiries are answered. These dimensions, as well as other items that might be relevant to customer assessment of service quality on Web sites, need to be tested further.

On the basis of a comprehensive review and synthesis of the extant literature on e-SQ, in 2002 Zeithaml, Parasuraman, and Malhotra detailed five broad sets of criteria as relevant to e-SQ perceptions: (a) information availability and content, (b) ease of use or usability, (c) privacy/security, (d) graphic style, and (e) reliability/fulfillment. Availability and depth of information appear to be important because when users can control the content, order, and duration of product-relevant information, their ability to integrate, remember, and thereby use information improves (Ariely 2000). Ease of use appears relevant because Internet-based transactions are complex and intimidating to many customers. Privacy (the protection of personal information) and security (the protection of users from the risk of fraud and financial loss) have been shown empirically to have a strong impact on attitude toward use of online financial services (e.g., Montoya-Weiss et al. 2003). Graphic style—which embodies such issues as color, layout, print size and type, number of photographs and graphics, and animation—has also been shown to affect customer perceptions of online shopping (Hoffman and Novak 1996; Hoque and Lohse 1999; Schlosser and Kanfer 1999). Finally,

reliability/fulfillment has been cited as an important facet of e-SQ (Palmer, Bailey, and Faraj 1999; Wolfinbarger and Gilly 2003). In fact, Wolfinbarger and Gilly (2003) found that reliability/ fulfillment ratings were the strongest predictor of customer satisfaction and quality, and the second strongest predictor of intentions to repurchase at a site.

Based on the explorative study by Zeithaml et al. (2002), Parasuraman et al. (2005) provide the most comprehensive work on e-service quality. They empirically test a multiple item scale (E-S-QUAL) for assessing service quality of online shopping providers. Their findings correspond to the insights of their explorative study: two different scales are necessary to measure electronic service quality. The E-S-QUAL scale addresses core service quality aspects and consists of four quality dimensions (efficiency, fulfillment, system availability and privacy). Additionally, the E-RecS-QUAL scale is proposed to be relevant when customers face “nonroutine encounters” during the online-shopping process which are related to service recovery like product returns, dealing with problems, etc. (Parasuraman et al., 2005). This latter scale is composed of three quality dimensions (responsiveness, compensation and contact).

The literatures on e-service quality and customer satisfaction suggest : a) service quality and satisfaction has different construct though they are highly related concept. b) Researches regarding service quality and satisfaction constructs specific to Internet banking only is scares while many researches can be found in the domain of online retailing, general e-service etc. and c) Service quality determines customer satisfaction.

Depending on the findings of literature review and as per the objectives of the research two different constructs has been built : perceived service and customer satisfaction. To represent the full range of evaluative criteria of Internet banking service quality 9 dimensions have been identified which are “system availability”, “site aesthetics”, “ease of use”, “technical performance”, “reliability”, “privacy”, “trust “, “responsiveness” and “customization”.

## **METHODOLOGY**

### *Selection of the Banks*

Almost all of the public sector banks in India have launched their Internet banking services, but very few of them have been able to attract customers towards this comparatively new banking channel. To get a more accurate idea about the prevailing service practices of Internet banking, the Indian public sector banks which have a high volume and value of RTGS and

NEFT transactions were chosen for this study. Five such selected PSBs are - State Bank of India, Punjab National Bank, Bank of Baroda, Union Bank of India and Bank of India. Selection of the banks has been done on the data provided in the official website of Reserve Bank of India ([www.rbi.org.in](http://www.rbi.org.in)).

### *Questionnaire*

Items representing various facets of the 9 service dimensions were selected on the basis of the literature review. It resulted in the generation of 39 items approximately 4 items per dimension. Each item was recast into question to measure perceived service.

A questionnaire was designed for the Internet banking users to understand their perception level. The questionnaire had three sections : Section A : about the specific bank's performance on Internet bank services, Section B : about respondent's satisfaction by availing services offered by Internet banking, Section C : background of the respondent. As per the requirement of the study and to avoid ambiguity in analysis all the questions were framed positively. A five-point scale ranging from "Strongly Agree" (5) to "Strongly Disagree" (1), were used.

To have equality in measurement scale each customer rated the overall satisfaction of the corresponding bank on a 5-point Likert scale. The satisfaction construct was made up of 4 variables which measure the overall satisfaction of the customers of Internet banking. The associated questions were : Your overall satisfaction level with your bank's Internet banking services, Your overall satisfaction level with informational part of your bank's Internet banking services, Your overall satisfaction level with transactional part of your bank's Internet banking services, After using of the Internet banking your satisfaction has improved very much.

## **ANALYSIS AND FINDINGS**

### *Test running of the questionnaire and generation of scale items*

Data for initial 39-item instrument were gathered from a sample of 100 respondents in the city of Jaipur. The sample was judicially divided among male and female and included people of different age group, education level, income level and service categories. Screened and qualified respondents self-administered the questionnaire consisting of a 39 statements. This stage focused on: (1) fixing the instrument by retaining only those questions capable of discriminating well across respondents having differing quality perceptions about the bank in

several categories, and (2) examining the dimensionality of the scale by establishing the reliabilities of its components.

A reliability analysis was conducted by grouping the items according to the 9 a priori conceptual dimensions from which they were derived. Item total correlation for each of the parameter in each of these nine predetermined dimensions found to be quite high. Therefore after pilot survey no refinement in the scale was required. The values of coefficient alpha ranged from 0.837 to 0.961 across the 9 dimensions and there were no suggestion that deletion of certain items from each dimension would improve the alpha values. So, no items were deleted.

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Table 1: Reliability coefficients for the Indian PSBs' Internet perceived service dimensions (in the pilot survey with 100 respondents)

Dimensions	No of items	P
System Availability	4	.889
Site Aesthetics	3	.837
Ease of Use	5	.884
Technical Performance	4	.927
Reliability	4	.909
Privacy	7	.872
Trust	4	.879
Responsiveness	4	.903
Customization	4	.894

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The nine-factor solution was subjected to orthogonal rotation using Principal Axis Factoring. The rotated factor loading matrix of the test sample is shown in the table 2. This matrix is showing a stable pattern thereby confirming the factor structure.

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Table 2: Factor loading matrix following orthogonal (varimax) rotation of 9 factor solutions

for P scores

Items	Factor loadings								
	F1	F2	F3	F4	F5	F6	F7	F8	F9
<b>System Availability</b>									
PAV1							.830		
PAV2							.800		
PAV3							.880		
PAV4							.870		
<b>Site Aesthetics</b>									
PSA1									.900
PSA2									.810
PSA3									.830
<b>Ease of Use</b>									
PEU1		.870							
PEU2		.860							
PEU3		.810							
PEU4		.760							
PEU5		.780							
<b>Technical Performance</b>									
PTP1			.830						
PTP2			.890						
PTP3			.930						
PTP4			.920						
<b>Reliability</b>									
PRE1					.890				
PRE2					.920				
PRE3					.920				
PRE4					.780				
<b>Privacy</b>									
PPR1	.860								
PPR2	.800								
PPR3	.800								
PPR4	.680								
PPR5	.750								
PPR6	.720								
PPR7	.770								
<b>Trust</b>									
PTR1				.840					
PTR2				.840					
PTR3				.850					
PTR4				.810					

Items	Factor loadings								
	F1	F2	F3	F4	F5	F6	F7	F8	F9
<b>Responsiveness</b>									
PRS1								.930	
PRS2								.910	
PRS3								.830	
PRS4								.790	
<b>Customization</b>									
PCS1							.880		
PCS2							.870		
PCS3							.880		
PCS4							.820		

The factor loading matrix for the expectation items in table 2 suggests a nine factor structure with loadings equally distributed on all 9 identified factors. Also for each of the factors the variables has the highest loading on that single factor only. The minimum loading found is .680.

## FINAL SURVEY AND SCALE VALIDATION WITH NEW DATA

It was decided that the study will be carried out in four major metro cities of India as these places reflect a composite nature of population. This was done following the concept of quota sampling method. To decide the sample to be taken for each of the five pre-selected public sector banks and within four metro cities, number of ATM outlets of the banks in four metro cities has been collected. The assumption was ATM users are the prospective user of Internet banking as for Internet banking the customer should hold an ATM card of the respective bank. Percentage has been worked out to find out the ranking of the banks in terms of no. of ATM outlets in these five banks and four cities. The banks were not willing to share the list of Internet banking users due to security reason therefore this method was applied to select the customers. A total of 499 questionnaires were used for the final analysis.

The data was subjected to 2nd order confirmatory factor analysis using AMOS 19 to test the model fit and unidimensionality of scale items.

### *Item reliability*

33 items whose  $R^2$  values were equal or above 0.450 with were retained and 6 which were below this level were deleted. The model was run again for re-estimation and the final values are shown in table 3.

Table 3 : Standard regression weights of the P scores after removal of 6 identified items

	<b>Item</b>	<b>Regression weights</b>	<b>R square value (item reliability)</b>
1	PAV1	0.700	0.490
2	PAV3	0.688	0.473
3	PAV4	0.752	0.566
4	PSA1	0.681	0.464
5	PSA2	0.773	0.598
6	PEU1	0.705	0.497
7	PEU2	0.836	0.699
8	PEU3	0.811	0.658
9	PEU4	0.794	0.630
10	PEU5	0.817	0.667
11	PTP1	0.738	0.545
12	PTP2	0.676	0.457
13	PTP3	0.717	0.514
14	PTP4	0.695	0.483
15	PRE1	0.791	0.626
16	PRE2	0.787	0.619
17	PRE3	0.798	0.637
18	PRE4	0.717	0.514
19	PPR1	0.756	0.572
20	PPR2	0.731	0.534
21	PPR3	0.752	0.566
22	PPR4	0.715	0.511
23	PPR5	0.784	0.615
24	PPR7	0.757	0.573

25	PTR1	0.751	0.564
26	PTR2	0.703	0.494
27	PTR3	0.693	0.480
28	PTR4	0.700	0.490
29	PRS1	0.655	0.429
30	PRS3	0.793	0.629
31	PCS1	0.682	0.465
32	PCS2	0.683	0.466
33	PCS4	0.709	0.503

### *Convergent validity*

To analyse the convergent validity the factor loadings and the average variance extracted were examined. Most of the indicators have loading from 0.6 to 0.9 which is in line with Bagozzi and Yi (1988). With this the average variance extracted was more than 0.5 (except one case) which is acceptable.

In this research the average variance explained by each construct of perceived service has been shown in table 4

Table 4 : Average variance extracted and composite reliability of perceived service construct

	<b>AVE</b>	<b>Composite reliability</b>
<b>System Availability</b>	0.509	0.756
<b>Site Aesthetics</b>	0.530	0.692
<b>Ease of Use</b>	0.630	0.894
<b>Technical Performance</b>	0.499	0.799
<b>Reliability</b>	0.598	0.856
<b>Privacy</b>	0.561	0.884
<b>Trust</b>	0.507	0.804
<b>Responsiveness</b>	0.528	0.689

**Customization**

0.478

0.733

***Assessing the model fit***

The measurement model for perceived service confirms an acceptable model fit of data with chi-square=718.031, and degree of freedom = 486, CMIN/DF = 1.477 ; GFI (Goodness of fit )=0.919, AGFI (Average Goodness of fit)=0.907, CFI (Comparative Fit Index)= 0.968; NFI(Normed Fit Index)=0.908; RFI(Relative Fit Index)=0.901; TLI(Tucker-Lewis Index)=0.966; RMSEA(root mean square error of approximation)= 0.031 which shows unidimensionality of the factors.

***Discriminant validity***

Table 5 shows the AVE exceeds the squared correlations with the all the factors of perceived service thereby assuring discriminant validity of the nine constructs of perceived service.

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Table 5 : Inter construct squared correlation of the perceived service construct

<b>Construct</b>			<b>Inter construct squared correlation</b>
PAV	<-->	PSA	0.356
PAV	<-->	PEU	0.267
PAV	<-->	PTP	0.283
PAV	<-->	PRE	0.223
PAV	<-->	PPR	0.413
PAV	<-->	PTR	0.360
PAV	<-->	PRS	0.291
PAV	<-->	PCS	0.326
PSA	<-->	PEU	0.203
PSA	<-->	PTP	0.190
PSA	<-->	PRE	0.108
PSA	<-->	PPR	0.216
PSA	<-->	PTR	0.295
PSA	<-->	PRS	0.198
PSA	<-->	PCS	0.191
PEU	<-->	PTP	0.165
PEU	<-->	PRE	0.218
PEU	<-->	PPR	0.209
PEU	<-->	PTR	0.162
PEU	<-->	PRS	0.168
PEU	<-->	PCS	0.156
PTP	<-->	PRE	0.154
PTP	<-->	PPR	0.262
PTP	<-->	PTR	0.187
PTP	<-->	PRS	0.175

<b>Construct</b>			<b>Inter construct squared correlation</b>
PTP	<-->	PCS	0.156
PRE	<-->	PPR	0.309
PRE	<-->	PTR	0.127
PRE	<-->	PRS	0.309
PRE	<-->	PCS	0.225
PPR	<-->	PTR	0.384
PPR	<-->	PRS	0.437
PPR	<-->	PCS	0.384
PTR	<-->	PRS	0.358
PTR	<-->	PCS	0.194
PRS	<-->	PCS	0.406

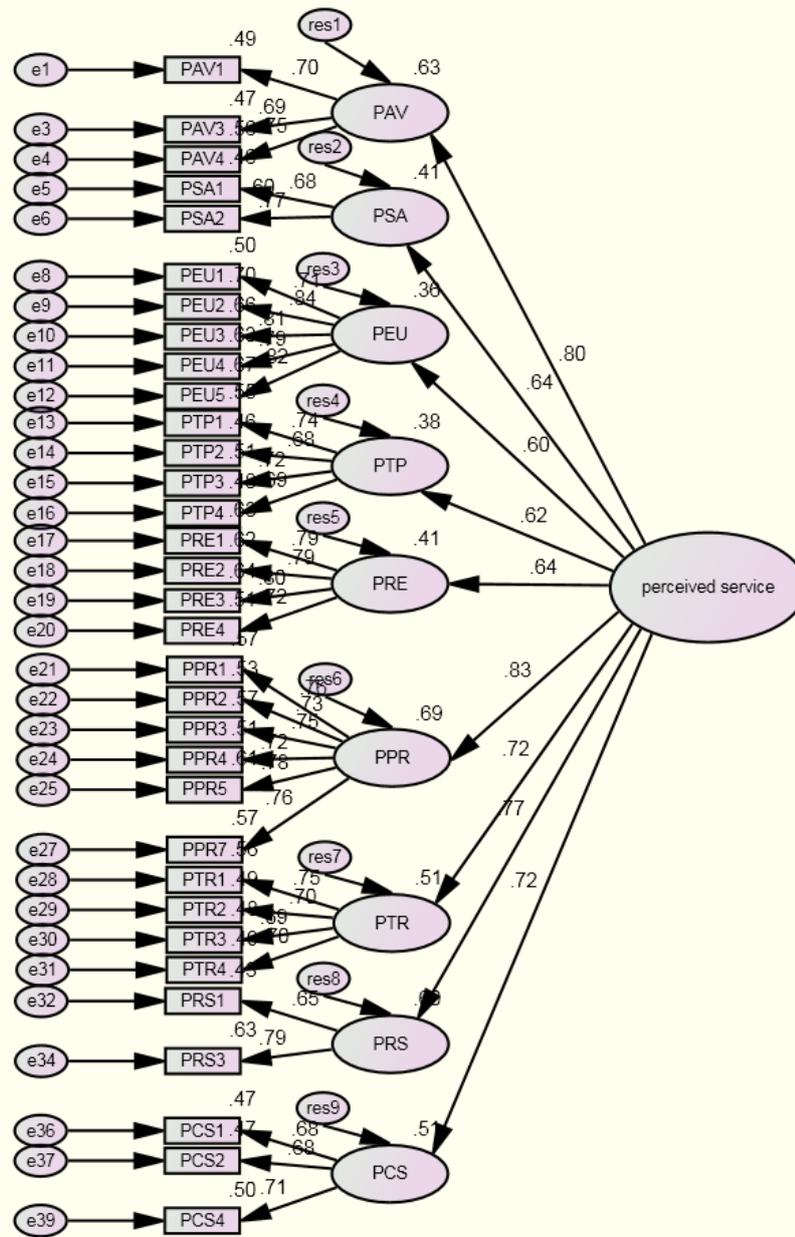


Figure 1: Perceived service construct

Customer satisfaction construct

In the satisfaction construct there are four items measuring the overall satisfaction level of the customers of Internet banking in a 9-point Likert scale. The satisfaction data was subjected to 1st order confirmatory factor analysis to test the model fit and unidimensionality of satisfaction scale item.

To check the individual item reliability within the satisfaction construct again  $R^2$  values have been checked. The values of  $R^2$  for the items measuring the satisfaction of the customers of Internet banking is shown in the table 13.

Table 6 : Standard regression weights of the satisfaction items

Item	Regression weights	R square value (item reliability)
SAT1	0.738	0.545
SAT2	0.800	0.640
SAT3	0.733	0.537
SAT4	0.699	0.489

In this construct the indicators have loading greater than 0.7 which is again in line with Bagozzi and Yi (1988). With this the average variance extracted is more than 0.5 (0.578) which is acceptable.

The measurement model for satisfaction confirms an acceptable model fit of data with chi-square=3.21 , and degree of freedom = 2, CMIN/DF = 1.609; GFI (Goodness of fit )=0.997, AGFI (Average Goodness of fit)=0.984 , CFI (Comparative Fit Index)= 0.998; NFI(Normed Fit Index)=0.996 ; RFI(Relative Fit Index)=0.987 ; TLI(Tucker-Lewis Index)=0.995 ; RMSEA(root mean square error of approximation)= 0.035

### *The model*

A structural equation modeling technique was used to find the relationship between perceived service and satisfaction. The AMOS 19 program was employed for this purpose. It was found that perceived service of Internet banking has a direct impact on the customer satisfaction.

7 fit indexes which are commonly used in the literature ( $\chi^2/d.f$ , GFI, AGFI, NNFI, CFI, RMSR, RMSEA) were employed to test model fit. As the values in Table 7 reveal, the fit indexes of

the model are included in the values which are acknowledged in the literature.

Table 7 : Summary statistics of model fit

Fit indexes	Recommended Value	Observed Value
Chi-square/ degrees of freedom	$\leq 3.0$	1.430
GFI (Goodness of fit )	$\geq 0.90$	.912
AGFI (Average Goodness of fit)	$\geq 0.80$	.900
RMR (root mean square residual)	$\leq 0.05$	.018
CFI (Comparative Fit Index)	$\geq 0.90$	.967
NFI(Normed Fit Index)	$\geq 0.90$	.900
RFI(Relative Fit Index)	Close to 0.90	.892
TLI(Tucker-Lewis Index)	Close to 0.90	.965
RMSEA(root mean square error of approximation)	$\leq 0.05$	.029

Figure 2 shows the standardized path coefficients with their respective significance level.

Figure 2 illustrates the significant structural relationships among the study variables. The direct path Perceived service  $\rightarrow$  SAT is significant since the regression coefficient ( $\beta$ ) is 0.544 with  $p < 0.001$ . The construct perceived service is composed of 9 latent factors "availability", "site aesthetics", "ease of use", "technical performance", "reliability", "privacy", "trust", "responsiveness" and "customization" which has standardized regression weight 0.790, 0.642, 0.616, 0.610, 0.650, 0.824, 0.707 0.772 and 0.717 respectively and all with  $p < 0.001$ . It was observed that within the construct perceived service also all the components were contributing significantly.

The standardized regression weights of all the individual components within each of these nine components of perceived service are shown in table 8.

Table 8: Standardized Regression Weights: (Group number 1 - Default model)

	Estimate
PAV <--- perceived service	.790
PSA <--- perceived service	.642

	Estimate
PEU <--- perceived service	.616
PTP <--- perceived service	.610
PRE <--- perceived service	.650
PPR <--- perceived service	.824
PTR <--- perceived service	.707
PRS <--- perceived service	.772
PCS <--- perceived service	.717
SAT <--- perceived service	.544
PAV4 <--- PAV	.749
PAV3 <--- PAV	.690
PAV1 <--- PAV	.701
PSA2 <--- PSA	.768
PSA1 <--- PSA	.685
PEU5 <--- PEU	.817
PEU4 <--- PEU	.794
PEU3 <--- PEU	.811
PEU2 <--- PEU	.836
PEU1 <--- PEU	.706
PTP4 <--- PTP	.694
PTP3 <--- PTP	.716
PTP2 <--- PTP	.677
PTP1 <--- PTP	.739
PRE4 <--- PRE	.717
PRE3 <--- PRE	.799
PRE2 <--- PRE	.787
PRE1 <--- PRE	.791
PPR7 <--- PPR	.757
PPR5 <--- PPR	.784
PPR4 <--- PPR	.715
PPR3 <--- PPR	.753
PPR2 <--- PPR	.730
PPR1 <--- PPR	.756
PTR4 <--- PTR	.700
PTR3 <--- PTR	.693
PTR2 <--- PTR	.701
PTR1 <--- PTR	.753
PRS3 <--- PRS	.794
PRS1 <--- PRS	.654
PCS4 <--- PCS	.713
PCS2 <--- PCS	.682
PCS1 <--- PCS	.678
SAT4 <--- SAT	.698
SAT3 <--- SAT	.730
SAT2 <--- SAT	.791
SAT1 <--- SAT	.751

The results showed that perceived service of Internet banking which consists of 9 individual dimensions is affecting customer satisfaction positively and significantly.

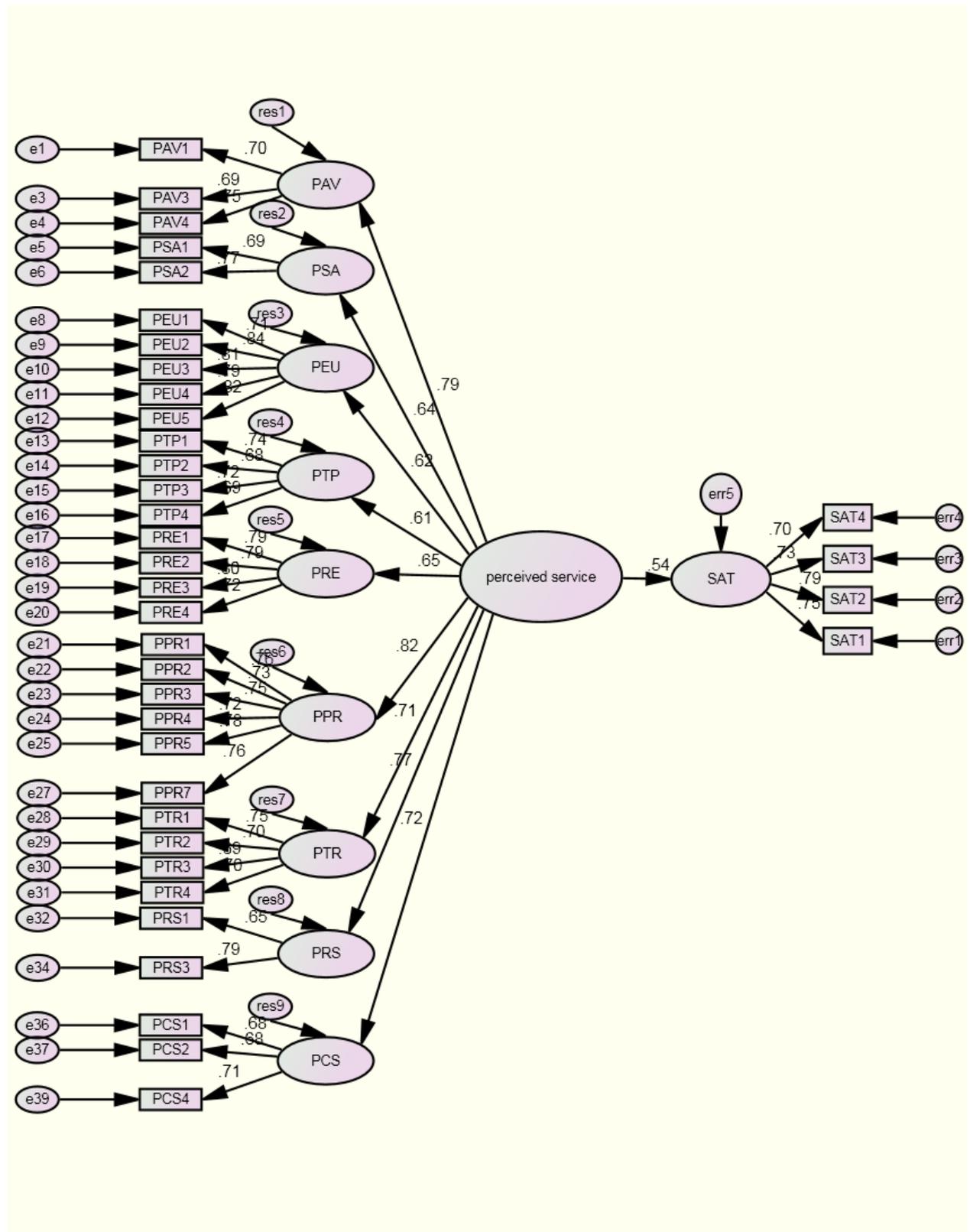


Figure 2 : The model showing perceived service of Internet banking determining customer satisfaction

## DISCUSSIONS AND IMPLICATIONS

The objective of the paper was to develop a scale to measure perceived service and to derive the relationship between perceived service and customer satisfaction in the context of Internet banking service provided by the Indian Public sector banks. There are twenty five public sector banks in India but all of them have not been successfully promoted Internet banking services. To get an accurate information regarding the quality of Internet banking services five banks have been selected that have recorded highest amount of NEFT and RTGS transactions both volumewise and valuewise. Experienced customers of these five PSBs have been questioned to have an idea about how they perceived Internet banking service. The questionnaire had two parts. The perceived service part of the questionnaire was developed on nine predefined latent constructs, which were selected from the in depth review of earlier literatures in this field. The satisfaction part of the questionnaire was containing four questions on overall satisfaction level of the customers. A test run was conducted with 100 samples and reliability testing of all the constructs was carried out. The individual parameters in nine constructs had quite high loadings and no significant cross loading was observed. Therefore no modification in the construct structure was found to be required.

In the final survey a total of 499 data collected from the customers of five selected PSBs was analysed. From 39 initial items 6 items were dropped as they had a  $R^2$  value less than 0.450. In the final structure of perceived service, privacy and availability were identified as the most important dimensions. Responsiveness, customization and trust were the dimensions which had found to affect the perceived service to moderate extent. Reliability, site aesthetics, technical performance and ease of use are the constructs which has the lowest weightage in determining perceived quality of service for Internet banking. The satisfaction construct was checked for convergent validity separately.

Perceived service construct and customer satisfaction construct was joined together to check the relationship between these two. The final model fitted well within the recommended value of various fit indices. Perceived service influences the satisfaction positively and significantly.

The research implies that customer satisfaction can be enhanced by providing better services to the customers. Special care should be taken to improve the service in those constructs of perceived service which has a very high loading such as privacy and availability of the banking

website. Privacy of the personal information and financial information is one of the most challenging areas where the service providers should give more emphasis for improvement.

For this they should implement latest web security mechanisms. Banks should also have effective fraud detection and fraud control mechanism in practice. Availability of the banking website is still major issue to the customers. Banks should improve on the network connection and load time of the banking website. Customers also perceive that banks should be responsive enough to rectify the mistakes in time and it should be done with minimum effort from customers' end. Banks should try to provide more customized service. This will also help the customers to be at ease even if they are not interacting with the bank personnel while availing retail banking services over Internet. The results also indicate that the online shoppers have matured and the technology has also been well adopted as the customers are giving more weightage for rectification and less for technical performance and ease of use.

## **LIMITATIONS AND FURTHER RESEARCH**

The scale can be tested on any other sample by varying the selected banks. The banks were selected on the basis of their value and volume of RTGS transactions. No lists of Internet banking customers were available for the public sector banks. Some other PSB can have more number of Internet banking customers who are not engaged in transactions but they use the bank website for non transactional operations.

However, as the five selected banks accounted for high rate of RTGS and NEFT, therefore it may be assumed had a low incidence of problem encounters. There is thus a need to further examine the reliability and validity of the scale in the context of more diverse Internet banking websites that have a higher incidence of problem encounters and to refine the scale if necessary. The developed scale can be verified again by applying confirmatory factor analysis which will assure the explored dimensions of this research.

While developing the scale for perceived service, experiential aspects such as pleasure of using Internet banking without visiting the bank branch has not been kept within the scope of this study. This was not kept under the purview of this research because these items are customer specific and arbitrary in nature. However this leaves a scope for further study as what the customers actually want psychologically from using Internet banking may influence the perception of the service quality of Internet banking.

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## UNAUTHORISED BUILDING AND FINANCIAL RECOVERY OF URBAN AREAS: EVIDENCES FROM CASERTA AREA \*

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### 1. URBAN ISSUES

*“Even to the most casual observer, it has become apparent how over the last forty years the southern Italian cities have doubled their extension even when the central areas have not increased and the number of their residents has actually decreased” (Talia, 1998, p. 35).*

Unfortunately, the settlement process is often linked to the phenomenon of unauthorised building, which continues to be a major cause of the disorder in the southern Italian cities and especially in our region and province.

In 2010, CRESME (Centro Ricerche Economiche Sociali di Mercato per l'Edilizia e il Territorio) recorded 26.500 unauthorised buildings, 18.000 of them were new. This is one of the highest rates of land consumption in Europe, accounting for 7,3% of the total area – only the Netherlands, Belgium and Luxembourg have been able to do worse, according to ISTAT (Report Legambiente, 15/3/2012). ISPRA (Istituto Superiore per la Protezione e la Ricerca Ambientale) also confirms this alarming situation, stating that between 1995 and 2009, about 4 millions of new houses were built in Italy, an increase over the past 15 years of 12% of the urbanized land and 4,800 hectares of land compromised forever due to building work.

Eventually, the Land Registry identified 1.081.698 urban housing units that have been never declared: about 34% of the cases are residential properties, but also include warehouses, garages, and workshops. “A good part of the million *ghost properties* are presumed to be illegal, in whole or part” (Report Legambiente, 15/3/2012).

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\* Although the work is the result of the joint contribution of the authors, Claudia De Biase has written the paragraphs 1 and 2; Fabiana Forte has written the paragraphs 3 and 4.

Unquestionably, the issue of unauthorised building is complex. There are different degrees of abuse and there have been numerous definitions of the phenomenon over the years. Generally, it is possible to distinguish between low unauthorised building (out of necessity), caused by the individual needs for homes “which is not provided for in time and adequately by plans and programs for the development of the municipalities” (Borri, 1985, p. 13) and high unauthorised building (speculation properly meant) caused by speculative factors, “aimed at contrasting every planning element and collective constraint of land use” (Borri, 1985, p. 13). Ricci (2003) introduced the concept of so-called micro-unauthorised building, which is, according to the author, one of the most common forms in our region. This category includes all those “... subtle changes that result in a distortion of the whole landscape” (*ibidem*, p. 107). Another concept is that of opportune unauthorised building, due to an economy based on illegal activities and “a culture of illegality that has ancient roots and current habits” (*ibidem*, p. 108).

Whatever the case, unauthorised building has a strong influence on urban planning: the saturation of empty spaces, the change of the urban weights of the different areas, the spread of non-urbanized zones, the different distribution of transport infrastructures, the total lack of planning standards, are just some of the consequences of this “phenomenon”.

As noticed by Abbate (2009), at first unauthorised building reveals itself in the South of Italy mainly by the building of accommodation destined for personal uses; in the Seventies, the phenomenon changes and a sort of speculative unauthorised building arises. This has been able to respond to the demand of accommodation that was not satisfied by public offering.

Up to now, unauthorized building strongly characterizes the South of Italy and it is a clear signal of urban development. The urbanization process does not deal only with the development of already existing big cities but it also concerns with new settlement and occupation of empty areas where the amount of unauthorized buildings is considerable (Garano, 1998).

Campania Region is one of the Italian Southern Regions with the highest rate of unauthorized building. In Campania, “in view of how much has been built, in 2011, unauthorised building works represented 13,4% of the total, 25.800 abuses, including units as well as the expansion of existing buildings or new non-residential buildings. From 2003, the year of the last building amnesty, to 2011, more than 258.000 cases of unauthorised building works, relating to new homes and extensions to existing buildings or new non-residential buildings were

realised, with an estimated turnover of €18.3 billion euro as reported by Legambiente” (Il Denaro, 2/11/2012).

One of the provinces with the highest percentage of unauthorized building is Caserta where, as already reported in the notes of the prefect in 1991, “unauthorised building has assumed alarming dimensions and gravity, with it being one of the ways to launder money by the local Mafia organizations and the structures built illegally and not registered being in the hundreds” (Report Legambiente, 18/12/2012, p. 3). In 2009, in the Caserta province, about 15.000 unauthorised buildings were ordered to be demolished, with 10,000 being in the Agro-Aversa area (Demolition office, the prosecutor's office of Santa Maria Capua Vetere). Moreover, in 2011, Legambiente estimated the presence of 41,361 “ghost properties, or parcels of land at risk”, just in our province (Il Denaro, 2/06/2011).

There are interesting data regarding the demolitions: in the city of Caserta from 2000 to 2011, of the 370 demolition orders issued, only 40 or 11% were actually executed. As underlined by Legambiente (2012) “alarming data indicating that the phenomenon continues to thrive throughout the region, devastating the landscape and feeding a chain of illegal cement, which revolve around not indifferent interests. Next to the *black hole* of demolitions, the results of the research show that there is a truly poisoned legacy of the previous building amnesties, represented by hundreds of thousands of outstanding requests, presented under the laws 47/1985, 724/1994 and 326/2003” (Report Legambiente, 18/12/2012, p. 2).

In addition to legal issues, unauthorised building, as previously mentioned, has, above all, a strong territorial impact. According to the Provincial PTCP (Piano Territoriale di Coordinamento Provinciale), approved in April 2012, about 12,000 units were realised without Prg (Urgan General Plan), of which 88% was made prior to the 1985 amnesty (Piano Territoriale di Coordinamento Provinciale of Caserta - Report, pag. 234). The highest concentration of these units is in the conurbation of Caserta, in particular, that of Aversa and along the Domitian coast.<sup>17</sup>

An interesting possibility for the recovery and redevelopment of these areas is LR 16/2004, which reintroduces the so-called “Plan for the recovery of unauthorised building works” (L. 47/85, L. 298/85).

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<sup>17</sup> As highlighted by the PTCP the worst case of unauthorised building works in the province is the town of Casal di Principe. According to the data in the table, it has a percentage of surface abuse of 35.5% of its total territorial expansion.

In fact, in accordance with current regional legislation, since 2004, municipalities in the drawing up of the PUC, are required to cordon off the unauthorised buildings (existing at December 31, 1993) subject of amnesty<sup>18</sup> with the aim of:

1. realising adequate primary and secondary urbanization;
2. respecting the historical, artistic, archaeological, landscape and environmental as well as hydrogeological interests;
3. implementing a rational territorial and urban insertion of the unauthorised works (Art. 23, c. 3, LR 16/2004).

For the realization of these interventions, a new PUA can be expected, i.e. a recovery plan for the unauthorised buildings which, as set out by the law, may be intended solely for already authorised or expected to be authorised buildings (Art. 23, c. 6, LR 16/2004).

With this possibility offered by the regional law, unauthorised areas should, at first, be transformed into residential areas, equipped with the essential primary and secondary urbanization, and subsequently become an integral part of the urban context. The urban sprawl is, in fact, especially in the conurbation of Caserta and Aversa, a result, never programmed, of the constant abuse of the surrounding agricultural land.

As pointed out, the Provincial PTCP, "in the face of a relatively urbanized area, there is a significant impairment of the suburban territory" (Piano territoriale di coordinamento provinciale of Caserta- Report, pag. 185), determined also, and perhaps above all by widespread unauthorized building.

It is therefore evident that the PUA (implementing urban plans) is an attempt to establish rules for urban planning as well as ensure adequate planning standards. Undeniably, for any interventions on the unauthorised buildings to be carried out, the financial resources to be used must be those "arising from donations as well as the concession fees and penalties payable for the issue of certificates of permission in amnesty" (Art. 23, c. 4, LR 16/2004). The choice is due to a logic that "... cannot submit, without good reason, to those who have committed abuses to bear the brunt of the illegal conduct of others, as the recovery needs of the urban fabric must still be reconciled with the legitimate interests of all citizens" (T.A.R. Lazio Roma, sez. I, 05/04/2004, n. 3135).

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<sup>18</sup> Under the Law of 28 February 1985, n. 47, Chapters IV and V, and in accordance with the law of 23 December 1994, n. 724, Article 39.

## **2. UNAUTHORIZED BUILDING IN CASAL DI PRINCIPE: A URBAN ANALYSIS METHOD**

In the province of Caserta, Casal di Principe, which is already famous because of organized crime, is one of the municipalities with the highest amount of unauthorised buildings (only the 30% of the total has obtained the building sanction). The municipality is placed at South West in the province of Caserta; it covers a surface of 23,26 Km<sup>2</sup>; the citizens are 19.336; and it is inside the district of Aversa. The municipality of Casal di Principe, however, shows a peculiarity: the main urban core of buildings starts from the built up area of Aversa and develops itself towards west and so toward the coast.

As already said, Casal di Principe is a municipality with a high rate of unauthorised buildings characterized by low levels of construction density and physical quality, by small parcels enclosed by cement paddocks or walls, by the fact that just one, two or three families live there, by the fact that the building are no taller that three floors, and by the presence of adjacent lots.

At the same time, Casal di Principe is also characterized by a strong deficiency of standard areas: the amount of planned public equipments should be 44,4 hectares while the amount of existing public equipments is 6,1 hectares.

The high presence of unauthorised building and the low presence of public equipments are the main features of this municipality.

The unauthorized buildings in Casal di Principe are concentrated in a specific area the “Area Agricola Semplice (E2)” of PRG. This area comprehends more than 60% of the total municipal area and it is destined to an agricultural use. In order to determine the percentage of unauthorized buildings we use a method based on:

1. the overlapping of the actual map of Casal di Principe (available on google maps) on the map of PRG zoning;
2. the localization of buildings that are unauthorized, or that got a building sanction or that are under preliminary investigation by Laws 47/85, 724/94 e 10/04(326/03);
3. the localization of building seized to racketeers;
4. the localization of ghost buildings.

**Figure 1:**The illegal buildings in Casal di Principe

In 2009, 789 are the unauthorized buildings (which represents the 11,94% of the total). The highest concentration is in the West area, towards Villa Literno. In Casal di Principe, 553 buildings have been authorized by three national laws - 47/85, 724/94 e 10/04 (326/03) – and so the 9,51% is regular.

**Table 1:** Buildings that got a sanction and that are under preliminary investigation in 2009

2009		
Laws	Number of buildings that got a building sanction	Number of building that are under preliminary investigation
L. 47/85	233	151
L. 724/94	272	119
L. 10/04	48	18

Source: Personal elaboration by de Biase C. and D'Aponte D.

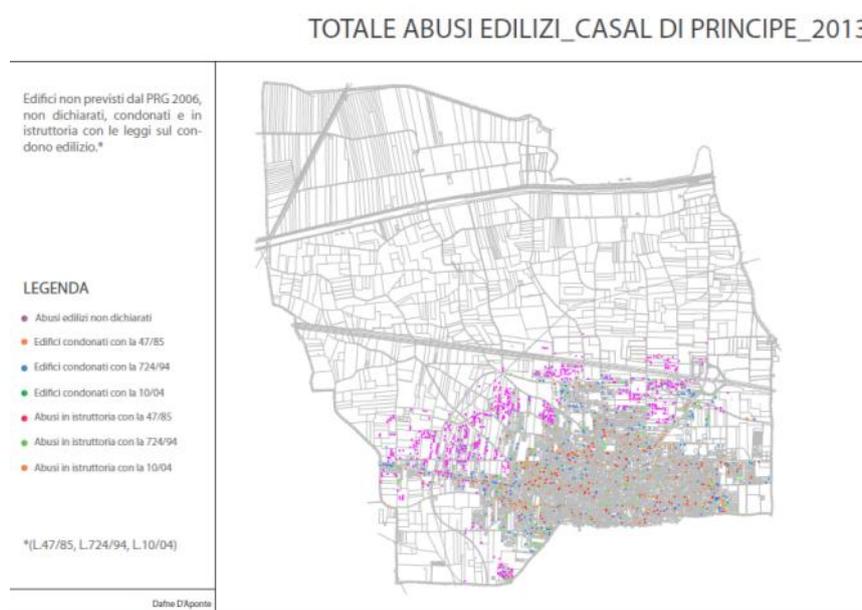
In 2013 the situation radically changes. The unauthorized process of building increases of 562 in just three years. In the end, the unauthorized buildings are 1.351 and they represent the 18,85% of the total. By adding 45 buildings that got a sanction, the percentage is 10,28%.

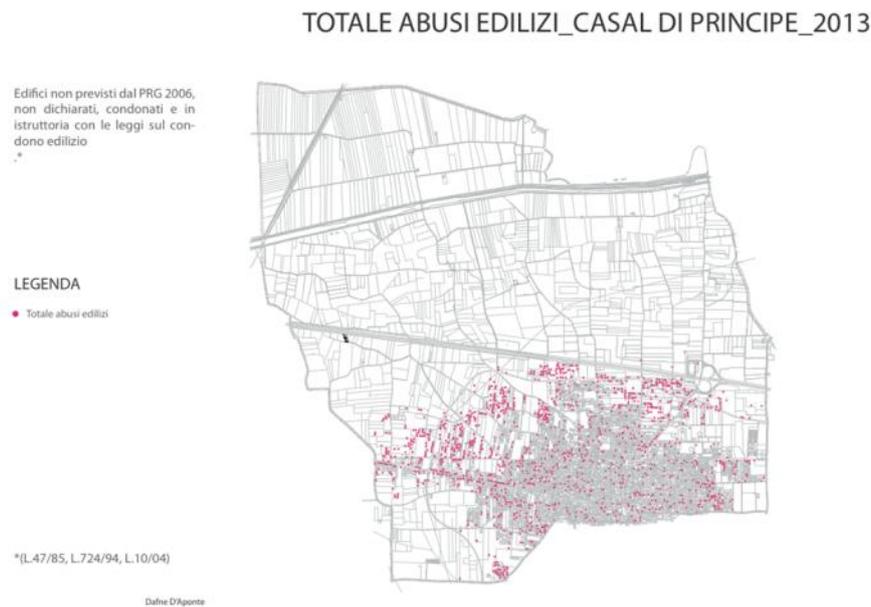
**Table 2:** Buildings that got a sanction and that are under preliminary investigation in 2013

2013		
Laws	Number of buildings that got a building sanction	Number of building that are under preliminary investigation
L. 47/85	260	124
L. 724/94	283	108
L. 10/04	55	11

Source: Personal elaboration by de Biase C. and D'Aponte D.

**Figure 2.:** The unauthorized buildings in Casal di Principe (2013)





**Figure 3:** The unauthorized buildings in Casal di Principe and the buildings that got a building sanction (2013)

The study proceeds by underlining the number of abuses per each *Zona Omogenea* del PRG. As a result, there is a high density of buildings without planning permission in the following areas: rural, destined to manufacturing settlements, destined to commercial aims, and of public interest.

**Table 3:** Number of unauthorized buildings

Number of unauthorized buildings	<i>Zona Omogenea</i> del PRG
8	B2, B4, B7 - Urbane di completamento interne
1	B3-Urbane di completamento esterne
7	D1-Produttive artigianali isolate esistenti
56	D2-Produttiva artigianale e commerciale
456	E1-Agricola di salvaguardia urbana
41	E2-Agricola semplice
4	F2 – Attrezzature pubbliche di interesse generale
22	G – Commerciale e di servizi
3	Attrezzature di interesse comune

Source: Personal elaboration by de Biase C. and D'Aponte D.

In the end, it is possible to affirm that 6,4% of existing building in the municipality of Casal di Principe are unauthorized. This rate grows up by 142 buildings at year that means it increase of a percentage of 19% each four years.

In order to provide a complete frame, it is very interesting to deal with the 81 buildings seized to racketeers (64 are buildings, 17 are firms). Thanks to the Cosenostre geo-blog ([www.cosenostre.org](http://www.cosenostre.org)) and to tables by Agrorinasce ([www.agrorinasce.org](http://www.agrorinasce.org); Centro Studi Fondazione Polis, Area Beni Confiscati, *I beni confiscati in Campania*, 2012) it was possible to localize only 29 seized buildings.

The seized buildings are different from the other ones. They have represented the power of racketeers. Their new use by public Institutions and society represents the lost of racketeers' power in their own area. This is a change that the racketeers do not accept so easily. However, the new use of seized buildings shows how legal society grows and develops itself in non-legal areas ([www.cosenostre.org](http://www.cosenostre.org)).

The last topic on which it is worth focusing deals with ghost buildings (Commi 8, 9 e 10 dell'articolo 19 del decreto-legge 31 maggio 2010 n. 78 convertito, con modificazioni, nella Legge 29 luglio 2010, n. 122), i.e. the buildings that have never been declared as existing. The ghost buildings are concentrated in the west part of the municipality, for which a specific recovery plan has been thought<sup>19</sup>. Out of 129 buildings, 33 have been built without authorization and they have not been declared and 1 is under preliminary investigation (Law. 47/85).

As for the ghost lots, institutions can act in different ways according to the *status quo* of each lot. If there are regular buildings in ghost lots, institutions must verify the regularity of the building according to the laws referred to the year of foundation and to the ones in force now. If the result is positive, the owner can have the amnesty authorization (*sanatoria*) and then the building is regular. If the result is negative, the building must be demolished.

If there are buildings waiting for regularization in ghost lots, the owners must wait for preliminary investigation. If the result is positive the building becomes regular; if the result is negative, the building must be demolished.

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<sup>19</sup> The recovery plan has been proposed by D'Aponte D. in her graduate thesis in Urban Planning under the supervision of Assistant Professor de Biase C., Faculty of Architecture, SUN.

In conclusion, Casal di Principe is a municipality with several criticalities that are linked to the non-respect of in force laws. Only through a recovery plan will be able to restore the rules and to make Casal di Principe a liveable municipality.

### 3. UNAUTHORIZED BUILDING, LOCAL FINANCE AND APPRAISAL ISSUES

According to the Italian legal system, Local Administrations (or Municipalities) - on the basis of territorial government rules – concern with planning and building matters and, above all, they have the faculty to transform urban areas. The right or permit to build is given under the payment of a correspondence public right, a concession fee or “*contributo di costruzione*”. This fee, corresponded to the Municipality, is inserted into the Municipal Budget, the tool that sets out the local government’s plan for revenue and expenditure for an annual or multi-year period. In last years “the importance of budgets has grown significantly as cities face increasingly difficult expenditure and revenue decisions in an environment of increased demands of services and infrastructure” (UN-HABITAT, 2009).

In the Municipal Budget, revenues are classified with “titles” (six titles) and “category”; the Title IV “Disposal of fixed assets, capital transfers from other governments and private entities” contain “concession fees and sanctions” (*permessi di costruire e relative sanzioni*) and in this title converge the monetary sanctions derived from the violation of the planning and building rules.

The sanctions are established on the basis of Presidential Decree No. 380/01, so called *Testo Unico dell’Edilizia*, that provides for building activities regulations. Particularly, three forms of sanctions are foreseen: 1) demolition; 2) pecuniary sanction; 3) free acquisition to the municipal assets. For the most relevant works (as new construction or building renovation) without permit, the penal sanction establishes the demolition; for less relevant works, there are pecuniary sanctions, which can vary from 516 euro up to the double of the increase of the building value resulting with the realization of the illegal works

The Decree No. 380/01 also establishes that if the interventions are realized without building permit or in a different way or in absence of statement of the start of works (*DIA - Denuncia Inizio Attività*) or differently from it, the responsible of illegal works or the actual owner of the building can obtain the permit “in sanatoria” or the retrospective building permit. This can happen if the intervention are in compliance with the planning and buildings rules in force

both at the time of the realization of the building and at the time of demand presentation. However, in order to get the “sanatoria” it must be paid an amount equal to the double of contribution of construction.

In this perspective, and considering the unauthorized building phenomenon (in Italy this phenomenon is very old and vast that three building amnesties, the last in 2003, could not solve the problem) the opportunity of financial recovery that could result from “oblations”, along with the concession fees and sanctions provided by law 16/2004, should not be underestimated (as has happened up until now), especially in light of the disastrous effects of the current economic recession on the budgets of local authorities, which are forced to deal with increasingly limited resources and an increasingly challenging internal stability pact.

In particular, in the regularization of unauthorized building, the Law of the Campania Region n. 10/2004<sup>20</sup> article 6 (size of the offering and concession fees, paragraph 3 and 4) already provides that the concession fees relating to unauthorised works under amnesty or “sanatoria” were increased by one hundred per cent of the amount established by current regulations and that the proceeds from this increase were primarily used by municipalities to meet the expenses necessary for the demolition of unauthorized buildings in their territories, as well as the implementation of measures for the redevelopment of unauthorised buildings.

With the Recovery Plan of Unauthorised Buildings, established by LUR 16/2004, the regularization process of unauthorized buildings takes a view of the whole and no longer a “case by case” perspective, facing the question in overall terms, or the urban and environmental redevelopment of entire urban areas<sup>21</sup> and, especially, “suburban”, that in the province of Caserta, have developed everywhere, without any planning rule, in the total absence of urbanization and public services, frequently promoted by the expansion of the municipalities in peripheral areas for agricultural use. This last phenomenon recalls the serious question of the “consumption of territory” that nowadays is very relevant not only in Campania Region (Campos Venuti, 2013).

In order to implement the plan, “sanctions” play an important role, becoming a significant item of revenue and capital expenditure (or investment). In this context, analysis of the latest municipal budgets (as in the case of Casal di Principe) could help highlight both the

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<sup>20</sup> RL 10/2004 “Rules for the regularization of unauthorized building pursuant to Legislative Decree 269/2003, as amended by art.32 conversion law 326/2003 and subsequent amendments and additions”.

<sup>21</sup> Report of the Town Plan the Council of Sorrento prepared by the Head of Department IV of the City of Sorrento, Eng. G. Imperato under the guidance of Prof. Arch G. Riano (PUC approved by Executive Decree n. 502 of 18/07/2011).

effectiveness of this tool (if used) as well as the financial management capacity of local authorities (De Mare *et al.*, 2010).

The revenues from the issuing of “building permits” introduced by Presidential Decree no. 380/2001 (the former building permit introduced by Law 10/77) are restricted funds in the budget of the local authority (Forte F. 2007), to be used for the construction of primary and secondary urbanization works as well as the maintenance of the assets (subject to the provisions of the recent decree “Milleproroghe” which involves the use of the revenues for current expenses).

In addition to the revenues from unauthorised building works, law n. 662/96 introduced concession fees for the regularization of unauthorised buildings (Article 2, paragraph 48), registered in Title IV of the Revenues and intended: for the cost of investigating claims of right to rectify the situation; to anticipate the demolition cost of the works referred to in Articles 33 and 32 of Law no. 47/85; for the demolition of works that are not subject to the amnesty; interventions for urban and environment redevelopment; for the creation of primary and secondary urbanization works.

Assuming that the city “costs” and the resources available for the realisation of community facilities and services are scarce, if not minimal, as in the current economic situation, in the face of a growing problem which is that of unauthorised building “which has always distributed a wild urban revenue” (Tocci W., 2009) it is no longer possible to continue to ignore policy instruments that, in numerous municipalities in the province of Caserta (the data above highlights only part of the problem), may allow for the recovery of “liveability” for the community that is widely impaired .

In terms of unauthorised building and financial recovery, it is worth highlighting the effectiveness for tax purposes of the census of so-called “ghost” buildings started some time ago by the Land Registry (starting with DL 266/2006), i.e. a series of buildings never declared to the Land Registry, many of them illegal (houses, garages, basements, etc.), resulting in lost revenue for the State and municipality. According to the data of the Land Registry in Campania, there are about 295mila ghost properties, with the province of Salerno (105,228 properties) ranking first, followed by Naples (59,859), Avellino (55,161), Caserta (41,361) (see the case of Casal di Principe Municipality) and Benevento (33.86).

Finally, it is also worth taking into account the crime of unauthorised building in protected areas with landscape and environmental constraints (consider what has happened to the

UNESCO sites of the Royal Palace of Caserta, San Leucio and Carolino Aqueduct, that is one of the 23 Italian sites risking to lose the UNESCO brand for unauthorized building and degradation, Legambiente, 2011), in which the damages, in its various forms, are of particular interest from an appraisals (Manganelli, 2009).

The Italian Code of the Cultural and Landscape Heritage (art.167, Legislative Decree n. 42/2004) ascertains that, in case of violation of the obligations and orders, the transgressor shall be obliged to restore the cultural property to its original state at his own expense or “pay a sum equivalent to the greater amount between the damage caused or the profit derived through the transgression”. The sum is determined by the Municipality on the basis of an official assessment and shall be utilised for safeguarding purposes, works for reclamation of landscape values and the upgrading of deteriorated areas.

The sanction for the indemnity is assessed through a purely financial criterion. Several are the procedures used by municipalities in order to determine the value of illegal work: some of them are referred to cadastral value (established by *Agenzia delle Entrate* for property tax); others are based on the difference between the value of illegal works and the cost sustained for its realization; eventually, other procedures adopt criteria of pre-existent and old norms etc. The limit of these assessment procedures is the exclusion of the immaterial or intangible values that characterizes environmental and historical heritage. From an appraisal point of view, a more integrated approach for the evaluation of environmental damage occurs, in the perspective of the “total economic value” (De Francesco et al., 2012) or the “complex social value” (Fusco Girard, Nijkamp 1997).

#### **4. UNAUTHORIZED BUILDING IN CASAL DI PRINCIPE: LOCAL FINANCE AND APPRAISAL ISSUE**

With specific reference to the local finance in the Casal di Principe Municipality, it is interesting to analyze the Municipal Budget in the last years. It is composed by two main financial documents: the preliminary budget (*bilancio di previsione*) and the final budget (*conto consuntivo*). In the Title 4.05 “concession fees and sanctions” the two voices are indicated separately: the revenues deriving from this title in the last five years demonstrate a significant decrease, especially in the last year (see tab 1). In 2008 and 2009, the years with the most relevant revenues, the main amount comes from concession fees, not more restricted in the

investment expenditure for public facilities and urban recovery, but usable also for the current one.

Both revenues represent an important resource for the Municipality that, in 2011, felt in financial imbalance (as many others in Caserta Province). For the concession fees the Local Authority recently has also provided to the adjustment and updating of the fees with Municipal Resolution n.5/2013 that, highlighting the gap between the real costs of public facilities (very increased in the last years) and the charges, establish the updating of parametric schedules for primary and secondary urbanizations and for the construction costs. However, as for the sanctions, it is urgent and necessary to proceed in the examination of the demands for building sanction that are yet unsold. This kind of revenues, in a municipality characterized by a high concentration of unauthorized buildings and a scarce equipment of public facilities and services, could represent a significant opportunity to collect resources in the pursuit of “efficacy” and “efficiency” principles in the urban and territorial management.

**Table 4:** Casal di Principe Municipal Budget: revenues from “contribution and sanctions” from 2007 to 2012

Title IV. Category 4.05.1050 <b>Contribution and sanctions</b>	2012	2011	2010	2009	2008	2007
preliminary budget	€ 366.000,00	€ 1.000.000,00	€ 1.100.000,00	€ 1.350.000,00	€ 475.000,00	€ 475.000,00
final budget	€ 203.142,35	€ 338.143,29	€ 722.209,82	€ 911.762,35	€ 1.386.780,72	€ 583.870,08

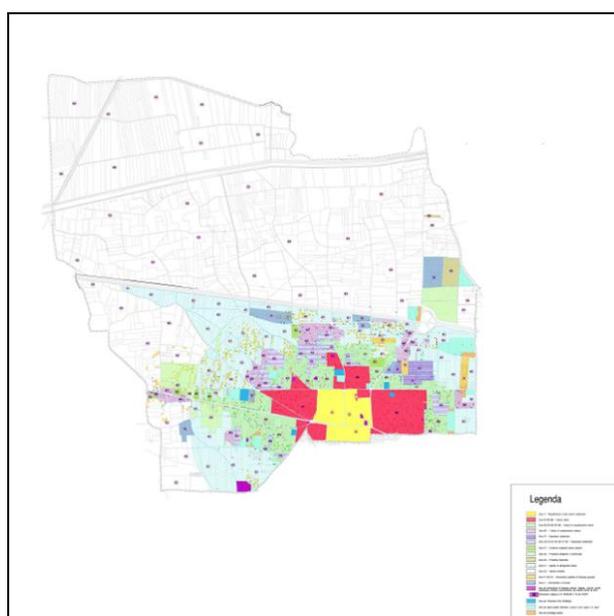
*Source: personal elaboration on the basis of Municipal Budget data*

Analyzing the Casal di Principe Municipality also in terms of market value of residential buildings, using the database for real estate market prices run by the Agenzia del Territorio (Land Registry), through OMI (*Osservatorio Mercato Immobiliare*, Real Estate Observatory), its possible develop some considerations. OMI database divides the national territory into homogeneous market level portions on the basis of shared characteristics (such as urban planning, social and economic aspects, provision of services, etc). Each municipality is divided into one or more areas (so called “OMI zones”) that are homogeneous in terms of price levels. For each zone a minimum and a maximum value are provided according to the type of use (residential, commercial, tertiary, industrial). With reference to maximum market values (generally the values from OMI are underestimated) for residential building in Casal di Principe, over the period 2012-2002, it is possible to deduce a trend that is not particularly dynamic and a modest market appreciation. The difference between central (B1, B2, B3, B4), semi central (C1, C2) and peripheral areas (D1) is very law. In this last area, indicated in the Master Plan as homogeneous zone D2 - productive, artisanal and commercial zone - several

unauthorized buildings are localized. The scarce transparency of the urban real estate market does not allow to distinguish among a market of legal products and a “submarket of illegal products”, object of sanctions and, indeed, of appraisal (Forte C., 1970).

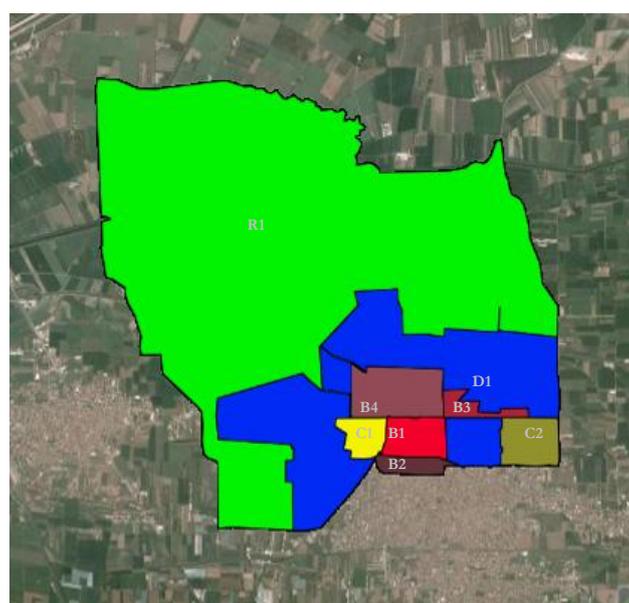
Also in the zone indicated in the Master Plan as Zone E (agricultural of urban safeguard) and by OMI as zone R: Rural (devoid in real estate assessment) – there is a high presence of unauthorized buildings that constitute a particular form of real estate submarket.

**Figure 4.** Master Plan Casal di Principe, 2006



(source: Local Administration)

**Figure 5.** Omi Micro Zones



(source: Agenzia del Territorio)

**Table 5:** Casal di Principe, micro zones and residential building market values trend (OMI)

Casal di Principe OMI zones	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002
B1 NUCLEO STORICO C.SO UMBERTO C.SO ITALIA-VIA VATICALE	€ 1.050	€ 900	€ 950	€ 950	€ 800	€ 600	€ 600	€ 430	€ 430	€ 410	€ 410
B2 NUCLEO STORICO-CORSO UMBERTO E TRAV.	€ 1.050	€ 860	€ 900	€ 900	€ 800	€ 800	€ 800	€ 600	€ 600	€ 570	€ 570
B3 CVIA VATICALE-VIA CONTE DI CAVOUR-VIA VATICALE	€ 1.050	€ 760	€ 800	€ 800	€ 800	€ 800	€ 800	€ 600	€ 600	€ 570	€ 570
B4 VIA DELLA PACE-VIA CARAVAGGIO-VIA PADOVA-VIA MARSALA	€ 1.050	€ 950	€ 1.000	€ 1.000	€ 800	€ 600	€ 600	€ 430	€ 430	€ 410	€ 410
C1 C.SO UMBERTO E TRAV.VIA PARROCO GAGLIARDI ....	€ 1.200	€ 760	€ 800	€ 800	€ 800	€ 800	€ 800	€ 820	€ 600	€ 570	€ 570
C2 CONFINE CON VILLA DI B.PROLUNG VIA CAVOUR-	€ 960	€ 760	€ 800	€ 800	€ 800	€ 800	€ 800	€ 600	€ 600	€ 520	€ 520
D1 VIA CIRCUMVALLAZIONE PROVINCIALE PER VILLA LITERNO	€ 900	€ 760	€ 800	€ 800	€ 800	€ 800	€ 800	€ 550	€ 550	€ 670	€ 670

Source: Agenzia del Territorio

In sum, the unauthorized buildings phenomena in the Casal di Principe and in the overall Caserta Province results very serious. All the actions to contrast it, both at the urban planning and at local finance level, are possible only with a rigorous census and updating activities, nowadays ever more supported by GIS (Mattia et al., 2013).

Since 2010, in the monitoring direction for the fight to illegal interventions, the Campania Region operates with the on-line data bank CON.AB.ED (Contrasto Abusivismo Edilizio) and the Mistrals Project in collaboration with the satellite-monitoring center MARSec (Mediterranean Agency for remote Sensing and Environmental Control).

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## ENTREPRENEURSHIP, VENTURE CAPITAL, AND THE VALUATION OF FIRMS IN MATURITY STAGE

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### ABSTRACT

We analysed the performance of mature Portuguese firms that have been (partially) held by Venture Capital funds in the post investment phase, precisely four years after an exit occurred, to verify if the valuation of firms in maturity increased or decreased. Using a sample of 38 firms, aging more than 15 years, sold out by Venture Capital funds between 1995 and 2004, we evaluated the performance of these Firms through performance and sustainability indicators. We found evidence of growth in Sales, in Exports, in Book Value, in Headcount and a good coverage of ISO standards implementation. The valuation of the majority of firms increased using relative evaluation measures such as Sales Price Value and Book Value.

**Keywords:** Entrepreneurship; Venture Capital; Divestiture; Maturity.

### INTRODUCTION

In this paper, we investigate the impact of Venture Capital as adding value partner to Portuguese firms in maturity stage, especially in traditional business activities, and test if whether or not this is an enduring impact, assessed by valuation increase of these firms after four years of an exit.

We chose this type of firms – companies in maturity – for two main reasons: (i) in Portugal, and in the time-frame 1995-2004, mature firms from traditional business activities tended to use Venture Capital to achieve growth and go international; (ii) there is a lack of research relating venture capital with this stage in the lifecycle of companies, however there is a variety of works revealing the positive impact of Venture Capital in entrepreneurship through firm performance in early stages of development.

To complement our analysis, we developed two surveys. Survey I was applied to managers of Venture Capital companies, managing one or more funds (VCs) to assess their perception on the result of the activities carried out with portfolio companies during the investment period. Response rate for survey I was expressive (66.7%). Survey II was sent to portfolio companies' managers but the rate of response was not representative and the data thus collected was not used to test variables.

## **THEORETICAL BACKGROUND**

Gorman and Sahlman (1989), is a seminal work in the study of the (positive) effects of VCs on their portfolio companies. It sustains that VC managers supply effective support to their portfolio companies in the following areas, by order of importance: additional fund raising, review and support on strategy formulation, management team's recruiting and training, operational planning, and establishing contact with potential customers, suppliers and money lenders. According to Timmons and Bygrave (1986), VC networks comprehend both current and past portfolio companies, investors and other VCs. Rosenstein (1988), highlights the benefits of VC experience and its network resources to portfolio companies.

Busenitz et al. (2004), concluded that Venture Capital provides a feedback of constructive strategy in the decision-making process, leading to portfolio companies' better performance.

### *Factors influencing performance*

Previous literature has tested different factors contributing to assess a positive impact of VCs on their portfolio companies. Cornelius (2005), investigated *top management quality* in VCs and observed changes in the north-American industry over the 15 years prior to the study. He concluded that present VC managers come mostly from the financial industry and hold MBA or equivalent degrees. These managers are more risk-averse than their predecessors and manage a growing number of portfolio companies given the increase in the average size of investment vehicles. White *et al.* (2007), took the portfolio companies' manager to support the association between a certain type of leadership for different growing phases of the company allowing them to rise up alert signs by phase of development. Sapienza and Korsgaard (1996), concluded that VC investors have a high level of *Confidence* and commitment towards entrepreneurs. Duffner *et al.* (2009), found out a significant and reciprocal relation between trust and success. Bottazzi *et al.* (2008), by analyzing the determinants and consequences of

VCs investors' pro-activity concluded that *VCs' managers with previous experience* in the business are more active in recruiting managers and directors, helping in fund raising and interacting with portfolio companies. *VCs' Network of contacts* made available to portfolio companies is of utmost importance in company's development, not only for purposes of capital return but also for purposes of management. For Shepherd and Zacharakis (2001a), Venture Capital is like an information tag about the capabilities of entrepreneurs' management team and evidence of trust in past relations with investors. Mäkelä and Maula (2006), suggested that international VCs have a positive impact in *Internationalization Strategy* which could be valuable to the company in terms of new venture's legitimacy in an unknown market. Maula *et al.* (2005), added that VCs are important to help portfolio companies getting new foreigner customers. Hsu (2004), concluded that entrepreneurs are prepared to accept a discount on their start-up's valuation if it makes possible to get VC investment with better *Reputation*. Gorman and Sahlman (1989), studied the variable *Communication* as an influencing factor in portfolio companies' performance and concluded that most managers spend more than half of their time monitoring their portfolio companies and the balance to decide on new investments and administration. Jääskeläinen *et al.* (2006), took a different approach on the attention given to portfolio companies relative to VC performance thus establishing a relation between investor's activities and VC performance. Hellmann and Puri (2002), approached the *Professional management models* and concluded that VCs are responsible for portfolio companies' upgrade in terms of management capabilities, at the level of Human Resources, Marketing and possibly General Management mainly through the appointment of a new CEO. It was also concluded that VC officers play a much wider role than the traditional function of financial intermediation. Sahlman (1990), considers that *Funding duration* is an influencing factor for portfolio companies' success because VC investments are typically long term's. Further, Gompers (1994) refers that a large number of projects take decades to return benefits and if funding suppliers don't have the same length orientation potential portfolio companies loose access to money. Niosi (2003), studied the *Exit option* and concluded that VCs look forward to close IPOs for their portfolio companies which is the best case scenario for both VC and portfolio companies in terms of valuation. Venture Capital is recognized to have an impact on portfolio companies' strategy of *Investment in Innovation and Technology* working as an influential factor on value added. In the US there is strong evidence that VCs' portfolio companies produce evermore valuable patents (Kortum and Lerner, 2000), innovating more frequently and achieve a higher professional level earlier (Hellmann and Puri, 2000; 2002) than non VC backed companies. Hellmann and Puri (2002) studied the

*Expertise, Strategy, and Marketing* supplied by VCs by measuring the time to market of portfolio companies and concluded that Venture Capital has a strong association with products successfully reaching the market. Venture Capital actually increases this probability in 79%. This proves that VCs play a fundamental role in portfolio companies' marketing performance. Our survey shows that VCs' managers believe the most important portfolio companies' post-exit performance factors to be, by order of importance: Top management quality; Confidence; Experience; VC contact network; Internationalization strategy; Governance model; VC reputation; Communication; Management model; Contract duration; Exit option; Innovation investment; Technology investment; Marketing and Strategy support; Influential level; Shareholding percentage.

### ***Relative or comparative valuation***

Damodaran (2012), sustains that despite the importance and discussion around the discounted cash flow method, or net present value, reality shows that most asset valuations are made by the relative valuation method, i.e, asset pricing is made based on the market transactional price for similar assets. Therefore, we used two of the more used multiples in relative or comparative valuation: *Price Book Value* and *Price Sales Ratio*.

*Price Book Value* (PBV) reflects the relation between company price and accounting valuation. According to Damodaran (2012), there are advantages in using these multiple-based methods because it is a relatively stable and intuitive measure of value that could be compared with market price and get a reasonable consistency from accounting standards allowing for comparison between similar companies, looking to abnormal valuations or undervaluation, and making valuation of companies with negative profitability.

According to Damodaran (2012), multiple revenue method or *Price Sales Ratio* (PSR) has received increasing attention from financial analysts resulting from its advantage over other ratios: Revenue figure is easy to attain even for companies with negative profitability and it is not significantly affected by accounting policies like depreciation, inventory, and extraordinary events. PSR is an interesting tool to examine the consequences of pricing policy changes and other corporate strategic decisions and also it makes much easier to compare companies from different markets and different accounting standards.

### Sustained performance

The idea that increasing shareholders' value is the main purpose of a company has been increasingly criticized since corporate social responsibility and the best interests of tax payers became a major societal concern. Focusing on shareholders' value does not only help decision making for social issues such as employment and business ethics but also it could destroy companies' long term value thus diminishing shareholders' value. Edward Freeman's (1984) stakeholder theory is at the center of this debate trying to balance the best interests of all stakeholders. However, it acknowledges that companies must remain competitive, combining good financial performance with employee and customer satisfaction, with usefulness to society, and with solid ethical principles is an accomplished company. Companies today understand the importance of taking into account stakeholders' interests: suppliers, employees, community, customers, consumers, society, and environment. According to Waddock and Graves (1997), corporate social irresponsibility leads to negative financial consequences. According to Epstein and Roy (2001), there is a growing number of top managers acknowledging the relevance of formulating a strategy of corporate social responsibility. Nevertheless they believe is very difficult to put it into action. These authors mention structures like the Balanced Scorecard, ISO 14001, and environmental management systems (EMS) as patterns of such a strategy. Hillman and Keim (2001), studied the relation between social performance and financial performance to conclude that social performance depends positively on a financial performance consistent with a perspective of scarce resources and that financial performance depends on social performance, in harmony with stakeholders' efficient management theory. Marom (2006), believes that the complexity of the field and the existence of contradictory results call for a unified theory of the relation between social performance and financial performance. This author promptly rejects any pretension of finding a universal relation between these two types of performance. Nelling and Webb (2009), mentioned several surveys of statistical significance and non-significance between the two variables to sustain neutrality in the relation. Either way, these authors reject the hypothesis of social responsibility being a competitive disadvantage, meaning that it doesn't make any sense stating that social programs diminish financial performance, negatively affecting shareholders.

### *Hypothesis*

Hypothesis 1: The valuation of firms in maturity stage that have been sold out by VCs is higher 4 years after the exit than it was in the exit moment.

Hypothesis 2: *Contract Duration* and *Shareholding Percentage* have a positive impact on the valuation increase brought by VCs to portfolio companies.

### **Data and Measures**

In order to assess portfolio companies' sustained performance, we used financial performance ratios that were identified both in literature and in VCs' practical use.

#### *Dependent variables*

##### Market performance:

- Sales Growth (SG) and External Markets Sales Evolution (EMSE).

##### Financial Performance:

- EBITDA Evolution (EBITDAE), Cash Flow Evolution (CFE), and Book Value Evolution (BVE).

##### Sustainability:

- Headcount Evolution (HCE) and Number of Quality Certifications (NQC).

Variable assessment was made through growth percentages between fourth and fifth year after an exit occurred. Whenever companies were sold out between 1995 and 2000, we used growth percentage from 2005 to 2006. To assess External Markets Sales Evolution we used data from 2006 and 2007, for portfolio companies sold out until 2001 (more than four years after the exit). To assess Headcount Evolution we used data from 2006 and 2007 because we could not find it from 2005 whenever portfolio companies were sold out until 2001 (more than four years after the exit). Whenever portfolio companies were sold out in 2002 and 2004 we used data from the fourth and fifth year after an exit occurred. The choice of headcount figure as indicator of sustainability allowed us to assess employment level evolution in portfolio companies.

#### *Independent variables*

Based on literature review and VCs practical experience, we selected the following independent variables:

- Investment Contract Duration (ICD);
- Shareholding Percentage (SP).

To test the hypothesis we used regression analysis with 2 independent variables and 7 dependent variables.

### **Research method**

We defined two different populations, one of them composed by VCs and the other composed by portfolio companies from 1995 to 2004, sold out until 2009. These firms were in maturity stage when they became part of a VC investment portfolio.

VC population was composed of 28 officially registered companies in Portugal.

Portfolio companies' population was defined as the firms that were totally or partially held by a VC and were in maturity stage (more than 15 years old) when they signed up an investment agreement. We did not control this population for investment contract duration or VC shareholding percentage.

### **Data collection**

VCs:

Out of the 28 VCs, 19 were managing 51 venture capital funds and 9 did not have any registered fund. We excluded 4 VCs because they did not have any registered funds nor reported their headcount and investment portfolio. Therefore population was reduced to 24 VCs. Response rate to survey I was relevant, 16 answers or 66.7% of the adjusted population. These 16 companies managed 42 funds or 82.4% of all funds and had a market share of 73% in 2009.

Portfolio companies – 1995-2004:

In December 2004, at the end of the relevant 10 year period, 18 VCs had 100% of the money under VC management (678 million Euros). Therefore we got information from portfolio companies representing 80.0% of all firms that, from 1995 to 2004, had been subject of acquisition and exit operations. Portfolio companies' database from the period 1995 to 2004 contains 407 companies. We excluded companies displaying no activity when this research

was conducted which means a mortality rate of 30.7%, in line with other studies about this industry like Sahlman (1990). We also excluded foreign companies and merged companies.

Table 1 displays company aging, when the investment occurred:

Age (years)	Nº of companies
≤1	90
> 1 x ≤ 5	34
>5 x ≤10	48
>10 x ≤ 15	23
>15	60
TOTAL	255

*Table 1 – Company aging*

We then launched survey II to managers of these 255 portfolio companies. Out of the population of these 60 companies aging more than 15 years at the investment date, we excluded 10 firms that were still portfolio companies when the research was conducted and 8 that were sold out after 2004. Out of the 42 remaining firms, we could only access financial reports of the full period studied for 38 firms.

Populations and samples:

VCs – We used a sample of 16 firms that agreed to be surveyed representing 66.7% of the population. These companies had a market share of 61.5% in 2009.

Portfolio companies – We used a sample of 38 firms aging at least 15 years at the date of the investment agreement, out of a population of 60 firms.

Statistical procedures, tests and results

For VC sample we used frequency analysis, average calculation, mode, maximum and minimum analysis. We estimated the reliability of survey I through Cronbach's Alpha. Regarding portfolio companies, we used frequency analysis, average calculation, modes and medians. Relation between dependent variables was verified through correlation models. To estimate independent variables predictability we used linear multiple regression.

Cronbach's Alpha - To assure internal consistency of scales and subscales of Survey I, we used the indicator Cronbach's Alpha. All tests indicated a good or greater than good result. VCs' management answers related with VC functions, with nine subscales, proved greater value than 0.82; Factors added value, testing sixteen subscales, proved to be greater value than 0.94 and Portfolio performance, testing sixteen subscales, proved greater value than 0.97.

Correlation tests between the concepts of Performance and Sustainability - Conducted tests of correlation between the dependent variables, in three cases, returned correlation with statistical significance: A strong positive correlation ( $r = 0.529$ ,  $p > 0.01$ ) between the constructs EBITDA Evolution and Cash Flows Evolution. A moderate positive correlation ( $r = 0.333$ ,  $p > 0.05$ ) between Sales Growth and External Markets Sales Evolution. A strong negative correlation ( $r = -0.775$ ,  $p > 0.01$ ) between Book Value Evolution and External Markets Sales Evolution. The overall analysis did not show any correlations between the remaining variables. The strong positive correlation observed between the tests EBITDA Evolution and Cash Flows Evolution seems appropriate - since they are based on company results. Also, a moderate positive correlation between Sales Growth and External Markets Sales Evolution is normal with the External Markets Sales Evolution with higher percentage.

Regression Results - We used linear regression to estimate the influence of independent variables "Duration on Contract" and "Shareholding Percentage" on the variables Sales Growth (DV1), External Markets Sales Evolution (DV2), Cash Flow Evolution (DV3), EBITDA Evolution (DV4), Book Value Evolution (DV5), Headcount Evolution (DV6) and Number of Quality Certifications (DV7). Results are presented for significance tests Distribution of Student (or t test) and Lavene (or F test), with no statistically significant value for sig when  $t \geq 0.05$  for a  $p < 0.05$ .

Significance of t:

Independent Variables	DV1	DV2	DV3	DV4	DV5	DV6	DV7
Contract duration	0.523	0.243	0.451	0.112	0.051	0.331	0.729
Shareholding Percentage	0.511	0.875	0.204	0.946	0.453	0.344	0.322

The result which lies closer to the value with statistical significance is the ratio of the dependent variable "Book Value Evolution" DV5 with the independent variable "Duration of the contract" with a significant value of  $t = 0.051$ .

Significance of F:

DV1	DV2	DV3	DV4	DV5	DV6	DV7
0.694	0.501	0.281	0.273	0.086	0.337	0.597

## ANALYSIS AND RESULTS

VCs:

Firms and human capital - the 28 officially registered VCs have a total of 188 employees. The average number of employees per VC is 6.7 with a maximum of 30. Excluding those who referred to have none, the average raises up to 8.2 employees per company, in line with US VCs in 2008 which had an average of 8.5 employees. VC employees are highly qualified: 87.2% have at least bachelor's degree however we only got one PhD graduate. In our research, most employees (86.1%) are graduated in Economics or Business/Management. In terms of age structure, 79.0% of all employees have 25 to 45 years old. Regarding prior professional experience, 55.9% already worked in a different industry, 37.1% come from VC business and 1.4% have worked both in and out the industry. Taking experience in portfolio companies' industry, the mode (37.5% of all answers) is "some experience" however 56.3% consider important to have a good knowledge of their portfolio companies' business.

VC representative in portfolio companies - according to managers, VC representation is usually done through a portfolio companies' board member (100% of all answers) but rarely on an executive function. Considering the number of portfolio companies, 64.3% of all VCs have 6 or less; 14.3% have from 10 to 20, and the same figure for those having from 20 to 40 portfolio companies. Only 2 VCs have more than 40 invested firms (7.1%) and those are State owned funds. The average number of portfolio companies per VC employee is 2.2. The biggest VC owning 150 portfolio companies has an average of 5 companies per employee. Contact regularity with portfolio companies is, in 93.8% of all cases, equal or inferior to monthly and the frequency for performance control is monthly in 43.8%, and quarterly in 31.3% of all observations. Therefore, we have a combined frequency of 75.1% of all answers. Performance evaluation targets are based in 2 or more ratios in 93.8% of all observations. Two

of the mentioned indicators (Sales Growth and EBITDA), analyzed simultaneously or combined with other indicators, are quoted by 87.5% of all managers. The combination with Cash Flow is quoted by 68.8% of them all. According to 87.6% of all VC managers in the Portuguese market rarely or never there is a replacement of portfolio companies' management team. This data is not in line with a previous survey conducted in the US by Gorman and Sahlman (1989), where VCs in average replace 3 CEOs of all portfolio companies during the investment agreements. Considering the importance of VC manager's role in portfolio companies' performance, they consider it to be high, for the following purposes and in the following order: Fund raising; General management; Back-office organization; Product and marketing strategy; Market information; Innovation strategy; Information systems; EU grants; Technology. About exit clauses, answers about divestiture strategy in Portugal are not surprising and are consistent with all other surveys carried out in the past. Management Buy Out and Management Buy In are first and second most common options. Unsurprisingly, in the US the most desired exit is through an IPO. When we asked VCs if in their opinion an investment agreement with a VC does increase portfolio companies' valuation, 93.8% of all respondents said yes. When we asked them if they agreed that this valuation increase effect would last far beyond the divestiture date, 87.5% agreed or tended to agree.

Portfolio companies' performance after divestiture - when asked about portfolio companies' performance after divestiture, 75.0% of all VC managers said it was good. For the same question but considering a four-year time-frame after the exit, the figure decreases to 62.5%. However 31.3% of all respondents said they did not have that information. This result is mainly due to scarce information about portfolio companies after the exit, which means that many VCs do not keep track record of prior investments. When we asked them what performance ratios did get better after 4 years, they answered "Revenue" and "Book Value".

*Portfolio companies:*

Firms and human capital - Table 2 displays key figures to characterize this 38 company sample:

Type of firm	
Revenues (M€)	1.100,85
Average Revenue (M€)	28,97
Revenue – External Markets	74.6%

Headcount	11,325
Average Headcount	298.0
Business activity	
Agriculture	2.6%
Manufacturing	73.7%
Retail	2.6%
Services	21.1%

*Table 2 – Sample's data (from 2008)*

Out of these 38 companies in maturity stage, 28 are manufacturers in traditional Portuguese activities, also in maturity stage.

Considering the size of these portfolio companies:

- Headcount – 19 SMEs (50.0%), 14 Big Enterprises (36.8%), and 5 Micro Enterprises (13.2%);
- Revenues - 24 SMEs (63.1%), 9 Big Enterprises (23.7%), and 5 Micro Enterprises (13.2%).

If we take “firm’s age” when the investment agreement was signed some of them are surprisingly old. Sample’s average is 57.5 years-old with a maximum of 180 years-old and a minimum of 16 years-old. 19 firms (50%) were more than 51 years old.

Investment agreement with VC – Duration and Shareholding percentage - VC managers (66.7%) consider the investment agreement duration as an “Important”, “Very Important”, or “Fundamental” event for portfolio companies’ success after divestiture. In our model, we used it as an independent variable. Average duration in this sample is 4.53 years. Only one contract was set for 10 years. Regarding shareholding percentage, sample’s average is 15.3% (minimum: 0.2 %; maximum: 48.0%). Clearly, VCs do not wish to keep control over portfolio companies.

Portfolio companies’ sustained performance - To evaluate performance we used the previously referred indicators. These are used as drivers combining performance and sustainability indicators, also used in assets’ relative evaluation. When we used multiple-method valuation, these indicators are computed for purposes of calculation. Positive or

negative evolution in the chosen indicators shows variable direction for purposes of company valuation. We did not consider variations in the multiples themselves.

Sales Growth (SG) - Total revenues from sales for the 38 companies in this sample after four years of an exit shows a positive evolution of 10.4%. Twenty-four of them (63.2%) had an increase ranging from 0.6 % to 174.7%. One company (2.6%) had no variation and thirteen companies (34.2%) had a negative variation, ranging from -1.5% to -31.0%. We can therefore conclude that 65.8 % of all companies increased or maintained Revenues from Sales. Our survey results are consistent with this analysis.

Sales for external markets - This sample shows a positive evolution of 19.9% in this indicator. Twenty-nine companies (76.3%) actually sold for external markets. Out of those twenty-nine, 79.3% increased their sales to external markets, ranging from 0.5 % to 769.0%. Six of them (20.7%) experienced a decrease in this indicator ranging from -5.5% to -47.0 %. In the survey, 93.8% of all VC managers categorized "Internationalization Strategy during investment agreement" as "Important", "Very important" or "Fundamental".

Cash flow - We calculated the cash flow of all sample companies for forth and fifth year and concluded a negative evolution of -37.6%. Fourteen companies (34.0%) increased their cash flow, ranging from 8.9% to 2,081.8%, and twenty-four or 63.2 % decreased their cash flow, ranging from -3.0% to -22,500.0%. Again, results from our survey were consistent with this analysis.

EBITDA - Evolution on EBITDA displays a negative variation of 11.3% for this sample. Fifteen companies (39.5%) increased their EBITDA, ranging from 3.0% to 279.5% and twenty-three (60.5%) had a negative variation in this indicator, ranging from -2.2% to 431.3%. Survey respondents had a more positive view on EBITDA evolution.

Book value - We calculated book value for all companies in this sample and got a positive variation of 2.4%. Twenty-five companies (65.8%) increased their book value, ranging from 0.7% to 345.1% and thirteen (34.2%) had a negative variation, ranging from -0.5% to -502.0%. Both VC managers' perception and these calculations returned the same conclusions: the majority of companies "increased" or "maintained" their book value.

Headcount - Year four after exit returned 11,083 employees for this sample's companies and year five 11,128. This means a positive evolution of 0.4%. While twenty companies (52.6%) increased their headcount, ranging from 0.7 % to 320.0%, four of them (10.5 %) had no

variation at all in headcount figure, and fourteen firms (36.8%) decreased their employee base, ranging from -1.0% to -20.6%. Survey and calculations returned similar conclusions.

Quality certifications - Twenty-seven companies (71.1%) were certified in at least one of the ISO standards. Six companies were certified in two or more ISO standards. Twenty-six companies (68.4%) had NP EN ISO 9001 certification for quality management systems. Four companies (10.5%) had NP EN ISO 14001 certification for environmental management systems. Eleven firms (28.9%) had none.

## DISCUSSION AND CONCLUSIONS

VCs' employee educational levels are adequate and their professional experience is convincing. Therefore, VCs seem adequately prepared to manage investment portfolios.

Portfolio companies' mortality rate (30.7%) is in line with international benchmarks and cannot be related with VC investment agreements. Portfolio companies' performance is generally positive: global amount of revenue from sales, sales to external markets, book value, and headcount, increased or stabilized between fourth and fifth year after VC divestiture. The number of exporting companies in our sample is quite impressive (76.3%). We actually believe that portfolio companies' internationalization should be subject of a deeper analysis. Global amounts for EBITDA and cash flow decreased between fourth and fifth year after divestiture. Considering two of the most used indicators in firms' relative or comparative valuation we concluded that Price Sales Ratio and Price Book Value would have at least a positive evolution for this sample's companies. Cash flow and EBITDA variables are used in corporate valuation through net present value (NPV), which we didn't do. According to Damodaran (2012), NPV analysis should not be used for assets whose cash flows are not positive or could not be reasonably estimated for future periods of time.

Hypothesis 1 was accepted because the valuation of firms in maturity stage at the date of VC investment which were later sold out, is superior after 4 years of divestiture. Three of the performance variables – sales growth, external markets, and book value – and one sustainability variable – headcount – had a positive behavior.

Regarding hypothesis 2, which seeks to establish factors influencing on the valuation increase produced by VC investment in the duration of the agreement with sustained performance, we could not find influential impact of selected independent variables – contract duration, and

shareholding percentage – on sustained performance dependent variables. We used linear regression, to estimate the influence of independent variables “Duration on Contract” and “Shareholding Percentage” on the variables Sales Growth, External Markets Sales Evolution, Cash Flow Evolution, EBITDA Evolution, Book Value Evolution, Headcount Evolution and Number of Quality Certifications. The result which lies closer to the value with statistical significance is the ratio of the dependent variable “Book Value Evolution” with the independent variable “Duration of the contract” with a significant value of  $t = 0.051$ . Therefore, H2 is rejected. However, we stress that independent variables’ selection was bounded by survey II’s low rate of acceptance.

Table 3 displays average results for each of the sustained development variables after four years of an exit (3 point Likert scale: 3 – increased; 2 – maintained; 1 – decreased):

Variables	Average
Revenues from sales	2.29
External markets’ sales	2.59
Cash flow	1.74
EBITDA	1.79
Book value	2.32
Headcount	2.16
Quality certifications	2.03

*Table 3 – Sustained development*

## IMPLICATIONS AND FUTURE RESEARCH

This work brings new perspective on venture capital’s role on portfolio companies both in terms of time impact and activity impact. Future research could explore the role of Venture Capital in internationalization of Portuguese companies. The influence of Venture Capital for internationalization in all development stages deserves further study as it is a key issue for the development of the Portuguese economy.

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## THE CHALLENGE OF ENGAGING ORGANIZATIONAL DIVERSITY IN DIVIDED SOCIETIES: THE CASE OF ETHNICALLY MIXED NURSES' TEAMS

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### ABSTRACT

This paper addresses the challenge of coping with organizational diversity in divided societies, saturated with protracted national conflict. It is based on a case study of nationally and ethnically mixed nurses' teams. The study attempted to explicate the nature of the challenge, patterns of engaging it and the consequences on team members' intra-team relations and collaborative interactions. The central insights that emerged from the research show that cooperation, teamwork and joint interactions of diverse employees indeed constitute a particular challenge in divided societies. The medical staff in demographically diverse institutions and in particular in diverse teams indicated intergroup biases, implicit discrimination and tensions due to the salience of social categorization and the faultline phenomenon. Such strains magnify in crisis situations, notably when violent incidents associated with the protracted national conflict, erupt. The study participants indicated difficulties in engaging diversity issues related to the national conflict, thus leaving them in a hidden sphere. The findings showed paucity of organizational level efforts to engage diversity and social divisions-related issues. Notwithstanding the complexities ingrained in diverse workplaces, saturated with social divisions, members of ethnically mixed teams by and large are capable of maintaining cooperative interactions and effectively perform their healthcare tasks. Engaging "otherness" remains a considerable challenge in diverse work-setting, especially when team-work constitutes the main work modality.

**Key words:** inter-group conflict, diversity, "otherness", a divided society, shared team goals, team cooperation.

### INTRODUCTION

The 21<sup>st</sup> century features significant changes, reflected in a mounting diversification of the workforce and organizational membership due to globalization and immigration trends (Coleman, Selden, & Selden, 2001). Elucidating the consequences of social schisms on diversity-related processes and performance in organizations is deemed essential in this era, characterized by socio-political, cultural and economic complexities, competition and concurrent increasing interdependencies among individuals, groups and organizations, hence the need for collaboration. However, the ramifications of such transitions on organizational behavior aspects such as relationship dynamics, particularly interpersonal and intragroup cooperation, have largely escaped employers' and employees' awareness (Desivilya & Rottman, 2012; Desivilya, Rottman & Raz, 2012). We argue that such immensely altered societies present a significant challenge for organizations. The major query to be examined is how do social divisions (inter-group conflicts) in societies influence the construal of diversity at work and ways of coping with this phenomenon? This article examines the consequences of social divisions on coping with diversity in work organizations. To engage the contemporary complex developments requires a critical analysis of the concepts of diversity, intergroup protracted conflict and of diversity management practices. What does the concept of diversity mean? What does diversity management entail in the context of a divided society and how does it influence the recognition of diverse voices, their articulation capacities and cooperation among various ethnic groups within the team context?

The current article attempts to illuminate the experiences of diversity primarily through the national and ethnic minorities' lens (versus national majorities' eyes) as these social groups have been often excluded, delegitimized and discriminated against in the workplace (Clair, Humberd, Caruso, & Roberts, 2012; Clair, Beatty & Maclean, 2005; Coleman Selden & Selden, 2001). The paper focuses on the Israeli case of demographically diverse employees in health organizations, highlighting the latent aspects in the relationship dynamics among diverse individuals and groups in organizations, such as the elusive stereotypes and biases, repressed fears of the other and implicitly imbalanced minority-majority power relations. We assume that diversity has prominent impact on work-place climate, employee relations, and actual cooperation in conflict-saturated social environments, manifested especially in the mixed teams' work dynamics. This research attempted to extend the knowledge base concerning the impact of organizational diversity in divided societies on the dynamics and performance in demographically heterogeneous work teams. Specifically, it explored the nature of diversity implications on team climate, patterns of engagement with this phenomenon and on intra-team cooperation as construed by nurses in ethnically mixed teams.

## THEORETICAL BACKGROUND

This section provides a brief overview of the central concepts and theoretical framework pertinent to the understanding of organizational diversity in the context of divided societies.

*Diversity* indicates variation in a wide range of group members' characteristics, including salient demographic features such as age, gender, race, nationality and ethnicity, and professional background and expertise (Mohammed & Angell, 2004). These scholars distinguished between surface-level and deep-level diversity. Surface-level diversity refers to the extent of demographic variation in a work unit, whereas deep-level diversity purports to disparities in personality, attitudes, values and capabilities. We embrace the construal of diversity as a group characteristic, focusing mainly on the surface level; namely, differences in demographic characteristics such as race, nationality, ethnicity, religion, gender and social class and other markers of social identity which have generated intergroup stereotypes, acts of oppression or discrimination (Ely & Roberts, 2008; Ramarajan & Thomas, 2010). Scholars of organizational behavior endeavored to elucidate the mechanisms underlying the influence of diversity on intra-organizational relations. Nationality and ethnicity constitute a significant component of diversity in contemporary organizations, affecting the capacity to manage internal relations and organizational performance (Desivilya & Palgi, 2011b; Friedman & Desivilya, 2010).

Harrison and Klein (2007) distinguished among three elements of diversity: **variety** (differences in information, knowledge and expertise), **separation** (differences in position or opinion among unit members, which reflect disagreement on a horizontal continuum), and **disparity** (differences in control of valued social resources such as pay and status among unit members which are distributed on a vertical continuum). The *variety* aspect of diversity accounts for the benevolent influence on organizational group functioning. Variety in members' characteristics (such as nationality or ethnicity) brings to the group a potential to view issues from different perspectives and consider greater array of options to solve organizational problems. In contrast with the positive effects of *variety*, *separation* and *disparity* elements of diversity tend to impede group functioning and obstruct its outcomes (Harrison & Klein, 2007).

The disruptive effects of diversity were explained by the theories of *social categorization* and *social identity* (Tajfel & Turner, 1986) and the notion of *faultline* (Lau & Murnighan, 1998). According to the *social categorization* and *social identity* model people tend to define and

distinguish themselves from others based on their group membership. Encountering individuals from different groups sets up the categorization process and gives rise to a tendency to form a more favorable image of one's own group in comparison to the image of individuals from dissimilar groups (*in-group favoritism*). In the context of nationally and ethnically diverse organizational groups, *in-group favoritism* may affect the internal climate and dynamics, making it more difficult for 'out-group' members to express their voices and exert influence.

The *faultline* model (hypothetical dividing lines splitting a group into subgroups and giving rise to polarization between in-group and out-group identities) refined the underlying mechanism accounting for the negative impact of separation and disparity in groups with diverse membership. Van Knippenberg *et al.* (2011) explained the contingencies underlying the negative effects of diversity in contrast with its positive impact, maintaining that the actual adverse influence of social categorization depends on its **salience**, rather than on the mere presence of differences. Thus, the negative effects of diversity tend to prevail when categorization salience is high, whereas its positive influence predominates when the work group adopts cooperative motivational orientation, team-identity and shared objectives, which in turn foster constructive interactions such as coordination and collaboration. As we argue later, the legacies of protracted national conflict **interfere** with the **development** of such **benign group climate**, instead accentuating **faultlines**; namely, promoting in-group favoritism by the majority members while dampening the advantages of diversity.

Ramarajan and Thomas' (2010) literature review indicated positive effects of diversity management on intergroup equality, intergroup relations and performance of diverse groups. They also specified the organizational level and individual level factors promoting benevolent outcomes, such as the positive influence of excluded groups' increased representation (minorities and women) in organizations, especially in positions of power and improving their career trajectories. Moreover, Ramarajan and Thomas (2010) showed that positive interactions among diverse group members and mutual perceptions concerning desirability of such intergroup contact tended to mitigate prejudice, negative attitudes and enhance inter-group liking. Other organizational scholars pointed at relational benefits of diversity as reflected in inter-group respect, openness, inclusion, minority members' sense of integration in organization and majority members' perception of uniqueness with regard to minority members (Brickson, 2000; Carmeli & Gittell, 2009; Dutton & Ragins, 2009).

Ramarajan and Thomas (2010) temper the positive outcomes of organizational diversity, arguing that the effects in each of the three domains are independent, consequently

intergroup equality may not necessarily be linked with positive intergroup relations or improved group performance. Research has yet not provided clear findings with respect to the relations among the three arenas.

Triana, Garcia and Colella (2010) showed that organizational support of diversity moderated the effects of perceived racial discrimination, consequently enhancing employees' affective commitment. However, this pattern of relationships may change for different ethnic or social groups. Ethnic or national minorities who have experienced frequent acts of discrimination and have a strong sense of ethnic or national identity, such as Afro-Americans, tend to interpret organizational efforts to support diversity as hypocritical. Such attitudes are conceivable in the case of Arab citizens in Israel, particularly when they work in joint teams, because such situations tend to enhance the salience of social categorization (van Knippenberg, *et al.*, 2011).

Social categorization can be especially pronounced in the context of social divisions; namely, in *divided societies*' thus, enhancing **faultiness**, increasing in-group favoritism by the majority members while impeding the creation of positive group atmosphere and thereby mitigating the benefits of diversity. We further contend that such disruptive effects are due to the reciprocal influence of individual level biases and limitations and social construction of intergroup power relations (Desivilya Syna & Rottman, 2012). The next sections explicate the processes motivating the multi-level combined effects of inter-group conflicts and diversity in *divided societies*.

A *divided society* implies deep inter-group splits penetrating through the society, with each social group featuring distinct cultural, religious and political identities (Hargie, Dickson, & Nelson 2003). Divided societies are characterized by "mutually contradictory assertions of identity in which one identity is validated or defined by suppressing another identity, making it difficult to presuppose any reciprocity of interests among groups" (Schaap, 2006: 266–7). Protracted national conflicts constitute rather extreme examples of a divided society with the most emphasized long-term consequences. The current article focuses on this phenomenon as it is based on an Israeli case which has evolved in such a context.

Previous research pointed at a host of negative ramifications of protracted conflicts on individual motivation and well-being, on interpersonal perceptions and group relations (Coleman 2004; Syna Desivilya 2004; Desivilya & Yassour-Borochowitz 2010; Friedman & Desivilya 2010). Continuous intergroup discord has a destructive effect on inter-group relations due to accumulative negative changes in attitudes, feelings, motivations, and behavior. Such protracted conflict gradually intensifies, often erupting into violence and

leading to perceptions of intractability: persistence and pervasiveness of the disputes, irreconcilable goals, threatened existential needs and escalation (Bar-Tal, 2011).

At the motivational level, each side adopts a highly competitive, intransigent stance, perceiving the conflict as a 'zero-sum game'. In the emotional realm, parties' feelings towards one another gradually change from anger to overall antagonism, often turning to hatred inflamed by vengeance. In the cognitive modality, adversaries rely on stereotypes and selective perception, disproportionately weighing negative information while discounting positive aspects. Increasingly negative perceptions of the other side breed mutual distrust. At the behavioral modality, adversaries encounter mounting difficulties in communication (Syna-Desivilya 2004; Bar-Tal, 2007; 2011).

The harmful transformations at the individual level seem inescapable due to universal human biases and limitations in processing the social world, termed by social psychologists *bias blind spot* or *meta bias* (West, Meserve & Stanovich 2012) and by Mitroff & Silvers (2010) as *errors of third and fourth kind*. Essentially, both formulations point at the inherent difficulty of individuals to think critically.

In parallel to the transformations at the individual level, changes also evolve at the group and the overall social context, reflected in rising ethnocentrism and groupthink (Syna Desivilya 2004). Each group tends to believe that its own goals are just, whereas the opponent group's goals are illegitimate (Bar-Tal, 2011). Groupthink symptoms include extreme within-group conformity and suppressed dissent. At the community level, a polarization effect gradually develops, namely, individuals and groups tend to join one of the rival camps. In addition there are manifestations of mounting mutual animosity experienced by both sides and a tendency towards sustaining a culture of conflict (DesivilyaSyna & Yassour-Borochowitz 2010; Bar-Tal 2011).

Despite the protracted conflict, Jews and Arabs in Israel interact on a continuous basis, maintaining interdependence and inter-group relations in various spheres of life. One of the central questions pertains to the impact of the Israeli-Palestinian conflict on the nature of work relationships between Jews and Arabs in the state of Israel (Desivilya Syna & Rottman 2012). The current article examines this issue, focusing on a case study of nationally and ethnically diverse nurses' teams. Citizens of Israel of varied national, ethnic, religious and cultural backgrounds have been working in joint medical teams in hospitals and communities, providing health-care to diverse patients' population. The interactions of such medical teams with patients have been maintained for many years in the context of the protracted Israeli-Arab conflict, yet the impact of such reality on their relationship and service

quality has not been systematically studied. Jewish and Arab medical workers have experienced all phases of the protracted Israeli-Palestinian conflict, including the most intense escalation stages (wars, terrorist acts and the two intifada uprisings). Thus, this case demonstrates an exceptional social phenomenon of health professionals from two adversary groups working in joint teams, treating patients from both groups even at times of violent conflict episodes. Maintaining social justice while managing diversity of work teams and delivering health-care services in the shadow of protracted national conflict that constitutes a significant challenge. Yet, research concerning the perceptions and actual coping patterns with such a complex reality has been scant. Hence, the current research intended to taper some of these gaps. It explicated the impact of organizational diversity in divided societies on the dynamics and performance in demographically heterogeneous work teams. Drawing on the literature concerning diversity in work teams (van Knippenberg *et al.*, 2011), among the potential factors that presumably account for the dynamics in diverse work teams of special interest, are individual level factors such as members' emotions towards teammates (notably empathy), mutual trust and joint professional identity. Group level elements are also significant; these include perceived intra-team support and intra-group cohesion especially in face of adverse events related to the protracted national conflict. The research has also examined the subjective outcomes of the dynamics within diverse teams such as individual members' perceptions of social justice. The major questions revolved around the **ramifications of diversity in the context of protracted conflict on team climate, patterns of engagement with diversity**, in particular the capacity of the national minority and various ethnic groups to express their **authentic voices**, and its impact on intra-team **cooperation**.

## METHODOLOGY

The current study constitutes the initial phase of a research program; namely, a pilot study, which employed a qualitative methodology. **The participants** were 12 nurses, members of nationally and ethnically mixed medical teams who work in public medical centers in the Northern region of Israel. The **research tool** was an individual, semi-structured interview conducted with nurses, members of mixed medical teams. The findings reported in this paper are based on interviews with 3 Muslim nurses, one Druze nurse, one Christian nurse and 7 Jewish nurses (3 of them are immigrants from the former Soviet Union and one of them maintains religious life style). The nurses were asked to provide a narrative description of an intra-team conflict episode, which was followed by questions probing their views on the following issues: the climate in diverse work team, communication patterns and cooperation,

the impact of diversity on the team functioning (medical care), issues associated with their social identity, a sense of discrimination, strengths and weaknesses of nationally and ethnically diverse teams and, diversity management at their work organization. They were also asked about the team's functioning at times of violent incidents associated with the protracted conflict (terrorist acts of Palestinians or Israel Defense Forces military acts against Palestinians). All of the nurses gave their consent to participate in the study and were promised confidentiality. The interviews were conducted face-to-face by the second author of this paper and took place at the participants' workplace. The average interview duration was one hour and a half. The interviews were audio-taped and transcribed verbatim. Content analysis was performed based on the principles of qualitative research. The data were analyzed in three main stages: in the first, "open coding", reading each interview from beginning to an end to get an initial impression of the emerging main topics. Then a mapping analysis was conducted - laterally compiling the data. The third phase involved going back to the interviews in order to accomplish a focused analysis designed to identify the interviewees' attitude to concepts or topics emerging from the professional literature (e.g., perceptions of diversity, internal team conflicts, etc.) (Shkedi, 2003; Strauss & Corbin, 1990).

## **FINDINGS**

We present the major findings of the pilot phase of the research program, which examines the internal dynamics in diverse work teams. The results underscore the hidden aspects of such processes, such as construal of intra-team work relations among members representing different national and ethnic social groups.

The major themes which have emerged from the interviews refer to the climate in a diverse work team, communication patterns and cooperation, the impact of diversity on the team performance (strengths and challenges of nationally and ethnically diverse teams), the majority's versus minority's perspectives on discrimination at work, team functioning in crisis situations related with the protracted conflict and diversity management at the organizational level. The next sections present the findings organized in accordance with their thematic focus.

## **TEAM CLIMATE**

The participants' responses suggest that national or ethnic diversity within the work team affects its climate primarily on occasions manifesting differences of opinions between nurses

from different social groups. The disparities are viewed as cultural in nature and tend to exacerbate inter-group tensions in the work team, which in turn impede the overall atmosphere and mitigate the motivation for cooperation. As put by one of the Arab nurses:

*"When there are cultural differences, such as between Christians and Muslims, they quarrel and the result is bad, they do not talk...do not want to work on the same side...there is an atmosphere of discomfort...you do not feel comfortable to work with someone you do not feel at ease..."*

One of the Jewish and one of the Muslim nurses noted tensions arising from the cultural differences between nurses born in Israel (both Jewish and Arab) and nurses who are immigrants from former Soviet Union, as demonstrated in the following quotations: *"...They are cold, as if they don't have feelings, both towards peer nurses and towards patients...not as the nurses from eastern countries, such as Tripoli, Morocco, Iraq and the Israeli born, or Arab nurses; It makes unpleasant work atmosphere"; "They feel superior, patronizing, they think they know everything, they are not nice, do not talk nicely, I had few unpleasant situations with them... and the staff do not like to work with them..."*

One interviewee relayed a strong tendency of the nursing staff to interact with peers from the same social group: *"sub-groups, sub-groups within the team... let's say the Russians with the Russians, Yemenite with the Yemenite, Moroccan with Moroccan...it's very salient..."*. Such pattern of sub-groupings within a single team alludes to the phenomenon of *in-group favoritism* (Tajfel & Turner, 1986; Byrne, 1997) and the salience of *faultline* phenomenon (van Knippenberg *et al.*, 2011).

## COMMUNICATION PATTERNS AND COOPERATION

Akin to the impact of diversity on team climate, internal communication processes and cooperation may be disturbed as a result of conflicts among team members belonging to diverse social groups. This is more likely to happen following extreme events, such as a terrorist act, and medical care of the victims (or the perpetrators). However, according to the interviewees, usually communication and cooperation among staff in diverse teams are quite effective. The common goal of providing high quality care to patients facilitates such constructive interactions. It creates a joint team-identity, which serves as a framework for organizing and coordinating behavior (Hinds and Mortenson, 2005). Arab and Jewish nurses were quite unanimous in their views about communication and cooperation in their respective diverse work teams. As put by the pilot study participants:

*"Each nurse comes from different culture and has different values, but our work is different, we need to be cohesive, have consensus... we work for the patients, it's not a private business, we are here to help*

*others and work here in cooperation even though each nurse has different mentality..." ; "There is cooperation all the time, morning and evening... For example if I work with a Druze male nurse, it's obvious he takes care of the men... I don't have to tell him anything..."*

## **THE IMPACT OF SOCIAL DIVERSITY ON WORK PERFORMANCE**

The interview responses seem to suggest that social diversity is reflected in somewhat different functioning amidst various social groups, which can be attributed to culture-bound customs and norms.

One of the Arab respondents relayed an event which in her view had adverse impact on a patient and indirectly on the team performance:

*"I worked with a Russian nurse... I care not only for the patient but also for his or her family, it's 90% of a cure. Family members have to feel that their loved one is in good hands... There was an old woman dying and her daughter wanted to stay with her, but the Russian nurse would not let her... she argued with her, she had no feelings. If she was more emphatic, putting herself in the daughter's shoes, she would have acted differently... Things like that interfere with the team functioning, but can help in treatment when the family trusts you...All this results from cultural differences..." (M1).*

The findings indicate that the intra-team diversity not only affects the patients but it also negatively influences its own members and their work performance. The employees contend that the internal differences lead to interpersonal tensions and conflicts which impede their functioning at work. One of the nurses described an incident with a physician from a former Soviet Union demonstrating such an adverse impact on work relations:

*"I don't agree that you treat this patient now. I will arrange for someone else to take care of her and this will solve this issue. You will not interfere with my job"; This Russian physician, she does not like that I communicate with her through messenger, that I enter her office. She simply does not like any contact. She always says that I just waste her time..."*

The respondents reported both strengths as well as challenges in nationally and ethnically diverse teams. Most posited that diversity fosters culture-sensitive care through enhancement of inter-cultural understanding. It also promotes high quality care by matching treatment and care with the culture-bound norms and needs of patients from various cultural backgrounds, as put by one of the interviewees: *"Because we have patients from different cultures if we have a nurse from the same culture as the patient, she understands the patient's behavior, why he behaves that way, for example is hysterical, shouts..."*

Diversity can also contribute to tailoring work schedules; namely, matching the work shifts in accordance with the national, ethnic or religious holidays. Another significant strength of diversity, noted by the interviewees was broadening their perspectives on various care-related issues. By contrast, the main drawback of diversity, indicated by the study participants, was mounting likelihood of conflicts and tensions as a consequence of discordant outlooks. The latter result lends further support to findings obtained in prior studies on work team diversity (Desivilya & Palgi, 2011b; Desivilya, 2008).

Another challenge arising from social diversity in teams purports to the use of language at work. The interviewees claimed that there is a very strict norm precluding use of any language other than Hebrew in the work context, as manifested by the following citation: *"Look, it's very disturbing when you come in and three people stand together and two of them are always talking (foreign language). I understand that it's easier for them to converse in their own language but it's uncomfortable for me, and for anyone else that walks by and does not know what you are talking about. For all I know you may be talking about us and it's extremely uncomfortable for the rest of us."*

In other words, speaking "foreign language" in the work-team setting conveys a message of insensitivity and lack of consideration, being impolite and disrespectful of other group members. Therefore most of the respondents have argued that it should not be allowed. In line with Foucault's (1994) arguments, language symbolizes power relations, allowing to exclude and marginalize less valued team members, engender a sense of injustice and distrust in turn mitigating motivation for cooperation (Tyler, 2012).

## **SENSE OF EQUALITY VERSUS DISCRIMINATION IN DIVERSE TEAMS: NATIONAL MAJORITY AND MINORITY PERSPECTIVES**

The findings revealed that issues associated with a sense of equality versus discrimination appear quite significant in diverse work forums, manifested at various arenas, as depicted below.

*Patients' attitudes and behavior.* Several respondents indicated cases of patients' racist attitudes and discriminatory behavior as a result of membership in different social group. Some of them reported that people occasionally refuse to accept medical care from members of "the other group". This issues were noted only when care was provided by an Arab nurse as manifested in the following quotation: *"...one day a patient approached an Arab male nurse in a clinic in a kibbutz and told him something ...that he got a job in a clinic because only Arabs work*

*there...I told him (the Arab nurse) as I tell each of the new nurses – Arabs or Russians that they have to 'swallow a frog' when they come to work in a kibbutz... later they became familiar with him, the fact that he is an Arab... but he is an extraordinary nurse..."*

**Implicit discrimination.** Minority members also reported personal experiences of discrimination as medical personnel reflected in their perceived inability to voice criticism, especially towards superiors, fearing sanctions, as put by an Arab participant:

*"There is one nurse in my team, an Israeli born Jew...This is personality, this is a character, she has no fear, once she told the head nurse that she is a liar. I as an Arab cannot tell such a thing, because I know that the next day I am out..."*

Not surprisingly Jewish nurses viewed discrimination from a majority perspective: they felt pressure not to get involved with criticism towards their minority counterparts, concede in conflict situations in order to avoid accusations of racism and discrimination, thus preserving intact work relations, as expressed by one of the Jewish nurses: *"Concerning a Muslim employee, she is also Muslim, when she notices that he evaded working she got angry at him, no reservations; I cannot allow myself to get angry at him. I know that he will right away say it's discrimination... I need to be careful..."*

**Delayed promotion.** Seemingly unfair promotion of Arab employees was another area of discrimination pointed by some of the interviewees, as expressed by a Jewish nurse: *"There was a male nurse that was angry in the hospital...He claimed that the management wouldn't promote him to be in charge of the entire department. I couldn't believe my ears. The common knowledge is that they (the Arabs) are only twenty percent of the staff, we had then over the twenty percent that are in high level positions, managing and in charge of various departments. I do not think it's discrimination."*

Most respondents argued that the formal rules and regulations preclude discrimination acts. Hence, by and large they viewed most of the management and work practices as fair and equal for all employees, regardless of their socio-demographic background. Albeit, this perception markedly changed when a specific event or case was narrated, revealing a gap between the desired and actual state of affairs, as put by one of the Arab nurses:

*"If there was a culture sensitivity there, they would have built something, some small room for Muslim population to pray...instead of going to pray at the lawn outside the hospital. They can find a corner in each department to pray, and add to it a small carpet, but it does not exist."*

**In-group solidarity versus out-group alienation.** Some respondents argued that here is solidarity and mutual support among employees of a similar ethnic or national origin. However, this internal sense of solidarity breeds perceptions and feelings of alienation and

inequality among employees of different ethnic and national origin (out-group) as manifested in the following quotation by an Arab nurse.

*"The Russians...at work they are creating groups of their own. They are very protective of one another, they are a kind of clan or tribe that defends themselves against everyone else, and are not allowing anyone to join this club of theirs. It is not allowed to hurt someone in their group, it is forbidden to talk about them. They're constantly protecting everyone in their group."*

**Majority-minority relations in diverse teams.** The findings point at two kinds of "majority": a **quantitative** one, which reflects the number of members belonging to a national majority within the team; and a **leading/normative majority**, namely a dominant group which sets the normative orientation of the team (regardless of their actual size) and constructs its actual dynamics. The former – quantitative - majority refers to immigrant nurses from the former Soviet Union, whereas the latter – normative- majority pertains to Jewish Israelis (born in Israel or old-timers). The normative majority in most cases succeeds in imposing its will on the other groups, at times resorting to harsh measures such as direct or implicit threat. The following excerpt from an interview with a senior Jewish nurse - a department head - concerning her conversation with one of her Arab subordinates, demonstrates the argument. The minority member made a feeble attempt to voice her consternation with respect to her superior's discrimination of an Arab nurse while favoring a Russian nurse. This endeavor was utterly silenced. Similar tendencies were identified in Clair *et al.* (2012) study which was conducted in demographically diverse work settings.

*"She wanted to talk and was crying heavily. She does not want to leave the department, she did not mean to say it...I told her: Look a person is expected to be somewhat logical, even if you have an opinion, not to express it. And don't start accusing one party. I think that if we speak openly in the State of Israel you know exactly what happens in contrast with any other place in the world. No complaint can be accepted on moral or democratic grounds...So let's not get into it because you are wrong all the way and you are very judgmental. You weren't there so you have no right to judge people. We don't judge what happened there. But you judge a person? She said that she was wrong and apologized that things really got out of control. That's it, she understood. The truth is she really made an effort not to talk around others, and around her there was also no talking. They knew how to take a distance in this case."*

## **TEAM FUNCTIONING IN CRISIS SITUATIONS RELATED TO THE PROTRACTED CONFLICT**

The interviewees contended that violent incidents associated with the protracted national conflict, aggravate tensions, thereby impeding team functioning. Interestingly, when the acts of aggression constitute a war with potentially negative consequences for all social groups in Israel (majority and minority alike), a fleeting solidarity between the national groups tends to develop, however leaving intact some legacies of the intergroup strain. Most cases of either party's violence (Israeli or Palestinian) generates markedly tense team atmosphere, considerably mitigating intergroup tolerance, in turn impeding motivation for cooperation. The following citations from the interviews' responses exemplify such difficult experiences of nurses in diverse teams: *"I feel tensions, I feel we refrain from talking, some employees boil inside and later burst on another issue, not the violent incident..."; "... we try not to look at each other, to hide these things, not to bring your personal feelings to work, there is no place for politics, you cannot be detached from your feelings, it's very difficult, you have difficulty to concentrate, but you do it, you do your work..." ; "...These tensions between Jews and Arabs burst during violent events, like war, terrorist acts..."*

## **DIVERSITY MANAGEMENT AT ORGANIZATIONAL LEVEL**

All of the study participants argued that their work organization has hardly dealt with the general issue of social diversity in medical teams, and specifically has not addressed its consequences, reflected in the toils of a daily practice. Furthermore, they maintained that department managers by and large prefer to evade direct confrontation with diversity-related issues of the workforce. They opt to sustain seemingly harmonious work relations ("*industrial peace*"). The following quotations substantiate the passive stance of the management concerning diversity-related issues: *"The organization, I am not sure the management is aware, knows anything. My superior knows, but he hardly deals with the problems... since I am an experienced nurse I am expected to manage these issues..."; Here it is difficult, I am expected to solve these problems, to ignore the racist thing...for example we had this Moroccan Jew patient, we had to put a Druze patient in the same room, he refused, said he cannot be with a Druze in the same room..."* Evading direct engagement of diversity issues, not only does not alleviate the tensions, but enhances a sense of frustration and bitterness, which in turn may hasten escalation of intergroup conflicts, harming intra-team work relations, as documented by Ramarajan and Thomas (2010).

## **DISCUSSION AND CONCLUSIONS**

The current study revolved around the ramifications of diversity in the context of a divided society, saturated with protracted national conflict, on team climate, patterns of engagement with diversity, in particular the capacity of the national minority and various ethnic groups to express their authentic voices. It also explored the impact of diversity in the specific inter-group context on intra-team cooperation.

The case of diverse nurses' teams described in this article corroborates the underlying assumption that management of diversities in divided society, in particular those ridden by protracted intergroup (national, ethnic and religious) conflicts, poses a formidable challenge for organizations. Notwithstanding the contribution of positive interdependence among diverse groups to collaborative efforts in the organizational arena, as was demonstrated by the current case, hidden aspects stemming from the legacies of prolonged national discord, impinge on the parties' relations and pose barriers on engaging "otherness" encapsulated in diversity and in societal divisions. This quandary is embedded in both, universal individual obstacles such as bias blind spot as well as construction of power by social institutions (Desivilya Syna & Rottman, 2012; Kristeva, 1991; Schaap 2006; West, Meserve & Stanovich 2012).

Such complex reality requires concerted efforts by organizations in order to cope with these largely latent difficulties to address "otherness" in organizations, foreshadowed by deep schisms such as protracted conflicts. These efforts include shifting hidden traces of exclusion, de-legitimation, silencing of voices and discrimination to the front of the stage, developing critical consciousness, education and training in "shadow negotiation" (Clair et al. 2012; Desivilya Syna, Rottman & Raz, 2012; Foucault 1994; Hansen 2008; Kolb 2004). In line with Kristeva's (1991) arguments, organizational efforts need to confront and overcome the separatist tendencies, acknowledge and respect the "strangeness" in others and in ourselves. As contended by this scholar when "otherness" becomes social, it is amenable to shaping in the direction of flexible society, which is not secluded within nationality, religion. Mixing of nationalities is accompanied by shedding-off of their political and social structures, thus ranging from voluntary cooperation to self-management, always keeping in mind that preserving dignity for ourselves should be matched with similar efforts with regard to the other. Such arrangement allows cosmopolitanism dwelling within national state or as labeled by Kristeva (1991) – having a coordinated diversity rather than uniform society.

The findings of the current study clearly show that hardly any of the above approaches and practices suggested above, have been enacted in in major health care centers. Nurses

operating within mixed team structures and providing health care services to a diverse patients' population are largely left to their own devices in coping with diversity in the context of deep social and national schisms.

Despite the meager evidence of engaging diversity at the organizational level, the current study seems to suggest that nurses working in mixed-teams by and large cope quite effectively in their daily practice, often taking advantage of the benevolent angle of diversity; namely, the *variety* element, such as tailoring care to cultural needs of the patients (Desivilya, Rottman & Raz, 2012; van Knippenberg, *et al.*, 2011).

Yet, cultural and social disparities do also leave adverse traces on intra-team work relations. Working in a mixed team-setting often enhances the salience of social categorization, amplifying faultlines, exacerbating the impact of differential perceptions with regard to patients and the nature of care, which in turn cause anger verging on animosity, disrespect, tension and alienation. Such feelings mitigate the motivation for cooperation among diverse team members. These findings corroborate previous research (Desivilya & Yassour-Borochowitz 2010; Friedman & Desivilya 2010; van Knippenberg, *et al.*, 2011). By contrast, when the work is performed in homogenous sub-groups (in-group), both the intra-group relationships as well as the actual functioning tend to improve according to the nurses' perceptions. This result also lends further support to the evidence obtained in previous investigations (Desivilya & Yassour-Borochowitz 2010; Friedman & Desivilya 2010).

The evidence collected in the current study indicates that the nurses' construction of their daily practices within diverse settings and in the context of deep social and national schisms, reflect a dynamic workplace environment. Diversity indeed affects their working routines, impinging on the team climate, communication and cooperation tendencies. Specifically, it changes diverse team members' capacity for inter-group tolerance, mutual understanding and motivation for cooperation, but its impact is usually moderate when the external socio-political environment is relatively tranquil. However, when a violent event occurs as a result of the persistent national conflict the intra-team the impact of diversity is magnified thereby transforming the intra-team relations quite dramatically. There is a growing polarization between members of the two national groups, in turn mounting difficulties in sustaining full-fledged contact. The salience of faultlines intensifies much further in comparison to tranquil periods (van Knippenberg *et al.*, 2011). Thus, members of the national majority and of the national minority tend to embrace clear national identity, clinging to their in-groups. The predicament of the minority is much greater as their voices tend to be completely silenced

(Clair *et al*, 2012; Desivilya, Rottman & Raz, 2012). The necessary work functions remain intact, but the overall atmosphere becomes highly tense (Desivilya, Rottman & Raz, 2012).

As diversity and social divisions constitute one of the fundamental features of the contemporary societies and consequently also of organizations and workplaces, the question still remains how to engage such complexities in order to materialize Julia Kristeva's (1991) quest of 'coordinated diversity' and dwelling in peace with "otherness." Based on the pilot study, we can conclude cautiously that nurses living in a divided society and employed in diverse workplaces vacillate among various modes of coping: in quiet periods manage to distill similarities and embrace shared identities, while in crisis situations resorting to avoidance and distancing from out-group members, while holding to their separate national identities. Although the difficulties of the national minority members loom larger, members of the national majority also experience the strains of the complex work reality. Future research needs to probe in greater depth the intricacies and fluctuations in the mixed-teams dynamics in an attempt to elucidate the potential mechanisms for mitigating inter-group alienation and destructive tensions, instead enhancing the collaborative tendencies through greater organizational social justice and shared identities (Tyler, 2012).

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## A BUSINESS STRATEGY DEVELOPMENT FRAMEWORK FOR SMES

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### ABSTRACT

**Purpose:** The purpose of this research is to evaluate the strategy process within SMEs. Based on those findings the research seeks to develop a strategic framework (BSC strategy process framework) to reflect the activities that SMEs perform during the strategy process.

**Design/methodology/approach:** The research approach is abductive that consists out of two stages. First a conceptual model is deduced from the literature which is validated against the findings from the interviews in the SME. The second stage induces a strategic framework to conduct strategy within an SME setting based on the findings that were deduced. The research strategy is based on a single case study

**Findings:** The strategy process that the SME uses is messy; it is not systematic; it is not sequential and is not clear. It was found that they carry out a very ad hoc implementation of strategic activities. Based on these findings, a revised conceptual model is presented, which shows the 'strategy implementation phase' receives most frequently attention, while the SME is least involved in 'strategy formulation'.

**Research limitation/implications:** The main limitation of this research is that the BSC strategy process framework has not been implemented and tested within a SME environment to find out how effective it is in practice. A practical limitation of this study is that to operationalize this strategy framework, a SME has to operate as an effective team.

**Practical implications:** Strategists within SMEs could improve the way they conduct their strategy by following the strategy process outlined in this article including the strategic activities. SME strategists are encouraged to use the suggested strategic framework for this purpose.

**Original value:** The study offers an innovative approach to understand how SMEs perform the strategy process through a case study. This research suggests a strategic framework such that SMEs can overcome their difficulties in performing strategy. The research approach is innovative because it critically examines the literature based on a case study and uses those findings through crystallisation as a basis to justify why SMEs should adopt the strategic framework.

**Keywords:** SME, Deliberate Strategy, Emergent Strategy, Strategy Formation Strategy Process, Strategy as Practice, Post-Processual Strategy, Balanced Scorecard( First, Second, and Third Generation), Quality Function Deployment, Strategic Framework, Business Tools, United Kingdom, Moderate Constructionism, Crystallization, A Single Case Study, Qualitative Analysis, Deductive Approach, Inductive Approach, Abductive Approach, Semi-Structured Interviews, Thematic Analysis And An Enumeration Approach.

## INTRODUCTION

The research aim is to understand the strategy process within SMEs, and to strategic tools for SMEs. According to Beaver and Prince (2004) SMEs have increased by 50% over 25 years, account for half the workforce, and 35% of the UK economy (Lou et al., 2011). In EU and USA, SMEs represent 99% of organizations (Burke and Jarratt, 2004). However, SMEs are not conducting strategic activities (Wang et al., 2007) a 'fact' which is primarily due to ignorance of the strategy process (Augustine et al., 2012).

## LITERATURE REVIEW

### Strategy Process

Strategy process stages	Stage 1		Stage 2	Stage 3		
	Deliberate approach	Stage Emergent approach	Deliberate and Emergent approach	Modern strategy process (activities based view)		
				Processual	Strategy as practice	Post processual
Time period	1960s – 1980s	1970s – 1990s	1980s – 1990s	1990 – 2000	2000s – Current	2007 – Current
Strategy process focused	Deliberate content focused	Emergent content focused	Deliberate and Emergent process focused	Emergent process focused	Extension to emergent process focused	Emergent practice focused
The Main Authors	(Chandler, 1962, Ansoff, 1965, Learned et al., 1965, Andrews, 1971)	(Johnson et al., 1998, Mintzberg et al., 1986, Mintzberg and McHugh, 1985, Mintzberg and Waters, 1985, Porter, 1980)	(Andersen, 2004a, Andersen, 2004b, Hart, 1992, Christensen and Donovan, 2000, Mintzberg et al., 1996), (Shrivastava and Grant, 1985, Nonaka, 1988, Wooldridge and Floyd, 1990)	(Mintzberg et al., 1998, Pettigrew, 1992, Pettigrew et al., 2003, Van de Ven, 1992, Whittington, 2001)	Jarzabkowski (2003), (Jarzabkowski et al., 2007, Jarzabkowski and Paul Spee, 2009, Jarzabkowski and Whittington, 2008, Jarzabkowski and Wilson, 2002, Whittington, 2006)	(Chia and MacKay, 2007)

Three strategy dimensions are *process*, *content* and *context* (Pettigrew, 1997, Chakravarthy and White, 2002). Originally, strategy focused on *content* (*strategic plan*). Long-term strategy formulation (deliberate) is criticized for lacking flexibility (Whittington, 2001); this lead to 'emergent' strategy, that deals with unplanned situations. Emergent strategy enables non-tangible factors (Boyd and Reuning-Elliot, 1998), i.e. political and contextual factors. To mediate between the deliberate and the emergent strategies, *strategy formation* bridges the gap between long-term planning and emergent strategy. Processual strategy focuses on actors and contextual aspects of strategy which emerged from market (Porter, 1998) and resource based strategy (Barney, 2001). Processual strategy its absence of micro activities is criticised (Johnson et al., 2003, Regnér, 2008) leading strategy as practice to focus on practitioners, practices and praxis (Whittington, 2006). Increased focus on practices evolved into post processual (Chia and MacKay, 2007).

**Table (1): The Anatomy of strategy process stages** There is no academic consensus regarding the strategy process phases. The debate questions if environmental analysis is part of formulation phase (Dudzevičiūtė and Peleckienė, 2010). Four phases are identified (e.g. Acur and Bititci, 2004), which are: environmental analysis, formulation, implementation, and evaluation including emergent strategy.

Strategies follow sequential iterative processes through these four phases. The process starts with analysis of the environment, internally and externally in relation to the market place (Côté et al., 2005). This is followed by strategy formulation, critical to the success of any strategy and performed through *strategic planning* (O'Regan and Ghobadian, 2002). This phase is usually the pitfall for SMEs (Baker et al., 1993). Strategy implementation depends on the quality of formulation. Critical success factors for implementation are cited in the literature (Aaltonen and Ikävalko, 2002, Atkinson, 2006). Measurements metrics are emphasised for importance during implementation enable strategy revision. Implementation leads to evaluation during which it can be determined whether further iterations of the strategy process are required (Côté et al., 2005). Emergent strategy is initiated through reformulated during on-going implementation.

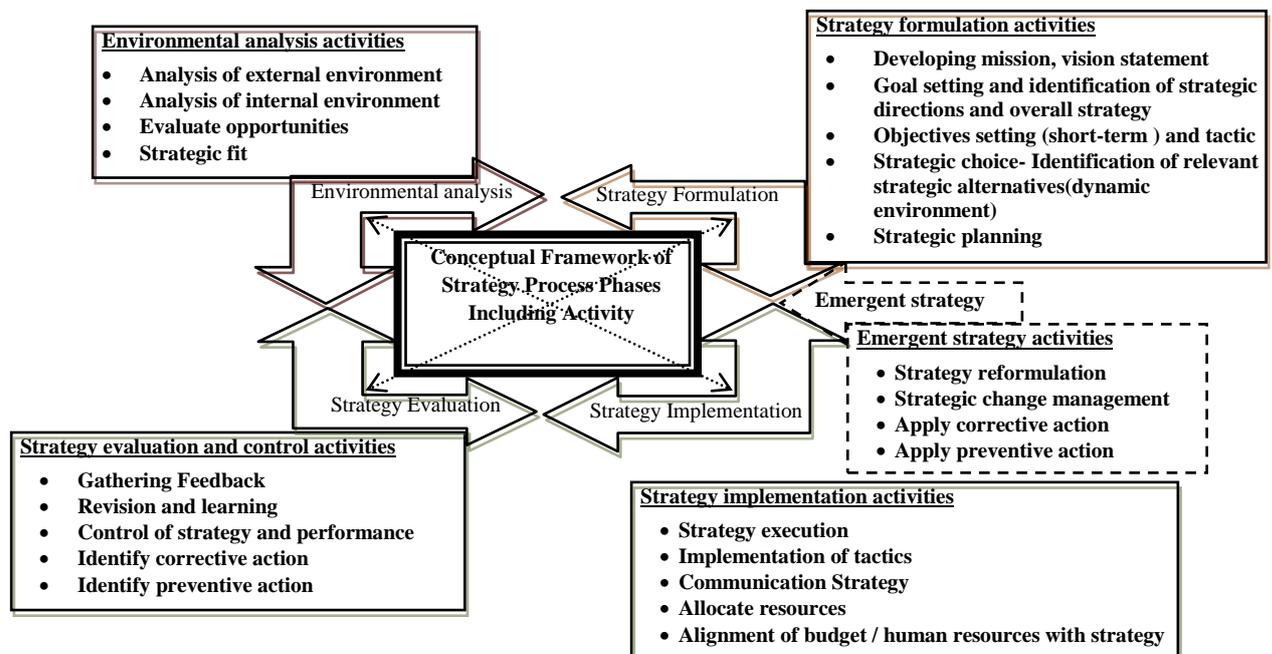
### **The Phases of strategy process and tools for their conduct**

Revision of literature found researchers to identified *tools* useful in conducting strategy formulation, implementation and evaluation (Ghamdi, 2005). Tapinos et al. (2011) recognized a gap in the literature with insufficient research on strategic management tools to support the strategy process. Furthermore, the surveys that investigate strategic management tools are so

wide, diverse and inconsistent, it's hard to draw any conclusions at all (Jarzabkowski and Wilson, 2006).

One tool that has been frequently cited is the Balanced Scorecard (BSC) of Kaplan and Norton (1992). In particular, the formulation and implementation phases are seen as areas where it may have a particular role to play (Mendes et al., 2012). BSC has had, it is claimed, a significant impact on strategy formulation, others argue that it makes an organization distinct in strategic terms (Tapinos et al., 2011). According to others, BSC enables performance measurement (Lawrie and Cobbold, 2004), and double loop learning (Sisaye and Birnberg, 2010, Rauffet et al., 2010) particularly for the evaluation phase. Also, it is claimed that BSC improves two way communication (Aaltonen and Ikävalko, 2002) between strategic and operational management (Atkinson, 2006).

Figure (1): The conceptual framework of strategy process



Over the three generations (Lawrie and Cobbold, 2004, Lawrie et al., 2006, Morisawa, 2002, Speckbacher et al., 2003, Guthrie and Yongvanich, 2011, Soderberg et al., 2011) of the BSC (Types I, II and III) itself, it has incorporated improvements to support its development as a performance measurement tool (Barnabè, 2011, Pongatichat and Johnston, 2008, Shulver and Lawrie, 2009). It has evolved into a strategic management perspective. Ultimately, some identify, it has become a tool for managing organizational change with the inclusion of a strategy map. See Table 2 for a summary of the claims.

Table (2): the evaluation of BSC

Type	Characteristics
<b>Type I BSC</b>	Financial and/or non-financial measures Grouped into perspectives
<b>Type II BSC</b> <b>A strategic management system"</b>	As for Type I BSC with added cause-and-effect relationships and some or all of the following characteristics: <ul style="list-style-type: none"> <li>• <b>Strategic objectives or strategic measures</b></li> <li>• <b>Targets and action plans</b></li> <li>• <b>Linkage between measures and organization's reward system</b></li> <li>• <b>Linkage between strategy and the budgeting process and the scorecard used as a basis for evaluating potential investments and initiatives</b></li> </ul>
<b>Type III BSC</b> <b>The final Balanced Scorecard is known as framework for a strategic management system and organizational change</b>	As for Type II BSC plus some or all of the following characteristics: <ul style="list-style-type: none"> <li>• An analytic and information system designed to support strategy review</li> <li>• <b>A process for learning and adapting the strategy in which managers validate (determine whether new strategic opportunities have emerged) and refine strategy</b></li> </ul>

Source: Adapted from: (Lawrie and Cobbold, 2004, Lawrie et al., 2006, Morisawa, 2002, Speckbacher et al., 2003, Guthrie and Yongvanich, 2011, Soderberg et al., 2011)

### **Integration of BSC with other strategic management tools**

The current study reviewed and evaluated the strategy process to understand how it was conducted within an organization. The research found through this evaluation of the strategy process that several limitations existed, not least the lack of formalization of process and the tools used. In conducting the review, it was observed that the case organization used several tools – as is recommended by some literature (Tapinos et al., 2011). The tools used included an informal SWOT analysis, scenario building, cost/benefit analysis and business case development, though often at the level of individual elements and not in an integrated way.

To further develop the case organizations strategy process, a context-driven revision of the BSC model was developed. This was identified as a suitable vehicle to be a more comprehensive and more formal approach, while still being in line with management expectation and experience. BSC is also one of the main strategy tools used in the strategy process elsewhere (Ahn, 2001, Atkinson, 2006). Therefore, the review and revision focused on other strategy management tools to support this approach: formal SWOT analysis, combined with the Quality Function Deployment approach were selected to support the BSC, with the aim of helping to overcome the limitations identified in the BSC in the literature (Barad and Dror, 2008, Koo, 1998). The literature review showed that these tools may be able to improve the BSC and this would help to overcome those limitations.

BSC cannot decide strategy or make a choice of strategic direction. SWOT analysis provides a better understanding of the internal and external environment of the organization, which

clarifies the strategic direction. Moreover, SWOT analysis helps the organization to understand the strengths and weaknesses that drive its strategic priorities (Papalexandris et al., 2005). The implementation of SWOT analysis helps to formulate strategies for the organization (Kaplan et al., 2008, Fernandes et al., 2006). The internal and external perspectives are analysed by a SWOT analysis from which the results (specific objectives) are placed in the strategy map, thus linking individual objectives into the BSC perspectives (Quezada, 2009).

Another important limitation of the BSC was found in its linkage model, the strategy map. However, there was no clear explanation of how the strategy map approach should be applied, or the detailed steps of the method. Based on the literature review, the QFD approach could perhaps make the strategy map more robust and reliable; a strategy map can be brought into action through QFD. Also, QFD provides integration between top-level objectives and operational level activities, which the BSC lacks. This would potentially enable a strategy plan produced by the BSC to be more effective, and therefore the strategy process could be implemented more efficiently by including the QFD strategy management tool in addition of the BSC.

Table (3) shows some examples for conclusion of the analysis of the previous literature review (theoretically or empirical) of the integration of BSC with SWOT analysis and/or QFD.

<u>Researchers</u>	<u>BSC &amp; SWOT</u>	<u>BSC &amp; QFD</u>	<u>BSQ</u>	<u>SME</u>	<u>Strategy Process</u>	<u>Strategy Map</u>	<u>Empirical</u>
(Papalexandris et al., 2005, Kaplan et al., 2008, Quezada et al., 2009)	✓					✓	✓
(Fernandes et al., 2006)	✓			SME	✓		✓
(Koo, 1998)		✓					✓
(Tan et al., 2004, Barad and Dror, 2008)		✓				✓	✓
(Tan and Bennett, 2007, Clegg and Tan, 2007)		✓		SME; micro-sized		✓	✓
(Dror, 2008)		✓					
(Lee and Ko, 2000)			✓	✓		✓	
(Lee and Ko, 2000, Lee et al., 2000)			✓				✓
(Ip and Koo, 2004, Chen et al., 2008, Lee et al., 2008, Chen and Cheng, 2009, Wang et al., 2010)			✓			✓	✓

Table (3): Overview of the literature review of strategic tool integration

## METHODOLOGY

### Research paradigm

The research adopted the moderate constructionism paradigm, on the basis that the researcher does not seek a universal truth, instead the researcher seeks to build up a multi-faceted community view (Järvensivu and Törnroos, 2010). Because epistemologically knowledge is mutually constructed between researcher and interviewees, a subjective ontological reality is formed. The research approach is abductive (Dubois and Gadde, 2002) through deduction of the conceptual model for the strategy process from the literature, this conceptual model is validated through falsification using the findings of the case study. This is followed by the induction of the suggested BSC strategy process framework for SMEs, based on the research findings (Elo and Kyngäs, 2008). Within this research paradigm a qualitative approach was adopted, which is reflected through the research methods (Patton, 2001, Bryman, 2012, Roshan and Deeptee, 2009).

### Research Aim Objectives and Questions

The aim of this research is twofold: it seeks to understand the strategy process within SMEs; and it aims to generate a strategy framework [using the BSC framework with other strategic tools (QFD and SWOT analysis)] to support SME management in the creation of a coherent strategy process.

### Research objectives

- To identify from the literature what is known about the strategy process, especially in relation to SMEs.
- To utilize a dynamic process view as an approach to clarify activities, strategy tools, techniques and methods in the SME strategy process.
- To develop a framework incorporating BSC and other business tools (SWOT analysis and QFD) to connect and carry out the strategy process.

### Research Questions

**Research Question 1:** What is the strategy process and how does it operate within the SME?

In order to answer this broad research question, the researcher has first to answer two further research questions, which are:

**Research Question 1a:** what are the key strategic activities in the SME and how are these performed?

**Research Question 1b:** Which strategic tools are used in the SME during the strategy process?

**Research Question 2:** How may a BSC strategy process framework [along with other business tools (QFD and SWOT analysis)] be used to support the strategy process in SMEs?

### Research methods

The research strategy is based on a single case study. The nature of the case study is explorative (Yin, 1994). Only a small number of studies have investigated the strategy process within SMEs. The research investigates a single holistic unit, as it treats the SME under observation as one unit (Yin, 2003), which is intrinsic (Stake, 2005, cited by Gilstrap, 2008 , p.2). According to Järvensivu and Törnroos (2010), the usage of a single case study is coherent within the research paradigm (Moderate Constructionism), in which a single case study is often used.

It was decided that a single case study would be appropriate based, on the type of case study (exploratory), its very nature (intrinsic) and the purpose for which the case study is applied (to understand the phenomena). The findings derived from the research actors are jointly constructed, which implies they are subject to context and the actors' community view. The primary data collection techniques to obtain the depth for this single unique case study is through interviewing the five key actors within the SME. This was supported through the use of archive and textual materials, supported by observation.

The research methods in the present study are divided into two sections. These are the data collection and data analysis methods. For the collection of data an interview was conducted with five of the key actors in the SME who held information relevant to this study. Once the data was collected through the interviews, it was analyzed through joint both *thematic analysis* and *Enumeration methods* (Data analysis process). Data analysis process is through joint both *thematic analysis* and *Enumeration methods*. *Thematic analysis method* involved the coding according to the themes (strategy process phases and activities) and its interpretation. *Enumeration method* determined the frequency with which each code phase and code activity for the strategy process was mentioned by a respondent. *Crystallization* enables a researcher to validate findings within a single case study, and seeks to obtain all the dimensions of the research in a similar way to a crystal, that is able to reflect light in all directions simultaneously. Crystallization was found to be suitable for the research based on the views of Järvensivu and Törnroos (2010). Crystallization takes into consideration that there is no universal truth. It was achieved through a multi-dimensional exploration of the data, based on the knowledge that the findings were subjective, and this offers a way in which a form of validity may be established.

## ANALYSIS AND DISCUSSION

### Introduction

The analysis within this section has evaluated the responses from the actors within the study and categorized them according to the phases and activities of the strategy process. To better understand this analysis it is further discussed in light of some of the finding within the literature of SMEs. This provides an insight into the SME and weights up the findings to determine how effective the SME is at performing strategy according to the strategy process.

### Environmental analysis phase

Within this study it was found that the more senior managers are involved in environmental analysis through the SWOT analysis. It was found that the focus is very much on technology to gain competitive advantage within the marketplace (with politics, economics and social factors largely ignored). Eternally the key factors seem to be the customer. Although the SME has limited ability in evaluation of opportunities based on internal strengths and external opportunities, extensive work has been done towards finding strategic fit between internal and external environments. This led the SME to understanding the difficulties to find an opportunity that they can take advantage from due to a lack of resources which is typical for SMEs.

		Analysis of External Environment	Analysis of Internal Environment	Evaluate opportunities	Strategic fit	Strategic tools
Actors	Operations and Board Director	<ul style="list-style-type: none"> <li>• Planning ahead through customer communications</li> <li>• Improved customer satisfaction</li> </ul>	<ul style="list-style-type: none"> <li>• Limited resources means that opportunities must be selected carefully</li> </ul>	<ul style="list-style-type: none"> <li>• Apply internal resource to external opportunities</li> </ul>	<ul style="list-style-type: none"> <li>• Communication with customers to plan ahead</li> </ul>	<ul style="list-style-type: none"> <li>• Informal/ Intuitive SWOT</li> <li>• Cost benefit</li> </ul>
	Business Development Director	<ul style="list-style-type: none"> <li>• Importance of technological developments</li> </ul>			<ul style="list-style-type: none"> <li>• Searching for new opportunities based on internal competencies</li> </ul>	<ul style="list-style-type: none"> <li>• Analysis used informally</li> <li>• What if scenarios and risk analysis are used to evaluate opportunities</li> </ul>
	Business Manager	<ul style="list-style-type: none"> <li>• Decision-making based on market threats and opportunities</li> <li>• Environmental analysis is an on-going activity</li> </ul>	<ul style="list-style-type: none"> <li>• Internal analysis through discussion and based on external changes</li> <li>• The analysis results are weighted to determine their importance</li> </ul>		<ul style="list-style-type: none"> <li>• Increase profit through new opportunities</li> </ul>	

### Strategy formulation phase

Determining the direction of the strategy was found to be mostly a senior management role through setting goals and objectives. In terms of strategic choice the SME is very much driven by available market opportunities with low risk as a key factor. The actual planning is mostly

focused on allocation of resources especially IT and the key planning tools used are business cases and action plan. With regards to strategic planning it was found that the SME is ahead of the game as most SMEs are not performing strategic planning (Wang et al., 2007), especially in the area of IT which is found to increase organisational performance ((Prasad et al., 2012).

	Development of mission and vision statements	Setting goals	Setting objectives	Strategic choice	Strategic planning	Strategic tools
Actors	Operations and Board Director		<ul style="list-style-type: none"> <li>• Provide public sector services</li> </ul>	<ul style="list-style-type: none"> <li>• Objectives defined in action plan</li> </ul>	<ul style="list-style-type: none"> <li>• Presentation of business cases</li> </ul>	<ul style="list-style-type: none"> <li>• Business case</li> <li>• Action plan</li> </ul>
	Business Development Director	<ul style="list-style-type: none"> <li>• Five to twenty year vision</li> <li>• Establish reliable IT infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>• Project cost and benefits must be approved</li> <li>• Increase customer service standards through IT</li> </ul>	<ul style="list-style-type: none"> <li>• Strategy must be approved by fiancé department</li> <li>• Reduce risk when possible</li> </ul>	<ul style="list-style-type: none"> <li>• Business case proposals for strategic choice</li> </ul>	
	Business Manager		<ul style="list-style-type: none"> <li>• Directors specify long-term goals</li> </ul>	<ul style="list-style-type: none"> <li>• Increase awareness of short-term objectives among staff</li> <li>• IT objective to enable day-to-day operations</li> </ul>	<ul style="list-style-type: none"> <li>• Key resource in planning is IT</li> </ul>	
	IT manager	<ul style="list-style-type: none"> <li>• Stay updated</li> </ul>		<ul style="list-style-type: none"> <li>• Ensure 100% IT uptime</li> <li>• Meet user requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Not choice, just seize opportunity</li> </ul>	
	Communication and marketing manager			<ul style="list-style-type: none"> <li>• Align IT with business operations</li> <li>• Review IT purchasing plan</li> </ul>	<ul style="list-style-type: none"> <li>• Less risky choices</li> </ul>	

### Strategy implementation phase

The SME was found to be most involved in the implementation of strategy. This is mostly through allocation of human resources, IT and budget management. Each of these is found to be closely related as they attempt to reduce resource usage to minimise the expense. Within the literature resources are the key obstacle for SMEs to implement their strategy. The SME executes its strategy through the implementation of tactics. IT was found the most central tactic to most of the strategies implemented by the SME. Although multiple communication channels have been identified, lack of communication and poor communication existed within the organisation. Furthermore, the SME does not use strategic tools for the implementation phase.

	Alignment with Human Resources and Budget with Strategy/ Allocate Resources Activity	Strategy Execution Activity	Implementation of tactics Activity	Communication strategy Activity	
Actors	Operations and Board Director	<ul style="list-style-type: none"> <li>• Development of human resources</li> <li>• Cost reduction in area of IT</li> </ul>		<ul style="list-style-type: none"> <li>• IT used as a tactic for day-to-day operations</li> <li>• IT as a tactic to reduce budget</li> </ul>	<ul style="list-style-type: none"> <li>• Feedback provided during meetings or in private</li> </ul>
	Business Development Director	<ul style="list-style-type: none"> <li>• Understanding of HR requirements</li> <li>• Training program</li> <li>• Meeting sales and marketing targets</li> <li>• Re-use IT to meet strategic objectives</li> <li>• Financial investment based on return on investment</li> </ul>	<ul style="list-style-type: none"> <li>• Diversify into private sector</li> <li>• Strategy formally implemented when bid is successful</li> <li>• IT used to implement strategy</li> <li>• Directors decide when strategy is implemented</li> <li>• IT to measure strategy performance during implementation</li> </ul>	<ul style="list-style-type: none"> <li>• Marketing and telesales services as a tactic to increase customer base</li> <li>• Sales and marketing as a tactic to increase revenue</li> <li>• IT as a tactic to meet strategic objectives</li> </ul>	<ul style="list-style-type: none"> <li>• Formal communication to implement strategy</li> <li>• Strategy communicated to staff for execution</li> </ul>
	Business Manager	<ul style="list-style-type: none"> <li>• Resource allocation depending on internal ability and market conditions</li> </ul>		<ul style="list-style-type: none"> <li>• Cost reduction tactics</li> </ul>	<ul style="list-style-type: none"> <li>• Weekly feedback meetings</li> </ul>
	Communication and marketing manager	<ul style="list-style-type: none"> <li>• Cash flow of day-to-day operations</li> </ul>	<ul style="list-style-type: none"> <li>• Provisioning of services to public sector</li> </ul>	<ul style="list-style-type: none"> <li>• Marketing research as a tactic to understand customer needs</li> </ul>	<ul style="list-style-type: none"> <li>• Discuss progress on a weekly basis</li> </ul>
	IT manager	<ul style="list-style-type: none"> <li>• Qualified staff to take advantage of IT</li> <li>• Unqualified staff</li> <li>• Inefficient budget management</li> <li>• IT resources to support the business functions</li> </ul>	<ul style="list-style-type: none"> <li>• Digitalize business processes</li> <li>• Strategy is executed when directions communicate it with managers</li> </ul>	<ul style="list-style-type: none"> <li>• Software packages as a tactic to achieve short and long-term objectives</li> <li>• IT as a tactic to meet business requirements</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of communication causes poor communication</li> </ul>

### Strategy evaluation phase

	Control of Strategy and Organization Performance	Gathering Feedback	Revision and Learning	Identify Corrective and Preventive Action	
Actors	Operations and Board Director	<ul style="list-style-type: none"> <li>• Project implementation evaluation</li> <li>• Quarterly monitoring meetings</li> <li>• Measurement of departmental performance</li> </ul>	<ul style="list-style-type: none"> <li>• Internal feedback at meetings</li> <li>• Sales stats discussed monthly</li> <li>• Quarter annual review</li> </ul>	<ul style="list-style-type: none"> <li>• Revision of the business process</li> <li>• Quarterly progress evaluation meetings</li> </ul>	<ul style="list-style-type: none"> <li>• Improve strategy execution (SE8)</li> </ul>
	Business Development Director	<ul style="list-style-type: none"> <li>• IT systems risk evaluation</li> <li>• Weekly strategy performance meetings</li> </ul>	<ul style="list-style-type: none"> <li>• Obtain customer feedback</li> <li>• Feedback through questionnaire</li> </ul>	<ul style="list-style-type: none"> <li>• Learning from staff feedback questionnaire</li> </ul>	<ul style="list-style-type: none"> <li>• Reduce risk of IT system down time</li> <li>• Evaluation for continues improvement</li> </ul>
	Business Manager	<ul style="list-style-type: none"> <li>• Weekly strategy control meetings</li> <li>• Raise awareness of short-term objectives</li> <li>• Strategy control through performance measurement</li> <li>• Review implementation results</li> </ul>	<ul style="list-style-type: none"> <li>• Measure organizational performance</li> </ul>	<ul style="list-style-type: none"> <li>• Strategy progress revision</li> <li>• Market research and competitive analysis for strategy revision</li> <li>• Evaluation through monitoring results</li> </ul>	<ul style="list-style-type: none"> <li>• Identification of communication problem</li> </ul>
	Communication and marketing manager	<ul style="list-style-type: none"> <li>• Balance sheet and survey to measure performance</li> <li>• Customer feedback collection</li> <li>• Strategy evaluation with project data and feedback</li> </ul>	<ul style="list-style-type: none"> <li>• Monitoring customer requirements and satisfactions</li> <li>• Collect customer feedback</li> </ul>	<ul style="list-style-type: none"> <li>• Improve services to increase customer satisfaction</li> </ul>	<ul style="list-style-type: none"> <li>• Proactive decision-making</li> </ul>
	IT manager	<ul style="list-style-type: none"> <li>• Strategy control based on results</li> </ul>			<ul style="list-style-type: none"> <li>• IT requirements forecasting</li> </ul>

In the literature it was found that most SMEs do not exercise strategic control (Oakes and Lee, 1999). However, in this study it was found that the SME has implemented several measurement systems for monitoring. The literature nevertheless criticises SMEs for the lack of resources leading to the inability of monitoring (Tenhunen, Rantanen and Ukko, 2001 cited by Rompho, 2011), especially for the gathering of feedback. The SME even applied advanced techniques of strategy evaluation during the revision and learning through looking at corrective and preventive action which is rarely performed by SMEs (Murphy and Kielgast, 2008).

### Emergent strategy

		Strategic change management	Strategy reformulation	Application of corrective and preventive action
Actors	Operations and Board Director	<ul style="list-style-type: none"> <li>• Technological and economic factors</li> <li>• Formal steering group to review business cases</li> </ul>	<ul style="list-style-type: none"> <li>• Reformulation depends on external environmental</li> </ul>	
	Business Development Director	<ul style="list-style-type: none"> <li>• Economic and technological change</li> <li>• Improve organizational performance</li> <li>• Flexible strategic management to increase performance</li> </ul>	<ul style="list-style-type: none"> <li>• Management meetings to improve business strategy</li> </ul>	<ul style="list-style-type: none"> <li>• When possible corrective actions are applied</li> <li>• Preventive action to overcome problems</li> </ul>
	Business Manager	<ul style="list-style-type: none"> <li>• Change management is day-to-day routine</li> <li>• Fast reaction to change through weekly meetings</li> </ul>		<ul style="list-style-type: none"> <li>• Emergent strategy through feedback</li> </ul>
	Communication and marketing manager	<ul style="list-style-type: none"> <li>• Increasing competition</li> <li>• Change management through market and project data</li> </ul>	<ul style="list-style-type: none"> <li>• Market and project data define emergent strategy</li> </ul>	
	IT manager		<ul style="list-style-type: none"> <li>• Procedures of corrective actions</li> </ul>	<ul style="list-style-type: none"> <li>• Training to overcome IT problems</li> </ul>

The SME in this study was found to not be very involved with emergent strategy activities, this when a strategy is being implemented. This is mostly through the management of change during the course of the strategy. It was found that this change in the strategy causes the requirement for changing the strategy through reformulation and aim to correct and prevent mistakes from happening. Although the SME is performing some of those activities, it is only to a limited extent and the actors with the SME are not completely conscious of this process taking place.

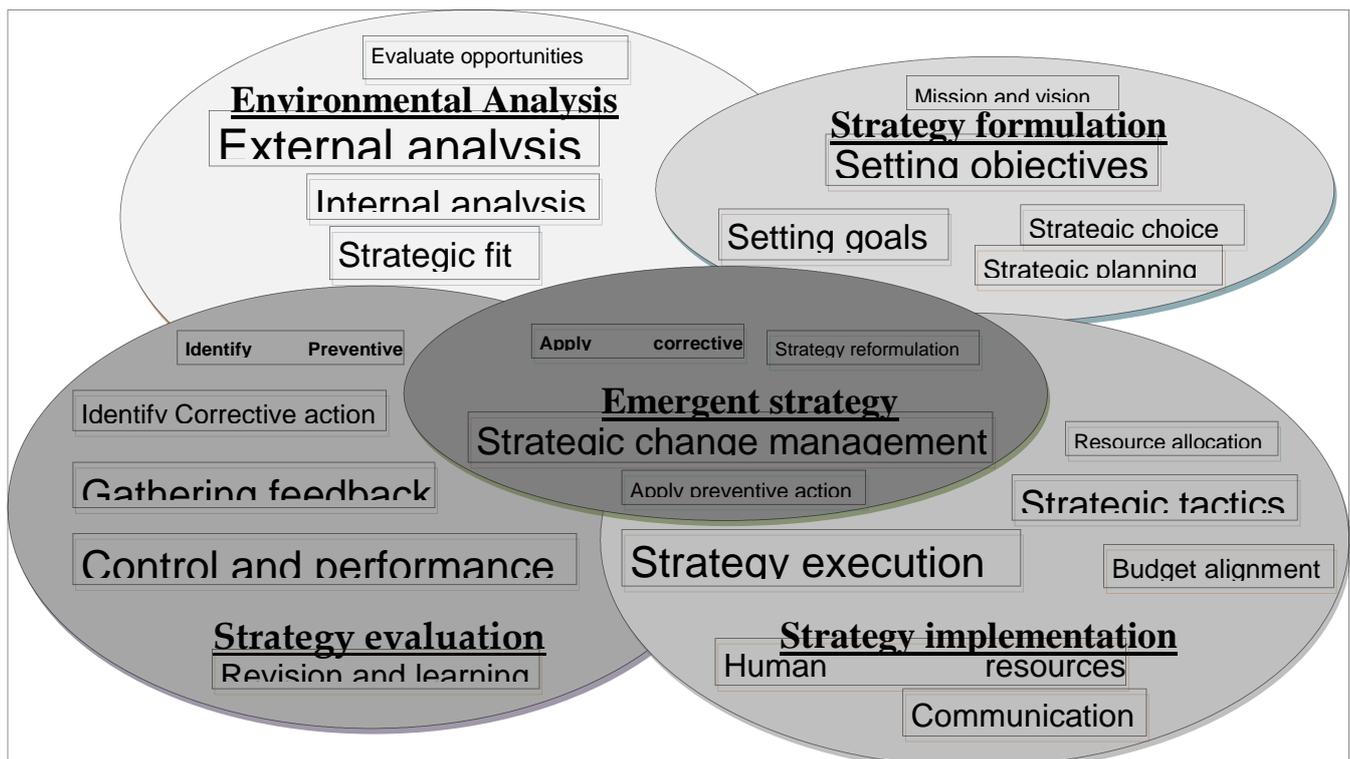
## RESULTS

The research within this study started with the evaluation of the literature with the purpose of developing an understanding of how SMEs perform strategy, which is depicted in the strategy process conceptual model. Based on those findings, this research seeks to evaluate how an SME is engaged with the strategy process. It was found that the SME is involved in all the phases and activities described within the literature up to a certain extent. In the reviewed conceptual model displayed above a revised conceptual model (Figure 2) is presented of the

study that depicts in proportion by size the level of involvement that the SME has in each and every activity within the phases of the strategy process. The 'strategy implementation phase' receives most frequently attention, while the SME is least involved in 'strategy formulation'. Whilst the literature lays out a systematic, sequential process the picture presented of the case study SME is somewhat different. The process that the SME uses is messy; it is not systematic; it is not sequential and is not clear. The reasons for this may be summarized as follows:

- Ambiguous communication of information
- Inability to manage development, growth, and innovation without a flexible approach
- A lack of systematic methods for defining strategy
- Importance/seeking new opportunities
- Short-term cash flows
- High risk in the SME

Figure (2): a revised conceptual model of strategy process



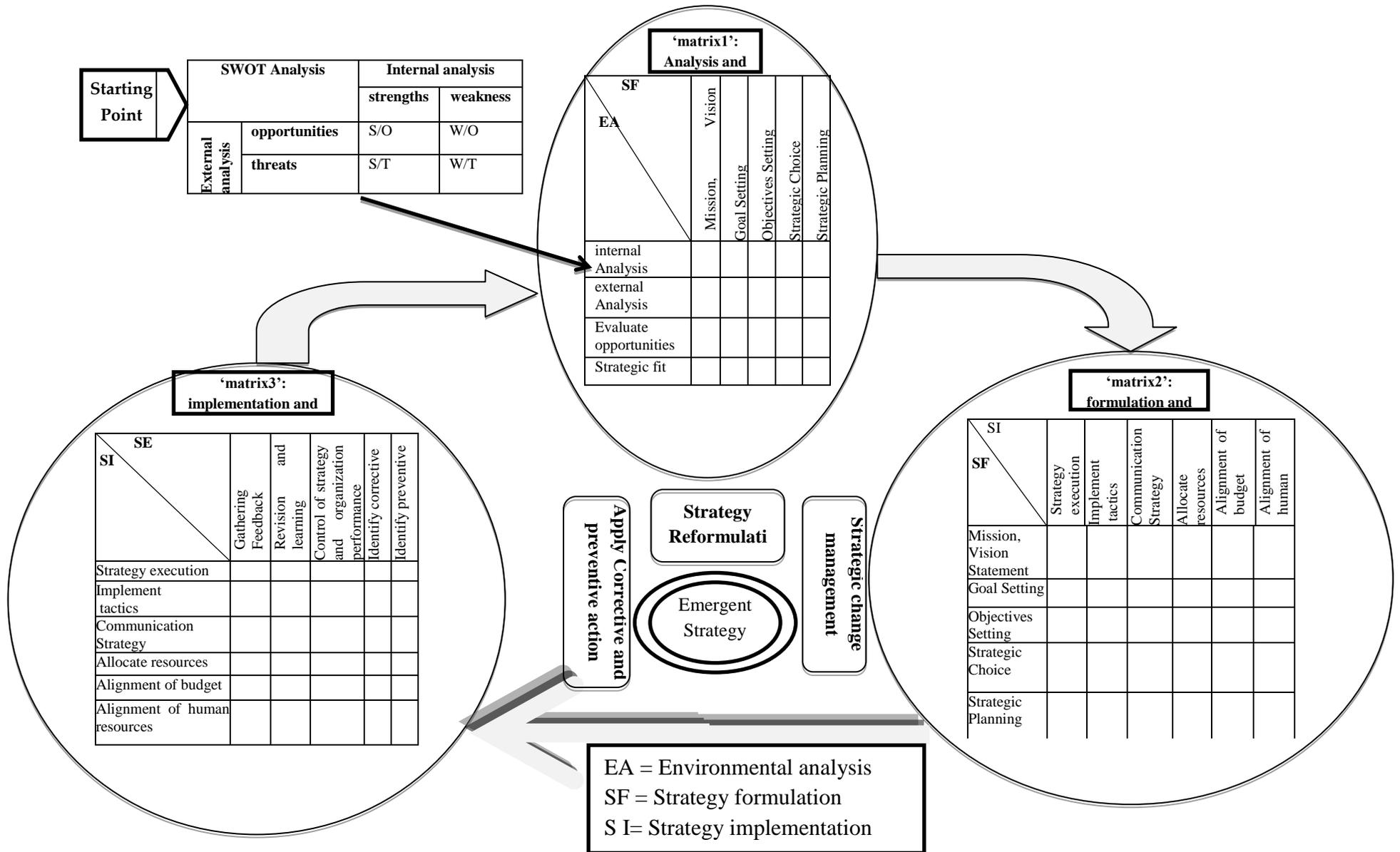
## **SUGGESTED FRAMEWORK AND FUTURE RESEARCH**

Based on the answers to the research questions, a contribution is presented which includes an integrated framework of the BSC, SWOT analysis and QFD tools (Figure 3). Justification is grounded on the literature, and the analytical findings that demonstrate how the framework may improve the strategy process for SMEs by addressing inherent difficulties within the strategy process.

The strategy framework functions through feeding the results of the swot analysis into the QFD matrix. The QFD process enables all the phases of the strategy process through the BSC. The evaluation of the strategy is done via the BSC measurement KPIs. Emergent strategy is incorporated through iteration.

The results of this study may hopefully facilitate future research that can expand on its findings, be conducted in different sectors, both public and private

Figure 3: Suggested BSC strategy process framework



## RESEARCH LIMITATION

The main limitation of this research is that the BSC strategy process framework has not been implemented and tested within a SME environment to find out how effective it is in practice.

## CONTRIBUTION TO THEORY AND PRACTICE

This study makes several contributions to the body of knowledge for a strategy process as management theory and practice. The contributions are the conclusions drawn from the literature review; the conceptual model that was deduced from the literature; the methodological implementation of the research paradigm of moderate constructionism and validation through crystallization; and finally, a suggested BSC strategy process framework that is constructed to aid SMEs in performing the strategy process as outlined in this article, as flows:

First: The adoption and use of the BSC framework in SMEs for the strategy process is rare, and little research has been carried out. The adoption and use of the BSC framework for the strategy process (as phases and activities) in SMEs is new, with no prior evidence of research into this purpose.

Contribution to theory within this research lies in suggestion of BSC strategy process framework (see figure 3), which adds to theory and it also adds to practice. This framework is developed through the synthesis of existing theoretical research on the strategy process and strategic tools, with evidence gathered from the empirical study within the SME, in order to understand how the SME performed the strategy process, and whether any strategic tools may be used to support this process. Based on the practice derived from the present study and theoretical knowledge from the literature, a strategy framework integrating BSC with two other strategic tools (SWOT analysis and QFD) is developed in order to support the phases and activities of the strategy process.

Through this Suggested BSC strategy process framework, SMEs may deploy a systematic approach to strategy. Through this systematic approach, SMEs are enabled to manage their cash flow and reduce risk; this also means that the SME can better manage growth and innovation. The framework is also novel in the following aspects which may support managers in maintaining a coherent strategy process, by overcome limitations for the SME, as follows:

- Synthesis of process phases.
- Activities in each phase are highlighted and positioned.

- Tools related/ connected to activates and phases
- The possibilities of implementation are explicitly considered
- Unified process
- A flexible and coherent process

Second: The findings of the research within the SME allowed the validation of the conceptual strategy process model ( see figure 1 and 2) in understanding how the SME perform strategy and which phases they go through implication to practice.

Third: The analysis of this research is unique and can be considered a contribution to knowledge, as it has not been seen in any prior literature. This was based on the methodology that was used. Within this research the researcher adopted a moderate constructionist paradigm, through which reality is socially constructed during the interviews between each interviewee and interviewer. To validate the results of the interviews the researcher used 'crystallization'. While crystallization is a known method, the method of application through which the results of each interview were categorized, according to the activities of the strategy process, is novel. This allowed a comparison of the interviewees and determined whether they had views which were compatible, or contradictory.

Fourth: A modified conceptual model of strategy process (based on the previous review of theoretical and empirical literature of strategy processes, see figure 2) is developed for SMEs.

## **IMPLICATION TO PRACTICE**

The implementation of the devised BSC strategy process framework is complicated and requires well-educated strategic managers. This is one of the factors for which SMEs have been criticized in the literature. For a SME to be able to implement the BSC strategy process framework there are some prerequisites, which are necessary to the success of this framework for the strategy process. The key requirement is strong leadership within the organization, which could be defined as top level management, as well as chief executive support and involvement in the process. These leaders must have a distinct view of where they are driving the business, proper business acumen, and knowledge of strategy and relevant strategy tools, as they are the key people who take control of decision making and the strategy framework. Consequently, it is found in the evaluation of this research that it is important that the resources of the SME are well managed, and it is suggested that specific roles are allocated within the organization to deal with human resources and finance as well as other resources, depending on the nature of the business. This is necessary to effectively implement the suggested a BSC strategy process framework, as this is one of the key weaknesses within

SMEs. At a broader level within the organization strong team working must exist, and it is essential that staff cooperate during the strategy process. At a human resource level, on-the-job training must be provided, such that business specific skills are of a high standard, so that confidence in strategy implementation is developed.

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## **“BACK TO THE FUTURE: THE VIRTUAL MUSEALIZATION IN PUBLIC MANAGEMENT. A RESEARCH NOTE FROM ITALY”**

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### **ABSTRACT**

The enhancement of cultural heritage has been a recurring theme within the scientific debate by scholars from different disciplines and in the political agenda of most countries over the last decades (Meneguzzo, Grossi, 2002; Ferri, Zan, 2012).

The purpose of this paper is to provide an analysis of the growing phenomenon represented by the "Virtual Musealization" of archaeological sites in Italy, focusing on the case of Pompeii and Herculaneum. The result will be a form of virtual accountability supporting on the one hand, the improvement in accessibility to museum services and particularly to the ruins of Pompeii and Herculaneum and on the other hand, facing the lack of resources and inadequate structures and skills for the protection and preservation of archaeological heritage of humanity (Zan, 2002; Ferri, Zan, 2012). The work aims to achieve the research objectives through an “inductive / deductive” search method (Yin, 1984, 1995).

*Keywords: Virtual, Musealization, Heritage, Public Management, Financial Sustainability*

### **INTRODUCTION**

The enhancement of artistic and cultural heritage has been a recurrent theme within the scientific and cultural debate by scholars from different disciplines and in the political agenda of most countries over the last decades (Meneguzzo, Grossi, 2002; Ferri, Zan, 2012). During the early 90s, researchers focused their attention on management practices, tools and models referring to arts and cultural organizations (Peacock, 1982; Frey, 1994; Towse, 1997; Christianse and Skaerbaeck, 199 , Zan, 2002), as well as on the development of new and different organizational forms (Sicca, Zan, 2006) under pressure from the New Public Management (Pollitt, 2001; Lapsley, 2008, Ferri, Zan, 2012; Lindqvist, 2012). These studies aimed at developing, analyzing and proposing different conceptual and management frameworks within a context characterized by increasing scarcity of financial resources and

regulatory complexity. The purpose of this paper is to provide an analysis of the growing phenomenon represented by the "Virtual Musealization" of archaeological sites in Italy, focusing on the case of Pompeii and Herculaneum. The result will be a form of virtual accountability supporting on the one hand, the improvement in accessibility to museum services and particularly to the ruins of Pompeii and Herculaneum and on the other hand, facing the scarcity of resources and the inadequacy of organizational structures and skills for the protection and preservation of archaeological heritage of humanity (Ferri, Zan, 2012).

## CONCEPTUAL FRAMEWORK

Over the last 20 years, dynamic complexity has been significantly shaping the public sector. This phenomenon is related to many factors embracing: the proliferation of social needs, the rising competition coming from the private sector (and higher opportunity for collaboration with it), market globalization and a rising number of players, the impact of advanced technologies, the short time-frame over which decisions are made, the higher intensiveness of unpredictability and strategic changes, and the scarcity of strategic resources.

Other economic-financial factors were a serious stagflation, welfare state crisis and growing government loans, in addition to a negative perception of bureaucracy.

These phenomena have been giving rise to the obsolescence of traditional management control systems in the public sector. The measurement of financial performance simply by using the aggregated method is no longer adequate. Accountability and prompt decision-making require proper tools allowing managers and decision-makers to understand how the aggregate financial performance can affect measures. Under this viewpoint, accountability breaking down raising critical management studies, is not the only means of making public service suppliers responsive to the citizens, but, in public choice terms, accountability becomes a "voice" rather than an "exit" option (Mulgan, 1997, 2000). This is also connected to a non-financial perspective, and particularly to the consideration of delays that are linked to the accumulation and depletion processes of strategic resources affecting performance drivers.

The most important changes were achieved within the New Public Management paradigm (hereafter NPM) by Italian local governments which were required to implement management concepts and tools in order to improve their own performance. NPM would refer to the development of innovative practiced routines being intended to improve

performance and to reinforce programs beyond the traditional conservatory government system (Borgonovi, 2005; Bardach, 1998).

Within this context the NPM would be better than public governance (Cepiku, 2005; Kickert, 2004; Meneguzzo, 2000) to achieve the two increasing inter-institutional relationships (Mussari, 2009, Borgonovi, 1994). This way, public service planning, management and supply will become something to be negotiated between a number of players, including government, the voluntary and community sector and the private sector (Rhodes, 1996). In this innovative model the problem is how to manage these composite networks (Kickert et al., 1997).

The new paradigm forces government to clarify "who does what" and "how to do what must be done" from a collaborative and responsible perspective (Osborne, Gaebler, 1992). Consequently Italian local governments have chosen to adopt a new institutional arrangement in order to become more accountable and responsible toward stakeholders and to improve citizen participation (Hood, 1998) avoiding asymmetry of information between citizens and politicians.

In the public sector, political accountability is a natural implication that is linked to the management of public resources coming from taxpayers and citizens (Aucoin, 1990). Accountability might be defined as a "chameleon-like term" to be used in reference to definite requirements arising from a relationship of responsibility, where one person or entity is responsible toward others for the performance of specific services (Mulgan, 2000) allowing stakeholders to assess their stewardship and empowering their decisions (Ricci, 2005).

Amongst three thousand museum sites operating in the Museum Virtual Library, only twenty-two are Italian museum sites. This circumstance emphasizes the long delay of our country in adapting museum exhibits to technology. This clear diagnosis highlights the vital need for a cure.

What is the reason that should encourage the use of new technologies in this field? It's preferable to recreate "digital originals", "cloning" the originals of our museums and our libraries in order to protect them, to allow a visit or a consultation to them with non-destructive effects (for example, an Etruscan tomb or a knowledgeable manuscript)? Would it be appropriate to recreate the "double" of the original that is preserved in churches, galleries, palaces in order to stimulate curiosity, favouring the promotion of tourism? Or, again, might it be intended to offer digital hidden details (the inverse of the square, the women's galleries

of churches, inaccessible areas of castles and historic buildings)? What should be the target audience of a virtual museum?

In other words, the issue is whether the "virtual museum" is to reproduce, as closely as possible, the real one, or if on the contrary must create an entirely new dimension. In recent years there has been an explosion of interest for digital libraries, on the side of virtual museums. This interest on the one hand has stimulated the development of research and studies, on the other hand it has contributed to numerous experimentations.

## **THE VIRTUAL MUSEALIZATION**

The virtual museum can be therefore regarded as an ideal museum model, which is appropriate not only for electronic museums just existing in the digital cyberspace, but also, even though with much effort, in relation to real museums, whose attention and resources are often focused almost exclusively on the museological aspects, related to the conservation of works of art, to the detriment of the communicative and narrative characteristics.

A virtual museum can ideally aggregate works and similar objects which are scattered in different places or recreate destroyed, lost, or designed but never built constructions. In its virtual version a museum can also present objects according to criteria which are alternative to those characterizing the real exposition that, for various reasons, are not optimal. It is possible to create endless combinations of themes, the same object can become a part of different paths.

The path of knowledge is individual and proceeds according to the natural function for associative ideas. The analysis of museum sites concerning their technology content and interfaces let us to identify some common characteristics. In terms of content an on-line virtual museum is generally composed of the following areas (of course not always presenting all areas as separate sections of the site):

- a) - practical information on access, location, hours and on-site services, which are sometimes accompanied by reservation services or purchase of tickets for remote access;
- b) - teaching tools specifically designed for informational and educational purposes, to help visitors understand a work or a finding, or carry out a thorough analysis of them (these resources are recurrent in technical science museums, but unusual in art museums);

c) - information about the museum itself, from both an historical perspective and an institutional view, as well as from a logistical and spatial analysis (often accompanied by maps and photographs);

d) - sections devoted to merchandising, sometimes developed up to be equipped with e-commerce systems.

e) - information relating to permanent collections is generally provided through thematic catalogues of works and artifacts or logistical plans linked to the museum maps (for each work news commentary and explanation are normally catalogued).

From a technical point of view, in reference to the types of navigation interfaces, museum sites are mostly based on standard web technologies, with format images.

## **VIRTUAL MUSEALIZATION: EVIDENCE FROM ITALY**

According to the Report of Civita in 2008, non-profit associations that are active in the field of cultural heritage, such as the services provided by the Sole 24 Ore, aroused great optimism, but these investigations do not contribute to the understanding of why Italy is still late in the application of technology to art museums and, above all, they do not help to understand the difference between an "on line" museum and a "virtual" museum both terms being used as unimportant synonyms. Italian museum sites certainly do not excel for the quality of communication and the level of technological solutions.

The management of cultural heritage in our country continues to suffer from a low level of technology and inadequate communication between those who are responsible for it, as well as the lack of a single computerized catalogue of the many hidden treasures in the various corners of the country. As a result, several attempts to use the network as a museum communication tool suffer from underinvestment in economic planning.

An example is represented by the site of one of the most famous and richest museums in the world, the Uffizi Gallery in Firenze. The site, in fact, despite being one of the first Italian virtual museums, has had virtually no development since its first embodiment, in reference to both graphics and content. The museum home page provides access to the various sections of the site dedicated respectively to general information, collections of the gallery, history, settings, and information and news. The section dedicated to the gallery is based on a simple interface consisting of a clickable map and several pages dedicated to single rooms, allowing the access to cards on the works they contain. Nothing more than a simple guide, if an

exception is made for a chance to virtually visit some of the rooms by means of the movie-map made of QuickTime VR. Another major Italian museum institution (even if formally located in a foreign country) is represented by the Vatican Museums that are in an even worse situation. In fact, although the official website of the Vatican Museums, whose handwriting is commendable, those who are interested to see pictures of some of the masterpieces of the Vatican Museums have to refer to a private site of a religious nature. The site that is strongly confessional makes it possible to access to about 1,400 high-quality images but it is devoid of any context information. It is divided into four sections: Vatican Museums, Sistine Chapel, Rooms Raphael and the Vatican City.

## **A CASE STUDY**

The Virtual Museum of Archaeology (MAV) in Herculaneum is an institution of international importance. It is owned by the Foundation Cives, with the participation of other local and regional authorities such as the Province of Naples and Campania Region. Its constitution dates from 2008. The cost for the implementation of the MAV was € 5 million in order to adapt the former school Iattarino to a multifunctional centre of culture. It consists of spaces for temporary exhibitions, an auditorium, a large multimedia archaeological museum, large-scale scientific and educational designs especially for schools. More than 70 multimedia installations, three-dimensional reconstructions, holograms, laser, touch screen, environmental effects, multisensory, tables and virtual books, fog screen, playing immersive exhibits and games, multi-synchronized and interactive interfaces, tracking the visitor. In December 2010, the reconstruction of the Schola Armaturarum - which collapsed just a month before - was completed, (a common restoration in reinforced material built in the 90s of the twentieth century. Spread over a total area of 5000 square metres, built on 3 levels, it was opened in 2008 after three years of planning involving the City of Herculaneum and the Province of Naples (which formed the foundation for the management of CIVES Mav ) and Campania Region since 2009. The magnificence of the ancient baths, the majesty of the city theatre, the chance to walk inside the grotto of Baia, to wander among the brothels of Pompeii. The big attraction is finally the 3D eruption of Vesuvius. The museum is located in an area of 5 thousand square metres and is articulated on three levels, including a 300 seat auditorium, with over seventy multimedia installations. All these efforts have produced positive effects in terms of attendance and business, thanks to a deep process of web accountability. In fact, the trend has been growing since the Museum was radically renewed

and the 3D projection of the film on Vesuvius. In the first quarter of this year, there has been an increase of 15% attendance in the context of a general crisis of cultural consumption and in the presence of a drop of at least 20% attendance in the tourism industry. In April there was a real boom doubling the number of visitors, both during the week and on weekends. Mav 2.0 means that: a museum adapts itself to the evolution of technology, realizing emission of science and a strong focus on new generations of digital natives. The complex management of a virtual museum as the Mav in Pompeii and Herculaneum, is characterized by a particular flexibility. The human resources who are devoted to the virtual museum display, are represented by ten units of work, including eight employees with part-time contracts (50% of full time), with an average age of 27 years. Six people on the whole, receive approximately 70,000 guests every year, and hundreds of cultural events, website, communication, promotion, planning and programming.

In the first two years of life, the MAV earned about 7,000 euro per day, but these amounts were barely sufficient to cover its start-up costs alone. The third year cash flow registered a surplus of management, allowing the museum to survive and pay the costs of operation and maintenance. The ordinary state funding supporting and ensuring the Mav financial sustainability, is still virtual. This circumstance gives explanation of why museum-virtual and virtual museums on the network which are similar to the Mav in Herculaneum and Pompeii, recognize the process of reporting on their activities as the strength of the principle of public companies' social responsibility in which accountability can become a significant part in terms of the value of qualitative information, in addition to the economic-financial component. Recent trends, not only in public company as the MAV, but also in private companies, to seek greater levels of accountability and transparency in decisions and actions can be linked to several factors (Ricci, 2010):

- Recent accountability different meanings, no longer based on the compliance to rules and regulations, but meant to be a guideline to facilitate the participation of citizens and the administrative action as a tool to inform citizens about the level of achievement of objectives and to highlight areas of responsibility (politicians and managers) in the measurement of results;
- A clearer definition of the models of performance, measurement and determination of the level of autonomy in order to achieve genuine separation of areas of activity between different levels of government (governance and internal accountability);

- The construction of models of representation and accountability for citizens to increase the level of knowledge of administrative activities and sharing of the results (external governance accountability);
- Improving the quality of public services through the definition of standard and quantitative targets for an easy and immediate assessment of the levels of citizen satisfaction (customer satisfaction);
- The improvement of internal and external control to promote autonomy in the evaluation of both the results and the performance that have been achieved.

Seven key variables are helpful to identify a proper system of accountability (Ricci, 2010):

- an articulated and clear planning process;
- a clear definition of inside and outside responsibilities;
- an adequate system of accounting and non-accounting;
- an effective internal monitoring and evaluation program;
- periodic disclosure of information;
- significant benchmarking activity `;
- a valuable use of technology in communication.

These factors should reflect the best processes of assessment and accountability.

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## PPP AND PUBLIC WORKS LAW IN FRANCE

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### ABSTRACT

Public-Private Partnership (PPP) is a highly increasing way of public technical works execution and of public services delivery through the long-term commitment of the private contractor.

France has recently adopted a legislative framework on PPP while public works law is not applicable for it. This paper examines whether the framework is an actual enhancement of the traditional law on public works.

A preliminary evaluation state procedure is obligatory, in order to decide whether the eventual use of the PPP method is value for money, and it constitutes a crucial modernization of the traditional law on the matter. The French state, endowed with a very important precedent of concessions, has managed to make use of the PPP model with success even in the delicate domain of museums and cultural heritage scopes, let alone in a rather innovating way. The paper makes a comparison of the public works law with the PPPs legislation and the concessions one by indicating the most significant similarities and differences.

Last but not least, PPP contract model does not exemplify only the contracting out phenomenon, along with the public works traditional method and the concession one, but also the School of Thought of New Public Management (NPM) initially putting the stress on privatization of public companies and afterwards on contracting out.

**Keywords:** Public - Private Partnership (PPP), Contracts, Public works law, Concession, French legal order, Contracting out, Preliminary evaluation, New Public Management (NPM), Museums, Culture

## **INTRODUCTION: PPP LAW AGAINST TRADITIONAL LAW IN FRANCE**

PPPs constitute long-term contracts of technical works construction or of services provision, with allocation of risks between the public sector and the private one that is supposed to ensure beforehand financing of the scopes. The term “sponsored PPP” declares the PPP case, in which the cost of providing the service is jointly borne by the users of the service and the government through a capital subsidy, not wholly borne by the Public Administration (administrative PPP). On the contrary, in the traditional type of public works contracts there is no allocation of risks and the private contractor gets the reward for the part of the technical works already completed during the execution of the contract, uniquely by the public contractor.

France is a country endowed with a long history of concessions and many examples of PPPs in various domains of public interest (defence, education, health, environment, transport infrastructure, urban facilities, energy, culture and sports) and challenges particularly the scientific interest.

In French law, Law 85-704 (called MOP) and Ordinance 2004-559 constitute the hard-core legislation, as modified, on public works and PPPs respectively.

*We assume that PPP law constitutes an actual enhancement of the traditional law on public works in the French legal order.*

## **CRITERIA OF OPTION OF THE PPP INSTITUTION**

According to Ordinance 2004-559 and the relevant newer legislation, it is obligatory to proceed to a preliminary evaluation of legal, financial and administrative nature, to demonstrate that PPP is preferable to any other type of public contract.

The process of pre-assessment is carried out in two stages: the first investigates whether the selection criteria of the contract are met and the second is a comparative analysis to confirm that PPP is the most appropriate.

The criteria are the following:

### *1. The complexity of the project*

There is a complex task and situation and the public sector is unable to determine in advance the technical tools for the needs of the construction or operation of the project or to determine the economic-legal settings (weak financial structure, identification of needs in

human resources, etc.). It is to pay special attention to the fact that this criterion is usually activated for cultural projects.

### *2. The urgency of the project*

It is about avoiding a delay prejudicial to the public interest in the project, regardless of the cause of the delay, or acting as a response to an unforeseen situation in form of force majeure. Projects that have security problems and cases of lack in equipment also have an urgent character. The evaluation reports must analyze the positive effects of the rapid project execution while justification is not only based on the criterion of the emergency but also on other ones, like the complexity.

### *3. Greater efficiency (favourable balance of advantages - disadvantages) against other forms of procurement*

This alternate criterion has been inserted through article 2II of Law 2008-735, modifying the initial legislation on PPP in order to facilitate the use of the PPP mechanism. Therefore, a feature of PPP projects consists in the fact that their requirements are defined in terms of outputs rather than inputs on contrary to the conventional public works projects that usually focus on inputs. The choice of the partnership contract presupposes a comparative socio - economic analysis as well as a sensitivity one and a risk assessment and, as a result, it reminds of the concept of «best value for money» of the Private Finance Initiative (P.F.I.), namely of the PPP in the United Kingdom.

This method constitutes an important innovation against the traditional law on public works. The traditional law includes dispositions which refer to pre-assessment but they are not as precise and demanding as those of the PPP contracts. MOP law could usefully be modified to reflect the appearance of new contracts that it does not include but it needs a comparative study between the advantages and disadvantages, to perform a pre-evaluation of different alternatives (Grange, 2010).

## **CONTRACT AWARD PROCEDURES**

The award procedures of public works contracts and of PPP ones are the following:

### *1. Open procedure*

All interested persons, having the legitimate qualifications specified in the invitation to tender, may participate in this type of procedure, by submitting their bids.

### *2. Restricted procedure*

This procedure is applicable mainly in important or specialized works. Any private entities feeling that they have the qualifications specified in the declaration may declare their interest. Subsequently, a default takes place and, in the second stage, only these private sectors endowed with the qualified criteria are invited by the contracting authority to submit a bid.

### *3. Negotiation*

The negotiation procedure is provided for all the aforementioned cases in which a PPP contract may be chosen, i.e. complex projects, urgency or greater efficiency, while the unique prerequisite has to do with the height of the budget.

### *4. Competitive dialogue*

The contracting authority may use the competitive dialogue procedure in the case of particularly complex contracts, for which it considers that the use of the open or restricted procedure will not permit the award of a particular contract. This procedure is an important novelty introduced by EU Directive 18/2004. In France, this modern type is widely used while in the Greek legal order it is marginal and the restricted procedure is almost always chosen.

## **CONTRACT AWARD CRITERIA**

PPP and public works contracts, as previewed by the aforementioned EU Directive 18/2004, are awarded upon the following criteria:

### *1) Eligibility criteria*

They are related to the individual candidates and their particular qualifications (personal reliability, financial solvency, technical ability).

### *2) Criteria for the evaluation of tenders and contract award*

#### *a) The criterion of the most economically advantageous bid*

The contracting authority examines and takes into account, economic parameters - which is the case of the opposite criterion of the lowest price - and various other parameters of the contract scope (quality, price, technical merit, aesthetic and functional characteristics, environmental characteristics, running cost, cost-effectiveness, after sales service and technical assistance, delivery date and delivery period or period of completion and so on). These criteria should be clearly specified by the contracting authority, along with the weighting assigned to each of these.

#### *b) The criterion of the lowest price*

This criterion of merely financial content is excluded from the procedures of negotiation and competitive dialogue.

## FINANCING A PROJECT

Financing is carried out exclusively by the government in the common type of public works while in the case of PPP mechanism things are different. In France, the private sector must establish a Special Purpose Company, or “Special Purpose Vehicle” (SPV), that bears the responsibility and the risk of the financing of the execution of the contract.

Using private funds for construction and operation of projects can accelerate the infrastructure development program, without additional funds from the government. In case of constraints on government budgets, the development of PPP projects contributes to enhancement of both employment and economic growth (Venieris, 2007).

According to European Union practice, adopted by Eurostat and the EIB, the so-called 50% rule, given that co-financing by the public sector should not exceed 50% of the contract budget, as for a concession or a PPP contract. Otherwise, EIB does not borrow public carriers, as a general rule. .

## DISPUTE RESOLUTION

In France, according to ar. 22 of the Circular of 14 February 2012 (Guide of good practice in public procurement), the amicable ways for disputes resolutions relevant to public contracts are the following:

### *Mediation or conciliation*

The mediator is an independent third party that helps the two parties reach to an agreement. He does not have the ability to bind the parties legally and facilitates rather than directs the process.

### *Advisory committee's amicable settlement of disputes*

For all types of projects, it is recommendable to formulate a clause, under which the contracting authority authorizes a natural person to represent the contractor, upon notification of the contract. The representative may have a *mediating role* in resolving disputes arising during the execution of the contract. The preferable representatives have no hierarchical relationship with the people responsible for managing the project. It is about the advisory committees model, established by Ordinance 2010-1525.

### *Negotiation or transaction*

Under the terms of Article 2044 of the French Civil Code "*The transaction is a contract within the parties are terminating a born dispute or prevent one from being born.*"

#### *Arbitration*

A panel of arbitrators or arbitral tribunal, selected by both parties, undertakes to make a decision on the disputes. The arbitration may be predetermined through a special clause in the PPP contract or when a dispute arises.

Besides the above, another way of dispute resolution for PPP is:

#### *Expertise*

It is ideally suited to disputes and matters of valuation that are primarily dependent on technical issues. An independent expert in the matter of the dispute is appointed by the parties to resolve it.

## **PPP AND CULTURE IN FRANCE**

In the cultural context, the recourse of the French Administration to PPP contracts remains restricted (Maniatis, 2011). Nevertheless, the scopes of the contracts in the cultural domain are discerned by their novelties, which could be considered as inspired by the innovative character of PPPs.

For instance, the Theatre of Archipelago in Perpignan has been in operation since October 2011 and hosts a cross-border festival, shows and co-productions. The Marine Museum in Biarritz is a thermal-balance building, requiring no heating in the winter or air conditioning in the summer, for a scientific approach to oceanography through experiments.

The latest successful example of cultural PPP in France consists in the National Museum of Civilisations of Europe and of the Mediterranean, in Marseille. It includes an ancient fortress with an emblematic tower, closed for centuries and converted to a "museum-walk" connected with the main museum through a long bridge. This intervention indicates the recommendable, creative approach to the legal principle of sustainability for the historical monuments. In other words, monuments should not be treated statically, upon the negative alternative having the sense of mere prevention from damage (Maniatis, 2013).

The enhancement of the computers system in the Palace of Versailles constitutes the unique fiasco in the cultural domain through PPP. The failure was due not to mere incapacity of the private partner but to various reasons and the French museum managed to resume its normal operation soon, without making use to the contracting out, again (Vassilakou and Maniatis, 2012).

## FRENCH CULTURAL LEGISLATION AND LITERATURE

Victor Hugo's contribution to the French and the wider technical legislation has been significant. In his classic work "The Hunchback of Notre Dame" essentially makes this building as the main theme of his novel. Moreover, his article of 1832 titled "War to people that demolish" in the "Journal of Two Worlds" states that there are two things in a building: the use and the beauty. Its use belongs to the owner, the beauty to the world, therefore the owner has no right to destroy the building. The philosophy of heritage protection, especially of the architectural heritage, clearly derives from this text (Maniatis, 2013).

The first major act of the French state, from 1830 on, relevant to the protection of monuments is to create the position of a general inspector of historic monuments. This central decision-maker localized monuments to preserve and gave a motivated opinion on the feasibility of servicing and maintenance work to undertake for the monuments of the State. In 1834, Prosper Mérimée, a member of a generation of romantic writers, was appointed inspector general of historic monuments and travels throughout France and also abroad. His approach to heritage, particularly the religious one, was scientific, stripped of sentimentality, which renews the approach to heritage at the time. He achieved inter alia to save the Cluny building (in the centre of Paris) and discovered and saved the textile masterpiece "The Lady and the Unicorn" at the Boussac Castle. This project is now the key attraction at the Museum of the Middle Ages, namely in the Cluny building.

In France, there was a very early legislation on the protection of cultural heritage. The Fifth Republic, under the influence of André Malraux, politician and writer, gives a major role to the State, as for cultural affairs, and mainly provides for the first time a body of doctrine relevant to cultural policy, summarized in the Decree of 24<sup>th</sup> July 1959 (Maniatis, 2013).

The first generation of heritage legislation comprises initially law of 30<sup>th</sup> March 1897, in virtue of which private buildings could not be listed without the agreement of owner (but, in case of discrepancy, the Council of State could decide expropriation) and then law of 31<sup>th</sup> December 1913. That crucial text, institutionalizing the modern status of "historic monuments", has been incorporated since 2004 into the Code of Heritage.

The second generation of heritage legislation started with L. 903 of 4<sup>th</sup> August 1962, the so-called Malraux law) on "safeguarded domains". Besides the existent status of listed buildings, this pioneer law previews the potential creation of protected areas, to save and keep in economic operation entire sets of buildings, even in the very centre of cities.

PPP model, being inherently innovative, requires a preliminary evaluation (design) procedure for its activation, in addition to the similar, traditional procedure of the state (urban planning) and the modern one (spatial planning).

## **A NEW TREND OF PPP PROJECTS: COMMERCIALIZATION OF PRISONS**

A relatively new trend in PPP projects consists in the commercialization of traditional infrastructure of public entities.

This development is well exemplified by prisons managed by private partners through PPP contracts in some countries, such as the USA and New Zealand. In modern times, the United Kingdom was the first country in Europe to make use of private jails on the basis of 25-year duration PFI contracts. The first privately managed prison in the United Kingdom became the Wolds one in 1992, within a contract of 5-year duration. On the contrary, in Greece, according to article 2, par. 3 of L. 3389/2005, no PPP methodology is permitted for operations of state sovereignty in a strict sense (national defence, policing, administration of justice and enforcement of sentences imposed by the courts).

For the management of prisons, specialized companies have been created, let alone introduced in the stock market. In such centres cost containment is achieved, through prisoners' work and the delivery of services (correctional specialized services) with small fees.

Most companies pay the minimum wage, but many pay much less. The AT & T, for example, paid only \$ 2 an hour for prisoners of telemarketers, and Honda gets made car parts from convicts (convict-made) from prison in Ohio to \$ 2.05 per hour. Detainees usually only keep 20% of their payment, the state government grabs the rest, that is why the government is to support the provision of services of prisoners (Hightowe, 1998).

Last but not least, private management has raised severe criticism due to security problem and to lack of discipline. A high percentage of prisoner's escapes suggests bad management and raises security issues to local residents. Traditional – type prisons are more open to public scrutiny whilst PPP prisons are less transparent. It is quite hard to regulate and monitor the modern jails as violations of contractual obligations are difficult to detect. The use of prisoners as labourers is increasing unemployment for lawful citizens and may be regarded as opposite to the prisoners human rights.

## COMPARING PPP AND PUBLIC WORKS

From the legislative framework on PPP and the public works result the following principal differences and similarities:

Similarities	Differences	
	PPP	Public works
Main principles within the process of selection of contractors are the transparency and the protection of the free competition.	The private sector assumes substantial part of the risk of financing, construction etc.	The government bears all risks of the project after the definite completion of the project.
	The private sector deals with the public one through a Special Purpose Vehicle (SPV).	The private sector deals directly with the public one.
In final analysis, the cost of the project is carried out by the state (unless PPP scopes are reciprocal) 	Funding for the construction of the project (initially) is carried out by the private sector.	Funding for the construction of the project is carried out exclusively by the state.
	The repayment of the private sector is usually done by the contracting authority (e.g. availability payments, shadow tolls) or by users (e.g. motorway tolls), or by a combination of both (e.g. low user charges along with public operating subsidies).	The repayment of the private sector is done by the public sector on successful delivery of the project.

Table 1: Similarities and differences between PPP and traditional-type public works

## COMPARING PPP AND PUBLIC WORKS CONCESSION

According to EU Directive 18/2004, "Public works concession is a contract of the same type as a public works contract with the exception of the fact that the consideration for the works to be carried out consists either solely in the right to exploit the works or in this right along with payment". The concession was used in France in 1666 for the construction, financing and management of the project of Canal du Midi (Mediterranean – Atlantic Channel).

In French law, concessions are called Delegations, namely assignments, of Public Service (DSP). This scheme includes not only the concession, but also leases, advantageous contracts management etc (Lichère *et al*, 2009). It is to pay special attention that on international scale concession implicates transmission of power from the public authority to the private contractor (Lampropoulou, 2011).

The most significant similarities and differences between PPP and concessions are the following:

Similarities	Differences	
	PPP	Concession
They both consist in designing and constructing public works and providing services.	The private sector deals with the public one through a Special Purpose Vehicle (SPV).	The private sector deals directly with the public one.
Main principles within the process of selection of contractors are the transparency, the proportionality and the free competition.	Usually selected for non-reciprocal scopes.	Usually selected for reciprocal scopes.
They are contracts for pecuniary interest.	There is a central administrative body (MAPPP in France) competent for the contracts	There is no central administrative body competent for the contracts..
The private sector takes on a substantial part of the risks, let alone the fact that he initially must ensure the financing of the contract execution.	The repayment of the private sector is usually done by the contracting authority (e.g. availability payments, shadow tolls) or by users (e.g. motorway tolls), or by a combination of both (e.g. low user charges together with public operating subsidies).	The repayment of the private sector is done by the users.

Table 2: Similarities and differences between PPP and concession

## PPP AND NEW PUBLIC MANAGEMENT

The School of Thought that is called New Public Management (NPM) is a global phenomenon, whose reforms shift the emphasis from traditional public administration to public management (Larbi, 1999). It is about the transfer of business and market principles and management techniques from the private sector to the public one. According to this concept, the supply of public services should be done in commercial and competitive terms (Venieris, 2007). This management culture puts the stress on the central role of the citizen or customer as well as on accountability for results (Manning, 2000).

PPPs have become widely accepted and popular in public sector management, as they enable the public sector to benefit from commercial dynamism, innovation and efficiencies, harnessed through the introduction of private sector investors who contribute their own capital, skills and experience. The principles of NPM encouraged the establishment of PPPs as a new management tool (Khanom, 2010), let alone the fact that NPM initially put the stress on privatization of public companies and afterwards on contracting out.

The institutional forms of PPP vary from close *contracting out* cooperative efforts to infrastructure projects for building and operating new physical facilities such as schools,

tunnels, bridges or sports arenas (Greve and Ejersbo, 2002). They are viewed by private companies as alternatives to "raw" contracting out (ISS, 2002).

## CONCLUSION: PPP ENRICHING CONTRACTING OUT

In conclusion, PPP version of contracting out is as a principle an attractive method for technical works construction or services provision. It is about a modern legal tool, endowed with a lot of innovative regulations, such as the obligatory preliminary evaluation procedure that is to adopt within the traditional law on public works, in order to select the best type of carrying out each project. These dispositions are indeed an enhancement of the French law of public works and, as a result, the hypothesis of the present paper has been confirmed. Moreover, it is to underline that even crucial managerial data, such as the completion of innovative constructions in the delicate domain of heritage and museums, highlight this progress.

A recommendation for governments of countries with a separate and specific PPP law consists in considering the degree to which the requirements of traditional law on public works and of PPP law are aligned (Burger P. and Hawkesworth I.). Anyway, partnerships should not be seen as a panacea but be used in case that they add value (Her Majesty's Stationery Office, 2000).

Last but not least, PPP has already enriched in a rather satisfactory way the contracting out methodology that exemplifies NPM and the state planning, urban and spatial.

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## THE EFFECT OF MACROECONOMIC VARIABLES ON EXCHANGE RATE VOLATILITY

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### **ABSTRACT**

Exchange rate stability is a fundamental property for economic development of a given country. It promotes price stability, stable economic growth and investments. However one of the major problems that foreign exchange market faces is volatility. The risk associated with high volatility levels in the foreign exchange market have cost implications for a number of economic agents as well as the economy as whole. Taking into account the aforementioned with the use of monthly exchange rates from January 1999 to March 2013 the aim of the current study was to determine, if any, the relationship between macroeconomic variable and exchange rate volatility. Four different macroeconomic variables have been used, namely openness of the economy, interest rate differential, unexpected news and inflation. To examine the potential relationship two different approaches have been used so as to examine the robustness of the results to changes in the methodology. From the results it can be suggested that the results are not robust to method of estimation supporting the part of the relevant literature that argues that the non-significance of the macroeconomic variable in explaining the changes of exchange rate volatility might come forth from the differences in the methodology and not to the variables as such. Even though in the current study there was not a strong support for the existence of a relationship between macroeconomic variable and exchange rate volatility, while under GARCH methodology the relationship was found to be none, under EGARCH approach in different series certain variables were found to be statistically significant. As certain previous studies suggested, the magnitude and significance of macroeconomic variable on exchange rate volatility depend on the economic conditions of a given country.

## 1. INTRODUCTION

The Foreign Exchange Market is considered to be the biggest financial market in the world with an average daily turnover worth about 3.98 trillion dollars today. Aiming to facilitate businesses to perform transaction outside their local currency, with globalization foreign exchange market have witness a dramatic growth over the last three decades. This development is expected to continue even further in the future since integration of financial market and world trade is anticipated to continue to grow. Additionally, foreign exchange market is a market that operates round the clock on a global level, opening at Asia and specifically Tokyo, then Europe and finally US. For that reason the correct functioning of this market is of importance to governments as well as investors and companies.

Exchange rate stability is a fundamental property for economic development of a given country. It promotes price stability, stable economic growth and investments. However one of the major problems that foreign exchange market faces is volatility. Volatility is the dispersion of asset price returns. If exchange rates are volatile then prices in the economy follow volatile movements. For that reason policy makers are eager to quantify and forecast this type of volatility since it would help them to design as well as implement a more appropriate exchange rate policy so as to progress export and foreign direct investments, economic growth, and promote overall external macroeconomic stability (Kihangire, 2004).

Apart from the policy makers, exchange rate volatility is of interest to individual agents as well. Foreign exchange market brings together individual agents such as international investors risk and portfolio managers and brokerage firms. For all those agents' exchange rate volatility has important implication in their everyday decisions. Specifically, investors and risk managers have become global in an attempt to diversify their portfolios or hedge their risk. Knowledge about exchange rate volatility in conjunction with their risk profile would help make appropriate investment decisions and hedge their risk position. Furthermore, quantification as well as forecast of volatility is of importance to those agents that are dealing with international trade and again based on their risk profiles agents that are risk averse would minimize transactions with countries with high volatile exchange rates as opposed who are considered to be risk lovers.

Due to its importance for several players in the business world as well as governments exchange rate volatility there is an extensive literature in the subject matter. However, even though the literature on exchange rate volatility is long still there is no agreement as to the factors that influence this volatility. There is a variety of factor that empirical literature indicated that affect exchange rate such the openness of the economy [Hau (2002), Stančík

(2006)], interest rates (Juthathip 2009), exchange rate regime (Kočenda and Valachy 2006), inflation [Calvo and Reinhart (2000), Devereux and Engel (2003)], and unpredictable circumstance (Calderon and Kubota, 2009), where the degree of the impact of those factors depends on the economic conditions of a given country. On the other hand there is a number of literature that suggests that there is no link between macroeconomic variable and exchange rates. The primal notion behind this view is those macroeconomic variables do not exhibit the same increase as exchange rate volatility during floating exchange rate regime (Albuquerque and Portugal 2005).

Based on the aforementioned the aim of the current study is to estimate the exchange rate volatility based on monthly data for a number of currencies and with the use of macroeconomic variable to identify the possible causes of this volatility.

## 2. LITERATURE REVIEW

Volatility is the variation in the price of a given financial asset and is usually separated in to historical and implied volatility. The historical volatility is measured by the standard deviation which indicates the distress of the price of a security from its mean; the higher the deviation the higher the risk associated with the given assets. Implied volatility computes the volatility of a financial price in a forward looking method by deriving a volatility figure from its associated option prices.

Since volatility is associated with higher risk is it has been suggested that it damages the smooth functioning of the financial system and at the same time has a negative effect on economic growth (Rajni and Mahendra, 2007; Mollah, 2009). In essence volatility, irrespective of the underline assets, represents changes in investors' perceptions about the relevant market. The changes in perception mainly emerge with the appearance of new information about the market, but the extent of the effect is always determined by the relevance of the information together the level of surprise generated from it.

The literature has long concentrated on the sources of information that causes volatility. A novel research by Engle (1982) suggests that volatility is a result of new unexpected information whereas latter studies postulate that volatility is caused by a number of factors such as trading volume, changes in the in monetary and fiscal policies as well as changes in investors' risk preferences (Ajao and Wemambu, 2012).

Studies have found evidence that the financial position of an economy is affected by exchange volatility and for that reasons it can be suggested that any alterations in the exchange rate

markets have cost consequences for all economic agents. In general, since exchange rate is defined as the price of one currency in relation to another then the appreciation or depreciation of one currency over another points out the strengthening or deteriorating of one currency in conjunction with the opposing currency. Any deviation of from the equilibrium rate it is assumed to be exchange rate volatility.

If exchange rates are volatile then prices in the economy follow volatile movements. That was evidence in a numerous countries, and especially in those countries where their economic growth depended largely on exports (Sengupta and Sfeir, 1996). Benita and Lauterbach (2004) supported that exchange rate volatility have real economic costs that disturb price solidity, firm profitability and the overall economic stability. As volatility is associated with risk, then this risk increased transaction costs and diminishes the economic benefits from international trade because it creates uncertainty for the exporting company's earnings. A number of studies suggested that the existence of a well-established financial market would provide the advantage of hedging against that type of risk and thus either decrease or eliminate it [Makin (1978), Cushman (1983, 1986)]. Nevertheless more recent studies found evidence of a negative relationship between exchange rate volatility and exports [Tenreyro (2007), Arize et al (2008)]. The primary notion for this negative relationship rest on the assumption that a depreciation of exchange rate would result in export growth as indigenous good and services would be cheaper and hence more competitive and the same time would discourage imports since foreign products and service would be less attractive due to the associated high costs. On the other hand an appreciation would result in a reduction of exports and a boost of import (Aliyu, 2011). Since a depreciation of an exchange rate leads to a shift from imported goods and services to the local ones, this results also to a shift of income from importing states to the exporting ones. The end result is an alteration in the economic conditions and growth of both states (Azeez et al., 2012).

Another bulk of studies suggests that the effect of exchange rate volatility on a nation's economic performance depends on the exchange rate regime which the country follows. Earlier studies postulate that fixed exchange rate regime promotes economic growth and financial stability [Mundell (1973), Frankel and Rose (2002)]. On the other hand Fischer (2001), found evidence that a fixed regime lead to speculative capital inflows and overinvestment. The results of Bastourre and Carrera (2004), suggested that exchange rate volatility is greater when other factors that influence by volatility are accounted for and concluded that there is a negative relationship between exchange rate regime and volatility.

In terms of the effect of exchange rate volatility and FDI there are two different theories explaining their relationship. The first one, production flexibility theory postulates that there is a positive relationship between exchange rate volatility and FDI because companies are expected to be competent to change their variable factors following a shock (Bastourre and Carrera, 2004). On the other hand in accordance with the second theory, risk aversion theory, exchange rate volatility has adverse effect on FDI since the higher the variation in exchange rate the higher the uncertainty for the expected exchange rate and thus the lower FDI is reduced (Goldberg and Kolstad, 1995).

In regards to the relationship between economic growth and exchange rate volatility a number of studies found evidence that there is an inverse relationship between the two. A study in the economic growth European Monetary Union found support of the aforementioned relationship (Schnabl, 2007). The results suggest that stable exchange rates create stability for asset and labour market and thus boost economic growth. The study of David et al (2010) confirms the aforementioned negative relationship in the Nigerian manufacturing industry whereas Akinbobola and Oyetayo (2010) with the utilization of data from the same country again confirm the hypothesis but with a substantial time lag. However, when examining the relationship in small developed economies Polodo et al (2011) found no evidence of its existence in a dynamic setting.

Taking into account the importance of stable exchange rates in both the economy as well as individual agents there is an extensive literature in the subject matter. However, even though the literature on exchange rate volatility is long still there is no agreement as to the factors that influence this volatility. There is a variety of factor that empirical literature indicated that affect exchange rate such the openness of the economy [Hau (2002), Stančík (2006)], interest rates (Juthathip 2009), exchange rate regime (Kočenda and Valachy 2006), inflation [Calvo and Reinhart (2000), Devereux and Engel (2003)], and unpredictable circumstance (Calderon and Kubota, 2009), where the degree of the impact of those factors depends on the economic conditions of a given country. On the other hand there are a number of studies that suggests that there is no link between macroeconomic variable and exchange rates. The primal notion behind this view is those macroeconomic variables do not exhibit the same increase as exchange rate volatility during floating exchange rate regime (Albuquerque and Portugal 2005).

Examining firstly those studies that found evidence that economic variables alter exchange rates they indicated that there are a number of macroeconomic variables that are found to affect volatility but the degree of the impact of each of those variables differs and is

influenced by the specific country's economic situation. A number of studies have examined the effect of the openness of the economy. Hau (2002) found evidence of a negative relationship between exchange rate volatility and openness of the economy. By utilizing import to GDP as a proxy of the openness of the economy and standard deviation for the changes in real exchange rate as a measure of volatility he found positively statistically significant relationship between the two variables. His theoretical model rests on the proposition of small open economy that indicated that the more open the economy is the higher the flexibility of price levels, whereas this flexibility leads to a reduction in the money supply and productivity shocks and real exchange rate volatility. Hau's results are supported by Stancik (2006) that examined the relationship in six central and eastern European countries as well as Bravo and di Giovanni (2006). The latter study took also into account the effect of trade barriers on the relationship where the analysis shows support for the inclusion of trade barriers variables and also a negative relation between economic openness, measured by trade volume, and exchange rate volatility. Nevertheless as the authors indicated, the effect of the openness is not as vast as that of the trade barriers.

In terms of unpredictable circumstances, such government crises, market crises, industrial shocks and terrorist attacks, have been primarily examined by Dornbusch (1978) and Frenkel (1981). Frenkel (1981) with the utilization of monthly data between US exchange rate over British pound, French Francs and Deutsche Mark he indicated that since the forecasted changes in the exchange rates encapsulate only a minor portion of the real change, a large portion of the unforeseen changes emerge from the arrival of unexpected news. Further contrary to the basic economic theory, in his attempt to identify a proxy variable for the news, he postulated that there is positive relation between interest and exchange rate in an inflationary setting. Hence he found a positive correlation between news and exchange rates. One the drawback of the study was the utilization of monthly data. To apprehend the element of surprise caused by new information higher frequency data is need. To overcome the aforementioned problem Galati and Ho (2003) examine the hypothesis with the use of daily euro/dollar exchange rate. There results indicated that there is a statistically significant correlation between the news and exchange rate movements, where good news cause an increase in the currency and bad news a decrease. In the same line are the evidences of Sanchez-Fung (2003) and Stancik (2006).

A number of studies have examined the effect of interest rates and inflation on exchange rate volatility. Faust et al. (2007) with the application of intraday data evaluate the effect of different macroeconomic events on exchange rates including interest rate fluctuations. The

results indicated that exchange rates are affected by expected changes in foreign interest rates whereas inflation has found to have no or little the exchange rates. Additionally, in terms of inflation Albuquerque and Portugal (2005) suggested that there is a semi-concave relationship between exchange rate volatility and inflation rates.

On the other hand there is a number of literature that suggests that there is no link between macroeconomic variable and exchange rates. The primal notion behind this view is those macroeconomic variables do not exhibit the same increase as exchange rate volatility during floating exchange rate regime (Albuquerque and Portugal 2005). Another view as to the non-clarity of the causes of exchange rate volatility rest of the modeling approaches that have been employed (Chipili, 2009). As Erdemlioglu et al (2012) noted *'the goal for volatility modelers has been to simultaneously account for the most prominent features of foreign exchange volatility: (i) it tends to be autocorrelated; (ii) it is periodic, displaying intraday and intraweek patterns; and (iii) it includes discontinuities (jumps) in prices'* (Erdemlioglu et al (2012),pp.1). The models for measuring and forecasting exchange rate volatility are divided into two categories. In the first category are those models who aim to capture the key properties of weekly or daily exchange rate returns by describing the autocorrelation in daily and weekly volatility. Those models belong in the ARCH/GARCH family and based on their individual specification can either capture the short or long memory dependencies in exchange volatility. The second category aims to capture the changes on intraday horizon including discontinuities in prices, namely realized volatility (Andersen and Bollerslev, 1998). The realized volatility models are calculated from high frequency data, such as intraday data, as opposed to daily data. Even though realized volatility model provide the advantage of estimating volatility at every moment, data on intraday basis is not available for all markets and additionally even when data are available, it is not clear how to choose the optimum number of sample intraday intervals.

### 3. DATA

The sample totals 171 monthly observations covering the period from January 1999 to March 2013. The choice of data was primarily to capture the turbulent period of financial distress, that emerge with the collapse of the Baring Brothers in the US and drove the local economy into recession that eventual role over to Europe. But also to take into account a more flourishing economic era that took place at the beginning of the previous decade. An additional factor in terms of data period was of course the availability of data for all the three countries under examination. The data concerning the Eurozone has been obtained from the

website of the European Central Bank. Both the exchange rates as well as the macro variable for United Kingdom have been obtain from the website of Bank of England and OECD, and lastly the data for the United States have been attained from the website of Federal Reserve Board and OECD.

The summary statistic of the both the level and the first difference are presented in table 1 below. A point of notice is that the standard deviation of the level data is significantly lower for all the three exchange rate series as opposed to the higher values that exhibited after the first differencing. It is an important observation since the traditional measure of volatility for any asset is its standard deviation. Skewness and Kurtosis aim to detect any departures from normality, where the test rejects the hypothesis of normality when the p-value is less than or equal to 0.05. Since the normal distribution has a skewness of zero and kurtosis of three, the data can be considered as a non-symmetric one and as positively skewed relative to the normal distribution apart from the first difference of Euro/US Dollar suggesting that the series is normally distributed.

Even though that from an economic point of view in terms of volatility it is more important to evaluate the level rather than the monthly changes of exchange rates it is mostly common from previous studies that exchange rates are non-stationary. In fact most of the economic and financial time series they either exhibit trending behavior or nonstationarity, such as share prices and exchange rates. Hence prior to any further investigation it is appropriate for any research to identify the most appropriate form of the trend in the data.

Even though that from an economic point of view in terms of volatility it is more important to evaluate the level rather than the monthly changes of exchange rates it is mostly common from previous studies that exchange rates are non-stationary. In fact most of the economic and financial time series they either exhibit trending behavior or nonstationarity, such as share prices and exchange rates. Hence prior to any further investigation it is appropriate for any research to identify the most appropriate form of the trend in the data.

More specifically, a stationary time series is one whose statistical properties such as mean, variance, autocorrelation, etc. are all constant over time. For a time series to be stationary is of utmost importance so as to be able to obtain meaningful sample statistics such as means, variances, and correlations with other variables. Such statistics are useful as descriptors of future behavior only if the series is stationary. For a time series data to be stationary, it must:

1. Exhibit constant spread
2. Have no trend
3. Have no seasonality

The most common way to elevate the non-stationarity is by taking the first difference of the data. Accordingly, prior to examining the effects of the macro variable on exchange volatility the first step is to examine the level exchange rate for stationarity with the Unit Root test. Autoregressive unit root test is based on testing the null hypothesis that  $\phi = 1$  (difference stationary) against the alternative hypothesis that  $\phi < 1$  (trend stationary). It is named unit root tests due to the fact that under the null hypothesis the autoregressive polynomial of  $z_t$ ,  $\phi(z) = (1 - \phi z) = 0$ , has a root equal to unity. The null hypothesis assumes that a series  $y_t$  is trend stationary. When  $y_t$  is then first differenced it becomes

$$4. \quad \Delta y_t = \delta + \Delta z_t \quad (1)$$

$$5. \quad \Delta z_t = \phi \Delta z_{t-1} + \varepsilon_t - \varepsilon_{t-1} \quad (2)$$

Based on the evidence of non-stationarity, and following most of empirical finance literature, the variable to be modelled is percentage monthly exchange rate return which is the first difference of the natural logarithm of the exchange rate and is given by the following equation:

$$= 100 * \log \left( \frac{E_t}{E_{t-1}} \right) \quad (3)$$

where  $r_t$  is the daily percentage return to the exchange rate and  $E_t$  and  $E_{t-1}$  denote the exchange rate at the current day and previous day, respectively. As noted by Griebeler (2010), the justification for this transformation rest on the notion that exchange rates can be viewed as any other assets, since it has the characteristic of reserve of value.

Below there is description of the macroeconomic variable utilized in the current study:

**Openness of the Economy:** The openness of the economy is calculated following partly the specification of Hau (2002). Hau utilize import to GDP as a proxy of the openness of the economy whereas in the current study the variable is the sum of import and export to GDP. The openness of the economy is expected to have a negative relationship with exchange rate volatility.

**Inflation :** The inflation rate variable is the actual inflation rate of the given country/region.

**Interest:** The interest rate is define as the interest rate differential, that is the difference between the interest rate in the home currency and the interest rate in the foreign currency, following the study of Goyal and Arora (2010) who suggested that the interest differential increases volatility in the short period.

**Unexpected News:** The unexpected news variable is estimated based on the specification proposed by Frankel (1981) and later used by a number of other studies. As Stancik (2007) pointed out it is difficult to observe and quantify unpredictable circumstances or news hence an alternative measure should be used to evaluate those events. Based on the notion that that asset markets clear fast and react immediately to news the following then the unpredictable circumstances or news can be measure with the use of the following equation:

$$= (i - i^*) - E_{t-1}(i - i^*) \quad (4)$$

where  $i$  is the interest rate in the home currency and  $i^*$  is the interest rate in the foreign currency; the first term in this difference denotes the innovation in the interest differential and the second one denotes the interest differential which was expected to prevail in period  $t$  based on the information available at  $t-1$ . Following Stancik (2007) the interest rate differential is estimated from a regression of the interest differential on the constant, two-lagged values of the differential and the logarithm of the lagged spot exchange rate. The results of the three estimated regression are given the tables below. The variable is expected to have a positive effect on exchange rate volatility as indicated by a number of studies.

**Table 5: Descriptive Statistics for the three exchange rate series**

Variable	Observation	Mean	Standard Deviation	Min	Max	Skewness	Kurtosis	adj chi2(2)	Prob>chi2
<i>Level</i>									
Euro/US Dollar	171	1.212267	0.1884708	0.8532	1.577	0.0451	0.0003	14.17	0.0008
Sterling Pound/ Euro	171	1.396384	0.1759659	1.0867	1.6994	0.1136	0.0000		0.0000
US Dollar / Sterling Pound	171	0.6065041	0.0612391	0.4831	0.7139	0.1295	0.0000	19.02	0.0001
<i>First Difference</i>									
Euro/US Dollar	170	0.0282245	1.097882	-3.285712	2.843388	0.8799	0.8990	0.04	0.9807
Sterling Pound/ Euro	170	-.0515641	0.7738122	-3.757548	1.463097	0.0000	0.0001	28.50	0.0000
US Dollar / Sterling Pound	170	0.0232073	0.9573819	-2.586466	4.167232	0.0151	0.0013	13.58	0.0011

#### 4. METHODOLOGY

Following the relevant literature, to estimate the exchange rate volatility the GARCH model is going to be applied. The methodology and the specific of the model are going to be described below. The first in identifying the model based is to identify the degrees of  $p$ , autoregressive order, and  $q$ , moving average order. According to Gazda and Výrost (2003) from methodological stand point GARCH rests on the same assumptions as the ARMA method (Box-Jenkins, 1970). Hence the starting point in establishing the appropriate GARCH model is to identify the correct ARMA that fits the three data series.

##### a. ARIMA

One of the most prevalent methods for forecasting time series is the Box-Jenkins also known as ARIMA approach. ARIMA method rests on the assumption that the future value of a given variable is a linear function of its past observations as well a random error. An ARIMA model can be decomposed in two parts (Box et al., 1994). First, it has an Integrated (I) component (d), which represents the amount of differencing to be performed on the series to make it stationary. The second component of an ARIMA consists of an ARMA model for the series rendered stationary through differentiation. The ARMA component is further decomposed into AR and MA components (Pankratz, 1983). The Auto Regressive (AR) component captures the correlation between the current value of the time series and some of its past values. For example, AR(1) means that the current observation is correlated with its immediate past value at time  $t-1$ . The Moving Average (MA) component represents the duration of the influence of a random (unexplained) shock. For example, MA(1) means that a shock on the value of the series at time  $t$  is correlated with the shock at  $t-1$ .

**Table 6: Characteristics of the theoretical ACF and PACF for stationary processes**

Process	ACF	PACF
AR (p)	Tails off as exponential	Cuts off after lag p
MA (q)	Cuts off after lag q	Tails off as exponential decay or damped sine wave
ARIMA (p,q)	Tails off after lag (q-p)	Tails off after lag (p-q)

The methodology is based on a three step procedure.

1. Model Identification: Establish the stationarity of the different variables, identify seasonality in the dependent variable and with the use with the use of autocorrelation and partial autocorrelation functions of to decide which (if any) autoregressive or moving average component should be used in the model.
2. Parameter estimation: Attain the coefficients which best fit the selected ARIMA model.
3. Model checking: By testing whether the estimated model conforms to the specifications of a stationary univariate process. In particular, the residuals should be independent of each other and constant in mean and variance over time.

Stationarity is a necessary condition in building an ARIMA model used for forecasting, so data transformation is often required to make the time series to be stationary. There are a number of tests used to evaluate the stationarity of a data series, one of which has been already applied in the current data set is the Augmented Dickey Fuller unit root test. When the final model is approved then it will be used for prediction of future value of exchange rate.

The ARMA model can be written as follows when the data set is stationary:

$$= \alpha_1 y_{t-1} + \dots + \alpha_p y_{t-p} + \epsilon_t + \beta_1 \epsilon_{t-1} + \dots + \beta_q \epsilon_{t-q} \quad (5)$$

Which is actually a combination of an autoregressive AR(p) model and an a moving average

MA(q) model. The AR(p) is defined as:

$$y_t = \alpha_1 y_{t-1} + \alpha_2 y_{t-2} + \dots + \alpha_p y_{t-p} + \epsilon_t \quad (6)$$

where systematic part of  $y_t$  is a linear function of  $p$  lagged values

The MA(q) is defined as:

$$\epsilon_t = \epsilon_t + \beta_1 \epsilon_{t-1} + \beta_2 \epsilon_{t-2} + \dots + \beta_q \epsilon_{t-q} \quad (7)$$

where  $y_t$  is a moving average of past shocks to the process.

Equation 5 implies that the forecasted value is depended on the past value and previous shocks.

## b. GARCH

In order to evaluate volatility Bollerslev's (1987), Connolly's (1989) and Gregoriou et al. (2004) methodology is going to be applied by employing a GARCH (Generalized Autoregressive conditional Heteroscedasticity) specification for the conditional variance of monthly exchange rates. The GARCH method has a wide range of capital markets applications. The model is based on the assumption that forecasts of variance changing in time depend on the lagged variance of capital assets. An unexpected increase or fall in the returns of an asset at time  $t$  will generate an increase in the variability expected in the period to come.

Two of the most important empirical regularities of asset return are volatility clustering and fatter tails. As Madelbrot (1963) indicated volatility clustering implies that any significant or small changes in value are usually followed by similar changes in the opposite direction. Secondly, the distribution of returns has fatter tails (leptokurtic) than those of a normally distributed variable (mesokurtic) (Alagidede and Panagiotidis, 2006).

Additionally, as Connolly argued, "*Bollerslev's (1987) GARCH model offers several advantages: it incorporates heteroscedasticity in a sensible way (for a time series), it can be expanded to include other relevant variables in the conditional variance equation, and generally it offers more flexibility in robust modelling of stock returns*". (Gregoriou, Kontonikas, and Tsitsianis;2004. pp 218).

The test involves regressing the squared OLS residuals from the conditional mean equation  $\varepsilon_{it}$  against a constant and their lagged values. The variance of disturbance for a GARCH (p,q) model is:

$$\sigma^2_t = \alpha_0 + \sum_{i=1}^q \beta_i \varepsilon_{t-i}^2 + \sum_{i=1}^p \delta_i \sigma_{t-i}^2 \quad (8)$$

Or,

$$\sigma^2_t = \alpha_0 + \alpha(L)\varepsilon_t^2 + \beta(L)\sigma_t^2 \quad (9)$$

which is actually an Autoregressive Moving Average ( $p, q$ ) process,

where,

$q$  indicates the number of the moving average components, and  $p$  the number of the autoregressive components. In the polynomial form  $L$  denotes the lag operator.

$\alpha$ , and  $\delta$  are constant and non-negative parameters. This specification allows for the conditional variance to be dependent on past information, which will induce variability over time. More specifically, the conditional variance is explained by past shocks and past variances. The key features of this specification are that if  $p=0$ , the process reduces to an ARCH ( $q$ ) process and  $\varepsilon_t$  white noise process when  $p = q = 0$ .

Based on the estimated ARMA model the GARCH to be estimated in the study is GARCH(1,1). The GARCH(1,1) indicates that predicted variance rate is based on the most recent observation of the squared average and the most recent estimate of the variance rate.

The model to be estimated is the following:

$$\sigma^2_t = \alpha_0 + \sum_{i=1}^q \beta_i \varepsilon_{t-i}^2 + \sum_{i=1}^p \delta_i \sigma_{t-i}^2 + \phi NEWS_t + \gamma_i OPEN_t + \lambda_i IDIFF_t + \rho_i INFL_t$$

(10)

Where

NEWS = is the unexpected news variable measure as described above

OPEN = is the openness of the economy

IDIFF= is the interest rate differential

INFL= is the inflation rate

As the variance is expected to be positive, we expect that the regression coefficients  $\alpha$ ,  $\beta$ ,  $\delta$  are always positive, while the stationarity of the variance is maintained, if the coefficients  $\beta$  and  $\delta$  are smaller than 1.0. The conditional variability of the returns defined in equation 10 above is determined by three effects:

1. the constant part, which is given by the coefficient  $\alpha$  ;
2. the part of variance expressed by the relationship  $\beta_i \varepsilon_{t-i}^2$  and designated as ARCH component;
3. the part given by the predicted variability from the previous period and expressed by the relationship  $\delta_i \sigma_{t-i}^2$ . This component is termed as GARCH.

The sum of regression coefficients ( $\beta + \delta$ ) expresses the influence of the variability of variables from the previous period on the current value of the variability. This value is usually close to

1.0, which is a sign of increased inactivity in the effects of shocks on the variability of returns on financial assets.

### c. EGARCH

The main disadvantage of the GARCH model is its inappropriateness for modelling the frequently observed asymmetric effect of volatility, when a different volatility is recorded systematically in the case of good and bad news. In the case of martingale models, falls and increases in the returns can be interpreted as good and bad news. If a fall in returns is accompanied by an increase in volatility greater than the volatility induced by an increase in returns, we may speak of a 'leverage effect'. To capture this asymmetry, different models have been developed and the one used in this paper is the EGARCH model. This model captures asymmetric responses of the time-varying variance to shocks and, at the same time, ensures that the variance is always positive. The model was developed by Nelson (1991). In the general form, the conditional variance is written as:

$$\ln \sigma_t^2 = \alpha_0 + \beta_i \sigma_{t-i}^2 + \delta_i \frac{e_{t-i}^2}{\sigma_{t-i}^2} + \gamma_i \left| \frac{e_{t-i}^2}{\sigma_{t-i}^2} \right| \quad (11)$$

The EGARCH model is asymmetric because the level  $\left| \frac{e_{t-i}^2}{\sigma_{t-i}^2} \right|$  is included with coefficient  $\gamma_i$ .

Since this coefficient is typically negative, positive returns shocks generate less volatility than negative return shocks assuming other factors remains unchanged. In macroeconomic analysis, financial markets and corporate finance, a negative shock usually implies bad news, leading to a more uncertain future. Consequently, for example, shareholders would require a higher expected return to compensate for bearing increased risk in their investment (Wang, 2003).

In order to capture asymmetric responses of the time-varying variance to shocks, the study employs EGARCH(1,1), which has the following specification:

$$\ln \sigma_t^2 = \alpha_0 + \beta_i \sigma_{t-i}^2 + \delta_i \frac{e_{t-i}^2}{\sigma_{t-i}^2} + \gamma_i \left| \frac{e_{t-i}^2}{\sigma_{t-i}^2} \right| + \phi NEWS_t + \gamma_i OPEN_t + \lambda_i IDIFF_t + \rho_i INFL \quad (12)$$

Where

NEWS = is the unexpected news variable measure as described above

OPEN = is the openness of the economy

IDIFF= is the interest rate differential

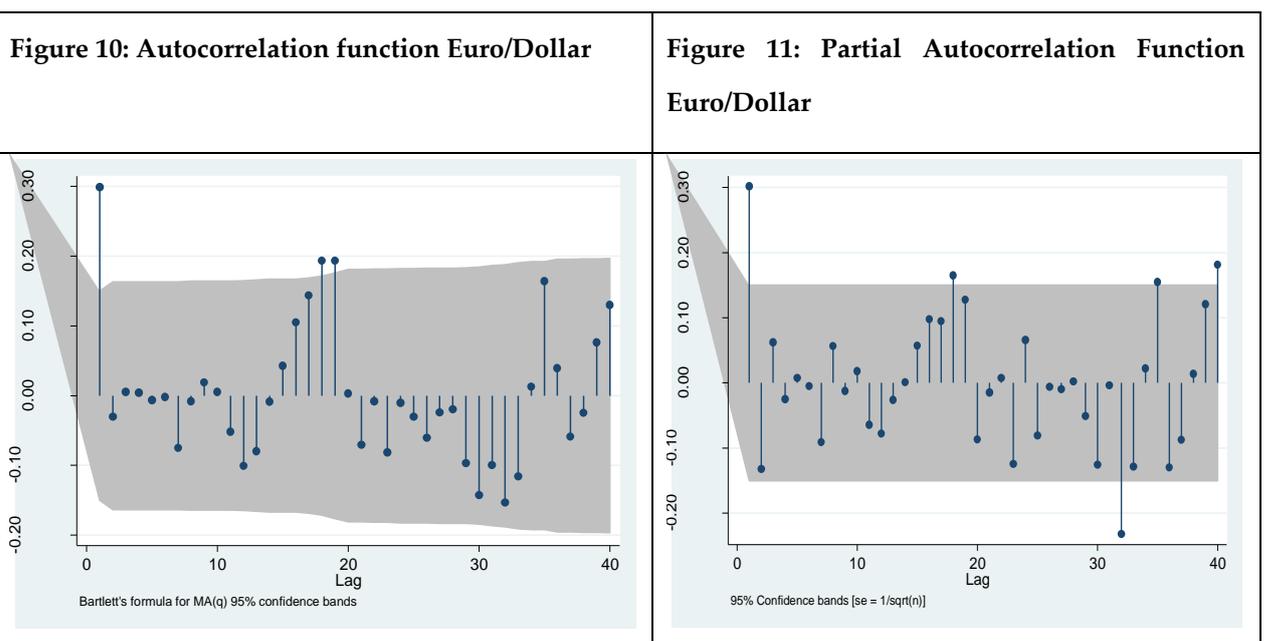
INFL= is the inflation rate

## 5. ANALYSIS OF THE RESULTS

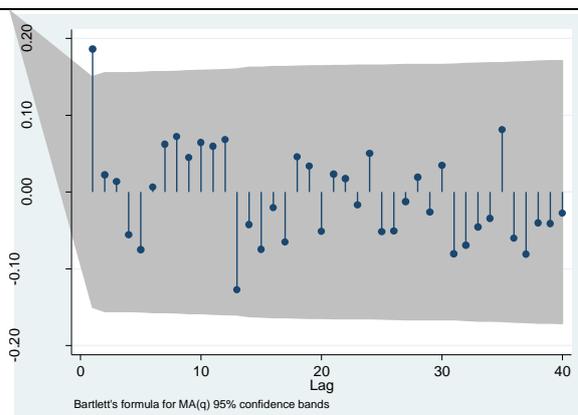
### a. ARMA model

The first step in an ARMA process is to examine the existence of stationarity in the series. As can be evidence from figures 1-3 in Appendix 1 the three exchange rates follow a different trend. In essence from Figure 1 it is clear evidence that the turmoil in the US economy have given a boost in the euro over the dollar. The same is evidence from figure 3 which exhibits the exchange rate between sterling pound and dollar. Another important point of notice from the figures is the level exchange rates do not appear to be stationary. Evidence to this is the augmented Dickey- Fuller (ADF) test that does not reject the hypothesis of unit root for any of the three data series.

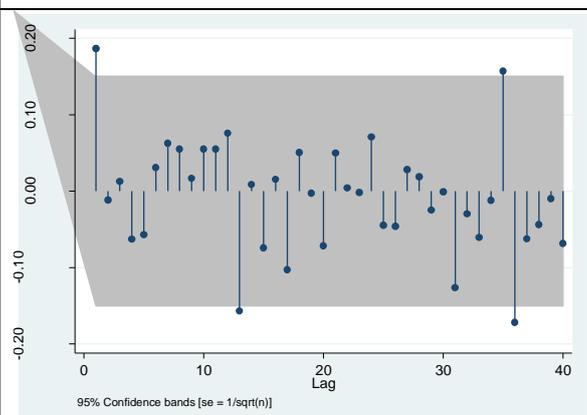
To examine the stationarity of the first difference data again the Dickey Fuller Unit Root test has been applied. As is evidence from the results of the ADF, (see Tables ) the difference exchange rate data, for all of the three series, has no unit root at different levels of significance.



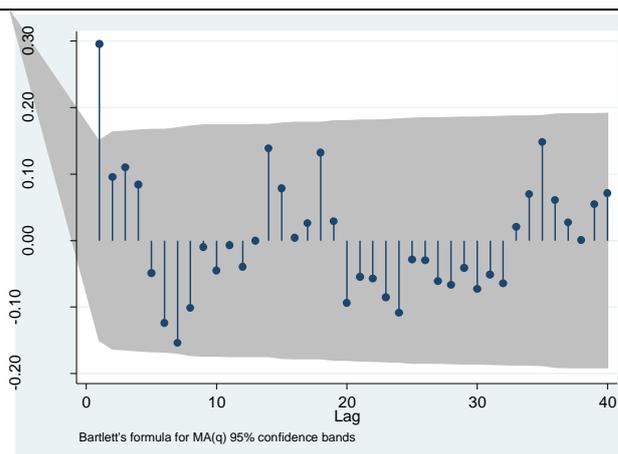
**Figure 12: Autocorrelation function Sterling Pound/Euro**



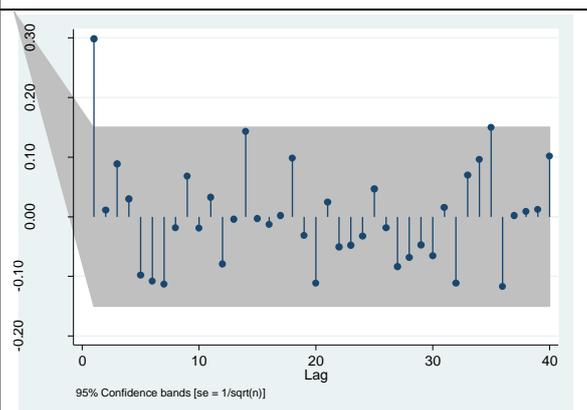
**Figure 13: Partial Autocorrelation Function Sterling Pound/Euro**



**Figure 14: Autocorrelation function US Dollar/Sterling Pound**



**Figure 15: Partial Autocorrelation Function US Dollar/Sterling Pound**



Once the stationarity is established the next step is to evaluate autocorrelation and partial autocorrelation functions to decide which (if any) autoregressive or moving average component should be used in the model. The autocorrelation function (ACF) can be used in identifying the order of MA process, which is determined by those error terms that are correlated over time (i.e. not independently distributed). On the other hand, the ACF cannot be used to identify the order of an AR process. This is due to the fact that the ACF of an AR process decays quickly (i.e.  $p(k)=\beta^k$ ). So, in order to identify the order of an AR process we use the partial autocorrelation function (PACF). The PACF can be seen as the ACF of the time series observations separated by lag of time  $k$  units with the effects of the observations in between eliminated.

The figures 1 to 6 present the ACF and PACF for the three data series. The first two figures concentrate on the euro/dollar exchange rate. It can be seen that the ACF has only one significant cut off at the first lag showing the presence of white noise whereas the PACF also shows one significant peaks at lag one and another one at 31. Nevertheless since the spike is quite smaller than the one in lag one and also is quite far in term of time, the model that describe the series under question is ARMA(1,1). In terms of the Sterling Pound exchange rate the ACF is more clear than the previous correlograms, it exhibits only on clear spike at lag one. In terms of the PACF apart from the spike at the first lag there are other 3 smaller spike in lag 13, lag 35 and lag 37, but because there quite small again the best model is consider to be ARMA(1,1). In regards to the US/Sterling pound exchange rate both the ACF and the PACF correlograms exhibit only one spike thus for the third series as well the best model is ARMA(1,1).

#### b. GARCH MODEL

In this section the estimated results for the GARCH model are presented. As indicated by the ARMA model the initial starting model to be estimated in GARCH(1,1) for all the three data set. For the first model, the euro exchange rate, the inflation variable has been excluded since with the addition of this variable the flat log likelihood has been encountered. For that reason apart from the specified independent variable of the GARCH model the variable included were the unexpected news, interest rate differential and the openness of the economy. Nevertheless the results indicate that neither the independent variable nor the GARCH components of the variance were statistically significant. After different estimates the best model is GARCH(2,2) the results of which are presented to the table below.

**Table 7: GARCH(2,2) EURO/DOLLAR**

Distribution: Gaussian			Wald	chi2(3)	2.96	
Log likelihood = -251.7297			Prob	> chi2 =	0.3980	
	<b>Coefficient</b>	<b>Std. Err.</b>	<b>z</b>	<b>P&gt;z</b>	<b>[95% Conf.</b>	<b>Interval]</b>
OPEN	-2.467799	4.940606	-0.50	0.617	-12.15121	7.215611
IDIFF	.0873775	.0598128	1.46	0.144	-.0298535	.2046084
NEWS	-2.447288	3.335223	-0.73	0.463	-8.984205	4.089629
$\alpha$	.5387514	.7089453	0.76	0.447	-.8507559	1.928259
<b>ARCH</b>						
arch						
L1.	.0635942	.0339669	1.87	0.061	-.0029797	.1301681

L2.	-.0542865	.0348618	-1.56	0.119	-.1226144	.0140414
<b>GARCH</b>						
L1.	1.77084	.1059007	16.72	0.000	1.563279	1.978402
L2.	-.8810039	.0942371	-9.35	0.000	-1.065705	-.6963027
$\alpha$	.1199394	.0371127	3.23	0.001	.0471997	.192679

It is clear evidence from the table above that the GARCH components of the variance are statistically significant for both lags and for ARCH only for the first lag. Also the significance of both  $\delta$  and  $\beta$  indicates that, lagged conditional variance and lagged squared disturbance have an impact on the conditional variance, in other words this means that news about volatility from the previous periods have an explanatory power on current volatility. Nevertheless none of the marcoeconomic variables are found to be statistically significant in explaining the exchange rate volatility.

The next estimates concerning the sterling pound exchange rate. Again the starting model was GARCH(1,1) but the best model was found to be GARCH(2,1) where the results are presented in table 11 below. The model depicts that macro variables are once more found to be statistically insignificant whereas the GARCH components of the variance are statistically significant suggesting that that news about volatility from the previous periods have an explanatory power on current volatility.

**Table 8:GARCH(2,1) Sterling Pound/Euro**

Distribution: Gaussian			Wald	chi2(3)	1.38	
Log likelihood = -184.7923			Prob	> chi2 =	0.7094	
	<b>Coefficient</b>	<b>Std. Err.</b>	<b>z</b>	<b>P&gt;z</b>	<b>[95% Conf.</b>	<b>Interval]</b>
OPEN	-1.66447	2.073383	-0.80	0.422	-5.728227	2.399286
Inflation	.0221953	.0464575	0.48	0.633	-.0688597	.1132503
NEWS	.0375944	.0521228	0.72	0.471	-.0645645	.1397532
$\alpha$	.8107405	1.129702	0.72	0.473	-1.403435	3.024916
<b>ARCH</b>						
arch						
L1	.2792774	.0932569	2.99	0.003	.0964972	.4620576
L2.	-.1932655	.1248646	-1.55	0.122	-.4379956	.0514645
<b>GARCH</b>						
L1.	.8441721	.1968875	4.29	0.000	.4582797	1.230064
A	.1943286	.0579973	0.69	0.487	-.0733904	.1539548

The last series, the US dollar exchange rate is best explained by a GARCH(1,1). Nevertheless, as can be seen from table 12 the only significant variable under this model in is lag ARCH

variable. Conclusively it can be argued that, at least with the use of GARCH methodology the exchange rate volatility does not seem to be affected by any economic variable included in the current study. This in turn suggests that policy makers cannot alter or minimize the volatility through monetary policy and thus they should aim to identify the causes of volatility in other possible variable such as the capital market. Another possible explanation is that the results might be affected by the choice of the methodology, as suggested by a number of studies (Albuquerque and Portugal, 2005)

**Table 9:GARCH(2,1) US Dollar/Sterling Pound**

Distribution: Gaussian			Wald	chi2(4) =	3.99	
Log likelihood = - 220.6709			Prob	> chi2 =	0.4068	
	<b>Coefficient</b>	<b>Std. Err.</b>	<b>z</b>	<b>P&gt;z</b>	<b>[95% Conf.</b>	<b>Interval]</b>
Inflation	.0961437	.0714556	1.35	0.178	-.0439067	.2361941
OPEN	.4804563	3.867831	0.12	0.901	-7.100353	8.061265
IDIFF	.001762	.0701759	-0.03	0.980	-.1393042	.1357802
NEWS	.0020699	.019756	-0.10	0.917	-.0407909	.0366511
$\alpha$	-.3630676	1.042259	-0.35	0.728	-2.405858	1.679722
<b>ARCH</b>						
arch						
L1.	.3220429	.1291755	2.49	0.013	.0688635	.5752223
<b>GARCH</b>						
L1.	.1564206	.2758753	0.57	0.571	-.3842851	.6971263
$\alpha$	.4504771	.1985525	2.27	0.023	.0613213	.8396329

### c. EGARCH MODEL

In this section the estimated results for the EGARCH model are presented. As indicated by the ARMA model the initial starting model to be estimated in EGARCH(1,1) for all the three data set. Again the first model is the euro exchange rate. The results are quite different from the estimates generated from the GARCH model suggesting that the results are not robust to the methodology utilized. Opposing to the GARCH model in the EGARCH all the macro variables are included in the estimation.

**Table 10: EGARCH(1,1) EURO/DOLLAR**

Distribution: Gaussian			Wald	chi2(4) =	6.23	
Log likelihood = - 250.8846			Prob	> chi2 =	0.1823	
	<b>Coefficient</b>	<b>Std. Err.</b>	<b>z</b>	<b>P&gt;z</b>	<b>[95% Conf.]</b>	<b>Interval]</b>
IDIFF	0.1239338	.0548822	2.26	0.024	.0163667	.2315009
NEWS	.9763706	3.969176	0.25	0.806	-6.803071	8.755812
OPEN	-2.632542	4.61361	-0.57	0.568	-11.67505	6.409968
INFLATION	.0280925	.1463075	0.19	0.848	-.2586648	.3148499
$\alpha$	.2899676	.6101827	0.48	0.635	-.9059685	1.485904
<b>ARCH</b>						
EARCH						
L1.	-.2715006	.0968395	-2.80	0.005	-.4613025	- .0816987
earch_a						
L1.	-.1664995	.1672978	-1.00	0.320	-.4943971	.1613981
<b>EGARCH</b>						
L1.	.6922596	.1194325	5.80	0.000	.4581762	.926343
$\alpha$	.0326356	.0385848	0.85	0.398	-.0429893	.1082605

The first point of notice is that the best model is the EGARCH(1,1) where the GARCH components of the variance are statistically significant. Additionally, in line with the results of Faust et al. (2007) the interest rate differential is found to be positively statistically significant suggesting that changes in the interest rates differences between the local and foreign country have an effect in the interest rate. The level of significance under consideration is at 95%.

For the second data series the best model was found to be EGARCH(2,1) the same as GARCH estimation. The difference between the two models is that in the previous estimation no macro variable was significant. On the contrary under the EGARCH methodology the openness of the economy is found to be negatively statistically significant in line with Hau's results as well as Stancik (2006) and Bravo and di Giovanni (2006). The result suggests that the more open the economy is the more subjective to external shock is the exchange rate. Additionally the EGARCH parameters are found to be statistically significant at 95% level of confidence interval. The results from the estimated model are presented in the table below.

**Table 11:EGARCH(2,1) Sterling Pound/Euro**

Distribution: Gaussian			Wald chi2(3) =	3.44		
Log likelihood = - 182.1075			Prob > chi2 =	0.3290		
	<b>Coefficient</b>	<b>Std. Err.</b>	<b>z</b>	<b>P&gt;z</b>	<b>[95% Conf.]</b>	<b>Interval]</b>
OPEN	-3.406579	1.479313	-1.81	0.050	-	.2768065
Inflation	.088593	.0704071	1.26	0.208	-	.2265884
NEWS	-.0244545	.0405544	-0.60	0.547	-	.0550306
$\alpha$	1.746477	.9963173	1.75	0.080	-	3.699223
<b>ARCH</b>						
earch						
L1.	-.3651818	.1120891	-3.26	0.001	-	-.1454913
L2.	.2769121	.1138588	2.43	0.015	.053753	.5000712
earch_a						
L1. .	174375	.1554576	1.12	0.262	-	.4790663
L2.	-.012976	.1598587	-0.08	0.935	-	.3003413
<b>EGARCH</b>						
L1.	.9190455	.0875157	10.50	0.000	.7475179	1.090573
$\alpha$	-.0541259	.0623461	-0.87	0.385	-.176322	.0680702

The final series is the US dollar exchange rate. Again the estimation between the two methodologies differ where the best model under the current approach is GARCH(1,2) . The similarity between the two models rest on the non-significance of the macroeconomic variables whereas the EGARCH Parameters are found to be statistically significant.

**Table 12: EGARCH(1,2) US Dollar/Sterling pound**

Distribution: Gaussian			Wald chi2(4) =	3.67		
Log likelihood = - 218.6872			Prob > chi2 =	0.2997		
	<b>Coefficient</b>	<b>Std. Err.</b>	<b>z</b>	<b>P&gt;z</b>	<b>[95% Conf.]</b>	<b>Interval]</b>
NEWS	.020776	.0164732	1.26	0.207		-.011511
IDIFF	.0959583	.0513634	1.87	0.062		-.0047121
OPEN	.020776	.0164732	1.26	0.207		-.011511

$\alpha$	-.3395792	.8614438	-0.39	0.693	- 2.027978
<b>ARCH</b>					
earch					
L1.	.1390792	.0548251	2.54	0.011	.031624
earch_a					
L1.	.2669954	.0955576	2.79	0.005	.0797059
<b>EGARCH</b>					
L1.	1.346139	.0559512	24.06	0.000	1.236477
L2.	-.8649947	.0609748	-14.19	0.000	- .9845032
$\alpha$	-.1395142	.077245	-1.81	0.071	- .2909117

## 6. CONCLUSIONS AND RECOMMENDATION

From the ending of the Bretton Wood fixed exchange rate regime, exchange rates both nominal and real exhibited high levels of volatility all across the globe. The risk associated with high volatility levels in the foreign exchange market have cost implications for all the economic agents as well as policy makers. From the stand point of agents, international investors and portfolio managers bear higher risk in their everyday investment decisions and companies that deal with international trade endure extra cost from the increase risk level. In terms of policy makers, evidence have shown that if exchange rates are volatile then prices in the economy follow volatile movements. Hence determining the factors that affect the exchange rate volatility is of upmost importance to a number of parties.

Based on the aforementioned the aim of the current study was to determine the relationship between macroeconomic variable and exchange rate volatility. The result of the literature on the subject matter are quite mix. A part of the literature suggests that there a number of variable that they do actually affect the exchange rate volatility such as such the openness of the economy [Hau (2002), Stančík (2006)], interest rates (Juthathip 2009), exchange rate regime (Kočenda and Valachy 2006), inflation [Calvo and Reinhart (2000), Devereux and Engel (2003)], and unpredictable circumstance (Calderon and Kubota, 2009), where the degree of the impact of those factors depends on the economic conditions of a given country. On the other hand there is a number of studies that suggested that there is no link between macroeconomic variable and exchange rates. The primal notion behind this view is those macroeconomic variables do not exhibit the same increase as exchange rate volatility during floating exchange rate regime (Albuquerque and Portugal 2005). Another part of the literature argues that the absence of the relationship between the two rest on methodological issue.

With the use of monthly exchange rates (euro/dollar, sterling pound/euro, and US Dollar/sterling pound exchange rate) from January 1999 to March 2013 the current studies aimed to examine the contradicting views of the literature. Four different macroeconomic variables have been used, namely openness of the economy, interest rate differential, unexpected news and inflation. The choice was primarily the importance that was given to them by prior studies. To examine the potential relationship two different approaches have been used so as to examine the robustness of the results to changes in the methodology. Indeed, in most cases the macroeconomic variables were found statistically insignificant. Specifically, under the GARCH methodology in all the three different data series no variable was found to be statistically significant. On the other hand when applied the EGARCH methodology the openness of the economy was found to be negatively statistically significant with sterling pound exchange rate in line with Hau's results as well as Stancik (2006) and Bravo and di Giovanni (2006). Taking into account policy makers might need to consider policies that would minimize this problem. If the structure of the external transaction of a given country cannot be altered an alternative solution is for this country to consider entering into a common exchange regime system as it is said to promote economic stability. Additionally, in line with the results of Faust et al. (2007) the interest rate differential is found to be positively statistically significant with the euro/dollar exchange suggesting that changes in the interest rates differences between the local and foreign country have an effect in the interest rate. Again this has certain policy implications, since policy makers when they aim in changes in local interest rate should not only consider inflationary policies and money supply, but they need also to alter the interest rate when a foreign trading partner changes its home interest rate. Depending on the trading volume between the two countries, a change in the interest rate differential would alter the exchange rate and would lead to trade imbalances.

Lastly, it can be suggested that the results are not robust to method of estimation supporting the part of the relevant literature that argues that the non-significance of the macroeconomic variable in explaining the changes of exchange rate volatility might come forth from the differences in the methodology and not to the variables as such. Even though in the current study there was not a strong support for the existence of a relationship between macroeconomic variable and exchange rate volatility, while under GARCH methodology the relationship was found to be none, under EGARCH approach in different series certain variables were found to be statistically significant. As certain previous studies indicated, the magnitude and significance of macroeconomic variable on exchange rate volatility on the economic conditions of a given country.

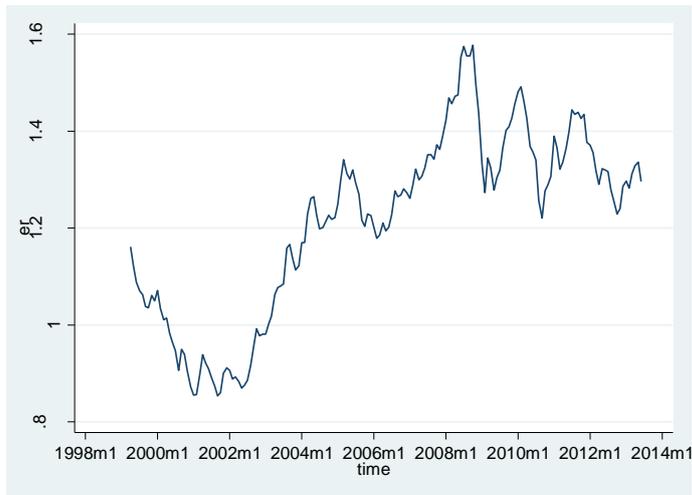
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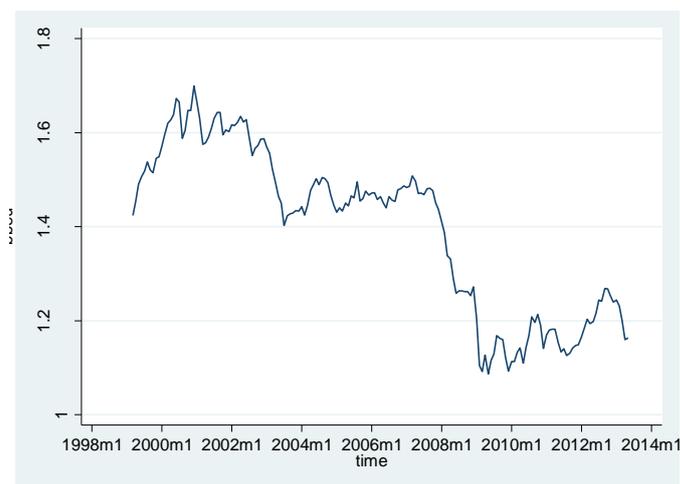
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**APPENDIX 1**

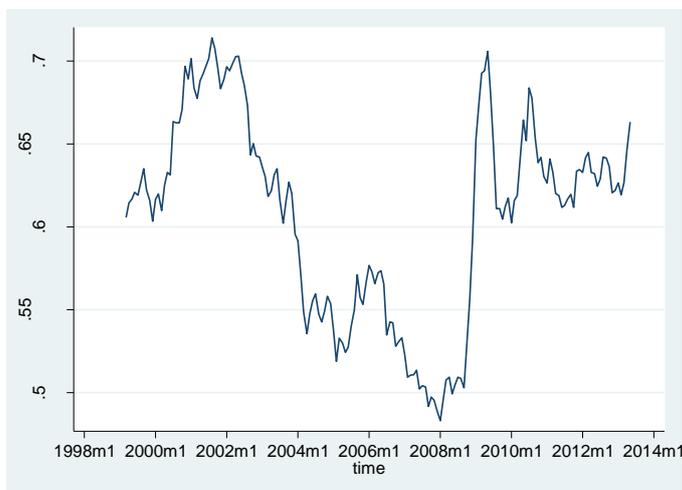
**Figure 16: Euro/US Dollar Exchange Rate**



**Figure 17: Sterling Pound to Euro**



**Figure 18: US Dollar to Sterling Pound**



## PORTUGUESE FIRM'S MOTIVATIONS AND DECISION FACTORS TO PARTICIPATE IN INTERNATIONAL TRADE FAIRS

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### ABSTRACT

Portugal is a small economy, with an open domestic market that needs competitive exporters to prosper. Trade fairs are an international promotion tool that can be used by firms considering export development and expansion. This study identifies the prime motives and barriers for exporting firms participate (or not) in international trade fairs and the critical decision factors involved in that choice.

The results indicate that a strong motive to exhibit at a trade fair is to reinforce the market presence of the firm, the possibility of finding new ideas and test new products, establish relationships with present and future customers, and enhance the brand image and reputation of the firm. The main barriers to non exhibitors firms were costs, bad previous experiences and lack of resources (financial, personnel and time). The firm's critical decisions factors to select a trade fair were value for money and the stand. The first, accounts for the ratio between costs and the mix of organizer's reputation, quality and quantity of attendees, and market coverage. The second includes the typology, size and location of the stand inside the space of the trade fair.

**Keywords:** International trade fairs, Motivations to exhibit or not, Firm's decision factors, Portuguese exporters.

## INTRODUCTION

Trade shows, trade fairs, consumer shows or mixed shows are not synonymous. According to UFI (2011), trade shows are business to business events, where firms in a specific industry can showcase and demonstrate their new products and services; trade fairs are confined to one industry or a specialized segment of a special industry; consumer shows are events that are open to the general public, where exhibitors are retail outlets, manufacturers or service organizations looking to bring their products and services directly to the end user; mixed shows are a combination of trade and public shows. AUMA (2007, p. 24) defines trade fairs as “market events of a specific duration held at intervals, at which – with a predominant appeal to trade visitors – a large number of companies present the main product range of one or more sectors of industry and mainly sell to commercial buyers on the basis of samples”. Although the term trade fair is more used in Europe and trade show in the United States, for the purpose of the current study these terms are used interchangeable, representing opportunities for firms interested in promoting their products and services internationally.

Trade fairs is not a new marketing promotion tool, but over the last years the global trade fair industry has grown dramatically worldwide. The total indoor exhibition space is 32.6 million m<sup>2</sup>, and the highest is offered by Europe (48%), North America (24%), and Asia (20%). In terms of countries, five of them (USA, China, Germany, Italy and France) account for 59% of the total world indoor exhibition space (UFI, 2011). The main international industry association was founded in 1925, in Milan (Italy), and in 2003 it becomes the Global Association of the Exhibition Industry (UFI), including 540 members ([www.ufi.org](http://www.ufi.org)).

The importance of trade fairs for firms will vary depending upon their size and the country of origin. For SME's (small and medium-sized enterprises) trade fairs play a unique role, because they take company personnel to foreign markets, allowing firms to collect market information, and assess market opportunities (Bowling and Adams, 1988; Freitas Santos, 2005). For small countries, as Portugal, facing a severe financial and economic crisis increasing exports is a priority. In 2011, a total number of 19.837 exporting firms are registered in the Portuguese Statistical Institute (INE), more 12% than in the year before. The need to increase this number in the future is paramount for the growth of the economy and the balance of payments, as Portugal experienced trade deficits in the past thirty years. For many Portuguese firms the domestic market has reached the point at which supply is exceeding demand. This is due to reductions in domestic growth, and increasing competition in local market. Consequently, research into the role of trade fairs as a mean to enter new international markets is of value to Portuguese firms who already exports, but also for those

in the early or pre-exportation stage. Research is also needed as a scarce number of studies have been developed in the last years focused on the Portuguese reality (Sarmiento, 1997; Viegas, 2000) and none, to our best knowledge, has emphasized firms' motivation, behavior and decision factors to participate at international trade fairs.

Although some studies have contributed to understand what might motivate firms to exhibit their products or services in international fairs, researchers have paid less attention to the specific reasons that encourage SMEs to become involved in those venues. Firstly, because participants in trade fairs invariably have differing objectives, depending on their size, experience, country of origin, products/services, and market focus. Secondly, the participating firms have to rise the occasion that fairs provide for selling and non-selling activities (information gathering, image building, relationship-building and motivational). Thirdly, the trade-off between perceived costs and benefits is subjective in nature as firms must be involved in pre-fair promotion, at-fair selling and after-fair follow-up activities to take full advantage of the exhibition. Finally, the resources allocated by each firm (booth size, location, design, attention-getting techniques, booth personnel) may influence the perception of success. Thus, it seems useful to study the combined reasons of trade fairs participation and non-participation of Portuguese firms in those venues.

The present study was designed in an attempt to identify the motives perceived by firms to exhibit or not their products or services in international trade fairs, to explain the behavior before, during and after the fair, and to investigate the decision factors that drive or inhibit the firms to exhibit at an international trade fair.

The following section outline some relevant previous research on trade fairs, the methodology and the study undertaken, and the results obtained.

## **1. INTERNATIONAL TRADE FAIRS: A REVIEW OF LITERATURE**

The role of trade fairs in the communication mix of the firms has been analyzed in international and global marketing textbooks. Johansson (2009, p. 557/558) refers to the international trade fairs stating that are "excellent promotional avenues for the global marketer". Albaum, Strandkov and Duerr (1998, p. 441/442) argue that trade fairs and exhibitions are "extremely important for some industries and some countries". Kotabe and Helsen (2010, p. 453/454) stress that trade shows are a "vital part of the communication package for many international business to business marketers". Onkvisit and Shaw (2004, p.429/433) indicate "overseas product exhibitions" as "one type of sales promotions that can be highly effective". In general terms, trade fairs are "events that bring together, in a single

location, a group of suppliers, distributors and related services who set up physical exhibits of their products and services from a given industry or discipline (Black, 1986).

Trade fairs are an important tool in the international promotion strategy of the small and medium-sized firms. In the early phases of the exporting process, trade fairs create an opportunity for considerable learning to take place, both about foreign markets, and the level of competition on the industry. Many contact activities takes place during the fair, but contact development and interaction with industry continues after the trade fair.

The first book specifically about trade fairs has been written by Norman (1986), and still is a reference on the theme. Several other books followed to help firms on “how to exhibit at trade fairs” (Appleyard, 2005), on making their presence more effective (Miller, 2000) and successful (Miller, 2006; Friedmann, 1999), or describing the tasks of exposition management (Morrow, 2002; Stevens, 2005).

Norman (1986) proposed a three stage process for planning a participation in a trade fair (before, during and after) that was followed by different authors such as Miller (2000); Viegas (2000); Appleyard (2005); Rhonda and Bozdech (2006); CEIR (2010); and, Donelson (2011). These authors agree that planning is the best procedure to develop a coherent and efficient participation in a trade fair in order to obtain the maximum return on investment. Also, empirical research has shown that a successful participation in a trade fair demands a strategic planning in all the stages of the event (Framis, 1994; Sarmiento, 1997; Siskind, 2005).

The aims for exhibiting at international trade fairs can be usually divided into selling and non-selling activities. Selling activities include lead generation, closing sales, finding new customers, qualifying leads and prospecting. Non-selling activities are broadly categorized as meeting existing customers, enhancing the image of the company, carrying out general market research, meeting new distributors or agents, launching new products and even enhancing staff morale (Kerin and Cron, 1987; Blythe, 2002; Rittichainuwat and Mair, 2012). Parasuraman (1981) and O’Hara (1993) consider the participation in a trade fair the second best tool of marketing, just after personal selling, as the mean to influence the buying decisions of customers.

Herbig, O’Hara and Palumbo (1997) identify several advantages to trade fair participation: i) the large number of qualified interested people that received the promotional message; ii) the possibility of introducing new products to a large number of prospects; iii) the potential customers that can be discovered; iv) the enhance goodwill to the firm; and, v) the opportunity of free publicity to the firm. A systematic approach to the advantages of participating in an international trade fair indicates the identification of potential customers,

the increase of customer loyalty, the introduction of new products to a large number of prospects, the reinforcement and improvement of corporate image, the gathering of competitor information, and selling (Bonoma, 1983; Moriarty and Spekman, 1984; Kerin and Cron, 1987; Hoshen, 1989, Bello and Barczak, 1990; Tanner Jr. and Chonko, 1995; Miller, 2000; Rhonda and Bozdech, 2006; Blythe, 2010; Li et al., 2011). An additional advantage, according to Trade Show Bureau (1994) is the average cost per contact at a fair which remained consistently one third of the cost of personal sales call. However, although the many advantages that trade fairs have, some drawbacks can be pointed out. The costs involved (space rental, freight, booth personal travel, and living expenses) still are expensive (Trade Show Bureau; 1994; Junior, 2005). The proliferation of trade fairs in terms of number, frequency, market focus, and specialization are confusing the exhibitors who need to be more selective and conscious about the cost/benefit analysis.

Berne and Garcia-Uceda (2008) studied the criteria used by potential exhibitors and visitors in their ex-ante evaluation of trade shows. The basic features suggested by the review of the literature on trade show evaluation and selection are: i) perception of information on trade shows, including type of trade show, convenience of the location and timing, the trade show reputation and its management, the anticipated quantity and quality of attendance; ii) marketing objectives of the firm, including customer acquisition and retention, interaction with the distribution network, product scanning and marketing research; iii) the perceived costs deriving from attending trade shows (relative and differential costs).

Blythe (2010) specify three strategies and nine tactics for exhibitors interested in participating in a trade fair: the strategy of selling, includes take orders, generate leads and make useful contacts; the strategy of communication (outbound), includes image enhancing, product information and establishing a product or company presence; the strategy of communication (inbound), includes meeting existing customers, identifying new customers and observing the competition. On the side of visitors the same author (Blythe, 2010) identify three strategies and eleven tactics: one of them (gather brochures) is common to all strategies (sources of supply, information sources, and entertainment). The other tactics include place orders, make appointments, sought and unsought information, analyse offers, gather free gifts, go to demonstrations and observe displays (Blythe, 2010). Tanner Jr. (2002) adverts that the success factors are mainly strategic, suggesting the centralization in one specific function with the responsibility of define, plan and implement the firm participation in all the fairs that take place annually. Miller (2006) reinforces this idea, detaching the role of booth personnel in the success of the fair. The author indicates ways to approach attendees, establish conversation

and agreements, increase the quality of the interaction, identify business opportunities, and capture contact information.

Herbig, O'Hara and Palumbo (1997, p. 375) studied the differences between trade show exhibitors and non-exhibitors to conclude that distinct significant characteristics exist. The exhibitors have "large, international-oriented industrial companies with many customers, technically complex goods, a high degree of customization and relatively expensive goods". On the contrary, "the more portable a product is, the more simple, the less tangible, the less technical, the more inexpensive a product is, the greater the likelihood to non-exhibit". In the same study (Herbig, O'Hara and Palumbo, 1997) has shown that exhibitors correlate almost perfectly with trade show advantages and non-exhibitors negatively so. One major inhibitor for small businesses still is the cost of participation in a trade show. Nonetheless, the causal link between size of the firm and the decision to participate or not in a trade fair, need more empirical support, as the results of the current research are weak (Kerin and Cron, 1987; Seringhaus and Rosson, 1998; Tanner Jr., 2002). In Canada, a study about collective versus individual participation in a trade fair, found that size and age of the firm are not discriminating factors (Seringhaus and Rosson, 1998). However, it is expected that small firms participated annually in a lesser number of fairs than the bigger firms (Kang and Schrier, 2011).

Hansen (1996), researching the motivations to participate or not in a trade fair underlines the enhancement of the corporate image, the collection of competitor information, the introduction or test of new products/services, the loyalty of current customers, the selling of products/services, and the identification of potential customers.

The motivations for trade fair participation was also investigated by Kijewski and Yoon (1993) who have identified five reasons that affect the exhibitor decisions: exhibition performance, marketing mix strategies, exhibition profile, costs of participation and human resources capacity. They found that firms are searching for trade fairs not only in a perspective of marketing and selling implementation, but also for considering the trade fairs as a platform of communication and relationship channels construction (Gopalakrishna and Lilien, 1995; Hansen, 1996). A convincing reason for that is pointed out by Blythe (2010) who states that the majority of attendees are not firm's buyers, but influent persons in organizations that have the buying or prescriptive power in the decision making process. Therefore, the traditional emphasis on selling must be change to a marketing relationship approach.

To make trade fair more effective marketers must evaluate their participation in an exhibition. Hansen (1999; 2004) presents a five dimension scale: an outcome-based sales dimension and four behavior-based dimensions, including information-gathering, relationship-building, image-building, and motivation activities. More recently, Shi, Smith and Zhang (2012) develop a four-dimension framework (sales-relational, psychological-related, market-exploring, and competitive-intelligence) to examine trade show performance against six trade show marketing strategies (visitor-attraction techniques, number of exhibited products, booth size, booth staff number, booth staff training and follow-up contacts).

The previous participation in a fair seems to be an important factor either for experience or inexperienced firms as the aims of each are very different (Motwani, Rice, and Mahmoud, 1992). In both cases, the vivid experience of the exhibitor, the perceived advantages of being at the fair networking with current and potential customers, and the presence face-to-face with direct competitors stimulates the return to the next fair (Kemp and Smith, 1998; Smith, Hama and Smith, 2003; Breiter and Milman, 2007). Kang and Schrier (2011) indicate that as experience increases exhibitors are more prompt to be less satisfied. The authors recommend more attention to event organizers, as they must be keen of the fact and able to define marketing strategies to correct those attitudes. One of the strategies, suggest the creation of a network of trade contacts available to exhibitors, allowing the access to a list of potential buyers (Kirchgeorg, Jung and Klante, 2010). Nevertheless, satisfied exhibitors are more prompt to return in future editions of the fair, as they perceived a lower risk of participation (Patterson and Spreng, 1997).

A substantial number of corporate executives still perceive trade fairs as a non-selling activity or a social event for those employees that attend (Skolnik, 1987). The effectiveness of a fair could be questioned, sometimes because the firms are unable to measure the return on their trade fair investment. Blackwell (2010) proposes a ratio (ROI - Return on Investment), as a process to evaluate the performance of the firm's presence at an exhibition. The author recognizes difficulties in the ROI calculation, as many variables are involved when a specific trade fair is considered. Bettis-Outland, Cromartie, Johnston and Borders (2010) add the index of Return on Trade Show Information (RTSI) that describes both tangible and intangible benefits that accrue to the firm as a result of information acquired at trade fairs. However, the authors advert that "in some cases, the same information that is acquired at trade shows is also available from alternative sources, potentially making it difficult to determine true RTSI" (Bettis-Outland, Cromartie, Johnston and Borders, 2010, p. 271).

In a scenario analysis, Kirchgeorg, Jung and Klante (2010) suggest that trade shows will continue to be an integral and indispensable part of the marketing mix of the companies. However, trade show companies should continue to move away from selling space and instead become information brokers who facilitate the networking and interaction of market players.

## 2. METHODOLOGY

The present study was conducted in Portugal and sought to examine the firm's behavior regarding international trade fairs. The objectives of the study were threefold. First, to find out what are the rationale and preferences of the firms that lie behind the planning of trade fair participation. Second, to examine the reasons why Portuguese firms participate or not in international trade fairs. Third, identify which firm's decision factors influence the choice of a specific trade show.

In the preliminary stage of the research process an informal exploratory study was undertaken. First, several unstructured personal interviews were made to managers of exporting firms and fair organizers in order to understand the intricacies of the research problem. Simultaneously, the researcher visited two international trade fairs: one in Madrid (Fitur, 2012), and the other in Paris (Moison & Object, 2012) to directly observed the behavior of exhibitors, attendees and the atmosphere of a trade fair. Since the problem is subjective in perception, a questionnaire was used as data collection instrument.

The questionnaire contained three parts. The first part is oriented towards the firms that already has been in an international trade fair, and included: i) questions about the operational and tactical decisions of the firms' participation; ii) two lists of typical reasons and decision factors - the first list was measured in a preference scale from 1 (most preferred) to 5 (least preferred), and the second list used a five-point Likert scale; iii) questions about the communication tools used by firms during the fair.

The second part of the questionnaire was only applied to non-participant firms, and included two lists: one, with the possible reasons to not participate, measured by a five-point Likert scale; the other one, with the factors that could alter the non-participation decision of the firm, measured by a preference scale from 1 (most critical) to 5 (least critical). The third part is common to both participating and non participating firms and contained the characteristics of the respondent firms, including sector of activity, size (number of employees and total sales), international experience (number of years in international markets) and international involvement (proportion of exports on sales and number of international markets). All the

lists used in the questionnaire were derived from those identified in previous studies in the area.

**Table 1 - Sample profile**

<b>Characteristics</b>	<b>Proportion (n = 68) (a)</b>
<b>Sector of activity</b>	
Construction	12.1
Textile and Shoes	9.1
Furniture and Decoration	19.7
Tourism	7.6
Others	51.5
<b>Number of employees</b>	
Less than 20	15.1
21 - 50	18.2
51 - 100	21.2
More than 100	45.5
<b>Total volume of sales (€)</b>	
Less than 500.000	7.5
500.000 - 2.499.999	18.2
2.500.000 - 10.000.000	27.3
More than 10.000.000	47.0
<b>International Experience</b>	
Less than 1 year	3.0
1 - 3 years	3.0
More than 3 years	87.9
Never exported	6.1
<b>Percentage of exports on sales</b>	
0% - 20%	24.6
21% - 50%	29.2
51% - 100%	46.2
<b>Number of export markets</b>	
0 - 5 countries	27.7
6 - 20 countries	40.0
More than 20 countries	32.3

Note: (a) Totals may be less than 68 as respondents did not complete all questions.

To select the Portuguese exporting firms for the study the researcher used a random sampling process, based on secondary data from public (AICEP) and private business and trade associations (AEP, AIP, ATP, APICCAPS, APIMA). The questionnaire was sent by e-mail or post, between January 20<sup>th</sup> and July 30<sup>th</sup> of 2012, to 1108 marketing managers responsible to handle exporting activities. After a telephone recall to non-respondents, a total of 68 usable questionnaires was used, which correspond to a response rate of 6.14%.

Table 1 describes the characteristics of the firms that participated in the study. As can be seen, the composition of the sample goes beyond the manufacturing sector to include tourism,

construction and many other sectors. Further, the size of the firms by Portuguese standards, varies between small (less than 100 employees) to medium (more than 100 employees). The total volume of sales can be equally divided with half of the firms below €10 million and the other half above € 10 million. Most of the respondents firms (87.9%) have international experience (more than 3 years), have been exporting to a diversified set of markets (32.3% for more than 20 markets) and the weight of exports on total sales are significant (more than 50% in 46.2% of the firms).

Preliminary analysis of the survey data using SPSS and *chi-square* tests revealed that there were no statistical significant relationships between firms characteristics (sector of activity, size by number of employees or total sales, volume of exports on total sales, number of export markets) and the participation or not in international trade fairs. The only variable showing a significant difference ( $p < 0.01$ ) was international experience, as suggested earlier in previous empirical evidence (Seringhaus and Rosson, 2001). Therefore, the sample proved to be relatively homogeneous and further data analysis was undertaken.

### 3. ANALYSIS AND RESULTS

The results of table 2 show that the main motive why Portuguese exporting firms participate in international trade fairs is to reinforce the market presence (mean score of 3.6) where the fair is taking place, enhancing its image among present and future customers, but also among competitors. It appears that Portuguese firm's are very conscious of the negative effects that the absence of a trade show could have on current customers' perception and the benefits attached of being at a fair. 16 of the respondents perceived this to be an extremely important reason to participate. Promote innovation and test new products (mean score of 3.19), increase customer loyalty (mean score of 3.03), and improve brand image and reputation (mean score of 2.9) were other important motives for participation and were perceived to be first choice factors by 6, 5 and 6 respondents, respectively.

**Table 2 – Motives for participation in international fairs**

Reasons	1 <sup>st</sup> Choice	2 <sup>nd</sup> Choice	3 <sup>rd</sup> Choice	4 <sup>th</sup> Choice	5 <sup>th</sup> Choice	Total	Mean (S.D.)
Reinforce market presence	16	9	7	4	6	42	3.6 (1.449)
Save costs due to a better relation cost per contact	2	4	5	3	6	20	2.65 (1.387)
Customer loyalty	5	6	11	5	5	32	3.03 (1.282)

Promote innovation, test new products	6	9	5	7	4	31	3.19 (1.352)
Tool to promote and introducing new products or services	5	5	8	11	8	37	2.68 (1.334)
Increase sales and customer portfolio	5	4	5	9	6	29	2.76 (1.405)
Improve brand image and reputation	6	9	6	11	7	39	2.90 (1.373)
Firm's routine	0	0	3	0	0	3	3.00 (0.0)
Imitation of competition	1	1	2	0	0	4	3.75 (0.957)
Disappointment with trade fairs	1	0	1	0	1	3	2.67 (2.082)

Note: Totals may be less than 51 as respondents did not complete all questions.

Somewhat unexpectedly, increase sales and expand customer portfolio ranked moderate on the motives of firms, with a mean response of 2.76 which clearly denotes that make direct sales is not of paramount importance for participants, although 5 of them considered a first choice motive. Similarly ranking below the expectations (mean score of 2.68), was one pivotal function attached to trade shows, that is, being a place to the promotion and introduction of new products. According to 20 respondents the cost per contact (mean score of 2.65) seems to be a forgotten or a lesser known criteria when a final decision must to be taken. The firm's routine and imitation of competition were the least important motives indicated by respondents for participation.

Table 3 suggests that costs was the major barrier to participation in an international trade fair, with a mean response of 4.06, and 6 respondents answering "strongly agree" with the statement that "costs of trade fair's participation are high and the return on investment difficult to obtain". This is a frequently cited disadvantage to not participate in trade fairs (Kerin and Cron, 1987; Seringhaus and Rosson, 1998; Tanner Jr., 2002; Kijewski and Yoon, 1993). Another intrinsic reason associated with the organization of the fairs was bad previous experiences (mean score of 3) which seems to marked negatively some of the respondents (5 firms reported agree or strongly agree). On the organizer side, assessing visitor and exhibitor satisfaction on several relevant topics could be important, not only to stand visitor profile analysis, but also to measure and monitor the success of a trade fair in a broadest sense. On the exhibitor side, the access to information regarding the event, such as the analysis of the visitor records, the assessment of competitors performance, the effectiveness of the

advertisement for the trade fair (TV, press, catalogues, etc.), the efficiency of the ratio between the number of invitation sent out and the number of visitors are all sensible areas that could increase exhibitor satisfaction and retention.

**Table 3 – Inhibiting factors to firm participation in international fairs (n = 16)**

Reasons	SD	D	NA/D	A	SA	Mean (S.D.)
Trade fairs are old-fashioned	1	4	8	3	0	2.81 (0.834)
Costs of participation	0	1	3	6	6	4.06 (0.929)
Bad previous experiences in trade fairs	1	4	6	4	1	3.00 (1.033)
The firm has no financial resources to participate	2	5	3	4	2	2.94 (1.289)
The firm has no qualified human resources to participate	3	7	3	3	0	2.38 (1.025)
The direct competition of the firm is in the same space	7	4	4	0	1	2.00 (1.155)
Trade fairs are time consuming	1	7	4	4	0	2.69 (0.946)
Firm's sector of activity is not present in fairs	2	4	4	2	4	3.13 (1.408)
Disappointment about trade fairs organizations	2	3	7	4	0	2.81 (0.981)
Don't know about trade fairs	5	7	3	1	0	2.00 (0.894)

Note: Note: Totals may be less than 17 as respondents did not complete all questions.

(SA) Strongly Disagree; (D) Disagree; (NA/D) Neither Agree nor Disagree; (A) Agree; (SA) Strongly Agree.

Some other important reasons are firm-specific, such as lack of financial resources (mean score of 2.94), need of qualified human resources (mean score of 2.38), and time-consuming process for the firm (mean score of 2.69). It seems that focus only upon resources and capabilities as the foundation for a firm's promotion strategy could limit its long-term success. The ability to establish relationships with new customers, gather information about competitors, partners and new products could make a difference over international direct competitors. Therefore, the trade fair participation must be envisaged as a long term promotional strategy rather than short term, oriented towards customer relationships building, and brand image and firm reputation enhancement.

As seen on table 4, more competitive costs are cited by 7 respondents as an extremely important factor that could change the decision to not participate in international fairs (mean

score of 2). This perception reinforces the idea already expended that costs are a critical inhibiting factor to many non-participant firms. Another important factor in terms of the highest mean score was more financial support from the government (2.06) which is available for Portuguese firms on a competitive basis, particularly for those who exports. Of course that government aid is always short, but firm's specific problem such as internal reorganization (mean score of 1.81) could disqualified the desired support.

**Table 4 – Drivers of change to become exhibitor (n = 16)**

<b>Factors</b>	<b>1st Choice</b>	<b>2<sup>nd</sup> Choice</b>	<b>3<sup>th</sup> Choice</b>	<b>4<sup>th</sup> Choice</b>	<b>5<sup>th</sup> Choice</b>	<b>Mean (S.D.)</b>
Transparency and credibility of trade fairs organizations	3	2	2	2	0	1.31 (1.493)
Better advertising and promotion of the fair	2	3	2	1	1	1.44 (1.632)
Costs more competitive	7	4	1	1	2	2.00 (1.506)
More parallel activities, such as seminars, workshops, etc.	1	1	2	3	0	1.31 (1.702)
Firm's internal reorganization	1	0	2	3	2	1.81 (2.073)
More financial support from the government	0	2	2	2	3	2.06 (2.081)
Improve location of stands in the fair	1	0	2	0	4	1.69 (2.213)
Dislike trade fairs	2	0	0	0	0	0.13 (0.342)
Lack motivation or incentive to participate	0	1	0	0	0	0.13 (0.500)
Other	0	4	0	1	1	1.06 (1.611)

Other changing factors were specifically related to trade fair organizers. The improvement of the location of the stands in the space of the fair, a better communication of the fair to prospects, the transparency and credibility of the organizer, and more activities during the fair (seminars, workshops) were all suggestions to attract potential new exhibitors. The remaining factors were seen as the least important.

Table 5 shows that 75% of exporting firms prefer to participate individually in an international trade fair on a foreign country or in Portugal. This individual approach assures the total control of the marketing objectives of the firm, the personalization of the stand, and a more focused attention to visitors. The collective participation is less frequent for exporting firms (25%), and the initiative usually comes from the government (Portuguese Agency for

Investment and External Commerce - AICEP) or from trade or industrial association. Nevertheless, many of the respondents (53.1%) see benefits in this type of participation. When asked about the importance of collectively participate in a trade fair, the majority of respondents (61.4%) see it as a strong contribution to reinforce the participation or even allow for the first time presence of a domestic firm in an international fair. Without support of government or industry associations many of the firms hardly have financial or organizational resources to apply to an international trade fair. On the contrary, some of the firms (38.6%) regarded collective participation as a limitation on their selling and marketing actions during the fair, reducing the possibilities of differentiation vis-à-vis competition. Almost all the firms have some experience of been in an international trade fair to exhibit their products or services to current customers and prospects (94.1%). Only 5.9% of the firms said that it was the first time that they have been involved in an international trade fair.

Most of the exhibitors (80.4%) made pre-fair arrangements before the show took place, including choose the location, define the booth size and the layout of the stand, and elaborate the promotion materials to attract attention, stimulate interest, and increase the number of visits to firm exhibits. Also marketing actions before the fair, such as sending invitations to current customers and prospects, and promoting the event in the website of the firm assume relevance in the communication-mix strategy. These actions are essential to inform customers about the trade fair and give them a free pass to meet with representatives of the firm. The return on investment of the international trade fair is moderated during the fair (8.3) and increases significantly (one to six months) after the end of the fair (72.9%). After one year the effects of the fair decreases to 4.2% and the firms need to repeat the virtuous cycle.

**Table 5 – Exhibitor’s behavior in international fairs**

<b>Variables</b>	<b>Number</b>	<b>Percentage</b>
<b>Individual participation</b>		
Yes	51	75.0
No	17	25.0
<b>Collective participation</b>		
Yes	26	53.1
No	23	46.9
<b>Interest of collective participation</b>		
No, limits individual actions	17	38.6
Yes, reinforces participation	22	50.0
Yes, only way to participate	5	11.4
<b>How many fairs annually</b>		
First time	3	5.9
1 to 3	23	45.1
More than 3	25	49.0

<b>Change stand between fairs</b>		
Never	3	6.0
Always	17	34.0
From time to time	7	14.0
Random	23	46.0
<b>Pre-fair preparation</b>		
Less than 2 months	10	17.8
3 – 5 Months	27	52.9
More than 5 months	14	27.5
<b>Marketing before the fair</b>		
Yes	48	96.0
No	2	4.0
<b>Return on investment</b>		
During the fair	4	8.3
One month later	13	27.1
Half year later	22	45.8
One year later	7	14.6
More than 1 year	2	4.2

Note: Totals may be less than 68 as respondents did not complete all questions.

Table 6 suggests that location of the stand was a prime driver of the decision for selecting an international trade fair, with a mean response of 4.48 on the 5 point scale used. From the exhibitor's perspective, credibility of the trade fair organizers (mean response of 4.46), profile of the attendees (mean response of 4.35), participation costs and the market coverage of the fair (mean response of 4.23) were other major critical decision factors.

The reputation and image of the organization are built on the basis of experience and communication strategies, such as the outcome of previous events, the personal experience, word of mouth and media exposure (advertising in general and specialized press). Other complementary media that could enhance the image of the organization are sponsorship by public authorities or endorsement by industry/trade associations or chambers of commerce. Another important decision factor to be considered in the decision for participating in a trade fair is the qualitative characteristics of visitors and the roles they play in their firms' purchase decision-making process. The quantity of the attendance is less important for exhibitors (mean response of 3.92).

The exhibitor's decision as to whether or not attend a trade fair is also influenced by the costs of participating in the event. These include costs linked to space rental, transport and freight, booth personnel travel, and living expenses (Junior, 2005; Berne and Garcia-Uceda, 2008). These costs are proportional to the number of fairs that the firm considers visiting per year, and must be managed according to the communication objectives of the firm's yearly marketing plan. Together with costs, the exhibitors ranked the target envisaged by the trade fair organization as equally important. It seems that firms tend to concentrate their

participation on vertical rather than horizontal trade fairs (Kerin and Cron, 1987). This could be explained by the marketing objectives of participating firms and the customer segments they want to target in order to developed sustainable relationships with suppliers, customers and channel intermediaries (Berne and Garcia-Uceda, 2008).

**Table 6 – Firm’s decision factors to participate in international fairs**

Factors	1	2	3	4	5	Mean (S.D.)
Credibility of the trade fair organization	0	3	0	20	25	4.46 (0.617)
Number of attendees of the previous trade fair	2	9	0	28	9	3.92 (0.739)
Competition participation	8	15	1	21	3	3.35 (0.911)
Promotion of the event by the trade fair organization	2	16	0	17	13	3.85 (0.875)
Structural conditions of the exhibition park	3	9	0	26	10	3.90 (0.805)
Market coverage of the trade fair	0	6	1	21	20	4.23 (0.831)
Profile of the attendee	1	2	1	20	24	4.35 (0.838)
Simultaneously events with the trade fair	5	21	6	14	2	3.02 (1.041)
Size booth of the stand	0	16	0	31	1	3.69 (0.512)
Location of the stand	1	4	0	14	29	4.48 (0.743)
Typology of the stand	1	11	1	24	11	3.90 (0.857)
Participation costs	0	5	1	23	19	4.23 (0.805)

Note: 5-point interval scale, from 1 least important to 5 most important.

The imitation effect (competition participation) and parallel activities during the show (mean responses of, respectively, 3.35 and 3.02) were seen as the least important decision factors to participate in an international trade fair.

Responses to the firm’s decision criteria to participate in international trade fairs were initially factor analysed using principal factor analysis with varimax rotation and the results are shown in Table 7. The Kaiser-Meyer-Olkin (KMO) test and Bartlett’s test of sphericity were computed to assess the appropriateness of factor analysis to the data. The KMO value was 0.763, and Bartlett’s test was significant at the 0.00 level. Both results demonstrate the factorability of the matrices being considered (Hair et al., 1995). A final three factor model

was estimated with 11 items, as one item (competition participation) falls under 0.50 (Hair *et al.*, 1995). The factor solution accounted for approximately 62.5% of the total variance explained, with all communalities ranging from 0.478 to 0.793 and eigenvalues greater than one. An examination of the factor loadings suggest that factor 1 was related to firms' concerns about the reputation of organizers, the number and profile of the attendees, market coverage of the fair and the costs of participation. The factor was termed "value for money". Factor 2 measured firms' concerns with the design, location and size of the stand in the fair. The factor was termed "stand". Factor 3 measured firms' concern about the promotion, animation and structural conditions of the venue. The factor was termed "dynamism".

Considering the internal consistency of the items within each dimension measured by examining the Cronbach reliability alphas, these show a high level for factors 1 (0.78) and 2 (0.756) but lower for factor 3 (0.524) suggesting lower reliability. In fact, Nunnally (1978) indicates that reliability alphas close to 0.70 indicate a high level of internal consistency between the individual scale items and the related factors. Consequently, the dimensions found to be reliable and viable were "value for money" and "stand".

The first factor assesses the cost of participation in a fair against the reputation of the organizer, the suitability of the attendees (number and profile) and the market coverage of the fair. It not only measures the costs of participation but also takes account of the mix of reputation, quality and quantity of attendees (present or potential), and the market coverage to judge whether or not, together, they constitute good value. The Portuguese exhibitors seem full aware of the costs and benefits of their decision, using different criteria to capture the best value for money.

**Table 7 - Principal Component Analysis with Varimax rotation (n= 51)**

<b>Variables</b>	<b>F1 Loadings</b>	<b>F2 Loadings</b>	<b>F3 Loadings</b>	<b>Communalities</b>
Reputation of the trade fair organization	<b>0.617</b>	-0.118	0.29	0.478
Number of attendees of the previous trade fair	<b>0.693</b>	-0.024	-0.029	0.482
Promotion of the event by the trade fair organization	0.167	0.090	<b>0.745</b>	0.591
Structural conditions of the exhibition venue	0.319	0.060	<b>0.765</b>	0.69
Focus of the trade fair	<b>0.795</b>	0.231	0.185	0.719
Profile of the attendee	<b>0.603</b>	0.384	0.204	0.553
Simultaneously events with the trade fair	-0.216	0.432	<b>0.539</b>	0.523

Size booth of the stand	0.237	<b>0.688</b>	0.369	0.665
Location of the stand	0.391	<b>0.800</b>	0.023	0.793
Typology of the stand	-0.022	<b>0.843</b>	0.053	0.719
Participation costs	<b>0.663</b>	0.471	0.095	0.67
<b>Measures</b>				
Eigenvalue	4.124	1.584	1.179	
Explained variance (%)	24.443	22.341	15.808	
Cumulative variance (%)	24.443	46.775	62.582	

Notes: Items measured on a 5-point Likert scale. Kaiser-Meyer-Olkin measure of sampling adequacy = 0,763; Bartlett's test of sphericity (significance  $p < 0,000$ ).

The second factor is specifically related with the typology, size and location of the stand on the fair. The trade fair stand is the firms' calling card and varies between exhibitors in terms of size, design and appearance. The results indicate that the Portuguese exhibitors are now placing a more definitive attention upon their stand's positioning in the trade fair, matching the standards of competition and the needs of visitors (present and prospect customers).

## CONCLUSION

The present study attempted to examine perceived motives and decision factors of Portuguese exporting firms to participate or not in an international trade fair. A strong motive to exhibit at a trade fair is the reinforcement of the exporter's market presence, particularly in international markets where the comparative costs of other promotional tools are relatively prohibitive. In descending order, the Portuguese exhibitors indicated the possibility of finding new ideas and test new products during the event, the establishment of sustainable relationships with important customer, the enhancement of the brand image and reputation of the firm. Contrary to expectations, increase sales and expand the customer portfolio ranked moderate, while promotion and introduction of new products ranked low on the motives of Portuguese exhibitors. The main barriers to non exhibitors firms are costs associated with the participation in the venue (rents of space and stand, travel and accommodation expenses, etc.), bad experiences on previous trade fairs, and lack of resources (financial, personnel and time). To overcome these barriers the non exhibitors suggest lessen costs, mainly by appealing to the support of governmental agencies (in the Portuguese case AICEP). Other barriers refer to the difficulties in choosing a better stand location inside the venue, the weak impact of the trade fair in the media, the reputation of the trade fair organizer and the animation during the fair.

To formulate meaningful assistance programs, it is necessary to be aware of the factors that influenced exporting firms to become involved in international trade fairs and also the reasons why non-exhibitor firms decide against involvement. While it is necessary to provide information, training, and resources to exporting firms to overcome barriers, it is also essential to highlight the benefits of exhibiting in a way that ensures non exhibitors respond positively to assistance. It is necessary to look at motives and barriers as part of a total incentive system rather than to treat them independently.

The attitude towards the individual or collective presence at an international trade fairs varies between Portuguese exporting firms. Some of them regard collective participation as a limitation in their selling and marketing actions, others as an opportunity to reinforce their international market presence. Most of the Portuguese exhibitors plan the participation before, during and after the fair takes place, but the return on the investment of the trade fair only achieve its peak after the fair (one to six months). Therefore, it is crucial that exhibiting firms took a long term approach when evaluating the return on the investment of a particular trade fair, as most of the results are intangible (image, reputation) and not immediately measurable.

The firm's critical decision factors to select a trade fair was "value for money", which means that costs of participation in an international trade fair was weighted by the mix of organizer's reputation, the quality and quantity of attendees, and the market coverage. Another important factor of decision was the typology, size and location of the stand on the fair, which represents the image of the firm, and must competitively respond to the dynamics of each trade fair environment (layout of the space, competition, type of attendees, etc.). These results have important implications for trade fair organizations. The first one suggests that costs still matter in the decision making process of the exporting firm, but are weighted by a mix of factors. The second implication indicates that the main focus of the exhibiting firms is rather on the size, design and location of the stand, than on competition observation, advertisement of the trade fair or animation during the fair.

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## EVALUATING THE GUIMARÃES 2012 EUROPEAN CAPITAL OF CULTURE (ECOC): A TOURIST PERCEPTION APPROACH

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### ABSTRACT

Guimarães has hosted, during the year of 2012, one of the European Capital of Culture (ECOC). The evaluation of the event is needed as public, private and community funds are involved. The approach considers the tourists (domestic and international) as external and independent stakeholders who assessed the cultural activities developed during the event and the attributes of the city.

The results of the survey show that hosting the 2012 ECOC was a major contribution for attracting new visitors to the city, although many of them just for a short period of time. The main source of general information collected by tourists was the Internet, and the traditional media. Only a small amount of respondents demonstrated a specialized knowledge of the cultural program. The most cited and appreciated performances came from the areas of music, exhibitions, and theatre. According to the perceptions of tourists, the tangible assets were clearly detached from the set of attributes of Guimarães, including buildings, churches and chapels, whereas intangible assets were less noted. Overall, Guimarães received a very positive evaluation related to city image and stay and is highly recommended by tourists to friends and relatives.

**Keywords:** European Capital of Culture; Evaluation of Mega Events; Cultural Tourism; Guimarães.

## INTRODUCTION

The evaluation of the European Capitals of Culture (ECOC) by external entities has become a requirement after the Decision n. ° 1622/2006/EC, dated from October 24, 2006, of the European Commission. Therefore, since the ECOC 2007 (Luxembourg and Sibiu), the European Commission publishes, in the official journal, synthetic ex-post evaluations of the events (ECOTEC 2009 and 2010; European Commission, 2009 and 2010).

Simultaneously, as festivals, fairs and international exhibitions and sporting mega events were taking an increasingly important role in the development of cities, regions and countries, the number of impact studies increased significantly (Fredline and Faulkner, 2000; Kim and Petrick, 2005; Ritchie, Shipway and Cleeve, 2009). Evaluation is a multidimensional concept that should include not only economic, but also social, environmental, and cultural impacts.

The approach used to assess the success of ECOC 2012 is the one of tourists, and their perception towards the city and the several realizations that take place during that year. Multiple studies have been made about the impact of mega events but fewer have focused on tourists as external and independent stakeholders, specifically on the evaluation of the activities of the European Capitals of Culture. The result of this research can be useful to managers interested in the planning and organization of future cultural events.

Considering the aims of the research, the paper begins with a brief review of the literature on impacts of hosting mega events, specifically cultural-related ones. The following section addresses the characteristics of Guimarães and the objectives underlying the organization of the 2012 ECOC. The third section describes the methodology used in the research. Section four presents the results of the analysis. The paper ends with some conclusions and the identification of a few limitations of the empirical research performed.

## 1 THE IMPACT OF MEGA-EVENTS

### *1.1 Advantages of hosting mega-events*

Hosting a mega event causes economic, social and environmental impacts. In most cases, the economic dimension is overvalued, comparing to the social and cultural ones. Kim and Petrick (2005), in the aim of their study about the FIFA World Cup 2002, that took place in Seoul, Korea, presented three reasons why the organizers of the mega events tend to privilege

economic analyzes and to ignore social and cultural impacts. These are: i) the social and environmental impacts are seen as "external" to the economic analysis; ii) the impacts are less tangible and difficult to measure; iii) the effects tend to be associated with negative factors and therefore their evaluation is not encouraged by the promoters of the events.

In what concerns the positive economic impacts, it is widely recognized that tax revenues, jobs and incomes tend to increase before, during and after hosting a mega event (Ritchie, Shipway and Cleeve, 2009). Deccio and Baloglu (2002), and Strauf and Scherer (2010), refer also greater opportunities for giving external visibility and promoting the city and the welcoming country, as well as investments in new infrastructure that residents and tourists can benefit from.

The hosting of a mega event can also be part of a larger program of urban regeneration, as it was the case of the 1992 Barcelona Olympic Games, which were associated with the development of tourist attractions, shops and restaurants, as well as the improvement of transport infrastructure (Ritchie, Shipway and Cleeve, 2009).

As positive social impacts, we could point out: the increase of community pride of the hosting population; the improvement of their quality of life; the strengthening of cultural values; and the reinforcement of the regional or national identity (Hall, 1992; Deccio and Baloglu, 2002; Waitt, 2003, Kim and Petrick, 2005; Kim, Gursoy and Lee, 2006; Ritchie, Shipway and Cleeve, 2009). In fact, according to Gursoy and Kendall (2006), some researchers have concluded that, for residents of places hosting mega events, as it was the case of Calgary, with the 1988 Winter Olympics, and Atlanta, with the 1996 Olympics, these positive social impacts, in particular, community pride and international recognition, were as important or more than the positive economic impacts. Many years before, Hall (1992) had also emphasized that environmental, sociocultural and political impacts may be more important than economic ones. Similarly, Deccio and Baloglu (2002) have claimed that conducting a mega event may also contribute to preserve the environment and local heritage.

In a research about the measuring of the impacts of festivals and cultural events of large scale, as major impacts on the local and regional economies, Langen (2008) and Langen and Garcia (2009) reported the expenditures incurred by visitors (direct, indirect and induced). In addition to these expected effects, Baker Associates (2007), reporting the results of the Glastonbury festival (UK), mentioned trade opportunities that arose from non-profit

organizations (security, monitoring, recycling), the positive image of the city (nationally and internationally), and the contribution to the formation of a local business culture.

### *1.2 Disadvantages of hosting mega-events*

Besides the benefits associated with the implementation of a mega event, local communities may also experience negative impacts of economic, social and environmental nature. Some of the costs associated with hosting a mega event are: the increase of the prices of goods, services and properties; traffic congestion and parking problems; increased crime and insecurity; and conflicts between residents and visitors (Deccio and Baloglu, 2002; Waitt, 2003). The environmental destruction and deterioration of cultural or historical resources are also damages that may arise from organizing mega events (Kim, Gursoy and Lee, 2006).

It seems to be obvious that a European Capital of Culture, as any international mega event, causes positive and negative impacts, but it has some peculiarities that distinguish it from the ones of sports events. On the one hand, its scope is broader, as it focuses on various aspects of the cultural life of the city. On the other hand, it has a higher temporal duration, as follows uninterruptedly over a year. Finally, its effects are more diverse because they occur at economic, social, cultural, political, physical and environmental levels.

### *1.3 Evaluation of European capitals of culture: a brief review*

The first detailed economic impact assessment of an ECOC occurred in Glasgow, in 1990, but since 1985 this kind of cultural events have been held annually in various European cities. In 1994 it was published a report about the first ten years of the European Capitals of Culture (Myerscough, 1994), emphasizing the recognition of the citizens that the title conceded to the city was important. The same report also shows the positive effects experienced by host cities on several dimensions, such as coverage by the media, and the development of culture and tourism.

In 2004, the European Commission has ordered a study to evaluate the success of the second decade of the European Capitals of Culture (1995-2004). This study concludes that the organization of a ECOC benefits the city and the country (Palmer/Rae Associates, 2004). However, points out the lack of development of a policy of adopting the best practices (benchmarking), and the absence of a common framework and performance indicators.

The evaluation process of each of the ECOC was required by Decision n. ° 1622/2006/EC, of October 24, 2006, and on December 22, 2009 [COM (2009) 689 final], was published the first ex-post evaluations: the 2007 (Luxembourg and Sibiu), and the 2008 (Liverpool and Stavanger) ones. In the following year, it was published the ex-post analysis of the 2009 ECOC (Linz and Vilnius) [COM (2010) 762 final, December 17]. The evaluation framework includes the following dimensions: relevance of the action; relevance to the city that hosts the mega event; management efficiency of the organization; effectiveness of ECC mechanisms at EU level; the effectiveness in the development of cultural activities; the effectiveness in promoting European dimension through culture; effectiveness in achieving social, economic, urban development and tourism; and sustainability of the event (European Commission, 2009 and 2010). Thus, the European Capitals of Culture can contribute to the promotion of local culture, supporting the development of artistic and cultural activities of local organizations and facilitating access to and citizen participation in these activities (Palmer/Rae Associates, 2004; LGR, 2008; ECOTEC, 2009).

Previously to Guimarães, Portugal had hosted two ECOC. The first was in Lisbon, in 1994, which contributed to the developing of projects of rehabilitation and reform of cultural buildings. The second one occurred in Oporto, in 2001, resulting in the construction of the Music House (Casa da Música), and the rehabilitation of the National Auditorium Carlos Alberto (Auditório Nacional Carlos Alberto).

The perception of the benefits or costs associated with a mega event, as well as its success or failure, may have impacts on the image of the destination (Ritchie, Shipway and Cleeve, 2009; Strauf and Scherer, 2010). When the tourist's perception of the negative attributes outweighs the positive ones, the image of the city image can be damaged. Therefore, it is of utmost importance that perceptions of tourists can be monitored.

## **2 GUIMARÃES ECOC 2012**

The European Capital of Culture initiative is funded by the European Union Culture Program and promotes Europe's cultural diversity. The initiative aims to highlight the richness, diversity and shared characteristics of European culture and promote understanding among citizens. The title has a long-term impact, not only on culture but also in social and economic terms, both for the city and for the surrounding region. Guimarães shared the 2012 title with the city of Maribor, in Slovenia.

Guimarães is considered the birthplace of the Portuguese nation, the site where Portugal was founded, in the 9th century, by King D. Afonso Henriques. He played an important role in many of the events that led to the independence of the country in 1143. Located in the northern region of Minho, Guimarães, with its distinctive 10th-century castle, was classified a world heritage site by UNESCO, in 2001. The city also prides itself on its architecture, including many traditional buildings from the 15th to the 19th century.

It was the first time that a Portuguese medium city hosted such a mega-event and the residents saw it as an opportunity to reinforce their pride and attract new visitors to the city. A second challenge associated with the hosting of the 2012 ECOC refers to enhancing the tourism industry, viewed by local authorities as a major driver for regional growth. A third challenge was the unique opportunity that the 2012 ECOC presented for Guimarães to reinforce the image of the city as a cultural destination, both, within the country and internationally.

The goals of the 2012 ECOC, in Guimarães, according to the institution in charge of the organization and promotion of the event were: i) empowering the local community with new human resources and professional expertise, by encouraging their proactive involvement; ii) transforming the city's economy, which historically in endowed of an manufacture economic basis, into an internationally competitive and creative economy; iii) transforming a space that passively preserves memory into one that constantly offers new and surprising cultural experiences.

The program focus on four themes: city; community; thought and arts; and the cultural program, which included music, cinema, photography, fine arts, architecture, literature, thought, theatre, dance, and street art. Besides the opening and closing ceremonies, which attracted many people, during 2012 there were approximately 600 different cultural events.

### **3 METHODOLOGY**

The methodology was quantitative in nature and used a survey research design as a common method to investigate the tourists' perceptions of the ECOC. The design of the questionnaire was based on previous studies and on the literature review about the evaluation of other ECOC, as mentioned before in section 1. After the design of the questionnaire (both in

Portuguese and English), a pre-test was performed to assure internal and external consistency of the questions to be raised to tourists.

The final questionnaire included three parts. The first part of the questionnaire dealt with the visit to Guimarães and contained six questions. The questions try to know the cities that tourists enjoyed the most in the North part of the country or in the country, the number of times the city was visited by the respondent, how many days he/she wanted to stay, in what city and type of hotel slept, and the reasons for choosing Guimarães. The second part explored tourists' perceptions regarding the 2012 ECOC. The questions included if the tourist previously knew the event and how he/she received the information, what was the main motive of the visit, if he/she wanted to participate in some of the events and the level of satisfaction with the events taking place. Other questions tried to understand the level of knowledge about the program of the 2012 ECOC, the interest of the tourist and if the program was coherent with the profile of the city. One question was dedicated to the most strong or weak attributes of Guimarães. The last questions of this part asked the tourist if he/she wanted to return to the city, how he/she evaluated the stay, what was the impression that retained and if he/she would recommend the visit to Guimarães to a friend.

The third part covered the demographic characteristics of the respondents (such as sex, age, education, income).

The final structured questionnaire was applied between August and September 2012, allowing for the collection of 390 completed and provided usable questionnaires. The questionnaire was administered in some symbolic sites, such as the castle of Guimarães and the "Duques de Bragança" palace (Paço dos Duques de Bragança) following the criteria of nationality to attain a random stratified sample. The source was the two Guimarães tourism offices and the tourists' data registered, by nationality, in 2011. The twelve main countries of origin identified in 2011 were: Spain (28.6%); Portugal (21.8%); France (14.0%); Brazil (4.9%); Italy (3.3%); German (2.5%); England (2.9%); Netherlands (3.0%); U.S.A. (1.0%); Japan (1.0%); Belgium (1.1%); and Canada (0.7%). The remaining 15.2% corresponded to other nationalities not specified.

The data were examined using a *t-test* analysis to identify attribute's perception differences between Portuguese and foreign tourists. Then, the attributes were factor analyzed to see if there were any common variables underlying the tourist's main perceptions of Guimarães during the 2012 ECOC.

## 4 TOURIST'S EVALUATION OF THE 2012 ECOC: A SURVEY

### 4.1 Sample

Table 1 presents the profile of the survey respondents. The origin of the tourists is almost foreign (around 80%) and Portuguese (20%), which significantly corresponds to the data registered at the two tourism offices of Guimarães. The characteristics of tourists that visited Guimarães show no significant differences between gender, but they are relatively young, with nearly half of the sample under 46 years old (56.0%). They are well educated (74.2 percent possess a university degree) and mostly are married. Most of the tourists are employed and relatively wealthy, declaring incomes above €2500 (48.2%) on a monthly basis.

Table 1 - Sample characteristics

Characteristics	N (390)	%
Country of residence (Nationality)		
Portugal	81 (106)	20.8 (27.2)
Spain	117 (116)	30.0 (29.7)
France	61 (52)	15.6 (13.3)
Brazil	21 (21)	5.4 (5.4)
Italy	20 (20)	5.1 (5.1)
Germany	17 (16)	4.4 (4.1)
England	12 (12)	3.1 (3.1)
Netherlands	13 (13)	3.3 (3.3)
United States	9 (5)	2.3 (1.3)
Japan	4 (4)	1.0 (1.0)
Belgium	4 (4)	1.0 (1.0)
Canada	3 (3)	0.8 (0.8)
Others	28 (16)	7.3 (4.6)
Age		
16 – 25 years	37	9.5
26-45 years	181	46.5
46-65 years	141	36.2
More than 65 years	30	7.7
Gender		
Male	184	47.2
Female	206	52.8
Marital Status		
Single	140	36.2
Married	222	57.4
Divorced/Widow	25	6.5
Education		
Basic/Secondary	100	25.8

Characteristics	N (390)	%
University	166	42.8
Master/PhD	122	31.4
Professional situation		
Employee	299	76.9
Unemployed	19	4.9
Student	26	6.7
Retired	40	10.3
Work at home	5	1.3
Income		
Less than €501	13	3.6
Between €501 and €1000	36	10.1
Between €1001 and €2500	136	38.1
More than €2500	172	48.2

Source: authors' own survey data.

These different age profiles could be explained by the context (country, region, heritage site type) and time (year, seasonality) where these studies have been performed. Given the nature of our sample (composition and size), no further considerations will be made regarding a definitive and specific typology of heritage tourists.

#### 4.2 Tourist's behavior

The results presented in Table 2 suggest that touring around the region is very important for cities such as Guimarães, which depends on the capacity of attraction of other middle cities located in the region. When considered as a set of cities (Guimarães, Braga, Viana do Castelo, and Douro), its total attraction capacity improves significantly. However, Porto still is the main "entry door" (30.1 percent) to the northern part of Portugal.

This occurs, first, because it is endowed with an international airport, a network of public transports (railways, buses, underground) and it is the place of departure for boats that travel to Douro. A second reason for the attracting role played by Porto metropolitan area has to do with its critical dimension, that enhances accommodation supply, both, in terms of quality (different star hotels) and quantity (number of beds). Finally, a wider range of attractions and experiences is available to different typologies of tourists in the metropolitan area, such as beaches, museums, Porto wine caves, and shopping.

Besides the importance of Porto as a tourism destination, it is very important that all the cities belonging to the northern region could benefit from tourism. The creation of thematic

itineraries (such as religious and wines routes), linking different towns and rural communities outside the Porto metropolitan area, is one strategy to increase the potential contribution of those places to regional development. However, as mentioned before, a major constrain persists, which is the tourism seasonality. Different strategies have been implemented to attenuate this phenomenon, which includes attracting selected typologies of tourists (such as seniors), organization of special events, academic conferences, professional seminars, among others.

Table 2 – Other cities visited by tourists

Cities	N	%
Braga	247	24.4
Porto	305	30.1
Viana do Castelo	157	15.5
Douro	112	11.1
Others	192	18.9
Total (a)	1014	100,0

Note: (a) Multiple response question.

Source: authors' own survey data.

As shown in table 3, hosting a mega-event such the 2012 ECOC seems to give a major contribution for attracting new visitors, as 71.5% of the respondents were visiting the city for the first time, and only 10% were returning visitors (more than 3 times). If one of the major objectives of the European Union when creating the ECOC was to give awareness to less known cities, we may conclude that the goal was reached in this particular case.

Table 3 – Tourists' intentions and accommodation

Questions	N	%
Have you visited the city before?		
First time	279	71.5
One time	35	9.0

Two/three times	37	9.5
More than three times	39	10.0
Total	390	100
How many days do you intend to stay in Guimarães?		
Less than a day	211	54.1
One day	101	25.9
Two/three days	50	12.8
Four to six days	18	4.6
More than seven days	10	2.6
Total	390	100
City where do you stay?		
Guimarães	112	32.0
Porto	97	27.7
Braga	29	8.3
Viana do Castelo	14	4.0
Others	98	28.0
Total	350	100
Type of accommodation		
Hotel	187	53.0
Hostel	44	12.5
Apartment	12	3.4
Family and friends	60	17.0
Camping	24	6.8
Others	25	7.4
Total	353	100

Source: authors' own survey data.

A clear weakness of the Guimarães destination was the short time of stay, with 80.0% of the respondents declaring that they would stay only one day (25.9%) or less (54.1%). Probably due to the large number of emigrants that each year use to visit their home country, 17% of the respondents declared to be accommodated at family and friends houses. The short time of stay has a negative impact on the accommodation chosen by tourists, as only 32% of visitors stayed in Guimarães, which loosed attraction for other neighbor cities (Braga, Viana do Castelo) or even larger cities, such as Porto. One possible explanation is the accommodation capacity (number of beds) of Guimarães, particularly in times of strong demand, as by the time some major events of the ECOC took place.

Table 4 indicates a wide variety of sources of information about the 2012 ECOC. The Internet was the main source (33.2%) used by tourists to access the general information about the event, followed by the traditional media, such as radio/TV (24.3%), and magazines and newspapers (11.2). However, the information sources that probably could be more useful in making decisions in terms of relevance for tourists were friends and family (12.9%), and the

tour guides (7.7%). This assertion is partially confirmed by the people that demonstrated real interest on the event (only 70 tourists out of 235), by knowing the entire program (23.8%) or part of it (71.5%). The level of depth knowledge of the program was very weak as only 25 tourists had an accurate and favorable opinion about the adequate match between the profile of the city and the cultural activities developed within the city during the survey.

Table 4 – Knowledge, attendance and satisfaction with the program  
of Guimarães 2012 ECOC

Questions	N	%
Knowledge of the event (Yes= 235)		
Friends and family	30	12.9
UNESCO site	2	0.9
Internet	78	33.2
Magazines/Newspapers	26	11.2
Radio/TV	57	24.3
Tour guide	18	7.7
Other	21	9.9
NR	3	1.3
Total	235	100
Knowledge of the program (yes = 70)		
Level of matching with expectations		
100%	30	23.8
75%	36	28.6
50%	32	25.4
25%	22	17.5
0%	6	4.8
Total	126	100
Attendance to cultural activities (Yes = 76)		
Music	47	37.0
Theatre	13	10.2
Exhibitions	33	26.0
Photography	10	7.9
Fairs	4	3.1
Workshop	3	2.4
Cinema	5	3.9
Dance	2	1.6
Pop up	4	3.1
Debates and conferences	2	1.6
Other	4	3.1

Questions	N	%
Total	127	100
Attendee level of satisfaction regarding particular events of the ECOC		
Very satisfied	2	8.7
Satisfied	10	43.5
Reasonable satisfied	11	47.8
Less satisfied	0	0.0
Nothing satisfied	0	0.0
Total	23	100

Source: authors' own survey data.

The program included a wide range of cultural activities, but only 76 out of 235 (32.3%) of the tourists attended some of the venues. The cultural activities most cited by the tourists were related with music (37%), exhibitions (26%) and theatre (10.2%), which was the part of the program oriented towards general audiences. The number of attendees surveyed that effectively assisted to a particular cultural venue (23 out of 235) were satisfied with the performance.

#### 4.3 Attributes' saliency of Guimarães

The image we have towards a region has a strong impact on how we view it as a destination - a place to invest in, or a place to live. One of the main outcomes that could be obtained with the organization of the 2012 ECOC was to determine which elements of Guimarães were included by tourists in their destination image. These elements are an integral part of the region's identity that has been proactively distilled, interpreted, internalized, and projected externally in order to gain recognition and to construct a favorable image. A regional destination image represents a set of beliefs and perceptions that people have about a given region, such as cultural heritage, landscape, nature, art, music, gastronomy, citizens, events and a diverse package of variables and auxiliary factors.

Table 5 presents the perceptions of all respondents regarding the different attributes of Guimarães in the broadest sense. As can be seen, in the top of the more salient attributes of the image of Guimarães stands the material heritage patrimony and include buildings and historic sites (3.08), and churches and chapels (2.28), which are closely related to the World Heritage status of the city. Below the score of 2 (mean), there are a wide range of items that

deserved the mention of several respondents, but lack relevancy in the perception of the majority of respondents.

Table 5 – Most valued attributes of Guimarães during the 2012 ECOC

Attributes	All (a)		Portuguese		Foreigner		<i>t</i> -test (b)
	Mean	S.D.	Mean	S.D.	Mean	S.D.	
Folk music	1.22	0.861	1.5	1.252	1.11	0.63	3.045*
Other kind of music	1.09	0.538	1.22	0.805	1.05	0.387	2.101**
Festivals and events	1.19	0.774	1.50	1.229	1.07	0.463	3.508*
Cultural life	1.46	1.179	1.85	1.529	1.31	0.982	3.379*
Writers	1.04	0.387	1.03	0.291	1.05	0.417	-0.476
Painting and sculpture	1.09	0.533	1.16	0.678	1.07	0.467	1.308
Craftsmanship	1.28	0.92	1.59	1.256	1.17	0.729	3.287*
Dance	1.03	0.281	1.06	0.41	1.02	0.214	0.933
Football	1.11	0.59	1.2	0.761	1.08	0.509	1.467
Other outdoor sports	1.02	0.253	1.04	0.389	1.01	0.178	0.944
Other indoor sports	1.03	0.307	1.10	0.584	1.00	0.0	1.828
Quality of the environment	1.81	1.496	1.69	1.39	1.85	1.534	-1.004
Buildings and historical sites	3.08	1.86	3.27	1.88	3.01	1.851	1.226
Museums	1.83	1.496	2.58	1.799	1.55	1.259	5.418*
Churches and chapels	2.28	1.712	2.95	1.848	2.02	1.589	4.577*
University and scientific knowledge	1.12	0.629	1.2	0.821	1.08	0.538	1.322

Notes: (a) Five-point interval scale, corresponding to 5 (very strong), 4 (strong), 3 (moderate), 2 (weak), 1 (very weak). (b) T-test for equality of means, assuming equal variances. (\*) Significant at  $p < 0.01$ . (\*\*) Significant at  $p < 0.05$ .

Source: Authors' own survey data.

A synthesis of the most salient attributes of Guimarães shows that it was perceived overall by tourists as a heritage and cultural city, encompassing buildings and historical sites, churches and chapels. These tangible assets are all physical and visible for tourists, facilitating the retention of some remarkable signs that shape the image of the city. These physical attributes are remembered later by tourists in photos and personal movies shown to family and friends. In a landscape full of images, it seems that physical attributes still do matter. The declaration of Guimarães as a UNESCO world heritage site, in 2001, has also brought awareness to the city.

On the contrary, the exposure to intangible assets stimulus was more passively received by the tourists and more easily forgotten. Nevertheless, the hosting of a mega cultural event, as the 2012 ECOC, should be viewed as a long term investment that need to be maintained if the city wants to be relevant in the competitive international market of tourism destinations.

There were no significant differences of perception between Portuguese and foreign tourists with respect to the attributes of "writers", "painting and sculpture", "dance", "football", "other outdoor sports", "quality of the environment", "buildings and historical sites", and "university". The major differences ( $p < 0.01$ ) were found in "cultural life", "folk music", "festivals", "craftsmanship", "museums", and "chapels and churches". That is, Portuguese tourists were more likely to value the cultural life (music, festivals, museums, chapels and churches) of Guimarães than the foreign ones.

The perceived attributes of Guimarães were factor analyzed to see if there were any common factors that drove tourists. The Kaiser-Meyer-Olkin (KMO) test and the Bartlett's test of sphericity were computed to assess the appropriateness of factor analysis to the data. The KMO value was 0.684, and Bartlett's test was significant at the 0.00 level. Both results demonstrate the factorability of the matrices being considered (Hair *et al.*, 1995).

Principal component factor analysis with varimax rotation was used to identify the underlying dimensions. After inspection of factors content for tourist's attribute perceptions of Guimarães, three items were deleted, two corresponding to a factor with a Cronbach's alpha less than 0.2 and further, and one that was isolated. A final four factor model was estimated with 13 items. The factor solution accounted for approximately 53.5% of the total variance explained, with all communalities ranging from 0.322 to 0.760. Although factors 3 and 4 have low reliability alpha, considering the interest for analysis, were retained.

The results of that factor analysis are listed in table 6. The factors represent the overall perception

of all respondents regarding the attributes of Guimarães and were labeled: “material heritage”, “intangible heritage”, “cultural performance”, and “sport and education”. Factor 1 is related to the basic material characteristics of the city, and it is responsible for explaining 21.41% of the total variance found, with a reliability coefficient of 0.67. It is followed by Factor 2 (11.52% of total variance and Cronbach’s alpha level of 0.56), which comprises items related to arts and cultural life. Factor 3, labeled “cultural performance”, contains dance and music (10.74% of total variance explained with the alpha level of 0.38). The final factor “sport and education”, represents 9.82% of the statistical variance and had a reliability alpha of 0.43. This factor is associated with the university campus, football and other outdoor sports.

Considering the internal consistency of the items within each dimension measured by examining the Cronbach reliability alphas, these show a high level for factors 1 and 2 but lower for factor 3 and 4. In fact, Nunnally (1978) suggests that reliability alphas close to 0.70 indicate a high level of internal consistency between the individual scale items and the related factors.

As said, the results indicate that tourists’ perceptions can be described in four dimensions. The dimensions were found to be reliable and valid, with “material heritage” as the main factor.

**Table 6 - Factor analysis results with varimax rotation of tourist’s attributes perceptions of Guimarães during the 2012 ECOC**

Components	Factor Loading <sup>a</sup>	Item means	Standard deviation	Eigenvalues	% of Variance	Cumulative %	Reliability Alpha
<b>Factor 1: Material heritage</b>		<b>2.249</b>		<b>2.780</b>	<b>21.411</b>	<b>21.411</b>	<b>0.672</b>
Churches and chapels	0.790	2.28	1.712				
Buildings and historical sites	0.771	3.08	1.860				
Museums	0.658	1.83	1.496				
Quality of the environment	0.540	1.81	1.496				
<b>Factor 2: Intangible heritage</b>		<b>1.219</b>		<b>1.498</b>	<b>11.523</b>	<b>32.934</b>	<b>0.559</b>
Painting and sculpture	0.805	1.09	0.533				
Writers	0.702	1.04	0.387				

Handicraft	0.534	1.28	0.920				
Cultural life	0.515	1.46	1.179				
<b>Factor 3: Cultural performance</b>		<b>1.060</b>		<b>1.396</b>	<b>10.735</b>	<b>43.669</b>	<b>0.383</b>
Dance	0.869	1.03	0.281				
Other kind of music	0.537	1.09	0.538				
<b>Factor 4: Sport and education</b>		<b>1.082</b>		<b>1.277</b>	<b>9.820</b>	<b>53.489</b>	<b>0.431</b>
Football	0.713	1.11	0.590				
University and scientific knowledge	0.659	1.02	0.253				
Other outdoor sports	0.650	1.12	0.630				

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Extraction Method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization; KMO (Kaiser-Meyer-Olkin measure of sampling adequacy) = 0.684; Bartlett's test of sphericity :  $p=0.000$ .

- a. Rotation converged in 5 iterations.

The dimensions "material heritage" and "intangible heritage" aggregate the main attributes that tourists perceived as unique and clearly distinctive of Guimarães. Each tourist has an image of all destinations where he/she has been to, but only remembers some of them if that image is truly remarkable. From the tourists' perspective, Guimarães has a historical build heritage, a quality of environment and a cultural life distinctive and easily accessed by people. These factors should support a differentiation strategy aiming to position the city as a set of historical attributes (tangible and intangible), beliefs, ideas and impressions that people associate with the birth of Portugal (Crompton, 1979; Kotler, Haider and Rein, 1993). The European Capital of Culture that took place during 2012 was an excellent opportunity to reinforce this niche, positioning and shaping the image of Guimarães.

In brief, the four factor solution offered by the analysis include a major factor of differentiation that surpasses all the other three, that is, the historical heritage of the city and the quality of its environment. These attributes should be the central elements of the city image, positioning and communication-mix.

One way of capturing the general impression caused by a tourism destination is asking to the tourist/visitor if he/she would recommend the city to a friend/relative or if he/she intends to return to the city. In the first case the results are very positive, with a mean of 4.85 regarding the recommendation to relatives and friends, but smaller in average terms in what regards the intention to return to Guimarães (mean of 3.58), which probably should be interpreted as an enjoyable city for a first time visit but not an enough exciting place for a new cultural experience. The evaluation of the stay and the city image are both quite impressive (means of 4.3 and 4.48) and denote a very good general impression of the tourists about the people and the city.

Table 7 – Recommendation of Guimarães

Questions	1	2	3	4	5	Mean	SD
Intention to return to Guimarães (a)	62	24	59	114	130	3.58	1.413
Recommendation of Guimarães (a)	1	0	7	40	334	4.85	.444
Evaluation of the stay in Guimarães (b)	0	0	10	212	109	4.30	.520
Evaluation of the image of Guimarães (c)	0	0	4	181	175	4.48	.522

Notes: (a) 1 – No, 2 – Probably no, 3 – I don't know, 4 Probably yes, 5 – Absolutely sure; (b) 1 – Very bad, 2 – Bad, 3 – Normal, 4 – Good, 5 – Excellent; (c) 1 – Very unfavorable, 2 – Unfavorable, 3 – Indifferent, 4 – Favorable, 5 – Very favorable.

Source: Authors' own survey data.

## CONCLUSIONS

During 2012 Guimarães has hosted one of the European Capitals of Culture. An attempt to evaluate the main outcomes of the cultural program was made in the peak of the program (August and September of 2012). The tourists' perceptions related to the ECOC program and the main attributes of Guimarães were captured by a survey research design.

The results indicate that touring around the region is very important for cities such as Guimarães, which depends on the capacity of attraction of other middle cities located in the region (Guimarães, Braga, Viana do Castelo, and Douro). Still, Porto is the main “entry door” to the northern part of Portugal.

Hosting a mega event such the 2012 ECOC seems to have been a major contribution for attracting new visitors, as the majority of tourists visited the city for the first time, and only a small portion were returning visitors. A clear weakness of the Guimarães destination was the short time of stay, which has a negative impact on the accommodation chosen by tourists, that stayed in other neighbor cities (Braga, Viana do Castelo) or even larger cities, such as Porto.

A wide variety of sources of information was used by tourists to know more about the 2012 ECOC. The Internet was the main information channel used, followed by the traditional media (Radio/TV, and magazines and newspapers).

There are only a small amount of respondents that demonstrated real interest on the event, by knowing the entire program or part of it. The level of depth knowledge of the program was very weak as only 25 tourists had an accurate and favorable opinion about the adequate match between the profile of the city and the cultural activities developed within the city during the survey. The program included a wide range of cultural activities, but the music, exhibitions, and theatre were the most cited ones and those that attended them effectively have shown appreciation with the performances.

The most salient attributes of Guimarães perceived by tourists were tangible assets, such as buildings, churches and chapels. The declaration of Guimarães as a UNESCO world heritage site, in 2001, has given the city domestic and international awareness. The saliency of intangible assets was less noted by tourist, even during the mega cultural event of the 2012 ECOC.

The differences between Portuguese and foreigner tourists are more acute when we considered the following attributes: museums, festivals and events, churches and chapels, craftsmanship, cultural life, folk music, other kind of music, football, and other indoor sports.

Overall, Guimarães was positively evaluated by tourists regarding the city image and was highly recommended by tourists to friends and relatives. The least positive indicator of satisfaction was the intention to return to Guimarães, which scores an average value,

probably because it was taken as an enjoyable city for a first time visit but not an enough exciting place for a returning cultural experience.

Therefore, we recommend a deeper knowledge of the tourism activity of Guimarães is needed in order to identify the profile of visitors and the type of holiday's activity they envisage to have. Of particular importance is the understanding of tourists' typologies (country of origin, demographic characteristics, and social and economic status), visit patterns (itineraries, duration, information sources, etc.), motivations to visit different cities and image perceptions. The results of these studies are critical for local tourism organizations (such as hotels, travel operators, politicians) to design consistent strategies to improve the movements of tourists around the entire region. Otherwise, even culturally motivated tourists interested in exploring new places and diversify experiences will tend to remain in places better served in terms of access and facilities, and that have a longer established image.

The increasing number of flights of low cost companies to/from Porto and the significant increase in tourists that came to Porto to stay for a weekend (short breaks) and the tourism attributes they are endowed with denote the potential of a few cities/territories of the northern Portugal as tourism destinations. In the particular case of Guimarães, a considerable strength is the favorable image that tourists retain about the city, while a strong weakness is the lack of critical size to be considered by its own cultural dimension. From this, it is taken, mostly, as part of one journey historical itinerary that includes neighbor cities.

One important limitation of the present study was assessing tourist's perceptions as a snapshot that captures a specific event in a particular time (August to September 2012), location (Guimarães) and a certain historical context (the hosting of the ECOC 2012). More studies are needed to cover more points in time and other locations around the country in order to compare for differences and similarities between the perceptions of heritage destinations sites (such as the Douro and Évora).

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## UNDERSTANDING THE HRM – PERFORMANCE LINK IN PROFESSIONAL SERVICE FIRMS: A MULTI-LEVEL PERSPECTIVE

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### ABSTRACT

This is a theoretical paper which aims to explore how and why the use of high performance works systems (HPWS) improves firm performance in professional service firms (PSFs). Extensive literature review indicates three research gaps as 1) the lack of focus on the professional service context in HRM research; 2) the lack of clarity on why this HR practice-performance link exists, the so called “black box” problem; and 3) the relatively undeveloped research of HRM in PSFs research. We propose a multi-level approach (organization, team and individual) and a longitudinal research design to close these research gaps. This paper contributes to better understanding how HPWS are operated in PSFs and the mechanisms through which HPWS work for organizational performance.

**Keywords:** High performance works systems (HPWS), firm performance, professional service firms (PSFs), multi-level analysis, longitudinal research design.

### BACKGROUND

The increase in the numbers of knowledge intensive firms is a major trend in the global economy. Professional service firms (PSFs) are attracting considerable attention from management researchers as their importance grows in scale and significance within developed economies.

The professional service firms are playing an important role in the world. For example, as one of the world’s largest professional services firms and the largest of the Big Four auditing firms, PricewaterhouseCoopers earned aggregated worldwide revenues of US\$29.2 billion for the financial year 2011, and employed over 175,000 people in 154 countries (PricewaterhouseCoopers, 2012, [www.pwc.com](http://www.pwc.com)).

PSFs consist of a highly educated and professionalized workforce who provide clients with customized knowledge (Empson, 2007; Greenwood et al., 2005; Maister, 1993). Examples of professional service providers include accounting, consulting, and legal services.

The difference between PSFs and other traditional manufacturing firms is that PSFs are knowledge intensive (Morris, 2001). PSFs are also different from other knowledge-intensive firms as they provide customized solutions/services to meet clients' needs (Morris and Empson, 1998). PSFs gain competitive advantage mainly through the expert knowledge of the professional workforce. Therefore, the human resource is the most valuable resource for PSFs.

## RESEARCH GAPS

Human Resource Management (HRM) plays an important role in helping organizations to achieve high performance. Three main research gaps were found in the existing studies of HRM in PSFs.

- HRM research in the context of professional service firms is *relatively undeveloped* (McClellan and Collins, 2011). Previous research on the relationship between HRM practices and firm performance has focused largely on manufacturing firms e.g. automobile plants, steel companies (Ichniowski and Shaw, 1999) and more routinized service firms like banks (Richard and Johnson, 2001) and call centres (Batt, 2002). Professional service firms are a valuable arena for studying human resources and resource-based views because the dominant resource, embodied in the skills, knowledge and experience of employees and owners, is evident (Hitt et al., 2001).
- The link between mutually reinforcing bundles of human resource (HR) practices and organizational performance is well-established. What is *less clear* is why this HR practice-performance link exists, the so called "black box" problem as shown in Figure 1. Researchers have called for closer examination of the "black box", that is, the *mechanisms* linking the two (Combs et al., 2006).

Figure 1. The Black Box of the HRM-Performance Link



- Systematic research on HR-related issues has been scarce in the literature on the professional service firm (McClellan and Collins, 2011). In PSFs, researchers have

previously addressed organizational structure (Greenwood et al., 1990; Pinnington and Morris, 2003), career systems (Morris and Pinnington, 1998) and knowledge management (Alvesson, 2001; Anand et al., 2007; Morris, 2001).

## RESEARCH QUESTIONS

Based on the above gaps and the call for deeper investigation of the “black box” in the HRM -performance link, this paper aims to explore the following questions:

- 1) What are the HRM processes through which HRM has an influence on firm performance?
- 2) How are HRM policies/practices implemented by line managers and what is its impact on team and firm performance?
- 3) How do employees perceive the HRM policies/practices as well as the line managers' implementation of HRM practices?
- 4) What is the psychological process whereby employees perceive the strength of the HRM system which impacts on their behaviours?
- 5) How do individual outcomes influence team and organizational level outcomes?
- 6) What is the impact of team climate on individual, team and organizational outcomes?
- 7) What are the causal linkages between HRM and firm performance?

## RESEARCH AIM

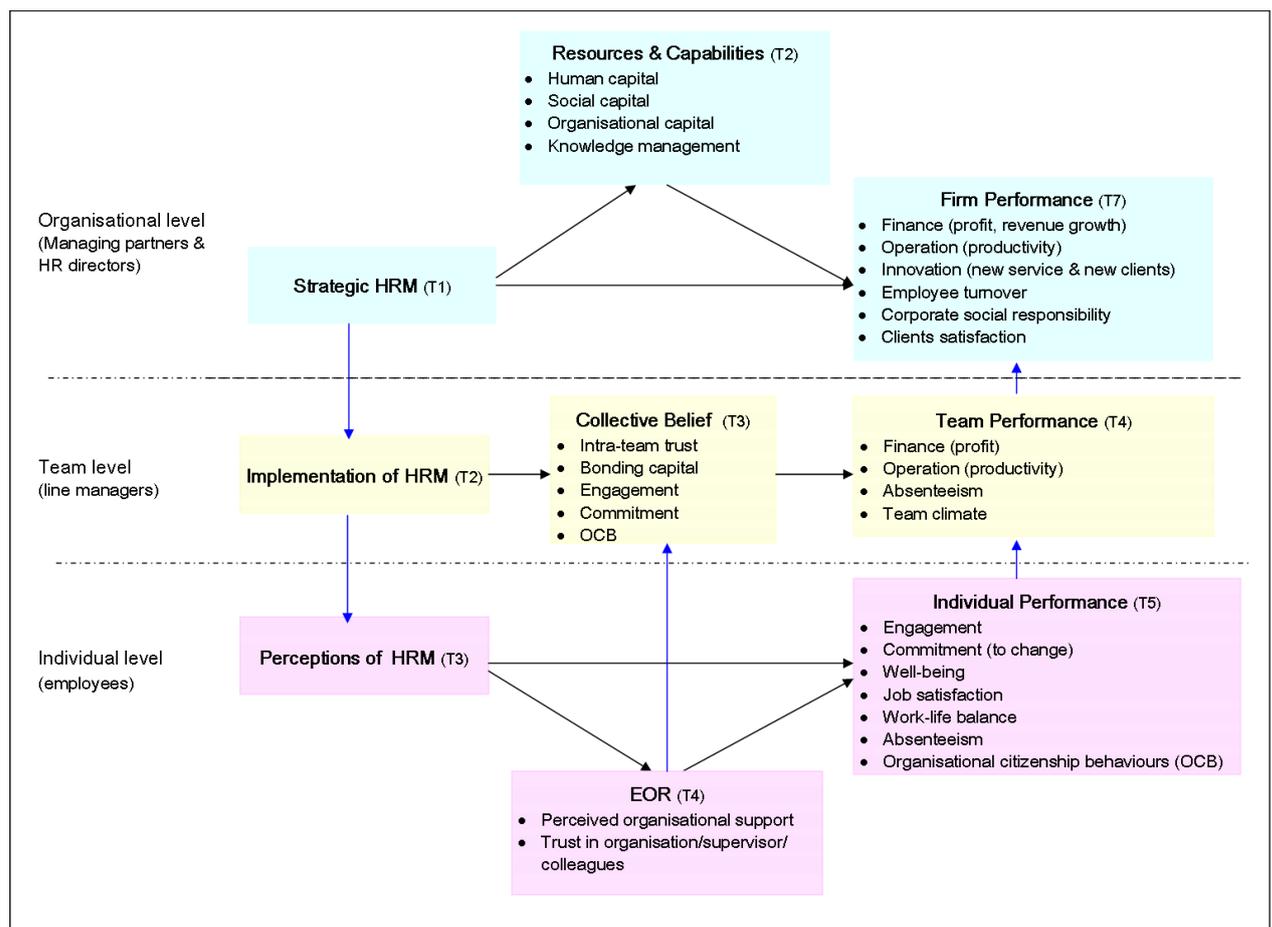
The aim of this paper is to investigate how and why HRM improves firm performance in PSFs using a multilevel approach and longitudinal research design. It integrates literature from organizational behaviour, HRM and strategy.

Figure 2 illustrates the conceptual model. The model indicates the focal constructs/variables at different levels of analysis as well as the inter-relationship of these constructs/variables.

- At the organizational level, the HRM practices such as selection, compensation, training & development, information sharing, team work and participation and their impact on firm performance are proposed. The measures of firm performance to be examined include financial, operational, innovation and corporate social responsibility (CSR). In addition, this paper claim a set of intermediate linkages through which HRM can influence organizational performance. In particular, this

paper integrates the resource-based view of the firm (RBV, Barney, 1991), the knowledge-based theory (KBT, Grant, 1996a, 1996b) and the evidence-based management theory (EBM, Rousseau, 2006; Rousseau et al., 2008), arguing that HRM influences firm performance through the creation of the resources of human capital (O'Sullivan and Sheffrin, 1998), social capital (Nahapiet and Ghoshal, 1998) and organizational capital (Subramaniam and Youndt, 2005; Youndt et al., 2004).

Figure 2 Conceptual Multi-level Model of HRM in PSFs



- At the team level, the link between line managers' enactment of HRM practices (Gilbert et al., 2011) and team performance are proposed. In addition, it explores the mediating effect of employees' collective beliefs such as intra-team trust, bonding capital, engagement, commitment and organizational citizenship behaviours (OCB).
- At the individual level, the employees' perceptions of HRM and their impact on employees' outcomes such as engagement, commitment (to change), well-being, job satisfaction, work-life balance, absenteeism, and organizational citizenship behaviours are addressed. In addition, the mediating effect of employee-organization

relationships (EOR) is proposed based on the social exchange theory (Coyle-Shapiro and Shore, 2007).

The research model proposes a horizontal impact between variables at the same level and also considers the vertical impact across different levels. This approach is supported by Purcell and Hutchinson (2007) who argue that HR practices influence employee attitudes and improve individual performance which in turn has an impact on team and organization performance. Therefore, the model proposes cross-level effects of HRM in PSFs as shown by the dashed lines in Figure 2.

Employing the resource-based view of the firm (Barney, 1991), dynamic capability theory (Teece et al., 1997), and the social exchange theory (Blau, 1964), the proposal explores how and why HRM works in PSFs by examining the HRM at three levels and linking them to the organizational, team and individual performance.

## DISCUSSION

Three research gaps have been identified. These are 1) the lack of focus on the professional service context in HRM research; 2) the lack of clarity on why this HR practice-performance link exists, the so called “black box” problem; and 3) the relatively undeveloped research of HRM in PSFs research. In this paper, a multi-level of HRM model was proposed. It helps to close these research gaps. It also highlights a set of intervening variables under which high performance work systems (HPWS) have an impact on organizational performance in professional service firms. By doing so, this paper contributes to the existing research in four ways.

Firstly, this model supports the argument by Boxall and Macky (2009). Using theory, they argue that the HR system influences organizational performance through its impact on work processes such as employee involvement which in turn links to employees’ job satisfaction, trust and commitment. These in turn link to organizational operating outcomes such as cost-effectiveness, labour turnover and absenteeism.

Secondly, the proposed model includes three levels of HRM, i.e. the HR policy at organizational level, line managers’ implementation of HR practices at team level, and the employees’ perceptions of HR practices at individual level. By doing so, this paper addresses the consistency of HRM (Wright and Nishii, 2007). Unravelling the “black box” effects has been a key issue in understanding how HR practices influence employee attitudes and individual performance, which in turn impacts on unit and organization performance

(Purcell and Hutchinson, 2007). According to Liao et al (2009), employees' perception of HRM is significantly different from intended and implemented HRM. The proposed model is among the first efforts to explore the intended HR practice-firm performance relationship.

Third, this proposed model explores the psychological processes through which employees differentially react to the same HRM practices. By doing so, it contributes to employing the process-based approach in studying HRM (Sanders et al., 2012). The process-based approach of HRM indicates that some HR practices may result in different individual and organizational outcomes.

Fourth, this proposed model also addresses the cross-level effects of HRM, such as employee perception of HRM, on team level performance. By doing so, it answers the call for multi-level research to more comprehensively understand how HRM works (Lengnick-Hall et al., 2009; Purcell and Hutchinson, 2007). So far, only a few studies have done so by aggregating data from the individual level to the unit level (e.g. Chuang and Liao, 2010; Gittel et al., 2010; Kehoe and Wright, 2010; Nishii et al., 2008; Takeuchi et al., 2009). This paper employs a multi-level modelling perspective instead of aggregation. Doing so allows for the exploration of the cross-level effects of HRM at the organizational, team and individual levels.

## **IMPLICATIONS FOR MANAGERS**

The proposed model links human resource management policy, practices and the employees' perceptions on them with individual, team and organizational performance. It provides a clear picture for managers on how HPWS work in firms. The managers who pay attention on the efficient and effective implementation of HPWS will build positive experience of management for employees which in turn improve their performance.

## **CONCLUSION**

Based on the research gaps identified in the literature, this paper proposes a multi-level model on how high performance work systems influence firm performance, i.e. organization, team and individual level. In addition, a set of mediating variables were proposed to explain the indirect links between HPWS and performance at difference levels. It contributes to better understanding the mechanisms through which HPWS links to firm performance, i.e. opening the "black box". Empirical work based on this model is expected.

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## THE DYNAMIC OF WINE SUPPLY AND PRICE FORMATION IN CHIANTI CLASSICO DENOMINATION

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### ABSTRACT

*Chianti Classico wine is one of the most important and oldest Italian red wine Denomination of Origin. In the wine sector its brand, the Black Rooster, is the most famous and know in the world. The structure of the DO is characterized by significant prices fluctuations of bulk wine, constant production and high land values. This situation has created uncertainty in farm investments and it has contributed to increase the supply in terms of surplus or stock. The particularity is also that DO is represented by formal institutions, contracts, branch and agreements and regulations between different producers' categories.*

*The purpose of this work is to reconstruct and explain the supply chain and bargaining during the bulk wine selling and price performance in one of most important and oldest Italian red wine Denomination of Origin (DO): Chianti Classico employing the Structure –Conduct and Performance (SCP) framework. The paper analyzes the DO structure and farmer's conduct with the aim to understand the logic behind the price formation and their performance. The interdependence among the different firms shows a singular character on the collective dynamics, collusion systems and informal rules observed that regulate the bulk wine prices (through unspoken agreement), supply control instruments and territorial systems.*

**Keywords:** Wine, Chianti Classico, Price formation, Structure, Conduct and Performance.

### 1. INTRODUCTION

The analysis of strategic configurations of the wine sector, as suggested by Miller (1990), should take into consideration the main determinants of the evolution in the market: supply

and demand conditions, rivalry, socio-institutional constraints, and the ownership structures, which are influenced by financial market and price pressures.

The objective of this work is to reconstruct and explain the supply chain and bargaining during the bulk wine selling and price formation in one of most important and oldest Italian red wine Denomination of Origin (DO): Chianti Classico employing the Structure – Conduct and Performance (SCP) framework. The paper analyzes the DO structure and farmer's conduct with the aim to understand their effect and influence on the price formation and market performance.

The Structure – Conduct and Performance as based on industrial economics (Scherer and Rose, 1990; Shepherd, 1990), is an analytical approach or framework used to study how the structure of the market and the behavior of sellers of different commodities and services affect the performance of markets. The paradigm SCP attempts to explain the market performance of an industry as a consequence of the industry structure and firm conduct assuming that there is a relationship between them. Much literature confirmed the performance of firms was associated with market structure and firms' strategic behavior. It has been argued that not only industry structure may influence firm conduct and market performance, but firm conduct and market performance are likely to feedback and influence industry structure (Egdell, 2000). The SCP model was developed by Bain in 1951, 1956 and applied to the manufacturing industry. The model comprises of three components: the industry structure, the firm conduct and the market performance. The former, which may refer to the number and size of stakeholders, product differentiation, entry and exit barriers, is determined by the market's organizational characteristics that affect the nature of competition and price behaviour within the market. Firm conduct pertains to the market's coordination mechanisms and the price policy applied by the supply chain's stakeholders.

The authors decided to focus on the Chianti Classico Denomination for several reasons. First of all, in the wine sector and not only its brand, the Black Rooster, is the most famous and know in the world. This was decisive and strategic over the years for the success and reputation of the DO. The second reason is that the structure of the DO wine is very particular: is characterized by prices fluctuations of bulk wine, steady production and high land values. This situation has created uncertainty in farm investments and it has contributed to increase the supply in terms of surplus or stock wine in the cellars. At the same time the DO is represented by formal institutions, contracts, branch and agreements and regulations between different producers' categories.

According to the SPC paradigm the structure of this paper is organized in four sections that analyze the production structure, market structure, farmers' conduct and their influence on supply chain and price performance. Through the Consortium Chianti Classico Data Base (C.DB), the author has described each producer's categories, and their representativeness inside the Consortium governance. The dynamics of supply and demand of Chianti Classico, was developed through the ARTEA (Agency for Agricultural payments in Tuscany) and C.DE time series that covering different period of observations.

## 2. PRODUCTION STRUCTURE OF CHIANTI CLASSICO

The first Italian grape-grower/winemaker Chianti Classico consortium was established on May 14, 1924, when a group of 33 producers gathered in Radda in Chianti to create a consortium to protect Chianti wine and its trademark of origin. The Chianti wine producing area was delimited in 1932 by ministerial decree and the boundaries have remained unchanged since then 1932. The decree described the district where Chianti Classico is produced as the "the oldest zone of origin," thereby recognizing its primacy and according it a special identity. In 1984 Chianti and consequently the oldest zone of origin, Chianti Classico obtained the Controlled and Guaranteed (DOCG) status, the highest recognition for fine Italian wines (Reg. 479/2008 CMO wine, Italian Minister Decree DL.gs 61/2010).

In 1996, a ministerial decree gave Chianti Classico its own DOCG, with production regulations different from those for Chianti wine. Since then Chianti and Chianti Classico have been two separate denominations, with different regulations and production zones.

According to article 17 of Italian law n.61/2010 and art.5 of Ministerial Decree on 16 December 2010, the Consortium proposed to carry out in respect of all the subjects included in the control system of the DO/IG protected, and promotion of brand and protection. The Consortium is administered by a Board. It is composed of 21 members elected from among the Consortium members and/or between their representatives. The assembly elects the Board members with the procedure provided by art.22 of the Consortium Statute.

On 2012, the percentage of wine produced by Chianti Classico Consortium member is equal to 86%. The 14% is the non Consortium members. Inside the Consortium structure, the members are divided in different groups or categories that identify different producers. The structure is composed by growers, winemakers and bottlers or industries.

The first category, *growers* includes members who obtain the majority of their production from their own vineyards. The purchases of grapes and/or wine are permitted provided that

they are lower production volumes. Mainly this category sells the grape to cooperatives or other winemakers.

The second category “*winemakers*” includes the producers and wine cooperatives that carry out activities of making and or bottling of wines on the condition that the wines produced and/or bottled are predominantly from grapes grown by contributing shareholders. The category also includes growers associated to such cooperatives as well as all those who perform predominantly wine-making activities.

The category “*bottlers*” or “*industries*” includes the shareholders, other than those mentioned in the previous, carrying on the bottling business and possibly winemaking. The bottlers’ category is very important not only for the number of companies but also for the size of the farmers. Mainly the bottlers’ category is composed by historical families but also by commercial and industrial groups. Table 1 below show members and non-members divided for each category.

*Tab.1 Chianti Classico Consortium members and non members until 2011*

	<i>Growers</i>	<i>Winemakers</i>	<i>Bottlers</i>	<i>Cooperatives</i>
<b>Members</b>	121	280	52	8
<b>Non Members</b>	151	26	0	0

*Source: Consortium Data base*

The winemaker represents the most important group with 280 producers. Among the cooperatives, tree has a substantial weight (calculated as the number of member and the hectoliters of wine produced) in the decision and bargaining into their category. The non-members growers are mainly the farmers that have very small planted surface (ha) and harvest (production of grape).

### 3. SUPPLY OF CHIANTI CLASSICO: INFLUENCES ON MARKET STRUCTURE

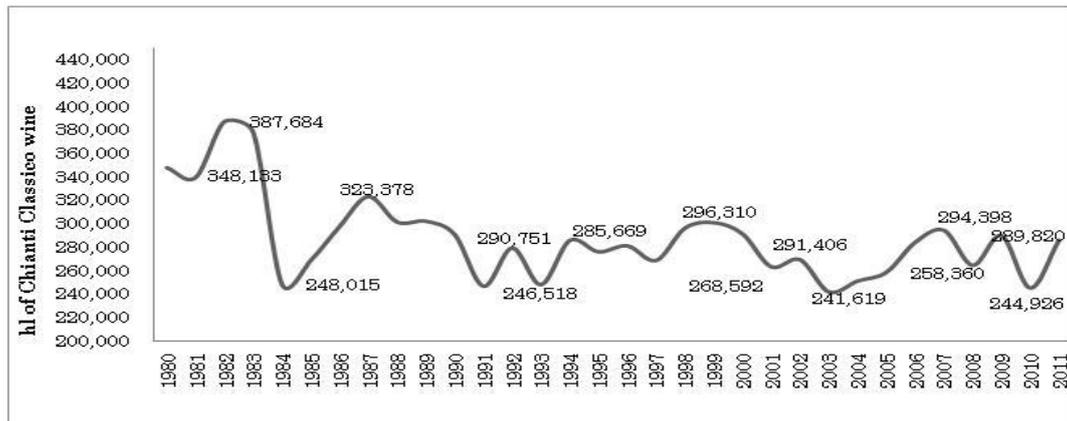
The concept of supply is used to describe how the quantity of commodities offered on the market varies by reason of resources. Supply is defined as the amount of a commodity offered for sale in a particular market during a specific time interval at the prevailing values of prices and any other relevant conditioning variables. Sometimes the adoptions of supply instruments are the consequence of market conditions and political agreement. The supply function for agricultural products is sometimes expressed as a simple relation between the quantity of output and the price of the output. Several researchers have estimated the cultivator supply to different techno-economic factors (Cummings, 1975a; Askari and Cummings, 1977; Cooley, 1973; Chen et. al. 1972; Tweeten, and Quance, 1969).

The Chianti Classico supply variable corresponds to analyze the hectoliters (hl) of wine annually produced in according the Chianti Classico disciplinary rules. The wine production can be totally bottled and sold in bottles with farmers labelling or selling as bulk wine to other Chianti Classico producers.

The supply structure is composed only by a single product mainly produced from a single variety of grapes (80 to 100% Sangiovese). Only the production of Chianti Classico wines is allowed in the area of denomination. This allows Chianti Classico wine to be issued as a Selection or Reserve or vintage. This is a unique case within the EU. The production rule allows the production of Vin Santo del Chianti Classico DOC and *Occhio di Pernice* DOC. In general, more DOCG wines can coexist in the same area. In Chianti Classico producers can choose before the harvesting time between IGT and Chianti Classico through vintage selection or vintage choice or they can choose to “declassify” their wines to “table wines” as the lower quality category.

Looking at the graphic 1, the production has only a small variation (4% per year) even if the decrease in particular years such as 1984 and 2002 was characterized by drastic climatic condition that has compromised the production in term of quantity and quality. For example, the year 1985 was characterized by a lot of snow and frost where most of the vineyards were destroyed. To the opposite, the summer of 2002 was very warm from June to August, and the product has suffered the dry and warm conditions.

*Graph. 3.2 The evolution of Chianti Classico wine production*

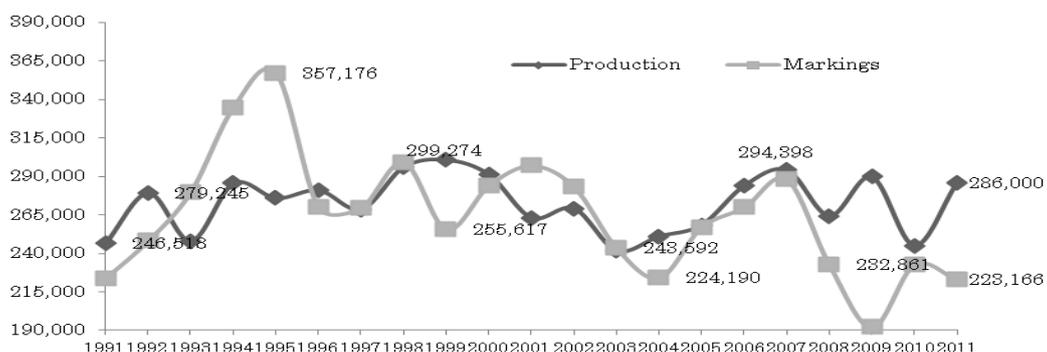


Source: Consortium Data base, our elaboration

The markings represents the hectoliters of wine sold (as Chianti Classico) in which the State marks are applied (Italian Ministerial Decree on 19 April, 2011). The result is the product is no more consider as "stock" in the winery. Each mark contains visible and invisible anti-counterfeiting systems with traceability managed by dedicated databases. According to the DO legislation, they are applied in all the bottles (0.25 lt., 0.75 lt., 3.00 lt., 5.00 lt.) that will be sold with a system that prevents its reuse.

Looking at the graphic 2 it is possible to notice that there is lag time between production and markings. This is true also because the Chianti Classico vintage is sold from October 1 of the year following the harvest. This graphic emphasizes the increase and decrease of a cycle of tree/ four years. In general, the periods of expansion (growth) have the duration of three years, followed by period's contraction recession.

Graph.2 Production and Markings: a comparison



Source: Consortium Data base, our elaboration

The shift sometimes is more or less among 20% with production values constants. The period 2004-2011 was crucial for the Chianti Classico. In 2004 the value was similar to the 1991 year. After this period, the values started to increase even if the maximum concentration in 2007 was almost equal to 1997-1998 years. The table 2 shows the annual fluctuation of marking between the different Chianti Classico categories. The most concentration of markings is represented by the categories *winemakers*.

Tab. 2 Evolution of marking (hl of wine) for different Chianti Classico categories

Year	Winemakers	Bottlers, Industries	Cooperatives	Total (hl)
2004	87.656	90.240	23.972	281.868
2005	92.577	108.520	26.252	227.349
2006	107.793	110.930	20.847	239.570
2007	113.246	110.427	24.148	247.821
2008	100.223	80.604	20.384	201.211
2009	83.163	72.262	92.640	248.065
2010	96.303	81.633	14.169	192.105
2011	98.858	87.467	13.233	199.558
<b>Total (hl)</b>	<b>779.819</b>	<b>742.083</b>	<b>235.645</b>	

Source: Consortium Data base

However, looking at the composition in term of number of farmers, the weight of bottlers is more impressive. Only 52 farmers belong to the group of bottlers; 280 in the winemakers group and 8 the cooperatives. According to this, all the categories have decreased their markings: from 2004 to 2010 there were less 89.700 hl marked and 82.00 hl from 2004 to 2011. The years 2004, 2007 and 2009 seem to be the "black years" for all the groups. Considering the average production equal to 289.000 hl, through the graph that for each year there more or less 90.000-100.000 hl that remain unsold in the cellar and DO increase its surplus (or stock).

The tables 3 show the main concentration of markings in terms of hectoliters of wine and percentage values among farmers that are included in the range. Over the past four years the market share held by the first 10 farmers in the Chianti Classico (80% formed by bottling companies) remained mainly constant around 42%, but down 9% from the peak reached in 2007. On the opposite side about 230 companies have covered 10% of the total markings, showing a growth of 3% in 5 years.

Tab. 3 Concentration of markings (hl and % values)

Farm/ hl wine marke d	2006		2007		2008		2009		2010		2011	
	hl	%										
<b>First 10</b>	126.68 9	<b>47</b>	146.61 1	<b>51</b>	108.88 9	<b>47</b>	80.035	<b>42</b>	97.797	<b>42</b>	100.67 1	<b>42</b>
<b>11 - 30</b>	67.717	<b>25</b>	65.319	<b>23</b>	58.966	<b>25</b>	49.990	<b>28</b>	65.290	<b>28</b>	65.229	<b>27</b>
<b>31 - 60</b>	36.428	<b>13</b>	35.535	<b>12</b>	31.221	<b>13</b>	28.715	<b>13</b>	29.578	<b>13</b>	34.583	<b>14</b>
<b>61- 100</b>	20.410	<b>8</b>	20.828	<b>7</b>	16.884	<b>7</b>	16.460	<b>8</b>	19.463	<b>8</b>	18.799	<b>8</b>
<b>101 - 150</b>	10.455	<b>4</b>	11.623	<b>4</b>	9.756	<b>4</b>	9.358	<b>5</b>	10.749	<b>5</b>	11.582	<b>5</b>
<b>Others</b>	8.253	<b>3</b>	9.825	<b>3</b>	7.981	<b>3</b>	7.939	<b>4</b>	10.355	<b>4</b>	11.315	<b>5</b>
<b>Total</b>	<b>269.95</b> <b>1</b>	<b>10</b> <b>0</b>	<b>289.74</b> <b>1</b>	<b>10</b> <b>0</b>	<b>233.69</b> <b>6</b>	<b>10</b> <b>0</b>	<b>192.49</b> <b>6</b>	<b>10</b> <b>0</b>	<b>233.23</b> <b>1</b>	<b>10</b> <b>0</b>	<b>242.17</b> <b>9</b>	<b>10</b> <b>0</b>

Source: Consortium Data base, our elaboration

Following table 4, it is possible to analyze the distribution of farms respect to the hectoliters of bottled wine focused on number farmers and their percentage value. From 2006 to 2011 the farmer included in the first categories increased from 127 to 134, even with the natural lag during the 2008-2009 years. With respect to the second categories, between 101 and 205 hl, there are farmer that increased from 18% in 2006 to 25% in 2010 and 23 % in 2011. Also the third category show a natural shift of more or less one two farmers each year. Different is the situation of the farmers included in the medium high level that register a decrease in number and percentage values. The highest level remained constant.

When the markings remain at lower values, the quantity of wine stock increases. This sum of stocks generates a surplus of bulk wine. The result is very difficult to manage, especially when is not possible to stop the production and behind each winery there are great sum of money investments.

Tab. 4 Distribution of farms for bottled wine (hl and % values)

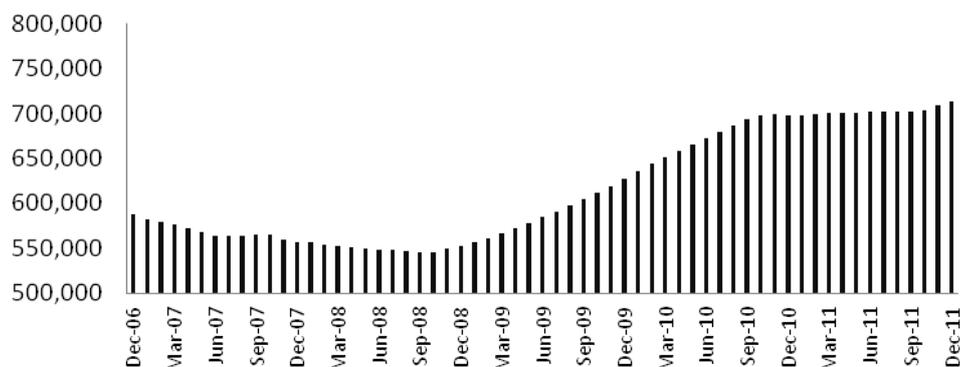
hl of bottled wine	2006		2007		2008		2009		2010		2011	
	n.	%										
<b>Until 100 hl</b>	127	<b>43</b>	123	<b>41</b>	130	<b>44</b>	139	<b>46</b>	134	<b>39</b>	134	<b>42</b>
<b>101 – 250 hl</b>	52	<b>18</b>	58	<b>19</b>	59	<b>20</b>	54	<b>18</b>	73	<b>25</b>	73	<b>23</b>
<b>251- 500 hl</b>	37	<b>13</b>	39	<b>13</b>	40	<b>13</b>	39	<b>13</b>	40	<b>10</b>	40	<b>12</b>
<b>501 – 1000 hl</b>	22	<b>8</b>	26	<b>9</b>	23	<b>8</b>	25	<b>8</b>	26	<b>11</b>	26	<b>8</b>
<b>1001- 2000 hl</b>	26	<b>9</b>	27	<b>9</b>	22	<b>7</b>	21	<b>7</b>	24	<b>6</b>	24	<b>7</b>

<i>2001 – 5000 hl</i>	18	6	12	4	12	4	12	4	15	4	15	5
<i>Higher 5000 hl</i>	11	4	13	4	12	4	10	3	11	4	11	3
<i>Total</i>	<b>293</b>	<b>100</b>	<b>298</b>	<b>100</b>	<b>298</b>	<b>100</b>	<b>300</b>	<b>100</b>	<b>323</b>	<b>100</b>	<b>323</b>	<b>100</b>

*Source: Consortium Data base, our elaboration*

Graphic 3 shows the increase of stocks that start in the period June-September 2008 and seems to never stop. The 2010 is also characterized by the presence of the 20% wine of 2009 vintage that was block as consequence of CMO blocage measures (that is to keep 20% of wine produced in wineries in order to maintain competitive prices).

*Graph. 3 Evolution of stocking per year*



*Source: Consortium Data base, our elaboration*

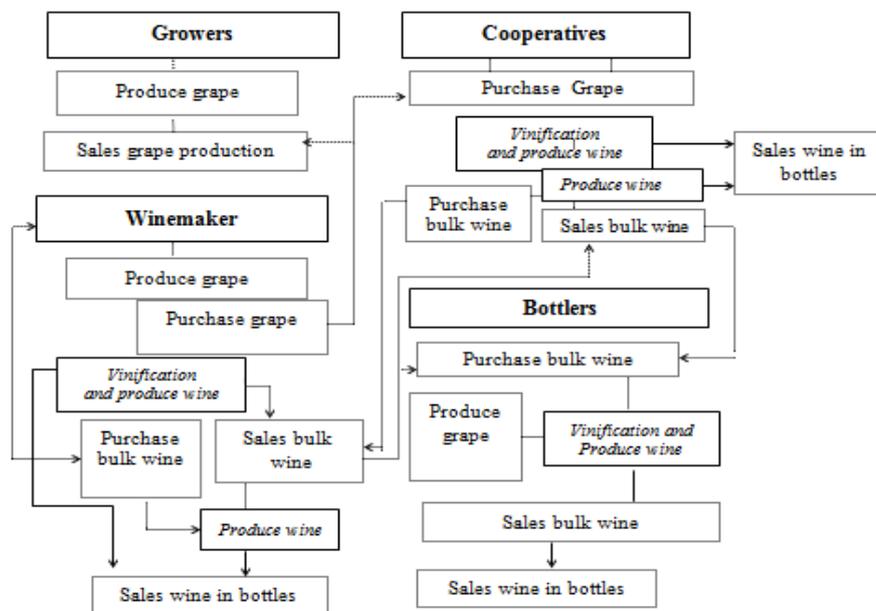
#### **4. THE DYNAMICS OF SUPPLY: INFLUENCES AND EFFECTS ON FIRM CONDUCT**

The competitive pressure in the wine market determined not only a differentiation of the companies operating in the business, in terms of supply strategy and management, but also in terms of variety of organization of production chains.

Looking at the structure in the figure 1, it is possible to observe that some company realizes a fully integrated production process (from grape production to selling wine in bottle) to deliver a specific product to the market and, at the same time, realize only a part of others production processes (only grape). The critical aspect of such complex organization of the wine sector is the presence of many inter-industry markets. The growers, produce grapes that can be sold to the cooperatives, if they are the members or others winemakers that produce grape and bought grape (the quota purchased must be less than that the produced one). The

winemakers produce wine in their cellars (owned or leased). At the same time, they can buy bulk wine from other farmers but in smaller quantities and add it to their grape production. A company that purchases (grapes or wine bigger quantities) loses the status of winemakers and becomes industrial bottlers.

Figure: 1 Chianti Classico supply chain



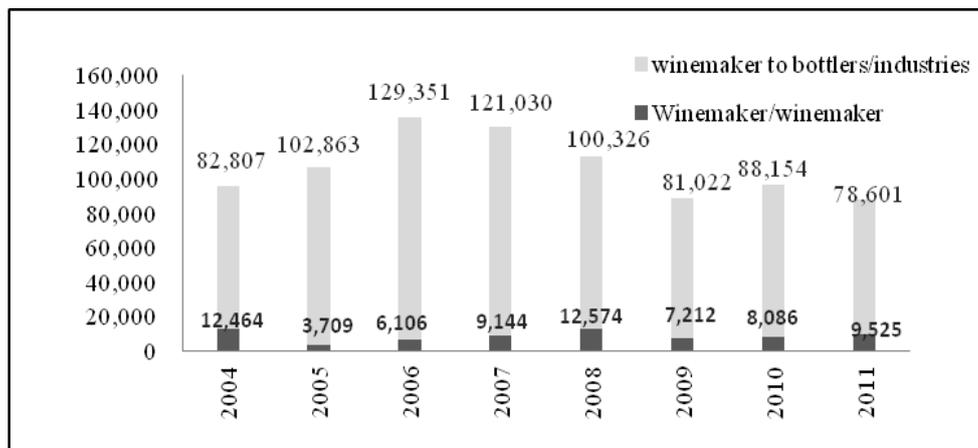
Source: elaboration by the authors, 2013

Cooperatives purchase the grape by growers through agreement pre harvesting. The growers are members of cooperatives and are forced to sell totally or most of the best production. In fact, the cooperative pays the tax on the basis of quality (defined as good health of grape and maturity of grape and their sugar content). After the vinification and ageing period, cooperatives sell the wine in bottles. Cooperatives can choose to sell the bulk wine to other winemakers or other categories. At the same time, they can buy the bulk wine (with the quantities allowed by the cooperative rules).

The main activity of bottlers is to buy bulk wine and then vinify in the DO area. The wine can be either sold totally in the bottles or can be transferred as bulk wine to other bottlers. The transaction between categories is defined as *floating*. The floating of wine is the sum of bulk wine sales between the different Chianti Classico producer's categories. The floating is sold inside the DO, and cannot leave as bulk wine. It is not allowed to bottle outside the production area.

Until 2011, the wine was sold as bulk Chianti Classico wine for the past vintage and as “*wine suitable to become Chianti Classico*” for the wine produced in the same year. From this new vintage 2012, the Consortium board has decided that the sale of the bulk will be permitted only with guarantee certificate. It is no longer allowed to sell wine without the certificate. Have the sale of wine bottles increased or has the trade among the farmers reduced? The answer can be finding in graphic 4 that represents the annual transaction (or sales agreement) between winemakers (Hl of wine/year) and the sales from winemakers to bottlers.

*Graph.4 The annual transaction among Chianti Classico categories*



*Source: elaboration by the authors*

## 5. STRUCTURE AND PERFORMANCE: THE EFFECTS ON BULK WINE PRICE FORMATION

Price negotiation for bulk wine start based on market and production conditions (vintage, total quantities (hl), quality of wines and the available quantity in the area for those specific vintage).

During the bulk wine selling negotiation “brokers or intermediary” and winemakers or bottlers take part in all the exchange sales stages (figure 1): before the agreement, during the negotiation and finally during the contractual arrangement. In first stage, brokers collect wine growers’ offers and merchants’ demands. Wine samples are required and gathered for different vintage. Wine samples are presented to potential buyers that taste wine, to gather samples, and also to collect “informal” and strategic information about the chemical composition and sensory characteristics.

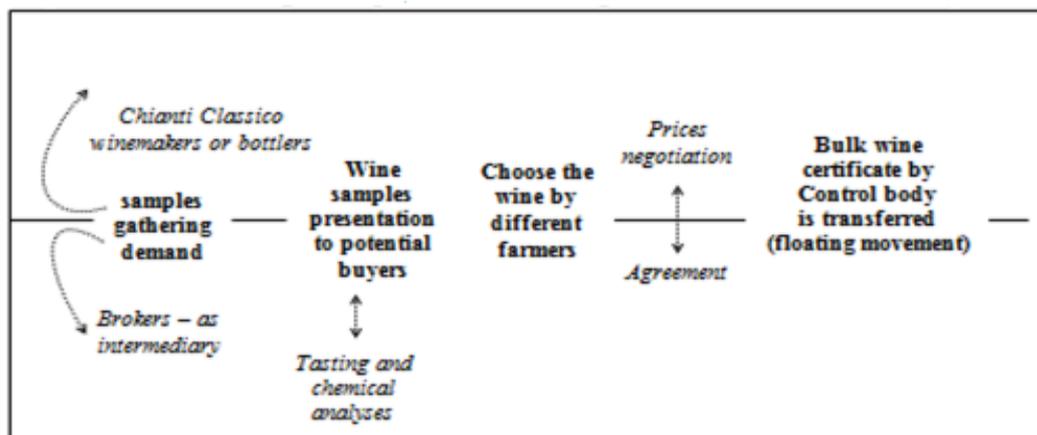
The weight of the buyer (as power policy in the DO) is fundamental to condition the final prices. These big firms (bottlers) have dominant market position respect to the farmers with lower market shares that follow the pricing changes prompted by the dominant firm. The

first 10/13 farms (the list of the farmers for income and marking like hectoliters of wine sold) in Chianti Classico, such as the bottlers (industries) and the historical and oldest wine families, control the prices and the transfer (between bottlers and producers and between producers and producers) of bulk wine. These groups are not often cohesion in a group.

The different historical composition (cooperatives, industries, historical families, etc.) generate different bargaining interests. If the main bottlers/industries or winemakers decide to pay the bulk wine (more or less), the consequence is that the price in the bulk wine market is influenced. The winemaker's categories sell part or totally their wine production, to the main farmers (bottlers and industries) that decide the quantity and the prices. The result is that the price will be shifted (more or less) in relationship with the type of buyers (Corsinovi, 2012).

The first 10/13 farms in Chianti Classico, control the prices and the transfer (between bottlers and producers and between producers and producers) of bulk wine.

Figure: 2 The bargaining process

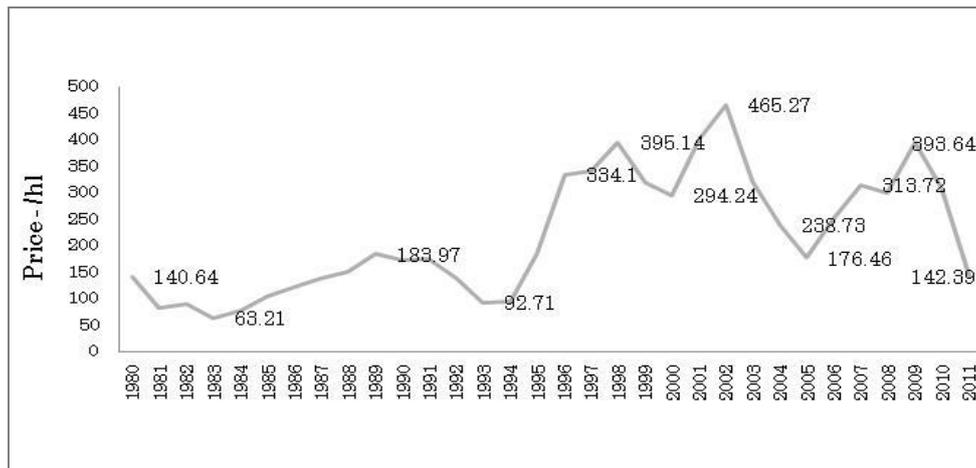


Source: elaboration by the authors, 2013

Fascinated with the brilliance of grand speculative events, the case of the wine sector, and Chianti Classico prices, is very particular and at the same time interesting. Graphic 4 shows a time series of Chianti Classico prices. The series are represented by 31 annual observations and refer to the period 1980-2011.

The average price is 207.90 € with peaks of 480 euro/hl especially in the 2000 year. In the last years, the price of bulk wine fluctuations have caused problems for many producers and report quotations from 140-170 euro per quintal today to 230-250 euro. The “cycles of prices” can last from 4 to 5 years. Over the medium term (two years), prices can fluctuate by 200%, while the production variable if we exclude vintages negative related to climatic factors- this shows a stable trend.

*Graph. 4 The performance: the effects on prices*



*Source: elaboration by the authors, 2013*

When the development cycle is well underway, prices tend to rise at a rate that gradually becomes more intense, reaching their peak a few months after the beginning of the next economic downturn. The unfolding of the recession has mirrored characters in the expansion: an early falls in the quantities with prices that remained stable. When the price drop ends to occur, the pace is faster, to continue even after the start of the new expansion.

## 6. CONCLUSION

The paper analyzes the DO structure and farmer’s conduct with the aim to understand the logic behind the price formation and their performance. In the case of Chianti Classico farmers, the factors that emerge as the most significant determinants of firm conduct constructs were those related to entry barriers, one form of tacit collusion occurs when firms set the same price as the leader, which may be the largest enterprise or the farmers that dominates the industry. The market power of the buyer is fundamental to establish the final

prices. These big firms (bottlers) have a dominant market position respect to the farmers with lower market shares that follow the pricing changes prompted by the dominant firm.

When there are few firms competing in a market, before choosing their strategies, they should consider those implemented by rivals, because it will significantly affect their economic performance. The interdependence among the different firms shows a singular character on the collective dynamics, collusion systems and informal rules observed that regulate the bulk wine prices (through unspoken agreement), supply control instruments and territorial systems.

The result is the tacit "collusion" needed not involve any "collusion" in the legal sense, and in particular need involve no communication between the parties. It is referred to as tacit collusion only because the outcome (in terms of prices set or quantities to sell, for example) may well resemble that of explicit collusion or even of an official cartel (Gaeta, 1993).

The number of competitors on the market is clearly an important factor.

First, coordination is more difficult, the larger the number of parties involved, in particular when coordination is only based on a tacit common understanding of the market conduct to the sustainability of collusion. For example, identifying a "focal point", in terms of market shares, may become less and less obvious, particularly when firms are not symmetric. Firms will find it easier to sustain collusion when they interact more frequently (Gaeta, 1993). The reason comes from the fact that firms can then react more quickly to a deviation by one of them. Therefore, retaliation can come sooner when firms interact more frequently.

To see this clearly, note first that firms could not tacitly collude if they did not anticipate interacting again in the future. Similarly, collusion is unlikely when firms interact only infrequently, since the short-term gains from undercutting a collusive price could then be "punished" only in a far future

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## AN ANALYSIS OF WORK COST IN COMPANIES LISTED ON THE FTSE MIB

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### ABSTRACT

The aim of this research is to analyze the cost impact of work factor of production on the company's financial statements for Italian companies listed on the FTSE MIB. Following a study of such cost in its various components, we have identified those with the biggest impact on the total work cost. Specifically, we have analysed, on one hand, the salary cost and other entries relating to employees; on the other, we have considered the company costs arising from taxation. In addition, we have examined whether there is any difference in terms of the impact of work cost with regards to the specific economic sectors of the companies under consideration.

It emerged a correlation between salary costs and operating costs, and between salary costs and turnover. This is due to the human factor being a highly important input in the company's production process and influencing the revenues made by the company through selling goods and services. This correlation is particularly evident within those economic sectors that are characterised by a high level of labour, among which are industrial products and services, travel and leisure, health.

In addition, a strong correlation between social security costs and operating costs has been identified. As operating costs vary social security costs also tend to change, despite being theoretically stricter due to their fiscal element. Finally, a time variable correlation has arisen between the other personnel costs and turnover.

This study brings literary contributions to the subject on an empirical level. The impact of work cost has been verified and quantified using a particularly representative sample. The sample itself constitutes 84% of the capitalization of the Italian stock market, which represents an international benchmark index, and makes it possible to describe the Italian economic texture in detail.

**Keywords:** Work cost; salaries and wages costs; social security costs; provision for employee benefits; other personnel costs; work cost impact.

## 1. INTRODUCTION

The relations between companies and their environment can be represented by an “input-output” model (Ferrero, 1987), according to which a company is placed in the middle of an exchange wherein it receives a series of inputs from its environment, such as factors of production, duties and conditioning, which all represent external forces that can be either positive or negative (Giacosa, 2012). Following a physical and economic transformation process, the company produces a series of outputs, consisting of fully finished products and influences (conditionings) for the company’s context. The work factor of production falls within the above-mentioned inputs, and impacts the technical and organizational structure of the company (Ferraris Franceschi, 1995).

The aim of this research is to analyze the cost impact of work factor of production on the company’s financial statements for Italian companies listed on the FTSE MIB. Following a study of such cost in its various components, we have identified those with the biggest impact on the total work cost. Specifically, we have analysed, on one hand, the salary cost and other entries relating to employees; on the other, we have considered the company costs arising from taxation. In addition, we have examined whether there is any difference in terms of the impact of work cost with regards to the specific economic sectors of the companies under consideration.

The importance of the subject is linked to a series of aspects; firstly, the work factor gains remarkable significance with regards to the company’s capability to combine all other inputs during the production activity process. Secondly, these inputs have a different effect according to the economic sector considered; sectors with the highest labour intensity seem, in fact, to be the most strongly influenced by the incidence of work cost.

The current research differs from previous studies that have followed an empirical profile. Specifically, the present study uses a sample that is particularly representative of the current Italian economic industrial context, and is made up of all Italian industrial companies listed on the FTSE MIB. The reasons for this representation are as follows: on one hand, their belonging to the FTSE MIB makes the sample very indicative, since it represents the benchmark index employed in the international context. On the other hand, the economic sectors in which the companies within the sample operate are very diversified, which thus fully reflects the Italian economic texture. Last but not least, even in the context of stock market capitalization, the capitalization of companies listed on the FTSE Italia represents 84% of the capitalization of companies listed on the Italian stock market (as of 31 January 2013).

## 2. LITERATURE

The work factor of production relates to human and intellectual activity, which, combined with other resources, allows the production of goods and services within the company. Companies transform, in an “economic” sense, human needs through the use of human resources (Ferrero, 1987; Farneti, 2007). In recent years, several important studies regarding the organization and management of personnel within companies have been conducted (Brusa, 1996). A rich body of literature has considered the work factor of production from many different points of view. The sudden changes in the companies’ labour request have been dealt with by many researchers, either generally or through specific analyses of different countries (Berman et al., 1994, Bertola and Rogerson, 1997).

Other studies have focused on the difficulties faced in terms of integrating human resources into the work market, and have studied the role of the mediators operating in the market (Fitzgerald, 1998; Budgen, 2008; Jain, 2010). In addition, it can be seen from the existing literature that the work factor represents, from a financial point of view, a pivotal element for enterprises, constituting a discriminating factor for their competitiveness (Porter, 1995; Becker and Huselid, 1998; Chen and Lin, 2004).

Many researchers have dealt with the subject of work cost with regards to its impact on the company’s balance sheet, either on a national (Dezzani et al, 2001) or an international level (Hermanson, 1992; Acemoglu and Pischke, 1999; Lev and Radhakrishnan, 2003). The effects of the introduction of international accounting principles (which were based on national accounting principles) on the companies’ balance sheets have also been considered (Haverals, 2007).

A particularly complex aspect of work cost with regards to its quantification is the end of service allowance. This subject has been considered by many authors (Dezzani et al., 2012). In particular, the employee benefits following the suspension of the service allowance have been subject to several studies, which have focused their attention on the “corridor method” (Amen, 2007; Fasshauer et al., 2008) or the transition from “defined benefit plans” to “defined contribution plans” (Swinkels, 2006).

However, the extant literature provides no unified vision on the connection between work cost and financial obligations (Marino et al., 2000; Bauman, 2001). Several researchers agree on the temporary effects of financial obligations on the work cost, but are divided when it comes to the permanent effects of these (Jackman et al., 1996; Nickell, 1997). Several researchers have also claimed that effects on work cost, either permanent or temporary, also

depend on other institutional variables considered, such as the work reforms within the country under consideration (OECD Employment Outlook, 2012).

Several models of work cost and taxation have been studied (Swenson, 1999), in particular the presence of taxation made up of a steady part and a proportional part (Lindbeck, 1996; Pissaderes, 1998). Some recent studies highlight the fact that the endogenous growth rate of employment changes as income tax and local tax vary (Zou, 1996; Gong and Zou, 2011).

Important quantitative analyses of the impact of the tax burden of the work cost on the balance sheet have been conducted in every single European country (Jacob, 2000; Marino, 2000; Buijink, 2002; Spengel, 2003;), though without creating correlations between the work cost and other balance sheet values. In addition, work cost analyses have been combined with other macroeconomic analyses (OECD, 1999; Marino and Rinaldi, 2000). Other researchers have used an empirical method of analysis to consider work cost. Such researchers have basically identified two different methods: “(micro) backward-looking”, which uses effective accounting data within existing companies (ex-post of the data); and “(micro) forward looking”, which is based upon ex-ante data on the hypothetical future of the company (Jacobs and Spengel, 2000; Spengel and Lammersen, 2001).

The current research, which follows an empirical approach, makes a contribution to the existing body of literature. It uses a highly representative sample, which constitutes 84% of the total capitalization of the Italian stock market (as of 31 January 2013). As a consequence, the results portray the economic reality of the main Italian industrial companies listed on the FTSE MIB, thereby allowing an international comparison, since the FTSE MIB index is used internationally as the benchmark index of the Italian stock market. At the same time, the research findings are pertinent to a multiplicity of economic sectors, since the companies within the sample operate in the most representative production contexts of the Italian production landscape. Last but not least, the variety of the economic sectors considered has allowed us to identify the different impacts of work cost in relation to the economic context in which the companies operate.

### 3. METHODOLOGY

#### 3.1. The sample

Companies	Sectors	Stock Market Capitalization	% sample
A2A	Public services	1,513.5	0.67
Ansaldo Sts	Industrial products and services	1,199.95	0.53
Atlantia	Industrial products and services	8,995.09	3.96
Autogrill	Travel and leisure	2,275.92	1.00
Buzzi Unicem	Construction industry and materials	1,976.3	0.87
Campari	Food and drink	3,343.63	1.47
Diasorin	Health	1,598.06	0.70
Enel	Public services	30,056.27	13.23
Enel Green Power	Public services	7,553.18	3.33
Eni	Oil and natural gas	67,181.06	29.58
Fiat	Automotive and industrial supplies	5,477.11	2.41
Fiat Industrial	Industrial products and services	11,552	5.09
Finmeccanica	Industrial products and services	2,763.5	1.22
Impregilo	Construction industry and materials	1,524.03	0.67
Lottomatica	Travel and leisure	3,126.34	1.38
Luxottica	Fashion	16,030.77	7.06
Mediaset	Media	2,248.33	0.99
Parmalat	Food and drink	3,245.18	1.43
Pirelli & C.	Automotive and industrial supplies	4,348.81	1.91
Prysmian	Industrial products and services	3,383.48	1.49
Saipem	Oil and natural gas	9,130.8	4.02
Salvatore Ferragamo	Fashion	3,157.53	1.39
Snam	Public services	12,610.17	5.55
Telecom Italia	Telecommunications	13,552.51	5.97
Terna - Rete elettrica nazionale	Public services	6,230.83	2.74
Tod's	Fashion	3,072.6	1.35
Total amount for sample		227,146.95	70.2 (of FTSE MIB)
Total amount for FTSE MIB		323,509.28	83.79 (of the Italian stock market)
Total amount for Italian Stock Market		386,076.01	

The Italian companies included in the sample are listed in the FTSE MIB. The FTSE MIB represents the international benchmark index of the Italian stock market, given its strong

representativeness. It is in fact made up of 40 private Italian societies of primary importance and high liquidity. Furthermore, its representativeness is due to the fact that the above-mentioned companies operate in multiple economic sectors, which portray the Italian economic texture. The market capitalization of the companies belonging to the FTSE Italia constitutes around 84% of the total capitalization of the Italian market (as of 31 January 2013).

We excluded banks, insurance and other financial companies, as we have opted to analyse a sample consisting of companies operating in the industrial, rather than the financial sector. The sample is made up of 26 companies (Table 1), which represents 70.2% of the capitalization of the FTSE MIB (as of 31 January 2013).

Table 1 - The sample (data in millions of in Euros)

Source: personal elaboration

### **3.2. Research questions and method**

To reach the goals of this research, three main research questions were formulated:

- RQ1: Is there a correlation between the cost of salaries and wages and the achieved turnover? Does this correlation vary according to the economic sector in which the company operates?

- RQ2: Is the variability of the social security costs comparable to that of the operating costs, or are the social security costs substantially static upon variation of the company's operating costs?

- RQ3: Do the various types of provisions for employee benefits and other personnel costs, of which most are non-compulsory, vary as the turnover varies?

On the basis of the above research questions, the following hypotheses have been developed:

- H1 (paired with RQ1): There is a correlation between the cost of salaries and wages sustained and the turnover achieved, since the human factor represents a source of particular significance with regards to the company's production process and the consequential turnover achieved. Such a correlation should be more prominent in those economic sectors with large incidence of labour. It is also supposed that such a relationship be dependent on the sector, since the higher or lower level of automation has a great influence on the work cost.

- H2 (paired with RQ2): The variation in social security costs is less prominent than that of operating costs, since the social security costs have a cost component which is more static (rigid) than the other cost categories.

- H3 (paired with RQ3): As turnover varies, the variability of the different typologies of provisions for employee benefits and other personnel costs and change accordingly? The achievement of high turnover makes it economically possible for the company to bear non-mandatory costs, such as employee benefits and other personnel costs, in the future.

The research methodology was organised according to the following phases:

- Phase 1: Analysis of regulation and literature review. This entailed an analysis of the work cost regulation conducted by international institutions (IASB), with particular reference to IAS 19, Employee Benefits, and to the IFRS 2, Share-based Payment. This was supported by an in-depth study of literature, which helped us to interpret the above-mentioned international accounting principles and understand their empirical application (in the context of previous studies) to specific samples.

- Phase 2: Empirical analysis. This involved an analysis of the information derived from the sample. The research methodology did not include interviews, since the information provided in the consolidated financial statements was considered sufficient to answer the research questions. With reference to *RQ1*, before linking the costs of salaries and wages to the turnover, we first identified the effects of salaries and wages on the operating costs, in order to verify whether salaries and wages represent a dominant element of the work cost. After observing a strong Pearson correlation between the costs of salaries and wages and the operating costs, we explained the variability within these costs by calculating the average annual wage, also comparing this information among different economic sector. Then, we compared the costs of salaries and wages and the turnover, to verify their Pearson correlation. With reference to *RQ2*, we firstly analyzed the impact of salaries and wages on the social security costs in order to evaluate the effects of these on employee compensation. Then, we calculated the Pearson correlation between salaries and wages and social security costs. The analysis of the correlation between the cost of salaries and wages and that of social security costs confirms how strongly the two are connected, which serves as a basis from which to answer *RQ2*. At this point, we compared the effect of social security costs on all operating costs, in order to measure their absolute value in every company of the sample. At the end, we calculated the Pearson correlation between social security costs and operating costs. With reference to *RQ3*, we firstly compared the other personnel costs incurred with turnover, as

these costs differ from wages and salaries and social security costs. Then, we calculated the Pearson correlation between the other personnel costs and turnover.

To further the analysis, the Pearson correlation ratio ( $p$ ) was used to identify a positive or negative correlation between the variables under examination in the various research questions. For this, it is necessary to underline the following conditions:

- if  $p > 0$  there is a direct correlation;
- if  $p = 0$  there is no correlation;
- if  $p < 0$  there is an indirect correlation;
- if  $0 < p < 0.3$  the correlation is weak;
- if  $0.3 < p < 0.7$  the correlation is moderate;
- if  $p > 0.7$  the correlation is strong.

- Phase 3: Delineation of the accounting effects of work cost. Following the analysis of the above-mentioned consolidated financial statements, we identified the accounting behaviours of the companies belonging to the sample, and delineated the main differences among the various economic sectors.

The study, which was conducted during 2010-2011, used consolidated financial statements and the AIDA database. Bearing in mind the research goals, an empirical methodological approach was preferred.

#### **4. FINDINGS**

The findings are illustrated by following:

- a) the correlation between cost of salaries and wages, on one side, and achieved turnover, on the other;
- b) the comparison between social security costs and operating costs;
- c) the variation of different types of provisions for employee benefits and other personnel costs towards turnover variation.

#### 4.1 The correlation between cost of salaries and wages, on one side, and achieved turnover, on the other

To answer *RQ1*, we wanted to identify the effects of salaries and wages on the operating costs, in order to verify whether salaries and wages represent a dominant element of the work cost. Table 2 displays mean, median and standard deviation of salaries and wages, operating costs and salaries and wages as % of operating costs for the sample.

Table 2 – Salaries and wages and operating costs (data in millions of Euros)

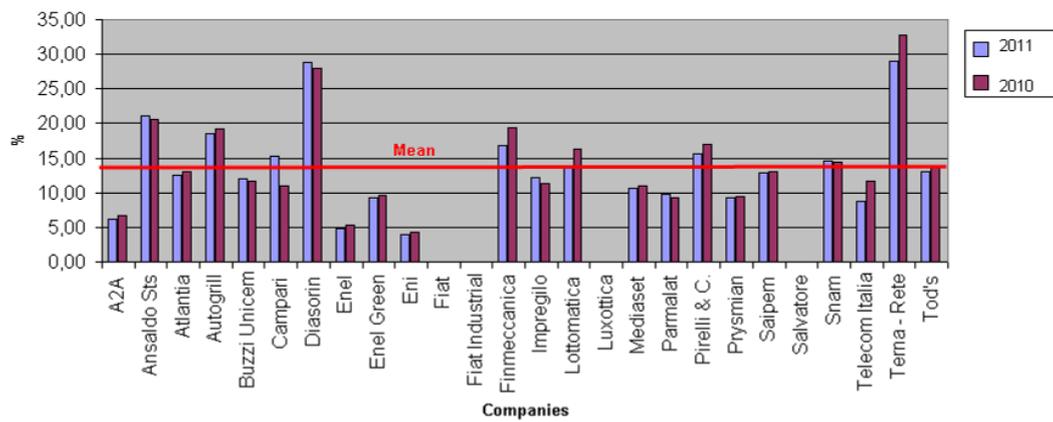
Data	2011			2010		
	Salaries and wages	Operating costs	Salaries and wages as % of operating costs	Salaries and wages	Operating costs	Salaries and wages as % of operating costs
Mean	1,063	14,050	12.95	990	11,518	12.99
Median	406	4,063	12.48	385	3,477	11.61
Std deviation	1,260	23,869	5.90	1,234	20,854	5.65

Source: personal elaboration

In 2011, the costs of salaries and wages accounted for a mean different share (12.95%) of the operating costs within the sample compared to 2010 (12.99%). However, companies such as Ansaldo STS, Autogrill, Diasorin, Finmeccanica and Pirelli & C., exceeded the mean. Other companies, such as A2A, Eni and Enel, were way below the mean: these companies, which belong to the public services sector, and the oil and natural gas industry, are characterised by a marked rigidity in terms of capital assets and a lower incidence of the human factor compared to the other production factors, wherein the human factor represents a lower work cost in the context of operating costs.

The variability of the cost of salaries and wages in terms of operating costs is not merely depicted by a comparison against the mean, but also with the median (12.48%), and the standard deviation (5.90%). A strong variability of wages and salaries against operating costs was also seen in 2010. Figure 1 shows this variability.

Figure 1 - Variability of salaries and wages as a proportion of operating costs



Source: personal elaboration

The correlation between salaries and wages and operating costs is strong in both years, as shown by the Pearson correlations, which equalled 0.85 in 2011 and 0.84 in 2010 (Table 3).

Table 3 – Pearson correlation between salaries and wages and operating costs

Pearson correlation	Salaries and wages 2011	Salaries and wages 2010
Operating costs 2011	0.85	
Operating costs 2010		0.84

Source: personal elaboration

After verifying the strong correlation between the costs of salaries and wages and the operating costs, it was necessary to explain the variability within these costs among the sample companies. For this purpose, we compared the costs of salaries and wages with the number of employees, by calculating the average annual wage (Table 4).

Table 4 – Average annual wage per employee (in Euro)

	2011	2010
<b>Data</b>	<b>Average salaries and wages</b>	<b>Average salaries and wages</b>
Mean	40,573	39,325
Median	39,722	39,724
Std deviation	13,455	11,523

Source: personal elaboration

It is evident that Enel and Eni (which both have a lower impact from work cost on the operating cost, compared to the mean), have a higher-than-average cost of salaries and wages compared to the mean. This means that the reduced influence of salaries and wages on the operating costs is linked to the higher value of the operating costs.

The analysis carried out so far only serves as a foundation from which to address RQ1. Before linking the costs of salaries and wages to the turnover, we conducted a preliminary evaluation of the representativeness of such costs on the operating costs.

Table 5 shows a comparison between the costs of salaries and wages and the turnover (for 2011 and 2010), since this latter represents a variable regarding the scope of the business activity. It is in fact hypothesised that there is a correlation between the actual turnover and the cost of the labour employed to achieve it. This hypothesis must, however, be contextualised by reference to the sector in question: some companies use a larger amount of labour, while others, which use more automated and technological systems, use less. At the same time, personnel costs can vary according to the different levels of personnel specialisation, which can have an impact on the hourly employee cost.

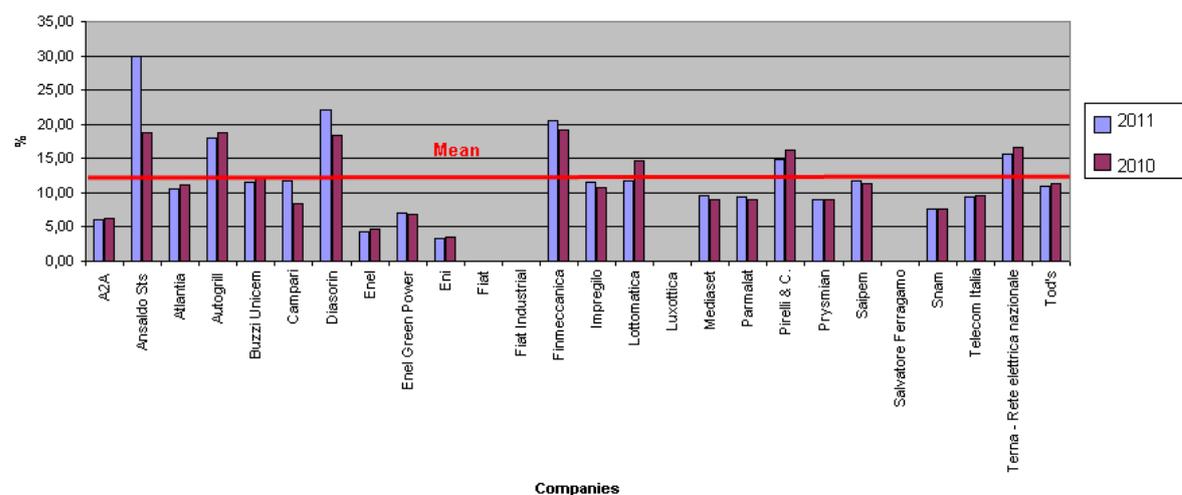
Table 5 – Comparison between salaries and wages and turnover

Data	2011			2010		
	Salaries and wages	Revenues	Salaries and wages as % of revenues	Salaries and wages	Revenues	Salaries and wages as % of revenues
Mean	1,063	15,151	12.09	990	12,901	11.10
Median	406	4,399	10.85	385	4,254	10.15
Std deviation	1,260	26,617	6.57	1,234	23,752	4.80

Source: personal elaboration

Figure 2 shows the high amount of variability seen in Table 5.

Figure 2 – Variability of salaries and wages as a proportion of turnover



Source: personal elaboration

The correlation between salaries and wages and turnover is strong in both years, as shown by the Pearson correlations, which equalled 0.82 in 2011 and 0.83 in 2010 (Table 6).

Table 6 – Pearson correlation between salaries and wages and turnover

<b>Pearson</b>	Salaries and wages 2011	Salaries and wages 2010
Turnover 2011	0.82	
Turnover 2010		0.83

Source: personal elaboration

With particular reference to economic sectors, we calculated Pearson correlation between salaries and wages, on one side, and turnover, on the other. It emerged that correlation is strong (more than 0.9) for the following sectors, which are characterized by a great fixed assets ratio:

- Construction industry and materials;
- Food and drink;
- Oil and natural gas;
- Public services.

When the relation between salaries and wages and turnover is considered, it is again clear that the companies that are furthest from the average belong to the public services and oil and natural gas industries (A2A, Enel, Enel Green Power, Eni and Snam); these companies are far below the average in this regard. Among the reasons for this are the marked rigidity of capital assets and the lower impact of the human factor (which produces a lower work cost) compared to the other production factors.

*The above results serve to confirm H1; there is a correlation between the cost of salaries and wages and actual turnover, since the work factor of production represents a resource of primary significance within the process of production, influencing the entity in terms of the revenues. This correlation is mostly evident in the economic sectors (among which are industrial products and services, travels and leisure and health), which have high labour rates.*

#### **4.2 The comparison between social security costs and operating costs**

To answer RQ2, we aimed to analyse the social security costs, which represent a crucial component of the work cost and are pivotal in terms of influencing companies' decisions to operate in one country, rather than another.

The variety of the companies within the sample did not allow us to consistently analyse the social security costs element, since every company had a different number of employees and different types of work contracts. We thus chose to equate the costs of salaries and wages compared to social security costs, in order to evaluate the effects of these on employee compensation (Table 7).

Table 7 – Salaries and wages and social security costs (data in millions of Euros)

Data	2011			2010		
	Salaries and wages	Social security costs	Salaries and wages as % of on social security costs	Salaries and wages	Social security costs	Salaries and wages as % of social security costs
Mean	1,063	258	22.60	990	240	24.53
Median	406	134	22.68	385	106	24.25
Std deviation	1,260	325	9.68	1,234	304	6.94

Source: personal elaboration

The proportion of social security costs within salaries and wages averaged 22.60% in 2011 and of 24.53% in 2010, with a median of 22.68% in 2011 and 24.25% in 2010. We can thus conclude that although the percentages of the mean and median diminished in 2011, the influence of social security costs on salaries and wages is remarkable.

In both years, the correlation between salaries and wages and social security costs is very strong, as shown by the Pearson correlations, which equalled 0.96 in both years (Table 8).

Table 8 – Pearson correlation between social security costs and salaries and wages

<b>Pearson</b>	Salaries and wages 2011	Salaries and wages 2010
Social Security Costs 2011	0.96	
Social Security Costs 2010		0.96

Source: personal elaboration

The analysis of the correlation between the cost of salaries and wages and that of social security costs confirms how strongly the two are connected, which serves as a basis from which to answer RQ2.

At this point, we compared the effect of social security costs on all operating costs, in order to measure their absolute value in the single companies within the sample. The results are shown in Table 9.

Table 9 – Social security costs and operating costs (data in millions of Euros)

<b>Companies</b>	<b>2011</b>			<b>2010</b>		
	<b>Social security costs</b>	<b>Operating costs</b>	<b>%</b>	<b>Social security costs</b>	<b>Operating costs</b>	<b>%</b>
Mean	258	14,263	2.60	240	12,081	3.04
Median	134	3,813	2.88	106	3,810	2.93
Std deviation	325	25,399	1.34	304	22,223	1.19

Source: personal elaboration

Bearing in mind the different sectors in which the companies operate, the median equalled 2.88% in 2011 and 2.93% in 2010. The mean went from 2.60% in 2011 to 3.04% in 2010, and the standard deviation varied from 1.34% in 2011 to 1.19% in 2010.

As we can see, the values for companies like Enel and Eni were much lower than the average of the sample under examination. As previously observed, with regards to salaries

and wages, Enel and Eni present high operating costs, which means that social security costs have a low level of influence on operating costs.

The correlation between social security costs and operating costs is strong in both years, with a further increase in 2011, as shown by the Pearson correlations, which equalled 0.79 in 2011 and 0.77 in 2010 (Table 10).

Table 10 – Pearson correlation between operating costs and social security costs

<b>Pearson</b>	Social security costs 2011	Social security costs 2010
Operating costs 2011	0.79	
Operating costs 2010		0.77

Source: personal elaboration

From these data, *H2 cannot be supported*. There is, in fact, a strong correlation between social security costs and operating costs and, as operating costs vary, social security costs tend to change. As a consequence, wages and salaries are strictly related to social security costs; most of the companies in the sample show that personnel costs are a significant component of their operating costs, and this in turn results in a high amount of variation in the operating costs.

#### **4.3 The variation of different types of provisions for employee benefits and other personnel costs towards turnover variation.**

RQ3 related to the other personnel costs. These personnel costs involved are derived from the profit and loss account, and differ from wages and salaries and social security costs. They generally include provisions for employee benefits and other generic personnel costs.

As in the previous analysis, the non-homogeneous data arise due to the diversity of the companies within the sample and the differences in terms of number of employees. In order to verify H3, we have to compare the other personnel costs incurred with all the operating incomes and the results achieved (Table 11).

Table 11 – Other personnel costs and turnover (data in millions of Euros)

Companies	2011			2010		
	Other personnel costs	Revenues	%	Other personnel costs	Revenues	%
Mean	111	15,477	1.09	152	13,812	1.27
Median	55	4,307	0.86	57	4,277	1.13
Std deviation	161	28,819	0.90	234	25,707	0.57

Source: personal elaboration

The percentage impact of provisions for other employee costs as part of the operating incomes fall into a very restricted range. The mean was 1.09% in 2011 and 1.27% in 2010, while the median was 0.86% and 1.13%, respectively.

The following specific points can be highlighted. In 2011, Enel (operating in the public services sector), had a much lower percentage of personnel costs compared to the average seen in other companies. These costs included positive revenue components linked to the completion of a retirement scheme programme, which led to a labour reduction, and a profit deriving from the newly settled agreement to suppress the energy discount for employees of companies operating in Italy. Eni (operating in the oil and natural gas sector) represents a huge difference compared to the average figure for personnel costs in the 2011 financial statements, which was derived from lower retirement scheme burdens in 2011. Snam (operating in the public services sector) showed some positive revenue components in both of the years analysed. This was due to the impact of increases in internal work. Telecom Italia (operating in the telecommunications sector), showed a strong difference between 2010 and 2011 with regards to other personnel costs, a difference which is mostly ascribable to mobility obligations.

The correlation between other personnel costs and turnover was strong in 2010, with a Pearson coefficient equal to 0.94; on the other hand, in 2011 such relation was moderate, with a Pearson coefficient equal to 0.64 (Table 12).

Table 12 – Pearson correlation between other personnel costs and turnover

<b>Pearson</b>	Other personnel costs 2011	Other personnel costs 2010
Turnover 2011	0.64	
Turnover 2010		0.94

Source: personal elaboration

From this information, *H3 can be confirmed*. The correlation between the other personnel costs and turnover was strong in 2010 and moderate in 2011. This shows a variability of the above-mentioned relation. As a consequence, particularly with regards to 2011, we can say that a variation in turnover is not related to a change in the other personnel costs within the same entity. However, an analysis on a wider time horizon would allow us to better verify the non-existence of such a relation.

## CONCLUSION

The human factor represents a constitutive element of a company, as it is a stimulus to entrepreneurial activity. The human element is pivotal to a combination of production factors: it represents the company's driving force, awarding exclusivity to the entire system and allowing it to function. On top of this, it blends in with the company's means, generating a unitary and inseparable entirety, in a coordinated, complementary and dynamic manner.

Given the importance of the work factor, a cost analysis of it is highly important, as it makes it possible to quantify its influence on other typical values within a company's financial statements. Specifically, from the analysis in the present study, a correlation between salary costs and operating costs, and between salary costs and turnover, have been identified. This is due to the human factor being a highly important input in the company's production process and influencing the revenues made by the company through selling goods and services. This correlation is particularly evident within those economic sectors that are characterised by a high level of labour, among which are industrial products and services, travel and leisure, health.

In addition, a strong correlation between social security costs and operating costs has been identified. As operating costs vary social security costs also tend to change, despite being theoretically stricter due to their fiscal element.

Finally, a time variable correlation has arisen between the other personnel costs and turnover. Specifically, the correlation is strong in 2010, and moderate in 2011. When the correlation is strong it means that upon variation of the turnover, other personnel costs, which are non-mandatory by law, change accordingly. When the correlation is moderate, variations in turnover are not related to variations in other personnel costs within the same entity. Nevertheless, in the case of either a strong or a moderate correlation, the achievement of economic benefits in terms of turnover makes it possible for the company to sustain future non-mandatory costs, such as provisions for employee benefits.

This study brings literary contributions to the subject on an empirical level. The impact of work cost has been verified and quantified using a particularly representative sample. The sample itself constitutes 84% of the capitalization of the Italian stock market, which represents an international benchmark index, and makes it possible to describe the Italian economic texture in detail.

This research is subject to several limitations. For instance, there is a need to verify the impact of personnel specialisation on the work cost, bearing in mind the differences between the various economic sectors. Such variable could change the analysis results, as it could influence the average unitary cost for every employee. In addition, it could be useful to extend the quantitative analysis across a wider time horizon, in order to evaluate the variability of the correlations among the different values. Also, it would be extremely useful to compare the Italian situation to other countries in Europe, in order to verify the different impacts of the work cost components.

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## A MODEL OF EFFECTIVE RECOVERY FOR ITALIAN COMPANIES TO OVERCOME THE FINANCIAL CRISIS

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### ABSTRACT

The purpose of our research is to outline a proposed model of recovery that Italian companies in financial crisis may adopt and adapt to their typical business needs. Due to the absence of a model recovery project in Italian literature and corporate regulation, a proposed model may equip management teams to deal with the delicate circumstances of financial crisis and increase their chances of returning to business as usual.

This model may be also applied by companies in other countries, thanks to the recovery project's common goal of delivering a company out of crisis, regardless of its location.

The significance of the research relates to the role of the recovery project. First, it is aimed at facilitating the recovery of a company in crisis. Secondly, it is a means for the company to disseminate economic and financial news to stakeholders, in order to overcome information asymmetries, which in the event of crisis are likely to cultivate a lack of confidence. An effective communication policy with stakeholders may increase the company's credibility, which may have suffered due to the crisis.

The findings of the research show that the crisis phenomenon is a very frequent occurrence in the lifecycle of a company. A sort of "normalization" approach to the crisis situation is commonplace, forcing the company into a new mindset for the anticipation and management of a crisis situation. To overcome a crisis, the recovery project has to include both a qualitative and quantitative component on the crisis phenomenon. The company has to reach a consensus on the content of the recovery project with stakeholders. Banks represent a privileged stakeholder, for which companies may create a single agreement for all banks involved. All parties have to commit to the recovery strategy, even adopting different behaviours towards various types of stakeholders.

**Keywords:** Recovery process; recovery project; effective communication policy; company's credibility; stakeholders.

## 1. INTRODUCTION

In the current economic climate, an increased number of firms are experiencing financial crisis. In addition, a company's descent from a normal operational state into a crisis is happening quicker than before. Situations now more often arise where a company is propelled into a state of crisis without chance to observe the usual warning signs.

Dealing with crisis in a systematic way requires the use of standardized tools and processes which can return the company to a state of growth/sustainability. The recovery project is one such instrument. A recovery project is a document that sets out the steps a company in financial crisis should follow in order to return to economic and financial stability (Guatri, 1986).

On studying the Italian regulations and literature, it yields neither the form nor content of a recovery project.

The objective of the work is to outline a proposed model of recovery which Italian companies in crisis may adopt and adapt to their typical business needs. The proposed model of recovery is derived from an empirical analysis of a sample comprising 98 recovery projects developed in Italy between 2009 and 2010.

This model is not applicable only to Italian companies, as one of the recovery project's key advantages is that it is universal in its application, regardless of company location, size or business type.

The significance of the research relates to the role of the recovery project, which does, in fact, have a dual purpose. Firstly, it is aimed at facilitating the return of a company in crisis to economic and financial stability. Secondly, it is a means of disseminating economic and financial information to stakeholders, in order to overcome information asymmetries (Singhvi and Desai, 1971; Stigler, 1994), which in the event of crisis are likely to reduce confidence in the company (Eccles *et al.*, 2001). An effective communication policy for stakeholders may increase the company's credibility, which may also have suffered as a result of the crisis.

The ability to effectively formulate and communicate the recovery project is a necessary condition of the company's survival. The success of this process depends on the stakeholders reaching a consensus (Lindblom, 1994) as a result of being informed of, and in agreement with, the policies and strategies proposed by the company (Owen, 2008). Consensus is a necessary condition for recovery, as it favours the provisioning of financial resources (Deephouse and Carter, 2005).

The motivation for the research stems from the desire to move towards a "normalization" of the crisis phenomenon in which the crisis may represent a normal phase of the business cycle. Therefore, management should foster a new mindset in preventing and managing a crisis situation, using a standardized method of problem solving. The recovery project may be considered as a standardized tool. Due to the absence of a model recovery project in Italian literature and corporate regulation, a proposed model may equip management and their advisors to deal with the delicate circumstances of financial crisis and increase their chances of returning to business as usual. An effective recovery project may promote both a new phase of development in the company's activities and an increase in its credibility with stakeholders.

This study builds on our previous research (Giacosa and Mazzoleni, 2011), which focused on the crisis phenomenon and on the recovery process, but was in an early stage of development. Thanks to a greater understanding of the sample, we have drawn out incremental findings with regard to the form and structure of the recovery project. In addition, this research analyses the company behaviour in increasing the firm's credibility with stakeholders throughout the recovery process.

The next section of the article comprises a brief literature review concerning the crisis phenomenon, prevention and management of the crisis. We then outline the research method, including the sample, hypotheses and the research phases. The next section is focused on the results and discussion. Finally, we construct some conclusions, implications and limitations of the research, which suggest avenues for further research.

## **2. LITERATURE REVIEW**

Literature on the matter of crisis emphasizes the following aspects under observation:

- definition, reasons and typologies of the company crisis;
- prevention of the crisis;

- management of the crisis situation.

Numerous international studies have been written on the matter of **definitions and causes of the crisis** (Green, 1992; Gundel, 2005; Mitroff, 2001; Danovi and Indizio, 2008; Norberg, 2011) **and different categories of the event** (Burton, 1993; Coombs, 2006; Deming, 2000; Foster, 1980; Guatri, 1986). Warning signs have been studied (Morin, 1976; Turner, 1976; Giacosa and Mazzoleni, 2011), even if the logic employed in crisis management appears confused, because actions taken to overcome the crisis may intensify the negative situation. Anglo-Saxon studies in particular have been initially conducted by means of case studies, which highlighted the causes of the crises and the recovery methods (Argenti, 1983; Taylor, 1982). Over time, the studies have changed the meaning of crisis: changing from the concept of crisis management as an episodic and rare moment in the lifecycle of the company (Bradley, 1978; Cazdyn, 2007) to that of continuous risk management (Culasso, 2009; Huber and Scheytt, 2013) of the crisis as a frequent phenomenon (Heath, 1998; Lalonde, 2007; Rosenthal and Pijnenburg, 1991; Roux-Dufort, 2007; Gao and Alas, 2010; Alas *et al.*, 2009), also due to a radical change in economic context (Slatter *et al.*, 2008; Pollio, 2009). What results from a crisis is a natural selection of companies (Chisholm-Burns, 2010), forcing the exit of inefficient firms from the market (Giacosa and Mazzoleni, 2012);

With regard to **crisis prevention**, the early studies were made into the financial aspects of a company situation to demonstrate the significance of the analysis of indicators (Fitz Patrik, 1931; Merwin, 1942). These studies generated a lot of criticism and in turn brought about a number of samples for predictions of insolvency in order to foresee bankruptcy within a certain time frame (Alberici, 1975; Altman, 1968; Altman and Haldeman, 1977; Appetiti, 1984; Tamari, 1966). Altman's model has inspired a great number of researchers, demonstrating the validity of the application of his model for small businesses and reducing the error margin contained in that model (Blum, 1969; Deakin, 1972; Edmister, 1972). Some scientists have further developed the structure of the forecast models, determining the degree of credibility of the results produced by each model (Cattaneo *et al.*, 1986; Teodori, 1989).

Regarding the **management of the crisis situation**, the literature has focused on the possible methods of company restructuring in crisis (Deeson, 1972; Ross and Kami, 1973). The most recent studies have analysed the various tools of recovery and illustrated the effects on business continuity (Booth, 1993; Mitroff, 2001; Slatter and Lovett, 2004; Smith *et al.*, 2005; Smith and Elliott, 2006), also comparing research studies in crisis management (Coleman, 2004; Pauchant and Douville, 1992). Furthermore, a large amount of literature has focused on the

process of business turnaround as a recovery strategy (Bibeault, 1982 and 1999; Lenahan, 2006; Schragger, 2003; Slatter, 1984; Sloma, 2000), distinguishing turnaround strategy from the recovery process (Guatri, 1995; Sciarelli, 1995; Amadio and Paparelli, 2009; Fazzini and Abriani, 2011). As a result, the company must be able to deal with crisis situations in a systematic way (Pearson and Clair, 1998) by using standardized processes and tools (Slatter and Lovett, 2004), such as the recovery project. The recovery project is considered as a means of communication with stakeholders (Pajardi, 2008; Whitney, 1999) to increase the company's credibility (Argenti and Barnes, 2009; Graham *et al.*, 2005; Netten and Van Someren, 2011; Reilly and Di Angelo, 1990). In addition, companies have to learn from crisis, with the aim of avoiding future recurrences (Roux-Dufort, 2000).

Regarding **recovery studies**, in Italy, the form and content of recovery projects have not been the subject of regulations or business literature. The Italian literature has carried out some in-depth analyses of companies' business plans, with reference to the development phase (AIFI, 2002; Borsa Italiana, 2003; Mazzola, 2003). However, it has not indicated the necessary adjustments that the business plan must undergo in the event of crisis in order to sustain the restructuring process of the company in question. Only recently have guidelines been proposed for the preparation of a recovery plan (Assonime-Cndcec-Università degli Studi di Firenze, 2010), by suggesting the logic of a business plan be used to guide a company out of crisis. Despite the importance of the subject of the recovery project, it has not been analysed even by the Italian Accountants Associations.

Given the absence of a model recovery project in Italian literature and corporate regulation, we make the following main contributions to the literature. First of all, this article aims to enrich the existing literature, providing a proposal for a model recovery project that companies can adopt by way of dealing with the crisis in a systematic way. In addition, our study answers the recent calls for research with practical relevance: due to an increased number of firms affected by financial crisis, a model recovery project may help the actors of the recovery process to interact with stakeholders in communicating the company strategy and finding a means to uphold business continuity.

### **3. METHODOLOGY**

#### **3.1 The sample**

The sample is composed of 98 recovery projects developed in Italy between 2009 and 2010,

comprising the largest restructurings over a certain period in Italy, during which the banking sector intervened as creditor. The sample has been provided by one of the most important Italian banks, which adopted the role of creditor.

The main characteristics of the sample are as follows:

- The majority were unlisted companies on the Italian Stock Exchange (86%); all of the companies are private ones.

- The sample is representative of different economic sectors: financial holding sector (11.6%), industrial products and services sector (11.2%), real estate (9.2%), household goods (8.2%), telecommunications (7.1%), construction (7.1%), fashion (5%), distribution (5%) and others minor sectors.

- More than half the sample (54.1%) had restructured debt of between €100 million and €500 million, a quarter of the sample (25.5%) had less than €100 million, while 14% had debts from €500 to €1,500 million.

- The sample contained both small to medium-sized firms and large ones: in this stage of the research, we didn't analyse the recovery project and firm's behaviour in relation to the size of the company.

Data concerning the number of Italian companies involved in a recovery process in 2009 and 2010 does not exist. Nevertheless, the sample has been considered by the banking sector as sufficiently representative in terms of number of projects, project complexity and amount of restructured debt. Indeed, the sample comprises the largest particularly well-known restructurings over a period during which the Italian banking system has evolved as a creditor.

### **3.2 Hypotheses and research phases**

In order to meet the research objective, the following core research questions were defined:

- *RQ1: What is the form and content of a recovery project that allows the company to get over the crisis in a systematic manner?*

- *RQ2: What actions does the company take to increase the firm's credibility with stakeholders over the recovery phase ?*

With reference to the above research questions, the following hypotheses have been developed:

- *H1*: The recovery project has to explain to the stakeholder the state the company in crisis was in prior to undergoing the recovery process, the characteristics of the crisis phenomenon, and the influences of the recovery project on the economic and financial condition of the company. To achieve these aims, the recovery project has to be a detailed and comprehensive document, including both qualitative and quantitative data, and information on the crisis phenomenon and the recovery strategy.

- *H2*: During the recovery process, the company has to adopt different behaviour according to the type of stakeholder. This strategy is intended to increase the company's credibility and influence the provisioning of resources.

The methodological approach applied is arranged in three phases.

**Phase 1** – An analysis of the national and international literature, and professional practices focusing on the crisis phenomenon and the process of recovery has been done. This phase allows us to identify some elements that would form the basis of a model recovery project. A “theoretical draft” of the recovery model was therefore prepared.

**Phase 2** – The theoretical draft of the recovery model was compared with the sample in order to identify some common and effective peculiarities of the recovery projects from which to build a model recovery project. For each case analysed, we acquired from the banking system the recovery project presentations offered to the various stakeholders. In addition, in almost all of the cases, the draft content or the actual content of the recovery projects have been analysed. The empirical observations derived from the analysis of the sample were used to integrate the theoretical draft of the model recovery project developed over the first phase. In particular, recovery projects from the sample were analysed with reference to aspects such as:

- the composition of the recovery project;
- the causes of the crisis;
- the recovery strategy;
- the redefinition of the strategic and operational aspects of the company;
- the modification or integration of corporate governance;
- the interaction and the agreements towards stakeholders.

The research methodology did not include interviews with companies from the sample because the documentation provided by the banks was sufficient to meet the purpose of the

research.

Based on both the empirical evidence arising from the sample and the theoretical draft of the model, we formulated an “advanced draft” of the model.

**Phase 3** – This advanced draft was tested via surveys. We needed a comparison with some actors involved in the recovery process. We chose financial advisors: this choice was dictated by their greater availability to participate in the research. In particular, the interviews were held with the managers of the restructuring departments of four of the major financial advisory services operating in Italy in debt restructuring from 2009. The interviewees have taken the role of financial advisor in 41% of the recovery projects of the sample (the other financial advisors weren’t available for interview within the period of research). The surveys carried out in the questionnaire were semi-structured; the applied questionnaire was composed of 28 questions, of which 13 were closed, 11 open and 4 gleaned mixed answers.

The data from these interviews was both qualitative and quantitative: in particular, quantitative information concerned some general aspects such as the number of interventions made, the reference sector involved, the amount of the debts restructured, the duration of the project, the composition of the recovery project and so on; qualitative information was about the financial advisor’s experience in the preparation of the recovery projects.

At the end of this phase, the exercise served to provide a “proposed recovery project” which takes into account both the literature, the empirical evidence from the sample and the results of the interviews.

The common approach in the survey takes inspiration from the basic principles of Grounded Theory (Glaser and Strauss, 1967), which was very useful in light of the dearth of earlier literature on the topic.

#### **4. FINDINGS**

The results gleaned from the study can be formulated as follows:

- the form and content of the recovery project model;
- the company’s actions in increasing its credibility with the stakeholder during the recovery phase.

#### **4.1 What is the form and content of a recovery project that allows the company to overcome the crisis in a systematic manner?**

In response to *RQ1 (What is the form and content of a recovery project that allows the company to get over the crisis in a systematic manner?)* the recovery project was considered an important means by which to explain to the stakeholders the characteristics of the crisis phenomenon, the status of the company before the recovery process, the recovery strategy and the influences of the recovery process on the economic and financial condition of the company.

The process of recovery has to set a forecast over a set period of time. It is useful to refer to the Anglo-American approach, for which a reasonable time horizon for the return to economic and financial stability is three to five years (American Institute of Certified Public Accountants, 2009).

The recovery project can be used in both:

- a formal sense, as it aims to renegotiate agreements with stakeholders in order to restore their trust in the company;
- in a substantive way, as it can encourage the company to redefine its strategic and organizational structure; the crisis phenomenon is an opportunity to analyse the company's weaknesses and address them.

Looking at the reference sample, the recovery project has been used in its formal sense: in fact, it has been employed to renegotiate the debt, mainly with banks. However, the significance of the substantive rehabilitation project has frequently been overlooked.

We hypothesized that the recovery project has to be a comprehensive document, containing qualitative and quantitative information about the company, the crisis phenomenon and the recovery strategy. Using the sample, we analysed the composition of the recovery project, with the purpose of verifying the nature of its content. It was found that the recovery project was generally composed of two parts (in 86.7% of cases):

- 1) The **recovery plan**;
- 2) The **economic-financial plan**.

The remaining cases (13.3%) didn't make a distinction between a recovery plan and an economic-financial plan (see Table I).

Table I – Cases where the recovery projects were divided into two parts

	No.	%
Yes	85	86.7
No	13	13.3
Total	<b>98</b>	<b>100.0</b>

Consequently, we analysed each part of the recovery project and their factual content, also distinguishing qualitative and quantitative information.

#### 4.1.1 The recovery plan

The recovery plan explains the crisis phenomenon, making a general presentation of the company and illustrating the causes of the crisis, and the economic and financial status of the company before the recovery process began. In addition, it analyses the strategy chosen by the company to resolve the crisis, the proposal and the negotiation with the stakeholders, and the guarantees provided for the successful conclusion of the process.

In order to be a detailed and comprehensive document, the recovery plan should be composed of the following parts:

1) **General introduction of the company:** a good understanding of the company is necessary if information asymmetry is to be reduced and company credibility with stakeholders is to be improved. This part has to contain a presentation of the company's history and activities; the past and future performances; and the activity of the company, detailing market position and comparisons with competitors. Illuminating the corporate structure and shareholders is also important. In addition, information about a substantial past reorganization of the company have been provided at least in a brief summary.

The need to establish a trusting relationship with stakeholders requires an extreme level of transparency with regard to introducing the company. A company introduction was found in all of the recovery projects from the sample (see Table II).

Table II – Presence in the sample recovery plans of a general introduction of the company

	<i>No.</i>	<i>%</i>
Yes	98	100.0
No	0	0.0
Total	<b>98</b>	<b>100.0</b>

This part of the plan is mainly qualitative, but also quantitative. The qualitative part explains the company's history and activities, its market and relationships with its competitors. In addition, the corporate structure and any past reorganizations are described. The quantitative part is useful to illustrate the qualitative one; it quantified the activity results, the market share and that of their competitors and, in addition, an in-depth quantification of corporate structure and shareholders, and past re-structuring are present.

According to the first part of the recovery project – the general description of the company – H1 is confirmed.

2) **Crisis phenomenon description:** this section should identify the originating factors of the crisis and its characteristics. Even if the cause of the crisis is generally financial, the purpose is to clarify some hidden causes, both financial and strategic. An untimely recognition of the symptoms or simply minimizing them, and misidentifying the crisis event may bring about a loss of company resources.

All sample cases contained a paragraph in the recovery plan which sets out the description of the crisis phenomenon (see Table III).

Table III – Presence in the sample recovery plans of the crisis phenomenon description

	<i>No.</i>	<i>%</i>
Yes	98	100.0
No	0	0.0
Total	<b>98</b>	<b>100.0</b>

The crisis management team needs to understand and analyse the causes of the event. Without clear identification, the chances of recovering effectively and overcoming the crisis situation are reduced. In the majority of the cases, the recovery project sets out the causes of the crisis (see Table IV).

Table IV – Presence in the sample recovery plans of the causes of the crisis

	<i>No.</i>	<i>%</i>
Yes	90	91.8
No	8	8.2
Total	<b>98</b>	<b>100.0</b>

Causes of the crisis have been described as follows (see Table V):

- **External causes:** these are highlighted in 73 of the cases (74.5%) (e.g. market crisis, drop in demand). In these cases, the recovery projects are understood as an instrument for resolving only external problems (without dealing with the issue of internal strategic reorganization/restructuring). Market analysis observed the general field of reference or macro-economic aggregates, without immediate impact on the company crisis. Only in a few cases have external causes of the crisis been described, drawing attention directly to the competitive context of the company. In some cases, the cause attributable to external factors is reasonable insofar as it is supported by reductions in turnover by up to 50% during one year.

- **Both external and internal causes:** these were given in 25 of the cases (25.5%). The frequently occurring internal causes are the reduction of the operational profitability, leading to a decline in the company's own products; the inability of the original management team to manage the business activity; a large investment in capital goods and inventories disproportionate to the current market situation; an excessive internal and external growth of the company; the actions of disloyal managers or managers who implement ill-advised operations with company assets.

Table V – Causes of the crisis

	<i>No.</i>	<i>%</i>
External causes	73	74.5
Internal and external causes	25	25.5
Total	<b>98</b>	<b>100.0</b>

This part is mainly qualitative, but also quantitative. The qualitative part describes the crisis causes and categorizes them as external and internal ones. The quantitative part refers to data and information about the content of the qualitative part. In particular, it quantified the crisis causes, such as the reduction of the operational profitability, a large investment in capital goods and inventories, and a sizeable and uncontrolled external growth of the company.

With regard to the second part of the recovery project – crisis phenomenon description – H1 is confirmed.

3) **The company's economic and financial situation before the recovery process:** the recovery plan has to indicate the economic and financial status of the company before the recovery process, treating the company's business activities as a going concern. All useful information concerning active assets, debt position and equity on the one hand, and revenues and costs on the other, have to be included to provide a clear and reliable presentation of the company's status. In addition, where relevant, the recovery project has to include information about legal proceedings stakeholders are taking out against the company.

Details of the initial economic and financial situation was found in the majority of the cases from the sample (91.8%) (see Table VI).

Table VI – Presence in the sample recovery plans of the initial economic and financial situation

	<i>No.</i>	<i>%</i>
Yes	90	91.8
No	8	8.2
<b>Total</b>	<b>98</b>	<b>100.0</b>

Generally, the financial standing in the initial phase of project preparation looks unbalanced in terms of the use of sources as well as the degree of dependence on third parties.

A high degree of stakeholder commitment to the recovery project was observed: the recovery project has been used in a timely fashion, thanks to a constructive discourse with the stakeholders. It follows that at the formalization of the recovery project, there were no disputes with creditors in 68 of the cases (69.4%), even if past due trade payables are present. In a great number of the cases suppliers have not stopped providing goods and services, but demanded terms of payment at rates no less than those in the past. In the remaining cases, companies are involved in legal proceedings: 14 cases (14.3%) involved suppliers of goods and services; 16 cases involved the banking system (16.3%) (see Table VII).

Table VII – Existence of legal disputes brought about by the creditors

	<i>No.</i>	<i>%</i>
No legal disputes	68	69.4
Legal disputes with suppliers of goods and services	14	14.3
Legal disputes with banks	16	16.3
<b>Total</b>	<b>98</b>	<b>100.0</b>

The third part of the recovery project is mainly quantitative, especially when indicating

the economic and financial situation of the company before the recovery strategy. All information concerning financial situation is related to active assets, debt position and equity; for the economic situation, it concerns revenue and costs. In addition, all legal proceedings by stakeholders have to be included. To describe this quantitative part, the recovery project contains a qualitative part which gives in-depth analyses of the economic and financial information before the recovery process began.

According to the third part of the recovery project – the company's economic and financial situation before the recovery process – H1 is confirmed.

4) **Recovery process strategy:** the recovery plan should identify the strategy the company will put in place with the purpose of overcoming the crisis situation. To ensure the recovery process is fully comprehensible and coherent, the recovery plan has to elucidate the strategy in place for the following key stages:

- an emergency strategy, to ensure the company's financial stability;
- a stabilization strategy, to guarantee the company will return to profitability;
- a development strategy, with the purpose of ensuring business growth and development.

In all cases there was a paragraph in the recovery plan that detailed the recovery strategy: in the majority of cases (67.3%), an earlier plan regarding product strategy, organization, management control, etc. is approved because the crisis is considered an exceptional event in the lifecycle of the company. The main purpose of the strategy is to renegotiate the conditions of the company's debt position. In the remaining cases, there was a change in the strategy (see Table VIII).

Table VIII – The confirmation of the past strategy

	No.	%
Yes	66	67.3
No	32	32.7
<b>Total</b>	<b>98</b>	<b>100.0</b>

The renegotiation of the commitments with suppliers of goods or services is the major

strategy (86.7%); alternatively, the solution is based both on debt rescheduling and reorganization of the company (13.3%) (see Table IX).

Table IX –Measures to overcome the crisis

	No.	%
Renegotiation of the trade payables	85	86.7
Debt rescheduling and company's reorganization	13	13.3
<b>Total</b>	<b>98</b>	<b>100.0</b>

The strategy is based on the assumption for which the business experiences a rapid return to pre-crisis levels. Therefore, the above-mentioned projects usually state conservative economic and financial forecasts for the current and following year; a relevant increase in rates of turnover are expected so as to be able to generate earnings and cash flows consistent with the debts accrued. No significant interventions regarding the costs structure of the company were envisaged. In 40 cases (40.8%) the current stakeholders increased the stock capital (see Table X).

Table X – New contribution in stock capital by the current shareholders

	No.	%
Yes	40	40.8
No	58	59.2
<b>Total</b>	<b>98</b>	<b>100.0</b>

It was then verified whether or not the strategic and/or operative structures were redefined. In most of the cases (85.7%), the strategic and operational structures of the companies have not been redefined due to the fact that crisis is frequently considered an exceptional and external event in the lifecycle of the company. In 14 of the cases (14.3%) that showed willingness to undergo company reorganization in light of the crisis, they did not provide any detail of what interventions were taken or their effectiveness. Out of the 14 cases, 10 (71.4%) projected a relative reduction of the business costs, primarily in terms of labour

costs and 4 (28.6%) redefined some of the strategic elements of the firm in question, such as products and markets (see Table XI).

Table XI – Redefinition of the strategic and/or operational elements of the company

	<i>No.</i>	<i>%</i>
No	84	85.7
Yes	14	14.3
Of which:		
Reduction of the business costs	10	71.4
Redefinition of some strategic elements of the company	4	28.6
<b>Total</b>	<b>98</b>	<b>100.0</b>

We observed a modification or integration of the corporate governance in 31 cases (31.6%). Some 25 of these 31 cases (80.6%) chose modification or integration of the controlling body, while 6 of the cases (19.4%) chose modification or integration of the managing board. All these requests derive from the banking system (see Table XII).

Table XII – Modification and/or integration of corporate governance

	<i>No.</i>	<i>%</i>
No	67	68.4
Yes	31	31.6
Of which:		
modification/integration of the controlling body	25	80.6
modification/integration of the managing board	6	19.4
<b>Total</b>	<b>98</b>	<b>100.0</b>

The fourth part of the recovery project is mainly qualitative, due to its strategic content concerning the “strategic map” (Brusa, 2011). It explains some important strategic objectives, including the company’s position in the competitive market; the product/market combination to develop; the quality level to be attained; the characteristics of the organizational structure; the role the management should adopt; the use of other strategic elements in terms of technology, price and quality; the model to incentivize managers. In addition, this part contains a quantitative part, which illustrates all information about the above strategy in quantitative terms.

Regarding the fourth part of the recovery project – the recovery process strategy – H1 is confirmed.

5) **Guarantees:** as the recovery project is subject to the risk of future events, it has to provide guarantees to stakeholders. In 8 cases (8.2%), the project has not foreseen additional guarantees to those originally granted to the banks (these cases are those that show larger bank loans). In 68 of the cases (69.4%), additional guarantees are provided by the company alongside the guarantees initially issued. In 22 of the cases (22.4%), additional forms of guarantees are provided by parties other than the company/group of companies involved in the recovery. Of these 22 cases, 5 (22.7%) represent intervention by consortia, 12 (54.6%) by third parties represented by shareholders/directors of the company in crisis, while 5 (22.7%) are third parties formally unconnected with the company (see Table XIII).

Table XIII – Provision of guarantees in favour of the recovery process

	<i>No.</i>	<i>%</i>
Absence of additional guarantees provided by the company	8	8.2
Additional guarantees by the company	68	69.4
Additional guarantees by parties other than company	22	22.4
Of which:		
Consortia	5	22.7
Third parties ascribable to shareholders/directors	12	54.6
Third parties formally disconnected by the company	5	22.7
<b>Total</b>	<b>98</b>	<b>100.0</b>

The fifth part of the recovery project is mainly quantitative. In particular, it contains all information about the guarantee types, the issuer, the amount guarantee, and all conditions concerning the guarantees.

#### 4.1.2 The economic-financial plan

The economic-financial plan expands on the effects of the recovery plan on the economic and financial situation of the company. It has to include the effects of the recovery strategy on the balance sheets, income statements and cash flow statements to demonstrate how the company is overcoming the crisis situation as a result of the recovery strategy.

Its purpose is to state the company's attitude to returning to profitability, during and after the recovery process.

It contains some documents concerning the economic and financial situation of the company, including:

- a prospective balance sheet;

- a prospective income statements;
- a prospective cash flow statements.

This data is present in almost all of the cases. All economic-financial plans contain the prospective balance sheets and income statements, due to the relevance of the content and the fact they are routinely drawn up as a matter of course by all companies. The prospective cash flow statements are provided in the majority of cases: some difficulties in the elaboration are experienced by smaller companies, due to the high technical skill required (see Table XIV).

Table XIV – Economic-financial plan content

	<i>No.</i>	<i>%</i>
Prospective balance sheets	98	100.0
Prospective income statements	98	100.0
Prospective cash flow statements	90	91.8
<b>Total</b>	<b>98</b>	<b>100.0</b>

These tables are provided in the recovery project, developing the assumptions upon which the forecasts for future business activity are based. Generally, assumptions are based on future operations that differ from those in the past.

The economic-financial plan is elaborated according to the method of plan development (AIFI, 2002; American Institute of Certified Public Accountants, 2009; Mazzola, 2003). In addition, the plan has been formulated in respect of the literature guidelines, with particular reference to the “prospective financial statements”. The prospective financial statements could be subdivided into the following (American Institute of Certified Public Accountants, 2009):

- financial forecast: based on assumptions made at the moment of the plan’s conception which are reasonably expected to occur (e.g. turnover developed on the basis of orders already contracted by the company);

- financial projection: based on hypothetical assumptions or the hypothesis that at the moment of preparation of the plan they were not yet verified (e.g. turnover developed on the basis of orders in negotiation).

Generally, the economic-financial plan in the recovery process contains a high level of uncertainty. Indeed, it is to a large extent determined on the basis of unverified assumptions at the moment of its preparation assuming significant discontinuity with the past. This is due to the fact that quite often the historical elements turn out to be inappropriate building blocks for recovery due to the causes of the crisis.

To reduce this uncertainty factor, the more popular techniques concern the period covered by the economic-financial plan. Generally, it may have a short-term horizon, increasing the reasonableness of the document. However, for a recovery plan to be successful often requires a longer duration. Indeed, this duration is about 15 years or more in 41.8% of cases and from 5 to 15 years in 37.8% of cases. The remaining cases (20.4%), required less than 5 years (see Table XV).

Table XV – Economic-financial plan duration

	<i>No.</i>	<i>%</i>
Less than 5 years	20	20.4
From 5 to 15 years	37	37.8
More than 15 years	41	41.8
<b>Total</b>	<b>98</b>	<b>100.0</b>

The use of sensitive analysis is also important in reducing uncertainty, allowing confirmation of how the conditions and status of the company before the recovery process began can be modified with changes of one or more relevant variables. Sensitive analysis allows us to estimate the margin of certainty or the sustainability of the recovery plan: it identifies the minimum level that some relevant indicators must reach in order to ensure achieving the objectives negotiated with the stakeholders (turnover, gross operating margin, contribution margin, etc.). The sensitive analysis is employed in the majority of the recovery projects (78.6%). In these cases, 40 of them (51.9%) carry it out through a stress test on the principal variables upon which the project is based, while 37 (48.1%) use multiple scenarios (see Table XVI).

Table XVI – The use of sensitive analysis

	No.	%
No	21	21.4
Yes	77	78.6
Of which:		
Stress tests	40	51.9
Multiple scenarios	37	48.1
Total	<b>98</b>	<b>100.0</b>

Due to the content of the economic and financial plan, this part is mainly quantitative. Nevertheless, a qualitative part is important in illustrating all economic and financial data and information included in this part.

According to this part of the recovery project – the economic-financial plan – H1 is confirmed.

According to the composition of the recovery project (recovery plan and economic-financial plan), H1 is confirmed: the recovery project has to be an inclusive document, including both a qualitative and quantitative component on the crisis phenomenon. Only the combined effect of these aspects allows the project to demonstrate to stakeholders the starting position of the company in crisis, the causes of the crisis, the recovery strategy and its effects on the economic and financial situation.

In addition, only an inclusive document can explain how the company is to overcome the crisis. A clear and complete communication of the recovery strategy is a requisite of meeting the wishes of the third parties, generating consensus and attracting the necessary resources.

Due to the absence of a recovery project model in the Italian literature and corporate regulation, this study allows businesses to have a model recovery project, which can be adapted according to the needs of any business. In a period characterized by a normalization of the crisis phenomenon, this recovery project model may represent a standardized tool in overcoming the crisis.

**4.2** *What actions does the company take to increase the firm's credibility with stakeholders over the recovery phase?*

In response to RQ2 (*What actions does the company take to increase the firm's credibility with stakeholders over the recovery phase?*), we considered the recovery project as a means of communicating with stakeholders, increasing the credibility of the company during and after the recovery process and developing the trust of the stakeholders. To increase the possibility of overcoming the crisis, the company usually interacts with several types of stakeholders in different ways. Nevertheless, the probability of unanimous acceptance of the project is greater in the case where the proposal is not adapted according to the various categories of stakeholders and involves the payment of all amounts payable even with a delay.

In the sample, the majority of companies (73.5%) developed specific agreements for the different types of stakeholders, according to the deadlines and the conditions of the debt (see Table XVII). Generally, companies require an extension of the debt repayment term and a partial payment of the debt.

Table XVII – Presence of differentiated agreements with stakeholders

	No.	%
Yes	72	73.5
No	26	26.5
<b>Total</b>	<b>98</b>	<b>100.0</b>

This evidence confirms H2: the companies of the sample adapted their behaviour according to the different categories of stakeholders.

Generally, the content of the proposal is different depending on the type of stakeholders. The recovery project analyses in detail the stakeholders' requests in order to facilitate recovery. Stakeholders involved in the sample cases are as follows:

- banks, in all of the cases (100.0%);
- financial administration through fiscal transaction (86.7%);
- suppliers of goods and services (46.9%), to ensure continuity in the supply of goods and services necessary in guaranteeing business continuity;
- employees (13.2%) with the aim of obtaining their support (Whitney, 1999; Pate and

Platt, 2002; Sutton, 2002) (see Table XVIII).

Table XVIII – Stakeholders involved in the recovery process

	<i>No.</i>	<i>%</i>
Banking system	98	100.0
Financial administration	85	86.7
Suppliers of goods and services	46	46.9
Employees	13	13.2

The banking system plays a significant role in drawing the recovery process to a successful conclusion. Certainly, the banking sector very often supports the recovery of the firm insofar as it is more resistant to the effects of delayed or written-off payments on its own borrowings. Companies of the sample often ask banks to accept payment subsequent to that of the suppliers of goods and services – considered strategic for the continuance of the activity – and it is also common for banks to receive requests for more loans to repay suppliers.

The interaction with the suppliers of goods and services is common when the trade payables are concentrated in a reduced number of significant unit amounts. Employees are also involved in the recovery process: this interaction is assisted by the intervention of trade unions on behalf of those most affected by the stakeholders.

The sample shows the presence of a high number of banks involved in recovery projects. In 35 of the cases, more than 10 credit institutions (35.7%) are identified; in 58 cases between 5 and 10 institutions (59.2%); in 5 cases fewer than 5 institutions (5.1%) (see Table XIX).

Table XIX – Number of involved banks

	<i>No.</i>	<i>%</i>
Fewer than 5 banking institutions	5	5.1
Between 5 and 10 banking institutions	58	59.2
Over 10 banking institutions	35	35.7
<b>Total</b>	<b>98</b>	<b>100.0</b>

As the sample shows, Italian companies' work with a higher number of banks per company, compared with others in Europe, reducing the level of the bank's knowledge of each company. The degree of complexity of the recovery project is influenced by the number of credit institutions involved: the projects that involve a limited number of banks are more straightforward compared with those in which a large number of banks are involved. For cases in which the number of institutions involved was more than 10, the project is assisted by different agreements with different banks.

In 78 of the cases (79.6%), a single agreement with several banks has been formulated, while in 20 of the cases (20.4%) it was observed that different agreements were made with some banks. Of these last cases, 15 of them (25.0%) envisaged sharing the agreements with other institutions with regard to the rescheduling of debts with the commitment not to undertake banking actions of recovery; in 5 of the cases were foreseen ways for resolving the situation, differing from those agreed with the other banks (see Table XX).

Table XX – The agreements with the banking system

	<i>No.</i>	<i>%</i>
Single agreement with banks	78	79.6
Different agreements with banks	20	20.4
Of which:		
Commitment to not taking recovery actions	15	75.0
Specific repayment plans	5	25.0
<b>Total</b>	<b>98</b>	<b>100.0</b>

It means that, according to the banking system, which represents the most influential actor in delivering a successful the recovery project, the majority of the companies of the sample made a single agreement (79.6%): different agreements with banks would create tensions between companies and banks due to the special treatment of some banks.

Companies appear to have interacted with the banks before the recovery process began, also due to the substantial investments over the last few years in the creation of divisions dedicated to dealing with companies in crisis. Through a plenary meeting, the company presents and negotiates the conditions of the agreements with all the banks.

The granting of new financial resources is influenced by the communication process between company and stakeholders. Indeed, one of the most delicate aspects of the projects analysed was the availability of agreements for new funding. In the sample, this provision is observed in 18 of the cases (18.4%). In the remaining cases, credit lines are confirmed by the banking system on the date the recovery project was agreed (see Table XXI).

Table XXI –Granting new financial resources

	No.	%
Yes	18	18.4
No	80	81.6
<b>Total</b>	<b>98</b>	<b>100.0</b>

The fact that a reduced number of cases are characterized by the provision of financial resources is definitely influenced by the absence of a specific Italian law protecting banks or other lenders involved in the project, who have taken the decision to increase their exposure with companies in crisis. Such a situation, at least from a legal point of view, is prevented by the Law n. 78/2010: art. 182-quarter Bankruptcy Law has made possible the deducibility of the borrowings granted by the banks used by the company in the formalization or the execution of the recovery project (made up in accordance with the agreement of debt settlement or the arrangement with creditors).

In accordance with *RQ2*, the company has to adopt different behaviour depending on the type of stakeholders (banks, suppliers, employees). The probability of acceptance of the recovery strategy by stakeholders depends on the ability of the company and the experience and reputation of its advisors to prepare a reliable and reasonable recovery project, communicating it in a comprehensible way. In evaluating the proposed recovery project by the stakeholders, both objective (deferred payments of overdue debts or partial write-off) and subjective elements (differentiation of the proposal according to the individual stakeholders or proposition of the same offer to all parties) are considered. Therefore, *H2* is confirmed.

As earlier literature affirms (Reilly and Di Angelo, 1990; Coda, 1991; Graham *et al.*, 2005; Argenti and Barnes, 2009; Netten and Van Someren, 2011), effective communication with the stakeholders could increase the company's credibility, influencing the provisioning of resources and the levels of trust towards the company. This communication process also includes the recovery project, as it concerns a delicate circumstance involving stakeholders'

interests (Foster, 1986; Ingram *et al.*, 2002; Meigs *et al.*, 2001). Due to the fact that every kind of stakeholder has been involved in the recovery process, the company has to adopt a transparency and shared communicational approach towards stakeholders.

## 5. CONCLUSIONS, IMPLICATIONS AND LIMITATIONS

The crisis phenomenon is a very frequent occurrence in the lifecycle of a company. A sort of “normalization” of the crisis situation is commonplace, forcing the company into a new mindset for the foretelling and management of a crisis situation.

The recovery project is the tool by which a company can return to a state of development in a systematic way. This research has developed a model recovery project, subject to any amendments and additions particular to each individual business’s needs. The recovery project is composed of two main parts in the majority of cases analysed (86.7%):

- The recovery plan: this is the most delicate part of the recovery project, as it explains some important factors that influence the success of the recovery process, such as the presentation of the company, the causes of the crisis (both found in all of the recovery projects from the sample (100.0%)), details of the initial economic and financial situation before recovery process (which was found in the majority of the cases from the sample (91.8%)), the recovery strategy (100.0%) and the policy of negotiation with stakeholders (91.8%). The recovery plan contains both quantitative and qualitative information.

- The economic-financial plan: this allows the parties involved to understand the effects of recovery strategy on the economic and financial situation of the company and its attitude towards overcoming the crisis. It contains both quantitative and qualitative information, but mostly the former. In particular, it contains documents concerning the economic and financial situation of the company, including prospective balance sheets (100.0%); prospective income statements (100.0%); prospective cash flow statements (91.8%).

According to the composition of the recovery project, it has to be an inclusive document, including both a qualitative and quantitative component on the crisis phenomenon. The proposed recovery project model effectively details the starting position of the company in crisis, the causes of the crisis, the recovery strategy and its effects on the economic and financial situation.

The company has to reach a consensus with stakeholders on the aims and actions contained within the recovery project, which are also influenced by the agreements proposed by the company to different categories of stakeholders. In particular, it emerged that the

companies of the sample proposed differentiated agreements with stakeholders in the majority of the cases (73.5%). Banks represent a privileged stakeholder, for which companies of the sample created a single agreement for all banks involved (79.6%) in order to avoid creating tension between banks.

The success of the recovery process depends on the ability of the company and its advisors to obtain an agreement with the banks, without which the recovery cannot be completed. In addition, other creditors are involved to varying degrees, such as tax administrators, supplier of goods and services and employees.

With the intention of increasing the company's credibility, the recovery project is an instrument of communication with stakeholders. Due to the strong dependence by third parties, stakeholders' dwindling confidence towards the company and the need for business continuity, the company has to effectively communicate the recovery process in order to succeed. The purpose is to regain the respect of its stakeholders and generate commitment from all parties on the recovery strategy, even adopting different behaviours with each type of stakeholder.

The implications of this research concern the above conclusions. All companies, whether the weakest or the strongest, have to consider themselves as being vulnerable to a potential crisis. Companies have to adopt a systematic approach to the problem, which makes use of standardised tools, such as the recovery project. As there isn't a reference model for the preparation of the recovery plan, the absence of generally accepted principles can generate some difficulties in recovery planning for companies and its consultants. A model recovery project may help several actors in the recovery process to interact with stakeholders, to communicate the company strategy to them with the purpose of finding a means to uphold business continuity.

A way of overcoming the limitations of the research would be to differentiate the companies' behaviour during the recovery process according to whether or not the companies are listed and to the amount of restructured debt involved. Indeed, these factors may generate several different attitudes towards overcoming the crisis situation, thus developing different behaviours worthy of study.

First of all, it has been supposed that the crisis is affecting unlisted companies more intensely than listed. Indeed, the culture of listed companies is more oriented towards disclosure: usually, listed companies report in advance the crisis phenomenon and its warning signs, before the company faces hard financial challenges. On the other hand, the unlisted companies tend to underestimate the effects of the crisis and postpone remedial

action until the time of maximum financial stress. This aspect might merit further study.

In addition, a further analysis may be conducted distinguishing the company's recovery behaviour with respect to the amount of debt rescheduled. Our hypothesis, which we will take on for the next stage of our research, is that this behaviour can manifest peculiarities in relation to the amount of outstanding debt, which is influenced by the number of stakeholders involved.

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## SERVICE FAIRNESS, SERVICE QUALITY AND RELATIONSHIP QUALITY EVALUATION EFFECTS ON CUSTOMER LOYALTY

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### ABSTRACT

The purpose of this study is to establish and empirically validate an integrated model identifying the causal relationships among service fairness, service quality and relationship quality and their joint effects on customer loyalty. The findings of the empirical study, based on data collected from the automobile after-sales service industry, largely support the hypothesized relationships proposed in the theoretical model. More specifically, they show that relationship quality measured as a higher-order construct reflecting supplier-customer relationship level in terms of satisfaction, trust and commitment is the main determinant of customer loyalty. Furthermore, it partially and fully mediates the relationships between service fairness and service quality with customer loyalty respectively. Thus, service quality and service fairness influence loyalty indirectly by strengthening the supplier-customer relationship quality, which was proved to be a better predictor of customers' attitude and behavior. Managerial implications of the findings are discussed and directions for further research are provided.

**Keywords:** Relationship marketing, Service fairness, Service quality, Relationship quality, Customer loyalty, Higher-order constructs, PLS-PM, Automobile after-sales services

### INTRODUCTION

A great deal of research exists on the interactions among the service evaluation constructs as well as their correlations with relationship quality and customer loyalty. However, an integrative model of these concepts has not been tested before. This study draws on three theoretical streams: the service fairness theory, the service quality theory and the relationship quality theory to predict customers' loyalty in services. Fairness theory explains how customers' fair treatment is linked to service quality and various attitudinal outcomes, such

as relationship quality, while the literature concerning relationship quality explains how the service delivery process works. Service fairness and service quality are considered as the foundations of establishing healthy bonds between customers and suppliers, which in lead to long-term customer relationships. Finally, relationship quality theory relates its dimensions with customer loyalty. The purpose of this study is to establish and empirically validate an integrated model that identifies the causal relationships among service fairness, service quality and relationship quality and their joint effects on customer loyalty. The paper is structured as follows. The next section reviews the literature and develops hypotheses. It is followed by sections devoted to methodology analysis, discussion of findings, implications and, last but not least, limitations and suggestions for further research.

## **LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT**

In this section the concepts of service fairness, service quality, relationship quality, and customer loyalty are analyzed and the interrelations among them are discussed.

### **Service Fairness**

The concept of fairness is rooted in the theory of justice, which is in turn is adapted from equity theory (Adams, 1965), suggesting that over-rewarded and under-rewarded relationship outcomes cause distress that people strive to reduce. Individuals are seeking a fair input/output balance and become satisfied whenever they feel their inputs are fairly rewarded. Perception of unfairness can lead to distress and dissatisfaction. In contrast, perception of fairness results in positive emotions and satisfaction (Patterson et al., 1997; Szymanski and Henard, 2001).

Service fairness (SF) or justice is understood across three dimensions: distributive, procedural and interactional fairness (Friman et al., 2002; Meng and Elliot, 2008; Clark et al., 2009; Ha and Jang, 2009; Yen et al., 2010). Distributive fairness (DF) involves price in relation to the outcomes of the service delivered and reflects customers' perceptions of the benefits and costs balance among parties. Procedural fairness (PF) is about exchange relationships and is associated with the elements of impartiality, refutability, explanation and familiarity of service personnel. Last but not least, interactional fairness (IF) deals with the fairness of interpersonal treatment and refers to: a) courtesy, respect and consideration shown by service representatives during the transaction and b) the extent and quality of mutual communication.

Several recent studies consider the relationship between customers and service providers on the grounds of the service fairness notion (Han et al., 2008; Ting, 2011; Chen et al., 2012; Zhu and Chen, 2012). Most, investigate individually the effects of each fairness dimension on other constructs such as satisfaction, service quality etc. or consider service fairness as a reflective higher-order construct having the three aspects of fairness as its sub-dimensions. Lately, Chiu et al. (2010) proved that service fairness is better represented as a higher-order construct having the three dimensions of fairness as first-order formative constructs. Given that the latter do not necessarily correlate, the elimination of any fairness dimension may alter the conceptual domain of the overall construct (MacKenzie et al., 2005). The current study, drawing upon Chiu et al. (2010), considers service fairness as a higher-order formative construct that is assessed by the summative effect of its distributional, procedural and interactional elements.

### **Service Quality**

Service quality (SQ) is a fundamental concept of services marketing representing along with perceived service value the factors that are used by customers to evaluate their service providers (Cronin et al., 2000; Brady et al., 2005). Consensus has been reached on that perceived SQ is an attitude or global judgment about the superiority or inferiority of a service (Grönroos, 1984; Parasuraman et al., 1998; Cronin and Taylor, 1992; Teas, 1993). Berry et al. (1988) maintain that SQ is a great differentiator and the most powerful competitive weapon of service organizations.

Grönroos (1984, p. 38) defines SQ as a perceived judgment, resulting from an evaluation process where customers compare their expectations with the service they perceive to have received. Later, Parasuraman et al. (1988, p. 17), defined SQ as *“the degree of discrepancy between customers’ normative expectations for the service and their perceptions of the service performance”*. They also argue that perceived SQ is interpreted across five dimensions: reliability, assurance, tangibility, empathy and responsiveness.

Many previous studies have identified a relationship between SF and SQ (Carr, 2007; Aurier and Siadou-Martin, 2007; Han et al., 2008; Kwortnik and Han, 2011). Carr (2007) argues that customers are considering the level of SF, when they evaluate the SQ of their service providers, in their effort to achieve a balanced level of service which in turn will increase perceived levels of SQ. As a result the following hypothesis is formulated:

*H<sub>1</sub>: Service fairness positively affects perceived service quality*

### Relationship Quality

Relationship quality (RQ) refers to customers' perceptions of how well a relationship fulfils customers' expectations, predictions, goals and desires (Jarvelin and Lehtinen, 1996). Hennig-Thurau and Klee (1997, p. 751) postulate that RQ is *"the degree of appropriateness of the relationship to fulfil the needs of the customer associated with the relationship"*. Although, there is no clear consensus regarding the dimensions comprising the construct (Hennig-Thurau et al., 2002; Athanasopoulou, 2009), most researchers converge on the idea that relationship quality is a higher-order construct made of several distinct, though related dimensions (Dwyer and Oh, 1987; Crosby et al., 1990; Kumar et al., 1995; Gummesson, 2002; Roberts et al., 2003; Woo and Ennew, 2004). The three most common such dimensions are customer satisfaction (CS), trust (TR) and commitment (COM) (Athanasopoulou, 2009). In services, Crosby et al. (1990) first conceptualised customer-salesperson RQ through TR and CS. Later attempts of research on RQ conceptualization added COM to the bundle of the concepts dimensions (Friman et al., 2002; Hennig-Thurau et al., 2002; Kim and Cha, 2002; Bennett and Barkensjo 2005; Farrelly and Quester, 2005; Huntley 2006). In the retail market, various studies seem also to converge on the notion that the dimensions of retail RQ include CS, TR, and COM (De Wulf et al., 2001; Moliner et al., 2007; De Cannière et al., 2009; Qin et al., 2009). However, other researchers split COM in its affective and calculative facets (Vesel and Zabkar, 2010). Affective commitment (AC) refers to a customers' free will to maintain the relationship with the firm that they do business with (Vesel and Zabkar, 2010), while calculative commitment (CC) is the state of attachment to a partner in recognition of the sacrificed benefits and losses incurred if the relationship ends (Geyskens et al., 1996), suggesting a rational, in financial terms weighing up (Pritchard et al., 1999). Following the studies of Vesel and Zabkar (2010) and Hennig-Thurau et al., 2002, the current study views RQ as a reflective higher-order construct having CS, TR, AC and CC as its first-order dimensions.

Research has shown that the perception of relationship fairness enhance RQ (Kumar et al., 1995). Nguyen and Mutum (2012, p. 408) argues that *"It is, in particular, important to develop processes and procedures which the other member of the relationship judges as being fair, in order to sustain the relationship"*. Based on that, it is posited that:

*H<sub>2</sub>: Service fairness positively affects relationship quality*

RQ is also strongly linked to SQ in various studies (Wong and Sohal, 2002; Roberts et al., 2003; Venetis and Ghauri, 2004; Carr, 2006, 2007; Shabbir et al., 2007; Liu et al., 2011; Ou et al., 2011). SQ is a recognised antecedent of CS (Herington and Weaven, 2009; Hu et al., 2009;

Jamal and Anastasiadou, 2009), which is one of the main dimensions of RQ. Caceres and Paparoidamis (2007) and Hsieh and Hiang (2004) indicated that improved customers' perceptions of SQ will influence aspects of RQ such as CS and TR, while Fullerton, (2005) validated the link between SQ and both dimensions of commitment. As a result, the following hypothesis can be postulated:

*H<sub>3</sub>: Service quality positively affects relationship quality*

### **Customer Loyalty**

Customer loyalty (CL) is the most important goal of relationship marketing given that results in increased profits, better acquisition rates from positive WOM, and reduced acquisition and retention costs (Zeithaml et al., 1996). Oliver (1997, p.392) defined CL as a “*deeply held commitment to rebuy or repatronize a preferred product or 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*”. According to Chu (2009), CL is a positive attitude and behavior related to the level of re-purchasing commitment to a brand in the future and as such a composite approach to loyalty is most appropriate. This study treats CL as a second-order reflective bi-dimensional construct having its attitudinal and behavioral aspects as sub-dimensions (Kwortnik and Han, 2011; Karjaluo et al., 2012)

A number of studies have investigated the linkages between SF and CL (Carr, 2007; Ha and Jang 2009) and SQ and CL (Roberts et al., 2003; Fullerton, 2005; Carr, 2007; Chao, 2008). Carr (2007) argues that when a customer feels that service provider's operational strategy is to provide unbiased services then he/she will feel greater levels of loyalty and repatronage intentions. Based on that the following hypothesis is outlined below:

*H<sub>4</sub>: Service fairness positively affects customer loyalty*

Building relationships with customers is a good way towards retaining customers loyal in the long-run (Sheaves and Barnes, 1996). To further reinforce this posture, a study conducted by Barnes (1997) suggested that it is unlikely for customers to be retained for long unless a genuine provider-customer relationship is present. Except of those studies which validated the direct links between RQ's dimensions and CL separately (Bettencourt, 1997; Garbarino and Johnson, 1999; Fullerton, 2005; Han et al., 2008; Deng et al., 2009; Sanchez-Franko et al., 2009). Hennig-Thurau and Klee (1997), Roberts et al. (2003) and Keating et al. (2011) have empirically validated the link between RQ represented as a higher-order construct composed by CS, TR, and COM and CL. Based on these findings the following hypothesis is posited:

*H5: Relationship quality positively affects customer loyalty*

The literature reports that SQ also has a well-established direct or indirect influence on CL (Zeithaml et al., 1996; Roberts et al., 2003; Fullerton, 2005; Carr, 2007; Chao, 2008). Fullerton (2005) found that both AC and CC partially mediates the relationship between SQ and CL in the retailing services setting, Keating et al. (2011) validated a direct link between SQ and CL in internet banking services except of the indirect one through RQ. Accordingly, the following hypothesis is advanced

*H6: Service quality positively affects customer loyalty*

Based on the review of the aforementioned studies, a model describing the proposed relationships among the nine constructs is shown in Figure 1.

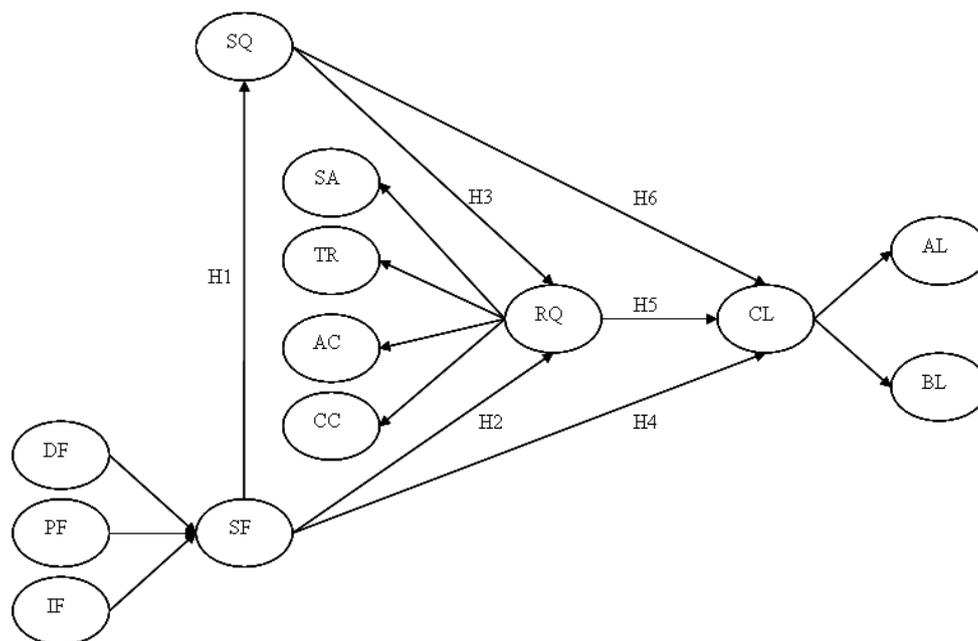


Figure 1: Proposed Model

## RESEARCH METHODOLOGY

The model was tested on evidence from the auto repair and maintenance industry. The particular service is selected for the following reasons. First, these services are crucial for manufacturers' future growth since brand repurchasing rates largely depend on customers' after sales experiences (Little, 2009). Second, due to the recession that many European countries are currently experiencing, high revenues from new sales cannot be easily achieved.

According to a report prepared by Little (2008), the after sales industry, which has been long neglected by automotive manufacturers in their business strategies, achieves a significantly higher ROI than new car sales. In Germany, for example, the after sales business generates more than half of profits while accounting for only 23% of revenues. Third, currently potential new private car buyers postpone or cancel buying a new car due to recession. This leads to an increasing average fleet age, where older cars demand more service, thus, creating a profitable market for after-sales service offerings.

### **Sample Profile and Data Collection**

In this study, prospective respondents were drawn from the customer base of a major European automotive distributor in Greece owning three service facilities in different areas of the Attica basin. A random sample of 1,000 active customers was drawn with no discrimination requirements. The fieldwork was conducted in September 2012 by four trained senior students over the phone. Prospective respondents were told that the survey was conducted on behalf of their after-sales service supplier. Contacts were made at different times of the day and days of the week in order for date and time related bias to be reduced. The procedure resulted in 420 filled questionnaires. After eliminating those with unanswered items, 408 usable questionnaires were coded for data analysis, yielding a net response rate of about 41%. Among the 408 respondents, 61% were males and 65% married. In relation to age, 12% of respondents were in the 18-24 age-group; 22% were in the 25-34 age-group; 26% were in the 35-44 age-group; 25% were in the 45-54 age-group, and 15% were older than 55. In terms of monthly income, 40% of respondents had a net income of less than € 1,000; 41% between € 1,000 and € 1,500; 15% between € 1,500, and € 2,000, and 4% more than € 2,000. Also, 40% of respondents had a university degree; 14% had some college education; 11% were university students, and 35% had a secondary school education. The sample included customers from different areas of the Attica region, 27% living in the southern part, 27% in the western part, 18% in the northern part and 9% in the eastern part. Finally, the median age of the respondents' cars was 5 years old.

### **Measures and Survey Instrument Design**

The questionnaire was designed with measures of the relevant constructs based on scales published in the literature. With the exception of the SQ items (measured with semantic differential scales), items were measured on 7-point Likert scales anchored at 1 (strongly disagree) and 7 (strongly agree). Four items were used to measure AL based on the work of

Harris and Good (2004) reflecting the cognitive; affective, and conative aspects of Oliver's (1997, 1999) four-step loyalty framework. To measure BL, the four-item scale developed by De Wulf et al. (2001); Oliver (1997), and Zeithaml et al. (1996) was utilized. The 5-item scales, included into Han et al.'s (2008) study, were used to measure AC and CC. Items measuring CS and TR were derived from the studies undertaken by Fornell (1992) and McKnight et al. (1998) respectively. The seven items used to measure SQ were based on the study of Parasuraman et al. (1988). Finally, the three subdimensions of SF were measured using the scales provided by Han et al. (2008).

## **EMPIRICAL RESULTS**

### **Measurement Model Assessment – First Order Constructs**

The method of partial least squares path methodology (PLS-PM), an implementation of structural equation modeling (SEM) with Smart PLS 2.0 M3 (Ringle et al., 2005), was employed to examine the model and test the proposed hypotheses. The selection of PLS-PM was based on criteria as outlined in the work of Hair et al. (2011) such as the complexity of the proposed model and the inclusion of reflective and especially formative higher-order constructs.

The initial analysis is concerned with the measurement model adequacy assessment. The test of the measurement model involves the estimation of convergent validity, internal consistency reliability, and discriminant validity of the study's first-order reflective constructs, which indicate the strength of measures used to test the proposed model (Hair et al., 2011). Convergent validity is suggested if loadings are greater than 0.7 on its respective factor, which implies more shared variance between the construct and its measures than the error variance (Carmines and Zeller, 1979) and . In the initial run of PLS-PM, where all available measured items were included, five items (2 items for the PF and DF scales, 1 item from the IF scale and 1 item from the SQ scale) presented factor loadings less than 0.6 and for that reason were eliminated. The factor loadings of the non-eliminated items, as shown in Table 1, exceed 0.725 providing strong convergent validity. Then the reliability of all latent constructs was examined using the measures of Cronbach's Alpha (CA) and Composite Reliability (CR) (Fornell and Larcker, 1981). Hair et al. (1998) suggest that a value of 0.7 provide adequate evidence for internal consistency.

LV	Variable	Mean	Std. Dev.	Loadings	t-stat	CA	CR	AVE
IF	IF1	4.924	0.888	0.905	49.055	0.927	0.948	0.820
	IF2	4.813	0.927	0.920	54.198			
	IF3	4.823	0.958	0.916	54.635			
	IF4	4.976	0.985	0.881	34.219			
PF	PF1	4.704	1.112	0.892	41.975	0.890	0.932	0.819
	PF2	4.736	0.986	0.916	53.988			
	PF3	4.736	1.021	0.907	52.484			
DF	DF1	4.837	1.011	0.909	41.416	0.872	0.922	0.797
	DF2	4.883	1.027	0.927	54.307			
	DF3	4.622	1.194	0.839	20.752			
SQ	SQ1	5.174	1.025	0.887	45.494	0.929	0.945	0.741
	SQ2	5.198	1.020	0.884	33.992			
	SQ3	5.356	1.043	0.903	43.124			
	SQ4	5.321	1.027	0.725	8.729			
	SQ5	5.315	0.997	0.867	25.012			
	SQ6	5.313	1.007	0.885	34.374			
CS.TR	TR1	4.620	1.041	0.886	34.348	0.955	0.963	0.786
	TR2	4.715	1.031	0.898	38.704			
	TR3	4.641	1.041	0.880	30.165			
	TR4	4.633	1.083	0.915	51.153			
	CS1	4.736	1.070	0.881	33.553			
	CS2	4.609	1.060	0.854	24.587			
	CS3	4.753	1.106	0.890	37.450			
AC	AC1	4.454	1.042	0.928	48.638	0.965	0.973	0.877
	AC2	4.402	1.094	0.941	73.757			
	AC3	4.432	1.111	0.942	71.514			
	AC4	4.565	1.061	0.930	49.367			
	AC5	4.530	1.076	0.943	83.594			
CC	CC1	4.516	0.909	0.882	29.297	0.908	0.932	0.732
	CC2	4.459	1.013	0.860	23.423			
	CC3	4.720	0.973	0.881	27.532			
	CC4	4.663	0.978	0.884	36.956			
	CC5	4.582	1.095	0.766	12.354			
AL	AT1	4.742	0.987	0.888	37.589	0.903	0.932	0.775
	AT2	4.649	0.997	0.900	41.993			
	AT3	4.440	1.203	0.819	17.214			
	AT4	4.668	0.972	0.911	52.431			
BL	BL1	4.761	1.077	0.864	23.706	0.903	0.932	0.774
	BL2	4.764	1.082	0.920	60.421			
	BL3	4.658	1.080	0.871	29.283			
	BL4	4.872	1.044	0.864	16.076			

Table 1: Descriptive statistics and psychographic properties of the first-order constructs

LV	Mean	Std. Dev.	IF	PF	DF	SQ	CS.TR	AC	CC	AL	BL
IF	4.883	0.852	0.906								
PF	4.726	0.941	0.765	0.905							
DF	4.785	0.958	0.731	0.759	0.893						
SQ	5.277	0.883	0.671	0.697	0.749	0.861					
CS.TR	4.673	0.943	0.681	0.750	0.773	0.788	0.887				
AC	4.477	1.010	0.495	0.609	0.651	0.677	0.796	0.937			
CC	4.586	0.848	0.558	0.624	0.648	0.686	0.766	0.729	0.856		
AL	4.632	0.910	0.628	0.707	0.696	0.716	0.798	0.760	0.764	0.880	
BL	4.761	0.946	0.607	0.638	0.656	0.680	0.778	0.645	0.719	0.740	0.880

Table 2: Correlations of latent constructs

As shown in Table 1, CA and CR of all reflective measures included in the study exceed 0.7, suggesting that all items are good indicators of their respective components.

Discriminant validity was assessed in two ways. First, the Average Variance Extracted (AVE), which indicates the amount of variance that is captured by the construct in relation to the variance due to measurement error, is examined. Second, the square root of AVE extracted from each construct, is compared with the correlations among constructs. The initial run of PLS revealed that, similar to Vesel and Zackbar (2010) and De Cannière et al.'s (2009) study, CS and TR are not distinct from one another and are thus combined to form a satisfaction/trust factor (CS.TR). The findings of the new run of PLS provided strong evidence of discriminant validity among first order constructs because, as shown in Table 1, all AVE values are greater than 0.73 which in turn exceeds the recommended cutoff value of 0.5 (Barclay et al., 1995), and as shown in Table 2, the square root of AVE for all first-order constructs is higher than their shared variances.

### Measurement Model Assessment – Second-Order Constructs

Second-order factors can be approximated using two approaches. One commonly-used approach is the repeated indicator approach (Lohmöller, 1989) where the second-order factor is directly measured by using items of all its lower-order factors. The procedure performs better when the lower-order constructs have about equal number of items. As stated previously, RQ and CL are modeled as second-order reflective constructs. In Table 3, the CR and AVE measures of both higher-order constructs are provided. CR and AVE for RQ equals to 0.972 and 0.676 respectively and for CL equals to 0.942 and 0.673 respectively, which are well above the recommended thresholds of 0.7 and 0.5 respectively, providing evidence of reliable second-order constructs (Wetzels et al., 2009). Finally all loadings of the second-order constructs on the first-order constructs exceed 0.885 and are significant at  $p=0.01$ . All of the

above support the proposed conceptualization of RQ and CL that they are reflecting customers' perception of their pre-specified sub-dimensions, namely SA.TR, AC, CC and AL, and BL respectively.

A. RELATIONSHIP QUALITY (CR = 0.972 AVE = 0.676)				
1st-Order Construct	Loadings	t-stat	95% Confidence Interval	R <sup>2</sup>
CS.TR	0.950	57.931	[0.918, 0.973]	0.902
AC	0.914	42.979	[0.881, 0.959]	0.835
CC	0.885	36.298	[0.796, 0.941]	0.783
B. CUSTOMER LOYALTY (CR = 0.942 AVE = 0.673)				
1st-Order Construct	Loadings	t-stat	95% Confidence Interval	R <sup>2</sup>
AL	0.935	50.484	[0.899, 0.967]	0.874
BL	0.930	48.227	[0.873, 0.961]	0.864

Table 3: Second-order reflective constructs assessment

Furthermore, the SF construct is modeled as a formative second-order construct. According to Tenenhaus et al. (2005), PLS-PM, as in the case of reflective higher-order constructs, can also be used for hierarchical models with formative constructs, by reversing the direction of the relationships between the higher and the lower-order constructs. However, this will result in a R<sup>2</sup> value for the higher order construct of unity. The measurement quality of the formative second-order factors was tested following the suggestions by Chin (1998) and Diamantopoulos and Winklhofer (2001). First, the correlations among the first-order constructs were examined. As shown in Table 4, the absolute correlations among the three first-order SF related dimensions vary from 0.731 to 0.765 with an average of 0.75. Though the correlations between first-order constructs of SF are relatively high, this result suggests that SF is better represented as a formative second-order construct, instead of reflective, since reflective second-order constructs would show extremely high correlations ( $\geq 0.8$ ) among its first-order factors (Pavlou and El Sawy, 2006).

The strength of the relationship between second-order constructs and their first-order dimensions is subsequently assessed. As shown in Table 5, all first-order fairness-related components were found to have significant path coefficients in forming the customer perception about SF. Results suggest that among the factors forming fairness perception, IF is the most important followed by PF and DF. This result is similar with those of Chiu et al. (2010) in the online auctions service setting and can be attributed to the credence nature of the service under investigation. The variance inflation factors (VIF) were then computed for these

first-order justice factors to assess multicollinearity (see Table 4 for VIF values). VIF values above 10 would suggest the existence of excessive multicollinearity and raise doubts about the validity of the formative measurement (Diamantopoulos and Winklhofer, 2001). The VIF values for the first-order justice-related factors varied from 2.709 to 3.028. Therefore, multicollinearity is not a concern for the Service Fairness construct.

SERVICE FAIRNESS					
1st-Order Construct	Coefficient Value	t-stat	95% Confidence Interval	R <sup>2</sup>	VIF
IF	0.427	1,533.148	[0.386, 0.459]		2.771
PF	0.337	1,156.184	[0.309, 0.373]	1.000	3.028
DF	0.331	1,200.919	[0.306, 0.366]		2.709

Table 4: Second-order formative construct assessment

#### Assessment of the structural model and hypotheses testing

The PLS-PM method was also used to confirm the hypothesized relations between constructs in the proposed model. The significance of the paths included into the proposed model was tested using a bootstrap resample procedure with 500 runs. In assessing the PLS model, the squared multiple correlations (R<sup>2</sup>) for each endogenous latent variable were initially examined and the significance of the structural paths was evaluated. The proposed relationships are considered to be supported if the corresponding path coefficients had the proposed sign and were significant. The PLS analysis results are given in Table 5.

DV	IV	Coefficient Value	t-stat	R <sup>2</sup>	Hypotheses Test
SQ	SF	0.769	22.983	0.591	H1 confirmed
RQ	SF	0.403	8.810	0.688	H2 confirmed
	SQ	0.479	10.470		H3 confirmed
CL	SF	0.199	4.743	0.784	H4 confirmed
	SQ	0.077	1.764		H5 rejected
	RQ	0.658	15.079		H6 confirmed

Table 5: Estimated results of the structural model and hypotheses tests

SF positively affects SQ as indicated by the value of the relevant coefficient ( $\beta = 0.769$ ;  $t = 22.983$ ) explaining 59.1% of the variance in SQ. Therefore, H<sub>1</sub> is confirmed since it was found to be statistically significant and the relevant path coefficients have the hypothesised signs. As far as the determinants of RQ, both SQ ( $\beta = 0.479$ ;  $t = 10.470$ ) and SF ( $\beta = 0.403$ ;  $t = 8.810$ )

almost equally affect RQ formation explaining 68.8% of its variance. These findings support the validity of H2 and H3, meaning that if customers perceive that the service provided is of high quality and provided fairly, the quality of their relationship with the provider increases. Finally, the determinants of CL are RQ and SF, explaining 78.4% of the variance in CL. However, RQ present a stronger influence on CL than SF, as indicated by model's coefficients of  $\beta = 0.658$  ( $t = 15.079$ ) for RQ and  $\beta = 0.199$  ( $t = 4.743$ ) for SF. Therefore, hypotheses H5 and H6 are confirmed. Although it was expected that both SQ will directly affect CL, the findings revealed that the relevant path coefficients ( $\beta = 0.077$ ,  $t = 1.764$ ) is not statistically significant. Thus, H4 was not confirmed, meaning that the relationship between SQ and CL is fully mediated by RQ. Roberts et al. (2003) arrived also at the same result suggesting that "the Relationship Quality scale completely subsumes the effect of the Service Quality scale" (p. 189). However, SQ indirectly affects CL through RQ since the relevant coefficient ( $\beta = 0.315$ ), as shown in Table 7, is statistically significant. Moreover, the indirect effect of SF on CL is statistically significant ( $\beta = 0.566$ ) and about 3 times higher than the relevant direct effect, highlighting the importance of RQ in customers' attitudes and behaviors.

## CONCLUSIONS AND IMPLICATIONS

The results of this study present many implications for service managers. First, the fact that interactional fairness is the most important for customers shows that service companies should manage the interaction with customers effectively at every point of contact. For example, in car service providers, there should be enough trained employees at the phone service of the company knowing how to deal with customers and engineers should be trained to deal with customer inquiries and complaints appropriately. Also, all customers should be equally treated because preferential treatment of certain customers can destroy the relationship developed. Second, the previous implication becomes even more important if we consider that the effect of service fairness to perceived SQ is very high. The results also showed that SQ is heavily affected by SF. So, if service providers are successful in providing a fair service, they will also probably be considered as high quality service providers. Thirdly, although there is a direct effect of service fairness to customer loyalty, customer loyalty is mainly affected through relationship quality. As customers stay with the same provider for longer periods, trust and commitment increase and therefore these customers exhibit an intention to stay with the same provider, and a tendency to refer the provider to others. So, if car service providers want to reap the benefits of loyal customers, the key rests in developing strong long-term relationships with customers.

Finally, SQ only affects CL through RQ. This means, that offering a high quality service is not enough to create loyal customers. Only when SQ is coupled by long-term quality relationships do we see signs of CL. This is particularly important in today's competitive environment where many providers offer the same type of service. However, the competitive advantage comes from managing relationships with customers effectively.

## LIMITATIONS AND FUTURE RESEARCH DIRECTIONS

This study, despite the significance of its findings, has a number of limitations. A first limitation is the industry-specific sample, which may affect our findings' generalizability. It is necessary to implement the proposed model in different relevant service settings before the interrelationships among service evaluation, relationship quality and customer loyalty are fully clarified. A second limitation pertains to that the findings and implications of this research were obtained using a cross-sectional study. This reduces the ability of the study to reflect the temporal changes in the research constructs. A longitudinal study on the subject is necessary in order to clarify the effects of temporal changes.

As far as future research recommendations are concerned, certain variables could be incorporated into the proposed framework to enhance its predictive performance and to provide better understanding of the customer's decision-making process. For example, a future research effort could consider the role of different type of switching barriers in the relation between relationship quality and customer loyalty. Moreover, future research can replicate this study in different types of services; and across different countries that are characterized by a different culture.

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## FROM OFFSHORE OUTSOURCING PROVIDER TO OWN BRAND MANUFACTURER: AN EXPLORATORY APPROACH USING RESULTS FROM THE PORTUGUESE FOOTWEAR INDUSTRY

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### ABSTRACT

The transfer of values chain from one country to another has expanded strongly in several countries around the world. Although the existent literature on offshoring is extensive, very little is known about this process from the perspective of the providers. This paper discusses how that process works when offshore outsourcing providers, shift to own brand manufacturers while still remaining engaged in a business relationship with their clients.

This research aims at providing an integrative analysis, through an exploratory approach, based on Systematic Combining, of the connections between knowledge transfer, absorptive capacity and own brand building from the perspective of the providers so as to fill the main gaps in the existing literature on the offshore outsourcing process. A purposive sample was applied and seven Portuguese offshoring providers were interviewed. Afterwards, the data collected was analyzed and coded.

Five core categories and their subcategories emerged: offshore outsourcing relationship, absorptive capacity, catalyst, inhibitors and brand building triggers. This newly found last category, which was not defined in the initial literature, demonstrates specific moments that catapult firms to own brand manufacture and that without them the process would be much slower.

This paper adds value to the existing literature since it contributes to theory building, relating to the providers' own brand building process through offshore outsourcing, including the internal process mechanisms that lead the providers in the pursuit of this given business model.

**Keywords:** offshoring, offshore outsourcing, providers, clients, absorptive capacity, own brand building

## INTRODUCTION

Nowadays offshore production is one of the pillars of globalization due to the central role it plays in global supply chains that serve global markets (Hill, 2007). In fact, numerous enterprises focus on cost-cutting strategies, such as offshoring. Nevertheless, other reasons, such as assessing qualified workforce or improvement of organizational flexibility have been highlighted as key factors affecting offshoring (Lewin and Peeters, 2006).

It is hoped that through this research, a better knowledge of the offshoring process from the perspective of the providers is achieved, given that literature on this topic can scarcely be found (Lahiri *et al.*, 2012). In a word, its purpose is to understand how the providers manage the shift to own brand manufacturers in the course of the offshore outsourcing relationship. Thus, this study aims to fill the gap in literature about this subject. Subsequently, this paper will discuss general concepts, such as absorptive capacity, in order to develop the study. Afterwards, it intends to propose a framework of analysis supported by a sample of Portuguese companies that started as offshoring providers and managed to create their own brand.

The lack of relevant theories on offshore outsourcing with specific focus on the providers influenced the methodology used in this study. Therefore, our methodology will be conducted by an exploratory approach based on Systematic Combining, which aspires to generate theory, rather than the confirmation of an existing one (Dubois and Gadde, 2002).

The Introduction is followed by a literature review on offshoring that analyzes the main points framed in the literature on the providers' side and other important concepts, such as absorptive capacity. After that, the next section addresses the methodological approach applied to this research. The research's findings are then presented. Finally, the main conclusions and limitations of this study are disclosed and directions for future research are given.

## LITERATURE REVIEW

Offshore outsourcing occurs when a third-party provider is external and located offshore. This is the concept that we will be focusing on during this research and, according to Manning *et al.* (2011, p. 382), it "means the client companies choose to source functions and process supporting domestic and global operations from outside their home countries, using third-party service providers". The cooperation established between a client and a provider

can benefit both agents and, moreover, offshore outsourcing is a method to achieve external and valuable knowledge (Chen, 2005; Jensen, 2009).

Clients may take some precautions related to knowledge transfer for fear of developing potential competitors (Li *et al.*, 2010). However, clients should transfer necessary know-how for providers in order to qualify them as certified providers (Chen, 2005; Li *et al.*, 2010). Furthermore, the processes are closely monitored and training programs may cover the necessary information for the members to conduct the process efficiently (Vivek *et al.*, 2009). Besides, during the entrepreneurial process, the actors become more interdependent (Vivek *et al.*, 2009), relationships also become more flexible over time and “clients (offshorers) transfer informal ownership of the process to the provider (offshore)” (Vivek *et al.*, 2009, p. 28). In this sense, it can be inferred that throughout these monitoring and training programs, the providers will have access to the client’s know-how and routines and, hence be able to develop their own skills. In addition, by providing technological assistance, training programs and quality control systems, the client contributes to the enhancement of the provider’s quality standards and awareness of the client’s market increases.

#### *Firms’ absorptive capacity*

The collaboration with other organizations allows firms to develop their field of action and it can help them to develop new products. However, to successfully obtain new knowledge from other companies, firms must command their ability to find, learn, explore and incorporate external knowledge in the firm’s own operations (Forfás, 2005). This subject of learning has been extensively addressed and studied in the literature on absorptive capacity. According to Cohen and Levinthal (1990) absorptive capacity relates to the company’s ability to identify the value of what is new, external information, and thus assimilate and apply it for commercial purposes. Furthermore, the authors argue that absorptive capacity plays the role of a link between a firm’s intrinsic ability to bring forward newfound products and improve existing ones (Cohen and Levinthal, 1989).

Cohen and Levinthal (1990) support that the companies with advanced prior knowledge, which embodies basic skills, shared language and/or own R&D produces, will be more capable of acquiring and using information from abroad because it will contribute to the recognition of the value of new information, assimilate it and apply it for commercial purposes.

From the perspective of Cohen and Levinthal (1990), absorptive capacity also depends on individual abilities and knowledge of the organizations employees and their absorptive

capacity. Furthermore, studies evidence that when employees are endowed with training and acquire new skills, firms can evolve in their absorptive capacity. Indeed, a positive correlation between the workers' training and organizational performance has been shown by some authors (Koch and McGrath, 1996). According to Lane and Lubatkin (1998, p. 473) "the ability of a firm to learn from another firm is jointly determined by the relative characteristics of the two firms". The authors support that a firm's absorptive capacity depends on the specific knowledge that the partner offers, the similarity between the structure and organizational practices with the business partner and the familiarity that the firm has with the organizational problems of the partner.

Networks also play a significant role in developing the firm's absorptive capacity by conferring skills and processing competences that can promote acquisition, assimilation and exploitation of knowledge to build innovation (Lane and Lubatkin, 1998; Lane *et al.*, 2001; Jansen *et al.*, 2005; Lane, *et al.*, 2006). Moreover, "organizations with higher levels of absorptive capacity will tend to be more proactive, exploiting opportunities present in the environment, independent of current performance" (Cohen and Levinthal, 1990, p. 137).

Cohen and Levinthal (1990) add that absorptive capacity involves three processes, namely acquisition and assimilation of information and, finally, the ability to exploit it. More recently, Zahra and George (2002) refined the concept and classified absorptive capacity into two types: potential absorptive capacity and realized absorptive capacity. In short, whereas potential absorptive capacity is related to the access to information and knowledge, realized absorptive capacity includes processing and incorporation of the gained knowledge in the company's own operations, i.e., realized absorptive capacity focuses on the performance of the firm (Zahra and George, 2002).

#### *Offshore outsourcing*

According to Grant's research (1991) on the resource-based theory of competitive advantage, the usual approach to the generation of resources has been on the shortage of firm resources and capabilities. The theorist believes that the firm has to determine whether to develop resources internally or obtain them outwardly. Hence, in order to take the most of the union of resources and capabilities, which belong to the company and to evolve a strategy leading to a competitive edge, it is essential for the enterprise to achieve complementary resources externally, and thus a firm must not be restrained to the exploitation of its own resources and capabilities (Teng *et al.*, 1995). Grant (1991) states that any absence of assets can be settled through purchases or strategic alliances. Therefore the providers can use the relationship with

their clients as a way of complementing their resources and skills by helping to improve their strategy to make good use of their capabilities before the opportunity to have their own brand.

In the same sense, according to Arruñada and Vásquez (2006) a contract manufacturer can use the knowledge acquired throughout the partnership with their clients to benefit its own brand. In fact, some providers have recently started to shift from contract manufacturing to own brand management (Horng and Chen 2008). Burmann and Zeplin (2005) reiterate that firms should focus more on long-term brand building rather than fix their attention on short-term profits since, by building their own brand, providers can not only gain greater profit margins, but also acquire higher market information concerning product design and improvement (Liu *et al.*, 2011).

However, whereas maintaining relationships between a client and a provider has been extensively examined in the literature, the topic of own brand building in contract manufacturers in the course of an offshore relationship has grabbed little attention from business researchers (Chen, 2005), and therefore this issue has, comparatively, been discussed to much lesser extent in existing literature (Liu *et al.*, 2008).

All transferred knowledge through offshore outsourcing can be strategically used by providers to learn and develop their inner skills (Chen, 2005). However, external knowledge is not easily available to use and cannot be merely achieved in the market (Fritsch and Kauffeld-Monz, 2010). Subsequently, much depends on the company's ability to recognize profitable modes of exploring its skills and competences, and to absorb newfound knowledge (Zahra and Hayton, 2008). So, it is very important for the provider that wants to become its own brand manufacturer to evolve its absorptive capacity. Moreover, a higher absorptive capacity and/or efforts to enlarge it can both encourage innovations within a firm, as well as its ability to manage innovation (Cohen and Levinthal, 1990). Further, through the combination of potential and realized absorptive capacity, firms improve their ability to innovate and are able to create new things (Yli-Renko *et al.*, 2001). For instance, firms may evolve their ability to build their own brand. Thus, a key point of numerous enterprises is whether to create their own brand or keep providing foreign brand owners. Liu *et al.* (2011) argue that own brand building is required for the contract manufacturers that have the goal and ability to follow their growth target. So, some factors that determine the adoption of own brand manufacturing should be pointed out as catalysts, on the one hand, and as inhibitors on the other.

Firstly, the current financial crisis and its dissemination to the global economy influenced the demand for foreign markets, which in turn affected contract manufacturing (Haiyan, 2011). Hence, the crisis may be a great opportunity for providers to upgrade to own brand manufacturing and face it as a possible solution. Besides, as contract manufacturers have access to the clients' value resources, such as R&D and marketing, they will be able to develop their own capabilities which they may later use to create their own brand (Arruñada and Vázquez, 2006; Liu *et al.*, 2008). Finally, governmental policies may support firms in improving internal innovative competences and afford activities to develop brands with own intellectual property, which stimulate the providers in moving from subcontracting to own brand manufacturing (Haiyan, 2011).

However, there are some inhibitors which may prevent manufacturers from creating their own brand and remain as providers. Firstly, when international demand is constant, firms prefer to remain as contract manufacturers so as to play it safe (Haiyan, 2011).

A risk of building a new brand occurs when there is a likely reliance on the client for product improvement and advanced technologies which lead the manufacturer to lose its ability to create and maintain a product advantage (Li, 2007; Li *et al.*, 2010). Another risk factor would lie on the additional costs (both financial and time) since own brand manufacturing requires the undertaking of value-adding activities such as design, branding building and strong technological and marketing ability (Haiyan, 2011). This, requires more investments and thus may constrain firms from pursuing own brand building.

Furthermore, efforts to build a new brand could generate conflicts between the contract manufacturer and its buyer. When the providers choose to have their own brand business, which may be quite similar to the clients' product line, they are somehow going against the clients' interests so that their customers may no longer pursue the collaboration with them and thus providers may ruin the relationship and spoil their clients' orders (Liu *et al.*, 2008). Moreover, a potential cannibalization may occur when the providers offer similar products to their clients. An article by Harvey and Kerin (1979) on the diagnosis and management of cannibalization suggests that the great similarity between product characteristics and the absence of perceivable differences in quality attributes by final customers might make the premium product vulnerable or cannibalize the sales in comparison to its cheaper brand substitute (Meredith and Maki, 2001). For this reason, providers may suffer retaliation from their clients due to potential threat of competition, and the latter might also consider ending

any cooperation. Hence, the providers need to evaluate the pros and cons of engaging in own brand building.

Arruñada and Vásquez (2006) argue that when the clients' commercial viability product depends on proprietary technology and processes, they need their providers to know their business well. Thus, clients should assure the providers' competence, currency of knowledge and good faith. Consequently, ethical issues concerning brand building may arise because, when the customers transfer knowledge to the providers, they trust their good faith. So, for this reason and due to ethical matters, the providers may not choose to create their own brand.

Another inhibitor could be the contract established to moderate the entrepreneurial relationship. "When specific assets are transferred to the vendor, there is a high risk of 'hold-up'" (Barthélemy and Quélin, 2006, p. 1779). Thus, to avoid potential opportunism by the providers, clients may resort to many features of the contracts (such as: penalties, incentives and monitoring) to offset opportunism risks and relieve hazards (Barthélemy and Quélin, 2006) and to prevent the providers from using their ownership.

Drawing some conclusions out of offshore outsourcing entrepreneurship, we may argue that there is the transfer of a set of informal ownership from the clients to the providers and the latter can learn from their clients. When the providers develop their absorptive capacity, they can better absorb that external knowledge to use in their own brand. However, whilst several aspects, which have arisen out of literature, might lead the providers to build their own brand (catalysts), there are other factors that hinder firms from pursuing it (inhibitors).

## **RESEARCH METHOD**

Eisenhardt and Graebner (2007, p. 26) state that in cases where "the existing research either does not address the research question at all, or does so in a way that is inadequate or likely to be untrue", one should resort to an approach based on theory building rather than theory testing. The lack of relevant literature influenced the methodology, and therefore, it led us to follow an exploratory approach based on Systematic Combining (Dubois and Gadde, 2002). This kind of approach is more profitable when the researcher's goal is to find out new things. Through this approach, Dubois and Gadde (2002) state that the researcher can expand his understanding of both theory and empirical world by moving from literature, to the data and

back to the field (but not necessarily in this sequence). Therefore, by going “back and forth”, the researcher can validate or refute their emergent conclusions.

Initially, a purposive sampling was used to recruit participants who meet the criteria. In total, seven enterprises were interviewed. This selection aimed to include firms from different sizes and ages. All firms are still providing to international firms, but also producing their own brand, except one firm that ceased its offshore outsourcing activity and now is working solely for its own brand manufacture. This sample falls on companies from the Portuguese footwear industry that began their activity as offshore outsourcing providers and created their own brand in the course of the relationship of offshore outsourcing.

According to Portuguese Footwear, Components, Leather Goods Manufacturers' Association's report (2012), Portugal is among the main European producers of footwear and is also in the midst of the top 10 footwear exporters for each rank of footwear except rubber & plastic and textile. Portugal accounts for 23% of the global leather footwear exports. In 2011, Portugal produced some 61 million pairs of shoes and its footwear exports increased by 21% in value. Its main trading partners are France, Germany, Spain and the Netherlands and the UK. Portuguese companies that, in the past, manufactured largely for other enterprises are manufacturing for their own brands. APICCAPS (2011) shows that between the period of 2002 and 2010 the resorting to trademarks and logos by firms become more intense up until 2008, when it then lessen, even though it is still at higher level than at the beginning of the decade. Therefore, it is necessary to underline that the footwear industry has particular inborn characteristics and singularities in its business environment that make it perfectly suitable for this study. The selection lies in the footwear industry because it would probably afford a valuable insight about this sector. Besides, we only resorted to this sector and origin, i.e., Portuguese nationality, in order to not create noise and to reach uniformity.

Data was collected through face-to-face interviews with the managers of each enterprise and after seven interviews, theoretical saturation was reached, i.e., no new or relevant information emerged. Since the main aim is to expand theory, the interviews included were only open-ended questions and the informants had the opportunity to freely express their experiences, thoughts and interpretations about the topic in their own words.

A literature review was used to loosely frame the research and to build an interview protocol which directed the conversation in such a way as to warrant that all questions were addressed. The interview protocol was composed of questions related to the issue in context, namely what contributed to the company's own brand creation while still providing offshore

outsourcing activities to foreign clients. The interview protocol was evolutionary since the insights of each discussion resulting from an interview were taken into account to the next interview, and so forth. Interviews were audio-recorded and transcribed. Furthermore, alternative sources were used, such as news from the press. Each interview's transcript and news from the press was analyzed and coded by using QSR NVivo10 software.

## **RESEARCH FINDINGS**

Nvivo software allowed us to classify data into nodes that correspond to categories. From the literature review four categories were developed (namely: offshore outsourcing relationship, absorptive capacity, catalysts and inhibitors). During the coding, particular attention was given to new data which had not been previously identified in the literature. After the coding a new category emerged (brand building triggers) and thus, in total, five core categories were settled on (Table 1): offshore outsourcing relationship, absorptive capacity, catalysts, inhibitors and brand building triggers.

A number of subcategories were also found that descend from the main categories. Likewise, in this instance, seven subcategories, which had not yet been referred to in the literature, were found (Table 1 – highlighted cells). Nvivo also allowed us to measure the incidence of each subcategory based on the number of references by the informants (more or less referred). The analysis process engaged in coding the data and searching for features or phenomena that constituted a demonstration of how providers turn into own brand manufactures. The coding brought an expansion of the list reported in the literature. These are important insights because they broaden awareness of the existence of new and important factors which lead firms to move from subcontracting to own brand manufacture and such findings were not previously stressed in the literature. The process was greatly dynamic, since we had to constantly go back and forth to verify the previously identified evidence against the emerging insights.

Categories	Offshore outsourcing relationship	Absorptive capacity	Catalysts	Inhibitors	Brand building triggers
Subcategories	Know-how	Poor knowledge	Know-how gained through the client	Lack of commercial knowledge	Crisis in the sector
	Learning	Qualified workforce	To hold a greater decision-making power	Additional costs	Firm's generational transition
	Training	Networks	Focus on long-term investment	Avoidance of potential conflicts with clients	
	Knowledge	Similarity between the structure and organizational practices of the provider	Client's volatility	Reliance on clients	
	Information		Financial crisis	To play it safe	
			Business expansion	Ethical issues	
			Own brand as major client	Legal contract	
			Governmental policies		
			Globalization		

+ referred  
↑  
- referred  
↓

Table 1. Coding resulting from the literature and empirical evidence

Source: own elaboration

It is necessary to enhance the new category and subcategories that have emerged from the analysis of firms that have created their own brand and those that have already been described in the literature review. Therefore, the following interpretations are given in order to provide a better vision of these new insights. However, a list containing a description of all categories and subcategories can be found in Appendix 1.

To hold a greater decision-making power: with own brand the providers are less dependent on the clients' rules and they could get benefits that only the own brand can offer. Clients' volatility: the providers argued that it is very difficult to foresee the clients' intentions and

foretell the moment when they will decide to no longer work with them in order to work with others. So, to escape from this volatility the providers decided to move to own brand manufacture. Business expansion: after providing for many years, the providers feel that they should expand their business because they are aware that working as providers is very reductive, and they mentioned the model of own brand as good way to reach that expansion. Own brand as major client: a great catalyst pointed out by the firms for creating their own brand is to take their own brand to be the firm's major client. Thus, it may be concluded that this factor is somehow related to others, namely, to have a greater decision-making power and avoid the clients' volatility, because when the own brand constitutes the firm's major client, the providers will have more control over their own business and, subsequently, they will not have to rely on clients' approval so often. Globalization: a few firms mentioned globalization as a motivation to create their own brand since this phenomenon incites firms to internationalize and compete fiercely and globally.

Brand building triggers: this category shows that there are specific moments during the firms' journey that catapult them to own brand manufacture. These triggers come outside the firms' scope and influence their general context. Even though firms had all conditions and catalysts to operate as own brand manufactures, without these triggers the process would be much lengthy. So these triggers precipitate the leap into the own brand building. From this category emerged two subcategories. Crisis in the sector: firms somehow anticipated that they would not go further just by working as contract manufacturers, and that led them to take a risk in their own brand manufacture. Firm's generational transition: the majority of the firms interviewed are composed by the owner's relatives, namely descendants who usually have a different vision and desire a different path. Thus, when this new generation takes the charge, they put into practice a new business model: own brand manufacture.

## **CONCLUSIONS, LIMITATIONS & FUTURE RESEARCH DIRECTIONS**

By a way of conclusion, a framework of analysis is proposed (Figure 1) that integrates the distinct contributions of relevant literature as well as this study's research findings. This framework shows that clients transfer knowledge to their providers who then may use it in their own brand. However, it is very important that firms develop their own absorptive capacity since it allows them to explore and incorporate that external knowledge. Numerous aspects operate as catalysts (know-how gained through the client; to hold a greater decision-making power; focus on long-term investment; client's volatility; financial crisis; business

expansion; own brand as major client; governmental policies and globalization) in firms pursuing brand building, but there are some inhibitors (lack of commercial knowledge; additional costs; avoidance of potential conflicts with clients; reliance on clients; to play it safe; ethical issues and legal contract) that might obstruct firms to follow that path. Finally, brand building is triggered by specific moments during the firms' routines. These triggers come outside the firms' scope and influence their general environment. Without these triggers the process would be much lengthier. Thus, they precipitate the own brand building process.

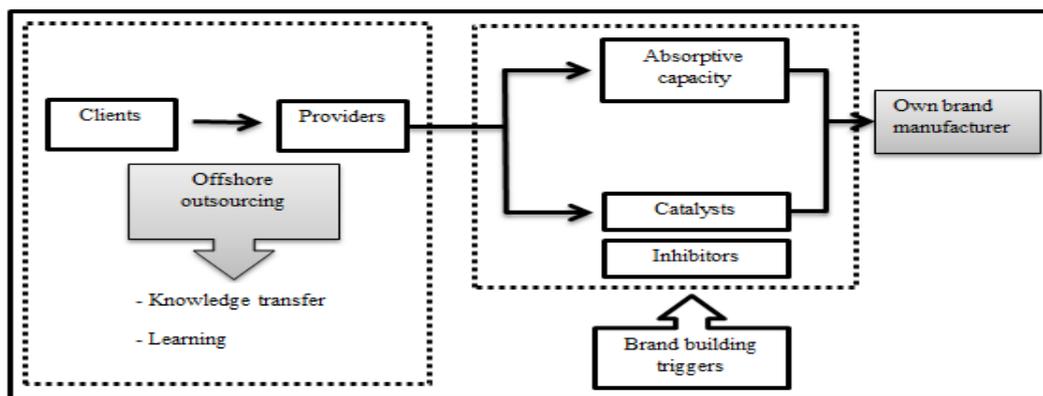


Figure 1. Providers' own brand building process

Source: own elaboration

The generic limitation of small sample subsists here. However, the strategy for case choice aimed to address this limitation. Moreover, qualitative research does not present much scope and potential as a qualitative research but it allows access to subtleties (Rosen, 1991) which enrich the theoretical field.

Some further research may be unlocked by studying different offshoring providers in Portugal among other industries, such as the traditional industries. The process could be reprised by conducting an exploratory approach in order to bring forward new results. Furthermore, another possible future research topic is the study of this process and comparing it to a sample of offshoring providers sharing the same macro-environment where own brand has not yet been created. In the course of this study, it has been noticed that most firms began by selling their own brand products across borders. Therefore, a new avenue for future research is the study of that action's influence on the firms' internationalization process.

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## Appendix 1. List of categories and subcategories with descriptions

		Support from the literature/Description	Reference
<b>Category</b>	Offshore outsourcing relationship	<p>It shows what clients transferred to providers during their relationship and, thus, what the providers gained with that relationship.</p> <p>The cooperation established between a client and a provider can benefit both agents and, moreover, offshore outsourcing is a method to achieve external and valuable knowledge</p>	Chen (2005); Jensen (2009)
<b>Subcategories</b>	Know-how Learning Training Knowledge Information	<p>Clients should transfer necessary know-how for providers in order to qualify them as certified providers</p> <p>The processes are closely monitored and training programs may cover the necessary information for the members to conduct the process efficiently</p> <p>During the entrepreneurial process, the actors become more interdependent relationships also become more flexible over time and “clients (offshorers) transfer informal ownership of the process to the provider (offshore)”</p>	Chen (2005); Li <i>et al.</i> , (2010)  Vivek <i>et al.</i> (2009)  Vivek <i>et al.</i> (2009, p. 28)
<b>Category</b>	Absorptive capacity	<p>To successfully obtain new knowledge from other companies, firms must command their ability to find, access, explore and incorporate external knowledge in the firm’s own operations.</p> <p>Absorptive capacity plays the role of a link between a firm’s intrinsic ability to bring forward newfound products and improve existing ones.</p> <p>All transferred knowledge through offshore outsourcing can be strategically used by providers to learn and develop their inner skills.</p> <p>Much depends on the company’s ability to recognize profitable modes of exploring its skills and absorb newfound knowledge.</p>	Forfás (2005)  Cohen and Levinthal, (1989)  Chen (2005)
<b>Subcategories</b>	Prior	Companies with advanced prior	Cohen and

	knowledge	knowledge, which embodies basic skills, shared language and/or own R&D produces, will be more capable of acquiring and using information from abroad because it will contribute to the recognition of the value of new information, assimilate it and apply it for commercial purposes.	Levinthal (1990)
	Qualified workforce	Absorptive capacity also depends on individual abilities and knowledge of the organizations employees and their absorptive capacity. Furthermore, studies evidence that when employees are endowed with training and acquire new skills, firms can evolve in their absorptive capacity.	Cohen and Levinthal (1990)
	Networks	Networks also play a significant role in developing the firm's absorptive capacity by conferring skills and processing competences that can promote acquisition, assimilation and exploitation of knowledge to build innovation.	Lane and Lubatkin, (1998); Lane <i>et al.</i> (2001); Jansen <i>et al.</i> (2005); Lane <i>et al.</i> (2006).
	Similarity between the structure and organizational practices of the provider	"The ability of a firm to learn from another firm is jointly determined by the relative characteristics of the two firms".	Lane and Lubatkin (1998, p. 473)

<b>Category</b>	Catalysts	It concerns the factors which foster companies to moving from contact manufacturing to own brand manufacture. Own brand building is required for the contract manufacturers that have the goal and ability to follow their growth target.	Liu <i>et al.</i> (2011)
<b>Subcategories</b>	Know-how gained through the client	As contract manufacturers have access to the clients' value resources, such as R&D and marketing, they will be able to develop their own capabilities which they may later use to create their own brand.	Arruñada and Vázquez (2006); Liu <i>et al.</i> (2008)
	To hold a greater decision-making	With own brand the providers are less dependent on the clients' rules and they could get benefits that only the own brand can offer.	Authors' insight

	power		
	Focus on long-term investment	Firms should focus more on long-term brand building rather than fix their attention on short-term profits.	Burmann and Zeplin (2005)
	Client's volatility	The providers argued that it is very difficult to foresee the clients' intentions and foretell the moment when they will decide to no longer work with them in order to work with others. So, to escape from this volatility the providers decide to move to own brand manufacturing.	Authors' insight
	Financial crisis	The current financial crisis and its dissemination to the global economy influenced the demand for foreign markets, which in turn affected contract manufacturing.	Haiyan (2011)
	Business expansion	After providing for many years, the providers feel that they should expand their business because they are aware that working as providers is very reductive, and they mentioned the model of own brand as a good way to reach that expansion.	Authors' insight
	Own brand as major client	It may be concluded that this factor is somehow related to others, namely, to have a greater decision-making power and avoid the clients' volatility, because when the own brand constitutes the firm's major client, the providers will have more control over their own business and, subsequently, they will not have to rely on clients' approval so often.	Authors' insight
	Governmental policies	Governmental policies may support firms in improving internal innovative competences and afford activities to develop brands with own intellectual property, which stimulate the providers in moving from subcontracting to own brand manufacturing.	Haiyan (2011)
	Globalization	A few firms mentioned globalization as a motivation to create their own brand since this phenomenon incites firms to internationalize and compete globally.	Author's insight

<b>Category</b>	Inhibitors	Factors that led firms thought to be inhibitors when deciding to start the own brand model. There are some factors which may prevent manufacturers from creating their own brand and remain as providers.	Haiyan (2011)
<b>Subcategories</b>	Lack of commercial knowledge	Own brand manufacturing requires the undertaking of value-adding activities such as design, branding building and strong technological and marketing ability. Firms possess the industrial know-how, but they do not have the commercial knowledge on the level of branding, marketing and design to create and maintain a brand.	Haiyan (2011)
	Additional costs	An inhibitor would lie on the additional costs (both financial and time).	Haiyan (2011)
	Avoidance of potential conflicts with clients	When the providers choose to have their own brand business they are somehow going against the clients' interests so that their customers may no longer pursue the collaboration with them and thus providers may ruin the relationship and spoil their clients' orders.	Liu <i>et al.</i> (2008)
	Reliance on clients	A risk of building a new brand occurs when there is a likely reliance on the client for product improvement and advanced technologies which lead the manufacturer to lose its ability to create and maintain a product advantage.	Li (2007); Li <i>et al.</i> (2010)
	To play it safe	When international demand is constant, firms prefer to remain as contract manufacturers so as to play it safe.	Haiyan (2011)
	Ethical issues	When the clients' commercial viability product depends on proprietary technology and processes, they need their providers to know their business well. Thus, clients should assure the providers' competence, currency of knowledge and good faith.	Arruñada and Vásquez (2006)

<b>Category</b>	Brand building triggers	It shows that there are specific moments during the firms' journey that catapult them to own brand manufacture. These triggers come outside the firms' scope and influence their general environment. Without these triggers the leap into the own brand model would be much slower.	Authors' insight
<b>Subcategories</b>	Crisis in the	Firms somehow anticipated that they	Authors'

	sector	would not go further just by working as contract manufacturers, and that led them to take a risk in their own brand manufacture. The majority of the firms interviewed are composed by the owner's relatives, namely descendants who usually have a different vision and desire a different path. Thus, when this new generation takes the charge, they put into practice a new business model: own brand manufacture.	insight
	Firm's generational transition		Authors' insight

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## **CROWDSOURCING FOR DUBAI APPAREL INDUSTRY- - MIRAGE OR A REALITY?**

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### **ABSTRACT**

‘Crowdsourcing’ is a unique operating model that utilizes the wisdom of a community by outsourcing a task originally performed by a designated professional, to an undefined but a large group of people, especially from an online community. Crowdsourcing has been used successfully for innovation, new product development and in fields like information technology, new venture financing, home furnishings and photography; however, it cannot be implemented for every business or in every geographical region. An organization faces the biggest challenge of flipping its business model upside down, with online community taking charge of process for continuous innovation and development from the owner. Outcomes could be less than satisfactory, if crowd is unable to provide right solutions within the stipulated time period.

Crowdsourcing can serve as means of distributed innovation for fashion design and development. Retailers could follow the “prosumer” concept wherein the members of an online community are buyers of the products developed by them.

This research aims to ascertain whether crowdsourcing model is applicable for Dubai’s apparel industry.

In- depth interviews with industry experts and local designers revealed their belief in the nascent model to be innovative, capable of creating a marketing buzz, suitable for short- term communication campaigns and for drawing a large online footfall. However, they expressed skepticism on the use of crowdsourcing as basis for their long- term marketing strategy. Designers agree that it is encouraging for budding talents to participate and express their creativity, however only in a vocational rather than a professional capacity.

Primary research was carried out to assess the relevance of this model for the apparel industry in Dubai. Univariate and multivariate analysis was performed on the data gathered and two major segments were identified - - each exhibiting different behavioral and psychographic characteristics.

Recommendations include initiatives towards capturing the interest of both the segments. While the luxury brands, which are exclusive in their approach, may not be able to adopt this model, many fast fashion and youthful brands could have varying level of benefits depending upon the crowdsourcing business practices adopted.

**Keywords:** crowdsourcing, online community, retail, technology innovation, strategic marketing

## **CROWDSOURCING: AN INTRODUCTION**

When Harvard Clinical & Translational Science Center (Harvard Catalyst) launched a contest to solve a tough computational biology problem to the crowd looking for solutions, skeptics may have smirked internally at the obnoxiousness of the idea. However, when the same crowd responded with viable solutions that were far more innovative and of high quality, the same lot of skeptics may have had to smother their smirks. Crowdsourcing attracted far superior and ingenuous solutions than what the in-house team of scientists was able to come up for the last fifteen years (Boudreau & Lakhani, 2013, p. 69).

While there are numerous examples citing how the power of crowd has benefitted organizations and institutions, there are some where this power has lost its leash. One such example is that of Technology, Entertainment & Design (TED) which is responsible for bringing content through conferences, now held across the globe. It was in one such conference where a fraudster actually got applauded for mere jargon connections on vorte x-based mathematics. It was widely criticized by the academics and professionals who knew about the subject. They were hugely appalled by the success of the conference and thereafter praises for the presenter who seemed to have no empirical evidence for his claims (Merchant, 2013, p. 79).

Crowd sourcing is a technique where the task originally performed by a specific set of individuals within an organization is now performed by the general crowd. The concept has evolved from "outsourcing" where the organizations give away the task to some other organization having required expertise. In this, the company gives away the task to an online

crowd in the form of “open call” to use their time, labor, creativity or experience. The company can source solutions from amateurs, volunteers or experts depending upon the nature of the task. “Crowd” participating in this is generally forms an online community. The crowd sifts through all the ideas or solutions and gives their preference for alternatives.

Then the “crowd sourcer”- the entity that put across the problem in the first place, owns these solutions and gives rewards to winning individuals. The award can be in the form of monetary reward, recognition or just appreciation. (Howe, 2008)

Steps involved in crowdsourcing are as follows:

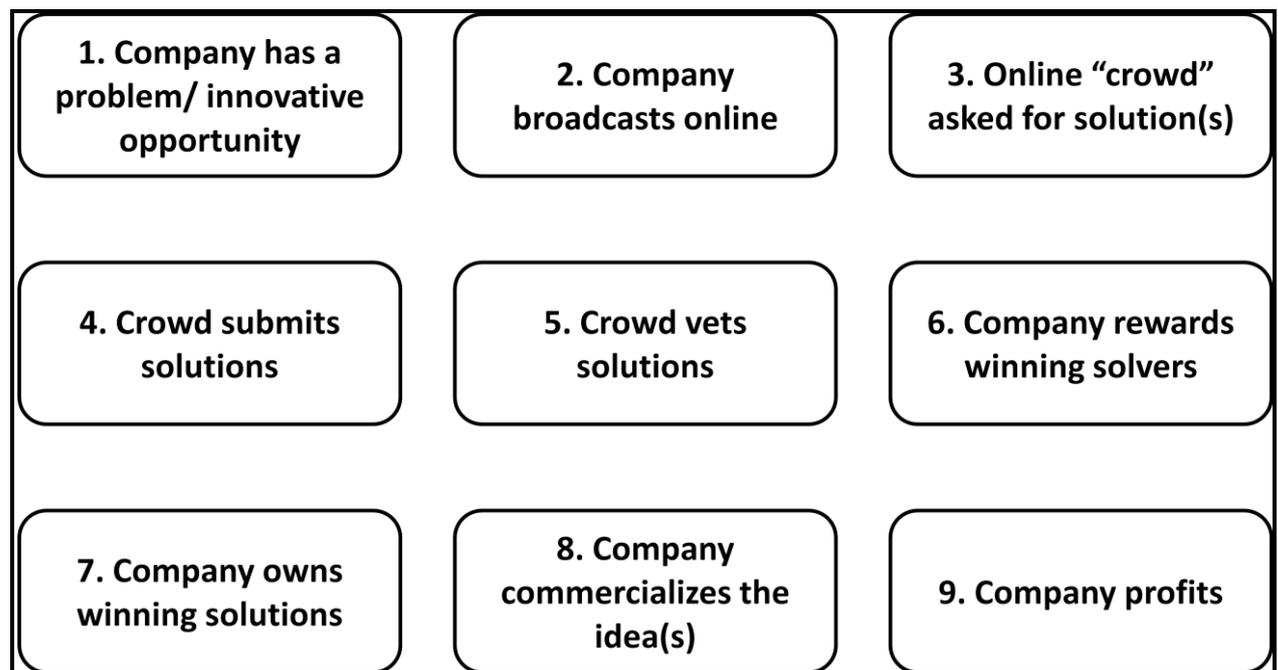


Fig. 1 Steps in Crowdsourcing; adapted by inserting Step 8 (Brabham, 2010)

#### *Crowd sourcing: World*

The term “crowd sourcing”, was first coined by “Jeff Howe” in his book “Why the power of crowd is driving the future of business” (2006).

It has been practiced for long with different organizations using it in different forms of business. Different software companies use this technique via a platform “Top Coder” to let different individuals design the algorithm to meet their programming specifications. (Gobble, 2012; Fried, 2012) Similarly furniture organization “made.com” uses this for getting the furniture designed, while advertising companies use this model for getting banners, posters and pamphlets designed. The market intelligence solution provider companies like “Chardiox” helps companies to set up crowd sourcing model for their businesses.

This model has proved beneficial for many organizations across variegated sectors. To name some- “Innocentive & Cambrian House” are software firms; “iStockphoto” is a unique photograph stocking organization from where one could buy professional images; “Trendwatching” is a consumer trend tracking consultancy; “NikeID” is the popular marketer of sneakers; “Threadless” which is a popular T-shirt crowdsourcing firm, based out of Chicago. (Anonymous, 2013)

#### *Crowd sourcing: Apparel*

Apparel retailers have also experimented and benefited from the crowdsourcing model. For retail organizations, this model helps them follow the “prosumer” concept wherein the crowd is the producer as well as the consumer of their products (Tapscott & Williams, 2008, p. 126). The “Threadless” was the first apparel company that started running its operations in year 2000 solely based on the crowd sourcing model. The company started with “T-shirts” and has expanded it to other products such as accessories, bags, iPod cases etc. Threadless gets more than 150 t-shirt designs and sells 15000 t-shirts every week. About 1.75 million visitors each month register in the company’s website. Threadless has become worth \$38 million dollar by just listening to the voice of the customer (Feitelberg, 2010).

So how does the model work? The company floats a theme every week and designers across the world put up their designs on that theme. The in-house team of the company selects the designs and put up the selected designs on the website for the “crowd” to vote. The voting process continues for a week with the top lot being filtered at every stage and moved to next. Finally, the designs are rated on a scale of 0-5 based on number of votes, comments posted and the internal team’s decision. This scoring serves as the decision point for the company to decide which design to be finally printed on the T-shirt and sold to the buyer community (Howe, 2008, p. 229).

Four primary motivators for participation at Threadless, which are equally true for other companies practicing this model for apparel, are the opportunity to make financial gains, to build creative skills, to take up freelance work, and for the love of community (Brabham, 2010).

Role of customers in crowd sourcing:

- The customers are more or less morally committed to the purchase of the most preferred design
- Customers initiate and take the responsibility for the advertising and attracting new customers

- The customers feel that they are part of the community and have great love for the community.
- Customers protect the company from any kind of activity of imitation or imitators, (hacking of website).

Following Threadless, many other organizations are practicing this model now. "Ink Fruit" uses this model for T-shirts, "Mod Cloth" for women dresses and "Sun Wrangler" for printed fabric. Wrangler has also recently come up with the launch of "Next Blue" to get ideas from crowd for designing of their new jeans. "Jo Bedu", a Jordan based organization, founded in 2007 is implementing crowd sourcing model to promote Arab designers. They use this for designing T-shirts and other apparels. T-shirts are generally designed with funny Arabic slogans and common slangs that have made them popular around the world.

However, crowd sourcing model cannot be implemented for every business. The major challenge being that this requires organizations to flip the business upside down. The community takes charge from the owner and owner does not have control over the things if the crowd is not able to provide right solutions in the stipulated time period. Also, people may not like to participate for every product and so this model can only be used for businesses which can entice consumers (Caulfield, 2009).

## **DUBAI: AN OVERVIEW**

Dubai is a cosmopolitan city with more than 200 nationalities. Every year, an increasing number of expatriates decide to make Dubai their home. The population of Dubai is currently 2.1 million, and has grown by 5% from 2012 (Al- Attasi, 2013). The female to male gender ratio of the population is approximately 1:3 (Population by Sex- Emirate of Dubai, 2013).

Institute of International Finance has projected UAE's GDP to grow at 3.6% which is a slight lull compared to the estimated growth of 4.8% from last year, owing mostly to the lower crude oil prices (Augustine, 2013).

### *Dubai Retail Industry: A focus on apparel*

As per Alpen Capital, UAE's retail sales are expected to witness a growth of 5-7 percent growth by 2016 (Anonymous, UAE retail sales to grow 7% by 2016: study, 2013).

Strong growth trends in retail are owing to the economic resurrection, high consumer confidence owing to high household spending, and growing acceptance of modern retailing concepts and expatriate wealth. Average household spending power/ or disposable income in

the UAE stands at \$14,400 per annum, as per property consultant Colliers International. Emirati households account for the lion's share of this spending with an average of \$23,000, while Western, other Arab and Asian households have annual spending power of \$19,500, \$13,500 and \$10,000 respectively. A.T. Kearney's 2011 Retail Apparel Index found that the UAE had the highest fashion clothing sales per capita per annum in the developing world, at \$785. The report attributed its success to 'high disposable income and immense fashion consciousness'. Dubai was a hub for major retailers and attracted a mixed assortment of value-oriented, fast-fashion, premium & luxury brands (Anonymous, UAE's retail sales to touch AED 151bn by 2015, 2013).

Interesting aspect is that non-store based retailing is also gaining momentum. The current contribution of internet sales is one percent of the total apparel market which is about USD5.4 billion. As per a report on Euromonitor, internet apparel has grown by 66 percent in 2012. Customers seem to be warming up to the idea of buying apparel online. Two key factors contributing to this phenomenon seems to be high internet penetration rates and security over online payments through credit/ debit cards (Potts, 2013).

#### *Crowd sourcing: Relevance for Apparel in Dubai*

The garments that people wear are a reflection of their individuality, identity, interpersonal position, culture and place they live in. T-shirts form an essential part of the wardrobe of people of all age group and gender. People like to wear T-shirt for various occasions like leisure, work, and routine lifestyle. T-shirts are very popular with people of all age group and many organizations are incorporating these as work wear. Dubai is located in the tropical area of the Middle East where T-shirts are one of the most preferred garments.

The T-Shirt being a fast moving garment type is very easy to manufacture and design. This is a very experiential garment where designers can creatively design different styles and select a wide range of colours. Also this garment can be worn for various purposes irrespective of gender and age which makes it even more. This is a type of garment where the crowd can easily use a template, design and creatively come up with unique designs for the crowd. T-shirts comes in fixed sizes and there are minimal fitting issues as compared to other garments categories. T-shirts require less lead time to manufacture and it enables to manufacture to come up with various collections frequently.

### *Problem Definition*

The fashion industry faces huge challenges with its supply chain, making it difficult to carry out adequate demand planning and forecasting. Most of these challenges arise during the product development lifecycle. It is difficult to sustain any brand in an industry where consumer preferences change at a rapid pace. As a result, the brands and designers face challenge in forecasting correctly. The long lead time explodes this problem with the merchandise being ordered long before the start of the next season. Adopting a business model that can involve consumers in the early phase of designing and manufacturing could resolve some of these problems (Bonabeau, 2009).

### *Objective*

The objective of the research was to understand whether crowdsourcing as a model would be acceptable in Dubai apparel industry. Also, we hypothesize that this model could be useful for only the casual category of apparel due to inherent design features and limitations of the model.

### *Sampling & Methodology*

Primary Research was done in two phases- qualitative and quantitative. Qualitative Research included in- depth interviews with experts (retailers- prospective and actual implementers of the model, and designers) and prospective participants in a crowdsourcing model format. Subsequently, a survey questionnaire was designed for capturing insights of the prospects. Non-probabilistic convenience sampling was employed. Survey respondents were at least 15 years of age and residents of Dubai.

### *Qualitative Research: Crowd speaks*

As a part of exploratory research, open ended questions were posed to ten people of various age groups and nationalities. This discussion with the respondents was done to understand their perception towards this model and to firm up the design of the survey questionnaire. Questions captured buying behavior towards T-shirts, satisfaction level of designs, openness to design competitions, trust in crowd's ability, trust in crowd's creativity, online shopping behavior and internet surfing. We found out that all of them used internet for leisure and the number of hours varied from 30 minutes to 5 hours. Most of them posted some form of content online and few of them participated in online competitions. The major drivers of participation appeared to be money, fame and interest. Friends had a certain degree of

influence on the participation levels. The people sought good designs irrespective of who the designer is and many were ready to wait for unique designs, with waiting period varying from a day to six months. While many felt that crowd does not have much potential, others felt that this model could tap hidden talent of the crowd.

Willingness to wait for a design was high if the brands were one of their favourites.

#### *Findings: Quantitative*

A close-ended questionnaire was administered to a sample size of 102 respondents. Factor analysis was performed on the key attributes identified. Extraction of factors was done using Principal Component Analysis. Rotation Method was varimax with Kaiser Normalization, with a Kaiser-Meyer-Olkin measure of sampling adequacy of 0.625 and significance < 0.05 (.000).

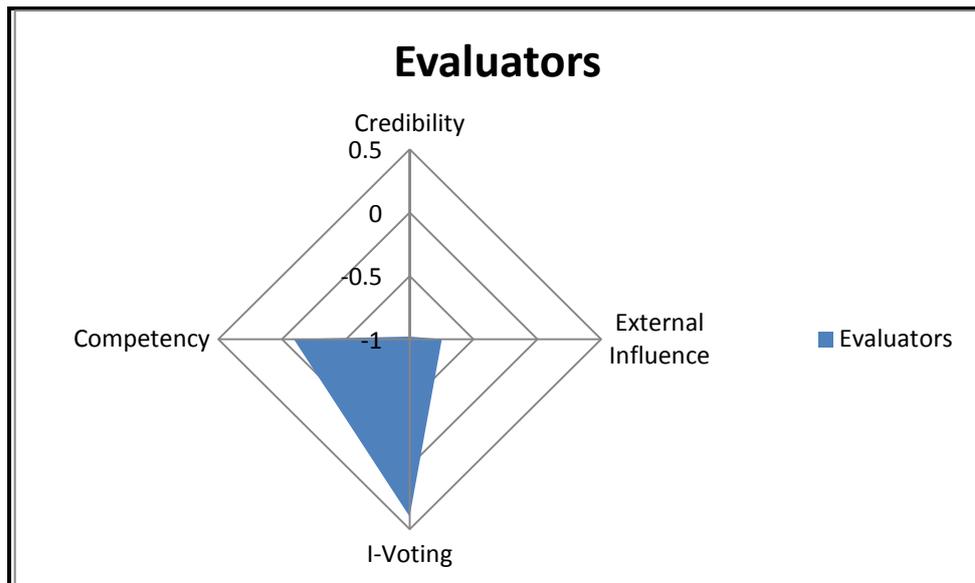
In the table below the rotated factors are presented:

Rotated Component Matrix				
Attributes	Credibility	External Influence	I-Voting	Competency
Crowd has the skills to assess the designs	0.773			
Posting designs online is a good idea	0.685			
Designs posted by crowd are of good quality	0.576			
Content on blogs is credible	0.474			
Participate if the brand is known		0.785		
Negative opinion of the crowd affects creativity		0.740		
Like to vote for apparel online			0.834	
People's votes would influence buying decision			0.661	
Creativity of the designs posted during competition				0.851
Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.				

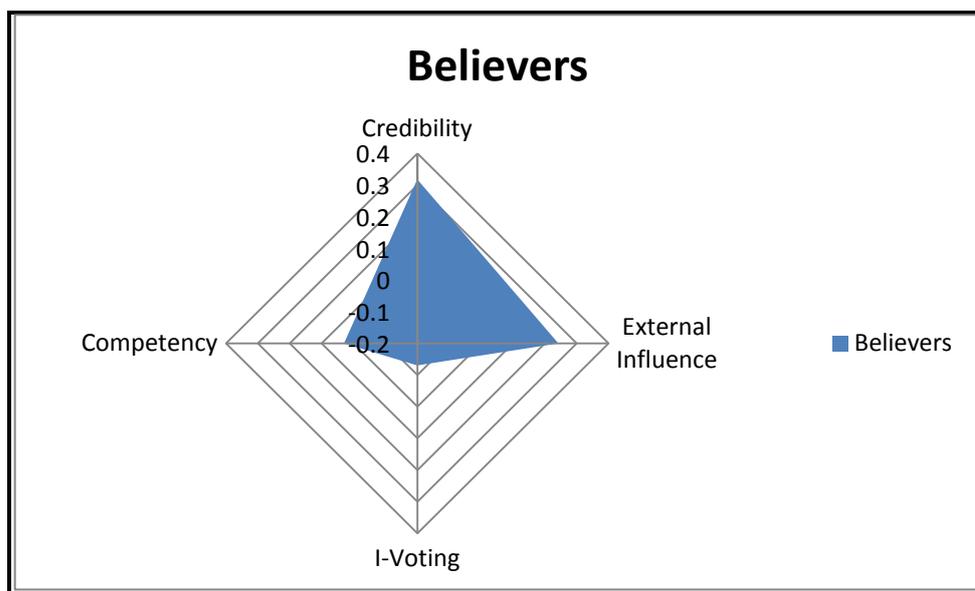
**Fig. 2 Factor Analysis**

The final rotated component matrix yielded four factors namely- credibility, external influence, I- voting, and competency.

Next, a cluster analysis was performed using K- means cluster technique. Two distinct clusters namely *Evaluators* and *Believers* were identified. 25 cases fell in the first cluster- Evaluators; while 77 respondents were pulled towards the second cluster- Believers. Following are the radar diagrams depicting their perceptions:



**Fig. 3 (a) Cluster 1: Evaluators**



**Fig. 3 (b) Cluster 2: Believers**

As shown in the figure 3(a), “Evaluators” were heavily skewed towards Competency and I-Voting factors.

I- Voting factor represents the fact that these people like to vote for apparels and their shopping behavior get influenced by other people’s voting. Also these people believe that the creativity of T-shirts designed during a design competition is good. However, they do not have the trust in the crowdsourcing model. They do not consider posting designs online to be a very good idea and do not think that the crowd has the required skills to assess their design,

if they would post any. They were also concerned regarding the quality of T-shirts designed in such competitions.

From Fig. 3(b), we observe that segment “Believers” consider this business model to be highly credible; however, they do get impacted by external influence. It shows people in this segment consider posting designs online a very good idea. They have belief in the ability of the crowd to assess their designs and they are also satisfied with the quality of the T-shirts. However, these people feel that the content written on blogs is not very credible and that their own creativity may get hampered by the negative feedback received from the crowd. Also, these people are more willing to participate in the crowd sourcing model as buyer, voter or designer if the brand carrying out such model is known to them.

The profile of the segments was collated through cross- tabulation analysis:

Profile Attributes	Evaluators	Believers
If the model is implemented, would predominantly participate as:	Voters	Designers
No. of t- shirts bought in a month from a store	3	2
No. of hours spent on the internet for leisure	2-4 hrs	1-2 hrs
Influence of friends motivates me to participate in online competitions	disagree to indifferent	agree to strongly agree
Age- group	25- 40 yrs	15- 25 yrs
Nationality	UAE nationals and Expat Arabs	Expat Asians and Westerners
Profession	Predominantly students	Predominantly young professionals (included amateur designers)

**Fig. 4 Segment profile**

#### *Recommendations for Believers*

Since the “believers” have more trust in this model and constitutes more respondents, retailers should focus on them first. Initiatives recommended are:

**Building strong brand image:** This segment’s allegiance to their favourite brands is strong and their participation levels could be enhanced, if the leading and popular brands engaged them innovatively in a regular fashion.

**Curb negative comments on blogs:** This segment is affected strongly by external influential factors. They believe they may not be able to justify their creative skills if the negative opinion about their designs is posted on the blogs. They have a fear of social evaluation and the company needs to address that. The company may keep a check on the blogs and regularly monitor and address undesirable comments towards individual designs (Shao, Shi, Xu, & Liu, 2012).

**Designer’s label:** Since the designers are more inclined towards recognition as compared to reward, it is important for the retailers to cater to this desire. An alternative is to put designers’ labels on T-shirts. This would encourage designers to participate more actively for fame (Wagner, 2011).

#### *Recommendations for Evaluators*

In order to address their concerns and engage them as part of the business model, we believe that the company needs to take the following steps:

**Right Communication:** Crowdsourcing model is fairly new to Dubai and most Arabs have not heard it before. Therefore, it is very important for the company to spread awareness about this innovative concept amongst the local and expat Arabs. Their apprehensions regarding this new model, if addressed effectively, would motivate people to participate more actively (Degen, 2010).

**Distributed Decision Making:** The people feel that the crowd may be biased while voting such that deserving designs may not win. Ensuring transparency and fairness in the design evaluation process would bolster people’s trust in the organization & process. Thus, decision making for choosing the winning design could consider both people’s vote as well as internal design team’s input (Wexlar, 2011).

**Quality of T-shirts:** People’s doubt in the quality of the T-shirts manufactured could be eliminated by keeping the suppliers, partners and other intermediaries involved in the operation process. This would ensure in solving technical issues in producing varied designs posted by the crowd.

**Hybrid Model:** It has been observed during qualitative interviews that Arab people in Dubai are more comfortable in buying clothes in the stores. Therefore, the company should use the

hybrid model in which the designs are posted and evaluated online to get more participation from the crowd and fast track the whole process. However, final merchandise, apart from being sold online, could be made available in retail outlets as well.

## **EXPERT OPINIONS**

One is willing to participate and buy through this model but distraction to buy from malls and regular concepts exists. To validate, we have indulged in discussions with few more retailers. A set of open-ended questions were asked to industry experts to understand the trends of Dubai apparel industry and gauge their opinion about the crowd-sourcing model. Key findings were recorded as follows:

As per the CEO of Ink Fruits Ltd- Mr. Kashyap Dalal, building the community of first ten thousand users was the most challenging task for the company. It took them around two years to do so after which the ride has been quite smooth with the community itself promoting the brand. Tying up with design schools has opened new doors for the company to get more participation as well as fresh and unique designs. The company ensures that the most deserving designs win in the competition by gaining crowds' consensus. Ink fruit, unlike many other organizations implementing this model, have an internal expert team participating in the final decision making, making the model highly transparent and credible. Ink Fruit gets over 100 designs every week through this model which, if designed by a team of 4-5 designers may not be completely relevant.

According Mr. Bharatesh Suvarna, General Manager-Operations of Splash Gulf- a fast fashion apparel brand, there are different segments of customers in the UAE market. While this creates huge opportunity for the brands, it becomes a challenge for the designers to design for each segment separately. The brands have to constantly find and develop new talents that can fulfill the fashion needs of the various market segments. There is always a need to develop unique designs that reflect modernity and Arab cultural heritage. The market here is futuristic and consists of educated people who have high disposable income, time and opportunities to do so. Therefore, the people are attracted to shopping and spend most of their leisure time in the malls. Dubai being a multicultural land has evolved its fashion industry from both east and the west attracting many established and upcoming fashion brands. Dubai is a fashion hub for many talented designers to showcase their designs. It's a land of fusion and authentic designs where the designers get the opportunity to showcase

their unique designs. Many designers from across the globe are making Dubai as home to design business.

An executive from Orient Craft Ltd. (India)- Ms. Shweta Kanwar, who manufactures merchandise for top apparel brands in Dubai believes that crowdsourcing could be a great platform for upcoming designers who don't have resources and are seeking recognition. However, established designers may not invest their time in this model. This model was more about passion for designing and recognition and depended a lot on the personality of the designer. The main concern that troubles designers is the threat to their Intellectual Property (IP) by engaging in this online activity. If the threat of losing Intellectual Property can be eradicated, more number of designers would be willing to participate in this model (Wexlar, 2011).

Crowd sourcing model is not a new concept for Splash Gulf. Their popular "Back to School Campaign" has invited designs from school children and winning designs were chosen for production and commercialization. They have also run this promotional activity in Dubai International Academic City where they displayed certain designs and students were asked to vote for their favourite designs. Highest voted designs were showcased in their stores for sales.

As per the Marketing manager of Rivoli Fashion Group, Mr. Kunal Kapoor, they have a dedicated team of in-house designers who conceptualize designs based on the fashion trends and show feedbacks. They have their own business model and don't feel that this model would be of much value to them. On the contrary, General Manager-Buying and Operations of Maxx Group, Mr. Sanjeev Matharu is excited about the model and believes that it could be a great platform for upcoming brands to build their business. However, conventional brands would prefer to use this as a below the line marketing exercise.

#### *Research Limitation*

One of the key limitations was the low awareness about crowdsourcing model amongst the crowd, thus the research was restricted to an exploratory phase.

Companies who have implemented the crowd sourcing model did not reveal the costs incurred during each stage of crowd sourcing. This has made carrying out a cost- benefit analysis of the model difficult. The sample size could have been larger and respondents chosen in a random basis

#### *Way Forward*

The crowdsourcing model offers enormous opportunity to engage the prospects on line. It offers an innovative format for building the brand and generating revenues. However, a company should exercise caution by ensuring its acceptance for its business and the market (Schweitzer, Buchinger, Gassman, & Obrist, 2012).

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## **A GROUNDED THEORY OF PERPETUAL RATIFYING. PUTTING LIFELONG LEARNING STRATEGIES INTO PRACTICE FOR BUSINESS COMPETITIVENESS**

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### **ABSTRACT**

The European Commission Lifelong Learning Programme has a target of involving over 6 million people in skills development and improving employment prospects. This foundation contributes to economic success and business competitiveness. Business leaders appreciate the strategic importance of lifelong learning initiatives within the workforce.

Businesses based in north east wales provided empirical data to develop a grounded theory which establishes what learning initiatives are utilised and in differing circumstance to resolve competitive concerns. An overview of the theory is presented.

Diverse business issues identify learning as being beneficial for on-going competitiveness. Three categories of learning are identified in the study; education, training and experience. The phrase 'once is not enough' indicates repetition and the perpetual nature of learning that in most situations requires verification.

The grounded theory of perpetual ratifying establishes the circumstances in which the selection of a learning approach is made and draws out the benefits derived from the learning. Business education leaders are urged to consider a move from subject specialisms to a more integrative approach that better reflects the nature of 21<sup>st</sup> century business environments and practices.

**Keywords:** lifelong learning; education; training, experience; dynamic capabilities; grounded theory

## INTRODUCTION

The European Commission for Education and Training allocated a budget of €7 billion for the period 2007-2013 (ec.europa.eu) as lifelong learning is a priority objective for the European Union and viewed as key to economic success. To establish ways in which private sector business draws on various educating practices and outcomes a grounded theory is developed in order to identify how concerns are resolved related to the maintenance of a competitive position.

In accord with grounded theory practice the paper is structured with the methodology as the first section, followed in sequence with the research findings, the conceptual framework leads to a discussion of the findings before commenting on areas for further research.

## METHODOLOGY

The methodology used in this study is classic grounded theory; the procedure is briefly reviewed and is followed by details of the sampling techniques utilised for the study.

Classic grounded theory is a general method of comparative analysis (Glaser and Strauss 1967) to fit an empirical situation and involves the discovery of theory from data which has been systematically obtained with a view to predicting and explaining behaviour. The approach is inductive and the analysis infers that the predictable patterns observed in the sample hold true (Nathaniel and Andreus 2010) for the others in a similar situation.

A grounded theory is developed from a series of conceptual analyses of empirical materials (Denzin and Lincoln 2013). The first stage in the generation of a grounded theory is the collection of data in the field by holding conversations about the central concern of the study. The data is then subject to the open coding process which breaks down the data in a line by line manner (Hernandez 2009) and identifies initial codes. Using gerunds is an effective method when coding as they suggest implicit actions (Charmez 2013) and provide linkages.

Following each data collection exercise memos are written to assist in keeping track of emerging ideas and connections (Roderick 2010). Constant comparison, which is deceptively powerful (Urquhart 2013) is also a repetitive exercise and consists of identifying similarities between incidents occurring in sequential data sets and enables nuances and meaning to be reviewed as theoretical categories are developed. A framework is shaped from the data

consisting of categories, which are conceptual elements of the theory (Glaser and Strauss 1967) and they are supported by the properties which contribute to a category.

Coding and constant comparison leads to a core category emerging that is identified as a central resolution around which other concerns revolve. At this stage workability is sought through theoretical sampling. Theoretical sampling is the response to querying where to turn to next in the data collection (Glaser and Strauss 1967) which refines and elaborates emergent categories. Pertinent data is sought; the process is deliberate (Morse 2007). Selective coding enables the data to achieve saturation, a state when there is an absence of new categories when additional data is collected (Green 2012) leading to empirical confidence and prevention of wasted additional data.

Memos are the foundation of grounded theory, without them there could be no grounded theory (Sandgren 2011). There is no prescribed format but they should contain sufficient identification to enable sorting in order to establish relationships and form the previously unwritten rules from which the new grounded theory is deciphered and written up.

A know nothing approach at the outset of a grounded theory utilises the perspective of those involved (Binsardi and Green 2012) to gain understanding. The literature is consulted following the data collection and analysis to provide additional theoretical insights.

## **SAMPLING**

In order to establish concerns related to learning practices that link with business competitiveness pre-scheduled conversations were held with nine private sector managers throughout January 2013 who had a concern regarding the level and validity of organizational learning in a variety of situations. A sample of this size is in accord with 'social units of any size, large or small, ranging from men or their roles to nations or world regions' (Glaser and Strauss 1967:21-22). Initial conversations lasted approximately one hour. Four respondents provided follow-up data in order to achieve saturation; this required a sequence of conversations lasting for approximately 30-minutes each. This medium enabled the collection of empirical data to identify ways in which resolutions were sought and achieved. Several scenarios are presented and educating practices to acquire new knowledge were implemented in order to retain a competitive advantage and performance levels, they are listed in table 1 below. The unit of analysis is the organization.

Interview	Factor
1	Customer and supplier requirements – business continuity
2	New and amended legislation – change in process or procedure
3	Succession planning – anticipating personnel changes
4	New technology and upgrades – process amendments
5	Identification of skill and/or performance gap
6	Mergers and acquisitions – extensive and far reaching changes
7	New Products/ product updates – knowledge extensions
8	Organizational changes – structures, processes and personnel
9	New recruits / staff turnover – knowledge gaps

**Table 1: Factors where learning initiatives are required for business competitiveness**

## GROUNDING THEORY OF PERPETUAL RATIFYING

The grounded theory of perpetual ratifying was generated from data provided in response to concerns related to the use and application of lifelong learning strategies in the maintenance of business competitiveness. Verifiable learning varied from being crucial and essential with a short-term urgency through to an identifiable strategic aim for the medium to longer term progression and development of the organization.

A data extract illustrates a positive selection bias towards individuals with evidence of learning related activities:

*“I prefer to take on staff with some fairly recent pdp on their cv; they have a different outlook on life and work, they are more positive and involved in their career, they are looking to improve.”*

Reference to the outlook of individuals taking part in learning opportunities supports the theory that they contribute to business competitiveness in a more proactive manner than individuals who neglect this aspect of their career.

Data was subject to line by line coding using a gerund style to retain a focus on the present that patterns out into three distinct sub-categories related to learning: education, training and experience. Depending on the organizational learning driver, the approach to closing the identified gap varied and in some instances drew on differing styles and ways of learning. It was immediately evident that there is a requirement to search beyond the term learning in order to saturate the data and consider the concepts linked to the act of learning that occur

outside the confines of compulsory education. There is one additional sub-category for the notion of lifelong.

## EDUCATION

*“Education paints a picture about a person – they can see projects through to completion.”*

Education is valued as a contributor for both current and future options and assists in the removal of role limitations and career ceilings. Completion of an educational programme results in permanent verification through the credentials acquired. Respondents acknowledge increased confidence, a development of social senses, personal status, authority and credibility. Beyond the visible traits the data also acknowledges the personal striving and internal desire to improve that drives individuals into post-compulsory education. These traits have value to the business manager and are frequently drawn on during the routine undertaking of tasks making up a work-place role. In addition, individuals demonstrate an increased propensity to undertake diagnostics and gain additional insight into prevailing issues. Judgement is evident in order to propose solutions that may not be immediately apparent and require tenacity to implement successfully.

This approach to learning was utilised by the respondents as a support in several areas. They include succession planning, closing sector or organization-wide skill gaps, for selected new recruits and existing people with the potential to develop when transformational change was anticipated. The respondents point out that there is a clear expectation that the organizational problems are used as examples during the learning programme so that a proportion of the time spent is conceived as having direct benefit as the learner, in effect, is able to operate in the informal capacity of an internal consultant. This element is identified in the data as payback.

## TRAINING

*“the training we’ve done related to work roles has been crucial to the business success”*

Training as a learning method is utilised for different purposes and outcomes which are more targeted, focused and short-term than education. They are mainly operational and routine; a data extract refers to training as being a lubricant that provides a smooth pathway for the organizational processes.

Induction provides the first layer of procedural training, followed by specific and role-related skills acquisition, gap training and instruction in order to reach a minimum standard of performance. At this stage the concerns are preparation and practise in order to become proficient through familiarisation and repetition.

Following mergers and acquisitions various forms of training are carried out to enable integration and a consistent approach to be presented by the newly created organization. Training is viewed as an investment by the employer and a sense of being valued by the employee. The process initiates new groupings and linkages between those taking part that endure beyond the formal training programme and serve to strengthen the emerging culture.

In addition training needs become apparent when there is a requirement to validate or assure processes and practices and business continuity is sought. Examples of this type of training include legislation changes that may prevent or restrict individuals practising when certification becomes compulsory. The need for an organization to achieve an ISO standard or sector specific certification is only obtainable via accredited and certifiable training. This takes place in a structured manner, is delivered by qualified individuals and there is a requirement to maintain a high level of attendance prior to the assessment processes to provide measures of achievement that match a specified standard.

As a learning method training is viewed as being developmental at both the individual and organizational level. It contributes to the reputation of the organization in a positive manner via improved practices and therefore supports the wider competitive position through the accumulation of training evidence.

## **EXPERIENCING**

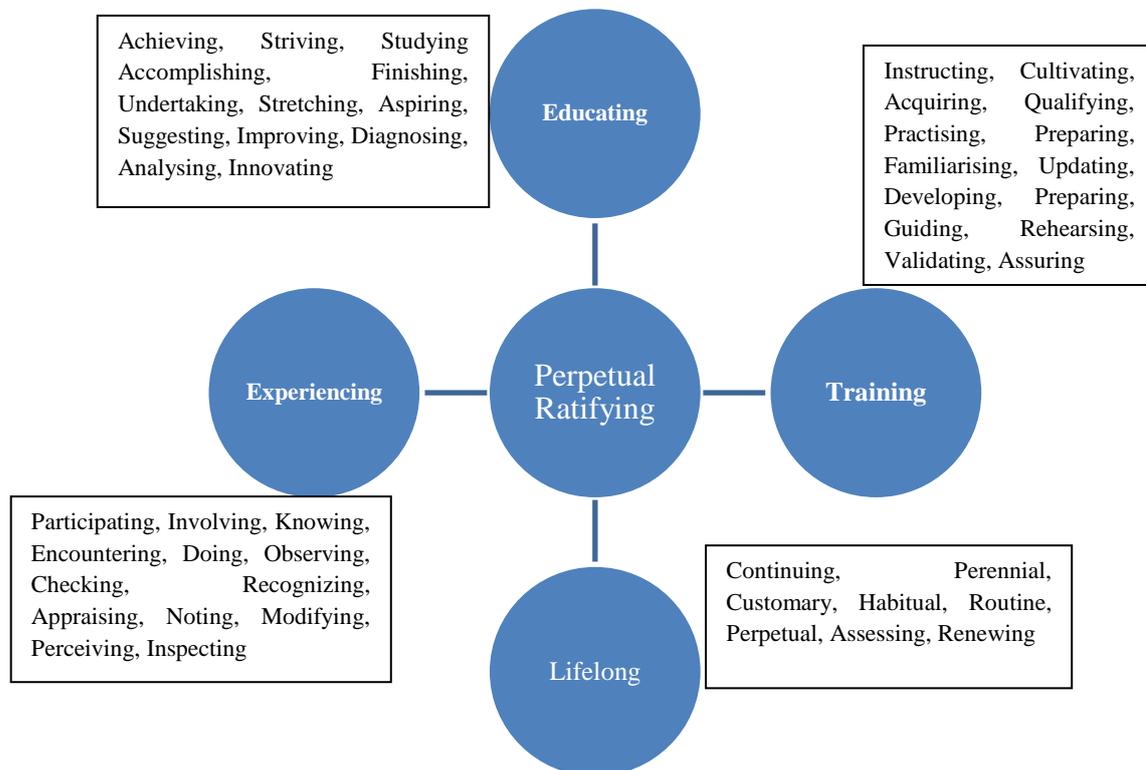
*“don't underestimate the University of Life, that is very important, being able to get a message across in a way that is understood”*

In some instances where competitiveness is challenged, such as change, drawing on learning acquired in previous situations proves to be of great value. This type of learning is utilised in assessing the use and application of resources and recalls successes and failures to consider either repetition or adaptation for the new change. The skills of reflection based on observations, insight and earlier experiences are cited in the data as being of particular

relevance and importance when evaluating a contextual scenario and reaching decisions that will impact on the future.

All the respondents refer to updating, that learning once is unlikely to be sufficient in an era of shortening product life cycles and an increasing dependency on technology that is described as being in a state of continual change. These examples reflect the dynamic nature of the 21<sup>st</sup> century business environment where job changes and a moving goal post for retirement are additional challenges.

The data makes reference to being dropped in and shovelled in to situations, particularly when they are unexpected, as being the only way to learn. Thinking time when problems arise is also highly valued and the ability to handle the range of emotions that may surface when a competitive challenge is being addressed.



**Figure 1: The Grounded Theory of Perpetual Ratifying**

## LIFELONG

Unstable business environments require adaptive practices, learning is no longer a one-off process. The data refers to assessments of skill bases that are integrated into strategic and

operational routines to ensure that learning is assessed on a frequent basis and renewed where outcomes dictate.

The core category which conceptualises lifelong learning is Perpetual Ratifying and consists of a diverse range of properties which illustrate the scope, depth and patterns within the data contributing to each of the four categories. Several indicators are readily transferable and demonstrate the modifiability of grounded theory.

## **CONCEPTUAL FRAMEWORK**

A brief review of studies related to aspects of competitiveness, learning approaches, styles and methods makes up the first part of the conceptual framework. This is integrated with specific business approaches that draw on the value of learning to enhance competitiveness and also considers the relevance of business education.

## **COMPETITIVENESS**

According to Cheung and Chan (2011) a well-developed competitiveness motive is a means of demonstrating superior capacity that requires different strategies to retain. The strategies require opportunities to engage in learning activities. This enables the acquisition of new knowledge and skills to demonstrate competency that occurs through training. Advancement is achieved through mastery as the human capital of an organization improves.

## **LEARNING**

Learning “refers to significant changes in capability, understanding, knowledge, practices, attitudes or values” (Coffield 2008:7) and concludes as a change resulting from the participation in some form of competence development programme (Kock and Ellström 2010:76). Lifelong learning is “to be viewed as something individuals undertake at all levels and ages in the workforce throughout their working lives” (Ahlgren and Engel 2011:333).

Educing is defined as “to hone individual skills and competencies” (Prestoungrange 2000:231). It is also a practice that draws on the lessons learned from one tradition to strengthen another (Withers 1995:4) and alludes to the practices of integration and cross-

functionalisation that have increasing relevance for the 21<sup>st</sup> century organizational structure and economic environment. Educing is not a widely used term; however at a conceptual level it captures the essence of education, training and experience by way of encompassing the aims of these learning approaches through formal, vocational and life perspectives.

## EDUCATING

Österberg (2004) identified a continuous need for learning due to market-based forces that drive change and result in a constant need for knowledge renewal. Galpin and Skinner (2004) researched the achievement motivation of high flyers, which they define as people aiming for senior management and anyone who is able to make a unique contribution to the future of the organisation. One of the dimensions in the study is mastery, which revealed the greatest difference between high flyers the general population, therefore demonstrating a benefit of business education and overall performance. Mastery is beyond competence (Senge 1990) and is achieved by continuous learning, it is a process.

A prevailing core element of 21<sup>st</sup> century business education is to support business activity via the enabling of individuals through knowledge acquisition. This underpins actions that are conducted in a manner that will achieve high self and corporate performance levels through focusing on job-related performance behaviours (Anninos and Chytiris 2011; Krishnan 2008). The interface through which this takes place is a transfer of knowledge to the receiver from the holder (Elmuti 2004) through diffusion.

However the specialist approach of business schools is criticised by Seetharaju (2012) as failing to adopt cross-disciplinary education in a process centric world of work where employability skills are increasingly based on process-based procedures. In order to achieve competitive advantage resources should be reconfigured into dynamic capabilities (Chien and Tsai 2012). Knowledge and learning mechanisms influence dynamic capabilities through the procedures of obtaining and absorbing knowledge that is relevant to the current environmental issues facing an organization. The learning and application require the presence of an intervention process that results in practical business application. This achieves a state of dynamic capability that is supported by mixing internal knowledge with other new domains located elsewhere (Hawass 2010) to support the required reconfiguration.

In order to close the gap between education and business Jones and Iredale (2010) propose an enterprise education pedagogy that supports work-related learning and in so doing brings

greater links between business and education through effective collaboration and increases student's awareness of the world of work. Maximum opportunities to enhance enterprising skills are developed in the expectation that they will be utilised, deployed and developed at a future point, whatever the career choice may be.

## **TRAINING**

The term training is defined as "an activity that changes people's behaviour" Ghosh, Joshi, Satyawadi, Mukherjee and Ranjan (2011: 248). However this is acknowledged as being somewhat simplistic and also incorporates enhancing individual job performance through a planned intervention (Chiaburu and Teklead 2005) and the facilitation of employees' learning of job-related competencies that include knowledge, skills or behaviours that are critical for job performance at a successful level (Noe 2009). Effective training requires a blending of organizational and individual development to support the pursuit of growth.

The outcome of training results in the improved application of day to day workplace activities through enhanced performance. Within the training literature there is a focus on the development of competencies in order to achieve improved job performance, these are individual level competences. Competencies are demonstrable characteristics of a person that enable performance and effectiveness with a certain position. They entail knowledge, skills and behaviours that facilitate employees to efficiently perform (Dessler 2009).

Kalargyrou and Woods (2011) consider trainer competencies as being a crucial aspect of successful training as employees often perceive training with scepticism because they have an impression that they need to participate in training to fix some aspect of their role. In order to overcome this view trainers need to provide trainees with good reasons about why the training is required. These requirements may stem from economic reasons linked to promotion or the personal satisfaction derived from learning.

Fix something training is a gap approach based on the identification of what is wrong or missing altogether and does not function well. There is a deficit between the desired situation and the current position (Govaerts, Kyndt, Dochy and Baert 2011:38). To move away from the more traditional gap approach, consideration of the appreciative approach is suggested. This is person-oriented and is centred round finding and enhancing solutions that are closely aligned with the qualities and ambitions that are improved through work-place learning.

## EXPERIENCING

According to Pavlica, Holman and Thorpe (1998) the process of learning in the university of life is not without its problems and this is addressed through the use of experiential learning theory. By adopting this approach, the learning outcome is 'most effective when it is grounded in everyday life, directed and controlled by the learner, rooted in a person's work experiences and has an obvious meaning for them' (Pavlica et al. 1998:301).

These authors accept that the Kolb (1984) theory of experiential learning has been most influential in managerial learning. However they suggest it is too isolationist and lacks the inclusion of social processes. This view is supported by arguing that experiences are normally influenced by contact with others and an important aspect of experiencing is listening to others. This is described as renting experiences to grasp understanding in a socially appropriate and empathetic way (Pavlica et al. 1998). The different aspects of learning through experience are integrated – learning, thinking, acting and reflecting to become a process. This process becomes a diagnosis; it is an active reframing of business situations rather than passive acceptance and becomes knowledge from within. Acquiring the ability to diagnose through experience involves the linking of the four structural dimensions in the process of experiential learning, these are:

- Personal involvement, concrete experience leads to knowledge grasp drawn from apprehension
- Reflective observation, collecting information, critical thinking, leading to intentional changes
- Conceptualization, experiments, analysis and logic, leading to sense making
- Active experimentation, risks, commitments, decisions, leading to knowledge extensions and entrepreneurial skill building

Practice is hallmarked by doing (Graff 2012), if a workable solution is not achieved at the first time of trying a second attempt is made with a slight difference in approach until a solution is found.

## DISCUSSION AND CONCLUSION

When asked to demonstrate ways in which various forms of learning assist in the resolving of concerns related to competitiveness a variety of approaches are utilised. Formal education provides credentials and endorsements together with the emergence of desirable traits such as tenacity. In addition the turbulent business environment requires diagnostics and interpretation in order to remain competitive, approaches that are used during education (Cheung and Chan 2011) programmes.

It is evident that education alone is not satisfactory to achieve and maintain business competitiveness and therefore educating practices are utilised that encompass training and developmental initiatives to gain specific new knowledge and skills (Dessler 2009). Adding these elements demonstrates patterning in the data where threads of mastery become strengthened via a range of approaches. There is a clear appreciation that learning is not a one-off occurrence and updating or acquisition is a requirement when changes of varying dimensions arise. These may be short-term to close an identified gap or longer-term to gain a skill or technique for long-term use and are stratified in nature in that they occur within any area of the business.

The properties of educating are learning (formal), training (vocational) and experiencing (life). It is evident that business draws on all three approaches to cope with and adapt to changing scenarios. It is crucial that business educators adapt to ensure the convergence between business and academia (Graff 2012) is built upon, which requires the incorporation of dynamic capabilities.

## AREAS FOR FURTHER RESEARCH

To expand the findings related to the benefits of educating practices an area for further research is to collect data from the actual participants as opposed to the managers or owners of a business to establish the benefits and outcomes from their perspective.

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## VARIANCES ANALYSIS OF THE FREE CASH FLOWS TO FIRM AND ITS IMPACT ON THE FINANCIAL STRUCTURE. SPARE PARTS MANUFACTURERS IN THE ITALIAN AUTOMOTIVE INDEPENDENT AFTER MARKET IN THE 2008-2011 PERIOD.

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### ABSTRACT

All along, the financial balance is basic for the continuity of a company and especially when money is the critical resource. The competitive strategy needs a coherent structure and the financial receipts and payments related to the core business drive the financial structure, i.e. the relationships between equity and financial debts. In this direction, management awareness is a true source of competitive advantage and for this reason it's necessary a coherent method of analysis and a comprehensive system of measures. The present essay investigates through the variances analysis the relationship between the free cash flows to firm and the change in the financial structure and it supports the idea of an equilibrated financial structure is first of all a question of core business competitiveness, namely the distinctive quality of its products, customers, suppliers, technologies, core competences, processes, etc., and then a financial evaluation. At the end it's summarized the variances analysis of the free cash flows to firm, and the related impact on the financial structure, with reference to the Spare Parts Manufacturers, 291 limited companies, operating in the Italian Independent Automotive Aftermarket in the 2008-2011 period.

**Keywords:** free cash flows to firm, variances analysis, financial structure, ebitda, net working capital

### 1. INTRODUCTION

The primary goal of every living organism is to continue to exist in the best state of health. For the company there are the same rules and the goal of a healthy continuity is essentially nourished of balance and, in particular, of economic and financial balance. The economic

balance is achieved if, when and as the return on invested capital (Phillips, 1997) of the firm is higher than the cost of capital (Modigliani and Miller, 1958) (also defined as the return that would have generated the same capital risk in similar conditions): in this scenario, the company creates economic value. The financial balance has multiple views that, for the object of this paper, are substantially related to two: the attitude of the company, on one side, to generate cash from its operating activities and, secondly, to finance consistently its own competitive strategies using the financial resources of the shareholders rather than debt capital, the so-called financial structure (Myers *et al.*, 1984).

With particular attention to financial equilibrium, the objective of this work is to investigate, under a purely financial point of view and then without analyzing the economic impact, the relationships that exist between operating cash flow and the choices, often constrained and binding, of financial structure.

In this framework of analysis, the basic thesis of the following pages is that the relations between the two expressions of financial equilibrium are, on one side, deep and mutually interconnected and, on the other side, essential to guide the competitive strategies in the sign of a lasting health.

These conditions of financial equilibrium, once shared the main methodological implications, are then analyzed in practice versus a real economic sector, so that you can better appreciate the significance, scope of interpretation and application issues.

## **2. LOGIC AND METRIC OF THE ANALYSIS**

The logic and the metric chosen for the analysis at issue are consistent with the objective of the company management to acquire promptly the wider awareness of the management priorities and to orientate properly their managerial decisions and actions. Consistently with this logical line are available “ad hoc” models of financial analysis more consistent with the above “managerial objectives” and in particular:

- a. as concerns the dynamic of cash flows, i.e. the receipts and the disbursements of the company, the logical driver is in the rational management that triggers them and in the different management area to which they belong: in this direction, there are operating cash flows related to the core business (the so-called free cash flows to firm) (Damodaran, 2001), cash flows related to the fiscal relationship with the treasury, cash flows related to extraordinary non-recurring events and cash flows related to shareholders’ equity and third-parties lenders debt;

- b. as regards the variances analysis the focus is on the individual factors that contribute to the determination of the free cash flows to firm (Fig. 1) and consequently cause changes in the financial structure. Through the variances analysis, as Anthony *et al.* (2004) claim, "Management wants to know not only *what* the amounts of the differences between actual and planned results were but also, and more important, *why* these variances occurred".

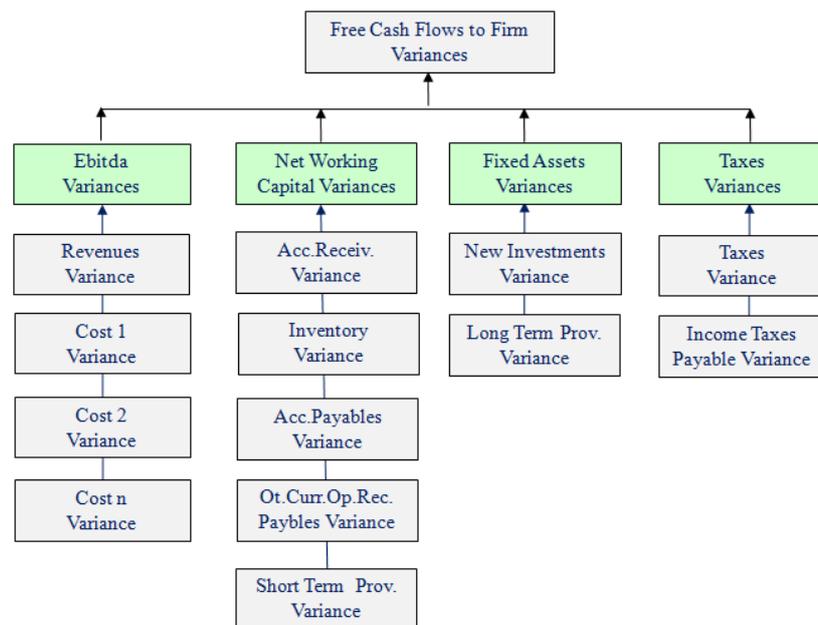


Fig. 1 – An overview of the Free Cash Flows to Firm variances analysis

- c. as concerns the financial structure, the logical assumption is the distinction of the funding sources between pure "full risk" lenders, the shareholders, and pure "partial risk" lenders, the third-parties lenders debt: in other words the financial structure under investigation is exclusively composed of shareholders' equity and net financial position lenders, the so called pure providers of capital.

### 2.1. Free cash flows to firm. Two basic ingredients

Before we get into the analysis of the dynamic relationships between free cash flows to firm (FCFF) variances and financial structure it's useful a synthetic overview of their nature. In this direction, FCFF:

- are a magnitude-flow, that is they belong to the family of the financial variables that can find measurement only with reference to a specific period of time (for example, an administrative exercise);
- arise from the union of the economic components of a given period and from the changes in balance sheet items (always related to the same period);

- c. show the ability of the company to generate or absorb financial resources from its own core business;
- d. determine the financial requirements to satisfy by resorting to the use of the financial leverage or new financial resources contributed by the shareholders.

### Two basic ingredients

The determination of the free cash flows to firm requires two basic ingredients:

1. revenues and related costs summarized in the so-called Income Statement (or Profit and Loss Statement or Earnings Statement): the following Tab. 1 shows (among the many) a classic synthetic Added Value-Ebitda Income Statement based view:

Income Statement	Time Period n	% vs Net Revenues	Time Period n-1	% vs Net Revenues	Managerial Meaning
a) Net revenues (or sales)	1.000	100,00%	950	100%	Product between volumes sold and related selling prices
b) External operating costs	-400	40,00%	-390	-41,05%	Product between volumes purchased from external suppliers (raw materials, services, consulting, etc.) and related purchasing prices
c=a+b) Added value	600	60,00%	560	58,95%	Value added by internal operating costs (labor costs and depreciation) compared to the external operating costs
d) Labor cost	-250	25,00%	-260	-27,37%	Amount of the costs related to wages and salaries
e=c+d) Earnings before interests, depreciation and amortization (Ebitda)	350	35,00%	300	31,58%	Margin generated by the core business before interests, depreciation and amortization
f) Depreciation and amortization	-40	4,00%	-30	3,16%	Periodic decrease in an asset's value caused by obsolescence
g) Provisions for risks and future costs	-10	1,00%	-10	1,05%	Periodic provisions to support future risks and costs
h= $\sum$ e:g) Earnings before interests and taxes (Ebit)	300	30,00%	260	27,37%	Margin generated by the core business
i) Interests	-50	5,00%	-50	5,26%	Financial expenses (or incomes) generated by financial debts (assets)
a) Extraordinary revenues/costs	0	0,00%	0	0,00%	Extraordinary expenses (or incomes)
k= $\sum$ h:j) Earnings before taxes (Ebt)	250	25,00%	210	22,11%	Margin before taxes
l) Taxes	-100	10,00%	-84	8,84%	Fiscal costs due to the Tax Authorities
m=k+l) Net income (NI)	150	15,00%	126	13,26%	Margin after taxes

Tab. 1 - Income Statement focused on Valued Added and Ebitda

2. investments and related funds of capital summarized in the so-called Balance Sheet (or Statement of Financial Position): the following Tab. 2 shows (among the many) a classic synthetic Balance Sheet view based on Net Operating Capital Invested (Brealey *et al.*, 2011), just net operating assets, financed by shareholders' equity and third-parties lenders debt, just pure capital providers:

Balance Sheet	Time Period and % to Net Operating Capital Invested				Managerial Meaning
	Time Period n	% to NOCI	Time Period n-1	% to NOCI	
a= $\sum$ b:d) Current operating assets	390	97,50%	350	102,94%	Financial resources invested in the core business for a period < 12 months
b) Accounts receivable	300	27,50%	270	79,41%	
c) Inventories	80	20,00%	60	17,65%	
d) Other current operating receivables	10	2,50%	20	5,88%	
e= $\sum$ f:i) Current Operating Liabilities	180	45,00%	180	52,94%	Financial resources provided by operating resources suppliers for a period < 12 months
f) Accounts payable	110	27,50%	130	38,24%	
g) Income taxes payable	50	12,50%	40	11,76%	
h) Other current operating payables	20	5,00%	10	2,94%	
i) Short term accumulated provisions for risks	0	0,00%	0	0,00%	
j=a-e) Net Working Capital	210	52,50%	170	50,00%	Net financial resources invested in the core business for a period < 12 months
k) Tangible and intangible long term asset, net	240	60,00%	220	64,71%	
l) Long term accumulated provisions for risks and costs	50	12,50%	50	14,71%	
m=k-l) Net Fixed Assets	190	47,50%	170	50,00%	Net financial resources invested in the core business for a period > 12 months
n=j+m) Net Operating Capital Invested (or total net operating assets)	400	100,00%	340	100,00%	Total net financial resources invested in the core business
o= $\sum$ p:s) Shareholders' Equity	290	72,50%	220	64,71%	Financial resources provided by shareholders' equity
p) Common stock	50	12,50%	50	14,71%	
q) Additional paid-in capital	30	7,50%	30	8,82%	
r) Retained earnings	60	15,00%	14	4,12%	
s) Net income	150	37,50%	126	37,06%	
t= $\sum$ u:z) Third-Parties Lenders Debt (or Net Financial Position)	110	27,50%	120	35,29%	Net financial resources provided by third-parties lenders debt
u) Short term financial debts	50	12,50%	60	17,65%	

v) Cash and cash equivalent	-10	2,50%	-10	-2,94%	
w) Long term financial debts	80	20,00%	80	23,53%	
z) Investment securities	-10	-2,50%	-10	-2,94%	
x=0+t) Net Operating Capital Acquired (or net financial position and shareholders' equity)	400	100,00%	340	100,00%	Net financial resources provided by shareholders' equity and third-parties lenders debt

Tab. 2 – Balance Sheet focused on Net Operating Capital Invested and Shareholders' equity and third-parties lenders debt

An appropriate mix of economic and balance sheet components generates automatically (through the indirect method) the so-called Cash Flows Statement: the following Tab. 3 shows (among the many) an “ad hoc” Cash Flows view based on the distinction between operating and financial cash flows and the related impact on the Financial Structure (shareholders' equity and net financial position):

Cash Flows Statement	Time Period and % to Revenues				Managerial Meaning
	Time	% to	Time	% to	
	Period n	Revenues	Period n-1	Revenues	
a) Ebitda	350	35,00%	300	31,58%	Margin generated by the core business before interests, taxes, depreciation and amortization
b= $\sum c_i$ ) $\Delta$ Net Working Capital	-50	-5,00%	-10	-1,05%	Cash provided/required by decreasing/increasing of Net Working Capital
c) $\Delta$ Accounts Receivable	-30	-3,00%	-20	-2,11%	Cash provided/required by decreasing/increasing of accounts receivable
d) $\Delta$ Inventories	-20	-2,00%	-10	-1,05%	Cash provided/required by decreasing/increasing of inventories
e) $\Delta$ Accounts Payable	-20	-2,00%	10	1,05%	Cash provided/required by increasing/decreasing of accounts payable
f) $\Delta$ Other current operating receivables	+10	1,00%	+5	0,53%	Cash provided/required by decreasing/increasing of other current operating receivables
g) $\Delta$ Other current operating payables	+10	1,00%	+5	0,53%	Cash provided/required by increasing/decreasing of other current operating payables
h) $\Delta$ Short term accumulated provisions (risks and costs)	0	0,00%	0	0,00%	Cash required by core business short term risk and costs
i) Provisions for short term risks and costs	0	0,00%	0	0,00%	
h=a+b) Current Cash Flow	300	30,00%	290	30,53%	Cash provided/required by core business before investments and taxes
i) $\Delta$ Tangible and intangible long term asset, net	-20	-2,00%	-10	-1,05%	Cash required by long term investment in the core business
j) Depreciation and	-40	-4,00%	-30	-3,16%	

amortization						
k) $\Delta$ Long term accumulated provisions (risks and future costs)	0	0,00%	0	0,00%	Cash required by core business long term risk and costs	
l) Provisions for long term risks and costs	-10	-1,00%	-10	-1,05%		
m= $\sum$ i:l) $\Delta$ Gross Fixed Assets	-70	-7,00%	-50	-5,26%	Cash provided/required by decreasing/increasing of Gross Fixed Assets	
n=h+m) Gross Cash Flows to Firm	230	23,00%	240	25,56%	Cash provided/required by core business before taxes	
o) Operating Taxes	-120	-12,00%	-84	-8,84%		
p) $\Delta$ Income taxes payable	+10	1,00%	+5	0,53%	Cash required by fiscal impact	
q= $\sum$ n:p) Free Cash Flows to Firm	120	12,00%	161	16,95%	Company's attitude to provide/require financial resources (after taxes) from its own core business	
r) Extraordinary revenues/cost (tax shield net)	0	0,00%	0	0,00%	Cash in/cash out due to extraordinary revenues/cost (net tax impact)	
s=q-r) Free Cash Flows to (Pure) Lenders	120	12,00%	161	16,95%	Free cash flow available to pure lenders	
t) Financial revenues/costs (tax shield net)	-30	-3,0%	-30	-3,16%	Cash in/cash out due to financial revenues/cost (net tax impact)	
u) Dividends to shareholders	-80	-8,0%	-80	-8,42%	Shareholders' pay out	
v) $\Delta$ Shareholders' equity	0	0,00%	0	0,00%	Variance of financial resources invested by Shareholders' equity	
w) $\Delta$ Net financial position	-10	-1,00%	-51	-5,37%	Variance of net financial resources invested by third-parties lenders debt	

Tab. 3 - Cash Flows Statement focused on FCFE and free cash flows to pure lenders

## 2.2. Financial structure and financial leverage

As concerns the financial structure, the latter is the mix of the financial resources provided by pure capital suppliers: shareholders' equity (common stock, additional paid-in capital, retained earnings, net income) and third-parties lenders debt (short and long term financial debts net of cash and cash equivalents and investment securities).

The relationship between net financial position and shareholders' equity is the so-called financial leverage (Blazenko, 1996) (see the following Tab. 4). The latter is a very important ratio for managerial trade-off evaluations in terms of financial risk (Markowitz, 1952), funding opportunities, cost funding, company reputation, etc. and for these reasons it's rich of pervasive managerial implications.

Financial Structure	Time Period and % to Net Operating Capital Invested				Managerial Meaning
	Time Period n	% to Net Operating Capital Invested	Time Period n-1	% to Net Operating Capital Invested	
a=Shareholders' Equity	290	72,50%	220	64,71%	Financial resources provided by shareholders' equity
b= Third-Parties Lenders Debt (or Net Financial Position)	110	27,50%	120	35,29%	Financial resources provided by third-parties lenders debt
c=b/a) Financial Leverage	0,38		0,55		Company's attitude to finance core business with equity to financial debts

Tab. 4 - Financial structure and financial leverage

### 2.3. The variances analysis of the free cash flows to firm

A variance is the difference between two values (Anthony, 2004). Typically, the first value represents what actually happened, that is, the performance actually achieved. The other value is a performance benchmark, such as a planned result (what the firm wanted to happen) or a historical result (what happened in the past) or the best competitor performance. A variance analysis involve the breakdown of the global variance into the individual factors that caused the variance. Obviously the algebraic sum of the single variances is equal to the global variance, but it's very important to realize that there isn't only one way to do variance analysis and managers perform different variances analysis because, as Anthony *and al.* claim, "the techniques used to analyze variances depend on management's judgment as to how useful the results are likely to be".

The variances analysis methodology involves five basic steps:

1. identify the individual factors that cause the global variance;
2. define the most useful sequence of the individual factors identified: generally, from a cash flow point of view, revenues are the starting point for the variances analysis;
3. always from a cash flow point of view, it's useful to normalize each absolute value to the revenues;
4. accordingly with the previous most useful sequence, the next step, so-called flexible phase of the values, is to replace each past value with its actual value and calculate the resulting amounts;
5. calculate the variance between the two above said amounts. In particular, there are two different algebraic evaluations about variance:

1. an *unfavorable variance* is the one that makes, all other conditions being equal, actual revenues/margins (costs) value lower (higher) than in the past (or planned target): for example, if the actual external operating costs are higher than in the past, the variance is said to be unfavorable;
2. a *favorable variance* makes actual revenues/margins (costs) value higher (lower) than in the past (or planned target): for example, if actual revenues are higher than in the past, the variance is said to be favorable. As Anthony *and al.* claim, "The words favorable and unfavorable do not necessarily connote value judgments about managerial performance ... but indicate only the algebraic impact of a variance ...".

As concerns FCFF variances analysis, the individual factors that caused the global variance between two periods (for example two years) and a related useful sequence are shown by the following Tab. 5. In particular, these eleven individual factors are connected to four different variances:

1. *ebitda (earnings before interest taxes depreciation and amortization) variance* generated by three individual factors - revenues, external operating costs and labor costs – coming from income statement;
2. *net working capital variance* generated by five individual factors coming from balance sheet - change in accounts receivable, change in inventories, change in accounts payable, change in other current operating receivables and payables, change in short term accumulated provisions and provisions for risks and costs - and by one individual factor coming from a mix between Balance Sheet and Income Statement, change in short term accumulated provisions and provisions for risks and costs;
3. *fixed assets variance* generated by two individual factors - change in tangible and intangible long term (net) assets and depreciation and amortization, change in long term accumulated provisions and provisions for risks and costs – coming from a mix between Income Statement and Balance Sheet;
4. *taxes variance* generated by one individual factor, taxes and change in payable income taxes, coming from a mix between Income Statement and Balance Sheet.

Individual factors of the global variance and a related useful sequence

From

Through

To

Income Statement	1. revenues		
	2. external operating costs		Ebitda variance
	3. labor costs		
	4. $\Delta$ accounts receivable		
Balance Sheet	5. $\Delta$ inventories		
	6. $\Delta$ accounts payable		Net Working Capital variance
	7. $\Delta$ other current operating receivables and payables		
	8. $\Delta$ short term accumulated provisions and provisions for risks and costs		
A mix between Income Statement and Balance Sheet	9. $\Delta$ tangible and intangible long term (net) asset and depreciation and amortization	Fixed Assets	
	10. $\Delta$ long term accumulated provisions and provisions for risks and costs		variance
	11. taxes and $\Delta$ payable income taxes		Taxes variance

Tab. 5 - Individual factors of the global variance and a related useful sequence. From Income Statement and Balance Sheet to four basic variances: Ebitda, Net Working Capital, Fixed Assets and Taxes

Using the symbol  $\Delta$  (delta) to represent the difference between an actual amount and a past one, the commonly used rules to find the single variances (V) are as follows:

- a. as concerns the individual factors related to the Ebitda V there are three specific variances (all the following variances can be further broken down; for example, the revenues variance can be splitted into three components: volumes (or quantity) variance, product mix variance and price variance (Anthony, 2004); the costs variance too can be decomposed into four components: volumes (or quantity) variance, mix variance, efficiency variance, price variance; the collection times variance can be disaggregated into three components related to the revenues: volumes (or quantity) variance, customer mix variance and price variance; etc.):

1. the *intensity revenues V* measures the effect on the FCFF related to a different amount of revenues:

$$\text{revenues } V = \Delta \text{revenues} \times (1 - \text{past \% cash absorption}) = 50 \times (100,00\% - 83,05\%) = 8,47$$

In synthesis, the increasing revenues generates, all other conditions being equal, a favorable variance equal to 8,47 (2,18% to actual revenues or 5,26% to past FCFF);

2. the *external operating costs efficiency V* measures the change in the FCFF caused by a different rate of external operating cost efficiency:

$$\text{external operating costs } V = \text{actual revenues} \times \Delta \% \text{ cash absorption by external operating costs} = 1.000 \times (41,05\% - 40,00\%) = 10,52$$

In synthesis, the better external operating costs efficiency produces, all other conditions being equal, a favorable variance equal to 10,52 (1,05% to actual revenues or 6,54% to past FCFF);

3. the *efficiency labor costs V* measures the effect on the FCFF due to a different level of efficiency labor costs:

$$\text{labor costs V} = \text{actual revenues} \times \Delta\% \text{ cash absorption by labor costs} = 1.000 \times (27,37\% - 25,00\%) = 23,68$$

In synthesis, the improved labor cost efficiency generates, all other conditions being equal, a favorable variance of 23,68 (2,37% to actual revenues or 14,71% to past FCFF).

The sum of the above 1), 2) and 3) variances generates the so-called Ebitda variance:

$$\text{Ebitda V} = \text{revenues V} + \text{external operating costs V} + \text{labor costs V} = 8,47 + 10,52 + 23,68 = 42,68.$$

In synthesis, the higher Ebitda produces, all other conditions being equal, a favorable variance of 42,68 (4,27% to actual revenues and 26,51% to past FCFF).

- b. as concerns the individual factors related to the Net Working Capital V there are five different variances:

1. the *collection times V* measures the effect on the FCFF related to a different days sales outstanding:

$$\text{collection times V} = \text{actual revenues} \times \Delta\% \text{ cash absorption by accounts receivable} = 1.000 \times (-3,00\% - (-2,11\%)) = -8,95$$

In synthesis, the worsening of collection times from customers generates, all other conditions being equal, an unfavorable variance of -8,95 (-0,89% to actual revenues or 5,56% to past FCFF);

2. the *inventory V* measures the effect on the FCFF related to a different days inventory outstanding:

$$\text{inventory V} = \text{actual revenues} \times \Delta\% \text{ cash absorption by inventory} = 1.000 \times (-2,00\% - (-1,05\%)) = -9,47$$

In synthesis, the worsening of the inventory rotation produces, all other conditions being equal, an unfavorable variance of -9,47 (-0,95% to actual revenues or 5,88% to past FCFF);

3. the *payment times V* measures the effect on the FCFF due to a different payment time of suppliers:

$$\text{payment times V} = \text{actual revenues} \times \Delta\% \text{ cash absorption by accounts payable} = 1.000 \times (-2,00\% - 1,05\%) = -30,53$$

In synthesis, the worsening of time payment to suppliers generates, all other conditions being equal, an unfavorable variance of 30,53 (3,05% to actual revenues or 18,96% to past FCFF);

4. the *other current operating receivables and payables V* measures the effect on the FCFF due to a different incidence of the other current operating receivables and payables:

other current operating receivables and payables  $V = \text{actual revenues} \times \Delta\% \text{ cash absorption by other operating receivables and payables} = 1.000 \times (2,00\% - 1,05\%) = 9,47$

In synthesis, the improving of the current operating receivables and payables incidence generates, all other conditions being equal, a favorable variance of 9,47 (0,95% to actual revenues or 5,88% to past FCFF);

5. the *short term provisions risks V* measures the effect on the FCFF related to a different level of use of short term provisions for risks:

short term provisions for risks  $V = \text{actual revenues} \times \Delta\% \text{ cash absorption by use of short term provision for risks} = 1.000 \times (0,00\% - 0,00\%) = 0,00$

The sum of the above 1), 2) 3), 4) and 5) variances generates the so-called Net Working Capital variance:

Net Working Capital  $V = \text{collection times } V + \text{inventory } V + \text{payment times } V + \text{other current operating receivables and payables } V + \text{short term provisions risks } V = -8,95 - 9,47 - 30,53 + 9,47 + 0,00 = -39,47$ .

In synthesis, the greater amount of Net Working Capital produces, all other conditions being equal, an unfavorable variance of -39,47 (3,95% to actual revenues and 24,52% to past FCFF).

- c. as concerns the individual factors related to the Fixed Assets  $V$  there are two different variances:

1. the *new investments* (originated by the algebraic sum of change in the net fixed assets and depreciation and amortization)  $V$  measures the effect on the FCFF related to a different rate of new tangible and intangible investments:

new investment  $V = \text{actual revenues} \times \Delta\% \text{ cash absorption by new investments} = 1.000 \times (-6,00\% - (-4,21\%)) = -17,89$

In synthesis, the increasing new investments generate, all other conditions being equal, an unfavorable variance of -17,89 (-1,79% to actual revenues or 11,11% to past FCFF);

2. the *long term provisions risks V* measures the effect on the FCFF related to a different level of use of provisions for risks:

long term provisions risks  $V = \text{actual revenues} \times \Delta\% \text{ cash absorption by use of provision}$   
 for risks =  $1.000 \times (-1,00\% - (-1,1\%)) = 0,53$

In synthesis, the higher use of provisions for risk generates, all other conditions being equal, an unfavorable variance of 0,53 (0,05% vs actual revenues or 0,33% vs past FCFF);

The sum of the above 1) and 2) variances generates the so-called Fixed Assets variance:

Fixed Assets  $V = \text{new investments } V + \text{long term provisions risks } V = -17,89 + 0,53 = -17,36$ .

In synthesis, the greater amount of Fixed Assets Capital produces, all other conditions being equal, an unfavorable variance of -17,36 (1,74% to actual revenues and 10,78% to past FCFF).

d. as concerns the individual factors related to the Taxes there are two variances:

1. the *taxes pressure*  $V$  measures the effect on the FCFF related to a different tax rate pressure:

taxes pressure  $V = \text{actual revenues} \times \Delta\% \text{ cash absorption by taxes pressure} = 1.000 \times (-12,00\% - (-8,84\%)) = -31,58$

In synthesis, a higher tax rate pressure generates, all other conditions being equal, an unfavorable variance of -31,58 (-1,90% to actual revenues or -19,61% to past FCFF);

2. the *payable income taxes*  $V$  measures the effect on the FCFF related to a different payable income taxes level:

payable income taxes  $V = \text{actual revenues} \times \Delta\% \text{ cash absorption by payable income taxes} = 1.000 \times (1,00\% - 0,53\%) = +4,74$

In synthesis, the higher level of payable income taxes pressure generates, all other conditions being equal, a favorable variance of +4,74 (+0,47% to actual revenues or 2,94% to past FCFF);

The sum of the above 1) and 2) variances generates the so-called Taxes variance:

Taxes  $V = \text{taxes pressure } V + \text{payable income taxes } V = -31,58 + 4,74 = -26,54$ .

In synthesis, the increasing negative fiscal cash flows produces, all other conditions being equal, an unfavorable variance of -26,54 (2,65% to actual revenues and 16,67% to past FCFF).

The following FCFF Bridge, Fig. 2, summarizes the contribution of each individual variance to the FCFF global variance. In particular, it's very important to identify if the

change in FCFF is due to an Income Statement factor or to a Balance Sheet factor, and in particular to a contribution of ebitda, net working capital, fixed assets and taxes.

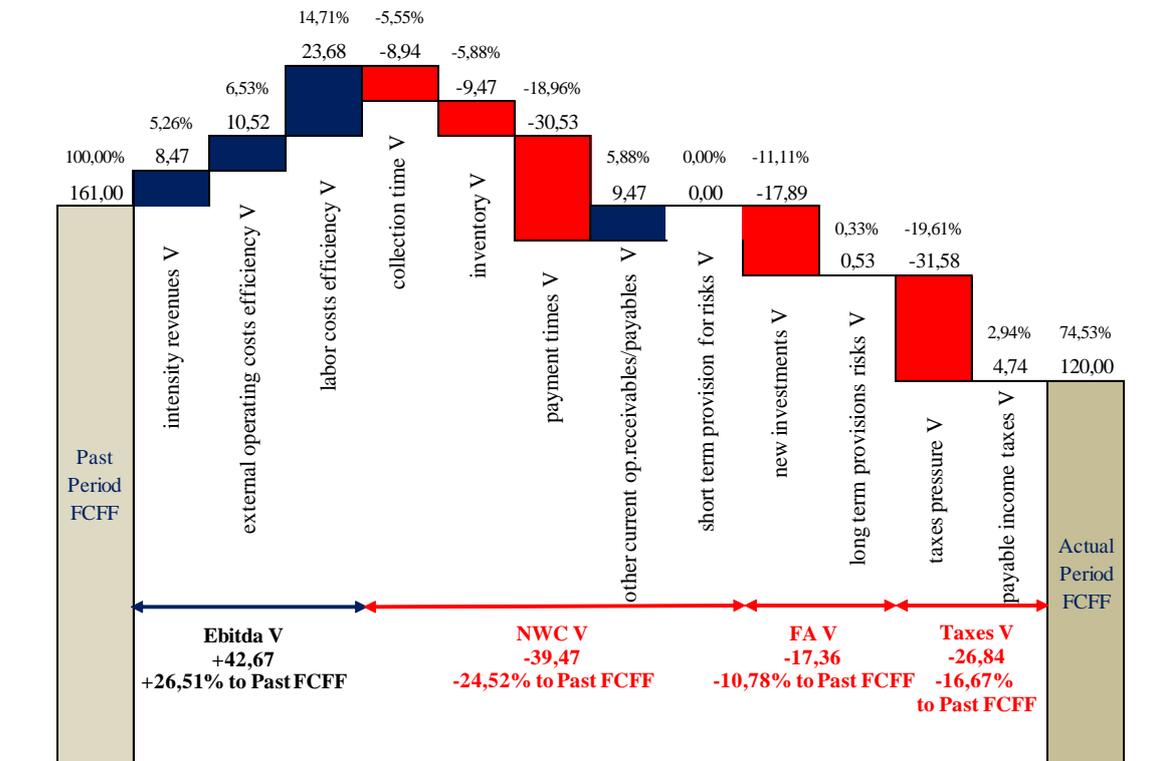


Fig. 2 – Free Cash Flows to Firm bridge

Under a managerial point of view it is essential, on one side, to measure which managerial processes – selling, purchasing, innovation, etc. - are increasing (or decreasing) FCFF and, on the other side, to identify the best way to preserve good performance, that is the positive FCFF variances (in the example the ebitda components), and to correct bad performance, that is the negative FCFF variances (in the example the net working capital and taxes components). By the variances quantification, the management conquists the precious opportunity to focus the right energies on the most relevant critical points and to concentrate on the existing, and frequently hidden, relationships between the different variances.

### 3. From the variances analysis of the free cash flows to firm to a different financial structure. Synthetic relationships of equilibrium

Between FCFF and financial structure there is a strong relationship in terms of financial equilibrium and healthy continuity of the firm. In this direction, positive FCFF variances are, financial and extraordinary costs paid, the most authentic way to lead the company towards a double purpose: the financial structure target and the competitive position target. In particular, the positive FCFF variances, all other conditions being equal, allow:

- a. the strengthening of the degree of financial independence and therefore a greater bargaining power towards stakeholders;
- b. a continuous pay out of dividends with a consequent shareholders' satisfaction;
- c. an improvement of the financial debts quality: extension of financial debt maturities, lower funding costs, greater possibilities to reduce the amount of financial debts;
- d. a better competitive reputation.

In the above example the reduction of FCFF, from 161,00 to 120,00, causes, all extraordinary and financial and dividends conditions being equal, an identical impact, -41,00 on the process of reducing the Net Financial Position, from 51 of the past year to 10 for the current year (Tab. 6). In particular, this is the difference between positive ebitda variance (+42,67) and negative net working capital (-39,47), fixed assets (-17,36) and taxes (-26,84) variances.

Financial Values	Time Period and % to Net Revenues				Managerial Meaning
	Time Period n	% to Net Revenues	Time Period n-1	% to Net Revenues	
a. Free Cash Flows to Firm	120	12,00%	161	16,95%	Company's attitude to provide/require financial resources (after taxes) from its own core business
b. Free Cash Flows to (Pure) Lenders	120	1,00%	161	16,95%	Cash flows available for pure lenders
c. Financial revenues/costs (tax shield net) and Dividends to shareholders	-110	-11,00%	-110	-11,58%	Cash out by financial revenues/costs and dividends
d=b-c) Net Financial Position reducing through change in FCFF	10	1,00%	51	5,37%	
e. Net Financial Position	110	11,00%	120	12,63%	Financial resources provided by third-parties lenders debt

Tab. 6 – The change in Free Cash Flows to Firm drive (extraordinary, financial and dividends cash out conditions being equal) changes on the financial structure

#### 4. Spare Parts Manufacturers in the Italian Automotive Independent After Market. The variances of the free cash flows to firm and the financial structure in the 2008-2011 period

This last section highlights, in brief and in accordance with the purpose of the present work, the results obtained from the Competitive Risk and Enterprise Value Research Center of the Polytechnic of Turin (Italy), whose mission is to develop models and metrics for measuring economic performance. First of all, some information about the analysis scope:

- a. the results of the analysis are focused on the free cash flows to firm variances analysis and their impact on the financial structure;
- b. the statistical sample is composed by 291 limited companies operating in Italy as Spare Parts Manufacturers for the Italian Automotive Independent After Market. The above 291 companies are composed by 36 large companies (turnover greater than € 100 million), 43 medium-sized enterprises (turnover between 30 and 100 million euro) and 212 small business (turnover lower than € 30 million). All data, extracted from the financial statements officially registered at the Italian Chambers of Commerce, are public;
- c. the 2008-2011 is the analyzed period and for each period the FCFE variances analysis shows the contribute of each individual factor as ebitda, net working capital, fixed assets and taxes and the related relationship with the financial structure.

The set of all the 291 companies shows, in brief (Tab. 7), the following financial highlights:

- a. a slight increase in revenues (2011-2008 cagr of +0,47%);
- b. a meaningful decrease in ebitda (2011-2008 cagr of -2,08%);
- c. a small increase in taxes with a 2011-2008 cagr of +0,36%;
- d. an increasing of net capital invested (cagr of +0,98%) in both its components, net working capital (cagr of +1,33%) and net fixed assets (cagr of +0,55%);
- e. a consistent improving in the financial structure: shareholders' equity, cagr of + 1,95%, and third-parties lenders debt, cagr of -19,38%.

Financial Highlights	2011	2010	2009	2008	Cagr 2011/2008
Net revenues	14.367.975	13.794.764	11.865.651	14.168.271	0,47%
Ebitda	1.057.623	1.097.205	894.752	1.126.306	-2,08%
Taxes	229.053	211.284	152.926	226.569	0,36%
Net Working Capital	2.391.162	2.280.608	2.125.237	2.298.281	1,33%
Net Fixed Assets	1.910.717	1.939.896	1.867.210	1.879.459	0,55%
Net Capital Invested	4.301.879	4.220.503	3.992.447	4.177.740	0,98%
Shareholder's Equity	4.179.437	4.367.495	4.124.765	3.944.051	1,95%
Third-Parties Lenders Debt	122.442	-146.992	-132.318	233.689	-19,38%

Tab. 7 – The main financial highlights for the Spare Parts Manufacturers in the Italian Automotive Independent After Market

As concerns the individual factors of the FCFF variances analyses, the Tab. 8 highlights some interesting observations:

- a. except for 2010, ebitda has always negatively contributed to the improvement of the FCFF: in other words, the lower Ebitda produces for three years on four, all other conditions being equal, an unfavorable variance: -0,53% to 2011 revenues, -0,36% to 2009 revenues and -1,41% to 2008 revenues. The critical point is especially related to the external operating costs (always negative except the 2009) which are absorbing the positive contribution of revenues to FCFF: it's an uneconomic exchange between revenues and external operating cost. On the contrary, labor cost generates a favorable variance in 2011 and in 2010, but is not enough to change the sign of ebitda variance;
- b. as regards to the net working capital the contribution to FCFF is always, except for 2010, positive and first of all thanks to lower collection times, for the second consecutive year, and to a favorable variance of the other current operating receivables and accounts payable;
- c. the positive fixed assets variance is mainly due to an investment slowdown and this trend could have a negative impact on future results; without this investment cutting, 0,95% to revenues in 2011, the FCFF variance would have been negative in 2011, -0,10% to revenues;
- d. higher taxes produce an increasing unfavorable variance: -0,47 to revenues in 2011 and -0,22 to revenues in 2010.

Free Cash Flows to Firm: Individual Factors V (to Revenues)	2011	2010	2009	2008	$\Delta$ 2011-2008
a=b+c+d+e)Free Cash Flows to Firm V	0,85%	-2,13%	3,11%	0,80%	0,05%
b)Ebitda V	-0,53%	0,92%	-0,36%	-1,41%	0,88%
b1)Revenues V	0,06%	0,51%	0,05%	0,00%	0,06%
b2)External operating costs V	-0,77%	-0,53%	1,12%	-0,86%	0,09%
b3)Labor costs V	0,17%	0,94%	-1,52%	-0,56%	0,73%
c)Net Working Capital V	0,63%	-2,46%	0,02%	3,48%	-2,85%
c1)Collection times V	0,70%	0,51%	-4,22%	4,27%	-3,58%
c2)Inventory V	-0,79%	-2,07%	2,21%	0,71%	-1,50%
c3)Payment times V	-0,58%	2,02%	1,62%	-4,06%	3,47%
c4)Other current op. rec. acc. paybles V	1,31%	-2,93%	0,40%	2,55%	-1,25%

d)Fixed Assets V	1,23%	-0,37%	1,83%	-1,63%	2,86%
d1)New investments	0,95%	-0,06%	2,56%	-2,31%	3,25%
d2)Long term provisions risks V	0,28%	-0,31%	-0,74%	0,68%	-0,40%
e)Taxes V	-0,47%	-0,22%	1,62%	0,37%	-0,84%
e1)Taxes pressure V	-0,20%	-0,10%	0,68%	0,48%	-0,67%
e2)Income taxes payable V	-0,27%	-0,13%	0,94%	-0,11%	-0,17%

Tab. 8 – The main individual factors of the FCFV variances analysis for the Spare Parts Manufacturers in the Italian Automotive Independent After Market

As concern the relationship between the FCFV variance and the impact on the financial structure, Tab. 9 shows how the positive 2011 FCFV, +0,85% to revenues, is higher than extraordinary revenues/costs (tax shield net) V, -0,69% to revenues, but not enough to hold up shareholders' equity V needs, -3,80% to revenues, and all this in despite of a positive financial revenues/costs (tax shield net) V to revenues, +0,35. It means a financial deficit V to revenues equal to -3,28% satisfied through, on the one hand, the 2011 FCFV, +1,40% to revenues, and, on the other side, an increasing of the Net Financial Position V, + 1,89% to revenues.

Free Cash Flows to Firm: Individual Factors V vs Revenues	2011	2010	2009	2008
a)FCFV V to revenues	0,85%	-2,13%	3,11%	0,80%
b)Extraordinary revenues/costs (tax shield net) V to revenues	-0,69%	0,74%	0,46%	-0,58%
c=a-b)Free Cash Flows to Pure Lenders V to revenues	0,17%	-1,39%	3,57%	0,22%
d)Financial revenues/costs (tax shield net) V to revenues	0,35%	-0,28%	0,39%	0,31%
e)Net Shareholders' equity V to revenues	-3,80%	-1,35%	-0,55%	-0,87%
f=c+d+e)Financial Surplus (-Deficit) V to revenues	-3,28%	-3,02%	3,40%	-0,33%
g)Third-Parties lenders debt (or net financial position) V to revenues	1,89%	-0,11%	-3,08%	1,13%
h)FCFV actual period to revenues	1,40%	3,13%	-0,32%	-0,80%
i=g+h)Third-Parties lenders debt V vs revenues + FCFV actual period to revenues	3,28%	3,02%	-3,40%	0,33%

Tab. 9 – The main individual factors of the FCFV variances analysis for the Spare Parts Manufacturers in the Italian Automotive Independent After Market and the impact on the financial structure

In synthesis, in 2011 Spare Parts Manufacturers generate a favorable but insufficient FCFV: at the same time, they, on the one hand, increase third-parties lenders debt and, secondly,

decrease shareholders' equity realizing by this way an important change in the Financial Structure in the direction of worsening the level of financial independence.

### 3. CONCLUDING REMARKS

As shown in the present essay there are strong relationships between free cash flow to firm and financial structure: a rigorous management of FCFF is the best way to manage seriously the financial structure (and sometimes vice versa). The variances analysis is a simple, flexible and precious method able to quantify the impact of the management process, from competitive strategies to managerial actions, on the financial structure equilibrium. Through ebitda, net working capital, fixed assets and taxes variances it's possible to investigate each link between the economic and balance sheet side and the financial one, too often the dark side of the firm crisis/weakness and almost always the true over boosting for a continuous competitiveness. Each variance in the individual factors of the FCFF is, all extraordinary and financial cash in cash out being the same, a variance in the financial structure and consequently it is a variance compared to those who finances the company and its possibilities to belong to the future.

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**ORGANISATIONAL CULTURE AND THE VALUE  
PRIORITISATION OF A FIRM'S INTELLECTUAL CAPITAL:  
TOWARDS A CONCEPTUAL FRAMEWORK**

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**ABSTRACT**

Ulrich defined intellectual capital as Competence x Commitment. The model was later extended to include Control as a key ingredient to measure and leverage intellectual capital. In an earlier paper, we expanded this model to include two additional dimensions, Creativity and Culture, and defined the relationship between intellectual capital and the following five critical variables: Competence, Commitment, Control, Creativity, and Culture. We showed how the interrelationships between these variables can help firms to define and describe their intellectual capital assets.

In this paper, we focus on conceptually exploring organisational culture and its impact on building a strong organisational foundation for intellectual capital. In particular, we focus on the collective dynamics of the type of organisational culture and the characteristics and volatility of the industry in which the firm operates, and its influence on a firm's ability to develop and leverage its intellectual capital. Underlining the increasingly critical strategic importance of tacit knowledge and resources in competitiveness and sustaining competitive advantage, this paper provides a framework that CEOs and senior managers can use to identify and prioritise the value of intellectual capital to their firm based on the organisation's culture and industry characteristics in which the firm operates. In concluding we draw together various convergent strands from associated research streams, and present a 2x2 matrix conceptualising intellectual capital complexity in relation to the firm's level of competitiveness. In this paper we seek to preliminarily explore, as well as encourage additional research to further develop and test this framework in order to establish the interrelationships between organisational culture and intellectual capital.

**Keywords:** Intellectual Capital, Organisational Culture, Knowledge Management, Tacit Knowledge, Intellectual Assets, Intellectual Framework

## INTRODUCTION

The culture of an organisation is influenced by a number of factors, including the industry within which it operates and its maturity cycle, industry volatility, the age of the organisation, leadership style of its senior management, competitive pressures, organisational structure, and various other related factors. Because of its very intrinsic and abstract nature, culture means different things to different individuals, often even within the same organisation – this is even more so accentuated across organisations, industries, regions, countries, and cultures.

Ulrich (1998) defines intellectual capital (IC) as 'Competence x Commitment'. This was later extended to include Control as another key element for measuring and leveraging intellectual capital. In an earlier paper we further extended this model to also include an additional two dimensions, Creativity and Culture – providing a fundamental basis supporting the other elements, fostering conducive dynamics for IC development, enhancement and exploitation (Gupta and Azzopardi 2013). Facing ever competitive and dynamic environments, many firms increasingly recognize the value of their intellectual capital. However, this does not automatically translate into full scale leveraging of their intellectual assets to build a sustainable and successful enterprise. Intellectual capital is of value only if an organisation capitalises on it. To use an analogy, if intellectual capital of employees is viewed as a seed and the organisation is the soil, the characteristics of the soil and its nurturing elements impact the ability of the seed to grow and bloom. The soil for intellectual capital is the culture of an organisation.

Culture is immensely powerful and impactful on organisational dynamics and hence must in this regard be singled out and its impact on the value prioritisation of the firm's intellectual capital should be carefully studied. While many other elements of an organisation can be replicated, such as structures, systems, and even products and services, an organisational culture that promotes learning and the leverage of knowledge is hard to imitate – and further, provides competitive and sustainable advantage prospects for firms (Barney, 1986). In addition, a healthy and conducive organisational culture contributes to other critical components of intellectual capital, such as human capital, technology capital, business

capital, and social capital (Martin-de-Castro, 2006). This is not to say that the other four elements, namely, Competence, Commitment, Control (Ulrich, 1998), and Creativity (Gupta and Azzopardi, 2013) are less valuable. It simply means that if an organisation does not pay close attention to the impact of its culture on its intellectual capital, the other four 'C' elements supporting the development and leverage of intellectual capital are likely to be adversely affected or compromised – impacting on the firm's IC prospects.

In this regard, while culture is almost unanimously understood to be a critical and defining characteristic of the DNA of an organisation, there is no single definition of organisational culture. Though much has, and continues to be written about organisational culture, like many evolving fields it remains bereft of universal definitions. While an extent of convergence is evident, on-going academic debate and research initiatives adopt varying perspectives informed by different theoretical approaches. This is understandable, as by its nature organisational culture and its myriad interrelated dynamics presented by diverse organisations' contexts and circumstances are complex. Consequently, while highlighting that organisational culture can be a source of sustainable competitive advantage (Barney 1986), in their recent extensive review of instruments for exploring organisational culture in the extant literature, Jung et al (2009, p.1087) indeed concluded, as may be expected, that "there is no ideal instrument for [organisational] cultural exploration. The degree to which any measure is seen as 'fit for purpose' depends on the particular reason for which it is to be used and the context within which it is to be applied".

Yet notwithstanding, as inferred earlier, what is almost universally accepted though is that organisational culture can be an intrinsic and invaluable asset that often is the cornerstone of long-term sustainable success. Bontis (1998) suggests that cross-references between intellectual capital data and the cultural dimensions proposed by Hofstede (1980) can show interesting relationships between concepts. In this respect, culture is valued as much, if not more, than tangible assets in mergers and acquisitions because it is not only hard to imitate, but also it may take competitors many years and many mistrials to imitate and attempt to cultivate a successful and healthy organisational culture. Lacking a universal definition, it becomes imperative for each organisation to be able to define and develop a universal language of its own culture – as well as acknowledge that while the other 'C' characteristics influencing IC are also important and influential, ultimately they are in turn, impacted by the underlying organisational culture. For example, all organisations need control mechanisms.

Still the culture of the organisation determines whether such controls stifle or facilitate organisational learning. Often, there are indirect references to the role of organisational culture in intellectual capital literature, particularly as it relates to structural capital where structural capital is defined as the organisation's "*strategies, processes and policies*" (Dzinkowski, 2000). However, an organisation's culture is more than the sum of its strategies, processes and policies.

In this regard, we use the following definition of organisational culture in this paper (Wu, 2008, p. 2540):

"organisational cultures consist of interactions among critical masses of people with different preferences and past choices that have the capacity to wield critical influences upon each other, both in the short and long terms, within and beyond the confines of organisations and resource constraints."

In the next section, we identify and elaborate on an existing model that classifies different types of organisational cultures. We then conceptualise the impact of different types of organisational cultures on intellectual capital.

## **ORGANISATIONAL CULTURE MODELS**

Beyond specifics narrowly associated with particular organisational types, contexts or sectors, in line with stated research objectives, this paper adopts a broader scope on organisational culture towards establishing a generic conceptual platform and model adaptable to different organisations. This enhances applicability for comparative research across different organisational types, sectors or industries, and enables the utilisation of the model as an analytical strategic tool for management practice and consulting purposes.

This paper builds upon the established model of organisational culture types adapted by Deshpande et al (1993) from the works of Quinn and Rohbraugh (1983) and Cameron and Freeman (1991). In a nutshell, the basis for this model derives from Quinn and Rohbraugh's (1983) 'competing values framework' for organisational effectiveness analysis. Their research consolidated extant theoretical and empirical insight, establishing 'control-flexibility' and 'internal-external' as the major dimensions and basis for their practical 2x2 matrix – accounting for and condensing a broad range of important indicators impinging on organisational culture.

Prior to this framework, earlier studies were impractical for organisations to apply given the need to account for numerous dimensions (Quinn and Rohrbaugh 1983). Nonetheless, merging theoretical traditions deriving on the one hand from organisational behaviour and systems-structural domains, and transaction cost perspectives grounded in economics (Williamson 1975) on the other, as well as being consistent with the seminal works of Ouchi (1980), Mintzberg (1979) and Williamson (1975) on organisational forms, the sound relevance of this approach based on two key dimensions defining culture types is recognized and established (Deshpande, 1993; Saxby *et al*, 2002).

Here, this paper adopts and builds further on the slightly modified representation of this model put forward by Saxby *et al* (2002) – which also incorporates generic strategy as well as environmental scanning methods. Generic strategy and organisational culture are inextricably linked (Weick, 1985), and environmental scanning is a behavioural characteristic critical to organisational culture as it impacts the effectiveness of strategic planning towards sustainable competitive advantage in increasingly competitive and dynamic environments. This is aligned to the applied stance of this paper and practice-based application. Additionally, intellectual capital and knowledge being core, the authors of this paper develop this model further and posit that the importance, critical conduciveness to, and strategic relevance of tacit knowledge tends to comparatively increase along the ‘flexibility-control’ continuum on the vertical axis as one moves towards less mechanistic and more organic and unstructured, flexible organisational contexts (Figure 1).

This is crucially important since, all else being equal, as competition intensifies in increasingly dynamic and globalized markets, greater critical importance is placed on tacit forms of knowledge for sustainable competitive advantage and survival (Hall, 1992) – fundamentally in line with the resource- and knowledge-based views of the firm (Barney, 1991; Grant, 1991, 1996). Conversely, organisations competing in dynamic contexts characterized by volatility and greater extents of uncertainty tend to be less effective and conducive to competitiveness when organisational cultures are based on mechanistic processes founded on stability. The enhanced model of organisational culture types established for this paper is presented in Figure 1 below.



axis of this matrix, the 'organisational focus' continuum discerns between organisations' focus in relation to 'internal' or 'external' orientation. The various attributes and distinguishing characteristics of the four culture types are respectively indicated together with reference to the likely complementary generic strategy relevant to those organisational contexts vis-à-vis external environmental conditions typically associated with each culture type for the purposes of strategic fit.

This model (Figure 1) clearly indicates that one cannot be prescriptive when it comes to propose a universally acceptable definition of culture, or to promote an 'ideal' culture. Diverse and varying circumstances demand a culture that would befit the idiosyncratic circumstances of the organisation in question. Against this backdrop we can now conceptualise the role of intellectual capital and the development thereof again in line with the diverse and varying realities within which the organisation is operating – focusing our attention on the particular and unique characteristics of the firm and the realities of their concomitant industry dynamics.

## **FIRM CHARACTERISTICS, INDUSTRY DYNAMICS AND THEIR ASSOCIATION WITH INTELLECTUAL CAPITAL**

In a knowledge-driven economy, business leaders understand the strategic importance and value of intellectual capital and the need to leverage it for the long-term competitive advantage of the firm. While the economic value and sustaining power of intellectual capital is well understood and the direct and strong relationship between intellectual capital and the survival and success of a firm is widely embraced, what is less well understood are how to apply the IC models, tools, techniques and frameworks to deliver bottom line results. According to Reinhardt *et al* (2001, p. 796), "*The interaction between human capital, organisational capital, and customer capital can produce financial capital that, over time, can turn into equity recognized by the capital market, a status that enable the equity in turn, to influence the market value of the company*". In other words, intellectual capital can become the invisible hand that drives a firm's equity and increases its market value. This requires firms to carefully identify, compile, monitor, and grow a firm's intellectual capital assets. While this is necessary, it is not sufficient. Firms must also pay close attention to two additional dimensions: one, the interfaces and interactivity between the compartments or categories of intellectual capital itself, namely human capital, organisational capital, and customer capital, and two, the interfaces and interactivity between a firm's intellectual capital assets and the dynamic

business world within which it operates. It is the dynamic interplay of these two dimensions that results in further expansion and strengthening of a firm's intellectual capital and in turn, leads to *sustainable* competitive advantage and strengthening of its competitive positioning within its industry.

The ability of a firm to become a rigorous, resilient, agile and feared competitor in the marketplace is based on its ability to find the "gold" in the interfaces and interactions' between its human capital, organisational capital, and customer capital. While each one of the three dimensions of intellectual capital can drive profits, the core ability to strengthen and sustain one's competitive position in the marketplace comes from how a firm congeals and leverages the intellectual capital that lies on the borders or fringes of its various intellectual assets. In other words, this dimension determines the level of competitiveness of a firm in the marketplace and can range from highly competitive to non-competitive. The second dimension determines the interfaces and interactions that a firm has with the external world. In other words, how does a firm leverage its intellectual assets to compete in its industry with other competitors? How does it convert its internal currency of intellectual assets into products and services that the market wants and appreciates and more importantly, is willing to pay a premium for over the long-term?

These two dimensions are critical because this is what sets apart the highly competitive, and therefore, often times, the highly successful firms, from the ones that are less competitive and therefore, less successful. Each of these two dimensions is discussed below.

*The role of intellectual capital among highly competitive vs. non-competitive firms*

Molina *et al* (2004) used the following 14 variables to determine a firms' level of competitiveness: market share, profits, return on investment, technological provision, financial management, quality of products-services, after sales service, managers' educational background, customer royalty, supplier loyalty, location of establishment, employees' professional know-how, employees' commitment and loyalty, and firm's reputation. Highly competitive firms have a propensity toward growth and expansion, create and deliver new products and services rather than marketing similar products and services, venture into new markets rather than limiting themselves to existing markets. Molina *et al* (2004) further state that "*executives in highly competitive firms also display greater skilfulness in conceiving, developing, and exploring information technologies*", arguing that IT is a key force in the world of business today. Molina further argues that while both internal forces (business expansion, offerings of

new products and services, new markets, etc...), and external forces or market dynamics influence the competitive nature and positioning of a firm, internal forces are more significant in influencing the level of competitiveness of a firm. Therefore, the intellectual capital of a firm influences a firm's internal forces to become a highly competitive firm in the marketplace. We envision that when there is rich interactivity and interfaces between different segments of intellectual capital, it further strengthens the firm's ability to be perceived as a hard-to-beat competitor.

*The role of intellectual capital and market forces*

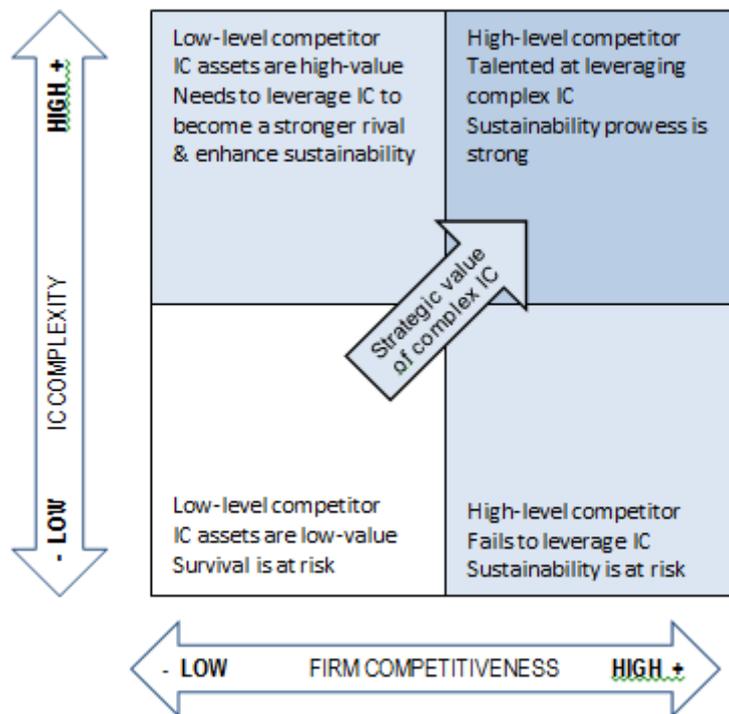
From a theoretical perspective, both the more traditional external/market-driven approaches to strategy (e.g. Porter's five forces analysis) as well as more contemporary approaches primarily driven by an internal emphasis leveraging capability and knowledge (e.g. resource- and knowledge-based views of the firm), require 'fit' between an organisation's strategic initiatives and its broader external environment in order to exploit opportunities for the growth and sustained success of the firm. In other words, firms must focus and build on their capacity and agility to apply their intellectual assets to address shifting market realities (Teece *et al*, 1997; Teece, 1998, 2007; Barney, 2001).

The impact of intellectual capital on the profits of a firm depends on its ability to 'play in its chosen field'. In other words, the internal currency of a firm's intellectual capital can be converted into market 'gold' only if a firm leverages its intellectual capital in ways that are more efficient, effective, valuable, and sustainable than its competitors. It is not enough to just 'play'. Instead, sustainability demands that players in the field be exceptional at changing the rules of the game depending on the landscape, the climate, the tools of the game, the spectators, and other factors that influence the ability to win the game. This is why it is not enough to simply use the same pool of intellectual capital that a firm's competitors have access to, but instead to seek and find higher-order or more complex intellectual capital that often lies hidden in the crevices between the interfaces of different categories of intellectual capital.

The matrix below conceptualises the association between competitive characteristics of a firm and the nature of intellectual capital and its knowledge characteristics (explicit or tacit) that are key success factors for effective competition in such contexts (Figure 2). Hence, in order to achieve sustainable competitive advantage a firm must systematically elevate itself to be a

high-level competitor among rivals and secondly, must apply its intellectual capital to leverage the market dynamics to its advantage.

**Figure 2: IC complexity vs. Firm's Level of Competitiveness**



[Source: The authors]

In consolidation, in Figure 1, we outlined the relationship between 'organisational structures' ranging from mechanistic processes to organic processes, and 'organisational focus' ranging from internal maintenance to external positioning. In Figure 2, we show the relationship between a firm's current competitive position in the marketplace and its stock of complex IC assets. While it is beyond the scope of this paper to elaborate on the relationship between organisational structures, focus, competitive positioning, and complexity level of IC, it is important to reiterate the inter-linkages between these four dimensions. It is clear that organisations that lean toward organic processes with an external focus are likely to rely on intricate and complex IC assets and therefore are likely to be strong players in the marketplace with an ability to keep other rivals at bay.

## CONCLUSION

In an earlier paper, we expanded the framework for intellectual capital to include two additional dimensions – culture and creativity – in addition to the three that are currently noted in the literature, namely competence, commitment, and control. In this paper, we focus on the inter-relationship and impact of culture on intellectual capital. In particular, we show the inter-play between different cultural types and levels of business volatility on intellectual capital and argue that the more volatile the industry is, the greater is the need for tacit knowledge, and the more critical it is for firms operating in this environment to adapt a flexible and organic culture that encourages the creation and leveraging of intellectual capital. Figure 2 may serve as a model against which a firm may check its position in terms of how effectively and proactively it is capitalising on its intellectual capital given the dynamic realities of the environment within which it must compete. This position will eventually help managers to take actionable steps forward to remedy their situation and ensure that they are on the right track towards becoming a high-level competitor because it is talented at leveraging complex intellectual capital thus ensuring its strong sustainability prowess. This conceptual paper sought to preliminarily explore these convergent strands and provide a foundation to encourage additional research to further develop and test these conceptual frameworks in order to establish the interrelationships between organisational culture and intellectual capital.

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## EXAMINING THE SEGMENTATION AND POSITIONING STRATEGIES FOR UNIVERSITIES IN CYPRUS.

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### ABSTRACT

**Purpose** - The purpose of this quantitative, correlational research study was to determine the relationship, if any, between segmentation and positioning strategies employed by universities in Cyprus to increase student enrollment.

**Design, methodology** - Each strategy was individually investigated using quantitative research methodology in one of the study's first two null hypotheses, and then collaboratively examined in the study's third hypothesis.

**Findings** - The findings allowed the rejection of all three null hypotheses. Relationships between segmentation and enrollment and positioning and enrollment were found to be relatively strong, with full-sample correlation coefficients of  $r(334) = .83, p < .01$  and  $r(334) = .86, p < .01$ , respectively. A moderately strong predictive relationship ranged from  $R^2 = .63, F(1, 107) = 183.23, p < .01$  to  $R^2 = .80, F(1, 106) = 415.72, p < .01$  between effective implementation of market segmentation strategy and enrollment. Similar findings showed a moderately strong predictive relationship ranged from  $R^2 = .48, F(1, 334) = 311.09, p < .01$  and  $R^2 = .84, F(1, 106) = 558.92, p < .01$  between effective implementation of positioning strategy and enrollment.

**Practical implications** - Marketers can increase the number of students at their institutions by implementing effectively the segmentation and positioning strategies

**Keywords:** Cyprus, segmentation, positioning, marketing strategy, marketing implementation

## 1. INTRODUCTION

Research studies show that academic administrators do not fully implement marketing strategies along with the concept of marketing. They put in practice promotion and price strategies, ignoring product, and distribution channel strategies. Similar to the findings of Lovelock and Rothschild (1980), Goldgehn (1991) and Helgesen (2008) indicated that U.S. colleges and universities do not implement marketing techniques properly within the context of a marketing plan. In addition, marketers in colleges and universities do not understand the different marketing concepts and hence, marketing strategies are not fully practiced or implemented by the staff (Bingham, 1993; Brown & Oplatka, 2006). These research studies showed that this problem still exists. However, the study's findings were expected to contribute to the existing body of knowledge by providing a current assessment of the segmentation and positioning strategies in the university setting in Cyprus.

## 2. PURPOSE OF THE STUDY

The purpose of this quantitative, correlational research study was to determine the relationship, if any, between segmentation strategies and positioning strategies currently employed by universities in Cyprus to increase their students' enrollment. Enrollment is an important factor that has a significant impact on universities' profitability and their survival. Other factors that have an impact on profitability were the increased expenses, the reduced revenues the waste and unnecessary overhead, none of which were connected to marketing. Marketing strategies were mostly associated with the marketing mix strategies, which different organizations and universities implement in their business and management operations (Kotler & Andreasen, 2008). Other marketing strategies that organizations apply to support the marketing mix strategies are the segmentation and positioning strategies. As a consequence, this research critically examined the segmentation and positioning strategies, which the universities in Cyprus implement in their business operation. The study examined the relationship between the implementation of segmentation and positioning and students' enrollment in a university setting in Cyprus. This research also examined the contribution effect of each strategy on universities' enrollment.

### 3. RESEARCH QUESTIONS

The research questions that have been formulated to examine the purpose of this study were the following:

1. To what extent, if any, is there a relationship between the implementation of a segmentation marketing strategy and enrollment in the Cyprus universities?
2. To what extent, if any, is there a relationship between the implementation of a positioning marketing strategy and enrollment in the Cyprus universities?
3. Which, if any, of the marketing strategies of segmentation and positioning more strongly relate to enrollment in the Cyprus universities?

The hypothesis questions for this quantitative research study are as follows:

*H1<sub>o</sub>*: There is no correlation between the implementation of a segmentation marketing strategy and enrollment in the Cyprus universities.

*H1<sub>a</sub>*: There is a correlation between the implementation of a segmentation marketing strategy and enrollment in the Cyprus universities.

*H2<sub>o</sub>*: There is no correlation between the implementation of a positioning marketing strategy and enrollment in the Cyprus universities.

*H2<sub>a</sub>*: There is a correlation between the implementation of a positioning marketing strategy and enrollment in the Cyprus universities.

*H3<sub>o</sub>*: There is not a strong relationship between the marketing strategies of segmentation and positioning and enrollment in the Cyprus universities.

*H3<sub>a</sub>*: There is a strong relationship between the marketing strategies of segmentation and positioning and enrollment in the three private Cyprus universities.

### 4. THEORETICAL FRAMEWORK

This brief review of the literature shows that universities do not fully practice segmentation, positioning and marketing mix strategies and hence, it can be argued that this has a significant effect on the business operations and on the students' enrollment (Anctil, 2008; Brown & Oplatka, 2006; Gabbott & Sutherland, 1993; Ghosh, Javalgi & Whipple, 2008;

Goldgehn, 1991; Johnson, Jubenville & Goss, 2009; Lovelock & Rothschild, 1980; Washburn & Petrosious, 2004). These studies examined only one concept of marketing mix, which was the marketing communications, or promotion, ignoring the other concepts that were the product, the place, the price, the segmentation, the targeting, and the positioning strategies (Chimanzi, 2004; Opoku, Hultman & Esmail, 2008). Hence, it can be argued that this has a significant effect on the students' enrollment because universities do not fully practice all fundamental marketing strategies. In addition, the decrease in enrollments affects not only the image and reputation of higher institutions but also their business operations.

Many researchers point out that the philosophy of marketing and specifically the different marketing strategies can contribute to the universities' greater effectiveness (Burns & Hayes, 1991; Ghosh, Javalgi & Whipple, 2008). Hence, the marketing strategies of segmentation and positioning can contribute effectively on the profitability of the different universities. Nevertheless, this brief review of the literature shows that research studies do not have enough evidence of how colleges and universities implement the different marketing strategies. On this perspective, this brief review of the literature shows that there are no formal surveys that examine the relationship between the effective marketing strategies and enrollment in a university setting. In addition, the literature review shows that there are no formal research studies that examine the contribution effect of each strategy on students' enrollment. This relevant literature review indicates a relationship between implementation of segmentation strategy and promotion strategy and enrollment, and the contribution effect of each strategy on organization's enrollment. However, studies do not prove this relationship and the contribution effects of the segmentation, positioning and marketing mix strategies in a university setting. Hence, it can be argued that the examination of the above relationship as well as the examination of the contribution effects of these marketing strategies was a need for additional research within the area of marketing strategies in a university setting.

## **5. SELECTION OF PARTICIPANTS**

The research questions for this study were examined with the method of quantitative research. Questionnaire surveys were given to academic administrators or public relations officers at each of the universities to examine the implementation of the different marketing strategies in their workplace. The universities in Cyprus were studied as one unit. In addition, the analysis was broken down by individual university, then the findings were

summarized to compare and contrast the different universities. The target population of this research study was 600 respondents. Specifically, the total employee target population for this study was 600 representing: 200 in the first university; 200 in the second university; and 200 in the private university. Questionnaires were given to academic administrators or public relations officers to each university, striving for as large a sample as possible, with a hope of a 50% sample. This research did not examine the entire population because then would not be able to conduct inferential statistics. Hence, a simple random sampling was used to select the participants. This study did not include students in the target population because the purpose of this proposed quantitative research study was to determine the relationship, if any, between segmentation strategies and positioning strategies implemented by academic administrators and directors of the administrative staff to increase students' enrollment.

An a priori power analysis using GPOWER (Faul & Erdfelder, 1992) was carried out to determine an appropriate sample size. The power of a test indicates the probability of correctly rejecting a false null hypothesis (Cohen, 1989). To detect a medium effect size ( $d = 0.5$ ), a total sample size of 176 was needed to conduct a one tailed paired sample  $t$  test on means with  $\alpha = 0.05$ , and power = 0.95, and a sample of 140 was required for  $\alpha = 0.01$  and power = 0.99. The total employee target population for this study is 600 participants. Hence, a priori power analysis using GPOWER was carried out to determine an appropriate sample size. A pilot study was conducted to test and determine the survey's effectiveness. A pilot test of the survey instrument was conducted with 40 academic administrators at each of the universities. For this reason, the number of the pilot test participants was 120. Based upon information collected, the study was modified accordingly.

## 6. RESULTS

### *6.1 Analysis of research question and hypothesis 1.*

The outcome of the correlation for the full sample is presented in Table I. This demonstrates a correlation of  $r(334) = .83$ ,  $p < .01$  at the .01 significance level between the two variables identified in the full sample (perceived effectiveness of implementation of segmentation strategies and perceived impact of segmentation strategies on enrollment). This correlation coefficient was found to be significant at the 0.01 level, exceeding the threshold of significance  $p < .05$  that was set for analysis.

Thus, in terms of the full sample, hypothesis 1 (alternative hypothesis) could be said to be supported and the null hypothesis was rejected.

**Table I.**

Correlation Across Full Sample for Perceived Effectiveness of Implementation of Segmentation Strategies and Perceived Impact of Segmentation Strategies on Enrollment

Correlations			Perceived effectiveness of implementation of Segmentation Strategies	Perceived impact of segmentation of strategies on enrollment
Perceived effectiveness of implementation of Segmentation Strategies	of Pearson Correlation	1.000	.83**	
	Sig. (2-tailed)		.000	
	N	336	336	
Perceived impact of segmentation strategies on enrollment	of Pearson Correlation	.83**	1.000	
	Sig. (2-tailed)	.000		
	N	336	336	

\*\* . Correlation is significant at the 0.01 level (2-tailed).

The analysis process above was repeated using the same evaluation levels, following a process that split the original data set into three separate, smaller datasets. This split was accomplished using the SELECT CASES function in SPSS, with the selection mode indicating "IF UNIS=?" (with each individual university selected in turn). Each sorted university dataset was then saved to its own file to facilitate the analysis process. The results of each individual university correlation are identified below.

The correlation outcomes between the two variables in use for this hypothesis at University A are presented in Table II. Using the same evaluation criteria as above, this correlation was found to be  $r(107) = .80, p < .01$  between the two variables with significance at the 0.01 level (two-tailed), below the  $p < .05$  level that was identified as the significance level

required for acceptance. Thus, for University A the null hypothesis was rejected and the alternative hypothesis was once again accepted.

**Table II.**

Correlation Between Perceived Effectiveness of Implementation of Segmentation Strategies and Perceived Impact of Segmentation Strategies on Enrollment at University A

Correlations <sup>a</sup>			Perceived effectiveness of implementation of Segmentation Strategies	Perceived impact of segmentation of strategies on enrollment
Perceived effectiveness of implementation of Segmentation Strategies	of Pearson	1.000		.80**
	of Correlation			
	<i>Sig.</i> (2-tailed)			.000
	<i>N</i>	109		109
Perceived impact of segmentation strategies on enrollment	of Pearson	.80**		1.000
	of Correlation			
	<i>Sig.</i> (2-tailed)	.000		
	<i>N</i>	109		109

\*\* . Correlation is significant at the 0.01 level (2-tailed).

a. Universities = University A

The results of the correlation analysis as performed above at University B are presented in Table III. Once again, significance at the 0.01 level (two-tailed) is found between perceived effectiveness of implementation of segmentation strategies and perceived impact of segmentation strategies on enrollment at University B only for a correlation coefficient of  $r(117) = .83, p < .01$ . Thus, for University B the null hypothesis was rejected and the alternative hypothesis was once again accepted.

**Table III.**

Correlation Between Perceived Effectiveness of Implementation of Segmentation Strategies and Perceived Impact of Segmentation Strategies on Enrollment at University B

Correlations <sup>a</sup>		Perceived effectiveness of Segmentation Strategies	Perceived impact of segmentation strategies on enrollment
Perceived effectiveness of implementation of Segmentation Strategies	of Pearson Correlation	1.000	.83**
	<i>Sig.</i> (2-tailed)		.000
	<i>N</i>	119	119
Perceived impact of segmentation strategies on enrollment	of Pearson Correlation	.83**	1.000
	<i>Sig.</i> (2-tailed)	.000	
	<i>N</i>	119	119

\*\* . Correlation is significant at the 0.01 level (2-tailed).

a. Universities = University B

The same process was used to identify the correlation, if any, between perceived effectiveness of implementation of segmentation strategies and perceived impact of segmentation strategies on enrollment at University C. The results of this analysis are presented in Table IV. This analysis showed a correlation coefficient of  $r(106) = .89$ ,  $p < .01$ , which was significant at the 0.01 level (below the  $p < .05$  level that was identified as the significance level required for acceptance). Thus, at University C as well, the null hypothesis for Hypothesis 1 was rejected and the alternative hypothesis was accepted.

**Table IV.**

Correlation Between Perceived Effectiveness of Implementation of Segmentation Strategies and Perceived Impact of Segmentation Strategies on Enrollment at University C

Correlations <sup>a</sup>		Perceived effectiveness of Segmentation Strategies	Perceived impact of segmentation strategies on enrollment
Perceived effectiveness of implementation of Segmentation Strategies	Pearson of Correlation	1.000	.89**
	<i>Sig.</i> (2-tailed)		.000
	<i>N</i>	108	108
Perceived impact of segmentation strategies on enrollment	Pearson of Correlation	.89**	1.000
	<i>Sig.</i> (2-tailed)	.000	
	<i>N</i>	108	108

\*\* . Correlation is significant at the 0.01 level (2-tailed).

a. Universities = University C

The analysis of hypothesis 1 indicated that the correlation coefficients were  $r(334) = .83, p < .01$  (full sample),  $r(107) = .80, p < .01$  (University A),  $r(117) = .83, p < .01$  (University B), and  $r(106) = .89, p < .01$  (University C), with significance for all correlation coefficients at the 0.01 level, which was below the  $p < .05$  level that was identified as the significance level required for acceptance. At all levels of analysis, including at the sample-wide level as well as at each of the universities, the null hypothesis for H1 was rejected and the alternative hypothesis was accepted. The research demonstrated that there was a correlation between the implementation of a segmentation marketing strategy and enrollment in the universities in Cyprus.

### 6.2 Analysis of research question and hypothesis 2.

As with hypothesis 1, a split dataset was used to generate both full sample outcomes and individual university outcomes for consideration and to ensure that the same results were found among the various datasets. The existing split data sets were used for this analysis as well, as the same variables were available within these data sets.

The first correlation for the two variables for hypothesis 2 was performed across the full sample, which included all three universities and is presented in Table V. This correlation analysis showed a correlation of  $r(334) = .86$ ,  $p < .01$  between perceived effectiveness of implementation of positioning strategies and perceived impact of positioning strategies on enrollment, at a significance level of 0.01. This is lower than  $p < .05$  (the established significance level threshold) and thus, the null hypothesis  $H_{2o}$  was rejected for the full sample and the alternative hypothesis is accepted. This analysis was repeated on the individual university level to determine if the results are consistent across all three universities.

**Table V.**

Correlation Across Full Sample for Perceived Effectiveness of Implementation of Positioning Strategies and Perceived Impact of Positioning Strategies on Enrollment

Correlations			Perceived effectiveness of implementation positioning strategies	Perceived impact of positioning strategies on enrollment
Perceived effectiveness of implementation positioning strategies	of Pearson Correlation	1.000		.86**
	Sig. (2-tailed)			.000
	N	336		336
Perceived impact of positioning strategies enrollment	of Pearson Correlation	.86**		1.000
	Sig. (2-tailed)	.000		
	N	336		336

\*\* . Correlation is significant at the 0.01 level (2-tailed).

The analysis above was repeated using the same variables and statistical significance level of  $p < 0.05$  at the individual university level to determine if the correlation observed in the full sample persisted across all three universities. This section presents the results of these three correlation processes, which were constructed using the split data set as indicated above. The results of the correlation analysis as performed above at University A are demonstrated in Table VI. In common with the full sample, university A showed a correlation between the two variables tested. A correlation coefficient of  $r(107) = .81, p < .01$  was found to be significant at the 0.01 level, exceeding the threshold of significance  $p < .05$  that was set for analysis. Thus, for University A this was found to be a significant correlation and allowed the rejection of  $H2_0$  and the acceptance of  $H2_a$ .

**Table VI.**

Correlation for Perceived Effectiveness of Implementation of Positioning Strategies and Perceived Impact of Positioning Strategies on Enrollment at University A

Correlations		Perceived effectiveness of implementation positioning strategies	Perceived impact of positioning strategies on enrollment
Perceived effectiveness of implementation positioning strategies	of Pearson of Correlation	1.000	.81**
	Sig. (2-tailed)		.000
	N	109	109
Perceived impact positioning strategies enrollment	of Pearson on Correlation	.81**	1.000
	Sig. (2-tailed)	.000	
	N	109	109

\*\* . Correlation is significant at the 0.01 level (2-tailed).

a. Universities = University A

The results of the correlation analysis as performed above at University B are presented in Table VII. University B demonstrated a very similar ranking to university A, with a correlation coefficient of  $r(117) = .87, p < .01$  which was found to be significant at the

0.01 level (below the  $p < .05$  level that was identified as the significance level required for acceptance). Thus, at the University B level as well as at the university A data level and in the full data set,  $H2_0$  may be rejected and  $H2_a$  may be accepted.

**Table VII.**

Correlation for Perceived Effectiveness of Implementation of Positioning Strategies and Perceived Impact of Positioning Strategies on Enrollment at University B

Correlations <sup>a</sup>		Perceived effectiveness of implementation positioning strategies	Perceived impact of positioning strategies on enrollment
Perceived effectiveness of implementation positioning strategies	of Pearson of Correlation	1.000	.87**
	<i>Sig. (2-tailed)</i>		.000
	<i>N</i>	119	119
Perceived impact positioning strategies enrollment	of Pearson on Correlation	.87**	1.000
	<i>Sig. (2-tailed)</i>	.000	
	<i>N</i>	119	119

\*\* . Correlation is significant at the 0.01 level (2-tailed).

a. Universities = University B

The final test that was performed during the examination of this area was for the University C dataset. The results of the correlation analysis as performed above at University C are presented in Table VIII. This analysis showed an even stronger correlation than any of the other three tests that had been performed. With a correlation coefficient of  $r(106) = .92, p < .01$  and a significance level of 0.01 (below the  $p < .05$  level that was identified as the significance level required for acceptance), this test also demonstrated a statistically significant correlation between the two variables that were tested, leading to a rejection of the null hypothesis  $H2_0$  and an acceptance of the alternative hypothesis  $H2_a$ .

**Table VIII.**

Correlation for Perceived Effectiveness of Implementation of Positioning Strategies and Perceived Impact of Positioning Strategies on Enrollment at University C

Correlations		Perceived effectiveness of implementation of positioning strategies	Perceived impact of positioning strategies on enrollment
Perceived effectiveness of implementation of positioning strategies	of Pearson of Correlation	1.000	.92**
	<i>Sig.</i> (2-tailed)		.000
	<i>N</i>	108	108
Perceived impact of positioning strategies on enrollment	of Pearson of Correlation	.92**	1.000
	<i>Sig.</i> (2-tailed)	.000	
	<i>N</i>	108	108

\*\* . Correlation is significant at the 0.01 level (2-tailed).

a. Universities = University C

The correlation coefficients found during the analysis of hypothesis two indicated that there were correlations of  $r(334) = .86, p < .01$  (for the full data set),  $r(107) = .81, p < .01$  (for University A),  $r(117) = .87, p < .01$  (for University B), and  $r(106) = .92, p < .01$  (for University C). All of these correlation coefficients were supported at a statistical significance level of 0.01, which was below the significance level of .05 that was set by the researcher for acceptance of the null hypothesis. This analysis showed that at every level the null hypothesis for Hypothesis 2 was to be rejected and the alternative hypothesis to be accepted. That is, the findings supported the contention that there is a correlation between the implementation of a positioning marketing strategy and enrollment in the universities in Cyprus.

### 6.3 Analysis of research question and hypothesis 3.

The analyses for research questions 1 through 2 focused on correlations, or identification in similarities of performance. However, this did not allow direct comparison of

the results, nor did it allow direct identification of the relationships between variables that may be found in this case. Furthermore, as correlation did not imply causation, it did not say anything about the potential causal relationships between the variables. To determine if there was a relationship between these two factors and enrollment, linear regression was chosen to examine this relationship.

Two linear regression processes were used to explore the issues involved in this evaluation. This was evaluated using a significance level of  $p = 0.05$ . These two regression processes were repeated four times each, as with the correlation processes. These included the full sample (all three universities combined) as well as individual runs for University A, University B, and University C. The results of this analysis are presented below, divided by the sample including full sample, University A, University B, and University C findings. The variable pairings used in three separate linear regression determinations for each of the analysis levels are identified in Table IX. These variables are consistent throughout the analysis levels.

**Table IX.**

Variable Specifications for Linear Regression Process

Variable	Description
X <sub>1</sub> (Independent)	Perceived effectiveness of implementation of Segmentation strategies
Y <sub>1</sub> (Dependent)	Perceived impact of segmentation strategies on enrollment
X <sub>2</sub> (Independent)	Perceived effectiveness of implementation of positioning strategies
Y <sub>2</sub> (Dependent)	Perceived impact of positioning strategies on enrollment

All regression equations were specified in the form  $Y_i = \text{slope} * X_i + \text{intercept}$ , in which  $i$  = the number of the variable as specified above. Each variable number corresponded to the related correlation-based hypothesis above. Each equation was specified for the variable pair using the appropriate matrix determination (Constant/B for the slope and Variable/B for the intercept).  $R^2$  values (from 0 to 1) were used to determine the strength of the relationship described by each equation, and the ANOVA output from each was used to determine if the relationship was statistically significant.

Following the process of specification for each of the models, the  $R^2$  values for each of the outcomes were considered to determine how strong the relationship between the two

variables was. The  $R^2$  value varies between 0 and 1, with 0 indicating no significant relationship and 1 indicating an absolute relationship.

The  $R$ ,  $R^2$  (coefficient of determination) and regression equation determined for each of the two variable pairings in the full sample are described in Table X.

**Table X.**

Linear Regression Outcomes ( $R$ ,  $R^2$  and Regression Equation) for Each Variable Pair, Full Sample

Variables	$R$	$R^2$	Regression Equation	$F$	ANOVA Sig.
$X_1$ (Independent)	.83	.70	$Y_1 = .206X_1 + (-.501)$	762.32	.000
$Y_1$ (Dependent)					
$X_2$ (Independent)	.69	.48	$Y_2 = .183X_2 + .016$	311.09	.000
$Y_2$ (Dependent)					

In the case of the relationship between  $X_1$  and  $Y_1$ , the  $R^2 = .70$ ,  $F(1, 334) = 762.32$ ,  $p < .01$  value indicates a moderate relationship between the two variables; colloquially, 70% of the variation in  $Y_1$  can be explained by the corresponding value of  $X_1$ . The ANOVA output for this test indicates a significance of .000, which is below the significance threshold of  $p = 0.05$ . Thus, this is accepted as a valid and statistically significant relationship on the sample-wide level. The  $R^2 = .48$ ,  $F(1, 334) = 311.09$ ,  $p < .01$  value in the regression analysis between  $X_2$  and  $Y_2$  indicates a more modest relationship. This demonstrated that 48% of the variation in outcomes in  $Y_2$  was explained in variation in  $X_2$ . In addition, it was a less convincing relationship and may make prediction based on  $X_2$  considerably harder, but remained a relationship that should be considered. The ANOVA test for this linear regression shows a significance level of .000, below the established level of  $p = .05$  required for assignment of statistical significance. Thus, this linear regression relationship is also accepted on the sample-wide level.

The analysis process was performed in the same way for University A as it was for the sample on the whole. The most important outcomes for the linear regression equations constructed for University A are demonstrated in Table XI. It should be noted that although the specific numbers were different in this case, the general strength of the relationships in each of the three cases was similar to the sample-wide pattern.

**Table XI.**

Linear Regression Outcomes ( $R$ ,  $R^2$  and Regression Equation) for Each Variable Pair, University A

Variables	$R$	$R^2$	Regression Equation	$F$	ANOVA Sig.
$X_1$ (Independent)	.795	.63	$Y_1 = .203X_1 + (-.459)$	183.23	.000
$Y_1$ (Dependent)					
$X_2$ (Independent)	.805	.65	$Y_2 = .208X_2 + (-.511)$	196.71	.000
$Y_2$ (Dependent)					

The relationship between  $X_1$  and  $Y_1$  demonstrated an  $R^2 = .63$ ,  $F(1, 107) = 183.23$ ,  $p < .01$  value (indicating that 63% of the variance in  $Y_1$  could be explained by  $X_1$ ). Although not a perfect predictive measure, this is relatively strong. The ANOVA analysis for this process demonstrated a significance of .000, lower than the  $p = .05$  threshold that was set. Thus, this can be seen to be a moderately strong and statistically significant relationship. The relationship between  $X_2$  and  $Y_2$  was a bit stronger, with an  $R^2 = .65$ ,  $F(1, 107) = 196.71$ ,  $p < .01$  value (indicating 65% of the variation in  $Y_2$  being explained by  $X_2$ ). This was accompanied by a statistical significance level in the ANOVA of .000, indicating that again this represented a moderately strong and statistically significant predictive relationship. The same process was used to create linear regressions for University B as in the other samples. The results of this are presented in Table XII.

**Table XII.**

Linear Regression Outcomes ( $R$ ,  $R^2$  and Regression Equation) for each Variable Pair, University B

Variables	$R$	$R^2$	Regression Equation	$F$	ANOVA Sig.
$X_1$ (Independent)	.83	.70	$Y_1 = .217X_1 + (-.763)$	267.28	.000
$Y_1$ (Dependent)					
$X_2$ (Independent)	.87	.76	$Y_2 = .216X_2 + (-.669)$	372.59	.000
$Y_2$ (Dependent)					

The relationship between  $X_1$  and  $Y_1$  in this case indicated an  $R^2 = .70$ ,  $F(1, 117) = 267.28$ ,  $p < .01$  value (indicating that 70% of the variation in  $Y_1$  is because of  $X_2$ ). This was accompanied by an

ANOVA significance level of .000, indicating that this was a statistically significant result. This can be described as a moderately strong relationship between these variables. The  $R^2 = .76$ ,  $F(1, 117) = 372.59$ ,  $p < .01$  value for  $X_2$  and  $Y_2$  showed one of the strongest relationships (indicating that 76% of the variation in  $Y_2$  was associated with the value of  $X_2$ ). This also showed an ANOVA significance of .000, indicating that the relationship was statistically significant. This is the one of highest levels of predictive power seen in the results as a whole.

Linear regressions were prepared for University C in the same fashion as the previous results. The outcomes of this analysis are described in Table XIII.

**Table XIII.**

Linear Regression Outcomes ( $R$ ,  $R^2$  and Regression Equation) for each Variable Pair, University C

Variables	$R$	$R^2$	Regression Equation	$F$	ANOVA Sig.
$X_1$ (Independent)	.89	.80	$Y_1 = .201X_1 + (-.337)$	415.72	.000
$Y_1$ (Dependent)					
$X_2$ (Independent)	.92	.84	$Y_2 = .211X_2 + (-.572)$	558.92	.000
$Y_2$ (Dependent)					

The first relationship,  $X_1$  and  $Y_1$ , indicates a very strong result with an  $R^2 = .80$ ,  $F(1, 106) = 415.72$ ,  $p < .01$  value (indicating that 80% of the variation in  $Y_1$  can be attributed to the value of  $X_1$ ). The statistical significance of this finding was indicated by the ANOVA statistical result of .000. Thus, this was accepted as a predictive model. The second relationship between  $X_2$  and  $Y_2$  also showed a very strong  $R^2 = .84$ ,  $F(1, 106) = 558.92$ ,  $p < .01$  value (indicating that 84% of the variation in  $Y_2$  at University C could be explained by  $X_2$ ). The statistical significance of this result is indicated by the ANOVA significance value of .000. Thus, this was accepted as a very strong predictive relationship.

The findings for the full sample level and at individual levels were consistent, although they varied in specific level. All results that were found were statistically significant. For the relationship between  $X_1$  and  $Y_1$  in all sample sets, there was a moderate to strong relationship ranged from  $R^2 = .63$ ,  $F(1, 107) = 183.23$ ,  $p < .01$  to  $R^2 = .80$ ,  $F(1, 106) = 415.72$ ,  $p < .01$ . This indicates that there is a predictive relationship between effectiveness of market segmentation performance and the impact of market segmentation on enrollment levels as

indicated by the findings of this study. The relationship between  $X_2$  and  $Y_2$  was similar in magnitude to the relationship between  $X_1$  and  $Y_1$ . The  $R^2$  value for this pairing ranged between  $R^2 = .48$ ,  $F(1, 334) = 311.09$ ,  $p < .01$  (in the full sample) and  $R^2 = .84$ ,  $F(1, 106) = 558.92$ ,  $p < .01$ . This demonstrates a widely variable but moderate relationship between the variables, which represented the effectiveness of a positioning strategy and the impact of positioning on enrollment levels as indicated by this study.

## 7. CONCLUSIONS

This research has shown that academic administrators appear to have a moderate to strong grasp of the use of segmentation and positioning strategies to force increased enrollment. As a consequence, the implementation of marketing is becoming increasingly effective in the university environment. Nevertheless, there are still some areas for possible improvement that were highlighted by this study. The most noticeable one is the concept of the marketing mix. Currently, it can be expected that universities make use of marketing communications or promotion such as catalogues and view books, websites, and other materials strongly to remain competitive and to draw in students. Universities use these marketing communications tools to reach students and to drive up enrollment figures. However, the use of promotion tools is not enough to sustain a long-term enrollment increase, and thus does not represent sufficient use of the marketing mix. University administrators need to consider other elements of the marketing mix to improve the enrollment outcomes. For example, private universities can increase their competitive positioning in the market by implementing the pricing feature of the marketing mix.

Thus, universities could increase enrollment from students seeking relief from increasing higher education costs in the private area by pricing their product competitively in the marketplace. However, universities must also consider the fact that may even discourage enrollment if students perceive that they are receiving an inferior product because costs are substantially lower than their competitors. Examining ways in which more of the marketing mix can be used, rather than simply the marketing communications aspects, will help to increase the university's value for money put into the marketing mix. Universities must understand that sustaining or increasing enrollment is essential for maintaining competitive advantage in the market, and so should not automatically reject any marketing mix element that will allow them to maintain this advantage.

One area that this research has provided a contribution is in formal study of the relationship between segmentation and positioning strategies and enrollment in a university setting. Thus, this research filled a gap regarding the implementation of marketing strategies in the university setting; whereas the literature review noted there has been little or no formal study. However, this research was conducted in a university setting, and did not examine interaction effects between the various marketing strategy tools. Instead, it focused on identifying individual effects of the segmentation and positioning on enrollment. This does leave an ongoing gap in the research in identifying, which of the various marketing mix strategy tools or elements such as product, price, promotion and place contribute to the student decision to enroll. Furthermore, another area of study that could be a good area for further research into the subject is the examination of the additional elements of the extended marketing mix such as people, process, and physical evidence. One suggestion for future study is regarding the possible ambiguous term of marketing mix. An avenue for further research might be to break down this term into specific terms such as price product, promotion and place to more accurately assess each variable's impact. In addition, it may be academically advantageous to expand the study to include other countries, such as those in Europe or the United States.

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## SOCIAL ASPECTS OF CORPORATE GOVERNANCE

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### ABSTRACT

The genesis of socially responsible investing in global corporate governance practices has been studied, the benefits of socially responsible investing has been identified, socially responsible investments and their methods have been classified, problems that prevent the formation and development of social responsibility and socially responsible investment of corporations in Ukraine have been identified, directions to encourage social responsibility have been proposed.

**Keywords:** corporate governance, social responsibility of corporations, socially responsible investment, social investment of the business, stakeholders, screening, government's motivation of corporation to social responsibility.

### INTRODUCTION

Current complex situation caused by the broad spectrum of economic, social and ecological problems the solution of which requires active participation of government and local authorities, businesses and citizens, made the world community come up with the concept of sustainable growth. This idea of this concept is to ensure economic growth and people's social security system while decreasing negative impact on the environment.

Social responsibility of corporations (SRC) has become the big business's contribution to the sustainable growth; which means its responsibility for the impact of their decisions and activity on society and environment, as well as providing stakeholders with full and reliable information.

### PROBLEM DEFINITION

The concept of social responsibility of corporations (SRC) as the tool for cooperation and partnership between the state and businesses as well as the way of improving social and labor relations during economic transformations has become the subject of the active discussion in scientific and business circles. The leading international agencies such as the United Nations,

International Standardization Organization, World Bank, UNESCO and others carry out varied research projects in this sphere. Problems of corporate governance and social responsibility of corporations have been researched by the following foreign scholars: Y. Blagov, A. Berli, G. Bowen, M. Van Marreviyk, N. Jacob, K. Devis, T. Donaldson, P. Draker, A Carroll, G. Minz, J. Moon, D. Matten, L. Preston, G. Fitch, W. Frederick, M. Friedman, R. Freeman, V. N. Yakimets and Ukrainian scientists: A. I. Amosha, V. A. Yevtushevskii, D. G. Lukianenko, A. S. Povazhniy, V. S. Ponomorenko, I. L. Sazonets, M. G. Chumatchenko, O. M. Yastremska and others.

Today a growing number of corporations have come to understanding that focusing only on financial aspects of the activities is not enough for the successful business. The increase of social funds, and pro-active attitude of the company in the sphere of social responsibility of corporations form their positive image, and raise the confidence of the shareholders, investors and other stakeholders.

Social responsibility of corporations is a socioeconomic institution that operates as a partnership of corporation and stakeholders, reduces the transactional expenses, finds the solution to the conflict of interest and obtains stable competitive positions by the corporation by means of social responsible investment, social reporting, social partnership, dividend policy and corporate communication. The study, generalization and adaptation of progressive world experience are quite important for establishing this institution in Ukraine. It is reasonable to consider the first instrument of corporate social responsibility that is socially responsible investment and to offer mechanisms how to adapt the best world practices in Ukraine.

The aim of the article is to study social aspects of corporate governance and socially responsible investments in particular that is one of the most important tools for improving corporate social responsibility.

## **RESEARCH RESULTS**

Today more and more investors understand the significance of nonfinancial factors in forming capitalization. They have an opportunity to contribute to the sustainable growth through socially responsible investment (SRI) in order not only receive profit from the money invested, but also create positive social changes, to reduce negative impact on the environment.

SRI is a process when the company chooses social responsibility and uses the appropriated social investments to benefit the main stakeholders and local community.

Summarizing the definitions of banks social investments given by V. N. Yakimtsev, L. I. Sazonets, Y. E. Blagov we come to the conclusion that social investments of the business are

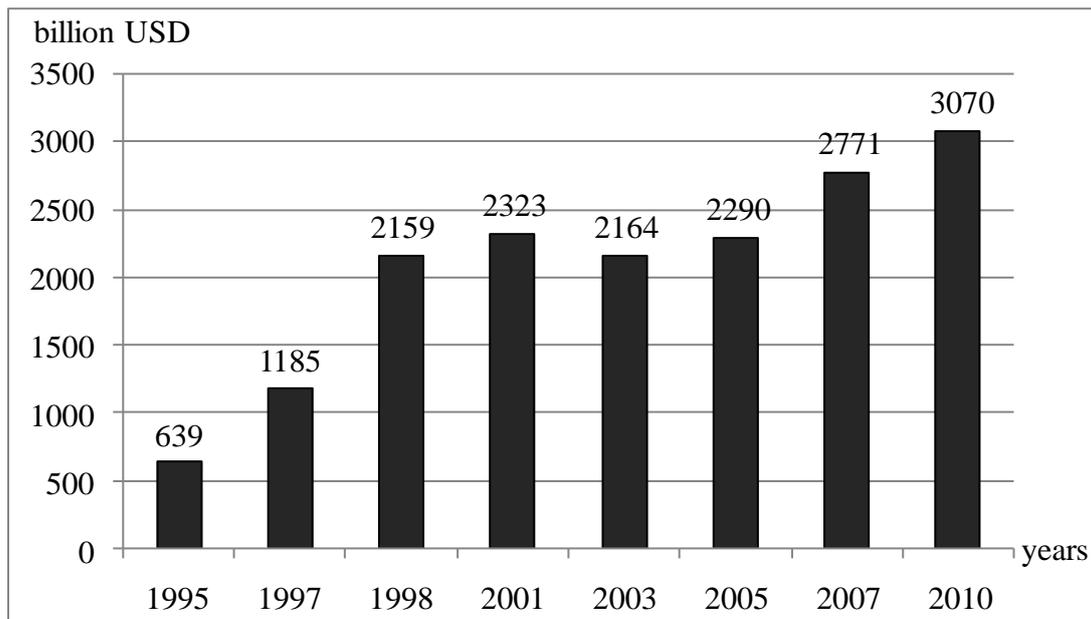
material, technological, administrative resources, financial funds of the corporation, that by the management decision are channeled to implement social programs, that are of interest to the main internal and external interested parties with a view to receive certain social and economic strategic effect [1, 10, 14].

SRI on the stock markets began to develop in 1960<sup>th</sup> and during next 20 years it was in congruence with the term „ethical investing" in a greater or lesser degree. Later it became only one of social responsible investment trends. The reaction of the civil society to the ethical problems became an impulse for SRI development in the USA. The establishment of PAX World Fund in 1971 that refused to invest money in those companies that received profit from the Vietnam War became a historical event. At that time Sullivan Principles were developed in the USA that confronted companies trying to invest into Republic of South Africa supporting existing apartheid regime there.

The European nations' concern about the problems related to human rights and labor practices had determined social criteria for making investment decisions. As a result, in the 1980<sup>th</sup> the transfer of „ethical investing" into „social responsible investment" started. In the 1990<sup>th</sup> the concept of sustainable growth and climate change hypothesis received international recognition. In view of that, the concept of SRI also included an environmental aspect.

The Russian scholar Y. E. Blagov states that after high-profile corporate scandals at the beginning of the 21<sup>st</sup> century such as the crash of Enron and WorldCom, the governors of the stock markets began to emphasize corporate governance. In 2002 in the USA the Sarbanes-Oxley law was adopted. It stated the demands to the emitters about internal audit, administration and information disclosure. The investors began to treat emitters' corporate government with more attention. It was accomplished by turning it into one of SRI's directions [1].

Within last fifteen years the corporate's investments into socially responsible programs in the USA raised five times and accounted for 3 billion US dollars in 2010 (Figure1) [12].

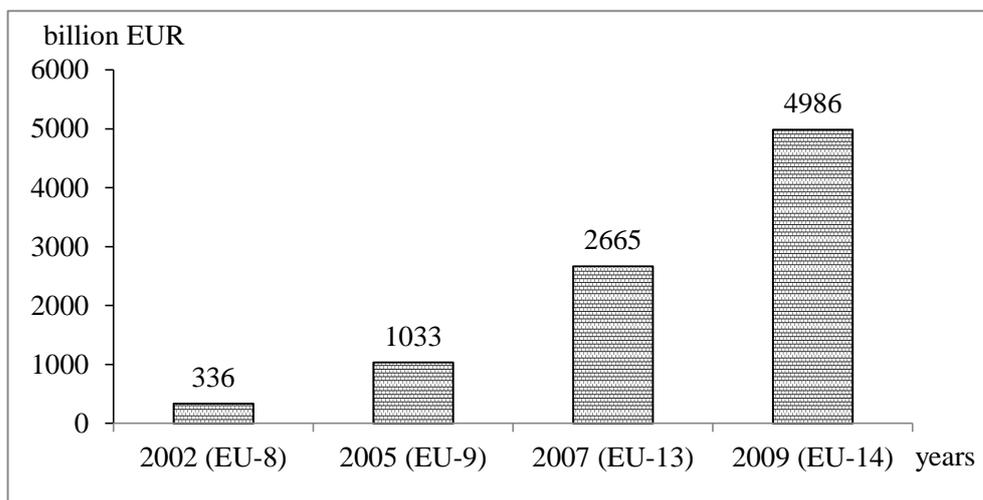


**Figure 1. Volume of socially responsible investments in the USA in 1995-2010**

Source: Stock markets in context of „Ernst&Yang" stable development, 2011.

Within 40 years SRI has evolved from individual practices of ethical investments to the separate segment of stock market with its participants and substructure.

At the beginning of 2010 the world volume of SRI was rated at about \$10,9 trillion that is 50 % more than in 2007 before the world economic crisis (Figure 2).



**Figure 2. Volumes of social investments in the world**

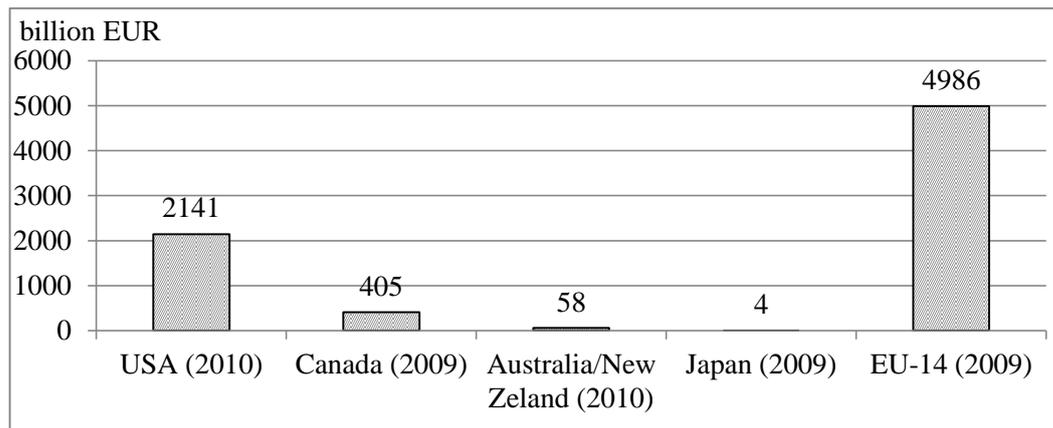
Source: Stock markets in context of „Ernst&Yang" stable development, 2011

Since PAX World Funds establishment in 1971 the number of investors who use SRI methods has considerably increased. There have been formed groups of institutional and individual investors in developed countries that follow the SRI established directions, criteria and methods.

Financial institutions that invest their own funds, insurance companies and retirement funds, investment banks (companies), that exercise administration of legal bodies' holdings, including churches, public and education institutions belong to the institutional investors in socially responsible investments.

The Ministry of Finance in Norway stated in the monitoring survey that retirement funds appeared to be SRI development catalysts. Thus, in 2000 there were some changes in pension legislation introduced in Great Britain and then in other countries of the EU and the USA. According to these amendments the retirement funds were obligated to broaden the degree of their participation in the SRI. For example, Norwegian State Fund has to „avoid the investment, which is bound with an unacceptable risk of assisting unethical conduct, particularly the violation of the fundamental humanitarian principles, serious human right violation, corruption or essentially negative environmental impact" [9].

Individual investors in SRI are investment companies that represent the interests of private persons or the private persons themselves who are professional participants in the stock market. The most popular form of SRI realization for the individual investors is unit (mutual) investment funds. In 2010 there were 879 mutual SRI funds in Europe, their volume accounted for about 75 billion euro, in the USA there were 250 mutual funds with the volume about \$ 316 billion.[15, 17]. From 2002 to 2009 the number of countries of the EU that also included their reports of the amount of socially responsible investment into the list of necessary statistical accounting reports: if in 2002 there were 8 countries that had such statistics, in 2009 14 EU countries provided the SRI statistics, besides, the volume of social investments during this period grew almost by 14, 83 times (Figure 3).



**Figure 3. Volume of socially responsible investments in EU\***

Source: Stock markets in context of „Ernst&Yang“ stable development, 2011; Green, Social and Ethical Funds in Europe 2010 Review. - Vigeo. - Milan, 2010.

There are several forms of social programs realization; however the most popular forms are traditional charity and social investment or venture philanthropy. The advantages of the socially responsible investments in comparison with traditional charity are in that fact that social investment is a long-term program that expects:

- integration of company's goals with social programs strategies;
- strategic approach to social programs realization and strategy development;
- corporation's initiative in social programs realization and development;
- investment is not only monetary and in-kind aid, voluntary work and financial participation of the corporation employees, but also partners' resources (government and self-governing authorities, noncommercial organizations other companies etc.);
- taking into account partners' interests on the condition of getting benefits for corporation;
- the programs of social investment are stable and economically grounded just as any other business ventures;
- program package is formed on the basis of indirect investment principles, that allows to combine different community activities.

According to V. V. Dorofienko and V. M. Goncharov social responsible investments as a process develops towards social partnership with the idea of establishing constructive cooperation among three parties: governmental establishments, organizations and society in order to solve a social issue. The effectiveness of the mechanism is due to the joined efforts of

the three parties. Thus, ideally, social partnership is the interaction of two or three parties to address the important social issues. This is beneficial to all participants and to the community where the project is implemented [13]. Social investment when classified according to investment objects and the impact level on the corporation and society can be divided into three groups: the first group comprises social investments that affect the corporation income directly and society indirectly, the second group is made up of the investments that affect both corporation income and society directly within medium- and long-term period, the third group contains the investments, that affect the corporation and certain focus-groups directly (Table 1).

The formation of SRI portfolio is based on the same approaches, as the formation of the traditional investment portfolios, including determination of the investment policy, short- and long-term goals, tolerance and risk, and also understanding of the tasks during the process of portfolio management.

The task of the traditional portfolio management is to achieve the optimal balance between risk and profit during a certain period of time. During the SRI portfolio management social, ecological and ethical investment aspects as well as emitters corporate governance practices are being considered.

It is reasonable to divide the SRI methods into two groups: screening (selection) of the investment object and influence of the shareholders. They supplement each other allowing taking SRI issues on different stages of investment cycle into consideration. The investment objects selection takes place before papers are obtained. Shareholders may have influence after the portfolio was formed.

Basic method of the SRI is negative screening or discarding. Generally because of ethical consideration investors remove from their portfolios emitters' papers of the companies from alcohol and tobacco industry, gambling and nuclear power.

Screening belongs to negative methods and based on the exclusion of the companies that do not follow SRI principles stated in the United Nations Global Treaty „The Millennium Development Goals“, basic International Progress Organization's conventions; OECD for global companies leadership [16].

*Table 1*

**Social investment kinds and their impact on interrelation "corporation- society"**

Level of impact	Kinds of investment
Direct profit of the corporation ;	investment in quality goods production and quality services provision
indirect (through commodity and services	investment in development of production (including modern and sufficient investment in basic methods), growth of economical

market) on the society	efficiency and competitiveness, innovation management
	investment in staff development
	investment in support and development of honest business punctual and full-scale payment of the taxes and charges
Direct on the corporation and society (mainly in medium- and long-term period)	growth of the dividend yield and punctual distribution
	investment in local community development within the territory of the residence
	investment in environmental defense rendering of monetary, financial and other kind of aid to the authorities completing complex social tasks (poverty, unemployment) and other in extraordinary circumstances
Direct on the corporation and certain focus-groups, projects	investment in programs of corporative philanthropy and clarity realization

Since the beginning of the 1990<sup>th</sup> investors have used positive screening when selecting those companies that realize active social policy and programs and minimize their business activities impact on the environment. The most common kind of the positive screening is the choice of the papers that belong to „the best“ companies in their sector (best-in-class). This allows to guarantee portfolio diversification.

Institutional investors also use reciprocal procedure that uses shareholders' rights to influence emitters' activity in SRI. The reciprocal approach implies meetings with the corporate management, voting during the general meeting of shareholders, signing shareholders' resolutions and interaction with MSM. The difference between this method and screening lies in that fact that the reciprocal action has the influence not on the security selection, but on the emitters' behavior with formed portfolio.

The group of the companies „System Capital Management“ (SCM) is a leading national corporation in social responsibility. In 2011 it took the first place for the fourth time in a row in the rating „Guards of the socially responsible companies“ held by the „Gvardia“ magazine of the „Galitsky Contracty“ publishing house. SCM was founded in 2000. It possesses its share in more than 100 Ukrainian enterprises. Their staff accounts for about 130.000 employees. The company is focused on six main business areas: mining, steel industry, power production, finance, telecommunications, MSM and real estate. The largest investment volume of the SCM is concentrated in the industrial sector. Power, mining and smelting companies that are the members of Metinvest and DTEK's: branch holdings (the companies of SCM Group) are the main source of the Group's income. Most of the Group's employees work for them, however, the investments in nonindustrial economic sectors are also quite substantial. To provide business sustainable growth the company took decision on further investment

portfolio diversification and business development in new areas. According to the plan, parts of the postindustrial directions - financial, telecommunication, media, and real estate are to be brought from current 10 % to 30 % by 2015. The main consolidated finance indicators of the SCM are presented in Table 2.

Table 2

**Dynamics of the main consolidated finance indicators of the SCM**

Index, bin. UAH	2005	2006	2007	2008	2009	Growth rate, in % of previous year			
						2006	2007	2008	2009
Assets	36,54	57,43	100,51	91,28	148,31	157,18	175,02	90,82	162,48
Gross revenue	28,57	33,93	48,29	80,72	65,21	118,75	142,33	167,15	80,79
Profit	3,39	5,32	8,81	15,15	5,06	156,93	165,72	171,92	33,40
Profits and other taxes expenses	1,49	1,76	1,91	4,07	5,23	117,91	108,60	212,40	128,50

Source: 1. Communication on progress of implementing the principles of the UN Global Compact in 2006. - Access mode: <http://www.sbm.com.ua>.

2. Report. Social responsibility: 2005 (in two parts). - Access mode: <http://www.scm.com.ua>.

3. Stable development report for 2008-2009. - Access mode: <http://www.scm.conuia>.

4. Stable development report of „System Capital Management” for 2009-2010. Laing foundation of the future.-Access mode: <http://www.scm.com.ua>.

Since 2005 the company has been restructuring management to ensure clear, obvious and effective corporate governance and structure that could meet the world standards. They also created supervisory boards for all branch holdings, and special branch committees to assist supervisory boards in social responsibility, auditing, assignment and compensation, strategy and investment; internal auditing and risk management. The company understands the sustainable growth as a necessity to develop independently, and build up relations with participants of social processes, considering their interests. Local expert evaluation was held in the SCM and essential stakeholders were determined. They include work groups of the firms, territorial communities, local self-governing authorities in regions where Group’s companies are located, state government bodies, MSM. The SCM undertook following obligations:

- to determine and understand social aspects of its activity and interests of the stakeholders;
- to consider and react to stakeholders’ needs;
- to report the decisions, internal and external activities of the company to the stakeholders.

The SCM and companies of the Group determine themselves as socially responsible business that strives to contribute into building strong and successful Ukraine - equal in rights member of the world community. The SCM proclaimed following SRC directions: responsibility for the employees, environmental protection, development of local communities, social investment, sponsorship and charity. Since 2005 the company has been publishing reports. Since 2007 they have been prepared according to GRI standard (21 indexes of social activity effectiveness are being used). Priority guidelines of the company's social investment are: investment in operations area development, labor and industrial safety, environmental protection, targeted assistance (Table 3,4).

Table 3

**SCM investment in different areas of the SRC\***

Index	2005	2006	2007	2008	2009
Investment in development of the operations areas	115,06	92,43 <sup>2</sup>	33,64	55,05	50,5
Investment in labor and industrial safety	54,00 <sup>1</sup>	250,70	281,50	572,20	490,40
Investment in environmental defense	73,06 <sup>3</sup>	767,57	997,10	1704,00	1527,00
Sponsorship and charity	14,84	14,00	1,83 <sup>4</sup>	1,17 <sup>4</sup>	d/v <sup>4</sup>
Other social investment	14,84	24,61	38,88 <sup>1</sup>	64,31 <sup>4</sup>	26,90 <sup>5</sup>
Social investments, total	271,7424	1149,299	1352,96	2396,74	2094,8

Source: 1. Communication on progress of implementing the principles of the UN Global Compact in 2006. - Access mode: <http://www.sbm.com.ua>.

2. Report. Social responsibility: 2005 (in two parts). - Access mode: <http://www.scm.com.ua>.

3. Stable development report for 2008-2009. - Access mode: <http://www.scm.conuia>.

4. Stable development report of „System Capital Management" for 2009-2010. Laing foundation of the future.-Access mode: <http://www.scm.com.ua>.

Notes:

<sup>1</sup> - the presented in SCM report data concern only two company's enterprises (Kryvyi Rih Southern Mining and Enrichment plant and „Azovstal" iron and steel works);

<sup>2</sup> - the presented data concern only three biggest company's enterprises;

<sup>3</sup> - the presented data concern only one company's enterprise („Yenakiieve" iron and steel works);

<sup>4</sup> - for the purpose of data comparability and because in 2007 „Ukraine Development" fund with such activities as sponsorship, charity, targeted assistance was founded this kind of socially responsible investment was excluded from general SRC report. The Fund's volume of investment during 2007-2009 in previously mentioned directions was about 70 % of total social investment value, given in the table;

<sup>5</sup> - investment in personnel training and development.

The special feature of the Group's approach to SRC is that targeted assistance since 2007 has been considered as a separate kind of social responsibility, individual project and Group's fund [5].

Table 4

**Dynamics and structure of all main social investment kinds of SRC Group\***

Index	Structure, %					Growth rate in comparison with previous year, %			
	2005	2006	2007	2008	2009	2006	2007	2008	2009
Investment in development of the operations areas	42,34	8,04	2,49	2,30	2,41	80,33	36,40	163,64	91,73
Investment in labor and industrial safety	19,87	21,81	20,81	23,87	23,41	464,26	112,29	203,27	85,70
Investment in environmental defense	26,86	66,79	73,70	71,10	72,89	1051,46	129,90	170,89	89,61
Sponsorship and charity	5,46	1,22	0,14	0,05	0	94,34	13,05	63,83	0
Other social investment	5,46	2,14	2,87	2,68	1,28	165,81	158,03	165,39	41,83
Social investments, total	100	100	100	100	100	422,94	117,72	177,15	87,40

Source: 1. Communication on progress of implementing the principles of the UN Global Compact in 2006. - Access mode: <http://www.sbm.com.ua>.

2. Report. Social responsibility: 2005 (in two parts). - Access mode: <http://www.scm.com.ua>.

3. Stable development report for 2008-2009. - Access mode: <http://www.scm.conuia>.

4. Stable development report of „System Capital Management" for 2009-2010. Laing foundation of the future.-Access mode: <http://www.scm.com.ua>.

The Group respects the right of its employees to establish and to join trade unions and other communities in order to represent their work and socioeconomic rights and interests. It also forms long-term partnership with trade unions, employees, pensioners, retired workers and other persons involved. Protection of the employees' labor law and their professional bodies, employment terms improvement and social protection coverage are regulated by collective agreement, concluded in all enterprises of the SRC Group.

Objective and subjective problems of social investment are caused by external and internal reasons. External reasons include the following: the public is not ready yet for an adequate perception of such kind of information; the state tries to use it in its interests; experts, partners and investors need it only occasionally, that's why the management of the corporation discloses only general information about socially responsible investing without „risking" the details of the relevant financial flows. These disadvantages are associated

primarily with the imperfection of the existing collaboration model between business, society and state. Internal reasons include lack of common idea of social investment and SRI; the lack of combination of social investment with expenses, associated with the main activity; unsystematic approach to socially responsible investment as a result of differences in goals, facing different centers of corporation's power; the presence of different, sometimes conflicting, requirements for accounting in internal and external programs; the lack of generally accepted standards of domestic companies' public social reporting, etc.

On the other hand, modern business environment forms principles that stimulate corporations to arrange and disclose information about social investment. Those principles are the following: the urgent need for disclosure of business problems to find common solution; the formation of a positive image of corporations and loyal public opinion; achievement of high degree of transparency with a view of further entering international stock markets and cooperation with foreign partners, investors, experts, and expansion of activities etc.

One of the main reasons that prevents transparency in social responsible investment is potential conflicts. This reason is mentioned in many works on social responsibility of corporations by V. S. Kuznietsov, O. S. Povazhnii, V. S. Ponomarenko, I. L. Sazonets. [2; 7; 8; 10] that take place after social investment information disclosure. The conflicts can come up between such stakeholders' groups as managers and investors; producers and consumers; corporation and tax authorities; corporation employees and people with low income; corporation government and society; recipients and distributors of social investments including senior executives and employees of corporations; distributors and recipients of social investments, a group of social investment recipients.

There is a number of possible ways in resolving this conflict that are successfully used in business environment:

- to establish noncommercial funds with social tasks at majority stakeholders' cost (for example «System Capital Management" group of companies with its «Ukraine Development" fund);
- to have a board of trustees with broad participation of the public and experts;
- to form the constructive partnerships with the state in order to establish effective standards and supervise social duties execution by all market entity.

As for directions and measures of state stimulation by SRC and socially responsible investment it is reasonable to divide them into short-term (by 2012), medium-term (by 2017) and long-term (by 2020), Table 5.

Table 5

**Measures of state SRC Stimulation**

Directions/ measures	Short-term 2011-2012	Medium-term till 2017	Long-term till 2020
Directions	<b>Upgrade of mechanisms of charity tax concession</b>	<b>Increase of social responsible investment appeal</b>	<b>Development of National Program SRC stimulation</b>
Measures	Simplification of VAT procedure; calculation in charity area	Expansion in the quantity and weightage of social advertising	Adoption of the best SRC world practice
	Adoption of the law on the decrease of the tax base by the charity expenses volume	Cooperation with MSM to publish SRC's programs (partial publication quota transfer, antitrust legislation correction)	Inspection and agreement of measures of the stimulation, determination of upgrading directions
Directions	<b>Informational partnership and SRC transparency growth</b>	<b>Legal regulations improvement</b>	<b>Development of the co-financing with business project</b>
Measures	Establishment of the best practices competition and SRC programs, rating publishing'	Inclusion SRC in necessary requirements for participation in privatization and tender competitions, capital investment projects etc. <sup>1</sup>	Development and adoption of the social partnership projects between state, business, local community of environmental defense financing, local community in operations areas development
	Conduction of conferences together with business and communities	Establishment of determination and formalization of parties rights and obligations necessity (employer and work collective, employees) in internal corporate papers (statute, collective and employment agreement, contract)	

**CONCLUSIONS**

Thus, unlike spontaneous sponsorship and charity, socially responsible investment as SRC's instrument due to its regular character, consistency and close link with the corporation allows to increase benefits for society and for itself.

Economical effect from socially responsible investment is growing with high level of corporation communicative activity aimed at explaining this activity aspect. Nevertheless, only few corporations display high level of transparency in this question today. The main reasons for that are: the absence of institutional premises, different stakeholders' groups' conflicts of interests. To solve these problems we need to promote the ideas about that

advantages of SRC, socially responsible investment and apply the effective management strategies to regulate the relationship among stakeholders.

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## HERITAGE PPP LAW AND MANAGEMENT

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### ABSTRACT

Public – Private Partnership (PPP) contracts model exemplifies the New Public Management, which recommends private sector mechanisms for state services. This School of Thought is based on “the rule of the three E” (Economy, Effectiveness, Efficiency) for the state. PPP novelty has already been a worldwide trend that may be proved to be suitable for the protection of heritage, even in sensitive cases such as museums, in spite of the failures in the museum of Versailles and in the Royal Armouries, in the United Kingdom. Besides, the coverage of monuments with earth serves various purposes of the state whilst private individuals also make use of it illegally, for instance by committing antiquities looting. So, there is an informal “Public – Private Practice” (or “Partnership” by improper use of the term), with a negative impact for heritage, instead of the potential use of the PPP legal tool for the protection of heritage and the promotion of culture. Finally, the PPP model in the cultural domain is to be correlated to the similar diachronic institution of sponsorship.

**Keywords:** PPP contracts, Culture, Heritage, Museums, New Public Management (NPM), Excavations, Antiquities looting, Coverage with earth, Criminal... “PPP”, “The rule of the three E” (Economy, Effectiveness, Efficiency)

### INTRODUCTION: REGULATIONS ON PPP CONTRACTS AND CULTURAL HERITAGE

Public - Private Partnership (PPP) has recently constituted a worldwide trend (Patrikios, 2009). The PPP contract is an agreement within public sector bodies enter into long-term contractual agreements with private sector entities for the construction or management of public sector infrastructure facilities by the private sector entity, or the provision of services

(using infrastructure facilities) by the private sector entity to the community on behalf of a public sector entity (Peirson and McBride, 1996).

Heritage is a formal term for inheritance, namely the property that has been or may be inherited by an heir, in the field of Private Law. Fortunately, legal culture has enriched the term and developed it in the field of Public Law (Merryman, 1989). Indeed, heritage signifies things such as works of art and immaterial cultural goods, like cooking recipes, and folklore that have been passed on from earlier generations. It is to underline that the notion of heritage is a dynamic one and the cultural law has the tendency to broaden it. For instance, the Convention on the protection of the world cultural and natural heritage, adopted by UNESCO in 1972, protects not only cultural heritage but also the natural one, namely formations and landscapes made by nature without human intervention. There is also an actual trend of codification on the matter, exemplified by the French legal order. Indeed, in 2004 France adopted a heritage code, the creation of which the Council of Europe encouraged (Du Bois de Gaudusson, 2006). Codification is particularly useful as, on the one hand, it presents the dispositions (archives, libraries, archaeology, museums or even the historical monuments) in a single set and, on the other hand, it facilitates the access to these dispositions (Monnier and Forey, 2009).

This paper focuses on cultural heritage, particularly historical monuments, as it is the common case of heritage.

*We assume that PPPs are suitable for the protection of cultural heritage, even in sensitive cases such as museums of royal heritage.*

## **PPP CONTRACTS LAW AND MANAGEMENT**

The first known case of concession from the public sector to the private one has to do with a great civil engineering project for the people of Eretria, in Greece, in the 4<sup>th</sup> century BC. They hired a foreign engineer, Chairephanes, in an attempt to drain a marshy area, situated rather far from the city, at the heart of their territory. This project exemplifies the “Build – Operate – Transfer (B.O.T.)” model, whose financing was undertaken by the contractor and his partners, who would take advantage of the land for ten years.

The concession model was in use in the times of the Roman Empire and later, in various countries. In France, it acquired a particular significance due to the fact that in the period of

the one-class (liberal) state, which was formed in the 18<sup>th</sup> century, the principle of the abstention of the state from any economic activity was strictly applied whilst the entities of local self-government enacted an active role to build up the welfare state.

It is to pay special attention to the fact that the concession model is compatible with cultural projects, even museums that are by definition non-lucrative organizations, in spite of the fact that, as a general rule, concessions are used for reciprocal scopes. For instance, before the introduction of the legal framework on PPPs in France delegations of public service and concessions were used in the cultural domain, as it was the case of the museum Jacquemart – André. In 1995 this museum in Paris had 20.000 visitors and an operation deficit of 458.000 euros. Since the adoption of the concession model, the museum annually has acquired 180.000 – 240.000 visitors and perceived 137.000 – 150.000 euros. It is not about an abandon of responsibilities but a delivery of them, within the state prefers to concentrate its efforts to the collection and the rehabilitation of the works of art (Legrand, 2005).

The United Kingdom is considered as the homeland of PPP through the institutionalization of Private Finance Initiative (P.F.I.) in 1992 for non-reciprocal scopes, such as schools, hospitals and jails but it was inspired by both concession model and legislation on public constructions in the French legal order. It is to signalize that PPP exemplifies the New Public Management, neoliberal School of Thought that refers to the tendency to adopt the principles and values of the private sector in order to meet financial objectives and goals (Kalogirou and Maniatis, 2012). The adoption of a legislative framework on PPP contracts has recently been very frequent, in comparative law. For instance, this institution has been introduced into the Greek legal order in virtue of Law 3389/2005 but it has not been tested yet in the cultural domain.

The PPP framework in the French legal order has very great similarities to the British model and has already been modified to become more flexible. In the cultural context, the recourse of the French Administration to PPPs remains restricted (Maniatis, 2011). The British experience demonstrates that these have to do with the implementation of heavy cultural equipments, such as spectacles rooms, theatres or libraries. In France, the Theatre of Archipelago, constructed in Perpignan since October 2011, has been programmed to host festivals with a trans-border character between the French culture and the nearby Spanish one. Besides, among others, the national Museum of the civilizations of Europe and the Mediterranean was constructed, in 2012, in Marseille. It is to signalize that the scopes of the contracts in the cultural domain are discerned by their novelties, which may be inspired by

the innovative character of PPPs. For instance, it is about the construction of an aquarium, the scientific attempt of approach to oceanography through experiments, the thermal balance in a museum building, the walk gardens connected with the aforementioned central museum in Marseille through a bridge, the services of digitalization of pieces of French cultural heritage as well as the Informatics services. More concretely, a PPP contract had been signed by the public entity "Versailles Museum" for the Informatics system mainly for tickets.

The topic of the dysfunctions of the PPP mechanism particularly in the heritage domain has not yet received considerable research attention, just like the similar topic of dysfunctions for cultural sponsorship (Maniatis and Kapralou, 2012). Editorial critiques often mention that PPPs liberate government finances, therefore increasing the set of infrastructure development projects that government can undertake, like the beneficial intervention of sponsors. However, recent empirical research supports the rather negative opinion that there is no *prima facie* economic reason to desire PPPs over Public Sector Provision (PSP) of infrastructure and PPPs hardly ever free public finances. Anyway, the legally required "special purpose company", created by the private winner of the competition procedure in the pre-contract stage, for the implementation of a PPP contract, matches well to the fundamental contemporary economics of infrastructure development projects. Lastly, it is anticipated that PPP modification will continue to advance in the future, when more detailed and specialized academic research has been adequately conducted (Chinyere and Xu, 2012). So, the legal concept is as a general rule positive but the economic crash test, although restricted at least in terms of quantity, proves to be apprehensive against the traditional way of constructing and managing public works. Anyway, it is self-understandable that it is about a very new legal and managerial tool that is open to essential changes, as implied by the aforementioned French experience.

## **NEW PUBLIC MANAGEMENT**

New Public Management constitutes an umbrella term covering a set of public sector reforms across most OECD countries. Its origins are associated with the Taylor's approach to Scientific Management, within management is identified as the organization technique to meet financial goals. (Christopoulou S., 2008) It is also strongly related to the UK Prime Minister Thatcher and the US President along with the New Zealand Labour government of 1984.

Thatcher and Reagan denied the 'planning' approach that had been the orthodoxy in the US and the UK public sectors in 1960s and early '70s and favored a 'business-like' one. Gradually, partly through doctrine and partly through trial and error, in early 1990s a number of influential commentators appeared to believe that there was one clear direction – at least in the Anglophone world. This general direction was soon labeled as the New Public Management (NPM) or (in the US) Re-inventing Government. (Pollitt and Dan, 2011).

The philosophy of the New Public management is based on “the rule of the three E” (Economy, Effectiveness, Efficiency) whilst the way this rule works is pictured in the following figure:

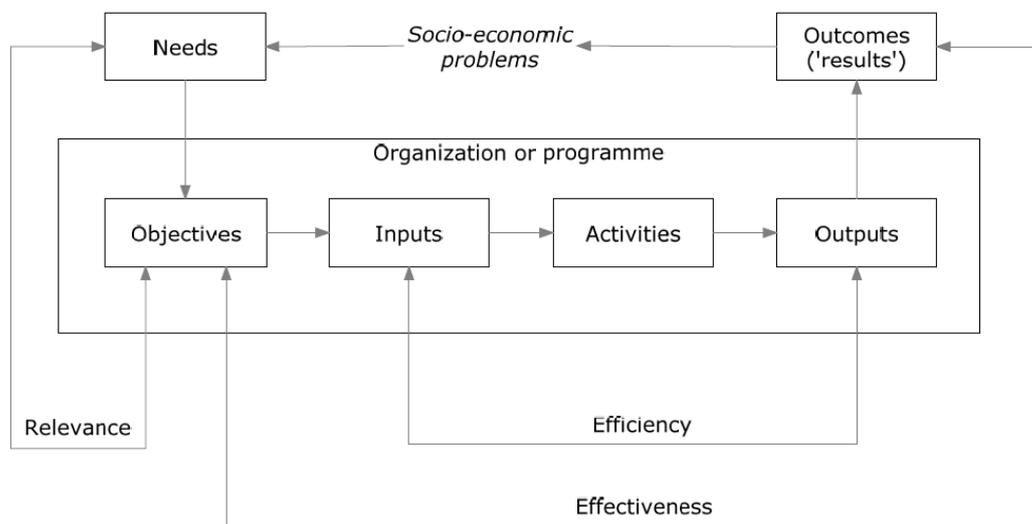


Figure 1 (Pollitt and Dan, 2011).

The NPM promotes the self-restraint of the state mechanisms of intervention as well of the institutional safeguards and their replacement by a set of standards of effectiveness through organizations of quality certification, assessment tests, strategies of competition enhancement e.t.c. (Markantonatou, 2011). It emerges as another model of operation of public services that contributes to the more qualitative management of contemporary social needs and includes actions submitted either to the classic management or to separate social sciences. The NPM is a two-level phenomenon. In the higher level, it is a general theory or doctrine, according to which the public sector can be improved through the adoption of business concepts,

techniques and values. In the more mundane level, NPM is a bundle of specific concepts and practices, including:

- Greater emphasis on 'performance', especially through the measurement of outputs
- A preference for lean, flat, small, specialized (disaggregated) organizational forms over large, multi-functional forms (e.g., semi-autonomous executive agencies)
- A widespread substitution of contracts for hierarchical relations as the principal coordinating device
- A widespread injection of market-type mechanisms (MTMs) including competitive tendering, public sector league tables, performance-related pay and various user choice mechanisms (Pollitt and Dan, 2011).

The NPM is considered as a "compact system of global significance" even though there are many differences in the way that is perceived and applied. That is why we can separate within the larger JDM four different models.

- The Efficiency Drive NPM Model
- The Downsizing and Decentralization NPM Model
- The In Search of Excellence NPM Model
- The Public Service Orientation Model

These subsets of NPM vary as for the emphasis in individual issues but not in the main targets. Their common denominator consists in the need of produced work measurability, of privatization of state functions, of staff and fees restriction, of business practices introduction, of autonomization of some parts of the management and of merge of some others (Markantonatou, 2011).

The major differences between public mandarins concept and NPM are shown in the following table:

Public mandarin phenomenon	New Public Management
Short-term programming	Long-term programming
Static setting of goals	Dynamic setting of goals

Avoidance of mistakes	Pursuit of success
Minor importance of the economic assets	Major importance of the economic assets
Hierarchical and rigid structure	Austere structure
Limited assignment of the decision-making power	Maximum assignment of the decision-making power
Emphasis on the procedural forms	Emphasis on the results

Table 1. Differences between public mandarin phenomenon and New Public Management (Christopoulou, 2008)

Whilst it is now fairly clear that the whole of the world is not following the same path, it remains true that NPM ideas spread very widely, and are often still seen as the most obvious route to modernization.

## THE MANAGEMENT OF PPP IN VERSAILLES

The case of the Castle in Versailles constitutes the first failed PPP contract in France instead of being an exemplary success according to the expectations of the government. In 28 May 2008 the direction of the competent public entity made the decision to get rid of the contract, signed by the former president and afterwards minister of Culture, with a company providing Informatics services. It was about the normal end of an abnormal partnership, given that during the 15 months since the signing of the contract, the PPP had been marked by many imperfections by the private partner's side. Among the defaults there were that the software of the tickets editing was unstable, extremely slow and unsatisfactory, by causing problems such as the enhancement of the queue of waiting visitors. It is to underline that PPP would have as a window display the sight-seeing of Versailles, whose gardens constitute an example of cultural (along with natural elements) heritage included in the "World Heritage List" according to the aforementioned Convention on protection of world cultural and natural heritage. More concretely, the Palace and the park have been listed in 1979 and constituted a part of the initial set of monuments of France in this important list. So, in principle the political choice to use this sight-seeing of worldwide prestige was correct.

Upon the competent public service for PPPs (called in French "MAPPP"), besides the incapacity of new technological tools management, the failure of the contract is due to the decision of the Ministry involved to delay the execution of the contract and to the fact that the acquisition of Unilog by another private company, Logica, caused a climate of uncertainty to its employees and, as a result, some of them left their workplace in the critical moment. "MAPPP" concludes that this case enhances its managerial position that the assigning authority should interfere as less as possible as for the contractual obligation, unless a dysfunction emerges.

After ending the contract, the public foundation of the museum and the national domain of Versailles took on again the internal management of the tickets reservation through the new systems of technology. Up the end of 2008 the problems had been fully resolved and the system of reservation functioned regularly. Moreover, the foundation noticed in its 2008 annual report that the ending of the PPP contract caused the need in recomposing the team of Informatics maintenance of the tickets system in order to face the development of the new tools of this system and that this activity should be externalized within a PPP contract.

## **THE MANAGEMENT OF PPP IN LEEDS**

In December 1993, a PFI contract was signed, of sixty-year duration, between the Royal Armouries and the private company "Royal Armouries International plc (RAI)" for the construction, operation and guardianship of the new museum of the United Kingdom, in Leeds. RAI would assume the entire risk and perceive the revenues coming from the visits of the public as well as from parking and restaurant services. In spite of the fact that the museum was delivered to use in time and in conformity to the budget, it did not manage to cover its operation fees and, as a result, in July 1999, after a revision of the contract with RAI, which was no more truthful, the Royal Armouries assumed the responsibility of the operation of the museum. This political decision highlights the subsidiary and financially unadvisable mission of the state in economy as the Ministry of Culture had to contribute by 10.000.000 pounds in order to save the museum from definite pause of operation. As a result of the revised contract, the Armouries received further financial back of 1.000.000 pounds annually and were supposed to economize approximately 2.000.000 pounds per year. The failure of the PPP contract is due to the very restricted demand, in comparison with the pre-evaluated one (approximately 60% of the expected levels in the first year of operation and 35% in 1999), and to the very restricted capacity of the building (pre-evaluation consisting in 1.300.000 visitors

per year with an average visit duration of 2,5 hours while in reality the number of visitors was 600.000-650.000, with a real average visit duration of 4 hours) and also to the policy of high pricing (up to 18 dollars per individual) in spite of the counsellors' warning on the matter (Legrand, 2005).

## **THE QUESTION OF EARTHED-UP HERITAGE PARTICULARLY IN GREECE: A CRIMINAL ... "PPP"**

Coverage with earth for immobile historical monuments constitutes a controversial issue, particularly widespread in the archeological practice on international scale (Maniatis, 2013). In Greece, during the excavation for the metro of Thessalonica, an Early Christian Basilica was discovered, in the station "Syntrivani", namely in the centre of the city. The monument was to be transferred in a distance of about 200 meters, in the park of the Theology Faculty of the Aristotle University of Thessalonica. However, this decision was attacked and finally the coverage with earth was decided. *"The future cannot and should not be built against the past"*, according to some archeologists reminding of the final paragraph of the Amsterdam declaration, adopted in 1978.

Besides, a recent double case of discoveries in the Greek region of Central Macedonia reveals the error, according to which the coverage with earth protects the monuments not only from the harm of their material substance but also from crimes, such as antiquities looting. Anyway, it is to signalize that in Thessalonica the "Syntrivani" square is added to the casuistic of the coverage of the immurement of the White Tower with earth and the prevention of the unearthing of the nicest temple in the "Antigonidon" square, which had been transferred there in ancient times, in virtue of the "wandering temples" custom (Maniatis, 2010).

Another recent case consists in coverage of a very important ancient temple with earth, during the excavations for the reconstruction of a line of the Athens-Piraeus Electric Railways. As the State makes use of this method for various legitimate reasons, for instance as a "mortgage" for an on-the-field research, to be accomplished by the future generations of archaeologists, some private individuals take benefit from it as a "mortgage" for illicit excavations of the current era, let alone the fact that they dissimulate accidental archeological findings to continue their own building works. As a result, a finding emerges, consisting in the counterbalancing dynamic of criminality against the controversial practice of Public

Administration. So, administrative and private practices result in a homogeneous total, particularly in the countryside. In other words, empirical research demonstrates clearly that there is an informal “Public – Private Practice” (or “Partnership” by improper use of the term), with a negative impact for heritage, instead of the potential use of the PPP legal tool for the protection of heritage and the promotion of culture! For instance, the comparable institution of cultural sponsorship has been used in France to reward anyone giving to the authorities useful information in case of looting of works of art.

## **CONCLUSION: SUITABILITY OF PPP FOR THE PROTECTION OF HERITAGE**

The implementation of the PPP model failed as for the emblematic museum of Versailles and the righting of this failure was not attempted through a similar contract. However, this datum should not cause misconceptions on the suitability of the model as PPPs, being themselves an innovation, have proved to be a vehicle conducive to other relevant innovations and to success, in managerial and legal aspects. Moreover, the failures in the United Kingdom should not lead to generalizations but to a more attentive application.

The hypothesis of the present paper has been confirmed in combination with the following major findings:

1. The PPP model constitutes a formal care of the state about the public interest and therefore it may be an antidote to the insufficient state policy for the protection of heritage in combination with private individuals' crimes, such as antiquities looting (phenomenon called criminal ... “PPP”). This function consists *inter alia* in promoting legitimate archeological excavations and in upgrading the guardianship of archeological sites and museums.
2. The PPP approach to the cultural domain of the public policy should be particularly flexible and attentive. It is to signalize that if monuments need protection and are considered as more important against the rest cultural goods, museums, at least the heritage ones, are more sensitive because, on the one hand, they need technical service often expensive and, on the other hand, they generally seem to be rather unattractive for the public as they have to do with the past, let alone of anachronistic character. Anyway, PPPs are suitable for non-lucrative scopes, such as museums, given that even concession, that is traditionally used almost only to reciprocal

projects, has conduced to success the management of museums and similar entities, in France. It is to pay special attention to the fact that PPPs, already in their initial form (PFI) in the United Kingdom, were orientated to merely non-reciprocal scopes of the public policy related to the crucial social fundamental rights of citizens (schools, hospitals) and to the nuclear of the state mission (jails), not to reciprocal scopes. This means that capitalism had already a very drastic and successful alternative against the common way of constructing public infrastructure, the concession contracts fully adaptable to new technologies of each era and intrinsically connected with reciprocal charges of end-users particularly in the domain of transports. In this socioeconomic context, PPP were conceived by New Public Management *formally* as a variant of the concession model, which keeps its traditional use particularly for transports, and *operationally* as an alternative against the traditional-type public works contracts, *not the concession ones*. So, the prejudice that PPPs are a neoliberal mechanism similar to concessions is legally accurate but is not usually confirmed in managerial terms.

3. PPPs in general are open to further scientific research and no fixed relevant assessment has resulted to date, on international scale. So, although they may be suitable for various scopes, such as the heritage ones, it is not sure that they are preferable to PSP of infrastructure, including the aforementioned function against the criminal "PPP" phenomenon.
4. Last but not least, PPPs for cultural scopes are characterized by an important particularity that still remains out of scientific discussion, namely their similarity to another diachronic institution of funding, the sponsorship. If kings have become a point of reference for PPPs due to some cases of failure of royal heritage management, a significant and non-elaborated question has to do with kings as a potential point of inspiration, enacting the role of Maecenas generally for PPPs. This development may be facilitated through the recommendable correlation of the PPP law to the cultural sponsorship one, as this proposal has been recently formulated (Vassilakou and Maniatis, 2012).

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# KNOWLEDGE-INTENSIVE STRATEGIES IN LOW-TECH SECTORS DURING THE CRISIS: THE CASE OF THE GREEK WOOD AND FURNITURE SECTOR

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## ABSTRACT

The paper explores the strategies used by Greek wood and furniture firms during the crisis under the lens of the newly developed notion of knowledge intensiveness. A field research of 394 firms contacted in 2012 revealed that in spite globalization and crisis the sector remains rather passive with limited effort to develop innovation. The majority of these firms are introvert with low cost and differentiation to be considered their main but rather weak strategies, since according to managers their competitive advantages are easy to imitate. Still, the effect of customer loyalty, size and exports is significant. Wood and furniture firms should try to become more knowledge-intensive, build capabilities, seek knowledge all along the value chain and place technology and collaborative efforts at the heart of their competitive advantage. This seems to be the best way to confront both crisis and globalization threats.

## 1. INTRODUCTION

During the last decade researchers have argued for the need of new strategy paradigms at firm level, based on knowledge. New theories have evolved around the notion of Knowledge-intensive entrepreneurship (KIE) which is considered a key socio-economic phenomenon that drives innovation, and economic growth enhancing the competitiveness of both firms and countries (Malerba and McKelvey, 2010).

So far, the debate on KIE has mainly focused on firms in high-tech sectors. To date, little attention has been paid to firms that belong to so-called low-tech, traditional and mature

industrial sectors. However, a small but increasing stream of empirical research has indicated the importance of KIE in these sectors as well (e.g. Karagouni and Kalesi, 2010).

The crisis revealed certain pre-crisis weaknesses of some countries (e.g. Greece and some southern and eastern European countries), sectors (e.g. traditional mature sectors such as textiles and furniture) and types of strategies (e.g. low-cost) and innovations (e.g. financial innovations). Future prospects for innovation in these countries and industries will greatly depend on their disengagement from current and adoption of novel approaches which turn more around knowledge.

The paper has been structured as follows. After a short description of the relevant theoretical framework, the Greek wood and furniture sector is described as the object of the survey. The following units present the results and the relevant discussion exploring the factors that affect innovative performance of these firms in crisis period and providing a clear mapping of the characteristics of the specific ecosystem.

## **2. THEORETICAL BACKGROUND**

Current theoretical and empirical research enhances the role that traditional sectors still play in modern and vulnerable economies and directs importance of innovation outside R&D-intensive fields (Robertson et al. 2009; Hirsch-Kreinsen and Schwinge, 2011). A new research stream (Smith, 2008; Hirsch-Kreinsen et. al, 2003; Karagouni and Caloghirou, 2013) focuses on low-technology industries claiming that besides their strong path-dependency they can be knowledge-intensive, develop knowledge-based innovation and invest in trans-sectoral knowledge seeking and learning (Hirsch-Kreinsen and Schwinge, 2011). According to Smith (2008) "Growth within the less glamorous, traditional sectors is certainly innovation-based and moreover it rests on cognitively complex and deep knowledge bases, which from time to time are subject to discontinuous change". Recent empirical research confirms that low-tech firms which became knowledge-intensive managed to improve their competitiveness by repositioning within the product supply chain (Schwinge and Kreinsen, 2012; Karagouni et al., 2012) and following market niche strategies. They further engaged export-oriented strategies in addition to this strategic orientation towards knowledge creation and innovation, especially in cases of limited domestic markets (Schwinge and Kreinsen, 2012).

Thus low-tech firms tend to develop different kinds of competitive advantage in order to address competition within their vulnerable and mature markets. Besides the well-known and mostly-used cost-leadership, they turn to differentiation and innovation. They engage mainly in new product development and frequent changes or improvements of process

technologies (Hirsch-Kreinsen 2008a, Robertson and Smith 2008, Robertson et al. 2009). While a very small percentage of individual low-tech firms develop R&D activities, the majority apply mainly open innovation (Hirsch-Kreinsen and Jacobson, 2008; Likar et al., 2008). Process, organizational and marketing innovations are more common (Heidenreich, 2009), while product innovations are in their majority incremental (Bender, 2004). A significant feature of low-tech innovation is the engagement of many stakeholders all along the value chain in open innovation. Suppliers are of utmost relevance in this context, since low-tech firms rely heavily on raw material, machine and equipment technological advances (Bender, 2004; Heidenreich 2009). In this context LMT firms are widely termed as “supplier-dominated firms” referring to Pavitt’s taxonomy of sectoral innovation modes (Heidenreich 2009; Robertson et al. 2003). While in-house R&D is not a crucial strategy element in low-tech sectors, firms can create innovation by becoming knowledge-intensive. Both literature and empirical findings (Gupta and McDaniel, 2002; Hirsch-Kreinsen, 2008; Schwinge and Hirsch-Kreinsen, 2012) show that accumulated knowledge can support a new way of combining inputs or resources based on exploitative learning processes, increase effectiveness and create sustainable competitive advantage. *Knowledge intensity* refers to external and/or internal ‘knowledge seeking activities’, ‘initial knowledge capital’ and relevant ‘human capital’ (Caloghirou et al., 2012). Knowledge-intensive low-tech firms seek mainly new technical and practical knowledge linking external knowledge with the firm-specific knowledge base (Bender and Laestadius 2005; Medanoça 2009; Robertson and Smith 2008) relying on training and highly qualified personnel skills.

According to this knowledge-oriented perspective, knowledge and competencies of “human capital” are valuable firm assets due to their firm-specific, socially complex, and path-dependent characteristics (Collins and Clark, 2003; Wright et al., 2001). Innovation is usually connected to motivation and ability of human capital to develop creative and innovative approaches. Human resource management’s role is crucial in nurturing the necessary conditions for this task. Firms use strategic HR practices, such as training, performance appraisal, and compensation, as means to motivate employees’ knowledge bases and their creative thinking (Chen and Huang, 2009).

Globalization and trade liberalization in combination with the global financial and public debt crisis that countries are now experiencing have created vulnerable and volatile environments. Mature industries are subject to major changes but cumulative knowledge and its creative combinations can provide novel options to companies in order to survive

(Protogerou and Karagouni, 2012). All the above indicate that knowledge-oriented strategies may play an important role in the enhancement of low-tech companies' performance and competitiveness by creating and sustaining strong competitive advantages.

### **3. WOODWORKING AND FURNITURE SECTORS**

#### ***3.1. Industry structure***

The wood product manufacturing industries or woodworking industries include the production of sawn wood, wood-based panels, joinery and carpentry materials, containers packaging and other wooden articles. The furniture industry is part of the down-stream value chain activities of this sector including other material as well. It is essentially an assembling industry, which employs various raw materials ranging from wood and wood-based panels to metals, plastics, textile, leather and glass. There are many different types of furniture with very different uses.

Woodworking and furniture industries are two vital, sustainable, innovative and eco-compatible sectors, with a turnover in 2009 of around €198 billion, an added value of around €60 billion and an employment rate of 2.1 million people in more than 300 000 companies (EU-27, Eurostat, 2012). The vast majority are SMEs, with the wood-based panel sub-sector and a handful of sawmills to be the exception. The furniture industry accounts for nearly half of this turnover, followed by the production of construction elements (19.3%), sawmilling (13.9%) and panel production (9.2%). The majority of furniture producers are micro-enterprises (less than 10 employees).

The sector faces growing competition from low-cost, emerging economies and a growing number of technical trade barriers. Furthermore, the furniture sector is not only facing difficulties in accessing wood as a raw material, but also a dramatic rise in the price of materials such as leather, plastics natural fibres and petroleum derivatives. The general financial and economic crisis has had a major impact on the entire sector: between 2008 and 2009 65000 companies shut down and turnover decreased by more than 20% (eu.enterprise.sectors).

#### ***3.2. Sector Dynamics and the role of Innovation***

Woodworking companies are considered innovative and knowledge-intensive (Smith, 1999; Hirsche-Kreinsen and Scwinge, 2010) demonstrating a continuous development of processes. Companies in the sector have built in high-quality innovation systems for both products and processes and excellent sectoral research and technological development knowledge centers.

Global machinery manufacturers, suppliers, the chemical industry, Universities and independent research centers develop synergies assisting the advancement of process and product developments. Innovations turn around engineered wood products, wooden composites, novel fittings and other wooden products.

Furniture companies are less knowledge-intensive or innovative regarding technical innovation. Investments in internal R&D processes are very low to non-existent, very few firms engage in radical breakthrough technologies and hardly any firm protects its intellectual property through patents. The sources of technological changes are often found outside the sector, for example, in the wood processing machinery, IT services, high-speed automation and manufacturing logistics, paints and lacquer (Poliacov et al., 2009).

Knowledge evolves mainly around aesthetic, design and fashion related issues and focuses on creativity and strong image building. Yet, process and product innovation is evident in the undertaking of lengthy processes of restructuring and modernization, development of sustainable production methods and novel business models (e.g. modular design). Major factors of competitiveness for the sector consist of research and innovation along the whole value chain (Figure 1) and mainly material and fittings, skills and quality, design and added value, knowledge and know-how, together with better access to third country markets.

## **4. THE WOODWORKING AND FURNITURE SECTORS IN GREECE**

### ***4.1. Industry structure***

Woodworking and furniture industries play a significant role in Greek economy, with a turnover in 2008 of around €2 billion, an added value of around €1 billion and an employment rate of 35.000 people in more than 15.000 companies (Eurostat, 2009). The vast majority is micro-companies, with the wood-based panel sub-sector and sawmills to be the exception.

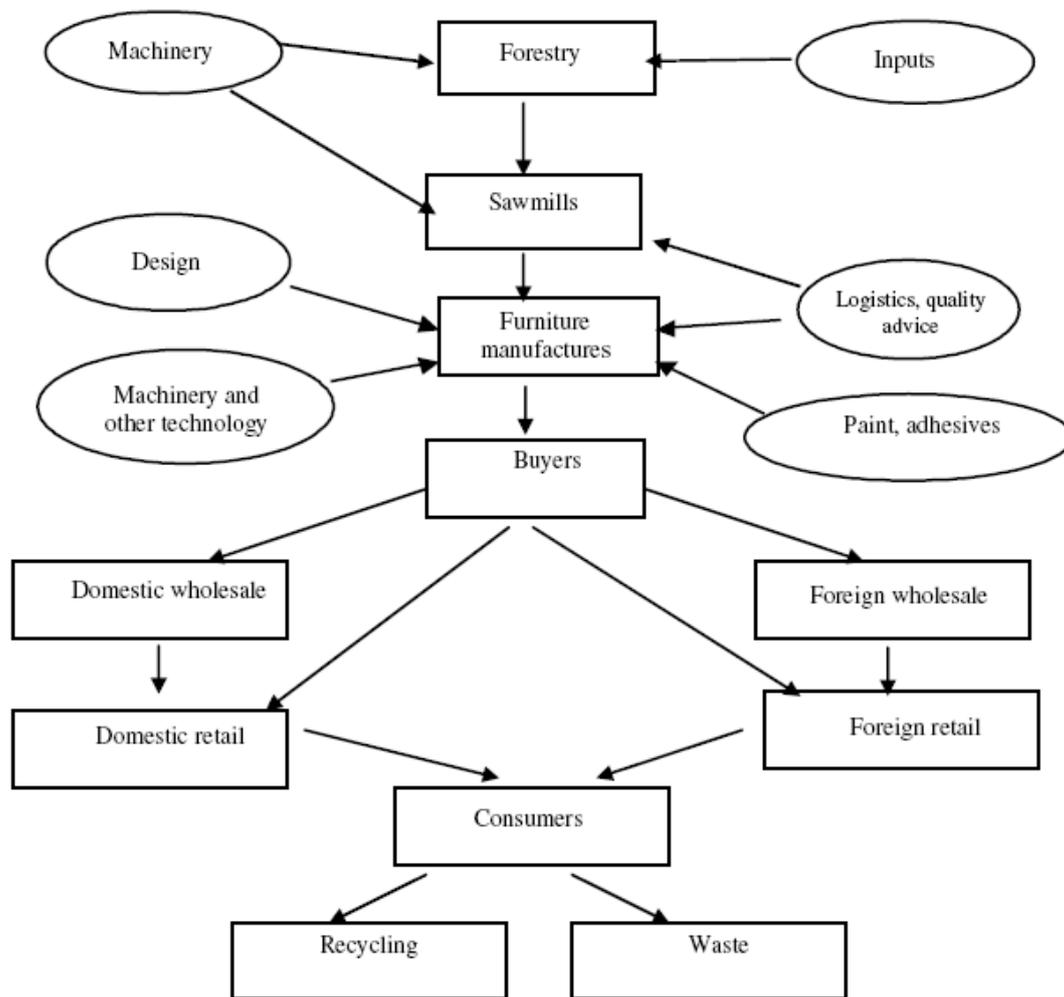
The sector is mature, highly fragmented and labour-intensive with many firms operating in a 'craft' production mode. 66% of the firms are less than 30 years old and cover mainly the domestic market, as exports are rather insignificant.

The industry faces growing competition from low-cost, emerging economies and a growing number of technical trade barriers. Decreasing production in absolute numbers was combined with the increasing number of trendy products from Italy and Spain, cheaper products from Turkey, China and India and different approaches such as of IKEA. Furthermore, it faces difficulties in accessing wood as a raw material and a dramatic rise in the price of materials such as leather, plastics natural fibres and petroleum derivatives (Tringkas et al., 2012). The general financial and economic crisis has had a major impact on the entire sector: In 2008 most companies had losses of profits (56.8%) or even damage (27.3%). Regarding the furniture sector, the production volume decreased by 47% among 2009-2011, and further by around 30% in 2012 (EL.STAT).

### *3.2. Sector Dynamics and the role of Innovation*

Greek wood and furniture companies are not considered as innovative even with the Schumpeterian concept of innovation. Recent research (Karagouni et al., 2010), which covered wood and furniture companies in the region of Thessaly, Greece, indicated that only an 18% of firms in the sample developed some incremental innovation. Improvements of existing products and purchase of process innovation are the main innovation activities. Advancement of existing and development of new equipment (AMT), the import of design systems (CAD), the application of CIM and MRP, as well as the pilot use of new or improved raw material or semi-finished products are further innovations pursued by Greek wood and furniture manufacturers. A network of international machinery manufacturers and suppliers play a significant role in research and development advances regarding mainly medium and large organizations (Tringkas et al., 2012). Furniture companies invest on differentiation through the development of aesthetic value and fashion. Yet, design is still underdeveloped while process innovation refers more often to restructuring and modernization.

Figure 1 Wood furniture value chain



Source: UNIDO

Major weaknesses of both sectors regard the lack of specialized technical personnel, overall organization and quality control while entrepreneurs' educational level is rather low (Likar et al., 2008). The last five years the sectoral context starts changing by becoming more knowledge-intensive. New entrepreneurs or successors have a high educational level and turn to research, innovation and knowledge management.

## 5. EMPIRICAL PART

### *Methodology and measures*

The survey was undertaken during the summer of 2012 in Greece (crisis period). The field research was conducted through personal telephone interviews with the aid of CATI (Computer Administered Telephone Interviewing). The original sample came from almost

2.296 SMEs which belong to the sectoral ecosystem of wood and furniture manufacturing and wholesale trade. The reason for including also trade firms in the sample is that at least in Greece they are very much linked with the manufacturing companies they collaborate. Thus, they could be considered as an integral part of the specific ecosystem. More specifically in the analysis we have included firms belonging to the following NACE Rev 1 sectors

- Sector 20 Manufacture of wood and of products of wood and cork, except furniture;
- Sector 36.1: Manufacture of furniture
- Sector 51.53 : Wholesale of wood, construction materials and sanitary equipment

The analysis consists of two parts. At the first stage we run an OLS regression, in order to understand the factors that affect innovative performance of these firms. At the second stage we try to build a typology of the examined firms by implementing cluster analysis and by using the variables that turned out to be significant. This provides a clear mapping of the characteristics of the specific sectoral ecosystem.

The first step in the analysis was to try to identify the factors that affect innovative performance of the firms. More specifically, the variables / measures that will be in the analysis are the following:

As dependent variable (variable INN) we use the number of product and/or process innovations that were introduced by the firm during the last three years.

As independent variables, that is elements that we believe that they might affect innovative performance, we use the following:

**COST\_LEAD:** Cost leadership measures whether the firm has a cost competitive advantage. It takes the value of 1 if the firm charges significantly higher than competition and scales up to 7 if the firm holds a significant cost advantage compared to all competitors. Due to the recession in the Greek economy and constraints from the domestic market, there is an urgent need for reducing prices. Therefore firms must find a way to re-organize their resources, to undertake process innovation. We expect firms that are cost leaders to innovate to a greater extent than those that they might offer more expensive products. However, the opposite could also hold, as successful product innovation may lead also to higher value added products, which should be priced with a mark up from the usual competition.

**DIFF\_LEAD:** differentiation leadership measures whether the firm has a competitive advantage based on differentiation. It takes the value of 1 if the firm's products do not differentiate significantly compared to competition and scales up to 7 if the firm holds a significant differentiation advantage compared to all competitors. A positive sign is expected here, as in order to differentiate firms must constantly innovate.

CR\_DES This variable is a measure of the difficulty of the competitors to copy the competitive advantage of the firm. It takes the value of 1 if the competitors can easily recognize and copy the competitive advantages of the firm and scales up to 7 if the competitors can hardly recognize and copy these competitive advantages.

MAN\_GR: It measures the management's commitment to achieve specific targets in relation to the company's growth. It takes the value of 1 if the managers are more interested in the typical everyday administrative tasks than having a strategic vision for the future and scales up to 7 if the managers are strongly motivated and committed to achieving specific growth targets.

CUST\_LY: It is a measure of the customers' loyalty. It takes the value of 1 if the customers buy products / services randomly and have no preference in brand name and scales up to 7 if the majority of the customers buy regularly the company's products and show a strong preference to the specific brand name. A high degree of customer's loyalty means that firms are not under pressure from the demand for innovation.

SPEC: This variable measures the firm's workforce of qualified personnel. It takes the value of 1 if only a small percentage of the firm's staff is highly qualified and scales up to 7 if the firm occupies specialized scientific staff in most of its departments and levels. A positive sign is expected here.

ICT: It measures whether or not a firm uses new technologies and tries to integrate ICTs. It takes the value of 1 if there is no effort to adapt to the new conditions by incorporating new ICT and scales up to 7 when the firm has a strong lead compared to its competitors to incorporate new ICTs. A positive sign is expected here, as firms that follow the latest developments on ICTs and try to integrate new technologies in their processes are more eager to change and especially process innovation.

CULT: This variable measures whether the business environment and culture encourages employees to take initiatives and propose new ideas. An evaluation of 1 means that no initiative or risk is allowed and any failures are unacceptable. On the other hand the value of 7 means that there are official processes that encourage the initiative and risk and potential failures to use as learning experience for the future.

BON: It measures whether there is any system of reward and recognition for successful ideas and innovation. It takes the value of 1 if neither formal nor informal recognition nor reward is available and scales up to 7 if there is a well established formal system of reward and recognition of staff suggesting ideas and successful innovations.

RD firms' spending takes the value of 1 if there are no R&D expenses and scales up to 7 if the company is a leader in its sector in relation to the R&D expenses (turnover rate greater than 10%).

COLL: It is a measure of the degree to which firms participate in research projects. It takes the value of 1 if the firm has not participated in any research program over the last 5 years and scales up to 7 if participating in R&D collaborations is a strategic choice of the firm.

SIZE: It measures the size of the firms in terms of employment. It takes the values of 1 for micro firms, 2 for small firms, 3 for medium sized firms

EXP: The exporting activity of the firm. It takes the value of 1, if the firm is not exporting and scales up to 7 if the firm is exporting more than 60% of its sales

EXP\*SIZE: It is an interaction term of exports and size. We are able to capture the joint effect of the two variables.

SEC: It is a dummy variable taking the value of 1 for manufacturing firms and 2 for trade firms

### *Sample descriptive*

In terms of size, the vast majority, almost 3 out of 4, are micro firms that employ less than 9 employees. Only 3.6% of the firms, 11 manufacturing and 3 from the trading sector are medium sized. In terms of location of headquarters, 60% are located in the two main cities (regions of Greece), whereas another 40% is located in various other regions of the periphery of Greece

Table 1: Size of the firms

Number of employees	Number of firms	%	<i>Manufacturing</i>	<i>Trade</i>
<=9	287	72,8	228	59
10_49	93	23,6	82	11
50 - 249	14	3,6	11	3
Total	394	100	321	73

The vast majority of firms do not export. A 15% presents some exporting activity but this is not an important part of their sales, as it represents less than 10% of their turnover. On the other hand there are 28 firms (7%), mostly manufacturing that they seem to export more than 20% of their sales

## 6. RESULTS AND DISCUSSION

Firms have evaluated at a 1-7 Likert scale the degree to which their competitive advantage is related with cost. While 9.6% of the firms responded with a 7, indicating cost leadership, more than half the sample responded with at least 5, indicating that they perceive themselves as cost leaders. On the other hand there are a 10% of firms that they feel they are significantly more expensive from competition, focusing probably on other niche markets with higher value added products.

Table 2: Cost competitive advantage: Degree to which competitive advantage is related with cost

Value (Likert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	23	18	29	99	146	41	38	394
%	5,8	4,6	7,4	25,1	37,1	10,4	9,6	100,0

1: The firm charges very high prices for its main products

7: The firm holds a significant cost competitive advantage

Almost 20% of the firms believe that the main source of their competitive advantage is diversification (rated 6-7 in the Likert scale). Another 20% lie at the other end of the spectrum, indicating those firms which are not significantly diversified from competitors.

Table 3: Diversification advantage: Degree to which competitive advantage is related with diversified products / services?

Value (Likert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	3	10	68	78	159	26	50	394
%	0,8	2,5	17,3	19,8	40,4	6,6	12,7	100,0

1: The products / services have quality / operational disadvantages among most other competitors

7: Firm's products/ services are largely differentiated from those of competitors

Almost half of the sample believes that their competitive advantage is rather easy to be imitated, so actually they do not possess a unique characteristic. On the other hand 20% seem to hold that rare sources of advantage or the capital requirements for this are too high.

Table 4: Imitation effect: How easy if for competitors to duplicate the competitive advantage of firms

Value (Likert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	68	47	84	52	59	26	58	394
%	17,3	11,9	21,3	13,2	15,0	6,6	14,7	100,0

1: It's easy for competitors to recognize and track the sources of competitive advantage of the firm

7: Competitors are difficult to recognize and reproduce the sources of competitive advantage of the firm. The capital requirements and manpower for this to happen is significant.

Another interesting topic that was explored in the survey was whether day to day management and business activity is the main concern of the managers-owners of the company. It is well expected for managers to do that, however sometimes and especially in micro firms, strategic planning and specific growth targets may not be at the heart of the business activity. Indeed, a 40% of the sample responded with 1 to 3 in the Likert scale indicating that they lack this strategic vision for the future, as making end meets.

Table 5: Managers' commitment to specific growth targets

Value (Likert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	117	11	32	49	78	6	101	394
%	29,7	2,8	8,1	12,4	19,8	1,5	25,6	100,0

1: Managers are mostly interested in day to day administrative tasks, lacking a strategic vision for the future

7: The managers are strongly motivated and committed to achieving specific growth targets

Furthermore, the customers' loyalty in the examined firms was also explored. Almost 40% believe that they have a relatively loyal customer base that is customers that they show a strong preference to the specific brands (products / services). This can be a disincentive for innovation, as firms are not under pressure from the demand for innovation.

Table 6: Degree of customer loyalty

Value (Likert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	40	4	30	40	127	41	112	394
%	10,2	1,0	7,6	10,2	32,2	10,4	28,4	100,0

1: Insignificant: Customers are usually random and have no specific preferences in brands

7: Very large: the vast majority of customer buys regularly the company's products and exhibit a strong preference to the specific brand

Less than 10% of the sample has a significant lead compared to competitors in terms of ICTs integration. More than half of the sample is rather a slow adopter of ICTs.

Table 7: ICT usage: Degree to which firm integrates ICTs

Value (Likert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	72	34	74	36	140	10	28	394
%	18,3	8,6	18,8	9,1	35,5	2,5	7,1	100,0

1: There is no attempt to adapt to the new technological conditions by incorporating new ICTs.

7: The firm has a strong lead compared to its competitors to incorporate new ICTs

Some factors of the internal environment of the firms were also examined in the survey aiming at identifying whether the business culture promotes risk taking or awards new ideas. A 30% of the firms have responded with at least 5 in the specific Likert scale, indicating those firms that seem to allow for such risk taking. On the other hand when firms are asked about formal award mechanisms of processes for recognition to the employees that suggest ideas or take initiative to promote innovation, then less than 10% responds positively (at least 5 in the Likert scale). So the perception of an environment that encourages risk taking initiative is not actually formally integrated in the business environment.

Table 8: Internal environment: The degree to which business culture encourages employees to take initiative and propose new ideas, allowing the risk of possible failure

Value (Likert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	114	13	93	44	96	11	23	394
%	28,9	3,3	23,6	11,2	24,4	2,8	5,8	100,0

1: No initiative and risk is allowed

7: There are official processes that encourage the initiative and risk, and potential failures are used as learning for the future.

Table 9: Award mechanisms: Degree to which there are systems of reward and recognition for ideas and successful innovation

Value (Lincert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	197		162		29		6	394
%	50,0		41,1		7,4		1,5	100,0

1-2. There are no formal nor informal recognition and reward mechanisms

7. There are well established formal processes of reward and recognition of staff suggesting ideas

In terms of R&D expenses more than 75% of firms do not spend any money on R&D.

As it was expected this traditional sector is not R&D intensive and any innovation stems from non R&D innovation.

Table 10: R&D expenses: level of R&D spending

Value (Lincert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	285	17	45	13	27	1	6	394
%	72,3	4,3	11,4	3,3	6,9	,3	1,5	100,0

1: No R&D expenses

7: The firm is a leader in its sector in relation to R&D (above 10% of sales)

Participating in collaborative R&D projects, at least publicly funded could be an alternative for those that do not want or simply cannot commit resources. However, the vast majority of firms has not participated in any R&D collaborative agreement during the last 5 years. Only 33 firms have responded with a 5 to 7 in the 1-7 Likert scale, indicating the most R&D intensive firms of the specific ecosystem.

Table 11: R&D collaboration: Degree of participation in research projects / collaborations relating to your business over the last five years?

Value (Lincert scale 1-7)	1	2	3	4	5	6	7	TOTAL
Number of firms	356	5			16	12	5	394
%	90,4	1,3			4,1	3,0	1,3	100,0

1: No R&D collaboration whatsoever

7: Yes, it is a main feature of the firm's strategy

All the above variables were included in an OLS regression. Results are presented in the following Table 12. The difference between Model 1 and Model 2 lies only in the use of the interaction term linking exports with size. Furthermore, a separate analysis was undertaken in the two main sectors, manufacturing and trade.

Regression results show that the effect of size and exports is significant, indicating that firms that export – mainly the larger ones – seem to innovate more. This of course may be explained by both directions: in order to be able to export, firms need to constantly innovate. But on the other hand, exporting activity may also trigger a more intense effort for innovation, as competition is more intense in international markets, therefore maintaining a market position requires the development of capabilities to innovate. It should also be noticed that in the trade sector, size is negatively related with innovation, although at a  $p < 10\%$  level.

Furthermore, cost leadership is positively correlated with innovation. However this result is strongly related with manufacturing firms, as in the trade subsample the factor is not significant.

Management commitment to specific growth targets is also positively related with innovation, although at a low significant level, as the result is significant only to firm from the trade sector.

Customers' loyalty or switching costs is the factor that is mostly significant for the whole sample and both subsamples. It turns out that despite the fact that most of the surveyed firms have committed customers, this is not a disincentive to innovate, but on the contrary is related with innovativeness. This might be explained by the idea of innovation risk. Since in order to innovate firms have to commit human and economic resources, the fact that they already enjoy a relative secure client base allows for investing in innovation.

Table 12: Degree of innovation:

	Total Sample Model 1	Total Sample Model 2	Manufacturing	Trade
EXP	0.14* (0.079)		0.22** (0.09)	-0.26 (0.19)
SIZE	0.16 (0.17)		0.274 (0.1814661)	-0.87* (0.47)
EXP*SIZE		0.078** (0.036)		
COST_LEAD	0.164** (0.064)	0.166*** (0.064)	0.135** (0.070)	0.295 (0.1830)
diflead	0.0136 (0.076)	0.0173 (0.075)	0.003 (0.083)	0.348 (0.2236)
crdes	0.0286 (0.048)	0.030 (0.048)	0.009 (0.055)	0.095 (0.1049)
mangr	0.0718* (0.040)	0.072* (0.040)	0.048 (0.0445)	0.234** (0.1104)
swcost	0.235*** (0.058)	0.234*** (0.0578)	0.230*** (0.0646)	0.07 (0.1511)
spec	0.098 (0.07)	0.100 (0.076)	0.143 (0.089)	-0.07 (0.1658)
ict	0.21*** (0.06)	0.21*** (0.0630)	0.165** (0.069)	0.41*** (0.1577)
cult	0.11* (0.06)	0.1082* (0.061)	0.135** (0.069)	-0.043 (0.1505)
bon	0.091 (0.08)	0.091 (0.080)	0.085 (0.089)	0.315 (0.2118)
rd	0.298*** (0.074)	0.3052*** (0.074)	0.287*** (0.080)	0.446* (0.244)
coll	-0.000 (0.07)	-0.0056 (0.074)	0.020 (0.080)	-0.2209 (0.2910)
constant term	-1.54***	-1.33***	-1.460**	-2.0922*

	(0.57)	(0.512)	(0.645)	(1.270)
Adjusted R-squared	0.3218	0.3235	0.3273	0.3684
F statistic	14.32***	15.45***	12.12***	4.00***
No of obs	394	394	321	73

Notes: \* significant at the  $p < 10\%$  level, \*\* significant at the  $p < 5\%$ , \*\*\* significant at the  $p < 1\%$ . Standard errors are reported in parentheses.

A business environment that strongly encourages initiatives and risk taking, and where potential failures are used as learning experience for the future is also related with innovation. But this is more important for manufacturing rather than trade firms

Finally, R&D is - as expected - positively related with innovation, however as it was described earlier it affects only a very small part of the sample. All other variables used in the equation turned out insignificant

At the next step of the analysis, we use the significant variables to perform cluster analysis. Results reinforce the presence of three clusters as given in Table 13.

	Firm characteristics	Innovative performance
Cluster A: Laggers	No outsourcing Limited use of Internet by the personnel Limited use of employees performance indicators No relationships with other actors in the value chain (suppliers / clients)	63% no innovation or product / process improvement
Cluster B Building capabilities	System of wages is highly appreciated by employees Significant training of the personnel Highly skilled personnel (same extent as firms from cluster C) Significant efforts to reward innovative ideas and risk taking	34% no innovation or product / process improvement
Cluster C: The established	Intensive effort for vertical integration	12% no innovation or product / process improvement

	Firm characteristics	Innovative performance
ones''	Technology at the heart of their competitive advantage, mostly collaborative R&D Intensive marketing activities Highly skilled personnel	

Cluster A include 125 firms and is dominated by 85% of micro firms, which are in any case the vast majority of the sample. Cluster B includes 149 firms and although 78% are micro firms, a 20% of them are small (10-49). Finally cluster C includes 120 firms, and only 54% are micro firms, whereas 38% are small, and 7.5% are medium firms. So actually there is clear size distinction in the 3 clusters.

From the above table, it is evident that cluster C – which includes most of the small and medium sized firms of the sample - is the better performing set of firms. It includes firms that can be characterized as more aggressive in the market with significant efforts to innovate and gain market shares from competition and constantly building a strong competitive advantage. Looking at the actual identity of these firms, this group represents the most established firms of the sectors, with a traditional position in the market. They have surpassed a crucial viability test and they try to grow by using all the right tools and mechanisms, although they commit limited resources to R&D.

On the other hand, cluster B seems to be more concerned with establishing a position in the market and building internal capabilities. They are in the process of integrating technology; they have invested in raising the educational level of the personnel and generally they try to align internal business processes with market developments. They are possibly more non-R&D innovators, at least those that actually innovate.

Cluster A is the worst performing set of firms. These firms seem to lag in all aspects of business development and not only on innovation. Their viability over the next 2-3 years seems to be highly questioned, as they are not in a course of building any sort of capabilities. Some defensive strategies of reducing costs are taking place, but nothing is certain on whether it could be sustainable.

## 7. CONCLUSIONS

The paper reveals some typologies of wood and furniture firms based on their strategic orientation towards innovation and knowledge creation. More precisely the study explored the factors that affect innovative performance of these firms in crisis period and provided a clear mapping of the characteristics of the specific ecosystem. The majority of these firms (3/4) are introvert, as they focus only on internal demand. These cannot be considered as knowledge-intensive or innovative. There is however a group of extrovert firms that seem to be able to export, although to a limited number of markets. These firms – despite the fact that they are also family run – are more innovative than the rest.

An interesting finding was that innovation is significantly connected to cost leadership. The common belief for the sector so far was that differentiation and creativity were the driving forces of competitive advantage. Yet human resource practices are under-developed since formal processes towards risk taking and innovative ideas are rather scarce. Therefore, the perception of an environment that encourages risk taking initiative is not actually formally integrated in the business environment.

In spite the fact that one should expect some stronger reaction towards globalization and economic crisis, the wood and furniture industry seems to remain rather passive with limited effort to network and outsource, to use ICT or explore and activate other linkages along the value chain. Some firms try to build capabilities in order to address markets focusing mainly on Human Resources. Bigger companies try to become more knowledge-intensive, seeking knowledge all along the value chain and placing technology and collaborative efforts at the heart of their competitive advantage. This seems to be the best way to confront both crisis and globalization threats.

The study indicates that the wood and furniture industry in Greece faces in its majority survival problems, since it seems unable to correspond to changes and new market behaviours. False assumptions on cost leadership and a focus on day to day management and business activity combined with old-fashioned ways on human-resource management do not allow for the development of sustainable competitive advantages.

In order to improve competitiveness and viability, wood and furniture firms must find ways to re-organize their resources renew strategies and turn to advanced product/process innovation instead of mere improvements or imitations. Managers should try to turn to exports developing all necessary networks for both new product development and promotion. Entrepreneurial and managerial teams should realize the importance of possessing and further cultivating a suitable internal environment by building specific

capabilities' set and further cultivating them. A business environment that strongly encourages initiatives and risk taking and where potential failures are used as learning experience for the future can support innovation.

Furthermore, specific efforts should be made regarding the enhancement of the sector's innovation system at least at regional or national level as well as the role of non-business innovation actors, along with institutional and financial support towards the sector's enterprises. Policy makers should develop more targeted innovation policies to encourage relative entrepreneurial and knowledge-intensive strategies taking into consideration all the above characteristics of the examined firms.

Our findings verify relevant theory and empirical research; competitiveness seems to be related to export-oriented strategies in addition to a strategic orientation towards knowledge creation and innovation. Knowledge-intensive wood and furniture firms are typical low-tech cases which seek mainly new technical and practical knowledge and engaged in frequent changes or improvements of process technologies. Human resource management's role has been proved to be crucial in nurturing the necessary conditions for innovation even with its wide sense.

The above research covers a specific time period. Further research is suggested in post-crisis period to compare the effects of knowledge-intensive and other types of strategies on survival and economic performance. Furthermore, this research can be extended to explore different kinds of strategies in relation to innovative performance and competitive advantage such as the resource-based view and the Dynamic Capabilities Framework. Another suggestion should be to extend the research in other low-tech sectors and compare their reaction to crisis and the strategies and competitive advantages they develop in order to survive in today's vulnerable mature markets.

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# PRODUCTION TECHNOLOGIES AND INNOVATION IN KNOWLEDGE-INTENSIVE LOW-TECH VENTURES: EVIDENCE FROM THE GREEK WOOD AND FURNITURE INDUSTRY

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## ABSTRACT

In this paper we argue that production technologies choice or development plays an important role in low-tech but knowledge-intensive venturing. A small but growing stream of literature emerges that stresses the importance of knowledge-intensive entrepreneurship in low technology industries and their role in advanced economies. Focusing on the empirical case of the Greek wood and furniture sector, we explore how new low-tech ventures use knowledge from multiple and often trans-sectoral fields to intensively create and deploy many forms of production-relevant knowledge in order to develop innovative production technologies, build their initial competitive advantage and enter mature and saturated markets. The results highlight that knowledge-based innovation is necessary to start a viable low-tech but knowledge-intensive venture. This refers mainly to production technology innovation and can be incremental or radical. The development process demands certain capabilities as networking, synthesizing competencies to tap into knowledge sources and learning. Entrepreneurs own specific traits and skills and are more than just passive technology adopters. Corporate venturing presents certain advantages compared to the new-to-the-world ventures regarding both sources access and necessary human and financial capital.

## 1. INTRODUCTION

Investments in knowledge and innovation are becoming critical in low-tech industries. Established or new-to-the-world companies of traditional businesses enclose a dynamic approach of knowledge in order to create competitive advantages and compete in mature markets (Hirsch-Kreinsen and Schwinge, 2011; Robertson and Smith, 2008). Yet, to our knowledge low-tech industries remain a rather unprivileged research topic in the framework

of strategic entrepreneurship and management on the basis of knowledge-seeking activities and innovation development.

The present paper is part of an ongoing study on Knowledge-Intensive Entrepreneurship (KIE) and low-tech industries. The research used multiple case study design (Yin, 1989) to build theory (Eisenhardt, 1989) based on a capabilities approach in order to offer some insight and explain new knowledge-intensive venture success and failure within low-tech industries. The concept of Knowledge-intensive entrepreneurship uses knowledge as the core of all entrepreneurial activities. According to Malerba and McKelvey (2010) KIE refers to new firms with significant knowledge intensity in their activities that develop innovative opportunities. The paper explores the role of production technologies in knowledge – intensive low-tech venturing. More specifically, we explore how new low-tech ventures use knowledge from multiple and often trans-sectoral fields to create and deploy many forms of production-relevant knowledge in order to develop innovation, build initial competitive advantage and enter mature and saturated markets.

Empirically, the focus of the paper was on the wood and furniture industries in Greece. The sectors are representative not only for Greece but for Europe and globally as well. They are old low-tech industries which showed little propensity and capacity to innovate in the past but due to global pressures today they have turned to knowledge-based innovation. Face-to-face interviews with local firms, research organizations and industry experts offered insight to analyze the nature of innovative activities both at the founding stage and later in the firms' lifespan, the central role of production technologies, the development of linkages and the complex use of knowledge sources.

The remainder of this paper is organized as follows. Section 2 provides a short literature review on the knowledge-intensive innovation pattern in low-tech sectors and the role of production technologies in general while the third section describes the research methodology. The fourth section gives a brief description of Wood and Furniture sectors regarding industry structure, technology and innovation in general and the fifth addresses more specifically these industries' profile in Greece. Section 6 contains the empirical part of the paper. Results draw on the types of knowledge-intensive ventures found in the sectors, their introductory innovation activities and the development of innovative production technologies using key knowledge sources. Types of knowledge linkages, capabilities needed and differences between new and corporate venturing will be further discussed. Finally, Section 7 summarizes the key findings and draws some conclusions.

## 2. THEORETICAL BACKGROUND

### *2.1. Knowledge-intensive Innovation in Low-tech Industries*

In the last few years a rich literature is emerging enhancing the role that traditional sectors play in modern economies and directing importance of innovation and technological change outside R&D-intensive fields (Hirsch-Kreinsen and Schwinge, 2011; Robertson et al. 2009). There is now a growing awareness that low-technology industries, which still make up a considerable share of production and employment in developed and developing economies, can be knowledge-intensive, develop knowledge-based innovation and invest in trans-sectoral knowledge seeking and learning (Hirsch-Kreinsen and Schwinge, 2011). According to Smith (2008) "Growth within the less glamorous, traditional sectors is certainly innovation-based, and moreover it rests on cognitively complex and deep knowledge bases, which from time to time are subject to discontinuous change"

Low-tech industries engage mainly in new product development and frequent changes of process technologies (Hirsch-Kreinsen 2008a, Robertson and Smith 2008, Robertson et al. 2009). While a very small percentage of individual low-tech firms engage in R&D activities, the majority apply mainly open innovation. Especially when referring to knowledge-intensive innovation, processes translate knowledge to innovation; i.e. in-house knowledge is developed by including new knowledge and technologies that stand out from the resources of the existing sectoral system (Robertson and Smith 2008; Hirsch-Kreinsen and Schwinge, 2011). This can be scientifically-generated knowledge as well as new combinations of technical and practical knowledge which create innovation. Process, organizational and marketing innovations are more common ((Heidenreich, 2009), while product innovations are in their majority incremental (Bender, 2004). Yet, there are many cases where product innovation cannot be separated from process innovation. While the phenomenon is more usual in the food sector there are many cases of innovative material treatments or additional process steps which introduce novelty. A significant feature of low-tech innovation is the engagement of many stakeholders all along the value chain in open innovation. Suppliers are of utmost relevance in this context, since low-tech firms rely heavily on raw material, machine and equipment technological advances (Bender, 2004, Heidenreich 2009).

### *2.2. Production Technologies and Knowledge-intensive Low-tech Ventures*

Technology is the process of applying the findings of science and other forms of enquiry to applied situations. Rosenberg (1982) defined technology as "knowledge of techniques, method, and designs that work and, that work in certain ways and with certain consequences,

*even when one cannot explain exactly why.*" Adopting this view for knowledge-intensive low-tech industries, technology can be treated as a set of pieces of knowledge ultimately based on selected principles, know-how, methods, experiences, and also, of course, physical devices and equipment. Production technology therefore involves applying the work of researchers and industrial practice to develop new products and processes covering technologies for an extremely varied range.

Low-tech technologies are usually well-established with technological norms, methods and leitmotifs to exist for many generations (Hirsch-Kreinsen and Schwinge, 2011) and with an increasing trend towards improvements and automatization. At a first glance processes and products seem rather standard and at an advanced stage, lacking the prevailing technological contingency of high-technology undertakings. Low-tech industries are generally confronted as "borrowers" of technology which may come from other sectors such as machinery, ICT and raw material producers (Bender, 2004; Hirsch-Kreinsen and Schwinge, 2011). Entrepreneurial or managerial teams have to locate and organize the individual and often miscellaneous pieces of product and/or process technology they need in order to innovate. That may range from production lines to engineering and operating procedures.

Besides the skepticism of low-tech innovation, there is a growing stream of literature indicating the importance and complexity of process innovations in low-tech industries (Hirsch-Kreinsen, 2003; Bender, 2004; Trippel, 2010; Hirsch-Kreinsen and Schwinge, 2011). Bender (2004) defines as process innovation changes in the production process including design and logistics. Hirsch – Kreinsen (2008a, 2008b) commends on the incremental character of such activities. Yet, there is no relevant theoretical or empirical work to our knowledge on the role of production technologies in cases of venturing and innovation within low-tech industries, especially within the frame of knowledge-intensiveness.

Within the notion of knowledge-intensive entrepreneurship a venture creation is tightly connected to knowledge-intensive innovation (Malerba and McKelvey, 2010). When referring to low-tech manufacturing, the transformation of an innovative business concept into a marketable product presupposes the choice and set up of the suitable production technologies. Entrepreneurs, entrepreneurial teams or managerial teams try to identify and acquire advanced production technologies to combine and create the technologies they need. In cases where the output of innovation constitutes the initial competitive advantage, planning and installing the suitable production technology entails a great amount of creativity and trans-sectoral knowledge combination (Karagouni et al., 2012). Advanced

production technologies enable “the firm to capture lucrative and more value added markets for growth” (Evers, 2011).

Knowledge is mainly incorporated into production via investment. The commitment to physical creation is a significant transition point in venture creation. Certain businesses require considerable tangible and intangible resources for the set up of production technology since most of them, besides the use of standard equipment and technology, develop production technology novelties.

Differences can be found when referring to new-to-the-world or corporate venturing. The set-up of production technology occurs in parallel with organization creation. This refers to the building of the physical structure, which can be common in the two types of ventures. It also refers to organizational processes that “surround production technology at the core” (Thompson 1967). The procedures which are usually required when installing the purchased equipment or the ex ante specification for systems to be constructed in an application-oriented manner, are both to a large degree based on the accumulated practical knowledge of the respective agent (Hirsch-Kreinsen et al., 2003). Thus new-to-the-world ventures encounter more problems, obstacles and inconsistencies related to corporate ventures; these can count on their accumulated knowledge, existing organizational regimes, routines and processes and relevant experienced human capital.

### 3. METHODOLOGY

A multiple exploratory case study research design was selected (Yin, 2003) to allow for theory building, since the present paper is a part of a broader research on KIE in low-tech sectors. The individual low-tech company was the unit of analysis. This research design enables the specification and elaboration of theoretical constructs and their relationships that are not yet well-defined in literature (Eisenhardt, 1989). Our sample of knowledge-intensive ventures follows Malerba and McKelvey (2010) definition of KIE (see above) and satisfies the following criteria:

- Knowledge-Intensive venture creation among 1998–2007
- Corporate venturing or new-to-the-world venture
- Evidence of being assigned to the most innovative companies in the market or product field through knowledge-seeking activities.

The most representative low-tech sectors in Greece are the food and drinks, wood and furniture, and textiles and clothing industry, which have also a significant share of

employment and value-added for the European manufacturing industry and economy. Data were collected from relevant sectoral databases, while sectoral experts gave information about new, knowledge-intensive ventures.

For the purposes of the present paper the authors used the sample of wood and furniture sector consisting of ten rich case-studies (Table 1). Face-to-face, in-depth interviews were conducted during 2009-2011 with different interviewees of the companies using a semi-structured questionnaire. Additional sources of information were employed such as plant visits, company reports, awards and company websites. Interviews with five industry experts and five scientists from Academia provided an excellent overview of the topics researched and a useful complement to the interviews.

There are four cases of corporate venturing and six of new-to-the-world firms. Regarding size there is one large, two micro, four small, and three medium sized enterprises. The ten cases belong to different subsectors of wood and furniture industries, are all knowledge-intensive and are located in different regions covering the whole of the Greek mainland. Six of the cases do not export at all, while two of them have a significant export orientation. Due to its heterogeneous composition, the ten-case sample is considered as quite representative of the two sectors in Greece.

*Table 1. Ventures' demographics*

a/a	Main Activity	Year of venturing	employees	Exports (% sales)	Main Type of Innovation	Location
F1	veneers, veneer stitching	2007/N	8	10	Process	Larissa
F2	lacquered/printed MDF laminate flooring	2004/CV	126	25	Process	Grevena
F3	Kitchen, wardrobe	2007/N	14	0	Process and business model	Karditsa
F4	panels, flooring – laminated products	2003/N	11	0	Product, Process	Grevena

a/a	Main Activity	Year of venturi ng	emplo yees	Exports (% sales)	Main Type of Initial Innovation	Location
F5	Evropanel furniture - walls	for 2001/N	9	0	Process	Giannitsa
F6	Marine Plywood wooden flooring decorative panels	2005/CV	185	50	Process	Korinth
F7	Wood pellets	2003/N	16	0	Product using novel Production Technologies	Sykourio
F8	Kitchen, wardrobe	1998/N	30	0	Process / Technology	Thessalin iki
F9	decking fences	2006/CV	10/1014	60	Product/ Production Technology	Chalkida
F10	Mattresses	2005/CV	180	0	Business model	Xanthi

CV: Corporate Venturing, N: New-to-the-world-firm

## 4. WOODWORKING AND FURNITURE SECTOR

### 4.1. Industry structure

The wood product manufacturing industries or woodworking industries include the production of sawn wood, wood-based panels, joinery and carpentry materials, containers packaging and other wooden articles. The furniture industry is part of the down-stream value chain activities of this sector including other material as well. It is essentially an assembling industry, which employs various raw materials ranging from wood and wood-based panels to metals, plastics, textile, leather and glass. There are many different types of furniture with very different uses.

Woodworking and furniture industries are two vital, sustainable, innovative and eco-compatible sectors, with a turnover in 2008 of around €221 billion, an added value of around €60 billion and an employment rate of 2.4 million people in more than 365 000

companies (Eurostat, 2009). The vast majority are SMEs, with the wood-based panel sub-sector and a handful of sawmills to be the exception. The furniture industry accounts for nearly half of this turnover, followed by the production of construction elements (19.3%), sawmilling (13.9%) and panel production (9.2%). The majority of furniture producers are micro-enterprises (less than 10 employees).

The sector faces growing competition from low-cost, emerging economies and a growing number of technical trade barriers. Furthermore, the furniture sector is not only facing difficulties in accessing wood as a raw material, but also a dramatic rise in the price of materials such as leather, plastics natural fibres and petroleum derivatives. The general financial and economic crisis has had a major impact on the entire sector: turnover decreased by more than 20% between 2008 and 2009 (eu.enterprise.sectors).

#### *4.2. Technology and Innovation*

Woodworking companies are considered highly innovative and knowledge-intensive (Smith, 2008; Hirsche-Kreinsen and Scwinge, 2010). Companies in the sector have built in high-quality innovation systems for both products and processes and excellent sectoral research and technological development knowledge centers. Global machinery manufacturers, suppliers, the chemical industry, Universities and independent research centers develop synergies assisting the advancement of process and product developments. Innovations turn around engineered wood products, wooden composites, novel fittings and other wooden products.

Furniture companies are also knowledge-intensive but less innovative regarding technical innovation. Knowledge evolves mainly around aesthetic, design and fashion related issues and focuses on creativity and strong image building. Yet, process and product innovation is evident in the undertaking of lengthy processes of restructuring and modernization, development of sustainable production methods and novel business models (e.g. modular design). Major factors of competitiveness for the sector consist of research and innovation (along the whole value chain and mainly material and fittings, skills and quality, design and added value, knowledge and know-how, together with better access to third country markets.

## 5. THE WOODWORKING AND FURNITURE SECTOR IN GREECE

### 5.1. *Industry structure*

Woodworking and furniture industries play a significant role in Greek economy, with a turnover in 2008 of around €2 billion, an added value of around €1 billion and an employment rate of 35.000 people in more than 15.000 companies (Eurostat, 2009). The vast majority are micro-companies, with the wood-based panel sub-sector and a handful of sawmills to be the exception.

The sector is mature, highly fragmented and labour-intensive with many firms operating in a 'craft' production mode. 66% of the firms are less than 30 years old and cover mainly the domestic market, as exports are rather insignificant.

The industry faces growing competition from low-cost, emerging economies and a growing number of technical trade barriers. Decreasing production in absolute numbers was combined with the increasing number of trendy products from Italy and Spain, cheaper products from Turkey, China and India and different approaches such as of IKEA. Furthermore, it faces difficulties in accessing wood as a raw material and a dramatic rise in the price of materials such as leather, plastics natural fibres and petroleum derivatives. The general financial and economic crisis has had a major impact on the entire sector: In 2008 most companies had losses of profits (56.8%) or even damage (27.3%).

### 5.2. *Technology and Innovation*

Greek wood and furniture companies are not considered as innovative even with the Schumpeterian concept of innovation. Relevant research (Karagouni et al., 2010), which covered wood and furniture companies in the region of Thessaly, Greece, indicated only an 18% of innovative firms in the sample. Improvements of existing products and purchase of process innovation are the main innovation activities. Advancement of existing and development of new equipment (AMT), the import of design systems (CAD), the application of CIM and MRP, as well as the pilot use of new or improved raw material or semi-finished products are further innovations pursued by Greek wood and furniture manufacturers. A network of international machinery manufacturers and suppliers play a significant role in research and development advances regarding mainly medium and large organizations.

Furniture companies invest on aesthetic value and fashion. Yet, design is still underdeveloped while process innovation refers more often to restructuring and modernization.

Major weaknesses of both sectors regard the lack of specialized technical personnel, overall organization and quality control while entrepreneurs' educational level is rather low. The last five years the sectoral context starts changing by becoming more knowledge-intensive. New entrepreneurs or successors have a high educational level and turn to research, innovation and knowledge management.

## 6. EMPIRICAL PART

### *6.1. Knowledge –intensive Innovation in Greek Wood and Furniture Sector*

Our research revealed that Knowledge-intensive ventures are rather rare in the Greek low-tech industries and especially the wood and furniture sectors. Yet, there were certain cases found which created initial competitive advantages due to knowledge seeking and a harmonic combination of externally acquired and in-house developed knowledge.

More precisely, **three types of knowledge-intensive ventures** could be traced. The **first type** presents a more balanced emphasis on different dimensions of innovation<sup>22</sup> and relies mainly but not solely on external knowledge seeking. Five cases belong to this type. The **second type** develops only the technical dimension of innovation combining both internal and external knowledge development. This group contains three cases and only corporate ventures, raising certain questions on knowledge-intensive corporate venturing. The **last type** focuses again on only the technical dimension of innovation relying on only external knowledge and refers to two new-to-the-world ventures.

Although our research started without seeking ventures of certain types of introductory innovation, it turned out that knowledge-intensive wood and furniture ventures develop mainly process innovation (Table 1). Even in cases of innovative products or business models, process changes and novelties were necessary to support the initial innovation. This is in line with relevant literature (Heidenreich 2009, Fagerberg, 2005). Hirsch-Kreinsen (2008b) further notes this close relationship between product and process innovation. More precisely,

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<sup>22</sup> *Note: Actually it covers the three axes of a new venture: technology axis which is relevant to the technical development of a novel concept up to full scale production, Market axis which refers to the interaction with the market and the business axis which includes the business steps needed such as commercialization and business scheme selection, business and relative model development and IPR protection.*

**Knowledge-based introductory innovations** of the ventures cover all four categories of the venture idea newness: (1) new to the world : one case with novel business concept and one with patented process technology, (2) new to the market (national / international market): eight out of ten cases, (3) new to the firm: all cases, and (4) a first mover or assigned to the most innovative companies in the market or product field: all ten cases are first movers at least at national level. Knowledge-intensive and innovative venture ideas can produce (1) novel products supported by novelties in production technologies (six cases) (2) methods of production, processes and technologies (all ten cases), (3) methods of promotion (one case) and (4) business models (two cases) creating niche markets.

However, most of the initial innovations cannot typically be characterized as “breakthroughs” or “radical departures”, since they more often constitute combinations of existing patents and innovations in general. W&F companies target more to innovate in functional parameters in order to produce initial competitive advantage, such as: quality (2 cases), functionality (3 cases), exploitation of innovations other produced but adapted to local conditions (3 cases), or present unique images either by a novel business model and method of promotion (one case), or innovative products which however do not constitute the core products of the company (one case). This can be a major characteristic of low-tech industries and specifically wood and furniture sectors.

In all cases of wood and furniture sector all innovations later in new ventures’ lifespan turn mainly around the initial novel concept. Yet, they are not mere improvements or additions to product families and refer mainly to process or concept innovations.

Patents and intellectual property protection are not popular among the cases although they are knowledge-intensive and one would expect much more focus on protecting knowledge. Agents of wood and furniture sector believe in the strength of their unique ideas. “No one can really copy the whole package” according to some of them. As one interview partner put it: “it is not enough even to watch the way an entrepreneur makes his/her strategic moves”. Another entrepreneur patented his novel technology but he is revealing its secrets to everyone who asks about it. *“I gave the technology to them. I will have more novel ideas. This is a way that we became famous. This is how they all visited my new company!”* There are two cases with patented technology but there are the exceptions. Almost all interviewees find the patenting procedure time-consuming.

### 6.2 Production Technologies of Knowledge-intensive W&F Ventures

Besides focusing on a few technological core competencies, most of the cases sustain competencies in multiple technology fields. Table 2 provides an overview on the respective partnering activities. Machinery suppliers and suppliers of raw and intermediate products play the most important role. They belong to various fields which somehow are connected to different links of the relevant value chain. Because of increasing technology convergence, these fields are often relatively different from the core technologies and this puts further emphasis on the importance of successful technology exploitation (Patel & Pavitt, 1997). Other knowledge sources are also involved confirm the view in the literature (e.g. Granstrand, 2000; Garcia-Vega, 2006; Bender, 2004; Hirsch-Kreinsen and Schwinge, 2011) that low-technology sectors rely on a variety of knowledge sources and make use of distributed and trans-sectoral knowledge bases.

New entrepreneurs or entrepreneurial teams usually develop novel business ideas and consume resources to combine or modify existing technologies or even support the development of new ones. Thus, they develop linkages which go beyond traditional buyer-supplier relations being more interactive. In most cases they co-operate with machine manufacturers to develop extremely specialized equipment to fit specific requirements. A kitchen manufacturer co-developed a multi-task machine to fit his novel "box-concept" of line production. The CNC machine was then patented by the manufacturer (with the kitchen manufacturer's permission) and won an innovation prize in a world machine exhibition.

The most impressive case was a woodworking corporate venture. The entrepreneur engaged 20 machine manufacturers of various fields, which were ranged as the global leaders in specific technologies to co-operate under the guidance of a leading consultant international company to produce "his technological miracle". This impressive operation ended with a patented MDF production technology which had cost more than 70 million Euros.

Table 2: Knowledge sources

Cases \ Knowledge source	F1	F2	F3	F4	F5	F6	F7	F8	F9	F10
Customers		1			2					
Suppliers of raw materials & intermediate products	4	3	7	2	1	1	2	3	3	4
Suppliers of machinery, packaging	3	20	4	3	2	5	4	6	4	5
Competitors (firms from the same sub-sector)	1	2			1		1			
Other firms	2	4	2	2	3	2	2	4	2	3
Universities, Technical	1	2	1	1	1	1	1	2	1	2

Colleges										
Consultants	1	3	1	1	1	1	1	1	2	2
Other actors / organizations	1			1		1		3	1	3
Total	13	35	15	10	11	11	11	19	13	19

All major technologies are developed mainly by European manufacturers. American machine suppliers are also used in two cases. Greek companies are used for supportive constructions and ICT solutions. This is however not strange since Greece lacks relevant industries; the same phenomenon is observed in other countries and other sectors as well (i.e. Trippl, 2010).

In table 1 there are three cases presented where the novel initial business ideas turn around innovative products. Yet, all three cases developed novel production technologies as well. One of them bought patented technology by an American research organization. However this technology had to be modified to suit local conditions and raw material. An almost “turn-key solution” turned to a new research; problems of the pilot production led to a formal European research project. This case denotes a further direction towards the potential hidden behind the so-called “purchase of embodied technologies”.

Yet, all cases show a rather weak relation to Universities and other research institutions. This can be attributed to the fact that there is only one relevant educational and research institute in Greece to fit the relevant field and it has been contacted by all ten cases (Table 2).

Among the cases, there are also two cases where the initial business idea is a novel business model. In both cases innovative production technologies, although incremental, supported the basic idea advancing existing ones. Both cases needed and developed co-operations with different technology areas and occupied international organizations.

In all cases wood processing technology, wood behavior science, chemistry, mechanical engineering, material engineering, ICT and extruding technology are engaged while certain other fields are involved in each case. A creative bricolage of research work and industrial practice results in innovative products and processes covering technologies for an extremely wide range. In parallel, improvements, parameterization and automatization are involved to solve problems and create new directions. These cases indicate that low-tech companies may be something more than just “borrowers” of technology. Yet, they verify the fact that entrepreneurial or managerial teams locate and organize the individual and often miscellaneous pieces of product and/or process technology they need in order to innovate.

The cases verified also existing literature (e.g. Smith (2008); Robertson et al., 2009) regarding the significance of raw materials and intermediate products in low-tech innovation. However their role during venturing does not appear to be that important; they rather support than

guide the initial novelty. In most cases novel material adds to properties of the final product or constitutes part of improvements. There is only one case where the innovative material gave birth to an innovative production technology and the opening of a new niche market. Once again suppliers of innovative raw materials are in their majority foreign companies.

A quite interesting issue is the fact that novel production technologies as venture enablers arise either as solutions to specific problems in the cases of corporate venturing and as a medium to create niche markets in the cases of new-to-the-world firms. All cases indicate that entrepreneurs (even new ones) have a satisfactory knowledge of the sectors and a relevant experience. This is rather expected; innovation in production technology cannot start without any previous involvement in the relevant fields. Most case-study firms are established by agents between 34 and 42 years old which strengthen the assumption of the significance of prior entrepreneurial experience and knowledge. There is only one exception where the entrepreneur is 26 years old. In this case, though, there was a strong family company as a sectoral background, important knowledge background and a sense of worldview on economic and other specific knowledge since the entrepreneur is a PhD holder and prior member of international large organizations. There are also two cases of corporate venturing with entrepreneurs older than 50 years old. These own the two larger organizations of the sample.

All four cases of corporate venturing present certain advantages compared to the new-to-the-world ventures. Resources are richer and abundant, networking and contacts are easier, organizational capabilities are higher and better developed. This is in line with literature which states that corporate ventures can benefit from their parents' resources, which are an important requirement for enhancing the innovation process (Thompson 1965).

The four cases of corporate venturing have engaged a significant part of human, social and financial capital in reaching various knowledge bases and translate combinations in novel production technologies. Path dependencies secure easier and faster co-operations, more trust and advanced planning. There is always a better mapping of the relevant areas of interest, while the problems of spatial proximity can be easier overcome. Accumulated technical and practical knowledge can also secure and enable further advances required. New-to-the-world ventures reported many problems, and obstacles related to important lack of relevant knowledge, significant waste of time in searching for appropriate knowledge sources, severe difficulty in establishing contacts and trust with stakeholders, lack of proper human resources and many inconsistencies between planning and realization.

Many times, even in cases of successful production establishment new entrepreneurs missed the qualified, interdisciplinary team which would embrace the design, engineering, production, marketing, procurement and quality departments due to the emphasis given on idea implementation through technology. Yet, all entrepreneurs admitted that learning was developed all along the founding stage. Even activities such as the installation and preparation of equipment and trial production were knowledge-generating activities.

All companies continued to be knowledge-intensive and innovative. Yet, the following innovations in these firms' lifespan are rather incremental and mostly product improvements, New Product Developments and applications of novel raw material. Process modifications are also reported; still not at the scale of the initial innovation.

All ten investments have survived the usually used five years criterion (Ensley et al., 2006). Most of them have shown an increasing sales rate till 2009. The severe economic crisis in Greece created significant problems in almost all of them.

## 7. SUMMARY AND CONCLUSIONS

A small but increasing stream of literature supports the ability of low-tech sectors to be knowledge-intensive, produce innovation and play a significant role in advancing technologies and technological change (von Tunzelmann and Acha, 2004; Robertson et al. 2009). Various scholars have also pointed out that low-tech innovation follows different ways of development than high-tech innovation; it engages open innovation forms instead of R&D, produces rather process than product innovation and is mostly supplier-dominated (Hirsch-Kreinsen and Schwinge, 2011). Yet, little is still known about the degree and modes of innovation development and technology embeddedness in low-tech new ventures. The paper claims that production technologies hold a significant role in knowledge-intensive venturing and deserve a further investigation, within the framework of knowledge-intensive entrepreneurship of low-tech sectors.

Empirically, the focus of the paper was on the wood and furniture industries in Greece. The sectors are rather representative not only for Greece but for Europe and globally as well. They are old low-tech industries which showed little propensity and capacity to innovate in the past but due to globalization and trade liberalization today they face enormous competition and have turned to innovation and learning challenges. Based on 20 face-to-face interviews with local firms, research organizations and industry experts, the nature of innovative production technologies and all innovative activities both at the founding stage and later in

their lifespan, relevant knowledge sources and linkages and mechanisms of implementation have been analyzed.

The empirical results have shown that Greek wood and furniture new ventures prefer to invest on production technology innovation in order to secure a position within mature and saturated markets. Technologies are developed as accumulation of various pieces of knowledge sources out of the strict sectoral limits, selected to fulfill conditions and limitations of the initial business idea and combined in novel ways ending up even with machinery innovation. The study has shown that low-tech but knowledge-intensive entrepreneurs interact with a wide range of stakeholders all along the value chain and at global level. Yet, machine manufacturers and raw material providers are the most important links; this was rather expected since we refer to production technologies, but not to the extent found. The results also seem to contradict the common belief that low-tech companies are just “buyers of embodied technologies”. Entrepreneurs co-operate with machine manufacturers to produce novel machines and equipment or even to develop novel processes.

Differences have been traced among corporate and new-to-the-world ventures. Established organizations seem to have the potential, capital and capabilities to develop far more advanced innovative production technology innovations than the newly established companies.

The study indicates that entrepreneurs need to own at least relevant technical and sectoral knowledge and must have developed corresponding capabilities to organize introductory innovations which will constitute the initial competitive advantage. Rather than being passive technology adopters adapting business ideas to existing production technologies, they must be active contributors to process development in order to differentiate. An overall knowledge of the sector all along the value chain and a competence of locating necessary knowledge sources out of the boundaries of the sector seem to be significant. Therefore bricolage, networking, synthesizing and learning capabilities may be core entrepreneurial capabilities for starting a new low-tech but knowledge-intensive venture. In terms of organizational practices, a variety of skill levels and forms of work organization is needed rather than simply the low-skill, hierarchical model that is often assumed. More precisely, technology-flows need to be managed by an interdisciplinary team in order to produce desired results in operations floor and translate them into viable competitive advantage.

Besides the managerial implications, the paper suggests that the role of production technologies should constitute a necessary part of innovation and venturing theory, especially for low-tech sectors, since it is the “vehicle” of business concept implementation in

manufacturing sectors. Within the framework of Knowledge-intensive entrepreneurship capabilities, mechanisms and practices should be also developed at operations level, since that is the level where knowledge selection, combination and elaboration creates tangible results of newly created knowledge.

Given the nature of our study, we do not argue that our findings may be generalized to other low-tech industries and nations. Further empirical and theoretical research is required to enhance our understanding on this specific direction of knowledge-intensive entrepreneurship and namely the role of production technologies in low-tech but knowledge-intensive venturing.

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## UNIVERSITY- INDUSTRY COLLABORATION A THEORETICAL FRAMEWORK

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### ABSTRACT

**Purpose:** Developing a theoretical framework for exploring factors promoting/hampering university-industry collaboration.

**Design/Methodology/Approach:** A review of the literature on the subject was carried out.

**Results:** The construction of a theoretical framework for studying motivations and barriers in connection with university-industry collaborations was accomplished.

**Limitation/Implications:** The developed framework is limited in terms of not reflecting dynamic features, changes, or developments of university-industry collaboration, but is well suited for investigating reasons for collaboration between university and industry, and barriers obstructing such collaboration.

**Originality/Value:** This study integrates research on cultural geography, inter-organizational collaboration, and university-industry collaboration, which is a novel approach.

**Keywords:** collaboration, inter-organizational collaboration, university-industry collaboration, motives for inter-organizational collaboration, barriers to inter-organizational collaboration, university-industry.

### INTRODUCTION

Knowledge management has changed the view on knowledge processes and knowledge production (Santoro and Gopalakrishnan, 2000; Hurmelinna, 2004; Rod, 2005; Hermans and Castiaux, 2007). Organizations, and society in general, have moved from acquiring knowledge through a traditional internal procedure to a network-based approach. Success in

managing knowledge development highly depends on the effectiveness with which the organization can gain, create, and transfer knowledge and resources, both within the organization and beyond its boundaries (Hurmelinna-Laukkanen, 2001, 2011). Knowledge in all areas and in all applications are increasingly collaboratively produced, distributed, and used (Kuhlen, 2003). One indication of this development is the growing number of university-industry collaborations (UIC), and the fact that governments around the world are requesting extended collaboration between universities and industries. In Sweden for instance, the Higher Education Act (1992:1434, 1.2) is since 1992 stipulating collaboration with the surrounding community.

This request, or political pressure, is only one of the driving forces behind UIC in Sweden, or in society in general. Policy makers and researchers commonly agree that UIC is one of the most promising constituents in strengthening knowledge development, and fostering innovation capability (Hofer, 2004). However, contrasting opinions is noted when exploring the interest in UIC from the perspective of the industry. In a survey, IBM (2006) asked the CEOs of various global companies to describe the most significant sources of innovative ideas. As Figure 1 illustrates, academia received the lowest rating. This raised the question: Why was academia rated so low, despite studies indicating UIC to be an important factor in development and innovation? Worasinchai *et al.* (2008) remarked: "This reinforces the fact that no suitable model or framework has been developed to make U-I relationship efficient, successful, and fruitful for both parties". They argue that comprehending what affects UIC is vital for accomplishing an effective UIC. Some researchers have concluded that many obstacles remain on the road to a successful realization of UIC (Lee, 2000; Rohrbeck and Arnold, 2006). Hofer (2004) suggested that assessing the motives for collaboration is necessary in order to understand the driving forces behind UIC.

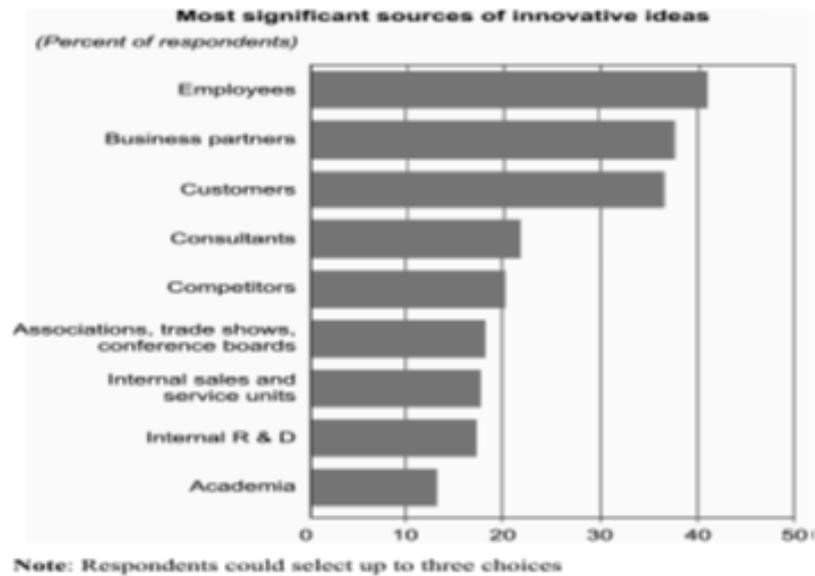


Figure 1. Significant sources of innovative ideas, as rated by CEOs of various global companies (Worasinchai *et al.*, 2008)

The purpose of the present study was to develop a theoretical framework for exploring motivations and barriers related to UIC. The framework will later be applied in a research project, investigating the collaboration between a local university in Sweden and organizations in the area.

## APPROACH OF THE LITERATURE REVIEW

A narrative review of the literature on university-industry collaboration (UIC) was chosen as approach. The choice was founded on recommendations previously proffered by scientists (Ghauri and Gronhaug, 2005; Bryman and Bell, 2007) who regarded it suitable for such a study. A detailed, rigorous systematic review of the literature (Green, 2006; Cronin *et al.*, 2008) was not needed, since the motive was to acquire a deeper understanding of the research area by enriching its discourse, which would form the foundation for the construction of the theoretical framework.

Literature to be included in the review was identified by conducting an electronic database search, the databases used being: ABI Inform, Academic Search Elite, EMERALD, Social Sciences Citation Index, PRIMO, and Google Scholar. The keywords used in the search were: collaboration, inter-organizational collaborations, university-industry collaborations, motives for inter-organizational collaborations, barriers to inter-organizational collaborations, and university-industry collaborations. Some of the acquired articles were literature reviews, or

contained a literature review section, which means that the motives and barriers in relation to collaboration were retrieved from a number of articles. Articles with overlapping data were consequently excluded. This strategy had its shortcomings, since only journal articles were included, while books were omitted.

## THEORETICAL FRAMEWORK

### *Collaboration – What does it mean?*

Collaboration is a very broad and encompassing term. It stems from Latin: “co” – together and “labore” – to work, i.e., it means working together. Historically, as in German and French, collaboration also means, “work with the enemy”. Collaboration is however commonly understood as working together, and policy makers, administrators, and the general public are vigorously promoting collaboration between organizations (Longoria, 2005).

Although the importance of collaboration has been emphasized for the past decades, the concept is not so easy to define. On the contrary, we find many different and sometimes contradictory definitions of collaboration (Wood and Gray, 1991; Axelsson and Bihari Axelsson, 2006; Franco *et al.*, 2006). Collaboration is sometimes used as a synonym for networking. For example Axelsson and Bihari-Axelsson (2006) made no distinction between networking, cooperation, and collaboration. They referred to institutional economic theory, and maintained that inter-organizational integration can be achieved either through the “visible hand” of management hierarchy, or through the “invisible hand” of the market. They also mentioned a third option, a network mode of integration, an intermediate between market and hierarchy, which amounts to more or less voluntary cooperation or collaboration between organizations. Some scientists do however distinguish between the concepts. Himmelman (1993) reckons that organizations have the following options for cooperating with other organizations:

- “Networking is exchanging information for mutual benefit (This is the most informal of the four options.).
- Coordination is exchanging information and altering activities for mutual benefit, in order to achieve a common purpose. Coordination requires more organizational involvement than networking, and can be an important strategy for change.
- Cooperation is exchanging information, altering activities, and sharing resources for mutual benefit, and to achieve a common purpose.

- Collaboration is exchanging information, altering activities, sharing resources, and enhancing the capacity of another organization for mutual benefit, and to achieve a common purpose. Members of a collaborative effort view each other as partners, and are willing to share risks, resources, responsibilities, and rewards.”

What thus distinguishes collaboration from other options is that collaboration is more complex and time consuming. The members view each other as partners, share risks, resources, and responsibilities. Collaboration should therefore be chosen with careful consideration (Himmelman, *ibid.*). According to Longoria (2005), it is important for the interested organization to clarify the meaning of the term collaboration. But defining what the term means is not an easy task.

In a literature review, Longoria (2005) identified fifteen definitions of collaboration. Among these, the following definition, offered by Wood and Gray (1991), was selected as the superior one: “Collaboration occurs when a group of autonomous stakeholders of a problem domain engage in an interactive process, using shared values, norms, and structures, to act or decide on issues related to that domain” (Wood and Gray, *ibid.*).

From this definition we can list a number of attributes that to some extent enables us to distinguish collaboration from other forms of cooperation between organizations.

- Autonomous stakeholders
- Stakeholders of a problem domain: a group of organizations with an interest in a problem domain
- Interactive process: a change-oriented relationship of some duration
- Shared rules, norms, and structures: participants sharing a negotiated order
- Action or decision: participants must intend to act or decide to do so
- Domain orientation: collaboration requires that participants orient their process, decisions, and actions toward the problem domain that brought them together.

#### *Motivations for collaboration*

What drives organizations in general and university-industry in particular to collaborate with each other? Tranquist (2001) argues that for collaboration to take place at all, a genuine wish to do so is fundamental. When reviewing the literature, Oliver (1991) found the following motivations for inter-organizational collaborations:

- Necessity: Organizations collaborate with each other in order to meet necessary legal or regulatory requirements.

- Asymmetry: Organizations collaborate with each other to exercise power or control over other organizations or their resources.
- Reciprocity: Collaboration may be based on reciprocity instead of asymmetry. Collaboration among organizations is emphasized, rather than domination, power, and control, and pursuing common or mutually beneficial goals and interests constitute the motives.
- Efficiency: This motive is internal rather than external. The purpose here is to increase the input/output ratio, with the intention of reducing the transactions costs and attain efficiency.
- Stability: Organizations change behavior as an adaptive response to environmental uncertainty. Uncertainty prompts organizations to establish collaborations with each other in order to achieve stability and predictability in their relations with others.
- Legitimacy. Enhancement of organizations' legitimacy was also a significant motive for collaboration.

Huxham and Vangen (2005) argue that the purpose of collaboration is to create collaborative advantage. They identified a number of common foundations for collaboration. These are:

- Access to resources: Organizations collaborate with other organizations to acquire access to technology, knowledge, expertise, and other resources.
- Shared risks: Organizations collaborate when the consequences of failure are too severe, the collaboration being a strategy to share and reduce risks.
- Efficiency: Economics of scale, operational efficiency, and coordination of public service delivery are plausible reasons for collaboration.
- Coordination and seamlessness: Coordination aids in avoiding duplication.
- Learning: Collaboration may be developed in order to enable mutual learning.
- The moral imperative: In today's society, important social issues cannot be tackled by organizations acting alone. Collaboration is essential when seeking solutions to many social issues.

A large variety of potential motivations for UIC were identified in articles on the subject of UIC. In a survey, including more than 400 research joint ventures, Lee (2000) found the motives for the industry to collaborate with the university to be: research on product development, research to explore new technology, solving technical problems, designing prototypes, providing seminars and workshops, conducting fundamental research, providing support to universities, and development of software. On the other hand, the reasons for academics to collaborate with the industry are: securing funds for graduate assistants and lab

equipment, gaining insight into one's own research, field test applications to one's own theory, supplementary funds for one's own research, assisting university's outreach mission, creating student jobs and internships, gaining knowledge useful for teaching, and searching for business opportunities.

In a study based on contributions from 49 academics and managers from industries and universities in Finland and Portugal, Hurmelinna (2004) found that the most frequently cited motivation for collaboration was "actualization/competitiveness", which reflects the acquisition of competitive edge. The second most frequently named category was "education with meaning", reflecting the need for more practical and useful education, more in line with the needs of companies as well as the society. Access to funding/financial resources, information, knowledge, and other resources were next on the ranking list. "Image", yet another frequently mentioned motivation, reflects the organizations' reputation, visibility, and social status.

Rohrbeck and Arnold (2006) stated that there are a variety of motivations for UIC, and that these vary depending on firm size, company culture, and geographic location of the firm. In their literature review, they found that the universities' motivations for collaboration are: enhancement of teaching, funding/financial resources, sourcing knowledge and empirical data, political pressure, enhancement of reputations, and job offers for graduates. The motivations for collaboration in the industry are: sourcing the latest technological advances, use of laboratory, personal resources/cost savings, risk sharing for basic research, stabilizing long term research projects, and securing new recruiting channels.

Based on 98 interviews with university administrators, academics, industry scientists, business managers, and entrepreneurs in two regions in the USA, Siegel (2003) found that the collaborating actors had different motives for the collaboration. A primary motive for university scientists to collaborate was gaining recognition from fellow scientists, by publishing articles in top journals, and making presentations at prestigious conferences. The secondary motive was financial gain, a desire to secure additional research funding for graduate students and for laboratory equipment.

The primary motives of the technology transfer office and the university administration were protection and marketing of the university's intellectual property. Secondary motives included securing additional research funding for the university via royalties and licensing fees, sponsored research agreements, and a desire to promote technological diffusion. The primary motive for collaboration (between companies) within the industry was financial gain, and the secondary motive was maintaining control of proprietary technologies.

Hughes (2006) identified four different functions for universities that might be conceivable motives for collaboration between universities and industries. The first function is educating people, providing suitably qualified human capital for the industry. The second is increasing the stock of codified knowledge, useful for the industry. The third capacity is their role in problem solving that concerns the needs of the industry. Finally, the fourth function, what Hughes called the “public space function”, included a wide range of collaborations between university staff and the business community, from informal social interactions, meetings, conferences, entrepreneurship, and entrepreneurship activities, to the exchange of personnel, including the role of internships.

Hughes further claimed that it is urgent to recognize the different elements that individual universities may stress, since these may reflect their own particular missions, economic circumstances, and particular localities or regions within which some of them are located.

#### *Barriers to UIC*

In spite of numerous motives for UIC, a number of barriers that collaborative partners must overcome to facilitate an effective collaboration, have indeed been identified in the literature. As mentioned above, the concept of collaboration is vague, and this is considered to be one of the factors creating barriers to UIC. An evaluation of collaboration between the Swedish higher education and the society reported, “One obstacle is posed by the vagueness of which the national authorities define the concept of collaboration”. (Report from National Agency for Higher Education 2005:24 R). However, this is only one of the barriers to UIC.

A concept capturing a prominent position in the reviewed articles is the impact of proximity on inter-organizational collaboration (Boschma, 2005; Knoblen and Oerlemans, 2006; Pablo and Perkmann, 2007). In their literature review, Knoblen and Oerlemans (ibid.) distinguished between the following seven forms of proximity:

*Geographical proximity* has been defined as the spatial and physical distance separating actors. It is believed that a short geographical distance facilitates face-to-face-interactions, and eases collaboration. A large distance may rather create barriers to collaborations between organizations.

*Organizational proximity* is a term suffering from a high level of ambiguity, and different authors define it in different ways (Knoblen and Oerlemans, op.cit.). Boschma (2005) defined it as “the extent to which relations are shared in an organizational arrangement, either within an organization, or between organizations”. Since similarity facilitates mutual understanding,

IOCs are expected to be more efficient, and to produce better results, when the organizational context of the partners is similar.

*Cultural proximity* Organizations with similar cultural backgrounds are expected to collaborate and interact more easily, showing better results.

*Institutional proximity* is analyzed on two different levels. At the general level, the concept is often based on similarities between the institutional frameworks of countries and regions, such as legislative conditions, labor relations, business practices, etc. Formal institutions (such as laws and norms) and informal institutions (like cultural norms and habits) are believed to affect the collaboration with their partners (Knoben and Oerlemans, 2006). The effect of institutions (formal as well as informal) on the norms and routines of an organization is however determined at a lower level (the dyadic level). Shared institutional norms and values are expected to facilitate collaboration between organizations.

*Cognitive proximity* is defined as "the similarities in the way actors perceive, interpret, understand, and evaluate the world" (Knoben and Oerlemans, op.cit.). Shared routines and cultures are considered expediting collaboration between actors.

*Technological proximity* is based on shared technological experiences and knowledge bases. Technological proximity between actors was inferred to aid development of technological knowledge and technologies.

*Social Proximity*, or relational proximity, is defined as a social relation, where trust between the agents is based on friendship, kinship, or experience (Boschma, 2005), enabling the exchange of knowledge.

In their literature review, Knoben and Oerlemans (2006) found that cognitive, institutional, cultural, and social proximity constitute parts of organizational proximity. Consequently, they reduced the proximity to three categories: geographical proximity, technological proximity, and organizational proximity. They argued that the three dimensions of proximity eliminated overlap, reducing the conceptual ambiguity.

A number of barriers to UIC were identified in the literature review. In a study based on interviews with three stakeholder groups: academic scientists, university administrators, and managers/entrepreneurs, Siegel *et al.* (2003) found that the three groups perceived the following as barriers to UIC:

- Difficulties in comprehending the university, the corporates, or the scientific environment and its norms
- Insufficient rewards for university researchers
- Bureaucracy and inflexibility of university administrators

- Insufficient resources devoted to technology transfer by universities
- Poor marketing/technical/negotiation skills of university administrators
- University too aggressive in exercising intellectual property rights
- Faculty members/administrators having unrealistic expectations regarding the value of their technologies
- Public domain mentality of universities

In a study based on contributions from 49 academics and industry managers, Hurmelinna (2004) found that obstacles for collaboration between university and industry mostly comprised:

- Different needs and objectives, and different attitudes
- Lack of knowledge/experience in terms of how to collaborate
- Lack of practical knowledge in universities
- Different time horizons, and different language/mental worlds

Rohrbeck & Arnold (2006) identified the following three categories of barriers to UIC in a review:

*Cultural barriers:* The university and the industry have divergent missions and goals. The mission of the university is to advance science and public good, while the mission of the industry is to make a profit, and to advance private good. The university and the industry also have different goals. The university's goal is to produce scientific results that are thoroughly validated (fundamental to the university), and to advance its scientific reputation. In contrast, the goal of the industry is to produce marketable products and services, and they are not interested in extensive validation of research results. The conflicting goals lead to conflicting interests in terms of secrecy and intellectual property rights (IPR). The industry is interested in acquiring confidential research results, but the university needs to publish the results (and to enhance scientific reputation) prior to application. Different cultures mean different basic assumptions concerning research results. For instance, speedy research results are by the industry generally assumed to be the result of effective management, in contrast to the university, where speedy results are associated with research being rushed, and validation being inadequate.

*Institutional barriers:* The nature of work is different at the university and in the industry. Universities are usually engaged in basic research, with diffuse, abstract, and complex goals, while the industry is more interested in applied research. The industry is seeking short-term profit and reports quarterly results, while reporting cycles at universities usually extend

much further. Perceptions of what the product of R&D actually entails also differ between the university and the industry.

Changes in organizational structure, and a change of responsibilities might create a barrier to collaborations. This is particularly likely when the UIC is initiated and run by a person, who later is replaced.

*Operational barriers:* Universities are mostly public institutions, and their operations are very differently organized in comparison with the profit driven industry. Most industries have well defined incentive systems, strategies, etc. Universities are more bureaucratic, and have no explicit incentives. Their processes of budgeting, task definition, and task execution are thus very different.

Lack of knowledge about the partner's processes creates barriers to collaborations. Insufficient coordination and project management are two other obstacles. Not accepting transferred results generated by the partner may be yet another hinder.

#### *Limitations of the study*

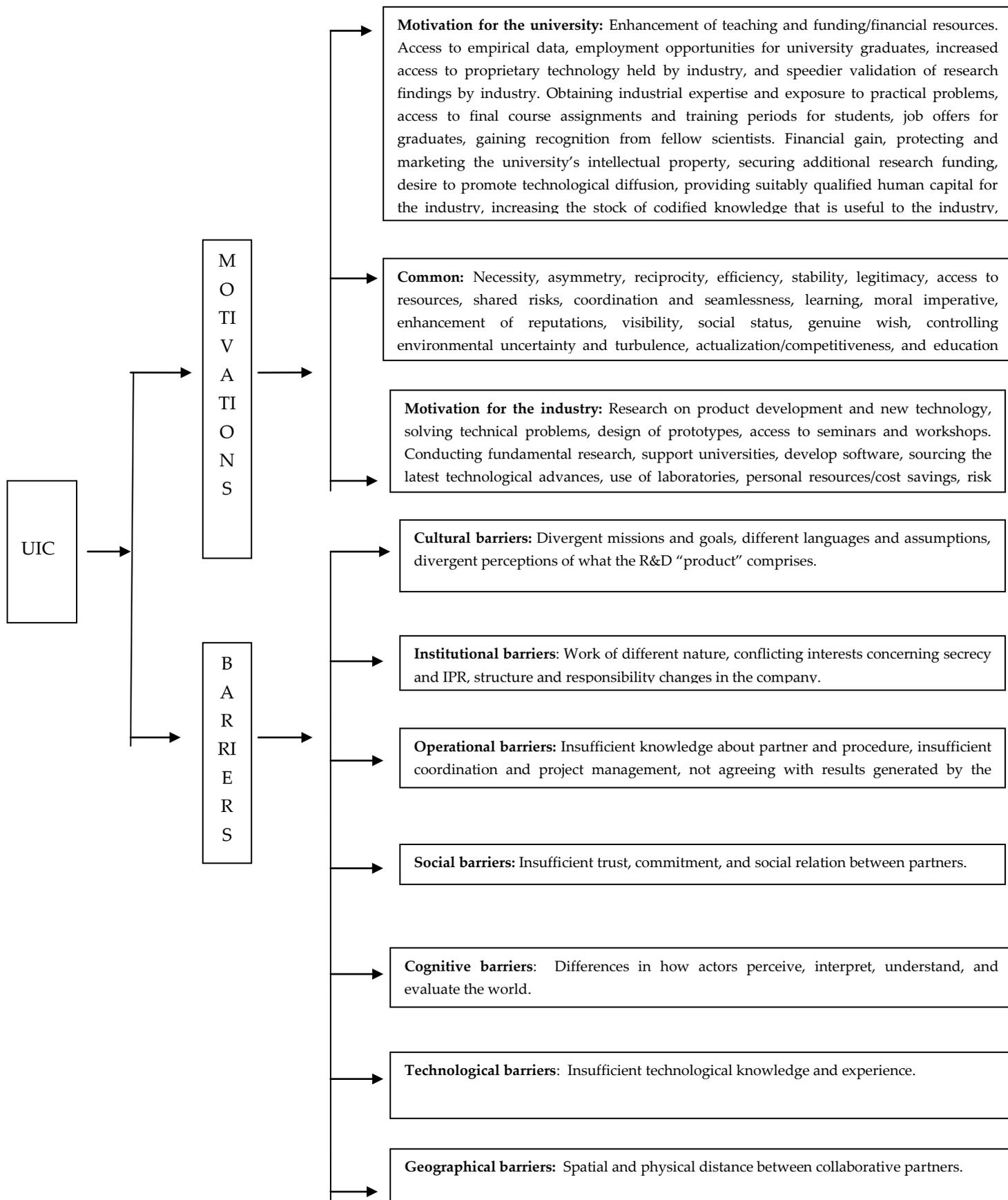
Understanding how the evolution of UIC is materialized, and comprehending its dynamic features yield crucial insights into how such collaboration might be governed. Notwithstanding, the framework developed here is intended for studies on motivations for and barriers to UIC. The designed frame is hence limited in terms of its contents, and does not reflect actual dynamic features, changes, or development of collaboration between partners.

## **CONCLUSIONS**

The review revealed a number of motivations for UIC. They were categorized into three groups. Some motivations were shared between the university and the industry. Other motivations related only to the university, or to the industry alone. The review also disclosed the existence of different types of barriers to UIC: cultural, institutional, operational, social, cognitive, technological, and geographical barriers. The acquired information provides an adequate theoretical framework (see Figure 2) for detailed research on motivations and barriers in relation to UIC, which is what this work aimed at, and it will be utilized in the next study, which specifically will be examining the collaboration between a local university in Western Sweden and organizations in its surround

Figure 2: University-industry collaboration; motivations and barriers

Source: Author's collection



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## NETWORKING FOR REGIONAL DEVELOPMENT: A CASE STUDY

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### ABSTRACT

*Purpose:* To elucidate what characterizes a network for regional development, why actors participate in such a network, and perceptions about networking for regional development.

*Approach/Design:* The study focused on using networking for regional development in Sweden, utilizing a qualitative method with a hermeneutic approach.

*Findings:* A network for regional development entails hierarchy, and may be characterized by dominance. A network is supportive, and networking is a necessary strategy for regional development. Increased societal complexity reinforces the need for networking. Networks comprise advantages as well as disadvantages. A network for regional development requires leadership, individuals who take the lead.

*Research limitations:* As this was an intra-case study, it was problematic to generalize the findings and to make a cross-case analysis.

*Practical implications:* The attributes of a network for regional development, hierarchy and dominance, constitute problems that need to be solved. The informal character of a network may create vagueness, making it difficult to produce tangible results. Hence it is vital to discuss results from different angles. An effective network requires a process leader who promotes trust and mutuality, and pushes the network in the desired direction.

*Originality/Value:* The present paper integrates research on network for regional development with general network theory, offering a better comprehension of the network model as a regional development strategy.

**Keywords:** network, networking, network-based strategy, regional development

## INTRODUCTION

Research on networking as phenomenon is abundant, and topics cover a wide range (see Gulati, 1998; Lind, 2006; Borgatti and Foster, 2003; Borgatti and Halgin, 2011). Economists and sociologists, e.g. Alfred Marshall, Max Weber, and Joseph Schumpeter, observed that networks of interdependent firms are crucial for enhancement of economic growth and innovations (Staber, 1996). Scientists working in the field of organization and management consider networking a means to manage companies' resource dependencies and environmental uncertainties (Pfeffer and Salancik, 1978), while neo-institutional economists (Williamson, 1985) regard networks as an alternative governance of markets and hierarchies. Staber (1996) identified other perspectives in his research on networking, e.g. network formation, trust building, conflict resolution, and partnering, and also pointed out network structures and networks for various developments, from organizations to regional economies. In a review of organizational network relationships, Borgatti and Foster (2003) unveiled a network-paradigm that incorporated social capital, embeddedness, network organizations, joint ventures, inter-firm alliances, knowledge management, social cognition, and a catch-all category. In a theoretical investigation, Lind (2006) identified four different approaches to network: as a perspective, a phenomenon, a research method, and as a strategy for development. Network as a development strategy is known to promote development of individuals, organizations, and regions, the latter being the focus of this paper.

Development roughly comprises three forms: a top-down planning strategy, a bottom-up activation strategy, and a network-based development strategy (Svensson and Von Otter, 2000). These strategies have been used in parallel; but over time, the activation strategy has gained popularity. Recently however, the network-based approach has gained interest (Gustavsson and Hofmaier, 1997; Svensson *et al.*, 2001; Swedish Quality and Competence Council, 2003; Holmquist, 2010; Sotarauta, 2010; Alderete and Bacic, 2012), and researchers in the area of small business entrepreneurship propose networking as a strategy for development (Staber *et al.*, 1994; Hoang and Antoncic, 2003; Cooney, 2005; Holmquist, 2010; Alderete and Bacic, 2012). In a study on small manufacturing businesses, Fuller-Love and Eysyllt (2004) found that networking improved performance more effectively than other strategies. Networking as a strategy for development, knowledge, and skills exchange

functions on all levels, from individuals to organizations and regions. It is designated to contribute to global economic growth (Svensson *et al.*, 2001, Lind, 2003; Möller and Svahn, 2004), as it is more efficient than other strategies, particularly when compared with traditional forms of inward-looking development strategies, like "Business Process Reengineering" or "Total Quality Management" (Holmquist, 2010).

Despite the interest in network-based approaches, the old systems remain strongly rooted in society, which hampers regional development (Harmaakorpi and Niukanen, 2007). Research on networking in this context is limited and thus called for (Holmquist, 2010; Alderete and Bacic, 2012). The ambition of the present study was to highlight some prominent ideas within network research in order to identify factors relevant to regional development by means of networking. The purpose was to improve understanding and knowledge of the network-based development strategy by seeking the answers to three questions: What characterizes a network for regional development? Why do actors participate in such a network? How do actors perceive participating in a network?

## **EMPIRICAL APPROACH**

A qualitative method with a hermeneutic approach was utilized in the study. An exploratory perspective was applied in accordance with Saunderson *et al.*, 2009). The chosen design was in the form of a case study, since this design facilitates retrieving answers to the questions "how" and "why" (Yin, 2003). The case was "Tillväxt Uddevalla" (hereafter TU; transl. Growth of Uddevalla), a network for regional development in Uddevalla, a city in West Sweden.

A network may be an internal network-based form of organization, like a decentralized organization, or it may consist of independent organizations connected by partnership (Hamaakorpi and Niukkanen, 2007). TU falls into the latter category. Network is in the literature defined as a set of dyadic relationships, or as a larger, multi-actor alliance (Gulati, 1998). A regional development network might be either of three archetypes: a large and loose regional development network, a heterogeneous multi-actor network, or a closed and homogeneous Public Sector Network (PSN) (Hamaakorpi and Niukkanen, 2007). TU is a heterogeneous multi-actor network, i.e. members are from different sectors of the society. The network has commonly accepted goals, and comprises several sub-networks. The TU

members mainly comprise representatives from small companies, different organizations, and authorities of Uddevalla City.

Selecting TU for the case study was founded on discussions and consultations with experts from academics and industry (Chisnall, 2005; Bryman and Bell, 2007; Saunder *et al.*, 2009). After four meetings of familiarizing with the members, seven individuals were selected for data collection. Interviews, conducted by means of a questionnaire with open questions, were carried out orally with four of the members, while the other three submitted written answers to the interview questions. In two cases, data collection was completed by telephone. A semi-structured interview guide (Bryman and Bell, 2007) was followed, and a conceptual framework (see below) was used as the foundation for constructing the interview guide (Ghuri and Gronhaug, 2005). After testing the questionnaire, the guide was forwarded to the respondents.

The present study assumed an abductive structure, rather than being deductive or inductive. In such a study the researcher moves between theory and empirical data, allowing understanding to emerge gradually (Alvesson and Sköldbberg, 2008). Abduction (“intermediate” between induction and deduction) is recommended for research on innovation systems, networking, and creative value networks (Patokorpi and Ahvenainen, 2009).

Three interviews were conducted at the respondent’s work place and one at Campus Uddevalla. Interviews lasted 2.5 - 3 hours. The informants were granted anonymity.

After a short presentation of the project, data collection (following the interview guide) was conducted as dialogues. Respondents were encouraged to explain and clarify their views about research issues. The interviews were recorded and subsequently transcribed. Transcriptions were sent by e-mail to the interviewed for approval.

An intra-case analysis was carried out (Miles and Huberman, 1994), i.e., data from a selected case were analyzed against the conceptual framework of the study. The analysis comprised three phases: data reduction, data display, and drawing conclusions (Miles and Huberman, 1994). The data reduction was extended in order to provide an organized, compressed assembly of information, permitting conclusions.

## THE CONCEPTUAL FRAMEWORK

Network is a concept used in many contexts, encompassing different meanings, e.g. relationships within a family or a neighborhood, club activities, cooperation and contacts between companies, governance mechanism, or an institutional form of exchange (Hägg and Johansson, 1982; Sjöstrand, 1985; Svensson *et al.*, 2001). Williamson (1975) defined network as a phenomenon between markets and hierarchies. Castells (1999) considered it a phase in organizational development from industry to service, and now the emergence of a network society: "Networks constitute the new social morphology of our societies." Castells built his analysis on the concept of "nodes" and "flows": "A network is a network of interconnected nodes." Borgatti and Foster (2003) declared, "A network is a set of actors connected by a set of ties. The actors (often called "nodes") can be persons, teams, organizations, concepts, etc."

Gustavsson and Hofmaier (1997) argued that the term network expresses a perspective rather than a well-defined concept. They made no attempt to define network and believed that a general definition is of no significance. Others share this opinion, and believe it is preferable to clarify its meaning in each specific context (Svensson *et al.*, 2001).

Attempts have been made to categorize networks. Borgatti and Halgin (2011) distinguish between group and network, claiming, "A fundamental part of the concept of group is the existence of boundaries. In contrast to groups, networks do not have natural boundaries." Utbult (2000) implies that the boundaries of a network are not always clear, and those included in the network may not even be aware of being part of a network structure.

### *Network as a development method*

Top-down planning strategy, bottom-up driven activation, and network-based strategy are the three development strategies (Svensson and Von Otter, 2000; Svensson *et al.*, 2001). The network-based development strategy combines the activation strategy with broad voluntary collaboration between different entities, and the driving force is common interest. The strategy is used for open projects; i.e., targets and expected outcomes are not as explicit as when a planning strategy is applied. The objective may be to change something, to develop skills, or to learn. It may also be to improve quality, competitiveness, and innovation climate, to contribute to regional and local development, or to achieve long-term economic development (Utbult, 2000; Svensson *et al.*, 2001; Lind, 2002). Alderete and Bacic (2012) state that when referring to local development or territorial development, we need to emphasize the importance of four main dimensions: the economic, social/cultural, environmental, and

political aspects. In an article from 1985, Granovetter applied the concept of embeddedness to market societies, arguing that all economic behavior is embedded in a larger social context by necessity. He insisted that, “most behavior is closely embedded in networks of interpersonal relations, and that such an argument avoids the extremes of under- and over-socialized views of human action”.

Using network as a development strategy is believed to promote development of individuals, organizations, as well as regions. Viewed from this perspective, networks consist of a number of autonomous actors helping each other reaching a goal they would not have been able to accomplish on their own (Svensson *et al.*, 2001; Hamaarkorpi and Niukkanen, 2011). Many individuals, companies, and organizations are applying a network model on their work processes (Dalsgaard and Bendix, 1998), without labeling it a network.

#### *Characteristics of the network*

Network and organization are usually viewed as opposites. While the network is informal, cooperative, spontaneous, and flat, and involves being engaged in relationships and side contacts, the organization is characterized by formality, controlled routines, hierarchy, and vertical contacts (Utbul, 2002). However, Svensson *et al.* (2001) believed that such a dichotomy is not meaningful. A network can be a form of organization even if it lacks legal status and formal relationships, and an organization may well be informal. The authors claimed that the distinguishing feature of a network is its equality foundation. Gulati and Singh (1998) discussed the existence of hierarchical elements in alliances, and proposed that more hierarchical controls led to greater coordination and better information processing capabilities.

The literature describes various traits characteristic of networks, for instance: Networks are problem-driven, and problems are situated (Gustavsson and Hofmaier, 1997). A network is self-organized, dynamic, has no hierarchy, and participation is voluntary (Dalsgaard and Bendix, 1998).

Various preconditions for a successful network have been described. Among these necessities are: network vision, time and resources, tempo and continuity, communication, reward forms, trust, equal relationships, external aid, motivation, curiosity, clear objectives, and performance criteria (Ershammar, 2000; Svensson *et al.*, 2001; Florén and Tell, 2004).

Bergh (2006) proffers the following recommendation to those involved in inter-organizational networks: "Be prepared to invest time and energy in participation; try to get others involved, and be active when the program for the network is formulated." Other factors essential for network strategy success are significant key individuals and a strong network leadership (Harmaakorpi and Niukkanen, 2007; Sotarauta, 2010), but also absorptive capacity of network actors: "A firm's ability to recognize the value of new information, assimilate it, and apply it to commercial ends" (Cohen and Levinthal, 1990).

#### *Why network?*

There are several explanations to why networks emerge, and a number of them are listed above in this paper (Pfeffer and Salancik, 1978; Williamson, 1985; Staber *et al.*, 1994). While Barnir and Smith (2002) put forward that social networks provide additional resources as well as emotional support to small enterprises, the idea of networks being crucial for organizations to master their tasks is far from new (Gustavson and Hofmaier, 1997). Several good examples from the U.S. and Europe have contributed to the current interest in networks, one example being Porter's (1987) analysis of the competitiveness of nations, in which collaboration between organizations indeed was the center point.

Svensson *et al.* (2001) pointed out the increased need for change and development in society, and believed that cooperation between firms in networks may be a strategy for support and stimulation of development. One important reason for the growing interest in networks, they claimed, is that the old control mechanisms, particularly the top-driven program model, no longer are effective. Nohria (1992) and Holmqvist (2010) both suggest that an increase in societal complexity, technological development, ongoing processes of innovation in society, the organization's contact with the environment, globalization, and growing demands on managers/leaders for extending business contacts are further reasons for an increasing interest in network strategies.

Lind (2003) highlighted value-adding and value diffusion as two reasons for emergence of networks. The flexibility of networks generates economic value for enterprises in a network. Lind also emphasized how cooperation in networks has positive effects on transaction costs. In addition to economic value, the network also creates social value, e.g. social capital and social responsibility. Diffusion pertains to how value spreads in a network.

Lavie (2007) underlines the significance of value creation in networks, and points out that earlier research insisted on more value creation, paying less attention to value

appropriation/value capture: "A firm whose alliance portfolio comprises a set of powerful partners may be unable to appropriate the benefits that its alliances produce."

The above discussion conveys that emphasizing the value creation effect of network resources alone is not enough. It is essential to stress the importance of value diffusion and value capture as well.

#### *Perceptions about networks*

The literature on networking lists a range of advantages/possibilities, but also a number of disadvantages/difficulties, associated with the network strategy (Svensson *et al.*, 2001; Lind, 2002; Holmquist, 2010). The advantages/opportunities are: 1) It is flexible; working arrangements and activities can quickly be adapted to external changes and internal needs. 2) When many actors cooperate, economies of scale occur, which increases the development capacity. 3) The cooperation is demand driven. It is based on the perceived problems and the actual situation of the participants, which makes networking concrete and results-oriented. 4) The open and flexible way of working facilitates creativity and innovation. 5) The cooperation is horizontal, and is based on voluntary participation, equal relationships, and exchange of experience. 6) The potential for exploiting external knowledge is increased, and organizing the cooperation is easier on an equal footing.

Some disadvantages/difficulties are nevertheless linked with the network strategy. 1) The arguing that networking is an effective method to strengthen development capability is difficult to verify, and so are tangible results. Vagueness and ambiguity about purpose, methods, and results constitute problems. 2) Allocation of responsibility is unclear. Ideas and proposals are raised - but who implements them? 3) A major weakness is the low representativeness. There is no broad-based participation. 4) The feedback is difficult to control. 5) The network may become restricted, participants forming a closed club, in which development stops at an individual level.

Notwithstanding these difficulties, the network approach can be, and is, used for regional development. However, exploitation of the potentiality of using network for development requires some necessary conditions.

## RESULTS AND DISCUSSION

### *What characterizes a network?*

Networks and organizations are often experienced as contrasts, networks being more informal, involving personal relations, and organizations entailing control, hierarchy, and authority (see above). The respondents in this study confirmed many of these characteristics, one of the comments being: "We work informally; anyone can participate and make his/her voice heard. We have an agenda for our meetings, but we select a new chairman at every meeting."

In the TU project some interviewees observed hierarchies and a lack of spontaneity. They did however appreciate side contacts leading to cooperation. These opinions are consistent with those of Svensson *et al.* (2001) who discerned no dichotomy between the two. They consider network as an organization without juridical or formal status, and mean that organizations may be informal and vague in the new economy. Gulati and Singh (1998) claimed that hierarchical elements are present in alliances and networks, and others elaborated this discussion (Lind, 2004), arguing them to be "social entities on an organizational level".

The interviewees disclosed divergent opinions about the constitution of the network. One member of the TU project deemed it positive that different community groups participates in the network, while another feared that TU incorporates groups raising important issues as a means of legitimacy, which might cause competition. A third respondent feared that presence of businessmen and politicians might lead to debates rather than a focus on solutions. TU comprises a number of individuals and organizations with different backgrounds; hence values and interests may induce differences in influence and power. This "membership disparity" might of course create a situation where some members may experience difficulties in obtaining a balanced member involvement. Large, resource-rich agencies, and institutions with well-educated, self-confident staff tend to dominate smaller organizations (Starkey, 1997). Lavie (2007) describes this situation as an asymmetric absorptive capacity between smaller and larger members of a network, leading to a value capture problem for the smaller members (see above).

Notwithstanding, different experiences and backgrounds in networks and debates may well provide extra value, as long as they are egalitarian (Svensson *et al.* 2001). Other researchers agree that different ideas and ideologies in a network can be "healthy, give creative tension and lively debates", but warn that, "...when strong-minded (and loud-mouthed) people with

conflicting ideas meet, they can disrupt network meetings and progress with excessive ideological, methodological, or technological debate. This may lead to alienation and withdrawals from the network by those who feel unjustly treated, or simply bored" (Starkey, 1997). Sennermark (2010) found that network members appreciate different backgrounds, and believed that they lead to interesting discussions. Different perspectives contributed to increased understanding of different roles and existing problems. Aderete and Bacic (2012) believe inter-firm networks to be a necessary condition for regional development, but not alone. The relationship with other social groups has an impact on how cooperation between firms affects territorial development.

Gulati (1998) showed that social networks have an influence on the creation and success of alliances and company webs. "By channeling information, social networks facilitate the discovery of new alliance opportunities, consequently influencing when, and how often, firms enter into alliances", state Gulati.

The conceptual framework defined above suggests that networks are characterized by equality, voluntariness, participation, and transparency. Not all respondents in this study agreed in full, one of them maintaining: "As a new member it's not easy to make one's voice heard, and get acceptance for one's ideas." Starkey (1997) pointed out that a network might be characterized by dominance; some acquire more influence than others. He suggested that one should solve this problem directly as it arises, or less influential individuals might choose to leave and/or turn to rivaling networks. Svensson *et al.* (2001) made it clear that no one voluntarily takes part in a network if one party constantly dominates. On the other hand, relations in networks are not always symmetrical; some have more power and influence than others (Sjöstrand, 2004). According to Lavie (2007): "The relative bargaining power of partners in the alliance portfolio constrains the firm's appropriation capacity."

Most TU members urged that engagement and unity around common issues were vital to participation and development of TU. Other prerequisites mentioned were: trust, equality, time and resources, active participation, process leaders, communication within the network, tempo, and continuity.

Reward affects the function of a network (Ershammar, 2000). Respondents commenting this regarded the meetings as such as sufficient remuneration, and agreed with the view of Svensson *et al.* (2001): As participation is voluntary, the work itself must be rewarding.

One respondent stressed the importance of high levels of ambition and commitment, i.e. "active participation".

The interviewees believed that the informal character of TU created vagueness, and might lead to unclear results, in the end affecting the function of the project. These opinions confirm previous work by Svensson *et al.* (2001), who conveyed that networks have difficulties showing tangible results; results are rarely discussed in terms of efficiency, but rather in words like synergies, contacts, and new ways of thinking, etc. A significant aspect of securing success of TU, forwarded by the respondents, is the presence of a process leader. Process leaders have a big impact on results (Swedish Quality and Competence Council, 2003), even when cooperation is prevalent in the group (Svensson *et al.*, 2001). The person initiating the network may be recruited as the leader, a "hub member", or one may use an external resource. The leader should encourage dialogue and discussion, but discourage debate. Dialogue is the most efficient strategy for a group to reach common understanding and knowledge (Swedish Quality and Competence Council, *op.cit.*). Harmaakorpi and Niukanen (2007) found that: 1) Strategic leadership was more effective than tactical or operational leadership. 2) Informal network leadership was superior to a formal network leadership. 3) Network leadership skills were more important than network management skills.

#### *Why network?*

Respondents found TU supportive, and they believed networking was a crucial strategy for development of the companies and organizations in the project, in view of their small scale and limited resources. Cooperation in TU meant pooled resources, and the work aimed at development not only of the region but also of their own organizations. Their main reasons for involvement in the network were cooperation between businesses and local authorities, and the opportunity to unite and raise common issues. Lavie (2007) means that value-creation may arise by: 1) using network resources to directly extend and reinforce value-creation opportunities, 2) generating value from resource combinations, and 3) indirectly profiting from network resources that enhance the value of internal resources, or that provide opportunities to incorporate external resources.

Resource dependency, environmental uncertainty, rapid change of society, cooperation between businesses, and the necessity of networks for growth and development are among the reasons for networking (as shown above in *Theoretical Framework*), and were sanctioned by

all respondents in the present study. Networking is a key factor for innovation and dynamism in territories (Holmquist, 2010; Sotarauta, 2010; Alderete and Bacic, 2012).

In spite of unity among the respondents concerning the reasons for being engaged in TU, opinions about how the work should be organized diverged. Networks are, according to Lind (2002), characterized by lack of formal decision-making and controlling structures. Trust and mutuality are essential, not a price mechanism and hierarchy. According to the Swedish Council for Quality and Competence (2003), it is vital to discuss leadership issues even though a network leader is not called a manager. Gulati and Sigh (1998) argued: "Alliances with more hierarchical controls are capable of greater coordination and show better information processing capabilities than those with fewer controls." They mean that alliances may include several hierarchical elements in their structure: 1) a command and authority structure, 2) incentive systems, 3) standard operating procedures, 4) dispute resolution procedures, and 5) non-market pricing systems, such as cost-plus systems. These hierarchical elements are present to varying degrees in different alliance governance structures (Gulati and Sigh, op.cit.)

#### *Perceptions about network*

Respondents recognized the advantages of TU; they perceived that they acquired strength as a group and were given opportunities to raise issues relevant to the development of the region. Respondents agreed with many of the virtues stated in the conceptual framework, and perceived that TU was flexible, dynamic, and that participation was voluntary. TU provides knowledge, coordination, interesting dialogues, idea exchange, and facilitates cooperation. They believed that TU could contribute to a good business environment, as it incorporates a broad affluent representation of businesses in Uddevalla. Some negative opinions about TU were also presented, e.g. worries that the flexibility of TU might cause work to dwindle. Selander (2008) reasons that flexibility (by definition) may result in the network developing from being too instable to being too formalized, and vice versa. The challenge lies in finding the balance between the two.

The respondents pinpointed some other difficulties with networking, for example in terms of communication: time consuming, long meetings, and lack of priority in the home organization. They also perceived lack of expediency once decisions had been made. Other comments included relevance of issues to work with, uncertainties around purpose and results. People lost interest in TU due to vague feedback on vague results, confirming the

views of Svensson *et al.* (2001), who argued (see above) that efficiency was not a concept much used in similar problem contexts. Some respondents called for increased formalization and a better network representativeness. The risk of the network limiting itself to be a closed club, only developing the participants was also put forward. It is vital for all networks to counteract development of membership despair, where ambitious people take over meetings, while the less active feel excluded. (Starkey, 1997; Svensson *et al.*, op.cit.)

#### *Conclusions and practical implications*

Networks are often claimed to be informal, flat, spontaneous, and characterized by equality, voluntary participation, and transparency. Nonetheless, the present study discloses that hierarchy exists in networks, and that dominance indeed is a network attribute. Should dominance emerge in a network, it must be reduced/eliminated, or less influential actors may choose to leave the network, as participation is voluntary. This would have consequences, since exchange of members in a network influences its performance (see above).

Leadership is crucial to the outcome of a network. Equality being the norm along with absence of a controlling structure and formal decision-making, are however factors making it difficult to lead a network. This study shows (as judged by the response by the interviewees) that a network is supportive, and that networking is a necessary strategy for development, particularly for small enterprises and organizations, with their limited resources. The increased societal complexity, requiring increased contact between actors, reinforces the need for networking.

Drawing extensive conclusions from one case study is problematic. It is nevertheless not far-fetched to suggest that small organizations with limited resources benefit more from an outward-oriented network-based strategy than from an inward-oriented planning strategy when developing their organization, and that this is likely to be true also for regional development. Although value-creation is an important effect of networking, to a small organization, value capture holds equal importance since this typically provides more challenges. Respondents left various positive as well as negative remarks on networking (see above), from which one may conclude that the challenge of a network is to find a balance between flexibility and formality.

This study made it clear that networking is an effective method for strengthening development capability. Showing concrete results is however not that easy, and may contribute to lack of interest in networking. Hence, actors should be made aware of that a

network-based strategy, rather than a planning strategy, often is used for open projects. Process leaders might play a significant role here by ensuring that actors in a network are realistic in their expectations about outcome and results, thus prohibiting disappointment due to unrealistic anticipation. Leading and controlling a network is difficult, since its informal character prohibits the use of market mechanisms or hierarchy as a governance structure. Trust and mutuality are consequently required, which process leaders need to promote in order to secure the desired outcome of a network.

The main contribution of the present paper is that it integrates research on network for regional development with general network theory, thus offering a better comprehension of the network-based strategy for regional development.

#### *Further research*

The aim of the present study was to explore how actors (in general) perceive their participation in a network, not to compare (similarities/differences) different actors' perceptions of participating in a network. One case study does not allow generalization of the findings. A qualitative, exploratory cross-case study would improve the analysis of results, and a quantitative survey research, with a large number of networks comprising many actors, would facilitate broadening and generalization of the results. Learning is of strategic significance to development. One interesting research area would be to study how learning networks operate, and to clarify the requirements for a development-oriented learning.

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## THE ADOPTION, APPLICATION AND IMPACT OF SOCIAL MEDIA IN FASHION MARKETING

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### ABSTRACT

The importance of social media is evident as millions of people use it to connect with others, share content and discuss different topics (Kaplan and Haenlein, 2010; Kim and Ko, 2010). Although it is clear that social media is powerful and ubiquitous, many fashion brands have been reluctant or unable to develop strategies and allocate resources to effectively engage with the new media. The aim of this paper is to critically review the literature that explicitly addresses the adoption, application and impact of social media by fashion brands. In particular, the paper seeks to explain what the new face of social media is, as well as it identifies its importance as a strategic marketing tool and proposes a number of alternative strategies for fashion brands. As demonstrated by our findings, implementing such strategies will allow fashion brands not only to survive, but also create new competitive advantages and thrive in the new global business environment.

**Keywords:** social media, fashion, strategic marketing, global business environment

### INTRODUCTION

Despite the myriad of digital and social media, the question of the state of fashion in the digital context remains largely unexplored, particularly with regards to the particularities of fashion management, which have posed a challenge in adopting digital technologies in the sector over the past two decades (Okonkwo, 2010; Tungate, 2009; Vecchi and Kontu, 2012). Until recently, the fashion industry has shown low commitment towards integrating advanced Internet technologies and its associated interactive and digital tools in the sector's

marketing and overall business strategies (Okonkwo, 2010). The fashion industry seems to be present and conduct business on the Internet as a result of ever evolving consumer needs and expectations. For instance, notable international fashion brands such as Versace and Prada did not have corporate websites until 2005 and 2007, respectively. The slowness of the fashion industry in establishing an online presence in comparison to other sectors visibly clashes with the common idea of an industry that is known for innovation, avant-gardism and creativity (Michault, 2009).

Coupled by the growing demand for a stronger online presence, the rise of social media in recent years brings forth new challenges to fashion brands. The importance of social media is evident as millions of people utilize it to connect with others, share content and discuss different topics (Hanna et al., 2011; Kaplan and Haenlein, 2010, 2011; Kietzmann et al., 2011). Although it is clear that social media is powerful and ubiquitous, many fashion brands have been reluctant or unable to develop strategies and allocate resources to effectively engage with social media (Michault, 2009; Okonkwo, 2010; Tungate, 2009). This attitude has changed in the last few years; social media such as YouTube, Facebook, Twitter, Tumblr, Instagram, Pinterest, Vimeo and Vine have become an integral part of how fashion brands connect with their consumers, providing immense opportunities for innovative marketing communication (Arthur, 2013; Bautista, 2013a; Kim and Ko, 2010; Nguyen, 2011; Wasserman, 2012).

The academic literature on social media is still in early stages and there is limited evidence of its potential as a strategic marketing tool. Furthermore, the connections between social media and fashion remain largely unexplored with little academic research on the applications of social media in the fashion context. To address this gap, our paper provides a critical assessment of the adoption of social media amongst three well established fashion brands, in order to identify the importance of social media as a strategic marketing tool and to propose a number of alternative social media strategies for fashion brands. As demonstrated by our findings, implementing such strategies will allow fashion brands not only to survive, but also create new competitive advantages and thrive in the new global business environment.

## **SOCIAL MEDIA AND MARKETING**

The process of adopting social media as part of the company's marketing programme requires new thinking and new tactics; traditional push marketing methods are incompatible with social networking (Li et al., 2007; Singh et al. 2008). Lack of experience in engaging social

media as marketing communication tools means, that, for many pioneers, this is still a trial-and-error process. In this respect there is a considerable knowledge gap on the real nature and importance of Web 2.0 and its added value for marketing strategy. Most knowledge on the role of Web 2.0 applications as marketing tools is primarily based on anecdotal evidence. This evidence also suggests that, paradoxically, the majority of firms pioneering in engaging social media as a marketing tool are large corporations. Based on field experience, our paper will classify the main paths marketers can follow in order to extract value from the strategic use of social media. Constantinides et al., (2008) identify three ways in which this could occur:

1. Engaging social media as PR and as direct marketing tools;
2. Engaging social media personalities for consumer influence;
3. Engaging social media for personalising the customer's online experience.

The three strategies are further explored through case studies of three different fashion companies by critically assessing their social media strategy. The next section illustrates the methods that were adopted for the research.

## **METHODOLOGY**

In line with the exploratory nature of the study, the current research relies on comparative case study research to critically assess the social media campaigns of three fashion companies. "Case studies represent a methodology that is ideally suited to creating managerially relevant knowledge" (Gibbert and Ruigrok, 2010) and they are considered the most appropriate as tools in the critical, early phases of a new management theory, when key variables and their relationships are being explored (Eisenhardt, 1989; Yin, 2008). Therefore case study research is particularly useful at the early stages of theory development, in which key themes and categories have yet to be empirically isolated (Eisenhardt, 1989; Elg and Johansson, 1997; Yin, 2008). Although we acknowledge the richness of adopting a single case study, multiple case studies provide a more solid basis for generalization and can provide substantial opportunities for theory-building (Dyer and Wilkins, 1991).

As illustrated in Table 1, we purposefully selected three case studies of fashion companies (Donna Karan, Calvin Klein and Burberry) to illustrate the strategic use of social media in the fashion industry.

Company	Founded	Country	Short description
Donna Karan	1984	US	An international New York based fashion house designing and marketing men's and women's clothing, sportswear, accessories and shoes through its own retail stores, department stores and specialty stores worldwide. Donna Karan International is part of the publicly traded LVMH Group since 2001.
Calvin Klein	1968	US	A New York based fashion house designing and marketing women's and men's collections from apparel, accessories, underwear and fragrances, to home furnishings through an extensive network of licensing agreements and other retail formats worldwide. The company is publicly listed.
Burberry	1856	UK	An international UK based fashion house designing, manufacturing and marketing men's, women's and children's clothing and non-apparel accessories globally through a diversified network of retail (including digital), wholesale and franchise channels worldwide. The firm is publicly listed.

*Table 1: Overview of case companies*

These fashion companies were chosen as they have all a quite diversified product range. Donna Karan and Calvin Klein are from the US and Burberry is from the UK. In particular while Burberry and Calvin Klein can be considered heritage brands for the UK and the US respectively, Donna Karan is of more recent establishment. Owing to the diversity of their retail operations ranging from a very narrow retail format such as own stores and flagship stores to a very diversified network of retail platforms they represent three emblematic examples of fashion brands and they all implement substantially very different digital strategies. In the light of both the exploratory nature of the study and the wide variety of the fashion brands' features, three case-studies was deemed as adequate to provide rich insights over the use of social media in the fashion industry.

The fashion industry was deemed as the ideal industry setting for the study since it is by definition a very creative industry (Vecchi, 2008), which is consumer-driven (Mosca, 2008), and where establishing empathy with the final consumers is of paramount importance (Venturi, 2011). Additionally, the choice of the sector was driven by the acknowledgment that in the creative industries, technology adoption is considered to be more extensive than in any other sector (Florida and Gates, 2001).

Data collection for each case study relied on the adoption of the following research protocol as outlined in the Table 2 below.

Case study dimension	Research objective	Sources of evidence
Company background	To contextualize the brand within the broader development of the company	Secondary literature Grey literature
Company history	To contextualize the social media strategy within the broader marketing strategy adopted	Secondary literature Grey literature
Social media strategy	To contextualize the social media strategy adopted in relation to the specific brand	Online observations and content analysis

*Table 2: Research protocol*

In order to produce three robust case studies we relied on a wide variety of sources ranging from secondary sources such as newspapers, industry reports and grey literature through primary sources by the means of online observations and content analysis.

First, in order to contextualize the brand within the broader development of the company we collected information about the company background. Second, in order to contextualize the social media strategy within the broader marketing strategy adopted, we collected information about the company history. While these two case study dimensions were investigated by mostly consulting secondary sources such as industry reports and grey literature, the brand's social media strategy was critically assessed by relying on primary data collection. More precisely, as previously done by Ross (2010) and by Nguyen (2011) the

investigation of the social media strategy relied on a qualitative online observations of the aforementioned three fashion brands whose social media activities across several social media were observed. For the purpose of the study, these were deliberately restricted to Youtube, Facebook, Twitter, Tumblr and Pinterest. Social media activity was then observed from January to June 2013. More specifically, as part of the qualitative observations of the brands' social media activities, these were assessed in relation to the content and according to the theoretical framework adopted from Constantinides et al. (2008) as previously described.

## FINDINGS

Table 3 below outlines the effectiveness of the social media strategies implemented by the three fashion brands as measured by number of likes on Facebook, number of followers on Twitter, number of subscribers on their YouTube channel and number of followers on Pinterest.

Brand	Facebook (likes)	Twitter (followers)	YouTube (subscribers)	Pinterest (followers)
DKNY	1,229,091	456, 181	2,212	13,275
Calvin Klein	7,252,805	722,415	17,384	n/a
Burberry	15,437,483	1,948,686	71,993	49,616

*Table 3: Overview of the case brands' social media presence on 30 June 2013.*

While the value of these numbers is surely questionable, they need to be contextualized within the brands' respective digital strategies as they provide a useful indication of the different social media platforms on which these brands tend to rely the most. Quite interestingly while the two heritage brands Calvin Klein and Burberry more extensively engage across all the distinct social media platforms (Calvin Klein does not focus on Pinterest but instead uses Tumblr for visual material as previously discussed), DKNY tends to rely more extensively on Twitter.

Arising from the discussion in the findings, Table 4 summarizes the different digital strategies implemented by the three fashion brands considered. Referring to the taxonomy previously introduced by Constantinides et al. (2008), DKNY seems to use social media as a PR and direct marketing tool, while Calvin Klein mostly engages with social media personalities and Burberry uses social media to allow customization.

Brand	Digital strategy
DKNY	Engaging social media as a PR and direct marketing tools
Calvin Klein	Engaging social media personalities for customer influence
Burberry	Engaging social media for personalizing the customer's online experience

*Table 4: Overview of the brands' digital strategies*

Our findings illustrate how there is a perceptible shift in fashion marketing. Newer tools in marketing such as social media are giving fashion brands the option to not only address their audience but also to interact with them in real-time. Indeed, social media is single-handedly changing the face of fashion marketing. Accordingly, the rapid adoption of social media requires marketers to have a 360-degree strategy to deal with more discerning consumers. Our findings demonstrate that fashion marketing is evolving into two-way communication and social media play a pivotal role in this process. While initially considered digital late-comers (e.g. Okonkwo, 2010; Tungate, 2009), the findings from our three illustrative case studies outline how fashion brands have often found novel and creative ways to implement digital strategies aimed at PR and direct marketing (as in the case of DKNY), new ways to engage celebrities to endorse their products (as in the case of Calvin Klein), new solutions to tap into consumer's creativity in the form of advertising concepts and to make the customer a co-producer (as discussed in relation to Burberry).

In particular our findings highlight some peculiarities in their use of social media and can surely provide useful lessons and valuable guidelines for companies in other creative sectors such as the design, the music, the film and the luxury industries. Social media were identified as a substantive method of promoting the fashion brands' identity by leveraging on consumers' emotions. Similarly, social media are increasingly employed to change consumers' perceptions of a fashion brand or a product. A very few fashion firms tend to use

social media as a distribution channel – those pioneers who do, they seem to have fully understood the broader implications that social media utilization might have for traditional fashion retail and implement a digital strategy that can successfully capitalize on their complementarities and synergies. This could be seen as the biggest innovation and change in practice in recent times. From a marketing perspective, the valuable experience of the three fashion brands provides novel insights into fully reaping the benefits associated with social media capitalization.

## ORIGINALITY

While the academic literature on social media tends to be very general and not sector-specific (Arthur, 2013; Bautista, 2013a; Kim and Ko, 2010; Nguyen, 2011; Wasserman, 2012), our study presents one of the first appraisals of the literature with regard to the likely development, implications and impact of the use of social media in fashion retail. Moreover the paper seeks to break new ground by attempting to use some evidence from the fashion industry to provide rich insights that could be valuable to firms in other sectors.

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## ACCOUNTING AGILITY AND THE PREDICTION OF CORPORATE FAILURE

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### ABSTRACT

**Purpose** – The main objective of this paper is to provide evidence about corporate failure prognosis in a developed market such as Greece and identify new value-relevant variables concerned with the quality of financial statements and the managerial choice of accounting methods and techniques in order to enhance the accuracy of the corporate failure prediction models.

**Design/methodology/approach** – In this paper multiple discriminant analysis, logit analysis and probit analysis are employed to construct models for the prediction of corporate failure. The impact of accounting agility and managerial discretion on the accuracy of the prediction models is explored.

**Findings** – This study identifies new value-relevant predictor variables concerned with the choice of accounting methods and techniques and also provides evidence that these variables enhance the accuracy of the existing corporate failure prediction models.

**Practical implications** – The existing corporate failure prediction models embody an endogenous flaw of the predictor variables that derives from the quality of financial statements and corporate agility concerned with the choice of accounting methods. Financial institutions should reexamine the efficiency of their methodologies concerned with their credit risk assessment.

**Originality/value** – The results of the study will redirect Academia's attention towards future research and they will also assist regulatory authorities to reconsider the current framework concerning managerial discretion.

**Keywords:** Accounting methods, managerial discretion, corporate failure prediction models

## 1. INTRODUCTION

Corporate failure is an important aspect of real economy since it affects first the society and then in particular a number of stakeholders such as employees and their families, managers, shareholders, creditors, auditors and many others. One of the main causes for this paper has been the extensive empirical research concerning managerial choice of accounting methods and techniques that aggravates the quality of reported accounting and financial information. However, it is limited on one accounting choice at a time and very often in a “positive” perspective to “explain” and “predict” as it is defined by Watts and Zimmerman (1986) and always as if the efficient market hypothesis stands in its strong form. On the other hand, corporate failure literature seems to neglect the preceding research and it limits the predictor variables of the existing models only to financial ratios as if accounting and finance are trapped in different water-tight compartments making their communication not feasible.

The main objective of this paper is to provide evidence about corporate failure prognosis in a developed market such as Greece and identify new value-relevant variables concerned with the quality of financial statements and the managerial choice of accounting methods and techniques in order to enhance the accuracy of the corporate failure prediction models. For the successful completion of our objective, we employed multiple discriminant analysis, logit analysis and probit analysis incorporating both financial ratios and choices of accounting methods and techniques as predictor variables of our models.

The remainder of this paper is organised as follows: In the next section we report a thorough literature review concerning corporate failure prognosis and managerial choice of accounting methods. Our research methodology including statistical modelling, sample and variable selection processes is embedded in the third section of this paper. The fourth section contains the empirical results of our research and the accompanying discussion of these results. Finally, our concluding remarks are cited in the fifth section of this paper.

## 2. LITERATURE REVIEW

Altman (1968) was the pioneer who employed multiple discriminant analysis (MDA) for the prediction of corporate failure with the use of financial ratios after the inspiring work of Beaver (1966) who developed a model with the use of univariate analysis. Until today, academics are striving to find the appropriate financial ratios that would maximise the accuracy and the predictive power of their models (Meyer and Pifer, 1970; Edmister, 1972; Altman et al., 1977; Eisenbeis, 1977; Martin, 1977; Ohlson, 1980; Collins, 1980; Altman, 1984;

Johnsen and Melicher, 1994) by testing them in various sectors, industries (Espahbodi and Espahbodi, 1984) and markets (Peel and Peel, 1988; Keasy et al., 1990; Tamari, 1984; Ugurlu and Aksoy, 2006).

During the last twenty years computer science researchers have also been engaged to this field due to the endogenous problems of the traditional statistical models which are based on the assumptions of linearity and normality that rarely exist in real economy. After two decades of relative research the current literature provides evidence that artificial neural network approaches, support vector machines and other computer based models outperform traditional statistical models (MDA and logit – probit analysis) in different industries, economies and eras (Altman et al., 1994; Lin and McClean, 2001; Alfaro et al., 2008; Yim and Mitchell, 2007; Tsukuda and Baba, 1994; Ozkan-Gunay and Ozkan, 2007; Etemadi et al., 2008; Lin, 2009; Huang et al., 2008; Wu et al., 2010).

Nevertheless, the financial patterns of failed corporations are more unstable than those of non-failed ones (Martikainen and Ankelo, 1991). Evidently, determinants of the efficiency of the corporate failure prediction models can be the economic cycle phase e.g. recession (Richardson et al., 1998), cash flow information (Sharma, 2001), the quality of accounting and financial information (Gadenne and Iselin, 2000), and the detection of fraudulent financial reporting (Liou and Yang, 2008). However, the existing legal framework offers enough space for creative accounting practices (legitimate and illegitimate) including aggressive choice and application of accounting principles (Mulford and Comiskey, 2002) that mitigate the quality of reported financial information. In cases where corporate bankruptcy has its roots in corporate ethics which form a direct link between the public interest and corporate strategy when possible conflicts are not successfully settled by law (Steinmann, 2007), the existing corporate failure prediction models under-perform when applied in different economies, markets and sectors.

Unfortunately, the current empirical research is confined to one accounting choice at a time when the majority of managers have an objective that could be better served by the combined effects of several accounting choices (Zmijewski and Hagerman, 1981). In some cases where their objective was concerned with income smoothing, executive compensation, valuation concepts, debt covenants and taxation purposes we witnessed the collapse of firms like Enron, Worldcom, Barings Bank, Imarbank and many others. The existing literature suggests that the determinants of the managerial choice of accounting methods is influenced by market imperfections such as agency costs, information asymmetries and externalities affecting non contracting parties (Fields et al., 2001). Agency

costs often provide guidance to managerial choice of accounting method in order to enhance executive compensation and avoid debt covenant violations (Holthausen and Leftwich, 1983; Smith and Warner, 1979; Zmijewski and Hagerman, 1981; Dhaliwal, 1980; Dhaliwal, 1988; Healy, 1985; Kosmidis and Terzidis, 2011), information asymmetries in the same way in order to manipulate corporate valuations (Gagnon, 1967; Copeland and Wojdak, 1969; Lewellen et al., 1985; Robinson and Shane, 1990) and externalities in order to influence external parties such as unions, lenders and government (DeAngelo and DeAngelo, 1991; Jones, 1991; DeAngelo et al., 1994; Astami and Tower, 2006),

### 3. METHODOLOGY

This paper is based on the prior work of Kosmidis et al. (2011) and consequently most of their methodological assumptions are adopted as well. This means that the paper focuses on the construction of an accounting-based corporate failure diagnosis model with data from Greece since accounting-based models outperform market-based models in terms of differential error misclassification costs (Agarwal and Taffler, 2008). The research sample contains 27 failed and 27 non failed companies which meet the criteria for the definition of micro, small and medium-sized enterprises provided by the Commission of the European Union (2003) and includes only companies with limited liability (Ltd) and societe anonyme (s.a.) in order to overcome the scarcity of publicly available information since these companies are obliged to disclose financial statements such as the balance sheet and the income statement in accordance with the Greek Financial Reporting Standards. Failed corporations are considered those having been bankrupt or discontinued operations and non failed corporations those that are going concern. The study extends from 2003 to 2009, a time period before the deep recession that Greece is suffering now while trade and services companies were excluded from the sample. The financial statements of these corporations are provided by the ICAP database.

The methodology of the existing literature varies among different predictor variables and different econometric techniques. The present study employs MDA, logit analysis and probit analysis to construct corporate failure prediction models based on data from a peripheral developed country such as Greece. MDA was originally introduced by Altman (1968) in order to discriminate the financially distressed from the financially viable corporations. MDA is widely used in classification problems where the dependent variable is

categorical and shares all multiple regression assumptions (pros and cons). The discriminant function is a linear function of the following form:

$$Cq = a + \sum_{j=1}^n b_{ji} FR_{ji} + \sum_{k=1}^m c_{ki} AM_{ki}$$

where  $C_q$  represents the multiple discriminant score for the category  $q$ ,  $a$  represents a constant term,  $FR$  represents  $j$  discriminant variables (financial ratios) and  $b, c$  represent  $n, m$  discriminant coefficients for  $i$  corporations. A key issue for our analysis is the introduction to the model the choice of accounting methods and techniques  $AM$  as  $k$  dummy variables.

Logit analysis is the logistic transformation of the ordinary regression model used for predicting the probability  $\pi$  of success (corporate bankruptcy) when the dependent variable is binary. The logistic regression model has the following form:

$$\text{logit}(\pi) = \log[\pi / (1-\pi)] = c + \sum_{j=1}^n b_{ji} FR_{ji} + \sum_{k=1}^m c_{ki} AM_{ki} = Z$$

where  $\pi/(1-\pi)$  is the odds ratio and  $c$  represents the intercept. The formula expressing the logistic regression model directly in terms of  $\pi$  is

$$\pi = e^z / (1 + e^z) = 1 / (1 + e^{-z})$$

where the probability  $\pi$  of success (corporate failure) lies between zero and one when the value of  $Z$  ranges from  $-\infty$  to  $+\infty$  for all  $FR$  and  $AM$  values (Agresti and Finlay, 1997). The relationship between the dependent variable and the independent variables is a non-linear sigmoid relationship. In corporate failure diagnosis problems where the dependent variable is categorical, the statisticians favour logistic regression over ordinary linear regression because the binomial distribution describes the distribution of prediction errors better than the normal distribution while the latter is more difficult to interpret especially in cases where  $Z$  takes values above one and less than zero.

On the other hand, probit analysis transforms percentages to probits (probability units) and the probability,  $\pi$ , of corporate failure is defined by the standard normal cumulative distribution function of  $Z$  as expressed in the following form:

$$\pi = \Phi(z)$$

where  $\Phi$  represents the cumulative distribution function of the standard normal distribution. Although the similarities between probit and logit analyses are numerous, the former is favoured when the data are normally distributed and vice versa.

The research sample is consisted of 54 corporations which it is adequate for failed corporations because it reflects the whole statistical population, however over-sampling of failed corporations may lead to a non-random sample but this compromise is embodied by other existing models as well due to the low frequency rate of failed corporations (Balcaen and Ooghe, 2006). The variable selection process is applied in six stages. The selection and computation of 41 financial ratios are performed in the first stage. The definition of these financial ratios is embedded in Appendix A. At the second stage, we perform cluster analysis of financial ratios in order to detect possible inter-correlations and thus avoid multicollinearity problems in model construction. At the third stage, two tail t-tests are conducted for all these 41 financial ratios. The null hypothesis assumes that there is no significant difference in the mean values of these financial ratios between failed and non-failed corporations while the alternative hypothesis assumes that there is significant difference. During the fourth stage, we apply univariate discriminant analysis to identify the financial ratios from each cluster exhibiting enhanced predictive power and thus reducing dimensionality (Hua et al., 2007). At the fifth stage, we conduct  $X^2$  tests between the choice of accounting methods and techniques and the status of the corporations in order to detect possible association of failed corporations with certain choices of accounting methods and techniques. Finally in the sixth stage, we proceed to the construction of the preceding models with and without the *AM* variables in order to witness the possible incremental information content of the *AM* variables in terms of enhanced ratios with correct classifications.

#### **4. EMPIRICAL RESULTS AND DISCUSSION**

We performed cluster analysis of all 41 financial ratios in order to detect possible inter-correlations among variables. We also employed the Ward linkage method to determine the distance between clusters. Based on the similarity level, the appropriate number of clusters is five. We also performed univariate discriminant analysis (UDA) and T-tests in order to detect the financial ratios that best discriminate the failed from the non-failed corporations. The preceding results of the first cluster are reported in Table I. It is obvious that there are discrepancies between UDA and T-test results. For example, FR31 and FR32

exhibit superior discriminatory power according to UDA results but there is no statistically significant difference between the mean values of these ratios for failed and non-failed corporations.

**Table I UDA and T-test results of Cluster 1 financial ratios**

Cluster 1						
Ratio	STATUS	MEAN	SD	T-values	Sign.	UDA %
FR31	Non-failed	0.0680	0.5400	0.89	0.380	70.40
	Failed	-0.0740	0.6370			
FR32	Non-failed	0.2900	3.2800	0.96	0.342	70.40
	Failed	-0.3900	1.6300			
FR28	Non-failed	5720	5324	1.16	0.251	68.50
	Failed	3440	8684			
FR29	Non-failed	3.5600	0.4470	3.39	0.002***	66.70
	Failed	2.7400	1.1700			
FR38	Non-failed	4.0900	4.1100	0.21	0.831	64.80
	Failed	3.7300	7.7800			
FR25	Non-failed	0.0345	0.0435	0.86	0.393	64.80
	Failed	0.0189	0.0834			
FR23	Non-failed	0.0588	0.0388	0.67	0.505	61.10
	Failed	0.0470	0.0823			
FR39	Non-failed	0.4370	0.7070	-1.35	0.184	57.40
	Failed	0.7300	0.8820			
FR21	Non-failed	0.2433	0.0887	0.88	0.385	57.40
	Failed	0.2160	0.1340			
FR27	Non-failed	10.20	24.10	0.93	0.354	56.60
	Failed	4.50	19.70			
FR18	Non-failed	16.00	27.80	-0.72	0.478	51.90
	Failed	32.00	114.00			
FR41	Non-failed	0.0472	0.0778	-1.03	0.311	51.90
	Failed	0.3300	1.4100			
FR24	Non-failed	0.1090	0.2210	-0.54	0.591	50.00
	Failed	0.3200	2.0400			
FR19	Non-failed	0.9930	0.4120	-0.62	0.539	50.00
	Failed	1.0970	0.7640			
FR40	Non-failed	0.2460	0.2230	-0.52	0.607	48.10
	Failed	0.3480	0.9930			

Note: Significant difference between failed and non-failed corporations at the \* 0.1, \*\*0.05 and \*\*\*0.01 significance level.

**Table II UDA and T-test results of Cluster 2 financial ratios**

Cluster 2						
Ratio	STATUS	MEAN	SD	T-values	Sign.	UDA %
FR36	Non-failed	0.9600	1.0700	2.85	0.008***	66.70
	Failed	0.3500	0.3000			
FR1	Non-failed	1.7080	0.9570	2.77	0.009***	64.80
	Failed	1.1640	0.3510			

FR2	Non-failed	1.3120	0.9220	2.56	0.015**	59.30
	Failed	0.8320	0.3160			

Note: Significant difference between failed and non-failed corporations at the \* 0.1, \*\*0.05 and \*\*\*0.01 significance level.

The UDA and T-test results of the second cluster are reported in Table II. Here, the two methods coincide as far as FR36 and FR1 is concerned but for FR2 although there is a statistically significant difference between the mean values of this ratio for failed and non-failed corporations, the UDA results are poor. The UDA and T-test results of the third cluster are reported in Table III. As previously reported, the two methods coincide in the majority of variables. However, it is worth mentioning that the T-tests of the ratios of this particular cluster exhibit no difference between the mean values of any ratio for failed and non-failed corporations.

**Table III UDA and T-test results of Cluster 3 financial ratios**

Cluster 3						
Ratio	STATUS	MEAN	SD	T-values	Sign.	UDA %
FR14	Non-failed	2.1030	0.2430	-1.24	0.225	61.10
	Failed	2.2380	0.5160			
FR16	Non-failed	1.8700	1.1600	0.14	0.890	61.10
	Failed	1.8200	1.3000			
FR35	Non-failed	0.4310	0.6630	0.78	0.437	61.10
	Failed	0.2890	6.7500			
FR10	Non-failed	1.9140	0.3920	-0.74	0.461	59.30
	Failed	2.0260	0.6730			
FR3	Non-failed	281.0	215.0	-0.73	0.472	55.60
	Failed	370.0	599.0			
FR4	Non-failed	2.3690	0.2530	-0.07	0.947	53.70
	Failed	2.3750	0.3550			
FR9	Non-failed	113.7	88.3	-1.02	0.319	51.90
	Failed	1118.0	5139.0			
FR11	Non-failed	218.0	169.0	-0.98	0.336	51.90
	Failed	1571.0	7168.0			
FR12	Non-failed	2.2490	0.2770	-0.34	0.738	51.90
	Failed	2.2880	0.5380			
FR13	Non-failed	148.4	99.2	-1.05	0.304	51.90
	Failed	842.0	3432.0			
FR15	Non-failed	184.0	175.0	-0.97	0.339	51.90
	Failed	1847.0	8878.0			

Note: Significant difference between failed and non-failed corporations at the \* 0.1, \*\*0.05 and \*\*\*0.01 significance level.

There are no discrepancies between UDA and T-test results for the financial ratios of the fourth cluster which are reported in Table IV. For example, FR33 and FR17 (FR26 and FR34) exhibit high (low) discriminatory power according to UDA results and there is also

(no) significant difference between the mean values of these ratios for failed and non-failed corporations and vice versa.

**Table IV UDA and T-test results of Cluster 4 financial ratios**

<b>Cluster 4</b>						
<b>Ratio</b>	<b>STATUS</b>	<b>MEAN</b>	<b>SD</b>	<b>T-values</b>	<b>Sign.</b>	<b>UDA %</b>
FR33	Non-failed	0.6210	0.2160	-2.86	0.007***	64.80
	Failed	0.7620	0.1360			
FR17	Non-failed	4.45	4.41	-1.89	0.068*	63.00
	Failed	9.20	12.40			
FR26	Non-failed	2.7700	3.7200	-0.83	0.414	55.60
	Failed	6.1000	20.5000			
FR34	Non-failed	3.3600	3.2100	-1.69	0.102	51.90
	Failed	6.7400	9.9200			

Note: Significant difference between failed and non-failed corporations at the \* 0.1, \*\*0.05 and \*\*\*0.01 significance level.

Accordingly, the same lack of discrepancies is observed between UDA and T-test results for the financial ratios of the fifth cluster which are reported in Table V. The majority of financial ratios that exhibit enhanced predictive power according to UDA results, show significant difference between the mean values of these particular ratios for failed and non-failed corporations as well.

**Table V UDA and T-test results of Cluster 5 financial ratios**

<b>Cluster 5</b>						
<b>Ratio</b>	<b>STATUS</b>	<b>MEAN</b>	<b>SD</b>	<b>T-values</b>	<b>Sign.</b>	<b>UDA %</b>
FR7	Non-failed	0.1520	0.2960	2.25	0.029**	66.70
	Failed	-0.0150	0.2480			
FR8	Non-failed	0.1300	0.2560	2.15	0.037**	66.70
	Failed	-0.0170	0.2470			
FR20	Non-failed	0.0770	0.1470	2.32	0.027**	64.80
	Failed	-0.0990	0.3650			
FR5	Non-failed	525206	993663	1.61	0.116	63.00
	Failed	-106220	1785202			
FR30	Non-failed	0.0720	0.1580	2.06	0.047**	57.40
	Failed	-0.0940	0.3870			
FR22	Non-failed	0.0346	0.0545	1.01	0.322	51.90
	Failed	-2.1000	11.0000			
FR6	Non-failed	3.7800	3.8100	0.60	0.551	51.90
	Failed	3.1600	3.8100			
FR37	Non-failed	0.2240	0.1740	0.32	0.754	50.00
	Failed	0.2100	0.1650			

Note: Significant difference between failed and non-failed corporations at the \* 0.1, \*\*0.05 and \*\*\*0.01 significance level.

During the final stage before the construction of the corporate failure prediction models, we conduct  $X^2$  tests between the choice of accounting methods and techniques and the status of the corporations in order to detect possible association of failed corporations with certain choices of accounting methods and techniques. As we can see in Table VI, twelve accounting methods and techniques are tested and we found significant dependence between them and the status of the companies in only three cases. In AM1 we witnessed non-failed corporations to capitalize their start up costs while the failed ones tend to do the exact opposite. In AM2 we found evidence of non-failed corporations to capitalize their R&D costs when failed corporations do not share the same attitude probably because they do not invest in R&D at all. In AM9 we also found significant dependence between the status of the companies and the provision for depreciation. In particular, failed corporations tend to avoid depreciating their fixed assets one year prior to their bankruptcy which is consistent with the contracting theory literature vis-à-vis income increasing techniques.

**Table VI  $X^2$  test results of Accounting Methods and Techniques**

Accounting Method	DEFINITION	$X^2$	Significance
AM1	Capitalization of Start-Up Costs	9.826	0.002 ***
AM2	Capitalization of R & D Costs	3.000	0.083 *
AM3	Intangible Assets	1.271	0.260
AM4	Investment in Associated Companies	0.333	0.564
AM5	Revaluation of Fixed Assets	1.862	0.172
AM6	Receive Government Grants	1.862	0.172
AM7	Provision for Pensions	0.114	0.735
AM8	Provision for Extraordinary Items	0.731	0.393
AM9	Provision for Depreciation	8.206	0.004 ***
AM10	Provision for Additional Depreciation	0.220	0.639
AM11	Tax - Exempt Reserves	0.114	0.735
AM12	Board of Directors' Compensation	0.220	0.639

Note: Significant difference between failed and non-failed corporations at the \* 0.1, \*\*0.05 and \*\*\*0.01 significance level.

For the construction of the three models, we choose only one financial ratio from each cluster in order to avoid multicollinearity problems although multicollinearity is irrelevant in the MDA model (Eisenbeis, 1977). Our objective is to construct three alternative models: i) the discriminant model (DM), ii) the logit model (LM) and iii) the probit model (PM), in accordance with the methodology of the preceding section. Then we introduce to these models the dummy variables concerning the choice of accounting methods and techniques in order to test the impact of these dummy variables on the accuracy and robustness of these models. The information content of the dummy variables is guided but not limited by the  $X^2$  results of Table VI.

The former three models (DM1, LM1 and PM1) without the use of the AM variables and the latter three models (DM2, LM2 and PM2) with the use of the AM variables appear in Table VII. The linear classification functions derived from DM1 and DM2 for the failed and non-failed corporations are also embedded in Table VII. The preceding discriminant functions of DM1 and DM2 lead to 81.5% and 87% of correct classifications respectively. Moreover, the probability to classify a failed corporation as non-failed (Type I error) is 18.5% for DM1 and 14.8% for DM2 while the probability to classify a non-failed corporation as failed (Type II error) is 18.5% for DM1 and 11.1% for DM2. Both DM1 and DM2 can be considered as robust since Wilks' Lambda low values (0.676 and 0.513) indicate excessive discriminatory power of the classification functions and the  $X^2$  statistic provides evidence to reject the null hypothesis that the mean values of the preceding classification functions are equal between the two groups of corporations.

In comparison with the DMs, the LMs outperform in terms of accuracy ratio of correct classifications and Type I & II errors. That is 83.3% hit ratio for LM1 and 90.7% for LM2, 14.8% probability of Type I error for LM1 and 7.4% for LM2 and 18.5% probability of Type II error for LM1 and 11.1% for LM2. Furthermore, both LM1 and LM2 can be considered as robust since the values of Nagelkerke  $R^2$  (0.462 and 0.700) which is a pseudo  $R^2$  statistic, an approximation of  $R^2$  for the linear models when the dependent variable (company status) is categorical, can be perceived as satisfactory and the Hosmer-Lemeshow goodness of fit statistics (0.746 and 0.273) are well above 0.10 and thus provide evidence that the LMs adequately describe the data.

#### **Table VII Estimates of the Discriminant, Logit and Probit Models**

Variables	DM1	DM2			LM1	LM2	PM1	PM2
	Non- failed	Failed	Non- failed	Failed				
Intercept	-35.161	35.562	-39.665	37.418	-2.404	-0.288	-1.097	-0.476
FR1	7.296	6.263	7.890	6.570	-1.666	-1.475	-0.950	-0.786
FR14	24.773	25.177	25.825	25.306	1.650	0.972	0.839	0.589
FR17	0.481	0.541	0.516	0.569	0.069	0.153	0.043	0.092
FR20	16.388	12.593	18.990	13.934	-4.011	-6.116	-2.247	-3.223
FR39	2.261	3.211	1.790	3.175	1.077	1.323	0.487	0.757
AM5			2.736	1.602		-1.533		-0.731
AM7			5.404	4.502		-2.191		-1.169
AM9			-6.721	-3.056		4.868		2.463
Wilks'								
Lambda	0.676		0.513					
X <sup>2</sup> (Sign.)	19.378 (0.002)		32.024 (0.000)					
Nagelkerke								
R <sup>2</sup>					0.462	0.700		
H-L Test					5.11	9.89		
(Sign.)					(0.746)	(0.273)		
Pearson X <sup>2</sup>							54.8	76.8
(Sign)							(0.233)	(0.002)
Accuracy								
Within								
groups	0.815	0.815	0.889	0.852				
Overall	0.815		0.870		0.833	0.907	0.815	0.889
Type I error		0.185		0.148	0.148	0.074	0.185	0.111
Type II								
error	0.185		0.111		0.185	0.111	0.185	0.111

The PMs under-perform in comparison with the LMs and outperform in comparison with the DMs, in terms of accuracy ratio of correct classifications and Type I & II errors. That is 81.5% accuracy ratio for PM1 and 88.9% for PM2, 18.5% probability of Type I & II errors for PM1 and 11.1% for PM2. Finally, PM1 can be considered as robust since the Pearson goodness of fit statistic (0.233) provides evidence that the PM1 adequately describes the data. However, this is not the case for PM2 where the Pearson goodness of fit statistic (0.002) is less than 0.05.

In any case, the AM variables exhibit enhanced information content and their introduction to the existing corporate failure prediction models attributes excessive discriminatory power. In terms of accuracy ratio and Type I & II errors DM2, LM2, and PM2 outperform DM1, LM1, and PM1 respectively. Moreover, our findings are consistent with the contracting theory since managerial choice of accounting methods and techniques is determined by market imperfections such as agency costs, information asymmetries and externalities (Fields et al., 2001). The combined effects of certain accounting choices and techniques on the accuracy of the existing corporate failure prediction models are also tested

while the current literature is limited on one accounting choice at a time when the majority of managers have a purpose that could be better served by the combined effects of several accounting choices (Zmijewski and Hagerman, 1981).

## 5. CONCLUSIONS

One of the main obstacles of this research has been the scarcity of publicly available information especially the data concerned with the choice of accounting methods and techniques of failed corporations. Nevertheless, we constructed accounting-based models for the prediction of corporate failure with Greek business data. Our motivation was to bridge the gap between the accounting choice literature and the prediction of corporate failure literature. We attained that with the employment of multiple discriminant analysis, logit analysis and probit analysis incorporating both financial ratios and choices of accounting methods and techniques as predictor variables of our models

Our objective was to construct the three preceding alternative models (DM, LM and PM), in accordance with the described methodology with and without the incorporation of the AM variables in order to detect possible incremental information content of the AM variables in terms of enhanced ratios with correct classifications. In any case, the AM variables exhibit enhanced information content and their introduction to the existing corporate failure prediction models attributes incremental discriminatory power. In terms of accuracy ratio and Type I & II errors DM2, LM2, and PM2 outperform DM1, LM1, and PM1 respectively. The combined effect of the AM variables used in the final models is obvious even though the  $\chi^2$  results among seemingly unrelated accounting methods are not consistent with the overall accuracy ratio of the models.

Finally, we believe that our study is limited to few accounting choices and techniques by the scarcity of publicly available information and future research is necessary in order to explore the impact of the plethora of accounting methods and techniques that are acceptable by different GAAPs on the prediction of corporate failure.

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**APPENDIX A**

<b>RATIOS</b>	<b>DEFINITION</b>
<b>Liquidity</b>	FR <sub>1</sub> Current assets to current liabilities
	FR <sub>2</sub> Current assets minus inventory to current liabilities
	FR <sub>3</sub> Current assets minus inventory to daily operating expenses
	FR <sub>4</sub> Natural logarithm of FR <sub>3</sub>
	FR <sub>5</sub> Distributable earnings minus reserves and directors' reimbursement plus depreciation
	FR <sub>6</sub> Natural logarithm of FR <sub>5</sub>
	FR <sub>7</sub> FR <sub>5</sub> to current liabilities
	FR <sub>8</sub> FR <sub>5</sub> to total liabilities
<b>Activity</b>	FR <sub>9</sub> Inventory to Cost of goods sold multiplied by 360 days
	FR <sub>10</sub> Natural logarithm of FR <sub>9</sub>
	FR <sub>11</sub> Receivables to annual sales multiplied by 360 days
	FR <sub>12</sub> Natural logarithm of FR <sub>11</sub>
	FR <sub>13</sub> Trade Creditors to Cost of goods sold minus depreciation multiplied by 360 days
	FR <sub>14</sub> Natural logarithm of FR <sub>13</sub>
	FR <sub>15</sub> FR <sub>9</sub> plus FR <sub>11</sub> minus FR <sub>13</sub>
	FR <sub>16</sub> Natural logarithm of FR <sub>15</sub>
	FR <sub>17</sub> Annual sales to equity
	FR <sub>18</sub> Annual sales to fixed assets
	FR <sub>19</sub> Annual sales to total assets
	FR <sub>20</sub> Annual sales t minus annual sales t-1 to annual sales t-1
<b>Profitability</b>	FR <sub>21</sub> Gross profit to annual sales
	FR <sub>22</sub> Earnings before taxes to annual sales
	FR <sub>23</sub> Earnings before taxes plus interest paid to capital employed
	FR <sub>24</sub> Earnings before taxes to equity
	FR <sub>25</sub> Earnings before taxes to total assets
	FR <sub>26</sub> FR <sub>24</sub> to FR <sub>23</sub>
	FR <sub>27</sub> Earnings before taxes to interest paid
	FR <sub>28</sub> Earnings before taxes to number of employees
	FR <sub>29</sub> Natural logarithm of FR <sub>28</sub>
	FR <sub>30</sub> CoGS t minus CoGS t-1 to CoGS t-1
	FR <sub>31</sub> Gross profit t minus gross profit t-1 to gross profit t-1
	FR <sub>32</sub> Earnings before taxes t minus earnings before taxes t-1 to earnings before taxes t-1
<b>Capital Structure</b>	FR <sub>33</sub> Total liabilities to total assets
	FR <sub>34</sub> Total liabilities to equity
	FR <sub>35</sub> Non-current liabilities to equity
	FR <sub>36</sub> Equity to total liabilities
	FR <sub>37</sub> Fixed assets to total assets
	FR <sub>38</sub> Equity plus non-current liabilities to fixed assets
	FR <sub>39</sub> Reserves to share capital
<b>Investment</b>	FR <sub>40</sub> Dividends to earnings before taxes
	FR <sub>41</sub> Dividends to equity

## **MEDIATING IMPACT OF “TRUST” IN THE RELATIONSHIP BETWEEN E-SERVICE QUALITY & CUSTOMER SATISFACTION IN THE CONTEXT OF INTERNET BANKING**

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### **ABSTRACT**

The main objective of this study is to find the role of trust as a mediating variable between e-service quality and customer satisfaction in Internet banking. Structure equation modeling has been used to analyze the effects of independent variable e-service quality on customer satisfaction and the role of mediating variable trust. Stepwise analysis has been done to examine the effect of trust on customer satisfaction. E-service quality was found strongly correlated with customer satisfaction. The results does not confirm trust as a mediating variable between e-service quality and customer satisfaction, though a positive significant relation can be found between trust and customer satisfaction when tested in a separate cause and effect model. The research implies that banking service providers should focus mainly on the improvement of the service quality of Internet banking to get more satisfied customers.

**Keywords:** customer satisfaction, e-service quality, E-S-QUAL, Internet banking, mediating variable, trust

### **INTRODUCTION**

In today's world of intense competition, the key to sustainable competitive advantage lies in delivering high quality services that will in turn result in satisfied customers (Shemwell, Yavas, & Bilgin, 1998). In an era of intense global competition; many organizations have now shifted the paradigm of service quality to customer's perspective (Parasuraman, Zeithaml, & Berry, 1985). Based on this paradigm, a customer will judge the quality of service accorded and determine whether it met his/her expectations (Grönroos, 1984; Parasuraman et al., 1985, 1988). Service quality and customer satisfaction are the two core concepts that are at the center of the marketing theory and practice (Spreng & Mackoy, 1996). The relationship

between service behavior and service quality has proven its role and importance in management/marketing (Valarie et al., 1996; Heskett & Sasser, 2010; Hutchinsona et al., 2009). The concepts of service quality and service satisfaction have been highly considered and used in marketing texts and activities, during previous decades. Marketing researchers have praised the advantages of satisfaction and quality, and have mentioned them as indices of an organization competitive benefit (Ruyter, 1997).

But an observed relationship may be part of a more complex chain of effects. These complex relationships are described in terms such as indirect influences, distal vs. proximal causes, intermediate outcomes, and ultimate causes; all of which share the concept of mediation. A mediator can be thought of as the carrier or transporter of information along the causal chain of effects.

Here, this study will measure the mediating role of trust as attributed by a customer to service quality of Internet banking and customer satisfaction. The main objectives of this study are to find out e-service quality through gap model (Service perception vs. Service expectation) based on the E-S-QUAL scale suggested by Parasuraman et al. (2005). Later, mediating role of trust will be studied. As evident from literature trust and e-service quality exert a positive influence on customer satisfaction.

## LITERATURE

### *Service quality and e-service quality*

Service quality has become as one of the key driving forces for business sustainability and is crucial for firms' accomplishment (Rust and Oliver, 1994). The importance of service quality has been proved as the ultimate goal of service providers throughout the world (Sureshchandar, Rejendran, & Anantharaman, 2002). Service quality has been defined as a form of attitude – a long-run overall evaluation (Zeithaml, 1988; Parasuraman et al., 1988) while perceived service quality as a general, overall appraisal of service. Original 22-item SERVQUAL instrument by Parasuraman (1985, 1988, and 1994). provided researchers with the possibility of measuring the performance expectations gaps composed by five determinants knows, reliability, responsiveness, empathy, assurance and tangibility. However, studies dealing with people-technology interactions imply that customer evaluation of new technologies is a distinct process. Findings from an extensive qualitative study of how customers interact with, and evaluate, technology-based products (Mick and Fournier 1998) suggest that (a) customer satisfaction with such products involves a highly

complex, meaning-laden, long-term process; (b) the process might vary across different customer segments; and (c) satisfaction in such contexts is not always a function of preconsumption comparison standards. Findings of different studies by Cowles 1989; Cowles and Crosby 1990; Dabholkar 1996; Eastlick 1996, Davis 1989, and Szajna 1996) reveal important differences in acceptance and usage of technologies across customers depending on their technology beliefs and suggest that similar differences might exist in the evaluative processes used in judging e-SQ.

In 2005 Parasuraman et al further developed E-S-QUAL, a Multiple-Item Scale for Assessing Electronic Service Quality. The basic E-S-QUAL scale developed in the research was a 22-item scale of four dimensions : efficiency, fulfillment, system availability, and privacy. The second scale, E-RecS-QUAL, is salient only to customers who had nonroutine encounters with the sites and contains 11 items in three dimensions: responsiveness, compensation, and contact.

#### *Customer satisfaction*

Satisfaction is a person's feeling of the pleasure or disappointment arising from comparing products perceived performance in relation to expectation. It is a state of experience that might vary in intensity but not in quality (Stauss & Neuhaus, 1997). Various authors reflect the notion that satisfaction is a feeling which results from a process of evaluating what has been received against what was expected, including the purchase decision itself and the needs and wants associated with the purchase (Armstrong & Kotler, 1996). Customer satisfaction is the primary mental state of customer which comprise by two thing (1) expectation before purchase (2) perception about performance after purchase (Oliver 1997, Westbrook & Oliver 1991). Bitner & Zeithaml (2003) stated that satisfaction is the customers' evaluation of a product or service in terms of whether that product or service has met their needs and expectations. According to Boselie, Hesselink, and Wiele (2002) satisfaction is a positive, affective state resulting from the appraisal of all aspects of a party's working relationship with another. Customer satisfaction is defined as a result of comparison between what a customer expects about services provided by a service provider and what the customer receives in actual terms (Caruana, Money, & Berthon, 2000; Parasuraman et al., 1988). If the service provided by an organization does meet a customer's needs and expectations, then this may subsequently lead to higher customer satisfaction (Foster, 2004; Parasuraman et al., 1988; Walker et al., 2006).

#### *Relationship between service quality and customer satisfaction*

A number of empirical studies did indicate a link between service quality and satisfaction (e.g., Fornell, 1982; Taylor and Baker, 1994). Extant research in this area shows that the proper implementing and dispensing of the core service quality features may justifiably increase customer satisfaction (Gronroos, 1984; Parasuraman et al., 1988; Walker et al., 2006). The service quality research literature is consistent with the notion of perceived quality models. For example, Parasuraman et al. (1985) state that a conceptual service quality model highlights that the match between service quality standards and customers' standards may decrease service performance gap and increase customer perceived value about the quality systems. Consequently, it may lead to higher customer satisfaction.

### *Trust*

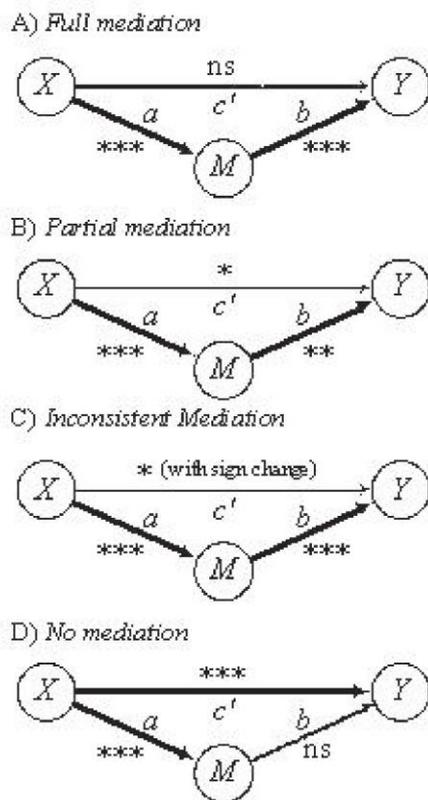
"Trust is like the air we breathe, when it's present, nobody really notices. But when it is absent, everybody notices." (Warren Buffet, qtd. in Sandlund, 2001). In business trust is viewed as one of the most relevant antecedents of stable and collaborative relationships. Wilson (1995) states "Trust is a fundamental relationship model building block". Trust is considered to be an important element of consumer perceptions about brands and companies (Aaker, 1997). Reichheld and Scheffer (2000) state that "To gain the loyalty of customers, you must first gain their trust". Trust is beneficial for both customers and companies: customers benefit through a reduced perception of risk toward service provider and through social benefits derived from a trusting service provider; companies benefit through increased sales, reduced costs, positive word-of-mouth and even employees retention (Moorman et al., 1993; Schurr et al., 1985). Zaheer et al., (1998) found trust to have an important role in facilitating closer buyer-supplier relationships by reducing the tendency of firms to take advantage of each other. Researchers had established that trust is essential for building and maintaining long-term relationships (Rousseau, Sitkin, Burt, & Camerer, 1998; Singh & Sirdeshmukh, 2000). Trust and commitments are key variables for businesses because a) they encourage marketers to work at preserving relationship investments, b) resist attractive short-term alternatives in favour of the expected long-term benefits of staying with existing partner and c) view potentially high-risk actions as being prudent because of the belief that their partner will not act opportunistically (Morgan & Hunt, 1994). Trust involves one person's expectations that another will behave in a certain way (Deutsch, 1958; Schurr & Ozanne, 1985). It can be defined as one party's confidence in the other relationship members reliability, durability and integrity and the belief that its actions are in the best interest of and will produce positive outcomes for the trusting party (Peppers & Rogers, 2004). Trust

between two parties requires that, if one part does not behave as expected, the other party will experience more negative outcomes than if the other does behave as expected (Deutsch, 1958). Morgan and Hunt (1994) stated that trust exists only when one party has confidence in an exchange partner's reliability and integrity. While defining trust Moorman, Deshpande, & Zaltman, 1993) referred to the willingness to rely on an exchange partner in whom one has confidence. If one party trusts another party that eventually engenders positive behavioral intentions towards the second party. Therefore if one party believes that the actions of the other party will bring positive outcomes to the first party, trust can be developed (Anderson and Narus, 1990). Doney and Cannon (1997) added that the concerned party also must have the ability to continue to meet its obligations towards its customers within the cost-benefits relationship; so, the customer should not only foresee the positive outcomes but also believe that these positive outcomes will continue in the future.

#### *Relationship between service quality and trust*

The quality elements of the e-service are expected to affect e-trust directly (Gronroos et al., 2000), because they represent trust cues that convey the trustworthiness of the site and the system to customers (Corritore et al., 2003). In a review of studies on online trust, Grabner-Krauter and Kalusha (2003) even interpret e-quality determinants as trust, i.e. trusting beliefs, and intentions to repurchase as trusting intentions. Furthermore, Corritore et al. (2003) call web sites objects of trust and suggest that navigational architecture and design elements have a direct effect on trust. A qualitative study by Davis et al. (2000) on e-tail brands also demonstrates the importance of e-tailer trust, with quotes such as "Think of brands I trust in terms of quality" and "if there was no trust, I couldn't allow the service to continue". Although these studies are not on e-trust, e-quality can be expected to have a positive effect also trust in the online medium. Therefore, in analogy with the arguments used to underpin the relationship between satisfaction and e-trust, we expect that the confidence customers have in online exchanges will be positively affected by the quality of their online experiences.

#### *Mediation*



Baron and Kenny's (1986) influential paper on mediation analyses stated three necessary but not sufficient conditions that must be met in order to claim that mediation is occurring (Kenny, Kashy, & Bolger, 1998; MacKinnon, Lockwood, Hoffman, West, & Sheets, 2002).

1. X is significantly related to M.
2. M is significantly related to Y.
3. The relationship of X to Y diminishes when M is in the model.

Where exogenous causal influence as X, the endogenous causal influence, or mediator, is referred to as M, and the dependent variable or outcome is referred to as Y.

Figure 1: types of mediation

source : Little et al., chapter 9 : structural equation modeling of mediation & moderation with contextual factors

Each of the three constructs must show evidence of a nonzero monotonic association with each other, and the relationship of X to Y must decrease substantially upon adding M as a predictor of Y.

#### Objectives

The current study has three major research questions: first, which features of e-service quality may affect customer satisfaction? Second, which features of e-service quality may affect trust? Finally, does trust affect the relationship between e-service quality features and customer satisfaction?

Hence, this study is conducted to measure three main objectives: first, the relationship between the e-service quality features and customer satisfaction. Second, the relationship between the service quality features and trust. Lastly, the mediating effect of trust in the relationship between e-service quality features and customer satisfaction that occurs in Internet banking in the context of selected Indian public sector banks.

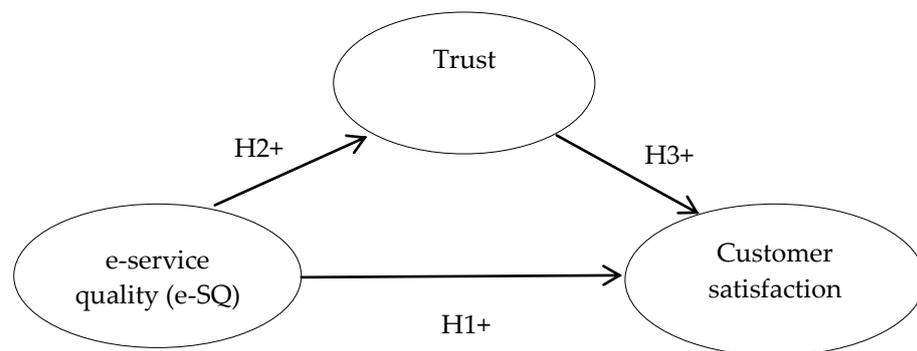


Figure 1 : Theoretical model of the study

Hence, it can be hypothesized that:

*H1: e-service quality has a positive significant effect on Customer Satisfaction.*

*H2: e-service quality has a positive significant effect on trust.*

*H3: Trust has a positive effect on customer satisfaction.*

## METHOD

### *Sample*

The empirical data are drawn from 367 customers of Internet banking from three selected public sector banks in India using a structured questionnaire. Data was collected from the metropolitan city of Kolkata, India. Response rate was 77%. Among the respondents 69% were male and 31% were female.

### *Questionnaire*

Structured questionnaires comprising of five sections have been used to collect data. The questionnaire has four sections : Section A : about your expectation on Internet bank services, Section B : about the specific bank's performance on Internet bank services, Section C : about

your satisfaction by availing services offered by Internet banking, Section D: about your trust on bank's performance and Section E : background of the respondent.

Following the trend of previous researches in this field 5 points Likert scale was used to measure all of these variables. e-SQ has been measured by using 24 items. A set of 24 Q (P-E) columns were derived in the data sheet of SPSS for analysis of the gap scores between perceived service and expected service to get the service quality of Internet banking. The idea of using difference scores has been used in developing scales for measuring constructs such as role conflict (Ford, Walker, and Churchill 1975). The trust has been measured by using 4 items and customer satisfaction has been measured by using 4 items.

The values of coefficient alpha ranged from 0.772 to 0.906 and there were no suggestion that deletion of certain items from each dimension would improve the alpha values. So, no items were deleted.

#### *Data Analysis*

To assess direct and indirect relationships among the studied variables a two-step procedure was followed using confirmatory factor analysis and structural equation modeling (Anderson & Gerbing, 1988). Amos 18.0 has been used to perform these analyses. The analysis has been done according to the following steps :

- i. The basic E-S-QUAL part of E-S-QUAL A Multiple-Item Scale for Assessing Electronic Service Quality model of Parasuraman et al. (2005) was adopted with minor modification and tested to get the e-SQ construct of Internet banking for the purpose of this research.
- ii. The proposed construct of customer satisfaction and trust was tested with CFA.
- iii. In the Model 1, path from the e-SQ to customer satisfaction have been examined.
- iv. In Model\_2, path from e-SQ to trust has been tested to satisfy the necessary condition 1 of mediation as proposed by Baron and Kenny's (1986)
- v. In Model\_3, path from trust to customer satisfaction has been tested to satisfy the necessary condition 2 of mediation as proposed by Baron and Kenny's (1986)
- vi. In Model\_4, path from e-SQ to customer satisfaction and paths from e-SQ to customer satisfaction mediated through trust have been examined.

## RESULTS

The reliability statistics of the three constructs has been shown in table 1. The reliability coefficient or alphas for the different constructs were computed using the reliability procedure in SPSS (version 19.0).

Construct	Sub constructs	No. of items	Cronbach's alpha
e-SQ	System availability	4	0.772
	Efficiency 1	4	0.773
	Efficiency 2	5	0.906
	Fulfillment	4	0.814
	Privacy	7	0.880
Customer satisfaction		4	0.831
Trust		4	0.804

*Table 1 : Reliability statistic of the constructs used in research*

The reliabilities of all the constructs used in this study were found to be above the standard set by Nunnally (1978), which is 0.50-0.60. The results found by exploratory factor analysis on the three constructs are shown in table 2.

Factor labels	Factor loadings	Eigen values	Percent of variance
<b>e-SQ</b>			
QAV1	.793	7.918	32.990
QAV2	.696		
QAV3	.738		
QAV4	.708		
QEff21	.719	2.629	10.953
QEff22	.849		
QEff23	.829		
QEff24	.831		
QEff25	.836		
Qeff11	.790	1.827	7.612
Qeff12	.715		
Qeff13	.702		
Qeff14	.730		
Qful1	.704	1.605	6.689
Qful2	.747		
Qful3	.664		
Qful4	.704		
QPR1	.712	1.228	5.115
QPR2	.705		
QPR3	.728		
QPR4	.708		
QPR5	.807		
QPR6	.697		
QPR7	.652		

Factor labels	Factor loadings	Eigen values	Percent of variance
<b>Customer satisfaction</b>			
SAT1	.813	2.654	66.346
SAT2	.844		
SAT3	.809		
SAT4	.792		
<b>Trust</b>			
PTR1	.817	2.519	62.978
PTR2	.790		
PTR3	.784		
PTR4	.782		

Table 2 : Factor analysis for e-SQ, customer satisfaction and trust

The data was subjected to 2<sup>nd</sup> order confirmatory factor analysis using AMOS 18 to test the model fit and unidimensionality of service quality scale item on all the constructs. Maximum likelihood technique was used. Confirmatory factor analysis involves the specification and estimation of hypothesized model of factor structure being measured by latent variables to account for covariances among a set of observed variable (Koufteros, 1999). The measurement model specifies how the latent variables are measured in terms of observed variables. The result of initial confirmatory factor analysis showed that R<sup>2</sup> values of two of the variables in efficiency1 construct and one variable of availability construct was below 0.450. These three variables were omitted from the e-SQ construct. The resulting confirmatory factor analysis showed that that the data fit the measurement model fairly well (refer table 3 & 4).

	Constructs	Indicators	Standardized coefficients	R <sup>2</sup>
e-SQ	System availability	qav4	.697	0.486
		qav3	.671	0.450
		qav1	.747	0.558
	Efficiency1	qeff13	.731	0.534
		qeff11	.673	0.453
	Efficiency2	qeff25	.835	0.697
		qeff24	.849	0.721
		qeff23	.836	0.699
		qeff22	.854	0.729
	Fulfillment	qeff21	.695	0.483
		qful4	.704	0.496
		qful3	.721	0.520
		qful2	.732	0.536
	Privacy	qful1	.734	0.539
		qpr7	.679	0.461
qpr6		.726	0.527	
qpr5		.776	0.602	
qpr4		.690	0.476	
		qpr3	.717	0.514

	Constructs	Indicators	Standardized coefficients	R <sup>2</sup>
		qpr2	.681	0.464
		qpr1	.742	0.551
	Trust	ptr4	.695	0.483
		ptr3	.685	0.469
		ptr2	.707	0.500
		ptr1	.758	0.575
		sat4	.699	0.489
	Customer satisfaction	sat3	.733	0.537
		sat2	.800	0.640
		sat1	.738	0.545

Table 3: Confirmatory factor analysis : standardized coefficients

Fit indexes	Recommended Value	Observed Value		
		e-SQ	Trust	Customer satisfaction
Chi-square/ degrees of freedom	$\leq 3.0$	1.8	14.14	1.609
GFI (Goodness of fit)	$\geq 0.90$	.938	.975	.997
AGFI (Average Goodness of fit)	$\geq 0.80$	.922	.875	.984
RMR (root mean square residual)	$\leq 0.05$	.011	.015	
CFI (Comparative Fit Index)	$\geq 0.90$	.966	.958	.998
NFI(Normed Fit Index)	$\geq 0.90$	.931	.955	.996
RFI(Relative Fit Index)	Close to 0.90	.921	.864	.987
TLI(Tucker-Lewis Index)	Close to 0.90	.961	.873	.995
RMSEA(root mean square error of approximation)	$\leq 0.05$	.042	.162	.035

Table 4 : Summary statistics of model fit

As it can be seen from table 3, the R<sup>2</sup> values, which explain the relative variance of the dependent variable, are satisfactory (larger than 0.450) (Joreskog & Sorbom, 1999). So, all manifest variables are valid for further analysis through Structural Equations Modeling (SEM).

Goodness-of-fit of all the three constructs (with minor variation in the construct of trust) indicated “reasonable or good fit” or RMSEA  $< 0.05$ . Brown and Cudeck (1993) suggested that root mean square error of approximation (RMSEA) between 0.05 and 0.08 provide reasonable error of approximation. Hair et al., (2009) suggested  $0.05 < RMSEA < 0.08$  is for “good fit”. CFI (comparative fit index) for all the three constructs  $> 0.90$  denoting a good fit. Hu and Bentler (1999) suggested that a rule of thumb for the CFI and the incremental indexes is that values greater than roughly 0.90 may indicate reasonably good fit of the researcher’s model. The GFI

was the first standardized fit index (Joreskog & Sorbom, 1999). GFI = 1.0 indicates perfect model fit. Therefore, a GFI > 0.90 demonstrates reasonable fit for all the three constructs used in this study. From the above goodness-of-fit evaluation, confirmatory factor analysis for the three constructs e-SQ, trust and customer satisfaction reasonably supported their model's fit.

#### *Convergent validity*

Convergent validity of a scale measure is used to assess whether the individual scale items are related or not (Susarala et al., 2003). It refers to the degree to which the two measures designed to measure the same construct are related (Netemeyer et al., 2003). To analyse the convergent validity the factor loadings and the average variance extracted were examined as suggested by Fornell and Larcker(1981). In this research most of the indicators have loading from 0.6 to 0.9 which is in line with Bagozzi and Yi (1988). With this the average variance extracted is more than 0.5 which is acceptable. In this research the average variance explained by each construct has been shown in table 5.

	<b>AVE</b>	<b>Composite reliability</b>
<b>System Availability</b>	0.498	0.748
<b>Efficiency 1</b>	0.493	0.660
<b>Efficiency 2</b>	0.665	0.908
<b>Fulfillment</b>	0.522	0.813
<b>Privacy</b>	0.513	0.880
<b>Trust</b>	0.506	0.803
<b>Customer satisfaction</b>	0.552	0.831

*Table 5 : Average variance extracted and composite reliability of service quality construct*

#### *Discriminant validity*

Discriminant validity provides the information about whether the scores from a measure of a construct are unique rather than contaminated by other constructs (Schwab, 2005). To assess the discriminant validity of the constructs the AVE of each construct was compared to their corresponding inter construct squared correlation as recommended by Fornell and Larcker (1981). Discriminant validity is given when the shared variance among any two constructs (i.e., the square of their intercorrelation) is less than the AVE of each construct. Table 6 shows the AVE exceeds the squared correlations with the all the factors.

<b>Construct</b>	<b>Inter construct squared correlation</b>
qav <--> qeff1	0.143
qav <--> qeff2	0.185
qav <--> qful	0.212

Construct			Inter construct squared correlation
qav	<-->	qpr	0.152
qeff1	<-->	qeff2	0.104
qeff1	<-->	qful	0.240
qeff1	<-->	qpr	0.291
qful	<-->	qeff2	0.271
qeff2	<-->	qpr	0.145
qav	<-->	trust	0.071
qeff1	<-->	trust	0.090
qeff2	<-->	trust	0.077
qful	<-->	trust	0.039
qpr	<-->	trust	0.072
qav	<-->	sat	0.228
qeff1	<-->	sat	0.161
qeff2	<-->	sat	0.354
qful	<-->	sat	0.315
qpr	<-->	sat	0.384
sat	<-->	trust	0.100
qful	<-->	qpr	0.483

Table 6 : Inter construct squared correlation of the constructs used in the study

#### Structural Equation Analysis

Table 7 shows the results of measurement models to test the hypothesis with regard to model paths. The first model, model 1 has examined the causal links of e-SQ and customer satisfaction. The second model, Model\_2 checks the causal relationship between e-SQ and trust. Model\_3, the third model checks the causal link between trust and customer satisfaction. Afterwards, Model\_1 has been compared with another model i.e., Model\_4 which has examined both the direct and mediated (indirect) causal links between e-SQ and customer satisfaction mediated by trust.

	Cmin/df	GFI	RMR	CFI	NFI	RFI	RMSEA
Model 1	1.7	.929	.013	.963	.921	.912	.040
Model_2	1.8	.928	.013	.959	.915	.905	.041
Model_3	2.4	.979	.013	.980	.967	.951	.054
Model_4	1.7	.920	.014	.959	.908	.899	.038

Table 7: Goodness of fit indices of the four models

#### Path Analysis

Considering the pattern of significance for the parameters estimated in Model 1, e-SQ has been found to be significantly related to customer satisfaction in the hypothesized direction.

In case of model 2, no significant relationships have been found in the identified paths among trust and customer satisfaction although some of the relationships are found to be in the hypothesized directions. However, e-SQ and trust are found to be positively and significantly related. e-SQ & trust and trust & customer satisfaction both are significantly related.

Path	Model_1		Model_2		Model_3		Model_4	
	Hypothesis	Coefficient estimate						
e-SQ → customer satisfaction	H1	.774***					H1	.761***
e-SQ → trust			H2	.529***			H2	.354***
Trust → customer satisfaction					H3	.315***	H3	.047

Note \*\*\*  $P < .001$

Table 8: comparison of standardized path coefficients for models

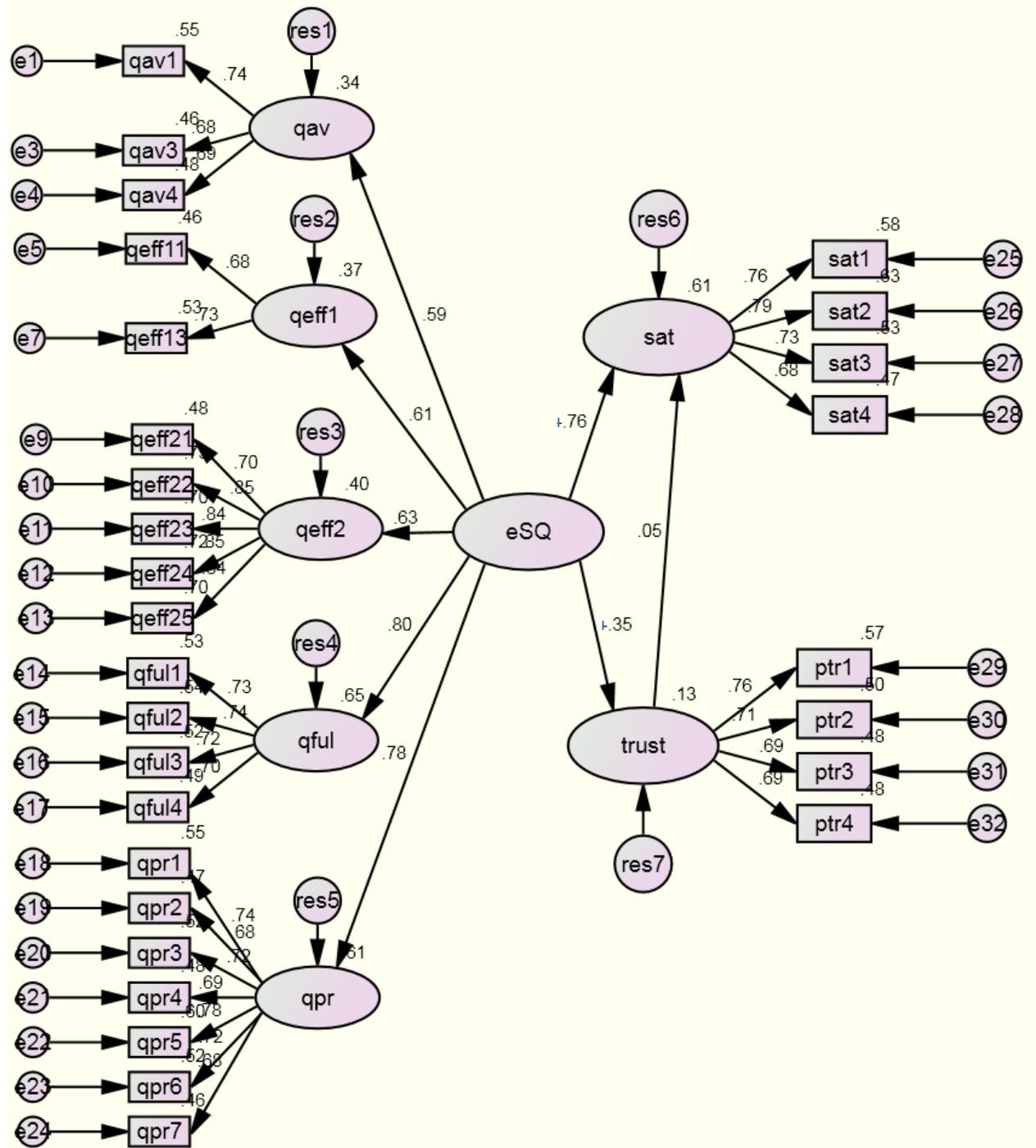


Figure 2 : The model of e-SQ influencing customer satisfaction and the mediating effect of trust

## DISCUSSION

While several authors have emphasised the multidimensional nature of service quality and the relationships between customer satisfaction and customer trust, this research sought to establish the bridges between e-service quality, customer satisfaction and customer trust in the context of internet banking. Using a sample of Internet banking customers this research has tried to find the mediating effect of trust between service quality and customer satisfaction. It investigates whether the postulated causal relationships among the e-SQ and customer satisfaction vary in two measurement models for the same group of customers.

Data supported the proposed model\_4, where direct paths from e-SQ to customer satisfaction and indirect paths from e-SQ to customer satisfaction as mediated through trust have been examined. The indirect path between trust and customer satisfaction has become non-significant. Therefore the model confirms that trust has no mediating effect between e-SQ and customer satisfaction. For Internet banking e-SQ is the antecedent of both customer satisfaction and trust. Hence, the management should primarily focus on e-service quality to enhance customer satisfaction and trust.

Model\_3 confirms a positive significant relationship between trust and customer satisfaction, but that relation becomes insignificant as soon as a path is attached between e-SQ and customer satisfaction. This incident denies the fact that trust is a mediating variable between e-service quality and customer satisfaction. Again to accept trust as a mediator, the relationship of e-SQ to customer satisfaction must decrease substantially upon adding trust as a predictor of customer satisfaction. Comparing standardized path coefficient of H1 for Model\_1 and Model\_4, no such substantial change in coefficient value can be noticed.

While determining the imperatives of 'how to win customers' trust' the service provider(s) must focus on both present and future time frame. The construct of trust contains belief in the brand or company, which provides the customers an assurance of positive outcomes not only for the present but also for the future. But in the field of Internet banking this have proven to have no effect on customer satisfaction. Global Consumer Banking Survey 2012 by Ernst & Young has revealed that Customers are becoming less loyal and increasing the number of banks they use. The overall proportion of customers planning to change banks has increased from 7% to 12% since 2011. Sensitivity to fees and charges is the leading driver of attrition, cited by 50% of customers. Customers with only one bank have fallen from 41% to 31%, while those with three or more have increased from 21% to 32%.

The study has also shown customers want lower costs and better service. Improving fees and charges is the top priority, as cited by 22% of customers. Customers' second priority is to

strengthen online and mobile banking. Customers prefer online channels for simple transactions, but they also demand high-quality, personal service for more complex transactions and advice. Pricing and service quality remain critical to customer satisfaction.

The survey has revealed that In India, 72% of customers say their confidence in the banking industry has increased during the past year. 68% attribute the improvement to more personalized, innovative service from their bank.

83% of customers have two or more banking providers, although those with only one bank have grown by 5% since last year to 17%. Of customers who multi-bank, 48% do so to find the best products or services, and 47% to obtain the best rates and fees.

Therefore, the survey result by Ernst & Young 2012 also suggest that it is the service quality which is the still the main predictor of customer satisfaction in Internet banking in India.

In the e-SQ construct qful has the highest factor loadings which relates to the fulfillment of the service promises. Privacy is another major factor of e-service quality. System availability and efficiency has a relatively low weightage in determining quality of service in Internet banking.

			Estimate
qav	<---	eSQ	.554
qeff1	<---	eSQ	.615
qeff2	<---	eSQ	.570
qful	<---	eSQ	.876
qpr	<---	eSQ	.774

*Table 9: Standardized Regression Weights of e-SQ*

Nevertheless, the findings of this study have to be interpreted considering few limitations. First, data were collected only from selected public sector banks; so the results might not hold true for other banks providing Internet banking service. Second, data collection was limited to the customers of those banks who live in Kolkata, West Bengal India; so the findings should not be generalized for all the subscribers of the entire country. Third, the current study was a cross-sectional study but to determine the causal paths of the studied variables a longitudinal study would have been more appropriate (Poon, 2004). In addition, the influence of other major variables like price has not been taken under consideration of this study.

## IMPLICATIONS

This research contributes to the progress of measuring the constructs of e-service quality (e-SQ) mainly adopted from the E-S-QUAL, satisfaction and trust. The items measuring these constructs in the Internet banking setting was tested and refined. The reliable and valid instrument confirmed in this research can be used by further studies detecting the relationships among these constructs in an extended context.

The findings also provide several managerial implications. The fundamental premise of the proposed research work model was to make banking service providers understand comprehensively the factors necessary to achieve high service quality that will significantly impact on customers' trust, satisfaction. Proper care should be taken to fulfill the service promises of Internet banking and privacy of the customers' informational data. By recognizing and analyzing these identified indicators, banking personnel will be better able to formulate and implement their strategic plans. The interpretation of the research model has the potential to help service providers better understand how customers assess the quality of service in Internet banking and how their service influence customer satisfaction and trust.

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## METRO CASH & CARRY UKRAINE: CHANGING HR STRATEGY IN LINE WITH BUSINESS STRATEGY

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### ABSTRACT

This pedagogical case describes the complex interrelations between the choice of localization strategy by a German origin multinational retail corporation and the impact of this choice on local activities in every country. The concept of HRM strategy is the focus of this case. It demonstrates contemporary approaches to HRM strategy development (starting from the organization values and culture) and describes the challenges that the HR manager in a multinational corporation subsidiary can face in implementing strategic changes, as well as in changing roles from supporting business operations to business partnership relations. It also reflects the importance of understanding the HR manager's potential in this role. The case study might be particularly interesting for entry- and middle-level HR managers who could learn how the market requirements can be transformed into an appropriate HRM strategy, and how this strategy can be implemented through different HRM practices.

This case was written in Ukraine under the research framework of the SCOPES project (Swiss-Russian-Ukrainian institutional partnership 2011-2013).

**Keywords:** Business strategy, HRM strategy, HR business partner, people management

### CASE DESCRIPTION

#### *Changes in global strategy*

METRO Cash & Carry is represented by more than 700 wholesale trade centers in 29 countries. More than 120,000 employees work for the Metro Group worldwide. The company's headquarters are in Düsseldorf (Germany). In 2011, sales revenue of the company reached about 32 million euros.

In 2011 a process of transformation started in METRO Cash & Carry. The program of changes included, first of all, vision, mission, values, strategy and culture of the company. In addition, the global management strategy was revised; as many issues as possible were given for consideration to the local management at the country representative office level. As the result, the Board of METRO Cash & Carry Ukraine retains the main responsibility and makes decisions on the company's business development in Ukraine.

#### *Changes in business strategy in Ukraine*

METRO Cash & Carry has operated in Ukraine for 10 years now, and today the chain is represented by 33 wholesale trade centers and a main office with a total workforce of 7,600.

Until 2009, the company grew mainly through a regional expansion, that is, through the opening of new trade centers. "Since 2009, this expansion has slowed down, and we are opening on average two trade centers every year. This fact, of course, reflected on the changes in the requirements for people, especially managers," said the Personnel Director of METRO Cash & Carry Ukraine Yulia Pilipenko. "This means that we moved from the expansion situation, where HR had been an administrative support for the business, to the situation in which we created HR strategy, playing the role of HR partner. This also led to the revision of our work standards".

The consequences of the global crisis were one of the reasons that prompted the company to change its strategy, by giving a vector to shift from extensive development to ensuring the growth through increased efficiency. However, this was not the only reason for the changes.

Another reason was the change in the competitive situation in each country, including Ukraine. When the company entered the market, the competition was significantly weaker, and in addition the consumers were ready to spend more money, rather than to save. But this situation has undergone major changes in the last 4 years.

The third important issue, which affected the changes in strategy, is the change in customers' needs. Business companies and private entrepreneurs are the key clients of the company. The crisis hit them heavily. Consequently, from now it is not sufficient for Metro as for their supplier just to provide high-quality products at its shelves accurately in time. The clients now expect that Metro will support them in their business development in a partner role.

METRO Cash & Carry has used a comprehensive strategic approach to the change challenge. People & Culture were highlighted as key company priorities at a global level, and special investments were assigned to develop them.

*The reasons for the need to change the organizational culture*

The key principle of the company's culture also has been (and remains) the fact that METRO is a big family. "Now we test the strength of our family atmosphere," says Yulia Pilipenko. "First of all, the new business strategy has challenged us with the issue of effectiveness. How well do we invest in any group of customers? Where do we need to re-focus? How much do we invest in our staff? Are our managers able to analyze the situation and make a decision? All this is again on the agenda. And it is not about how many hours you work. It's *what* you do and *how* you do it. This is the question. How do you work with suppliers? How do you work with your clients and with your colleagues? There are some things that can't be written in the job description. They all are connected to the soft competences, which, of course, are the hardest to measure, but they do significantly affect the results: the decision is wrong, time for contract is wrong, agreement's details are wrong. It all keeps adding to the result, which affects the sales.

*HR issues of current importance*

Facing the challenge of developing a new human resources strategy, you must understand your strengths and weaknesses in terms of HR management, to identify the current problems. The information on the findings of the Personnel Director of METRO Cash & Carry Ukraine, according to the results of her analysis of the current situation, is provided below:

1. There is the need to work towards the development of the company's image on the market both among customers and among potential employees. Such a conclusion was made with the help of the project of inviting university graduates for internship. It is called "Metro Leaders", and was started in 2011. After meeting with the students, HR professionals found that students do not know what opportunities METRO Cash & Carry might give them as an employer. Meanwhile, the company has a lot of advantages like clear rules for cooperation and compensation, good working conditions, the ability to gain international experience, the ability to grow quickly and increase your market value, the ability to have a career, etc.

2. The next problem can be formulated by a short quote. "When people are working in the Kyiv office, they feel that they have God's beard caught". Required changes directed to build an effective managing office, which would be oriented on *full assistance to the trade centers*. To emphasize this mission, the managing office was renamed the Store Support office. This change was followed by practical changes in the system of people management, together with using appropriate communication forms, aimed at achieving this mission.
3. Another focus of HR service aims to the changes in work with the talent pool. It should be said that the company has a system for the selection and development of employees with high potential. This system is aimed, first of all, at the training for the position of junior and middle management and is built on a global level.

At the same time new emphasis on effectiveness makes company management pay more attention to the staff of trade centers, improve the results of the evaluation and select and retain the most effective employees of the chain. "Some will remember that it was so good in the good old days with fixed compensations, and now it's too hard to live. But you will find a different opinion from those who are not ready to just stay in one place, who want to grow, who are ambitious, who want to be noticed, who want to be invested in, who want to build a career," the Personnel Director describes the situation. However, the company is interested in raising future representative office employees among those talented people who have been through the work in the trade center and have a deep understanding of the company business.

## TASKS

1. Determine the emphases that the new business strategy and the existing situation poses for HR function of METRO Cash & Carry Ukraine.
2. Form and submit the HR strategy of METRO Cash & Carry Ukraine for the period of 2013 - 2014 in the context of its key areas and strategic initiatives.

## TEACHING NOTES

### *Purposes of the case study*

1. To study the reasons for the changes in HR strategy of the company

2. To study approaches to and methods of developing HR strategy with METRO Cash & Carry Ukraine as an example

*Target audience of the case study*

There could be entry- and mid-level HR managers, or non-HR middle managers that have the task of understanding the alignment of business strategy and HRM strategy in their companies.

*Additional facts*

Information on basic points of HR strategy of METRO Cash & Carry Ukraine and implemented strategic initiatives follows.

***Introduction of performance management:*** This refers to people development management, based on work results for managers at all levels, as well as for non-managerial staff. The criteria for measuring employees' performance are key performance indicators (KPIs) and project goals. KPIs are divided into two groups. The first includes functional indicators that measure the quality of business processes. They are designed by a business unit which is responsible for the relevant processes. For example, the HR department develops indicators, which are then approved by the Board of Directors and which measure the results of the HR function. Other KPIs are financial performance indicators, reflecting the results of every department. These indicators are developed by financial control department. Each function has a list that contains both groups of factors, and this list is used to evaluate the performance of this function. Thus, the principle of "four eyes" is realized, which means self-control and performance control of the adjacent units for performance.

The reporting period for the result measuring is the year. The performance review is held semi-annually, and it looks like a discussion between a manager and his subordinate on interim results of KPIs and project goals. Performance management results are the basis for decision about employees' rotation and promotion.

***Compensation policy:*** The taken course on performance evaluation is reflected in the compensation system. From wage-leveling the company switched to the principle of rewarding a contribution into the overall result. Thus, the level of earnings of employees occupying the same position will be different.

Compensation policy for the top management remains the prerogative of Düsseldorf.

***Identification of talents within the company and attraction of outside talents:*** Potential evaluation is used to identify talents. We measure potential with several tools:

- The first is performance results. It shows whether the employee achieves his goals.
- The second is an assessment of six key competences. It shows the way an employee achieves his goals and whether his business conduct complies with corporate culture of the company or not.
- The third is development centers. For a certain level of positions, competence development centers are on a local level, i.e., held by Ukrainian HR management on their own. Exercises for development centers are developed by a consulting company which METRO works with at the global level. HR managers were taught the methods of development centers in the same company.

Starting from second level positions, managers go through competence development centers in international scope. Exercises used in learning are rather complex, and regional business leaders from different countries observe. An important element of such development centers is a cross-national, cross-cultural atmosphere, which allows evaluating the potential not only in terms of national culture and the local market, but in the global, international context. This tool allows you to compare the Ukrainian talent with talent from other countries and see what is necessary to develop for the Ukrainians to be successful in this international company.

Other important elements of talent management are meetings of top management (usually held at the end of the first quarter). They are held to discuss the best employees according to evaluation results who are suggested to be included in talent pool by their leaders. Every leader sees his candidate from a functional point of view, and colleagues provide an opportunity to see the potential reservist with cross-functional perspective. The outcome of these meetings is a list of employees who are enrolled in the reserve, and the list of potentials, in whose development company is ready to invest.

In order to attract talent from outside the company, the graduate internship program “Metro Leaders” was re-started in the company. Its aim is to select talents among universities graduates. The first 10 graduates who went through this program were employed in 2012.

**Staff training and development:** In 2011, METRO Cash & Carry Ukraine launched a program of mid-level manager development (SMDP). The first group has already completed their training, and in early 2013 the second group will start studying. The program was developed and conducted by teachers of INSEAD. It is aimed at developing the skills of project management, change management, the formation of the ability to work in a changing

environment and understanding of international development prospects of the retail segment. The program aims to ensure that its members will have the effect of “open eyes” and will be able to compare themselves to others, to improve cross-functional cooperation, and to understand the mechanisms of business development.

Similar programs for developing talent will also be in the future training plans.

It should be noted that the company plans to actively use not just training, but also the accumulation of relevant experience for the development of the necessary competences of employees. This means that special attention for the development of the staff will be on their involvement in the tasks of the level of complexity and the scale, which implies the need to rise above their current level of competence.

*Development and changes of organizational culture:* The head office offered an innovative tool to carry out the transformation processes of the corporate culture. This tool was developed by Oxford Leadership Academy. It implies that in order to change the results of the team, you should start with changing yourself (Self-awareness leadership). “This tool allows you to understand what your values are, what kind of leader you are, what you are able to do, and, finally, what do you need to change in your work in connection with the new strategy of METRO,” says Yulia Pilipenko.

All employees of Metro Cash & Carry Ukraine will study in this program in 2013.

*Commercialization of the HR function:* The meaning of this strategic project is that all the decisions taken in the field of HR would be based on business perspectives and on the efficiency calculation. This approach allows focusing on the implementation of solutions that are meeting business needs and are cost-effective.

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**EMPIRICAL STUDY FINDINGS OF FOREIGN LANGUAGE  
ADAPTATION OF THE INDIAN BUSINESS PROCESSING  
AGENTS AND EFFECTIVE COMMUNICATION AT A  
TRANSNATIONAL WORK PLACE**

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**ABSTRACT**

The proposed study focuses on two important aspects of foreign language adaptation namely; the relationship between adaptation of foreign language ( English) and its impact on the job effectiveness of the Indian Business Process Outsourcing agents. Also the study explores the relationship of age and adaptation of a new foreign language. The theoretical framework of the paper is based on the model suggested by Y. Kim's (1988, 2001). According to Kim (1988), Cross-cultural adaptation starts with communication, proceeds in and through communication, and is revealed in host communication competence, especially language competence.

The present study is part of a doctoral thesis, and reports its findings with respect to foreign language adaptation in a transnational workplace, the Indian Business Process Outsourcing Industry. It uses survey method and administers a structured questionnaire to more than 3000 BPO agents who have 2 years work experience. The analysis uses techniques like factor analysis and one way ANOVA to test the two hypotheses.

As regards the first hypothesis, language adaptation is important for effective communication. Thus the step to communication especially in a cross cultural environment, India scores well on this score. However a contradictory relationship is observed with respect to language adaptation and age. Thus the empirical data does not justify the hypothesis that, language adaptation is better at a younger age.

One of the policy implications of this study is that NASSCOM has funded new English language training schools to increase the supply of English speakers especially the "Queen's English".

**Keywords :** Business Process Outsourcing (BPO) agent , Language Adaptation, Effective Call.

## INTRODUCTION AND BACKGROUND OF THE STUDY

Acculturation is not a new area of study, scholars have studied and researched since the 1930s. (Herkovits et al; 1936) Although, communication, as an important construct of the study of acculturation is a new phenomenon, it has been a crucial point of acculturation research. (Gordon, 1964; Kim, 1988, 2001). Kim has contributed extensive research toward defining acculturation from a communication perspective. Kim has also emphasized the link between host country communication competence and adaptation of the sojourner. Kim (2001) emphasizes a stress-adaptation-growth dynamic model that features the cyclic tension of constantly moving forward and drawing back in adaptation growth. Her model features the concepts of deculturation, acculturation, and assimilation. She believed that assimilation in the host culture was the only path for the sojourner. Further, according to Kim (2003), knowledge of the host communication system is primarily knowledge of the language, but this includes not just linguistic knowledge of vocabulary, syntax and phonetics; but also knowledge of social codes and the way language is used in formal and informal settings. This study uses Kim's model (2001) as the Indian Business Process Outsourcing (BPO) agent is a unique case of adaptation, where he/she would be living in their home country, yet interacting with the host country's clients during their working hours, throughout the globe. Hence they need to be sensitive to cross cultural adaptation.

The proposed study focuses on two important aspects of foreign language adaptation.

1. Relationship between adaptation of foreign language (English) and its impact on the job effectiveness of the Indian Business Process Outsourcing agents.
2. Relationship of age and adaptation of a new foreign language.

## **LITERATURE REVIEW ON FOREIGN LANGUAGE ADAPTATION AND ITS IMPACT ON JOB EFFECTIVENESS OF THE INDIAN BUSINESS PROCESS OUTSOURCING AGENT**

Rapid developments in the Indian Economy post liberalization in 1991 have prompted Institutions like the World Bank to forecast that India would be the 4<sup>th</sup> largest Economy in the World by 2020( Budhwar, 2009). This has attracted a large numbers of foreign investors and companies to, India, after globalization. According to Budhwar and Sparrow (2002a), the trend of internationalization of business, globalization have all resulted in the growth of new markets and increased competition amongst firms at both national and international level. As such, in the present globalized era, the value of employees with cross-cultural skills and diverse demographic characteristics has increased. In order to maximize cross-cultural capabilities, language adaptation plays a pivotal role. Thus cross-cultural successes and failures depend on the communication processes in which the participants engage. Though not, much empirical evidence is available on the impact of cross-cultural literacy on the cost of doing business in foreign markets, it is fair to assume that cross-cultural literacy reduces the total costs of operating in foreign markets. ( Arora, 1980).

The present study is focused on language adaptation as one of the aspects of cross cultural adaptation of the BPO Agents of India. Pal and Buzanell (2008) comment that, Business Process Outsourcing are unique workplaces as they work for multiple geographical spaces and different time zones. According to Pal and Buzanell (2008), a BPO agent works in transnational work place in a 24\*7\* 365schedule. A BPO agent,in India, has an anglicized names and feigned western accents, and handles credit card problems and troubleshooting computers, collect debts and conduct customer satisfaction surveys. Pal and Buzanell (2008) further comment that, Indian call center work involves employees' providing voice-to-voice service to clients dialing toll-free numbers primarily in North America, UK and Europe.

The Indian BPO Agent has to learn the American or the European accent, as the client demands, work at night to cater to U.S./ Europe time zones, and adjust to an altered social and family life. The Indian BPO Agent is expected to be conversant with day-to-day American and European issues to the extent that they are able to carry on casual conversations with clients (Mirchandani, 2004; Shome, 2006). Further according to Balatchandirane, (2004), the foreign communication system indicator concerns the ability of BPO agent to identify properly and realize messages from the foreign client environment in different situations of interactions. This vocal and non- vocal communication cannot be fully understood as the non

verbal aspect of the communication is missing. This aspect of BPO communication with their clients is a challenging task.(Balatchandirane, 2004). The study thus empirical tests the relationship between foreign language adaptation (English) of the Indian BPO agent and their success at the workplace.

As regards India, it is a multicultural society, which has cultural diversity and influences of many regions/ cultural background and hence Indians are very good at adapting least two to three regional languages during their formative years of education. (Kohli, 1990). Linguistically India is a diverse country and it is home of some hundred languages and dialects and, , eighteen languages have been “officially” recognised and placed under the Eighth Schedule of the Indian Constitution. ( Pandharipande, 2002).

## **REVIEW ON FOREIGN ( SECOND) LANGUAGE ADAPTATION**

From the literature review on the subject of second language adaptation , there are many theories which are debatable. Badea ( 2001) cites, that there is a difference between second language acquisition and second language learning. According to Stephen Krashen, “Second language acquisition is the process by which children unconsciously acquire their native language, while learning stands for the “conscious knowledge of a second language, knowing the rules, being aware of them and being able to talk about them” (Krashen, 1982.page 69). Also, Vygotsky (1987) held that second language acquisition, is mediated by the learner’s first language and that to learn a second language at school and to develop one’s first language or mother tongue, involve two entirely different processes.

Vygotsky (1987) further states, that in learning a new language, one does not return to the immediate world of objects and does not repeat past linguistic developments, but uses instead the native language as a mediator between the world of objects and the new language. Vygotsky (1987) also argue, that, the conscious and intentional learning of a second language is dependent on a certain level of development in the native language; the process of learning a foreign language clears the path for the acquisition of higher forms of the native language; and learning a foreign language allows the child to understand his native language as a single instantiation of a linguistic system, as a result of which the child acquires a potential for generalizing the phenomena of his native language and for gaining conscious awareness of his speech operations and mastering them.

Moreover, Pecenek (2010), state, that there are many factors which impact the child's second language acquisition, which includes, age and, as a consequence, cognitive development, length and quality of the exposure time period, to the second language and the culture; attitude of the parents and linguistic- cultural environment .A theory developed by Krashen (1982), states, that in second language learning the principles of the UG (Universal Grammar) count only during the critical period, after which other learning mechanisms, not specific to first language acquisition, operate in the process of second language learning. Badea ( 2001), suggest, that, children acquire their native language without explicit learning, while for second language is usually learnt, though it may also be acquired or 'picked up' depending on the environmental setting and the input received by then second language learner.

Badea ( 2001), claims, that, initially, children use an internal linguistic guide towards any possible external linguistic information in the form of an inner template called Universal Grammar that "comprises all universal linguistic principles that pertain to all grammars and the way in which these are related" (Chomsky 1986: 56). Universal Grammar is also said to form the basis of all specific grammars of all possible human languages. There is a relationship of age, to second language acquisition. Age as an affective factor brings about different performance stages in second as well as first language learning. Traditionally, research in Critical Period Hypothesis and other variables has derived two major aspects of language learning--the younger, the better and the older, the better. Earlier, Studies (Snow and Hoefnagel-Hohle, 1982), have shown that adolescents and adults are in many ways better at learning a new language than children, except in the area of pronunciation. This is probably because, they are already literate in their first language and can use some of their knowledge about language and language learning when learning the second language. However, this doesn't answer the important question: What's the best age to learn a new language? This question, like most about language learning, cannot be answered so simply. It depends on the situation. In the paper titled , Critical period for language acquisition the authors (Snow and Hoefnagel-Hohle, 1982, pp 22 ) state that " For example, a child who is born to an American father and German mother living in the USA can start to learn both German and English from the moment he is born." This is probably the most favorable situation for anyone who wishes to speak two languages fluently as an adult. A child of school age who immigrates to the USA has no choice, and must start to learn the new language, English, as soon as he/ she arrives.

The words second language adaptation happens only after it is consciously learnt. In this paper, thus second or foreign language (English) has to be learnt and then after some practice would be adapted.

As per the educational policy of Indian states, most of the Indian at primary and secondary school study three languages of which one is the regional language (may or may not be their mother tongue), Hindi – the national language and English. (NASSCOM McKinsey Report, 2005). As language is the first step to effective communication especially in a cross cultural environment, India scores well on this score. As per the NASSCOM McKinsey Report (2005), India's English speaking manpower rates high in qualifications, capabilities, quality of work and work ethic. According to the norms of the BPO Industry in India, IELTS or equivalent score of 7.0 is an entry level qualification for a BPO Agent in India. (Merritrac Report, Oct 2007). Thus Indians are better adapting at learning more than one language in their formative years.

## **RESEARCH METHODOLOGY**

Kraemer (1991) identified three distinguishing characteristics of survey research. First, survey research is used to quantitatively describe specific aspects of a given population. These aspects often involve examining the relationships among variables. Second, the data required for survey research are collected from people and are, therefore, subjective. Finally, survey research uses a selected portion of the population from which the findings can later be generalized back to the population. The present study, uses a positivist philosophy and survey as a tool for examining the relationship between acquisition of foreign language adaptation and effectiveness at work place. This survey is a part of doctoral thesis, for which, the respondents were Indian BPO Agents, who had at least 2 years of work experience in the industry. Before launching a pilot survey, observations of the BPO firms visited were documented. One of these aspects was of training given to the newly recruited BPO agent, whose training included neutral voice training, English grammar and other soft skills training, computer assisted language learning (CALL). The foreign language adaptation questions of the structured questionnaire were aimed at identifying the communication competence of the BPO agent. It would also assess the BPO agent's ability to identify properly and realize messages from the foreign client environment in different situations of interaction. (Balatchandirane, 2004).

The structured questionnaire which was administered to the BPO agents in India, was initially pilot studied, questionnaire redrafted which was suggested by the HR executives of the Indian BPO firms and when internal and statistically validated and vetted by the supervisory team at Leeds Metropolitan University, the data collection work was undertaken. The questionnaire covered four aspects of cross cultural adaptation, namely – language adaptation, cultural adaptation, life style adaptation and value adaptation of the Indian BPO agents. In this paper, the empirical findings of foreign language (English) adaptation are presented.

A Total number of 3041 BPO agents answered the structured questionnaire which was administered to them , during their coffee breaks. This survey was quite voluminous and was carried out from November 2009 to May 2010. The sampling technique used was convenience sampling. The present study empirically tested two hypotheses with respect to language adaptation of the BPO Agents in India.

The two hypotheses for language adaptation of the Indian BPO agent are :

**(H<sub>0</sub>):** *Language adaptation is not an important factor for effective communication with the host country's clients for a BPO Agent.*

**(H<sub>0</sub>) :** *There is no significant difference in Language Adaptation and Age.*

Thus in the present study the first hypothesis is about establishing or negating a relationship between English, a foreign language and its adaptation, as a tool for effective communication at the transnational workplace. The second hypothesis is about the relationship between age of the BPO agent and foreign language adaptation. The entry level qualification for a BPO Agent is class 12<sup>th</sup> pass which is equivalent to Grade X. Also the entry level qualification is passing a test of English similar to IELTS where the minimum acceptable score is 7.0 ( Merit Trac Report, 2007) .

**STATISTICAL ANALYSIS : RESULTS AND INTERPRETATION**

	Frequency	Percent	Valid Percent	Cumulative Percent
1 Low Adaptation	954	31.3	31.3	31.3
2 Good Adaptation	1346	44.2	44.2	75.5
3 High Adaptation	747	24.5	24.5	100.0
Total	3047	100.0	100.0	

*Language Adaptation of the BPO Agents – Frequency Table*

From the above frequency distribution table, the study concludes, that the language adaptation of the BPO Agents to English as a foreign language is good. From the literature on second language acquisition, it is observed, that, for successful entry and continuous growth in a foreign market, effective communication with the unfamiliar business partner and adaptation to his culture is important. Globalization requires cross-cultural literacy, and successful management of diversity. ( Ang, 2008).

**TESTING OF HYPOTHESIS I, THROUGH FACTOR ANALYSIS.**

	N	Minimum	Maximum	Mean	Std. Deviation
q12	3096	1	2	1.71	.453
q18n	3096	1	5	3.71	1.372
q18o	3097	1	5	2.77	1.388
Valid N (list wise)	3054				

*Descriptive Statistics Table*

Question no 12, was asked so as to know the medium of instruction in school, since the entry level qualification for a BPO agent is class XII th pass, in English medium the survey wanted to reiterate this general observation. Also, Q18 n, was, do you believe that language proficiency is important for effective communication at work place? The maximum response was very often. This is because while working in a BPO firm, the agents have a perception that communication would be possible only when they are able to have a command over this

foreign language. They spend more than 9 hours on the phone talking to, convincing and solving problems of the callers from across the globe; hence they believe that only when they are able to speak and understand English they would be effective at their workplace. As regards, Q18 o, was, do you speak English at home and with friends while communicating? The maximum response was often, thus the urban Indian BPO agent speaks English at home and with their friends while communicating, this also helps him/her to be at ease with a foreign language.

	Component
	1
Q12	.355
Q18n	.654
Q18o	.731

Component Matrix

Extraction Method: Principal Component Analysis. a 1 components extracted.

The Component Matrix gives a table which contains component loadings, which are the correlations between the variable and the component. Because these are correlations, possible values range from -1 to +1. According to this table, the Principal Component I is loaded with Questions 18 o, 18 n and 12, and all are positively correlated. Thus the 2 most important questions which were important from language adaptation from the survey were :

Question 18 (n) Do you believe language proficiency is important for effective communication? There is a positive relationship between effective communication and English language proficiency. The Indian BPO Agents believe that communication would be possible when they have proficiency in English and be effective in a transnational workplace. Question 18 (o) Speak the language that is taught for business purpose with family and /or with close Friends? There is also a positive relationship between speaking the foreign language English with family and friends. This would further strengthen the language adaptation and they would be more comfortable while interacting with the host country's clients/customers. Also the empirical data analysis, supports, the hypothesis, that, language adaptation is an important factor for effective communication with the host country's clients.

Thus the null hypothesis, (**H<sub>0</sub>**): *Language adaptation is not an important factor for effective communication with the host country's clients for a BPO Agent*, is rejected.

Testing of Hypothesis II by using ANOVA

ANOVA						
		Sum of Squares	df	Mean Square	F	Sig.
(n) Do you believe language proficiency is important for effective communication	Between Groups	22.303	2	11.151	6.043	.002
	Within Groups	5613.075	3042	1.845		
	Total	5635.378	3044			
(o) Speak the language that is taught for business purpose with family and / or with close friends	Between Groups	16.963	2	8.481	4.405	.012
	Within Groups	5858.855	3043	1.925		
	Total	5875.818	3045			

ANOVA Table for Language Adaptation

Multiple Comparisons							
Games-Howell							
Dependent Variable	(I) Age Group	(J) Age Group	Mean Difference (I-J)	Std. Error	Sig.	95% Confidence Interval	
						Lower Bound	Upper Bound
(n) Do you believe language proficiency is important for effective communication	18 - 24	25-30	-.095	.051	.155	-.22	.03
		> 30	-.318*	.094	.002	-.54	-.10
	25-30	18 - 24	.095	.051	.155	-.03	.22
		> 30	-.224*	.095	.049	-.45	.00
	> 30	18 - 24	.318*	.094	.002	.10	.54
		25-30	.224*	.095	.049	.00	.45
(o) Speak the language that is taught for business purpose with family and /	18 - 24	25-30	.047	.052	.639	-.08	.17
		> 30	-.247*	.099	.034	-.48	-.01

or with close friends	25-30	18 – 24	-.047	.052	.639	-.17	.08
		> 30	-.294*	.100	.010	-.53	-.06
	> 30	18 – 24	.247*	.099	.034	.01	.48
		25-30	.294*	.100	.010	.06	.53
*. The mean difference is significant at the 0.05 level.							

## POST HOC TEST FOR LANGUAGE ADAPTATION

### INTERPRETATION OF THE RESULTS

The last column (Sig) is P-value. Since P is <0.05 for both the variables (n and o) there is a significant association between age and n as well as o.

Also the Post Hoc Test Table compares significance of difference between each pair of age groups. Since P (see Sig) is <0.05 for the pairs (18-24 and > 30) and (25-30 and > 30) the mean of these variables are significant in these two pairs of age groups. There is no significance of difference between ages 18-24 and 25-30 in 'n' as well as 'o'. There is a significant difference for Language Adaptation for Age  $\geq$  30 years. Thus the empirical observation, suggests that, Language Adaptation of English is higher at the Age group  $\geq$  30 years. Thus there is a significant difference between language adaptation and age. At a higher Age  $\geq$  30 years, the language adaptation is better. From, the empirical data analysis, it is evident, at a higher age, foreign language adaptation is better. Most of the literature on second language acquisition, supports learning second language at an early age.

### DISCUSSION

Thus the empirical data does not justify the hypothesis that, language adaptation is better at a younger age. While studying the effect of age on foreign language acquisition, one contradictory relationship which was observed in the present study, was that the language adaptation and proficiency was better at a higher age. Most of the literature review; the support is for learning second language at an early age. This can be traced to the development of English as a language. Before Independence and till liberalisation of the Indian economy, students studied English either as a first language or second language at school and were taught the "Queen's English". Their grammar, pronunciations, vocabulary and style all were

confirming to Standard English. Before 1990's the students in schools, studied "Queen's English" or Standard English. Further, the role of English within the complex multilingual society of India is far from straightforward: it is used across the country, by speakers with various degrees of proficiency; the grammar and phraseology may mimic that of the speaker's first language. After liberalization in 1990's though the students studied English language at school, and wrote formal English, they spoke in hinglish – which was assimilation of English and hindi (national This aspect is due to the prevalence of a new language in India called hinglish, which uses national language – hindi and English together. A mix of Hindi (the official national language of India) and English (an associate official language of India) that is spoken by upwards of 350 million people in urban areas of India, since 1990's or after liberalization. Hinglish uses English sounding phrases which can be spoken and understood by an average illiterate person in India. For instance, Pepsi's slogan 'Yeh Dil Maange More!' (The heart wants more!), a Hinglish version of its international "Ask for more!" campaign." This observation is evident from the study, where the more senior BPO Agents, whose age was above 30, had proficiency in English as a foreign language and had greater adaptation than the younger BPO Agents. This also reiterates, the findings of Merit Trac Report, 2007 where the new BPO agents had a average IELTS score of 7.0 and 7.5 where as it was equivalent to 8.0 for older BPO agents. ( Merit Trac Repor, 2007).

Thus we reject the second hypothesis that , there is no significant difference in language adaptation and age and conclude that there is a positive relationship between age and language adaptation. Thus in India, foreign language adaptation betters with age.

As regards the first hypothesis, Language adaptation is important for effective communication. Thus the step to communication especially in a cross cultural environment, India scores well on this score. As per the NASSCOM Mckinsey report (2005), India's English speaking manpower rates high in qualifications, capabilities, quality of work and work ethic. This places India ahead of competitors such as Singapore, Hong Kong, China, the Philippines, Mexico, Ireland, Australia and Holland, among others, each year; India graduates 220,000 software and computer science engineers. Bangalore, which is known as the Silicon Valley of India, produces 25,000 alone--almost as many as the entire U.S.A. Like the immigrants, the BPO Agents operating from India need to learn the communication patterns of the host environment,(acculturation), while some communication patterns acquired from their original culture have to be deleted "(deculturation). This process takes place by trial-and-error, where the BPO Agents gradually transform their personal communication patterns and achieves an increasing level of foreign country's communication competence.

## CONCLUSION AND RECOMMENDATIONS

India's graduates were 3.7 million, in 2010; of these, the Indian BPO Industry provides employment to 30% of the urban young Indian between the age group 18 – 25 years. (NASSCOM 2010). NASSCOM has introduced a national assessment tool to help identify new talent for the ITeS industry, and its creation of a National Skills Registry. NASSCOM funded a new English language training schools to increase the supply of English speakers (Sengupta 2006). One of the implications of this study for policy makers for Indian BPO Industry is to recommend NASSCOM to establish recognized training institutes, on lines of IELTS training centers and re-introduce "Queen's English" especially for the BPO agents.

As regards the limitations of the survey, it is limited to visits in the city of Mumbai (Bombay) where the researcher is currently residing and does not cover other cities of India and the analysis should be limited to the city of Mumbai (Bombay). As Mumbai (Bombay) is a financial capital of India, it is a "global city" and as such the culture, the lifestyles and values of these residents are different as compared to tier II and tier III towns on India. To make it more representative the study could have included some tier II and III towns which have many BPO firms.

## SUGGESTION FOR FUTURE RESEARCH

From a select group of BPO Agents, to whom accent neutralization training is given, a longitudinal study could be administered after three years to identify any patterns in the BPO Agent's foreign language adaptation through time.

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## MARKETING AND ORGANIZATIONAL LEARNING – EXPLORING THE CONNECTIONS

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### ABSTRACT

In marketing theory, the traditional transaction perspective has gradually been replaced by an interest in relationships as highlighted in the development of relationship marketing and the service dominant logic of marketing. While transaction marketing focuses on an objective level of marketing, relationship marketing focuses on the process between the object and the subject in terms of their relationship. However, the perspective of the subject, the marketers themselves, has long been absent. Development of the marketers as subjects should constitute a learning process in the marketing organization. Learning processes in organizations are studied in the field of organizational learning.

The purpose of this paper is to explore the connections between marketing and organizational learning. The paper is conceptual and based on a literature review of theories of marketing history and development as well as organizational learning. It is found that there are important connections between the two fields and a tentative model combining them is proposed.

**Keywords:** Marketing, organizational learning, marketing history, marketing theory, relationship marketing, service dominant logic of marketing, self-actualization marketing

### INTRODUCTION AND PURPOSE

Marketing theory started to emerge around the turn of the last century (Bartels, 1976). During the first half of the century a number of different marketing schools emerged (Sheth et al., 1988). One common factor in these early schools were that they focused on transactions between supplier and customer. In the latter part of the century, theories following a different

strand of marketing thought began to appear. It started with services marketing and industrial marketing in the 1970s and 1980s (Parasuraman et al. 1984, Ford et al. ), followed by relationship marketing in the 1990s (Gummesson, 1999) and later in the early years of this century by the service dominant logic of marketing, SDL (Vargo & Lusch, 2004). One common feature of these new theories were that they were relational to their nature and focused on the relationships between supplier and customers as well as with other parties in, above or below the market (Lagrosen & Svensson, 2006). Svensson & Lagrosen (2009) argue that these groups of theories can be seen as existing on different conceptual levels regarding marketing which involves three entities: the subject (the marketer her-/himself), the process (the marketing process) and the object (the market). According to Svensson & Lagrosen, the early transactional theories focus on the objective level, the market while the later relational theories focus on the process level. However, they claim that the third level, the subject, the marketers themselves, have received insufficient attention. They have coined the term self-actualization marketing for this level and they suggest that the development of this level constitutes a learning process for the marketers. As such it should be connected to the related field of organizational learning in which profound learning in organizations is studied (Argyris, 1993). The purpose of this paper is to explore the connections between marketing and organizational learning. This connection has been studied by other scholars (e.g. Morgan, 2004) but never in the light of the levels of marketing proposed by Svensson & Lagrosen (2009). The rest of this paper will be structured as follows. First a very short overview of the history of marketing is presented followed by the model of marketing on three levels of profundity. Then, organizational learning is introduced and after that, its connections to the levels of marketing are explored. On this basis, a model depicting the connections is proposed and finally conclusions round of the paper.

## **A BRIEF HISTORY OF MARKETING THOUGHT**

The early marketing theories had their roots in the subject of economics. The main difference was that the early marketing thought was more empirical, practical and descriptive. Only in the 1930s did marketing thought attain a more scientific level (Bartels, 1976). The focus of these early theories was restricted to marketing of physical goods (Engwall, 1992).

In education, courses in 'distributive industries' were created in 1902 and although they did not use the term marketing, they included many of the aspects that later came to be incorporated in the marketing field (Bartels, 1976). In 1905, the University of Pennsylvania

offered a course on 'the marketing of products' which is the first known example of marketing being included in a course title. The first comprehensive textbook in the subject was published in 1910 (Bartels, 1976).

The further development of the marketing discipline came to take place in the form of a number of different schools which originally were economic and non-interactive in their scope but later evolved into non-economic and/or interactive territory (Sheth et al., 1988). They focused on transactions and classifications of products seen from different perspectives (e.g. Copeland, 1923; Rhoades, 1927).

Later in the century, one school, the managerial school, came to dominate marketing thought (Sheth et al., 1988). This school was successful in co-opting fragments from other theories and structuring them into a practical framework for marketing management. As it focused on consumer products, marketing in general mainly became concerned with consumer markets (Engwall, 1992).

In the latter part of the century novel theories appeared which challenged the previous transaction-based marketing dominance. The first, which had been looking at marketing in industrial markets, and the second which had discovered the importance of services, both started investigating the peculiarities of their fields. One aspect that is common to these two lines of development is the significance of relationships. This has led to the emergence of theories regarding relationship marketing. Their proponents claim that they constitute a new paradigm of marketing utterly different from previous marketing theories, and incompatible with traditional marketing theory (Gummesson, 1999; O'Malley and Tynan, 2000).

Unlike many of the previous areas of marketing that almost completely developed in the U.S., service marketing is international marketing field. Grönroos (1990) argues that the original three schools of services marketing appeared in the form of one American, one French and one Scandinavian strand. At the beginning of service marketing, much time was devoted to explain and justify the differences between the marketing of services and products as the very legitimacy of the field was questioned (Brown et al., 1994). Initially, the characteristics of services as intangible, heterogeneous, inseparable and perishable crystallized as the most important factors (Gummesson, 1991). As the field of marketing has matured, this former relative consensus becomes more and more challenged by authors who claim that other factors such as the transfer of ownership is the real dividing factor (Lovelock and Gummesson, 2004).

Industrial marketing has always received less attention than consumer marketing, perhaps because it was considered less prestigious (Egan, 2001). In addition, it was considered rather straightforward. Research, in particular by the IMP group, highlighted the intricacies of marketing and has become an area of active research (Ford et al. 1998).

The interaction approach implies that customers and suppliers are considered active partners who seek, select, develop, manage and evaluate their relationship. This means that handling relationships is companies' main task (Ford et al., 1998). This approach also shows the importance of business relationships in the broader context of business networks. In a network the role and form of marketing has become ambiguous as all interactions have implications for marketing (Grönroos, 1994). In addition, these interactions take place at different levels and with so many people involved that they cannot be controlled in detail by senior management (Gummesson, 1999). In the network the "focal company" is studied in the context of its relations with, for example, customers, suppliers, distributors, competitors, co-operators (Ford et al., 1998).

Relationship marketing has been developed, particularly in the context of services marketing and industrial marketing. In addition, it has been influenced by traditional marketing and total quality management (Gummesson, 1999). In its early stages, relationship marketing has been seen as exclusively concerning services and business to business, but more recently it has made its entry into the consumer marketing (O'Malley and Tynan, 2000).

According to Brown et al. (1994), the advent of relationship marketing has led to a definite shift away from traditional marketing approaches. It came largely as a response to problems encountered in traditional marketing (Egan, 2001). As such, it has come to alleviate some of the recent criticisms against marketing (Schipper, 2002).

Since trust is an important part of any relationship, it has become an important concept in relationship marketing theory. Trust has the ability to reduce the risk (Selnes, 1998). Trust also means that business partners dare cooperate more closely, think more long term and become less sensitive to risk in the fear of opportunistic behavior by business partner decreases (Morgan and Hunt, 1994). Trust is also related to knowledge (Politis, 2003). The more knowledge the parties have about each other the easier it is to establish trust.

Recently, a strand of thought called the service dominant logic of marketing, SDL, has begun to challenge traditional marketing theories. The argument goes that this is not only a way of marketing services but a new way of regarding all marketing based on the value provided to

customers (Lusch and Vargo, 2006). Proponents of the service dominated logic argue that this is a completely new paradigm in marketing thinking that will replace the traditional goods dominant logic in the same way as the traditional physics has been revolutionized by the development of quantum physics (Vargo & Lusch, 2004). As SDL is relational, it can be seen as the logical continuation of relationship marketing.

## **LEVELS OF MARKETING KNOWLEDGE**

In every activity there must be a subject, an object and a process connecting them. Thus, Svensson and Lagrosen (2009) argue that the traditional, transactional marketing theories are mainly connected to the object, the market, while the relational theories are concerned with the marketing process. Moreover, they claim that the third level, the subject, i.e. the marketers themselves are not treated in marketing literature and they propose a new strand of marketing thought, self-actualization marketing. They propose that developing this field should be connected to learning. Finally, they also depict the above marketing theories as existing on different levels where the objective level is most expressed and gross while the subjective is most subtle and profound.

Figure 1. illustrates this discussion of viewing marketing knowledge as one divided into three levels. The implications are relevant for the debate between traditional transaction-based marketing and relationship marketing. Svensson and Lagrosen (2009) contend that these approaches are not contradictory, but complementary. The question is not whether marketers and companies should pursue transaction marketing or relationship marketing. Successful marketers and companies need to do both. The merit of the theories in relationship marketing is that they open up a different level of understanding of marketing knowledge.

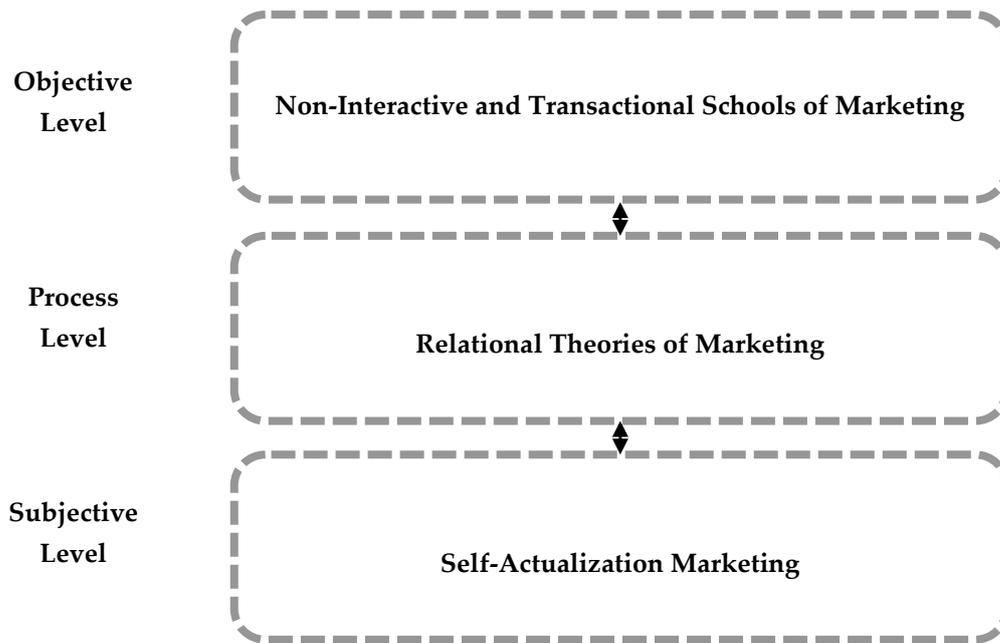


Figure 1: Levels of Marketing Knowledge (Svensson and Lagrosen, 2009)

## ORGANIZATIONAL LEARNING

Organizational learning is a theory that has been created in order to encourage more long-term success in organizations. It can thus be seen as a counterweight to the short-term thinking which unfortunately dominate today's business world. An important part of organizational learning is learning of leaders. This is related to their emotional intelligence (Goleman et al., 2002; Grewal and Salovey, 2005). The emotional intelligence concerns the extent of your own emotions you have access to and how to relate to others on an emotional level. It has been shown that leaders can learn more efficiently and smoothly if they have a high emotional self-awareness, which is a dimension of emotional intelligence (Goleman et al., 2002).

In a somewhat similar way that Svensson & Lagrosen (2009) propose levels of marketing thought some scholars describe levels of organizational learning (Senge et al., 2005). The deeper levels of learning means that a greater understanding of a greater whole is achieved. If a genuine and profound learning is created in an organization, it will affect its fundamental values (Argyris, 1993; Argyris and Schön, 1996). This kind of profound learning is called *double-loop learning*. In contrast, *single-loop learning* merely leads to more superficial changes in behaviours and working practices, which means that it is less sustainable.

A learning organization is characterized by employees learning together in order to produce the results that they have a genuine desire for. Thus, new and more expansive patterns of thinking are created (Senge, 2006). For the organization to be able to absorb these new thought patterns it must, however, be permeated by trust (Senge et al., 2005). Often, attempts are made to change organizations through changes in the organizational structure, operation, technology, communications, etc. These changes can only be effective if they are related to changes in thinking and values among employees (Schneider et al., 1996).

Many researchers also argue that an organization is not an objective phenomenon. Instead, the organizations are social structures created by those who participate in them and regard them (Weick, 1979). From this perspective, organizational learning becomes even more important. It then becomes a means to create organizations. The actual organization and development of organizations is by learning. Learning requires trust. Lack of trust has been shown to inhibit in-depth learning (Argyris, 1993). It has also been shown that relationships that are characterized by trust in an organization means that the learning that takes place will be easier to practical use (Goleman et al., 2002).

The relationships in an organization are also affected largely by organizational culture (Bruhn, 2003). This in turn is related to national culture (Hofstede, 1997). Senge (2006) has formulated five disciplines of organizational learning:

1. Personal mastery. There are two aspects: First, constantly clarify what is important. Often we spend so much time manipulating the daily problems that our deeper purpose in life becomes obscured. Therefore, we must approach our lives as creative work directed toward higher ideals. Second, view reality more clearly. Many companies and individuals are living in a self-made web of illusions. Breaking out of this trap is a process of learning.
2. Mental models. Our behaviour is often unconsciously guided by deeply held internal images of the world around us. These images have a tendency to limit our thoughts and actions in areas that are familiar. Therefore clarifying these assumptions is a first step toward change. To achieve this, we need to slow down our thought processes; so that we can become aware of the mental models they are based.
3. Shared vision. A shared vision is a vision that people throughout the organization carry. With impressive power, it can be seen as a force in people's hearts. Archetypes, generic families of problems, focusing on which leads to more holistic changes than

focusing on specific problems can be used in this process (Gillies and Maliapen, 2008).

4. Team Learning. If the energies of the members of a team are aligned so that they work in the same direction, the result is extremely powerful. Usually, the individual members have different ambitions and priorities leading to a waste of energy. Adjusting the team requires dialogue and deep listening between members. It is a skill that can be developed through reflective practice.
5. Systems thinking. This is the discipline that carries the main argument according to Senge (2006). It is the discipline that integrates and provides the basis for the other four. This means that organizations should be regarded as open systems where all components interact with each other and with the environment. Consequently, systems thinking is the main basis for organizational learning. There is some interdependence between the five disciplines, and they must be seen as a system of interconnected relationships with links to external organizations (Bui and Baruch, 2010). Yet systems thinking is not a new feature in organization theory. It goes back at least to the original theories on a general systems theory of von Bertalanffy (1950). The benefits of Senge is that he has established systems thinking in terms of organizational learning, which should be particularly useful for the study of organizational change. The systems view can be used to identify system archetypes, generic families of problems, focusing on which leads to more holistic changes than focusing on specific problems (Gillies and Maliapen, 2008).

One thing that is often forgotten about knowledge is that much of it consists of so-called tacit knowledge (Polanyi, 1967). This is knowledge that exists among employees and that they do not normally express in words, and that may not even be expressed in words. Nonaka & Takeuchi (1995) have created a model for handling the transfer of knowledge between tacit and explicit forms. Four processes are included:

- Socialization refers to the transfer of tacit knowledge between people. This is largely related to the organizational culture and group processes. It is a process that involves a sharing of experiences and thereby creating tacit knowledge which may consist of common mental models or various practical skills.
- Externalisation is making tacit knowledge explicit. For this purpose, metaphors, analogies and models are useful. Often, even images are used, as tacit knowledge is usually difficult to express in words.

- Combination is the process which transmits explicit knowledge from one form to another. Typically, these are used for transforming various concepts into a more comprehensive system of knowledge. Within this framework traditional education also falls.
- Transferring explicit knowledge to tacit knowledge is called internalization. This is linked to organizational learning and "learning by doing".

## **COMBINING MARKETING AND ORGANIZATIONAL LEARNING**

Several researchers have tried to connect marketing theory with organizational learning and market-based organizational learning has become a concept, particularly in relation to market orientation (Morgan, 2004), It has been shown that organizational learning can be an aide in the gathering of marketing intelligence needed for excellent customer service (Lee, 2004). Furthermore, organizational learning can be a useful tool when trying to make sense of vast data materials in database marketing (Bell de Tienne and Thompson, 1996).

On the other hand, outsourcing marketing functions may lead to impaired organizational learning regarding marketing aspects (Park et al., 2011) as organizational learning may be a way of connecting marketing with quality management (Bond III and Fink, 2003)

as well as increasing the speed of new product development (Menon and Lukas, 2004).

Although many efforts have been made to combine marketing and organizational learning, none has utilized the model of different levels proposed by Svensson and Lagrosen (2009). Nevertheless, as this model also addresses more profound levels of organizational thought, it ought to be particularly useful in this context. Our efforts to combine them has resulted in the model in Figure 2.

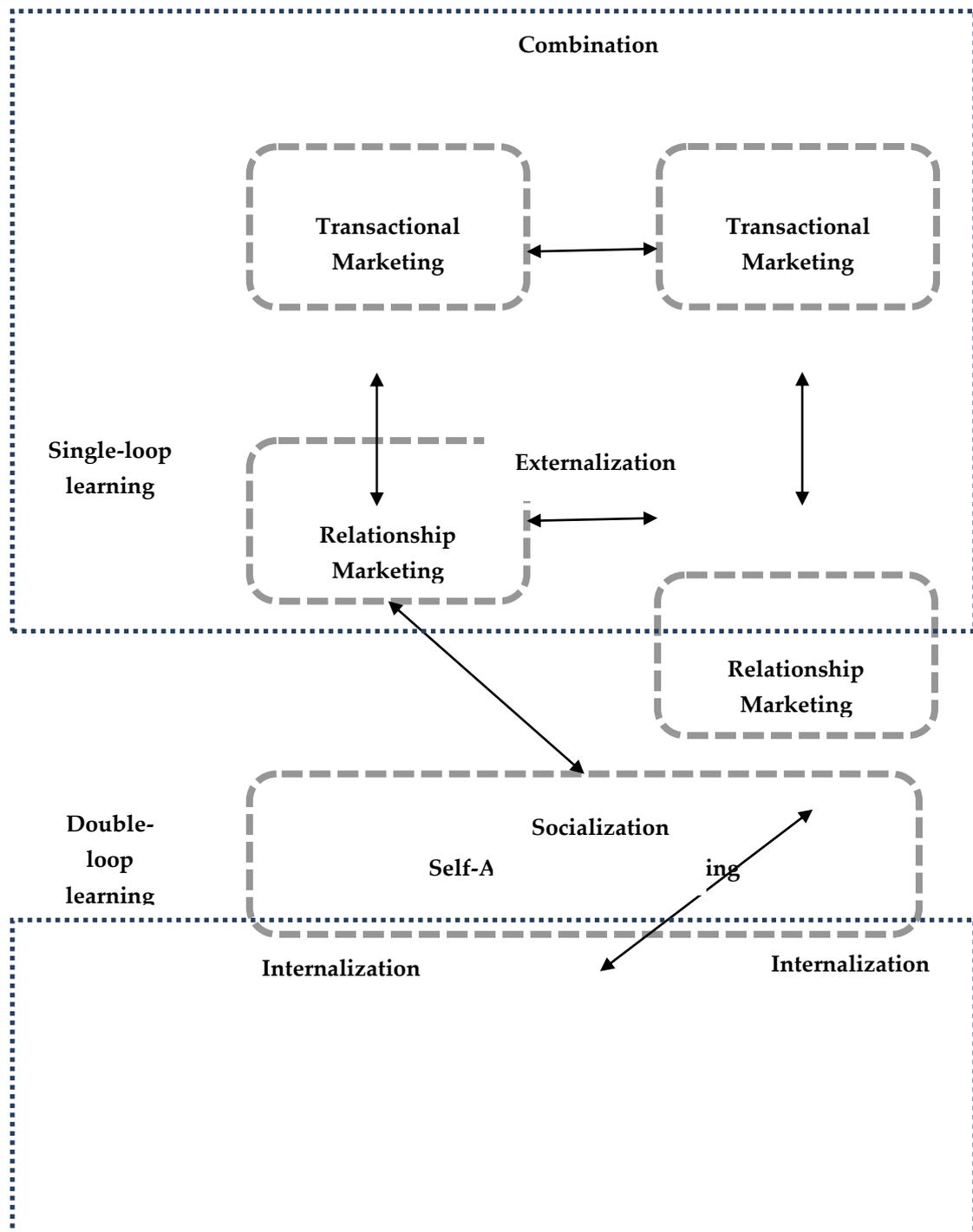


Figure 2. A proposed framework for study of the connections between marketing and organizational learning.

Regarding the combination with Nonaka and Taguechis (1995) framework of tacit knowledge, we make the following propositions. Transactional marketing mainly regards processes of combination as explicit and verbal or numerical arguments are used.

Relationship marketing occupies a key, middle, role in the model. Externalization of tacit knowledge as well as socialization are dependent on relationships between individuals in the marketing organization and its environment. Nonetheless, self-actualization marketing, which concerns our inner selves, is probably the only process in which internalization can occur.

Another aspect in the model is the connection to single and double loop learning. Transaction and relationship marketing concern learning on a more explicit level which may lead to changes in behaviours and activities. On the other hand, self-actualization marketing is related to our values, norms and inner assumptions. Thus, successfully carrying out self-actualization marketing requires profound level of the double loop kind.

## **CONCLUSIONS**

The conclusions of this paper are basically contained in the model in Figure 2. We have shown that there are important connections between marketing and organizational learning. Moreover, in the model, we have related them to profound models of both marketing and organizational learning. This model should be useful as a theoretical vantage point for empirical studies into the connection between marketing and learning. In addition, it ought to be helpful for marketing managers by providing insights into the deeper functioning of their marketing activities in a structured way.

## **MANAGERIAL IMPLICATIONS**

The conclusions of the paper should also be of interest for managers. The knowledge in the figure could bring additional understanding of the connection between learning and marketing which could aid managers in developing their long run marketing competence. When empirical research are carried out, the results should be of additional interest for managers.

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## THE ROLE OF CULTURAL AND SOCIAL NORMS ON INTRAPRENEURSHIP IN LITHUANIA

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### ABSTRACT.

The present article is to examine effects of social and cultural norms on intrapreneurship. The research question is: how social and cultural norms affect intrapreneurship. First of all concepts of entrepreneurship and intrapreneurship are defined relying on a rich interpretation within the scientific literature. The classification and definitions of terms lead to the presentation of such concepts as internal and external entrepreneurship, followed by a table of Intrapreneurship indexes. To understand better the phenomenon of intrapreneurship and how it works, authors identify main differences and similarities between entrepreneurs and intrapreneurs, and only then factors influencing intrapreneurial activities via cultural and social norms are scrutinized, leading to the model of relations between preconditions for intrapreneurship and its created results. The scientific literature analysis contributes to a better understanding of the current situation regarding intrapreneurship and entrepreneurship in Lithuania and is the first of the series of researches carried on in Lithuania. It is not possible to correlate the present research results with the previous studies; however, the paper will serve as a solid theoretical and scientific background for the further studies on entrepreneurship and intrapreneurship in Lithuania. Thus, having the Global Entrepreneurship Monitor (GEM) methodology presented, the publication is enriched by a solid data from GEM, Lithuania (2011) on effects of social and cultural norms on intrapreneurship. The article is terminated by designing the conceptual model of symbiosis between social and cultural norms and intrapreneurship, which could be used in preparing further entrepreneurship-related publications.

**Keywords:** Entrepreneurship, entrepreneur, intapreneurship, intrapreneur, national culture, social norms.

## INTRODUCTION

Cultural and social norms evolve in parallel with the accelerating globalization, which makes more difficult for organizations to adapt to the changing environment. Intrapreneurship is one of the main challenges for organizations, strongly related to the necessity for adaptation. The study of the role of cultural and social norms on intrapreneurship is important because *'Intrapreneurship plays a vital role in a country's economic growth and is critical to the economic development of both individual countries' and world trade. Intrapreneurship is not only associated with modern business ideals, it has evolved over time into a dynamic element of both developed and developing economies'* (Preez, 2005, p. 8).

Intrapreneurship is defined as entrepreneurship within an existing organization. (Sathe 2003; Thornberry 2002; Ferreira 2002; Scheepers 2009; Gautam 1997; Ulijn, Menzel 2004; Maier, Zenovia 2011; Antoncic 2007; Ahmad *et al.* 2011, 2012; Nicolaidis, Kosta 2011; Bosma *et al.* 2010; Cohen 2002; Möllers 2008). In the context of innovation, intrapreneurship is analyzed as a process that creates benefits for the organization (Seshadri, Tripathy 2006; Manimala *et al.* 2006; Mitchell 2007), highlighting the competitive advantage (Nicolaidis *et al.* 2011; Jarna, Kaisu 2005). Merrill *et al.* (2008), based on Manimala (2006), claim that one of the main barriers to intrapreneurship is the fact that organizations often block innovations, and this result leads to the failure of organizations (Merrill *et al.* 2008). However, in order to promote intrapreneurship it is necessary to create preconditions that can be defined as dimensions of the environmental, behavioural, organizational factors for potential intrapreneurs. (Karimi *et al.* 2011; Van Der Meer 2011; Alipour *et al.* 2011). These organizational and behavioural factors affect as key elements acting as a catalyst for intrapreneurship activities. Alipour *et al.* (2011), according to Kumar (2008), state that organizational culture is a vital element, which includes valuable opinions, belief, behaviour and norms, which influence the success of an organization. (Alipour *et al.* 2011). Menzel (2008, p. 59) based on Bloor & Dawson (1994) *'Not only national culture plays an important role for intrapreneurship, but also the influence of professional culture and its interaction with national culture. Professionals entering an organization bring in a large repertoire of cultural knowledge gained*

*not only from the wider society, but also from their professional training and previous work experience'.*

The scientific literature elucidates that cultural and social norms, formed in society, make an influence on the efficiency of intrapreneurship. This article is based on the GEM (Global Entrepreneurship Monitor) methodology and prepared with reference to the entrepreneurship study (2011). The study reviews factors that form an influence the intrapreneurship performance. The present paper looks at intrapreneurial processes from two perspectives. The first one analyses motives that help to encourage employees to involve in the intrapreneurial performance, and the second one analyses effects of cultural and social norms on the organizational efficiency, that act as a barrier or a catalyst for entrepreneurs in order to develop an intrapreneurship activity.

## **THE CONCEPT OF EXTERNAL AND INTERNAL ENTREPRENEURSHIP**

Relying on Thornberry (2003), Mitchell (2007) points out that entrepreneurship is '*a primary action*' or a catalyst, which is based on innovations and usually makes an effect on radical changes, setting up subsidiaries or creating new companies. This action is described as an '*external effect*', while the concept of intrapreneurship encompasses the entrepreneurial behaviour within the organization. Intrapreneurship can be understood as an '*internal effect*' which in the organizational environment is seen as a set of required skills. In addition, the corporate entrepreneurship (Sathe 2003; Thornberry 2002; Ferreira 2002; Scheepers 2009), internal corporate entrepreneurship (Gautam 1997), internal entrepreneurship, intrapreneurship (Ulijn, Menzel 2004; Maier, Zenovia 2011; Antoncic 2007; Ahmad *et al.* 2011, 2012; Nicolaidis, Kosta 2011; Bosma *et al.* 2010) and (internal) corporate venturing (Cohen *et al.* 2002; Möllers 2008) are similar concepts of entrepreneurship within the organization.

Hill (2003), based on De Coning (1992) emphasizes that in the today's business world the term of intrapreneurship is becoming the key element in defining capabilities of organizations in the pursuance of some activities, emphasizing new and innovative services or products. Intrapreneurship can include non-profit organizations, corporations, hospitals, schools and universities. It should be noted that the way to a successful intrapreneurship is not only hazardous, but also hard. Developing the spirit of intrapreneurship in the organization covers exchanges of organizational culture through setting goals, feedback systems and implementation of results-oriented reward systems. Seshadri, Tripathy (2006, p. 20) note that '*Cost reduction and/or improved customer focus tend to be the primary objectives of*

*innovation and intrapreneurship. At the level of an individual intrapreneur, the trigger for innovation could emanate from the desire to challenge oneself beyond the obvious. Intrapreneurs seeking to reinvent a company in order to increase efficiency may do so by removing 'unproductive layers' of bureaucratic hierarchy, harnessing the power of technology, proper delegation of authority and power or find other ways to improve efficiency and effectiveness'.*

According to Mitchell (2007), promotion of intrapreneurship in the organization is the essential factor in both large and small organizations, despite the fact whether it is a newly established company or not. While highlighting one of the key advantages of intrapreneurship a competitive advantage for the organizations while creating innovations should be underlined. The author claims that organizations tending to promote intrapreneurship should set up systems in order to encourage, facilitate and support processes of intrapreneurship and create opportunities for the development of intrapreneurs' skills. Referring to Alipour *et al.* (2011) and Mitchell's ideas (2007) can supplement that the aim of intrapreneurship is to create a new company within organization, creating the added-value for the economy and improving the organizational performance. Thus, intrapreneurship is as a vital element of economic and organizational growth generating competitive advantages (Nicolaidis, Kosta 2011). *'Intrapreneurship acts as a path to pervasive innovation and is a driver to make business diversify and remain aggressive. When uncertainty and risk from the environment are the major threats for entrepreneurs, for intrapreneurs they can be advantages'* (Ping-Yi, Huai-Zhi, 2009, p. 150).

It emphasizes that enterprises have to find a way to measure the level of intrapreneurship and to promote it accordingly (Dejardin 2000). Hill (2000) states that intrapreneurship can be measured using the following six indexes such as Task Innovation, Intrapreneurial Employees, Structural Flexibility, Incentive Policies, Intrapreneurial Leadership and Intrapreneurial Culture Indexes (Annex 1).

Alipour *et al.* (2011) claim that intrapreneurship associates with the organizational perfection and the need to assess the intrapreneurship, which depends on the individuals' work and their personal characteristics, organizational structure, policies, leadership and culture. These factors act as barriers or catalysts to intrapreneurship processes. Hill (2003) introduces the construct of all indexes which help to measure a level of intrapreneurship. The construct of task indexes means that *'a successful organization demonstrates a high rate of introductions of new products, services and innovations or different ways of tackling problems at the individual and organizational level, in terms of the identification, development and exploitation of new opportunities'* (Hill 2003, p. 56). The intrapreneurial employee index analyses the number of

intrapreneurial employees who are innovative individuals and have the willingness to embrace new opportunities. The organizational structure encompasses an enterprise which tries to achieve an appropriate level of hierarchy within an organization. An advantageous organizational policy means *'an organization that offers employees opportunities, the encouragement, motivation, and incentives to experiment with new ideas without having the fear of being punished as a result of possible failure. The organizational leadership refers to the environment, is visionary and flexible, encourages the teamwork, and an intrapreneurial philosophy'* (Hill 2003, p. 56). Hill (2003) claims that the culture in the organization acts via the interdependence, low power distance, low uncertainty avoidance.

Thus, intrapreneurship and entrepreneurship are important factors because they act as factors driving the organization and economy. For this reason, it is necessary to understand the differences between the entrepreneur and intrapreneur in the context of entrepreneurship and intrapreneurship (Figure 1).

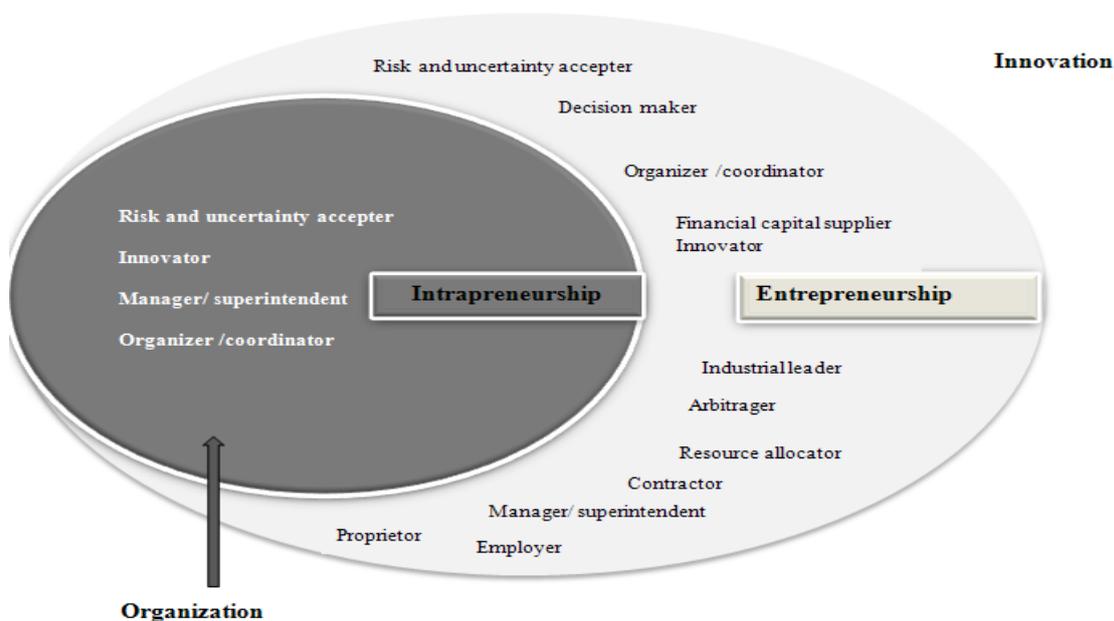


Figure 19. Differences between entrepreneurs and intrapreneurs in the context of entrepreneurship and intrapreneurship

Source: prepared by authors, based on: Ping-Yi, C., Huai-Zhi, S., 2009, p. 153.

Assessing characteristics of entrepreneurs and intrapreneurs four features out of twelve are the same as risk and uncertainty acceptor, innovator, organizer/coordinator and manager/superintendent. Maier, Zenovia (2011, p. 974), referring to Antoncic & Hisrich (2003), indicate *'that while intrapreneurs make risky decisions by using resources of a company, entrepreneurs make risky decisions using their own resources'*. Based on Antoncic's and Hisrich's (2003) and Davis' (1999) arguments, ensured that *'entrepreneurs prefer to develop a tacit*

knowledge in new organizations, instead of using procedures and mechanisms from other companies. On the other hand, intrapreneurs work in organizations that have their own policies, procedures, and bureaucracy' (Maier, Zenovia 2011, p. 974). In addition to this difference, Dejardin (2000), based on the Schumpeter's (1942) tradition, suggests that both entrepreneurs and intrapreneurs make 'a creative destruction' influencing businesses and economies.

## FACTORS INFLUENCING INTRAPRENEURIAL ACTIVITIES VIA CULTURAL AND SOCIAL NORMS

The benefits of intrapreneurship can be defined as the organization's growth and macroeconomic evolution (Merrill *et al.* 2008). Within the organization there are three dimensions encompassing intrapreneurship activities via the organizational, behavioural, and environmental factors, whose level can depend on cultural and social norms. As a result, such benefits of intrapreneurship as a new corporate strategy, satisfaction levels, new markets, profitability, increased competitiveness, new products and a new inner process can be formed.

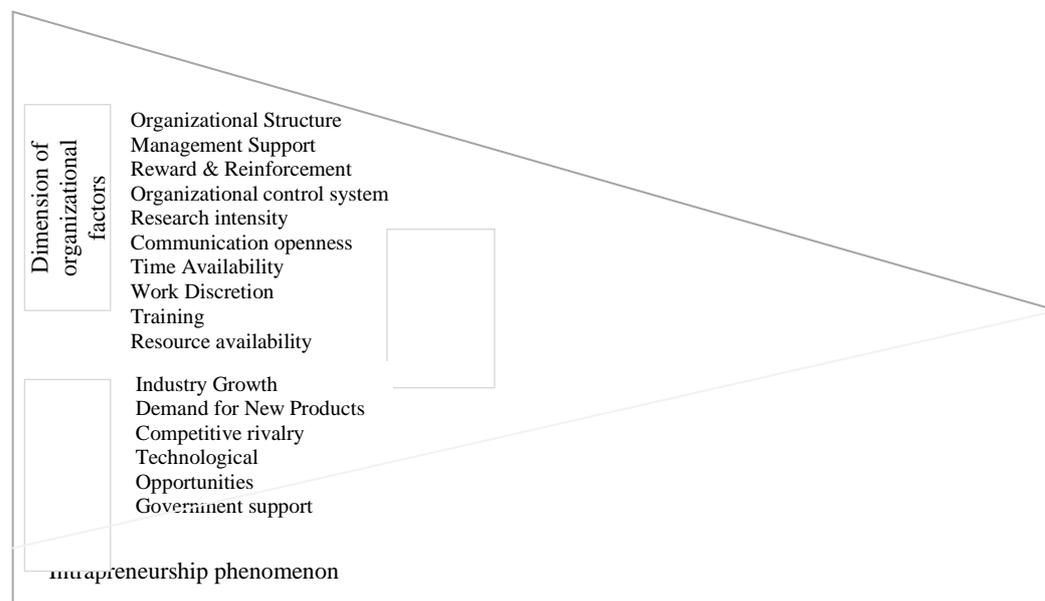


Figure 20. The relation between preconditions for intrapreneurship and its created results

Source: prepared by authors, based on: Karimi, A. *et al.* (2011); Ahmad, N. H. *et al.* (2012); Van der Meer, Arthur R. F. (2011); Alipour *et al.* (2011).

Relying on McGinnis' and Verney' (1987) argumentation, Ramsundhhar (2009) points out that in order to promote intrapreneurship in an organization, employees must not only

know, but also understand objectives of an organization. In addition, employees must understand the industry they work in. The authors claim that each organization must have a system which functions as a reward to employees for their innovative performance. Organizational rules should not restrict the freedom of employees because it impacts the level of innovativeness. Preconditions for intrapreneurship operate in three dimensions, i.e., the organizational, behavioural, and environmental factors. The first dimension is the organizational factors including the organizational structure, management support, reward & reinforcement, organizational control system, research intensity, communication frankness, time availability, work discretion, training and resource availability in an organization. Organizational factors act as the reason to encourage intrapreneurship among employees.

However, in order to accelerate the development of innovative processes workers' leadership and autonomy as well as accountability in the organization should be promoted. The third dimension encompasses environmental factors. The industry growth, the demand for new products, a competitive rivalry, and technological opportunities are the essential motives of contributing to the promotion of intrapreneurship in the organization. Thus, the current phenomenon of intrapreneurship results in the benefit for the organization and economy, creating a competitive advantage.

Pruskus (2003) indicates that by referring to the existing 'brains structures' Hofstede (2001) determines the behaviour of individuals. It is described as the 'Brain program'. If an individual 'installed' some values or attitudes in his/her childhood, it means that he/ she became the 'carrier of culture'. Young (2007), relying on Lewis' (1969) publications, points out that social norms are behaviour rules and communication with others. Hill (2003) shows that in the intrapreneurial organization the organizational culture acts via Hofstede's dimensions, i.e., Individualism versus Collectivism (IDV), Power Distance (PDI), Uncertainty Avoidance (UAI), Masculinity versus Femininity (MAS). The author discusses that an intrapreneurial organization should consist of collectivism, a low power distance, a low uncertainty avoidance, and femininity in the context of organizational culture. Thus, cultural and social norms are the key element for intrapreneurship.

According to Menzel (2008, p. 30) *'One may argue that, above all, intrapreneurship is basically a question of culture which is a question of the cultural background of the entire group of individuals involved. Such culture would be built around all principles related to the way an organization operates that will raise opportunities for creating profitable newness or difference in doing business. Yet, it is not fully clear how to define, measure, and implement such culture which supports intrapreneurship in industrial R&D.'*

The environment where social norms of collectivism exist 'We' self-awareness dominates. Thus, organizations and institutions affect an individual's personal life. It is also stated that an individual is emotionally dependent on institutions and organizations. '*Greater wealth brings more individualism and greater poverty more collectivism to a country*' (Gouveia, Ros 2000, p. 27). The power distance of social norms reflects the relationship between employers and employees, and if something goes wrong, the system is blamed, but not weaker individuals. The uncertainty avoidance of social norms concentrates on the tolerance for new things. Furthermore, individuals have the willingness to take an unknown risk. Hill (2003), based on Carrell, Jennings, Heavrin, (1997), points out that organizations promoting entrepreneurship within an organization have a low uncertainty avoidance, because the uncertainty is an integral part of life especially in the business world. It is noted that organizations tend to accept the unknown future and are willing to take risks. The social norm of femininity indicates that men and women should be gentle and caring about activities and relationships. Also, between genders there is minimal differentiation of emotional and social roles (Pruskus 2003).

Based on Trompenaars and Hampden-Turner, (2001), '*To influence or change the current culture or to implement a new culture the organization's or group's members must acquire a cultural knowledge, skills, or attitudes, thus, they must learn. Usually, cultural change processes require that people recognize the survival of the community at a stake*' (Menzel, 2008, p. 30; 31). Stull (2005), based on Krueger and Brazeal (1994), notes that norms and values make influence on intrapreneurship and Ping-Yi, Huai-Zhi (2009, p. 154) rely on Marcus and Zimmerer (2003) state that '*nascent intrapreneur is formed under the corporate culture and self-identification, not nature born. Current research found out that organization and policies are two important factors which will determine the success of intrapreneurship, so training program and employee education are critical*'.

In the case of Lithuania, intrapreneurial behaviour is affected by cultural norms, where '*The mobbing specificity is the feature of the Lithuanian mentality*' (Veinhardt and Zukauskas, 2010).. Cultural traits of materialism and post-materialism in Lithuania exist, i.e., and the individualism dominates. According to Štutiniene's (2008) study, within communities of local villages and small towns such traits of identities as the defensiveness, occurring in the form of insularity and ethnocentrism, dominate. Conservative attitudes and the fear of change play a major role making it difficult to adopt innovations.

## METHODOLOGY

The investigation regarding the role of cultural and social norms on intrapreneurship is continued by presentation of the Global Entrepreneurship Monitor (GEM, 2011) methodology. The present article supports important aspects of the research problem already tackled in the scientific literature review by the data from GEM (2011), which is the largest dataset on entrepreneurship worldwide.

*Global Entrepreneurship Monitor* survey is the largest study in the world on entrepreneurship (covering 90 researchers' teams from different countries and conducted since 1999). The GEM data is gathered annually and is derived from two main sources: *GEM Adult Population Survey (APS)* and *GEM National Experts Survey (NES)*.

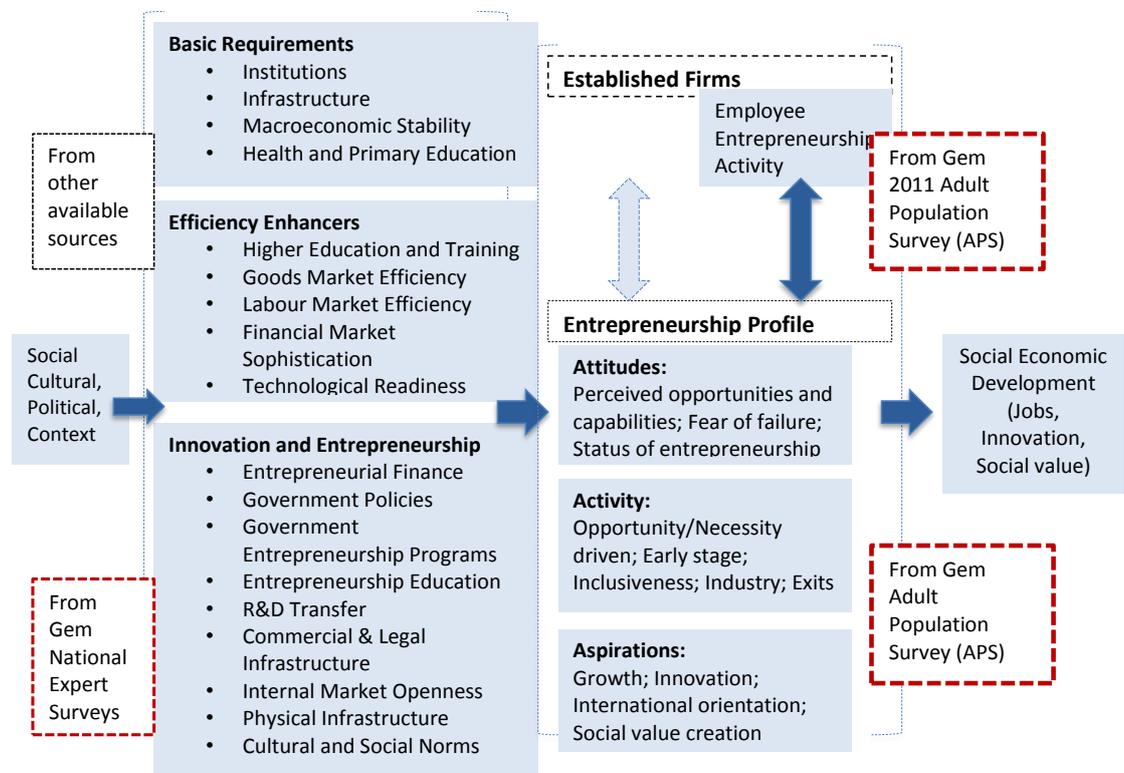


Figure 21. The GEM Conceptual Model

Source: GEM Global Report, 2011

The GEM model shows the institutional environment, the effect it has on entrepreneurship and on economic development. Two groups of conditions – basic requirements and efficiency enhancers, make an impact on entrepreneurship activity within the economies. Additionally, nine entrepreneurship framework conditions influence entrepreneurial initiatives and the rate and profile of entrepreneurship in different economies. The GEM Conceptual Model also illustrates the efforts of employee entrepreneurs, those who develop and lead new business

activities for their employers (i.e. intrapreneurship); this type of entrepreneurship was a special focus within this article.

Based on the Global Entrepreneurship Monitor methodology, countries were divided into three groups: 1) factors-oriented countries; 2) efficiency-driven countries 3) innovation-oriented countries. The study of entrepreneurship dynamics focuses on the transformation from one group of countries to another. GEM examines such entrepreneurship characteristics as motivation, innovation, competitiveness and growth potential.

Entrepreneurship is seen as a process, covering all the phases of the business cycle: from intending to start, to just starting, to running new or established enterprises and even discontinuing business. These surveys include the issue of new businesses, businesses ownership question or the motives for business terminating.

*Survey Objective* - the key purposes of GEM is to provide reliable data on entrepreneurship that will be useful in making meaningful comparisons, both internally and among countries with different economies over the time.

Lithuania has joined the project in 2011. During this time two waves of surveys were conducted. *GEM Adult Population Survey (APS)* and *GEM National Experts Survey (NES)* were conducted using Global Entrepreneurship Monitor methodology.

On the national level these two surveys allow monitoring the dynamics of attitude on entrepreneurs and entrepreneurship as well as the level of intrapreneurship in each country. This will provide the necessary guidelines for different sectors of economy in order to achieve the growth of social and economic welfare.

GEM APS Study in Lithuanian was conducted by independent market research company "RAIT" Ltd<sup>23</sup>, ESOMAR member. Studies were conducted annually from March to July 2011 and 2012. Approximately 2000 respondents of Lithuanian inhabitants aged 18-64 years old were interviewed each year. The survey was conducted using telephone interviews (CATI) method. The sample of respondents was drawn using random representative sample from adult population of Lithuania. The standardized questionnaire developed by the GEM consortium (7 sections of questions about nascent entrepreneurs, owners, potential entrepreneurs, terminated business entrepreneurs, informal investors, intrapreneurship and innovation). The maximum possible statistical error  $\pm 2,2\%$ .

GEM NES focuses on the experts' opinion of financial support, governmental policies and programs, education and training, R&D transfer, commercial and professional

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<sup>23</sup> The company was chosen by Lithuanian GEM team based on the evaluation of the vendor's research proposal.

infrastructure, market openness, access to physical infrastructure, culture and social norms, capacity for entrepreneurship, economic climate, work force features, political, institutional and social context.

Two GEM NES starting from 2011 were conducted in Lithuania (from April to July 2011 and 2012). 36 experts from 9 main sectors (financing; governmental policies; governmental programs; education and training; research and development transfer; commercial infrastructure; internal market openness; physical infrastructure; cultural and social norms) were interviewed each year. The NES sample comprises a minimum of 36 respondents, with four experts drawn from each of the entrepreneurial framework condition categories. Out of this sample, a minimum of 25% must be entrepreneurs or business owners, and 50% must be professionals. Additional aspects such as geographical distribution, gender, the public versus private sector, and level of experience are also taken into account in selecting the sample random representative sample. Each selected expert was approved by the global GEM team. The interviews were conducting using personal face to face interviews or using web interviews (CAWI) methods by the members of Lithuanian GEM team (International Business School at Vilnius University). A standardized questionnaire developed by the GEM consortium was used during the interviews.

In order to obtain more exhaustive information the combination of data from both surveys (APS and NES) is used. This method of analysis enables to get insights from population point of view about entrepreneurship as well as to get expert attitude toward specific situation in particular country.

Statistical data analysis was conducted using IBM SPSS Statistics software.

The raw data was sent directly to the GEM data team for inspection and uniform statistical calculations before being made available to the participating economies. All statistical calculation is done using SPSS program.

The quantitative research was carried out by the team of the International Business School at Vilnius University under the cooperation with the business-promoting agency 'Enterprise Lithuania' and the Ministry of Economy of the Republic of Lithuania.

Within the quantitative survey there were 2003 Lithuanian adults of the age group from 18 to 64 years interrogated. In terms of regional representation, the distribution of respondents reads proportions of regional spread at the country's level. Having the Lithuanian citizens' attitudes towards the entrepreneurs' activities and their education examined, next, perceptions of their career are tackled, then a special attention is paid to

social and cultural norms (including social support), which is terminated by the identification of opportunities and competences to start entrepreneurial activities.

The analysis of intrapreneurship calls researchers to examine the answers from two main groups of respondents, starting or helping to start the business, but still without the revenue received (N=255) and business owners (N=307). The expert interviews enclosed 36 experts that represented finances, governmental policies and programs, education and trainings, R&D, business and physical infrastructure, the market openness, cultural and social norms that led to an ingenious analysis how cultural and social norms affect the employees' entrepreneurship.

## **EFFECTS OF CULTURAL AND SOCIAL NORMS ON INTRAPRENERUSHIP IN LITHUANIA**

Results of GEM, Lithuania (2011) clearly illustrated the importance of attitudes, values, rules, norms, perceptions, processes, organizations or structures on intrapreneurship. The societal perceptions of such concepts as the work security or the liberty in realizing his/her ideas emerge as important motives to initiate and execute entrepreneurial activities while being employed by a company. Nearly sixty percent of respondents are sure that the work security is more important than the liberty in realizing his/ her ideas (32,6% absolutely agree, 24,6% agree).

Social and cultural norms strongly impact main motives to start a business separately or 'under the roof of an employer'. 42,7% of respondents starting or helping to start a business, but still without the revenue received, intended to use a good business opportunity; nearly one third of entrepreneurs as the main reason to start their business identified the inexistence of better employment choices in the market, while 11% indicated the combination of great business opportunities and inexistent employment choices in the market. 7,3% respondents started searching for new opportunities already working in other companies. Other respondents as principle motives indicated additional revenues, the willingness to help companies, the demand for services, realization of a dream, health, and insufficient salary in a previous job, the application of a good practice in Lithuania or such social aspect as a life style. 48,3% of respondents mentioned a larger freedom as the most important motive to use the business opportunity. More than half of respondents were not working in addition to a business, and 84,2% were employed before starting a business.

Similar reasons are found among entrepreneurs who are already business owners and generate revenues. Among their motives to start a business they mentioned the desire to

do things they are capable to do, their interest in a new business, freedom, no fear of failure, present optimism at a microeconomic and macroeconomic levels, personal characteristics. For these reasons the majority of respondents (78,2%) were the business owners or managers themselves. It is interesting to note that 37,4% respondents that have already started generating revenues from their business are in parallel employed by other companies, and 82,6% were employed before starting their business.

Another important aspect of the social cultural context is the social image of entrepreneurs, their characteristics and the perception of the environment in favour for the business creation process. Though 43,8% of respondents disagree with the statement that Lithuanian entrepreneurs are honest, and it was difficult to evaluate the ethics and care of entrepreneurs, one third of respondents evaluate entrepreneurs positively. The energy is one of the most important entrepreneurs' characteristics: more than 70% of respondents agreed with the statement that Lithuanian entrepreneurs were energetic people, and 40% of respondents expressed the innovativeness as an important feature of Lithuanian entrepreneurs.

In spite of rather positive social image of entrepreneurs, respondents have a relatively negative opinion about the entrepreneurial environment. More than two thirds (70,5%) of respondents stated that over the last two years they did not know people who started business in their environment. Such answers were supported by the perception of business opportunities in their living environment in the upcoming 6 years: only 19% of respondents considered their living place as having good possibilities to start the business. Analogically, the two thirds considered their living place being not in favour to start a business. The negative perception of the living place was accompanied by a negative evaluation of their skills, knowledge and expertise necessary to start a business: only one third of respondents had evaluated their skills, knowledge and experience as suitable.

Such societal perceptions call for an important Hofstede's dimension (2003) which is the uncertainty avoidance, directly related to the question regarding the fear of failure to start a business. This social and cultural feature is a clear illustration how cultural and social norms influence determinants of entrepreneurship. 49,8% of respondents state that the fear of failure negatively affects their decision to start the business. The uncertainty avoidance and the fear of failure is also the barrier for those who believe having sufficient knowledge, experience and skills to start their businesses, and only 12,7 % of respondents, with no respect whether they do this alone or in teams, are involved in the process of the business establishment, are self-employed or sell products or services to others.

The propensity of the population to use modern technologies is another important social aspect, which in term of intrapreneurship appears as the necessity to change technologies or to use technologies of an employer for their own business initiatives. Though more than 63,9% involved in a business, but still without revenues, use technologies and apply procedures necessary for the creation of products and services longer than 5 years, a rapidly changing business environment, the progress of information technologies and a severe competition in global markets demand 25,9% entrepreneurs to renew technologies and procedures more often, as technologies and procedures last from 1 to 5 years, and 10,1% of respondents need to do this every year. A similar situation is among business owners who already earn revenues. Though 72,4% respondents that are business owners stated that technologies and procedures necessary for business were alive longer than 5 years, 19,4% of respondents needed to renew them in the period from 1 to 5 years, while 8,6% of respondents needed to make necessary changes annually. Nearly 45% respondents-business owners used technologies that were completely or partially related to the previous or current employer.

Another aspect of a social and cultural context is the willingness to use the previous personal or colleagues' experience in business initiatives. This particularly encourages intrapreneurial activities. For instance, the previous experience in a company helped 46,5% of respondents to form the business idea, and 13,4% of employers provided or intended to provide a support for the business development or a necessary physical infrastructure. The previous experience is also useful because 46,7% respondents who have established their businesses intended to employ their ex or present colleagues. For 51,5% respondents who started their business a previous job experience helped to build a business idea. However, 90,4% of respondents indicated that their current or previous employers avoid of providing their business with a financial support of physical infrastructure. 31,1% of respondents accentuated the importance of working in other companies and particularly intentions to employ their current or ex colleagues.

The willingness to use the previous personal or colleagues' experience in business initiatives is accompanied by the willingness to use financial resources related to current or previous colleagues or personal investments into other businesses. This in many cases derives from cultural and social norms. 58,8 per cent of respondents who invested in other businesses allocated those investments to their relatives, and 31,6% to neighbours and friends. Other 2,6% dedicated their investments to colleagues, and 6,1% to unknown people with a good idea.

The concept of intrapreneurship incorporates such important cultural and social norms-related aspects as the cooperation in the generation and commercialization of innovative ideas. It is not enough to generate ideas and evaluate business opportunities; often those ideas are unrealized because of the lack of initiatives to execute them. Only 10 % of respondents helped to execute ideas during the period of the last 12 months. 49,9% of respondents needed one year or more for helping to establish a business. 80,2 % of respondents were the principle or co-owners of their businesses; 61,3% established and developed their businesses in a group of two people, and 26,3% were three people in a team while starting their business. Thus, the cooperation emerges once again as an important aspect of a social and cultural context.

Social relations are an important condition for entrepreneurship and intrapreneurship as the constitutive part of entrepreneurship. 48,8% absolutely agree and 26,1% respondents agree, that dealing with partners provide with a lot of business opportunities. One third of respondents (33%) had difficulties to decide, whether they would understand better having other people managing or consulting, while 40% of respondents were fond of initiating changes in business processes.

Such intrapreneurship experiences as the generation and commercialization of innovative ideas are crucial in order to start a business themselves. 71,9% of respondents were involved in the generation and execution process of new entrepreneurial ideas over the last three years. 33,9% of respondents managed such processes, 53,6% helped to generate such ideas, and 12,5% executed, managed and supported such processes. 57,4% of respondents were continually preparing and executing ideas not stopping themselves at the generation stage: 37,8% managed preparation activities and execution processes, 48,9% helped to prepare and execute activities, and 13,3% were responsible for both functions.

Education and training are the precondition to positively impact intrapreneurial activities. However, the role of education and trainings, according to experts, is not sufficient in encouraging entrepreneurship. There is the lack of orientation towards entrepreneurship at secondary and primary schools (69% experts consider as negative), where the creativity, initiatives and autonomy are not sufficiently supported, and there is not the knowledge on economic and business principles provided. Colleges, universities and business administration trainings are slightly more efficient in preparing specialists ready to establish and develop their business (50% experts consider it negative). In parallel, a professional, vocational and continuous education is evaluated the best (only 36 % experts evaluated it negatively).

Intrapreneurship in Lithuania, based on respondents' opinions, is sufficiently supported. There is more 'From top to bottom' decision making model in use. Experts more disagree than agree that employees who want to start their business can use resources, knowledge, connections received in their job position. However these are only a few observations regarding intrapreneurship. To excel the present article the conceptual model of effects of cultural and social norms on intrapreneurship is presented below. Social and cultural norms could be translated into such factors as the propensity of the society to use modern technologies, social relations and co-operation trends, a social valuation of entrepreneurs, environment, knowledge and skills, perceptions of the work security and the liberty in realizing ideas or the uncertainty avoidance. These social and cultural factors should be shaped by the education and training, the media, governmental programs and policies as well as the financial support in order to boost the intrapreneurial culture in the country and organizations, with employees largely involved in the generation and commercialization of innovative ideas, having the motivation to start business separately or 'under the roof of an employer', to use, if possible, current or previous employers' technologies, employing current or ex colleagues, using colleagues' financial support and personally investing, applying personal and colleagues' experience and managing better their risk. All these aspects would be impossible without the organizational structure, management techniques and innovations climate supporting the intrapreneurship phenomenon.

The model of effects of cultural and social norms on intrapreneurship could be linked to the GEM conceptual model via the intrapreneurial profile, which composes attitudes, activity and aspirations. The first pillar of attitude, based on the GEM conceptual model, tackles the perceived opportunities and capabilities of employees, the fear of failure as well as the status of intrapreneurs within organizations. Within the model of Effects attitudes correspond to the second group of factors. The activity pillar contains the opportunity and necessity-driven motives to start intrapreneurial activities as well as different stages of intrapreneurship. This pillar is liaised to the third group of factors within the Effects model. The aspiration (growth, innovation, international orientation, social value) from the conceptual GEM model relates to the first group of factors within the Effects model.

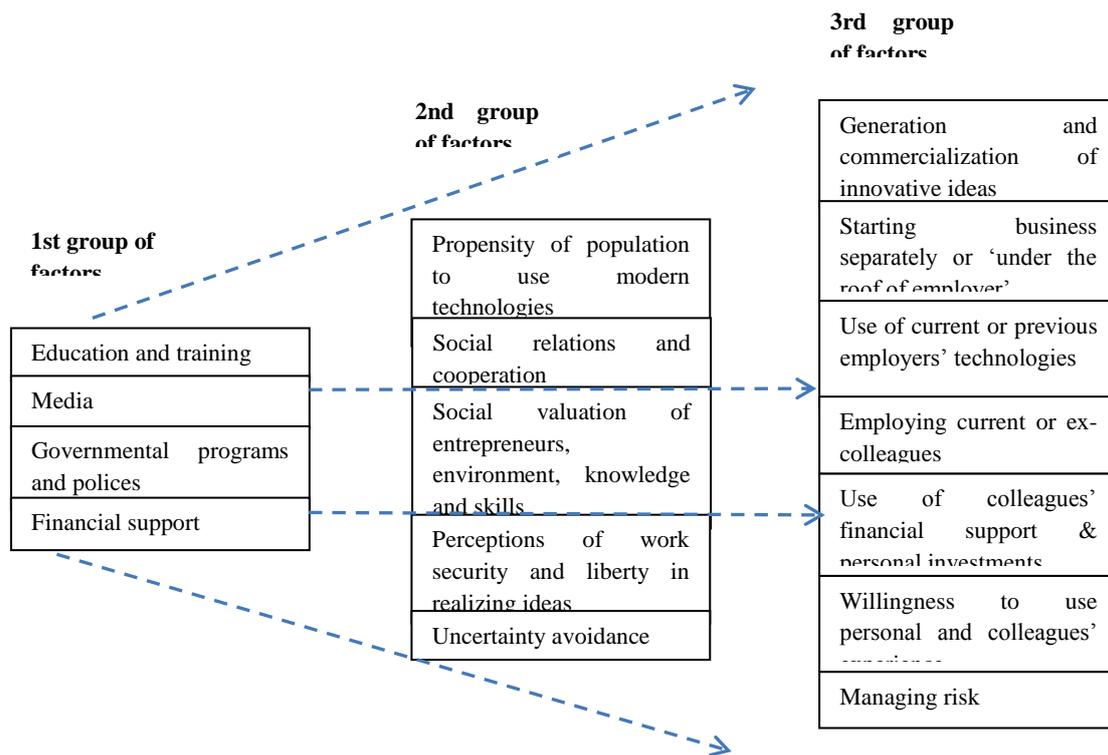


Figure 22. Effects of cultural and social norms on intrapreneurship

Source: prepared by authors, based on GEM, Lithuania (2011)

## CONCLUSIONS

Intrapreneurship is a distinguished part of entrepreneurship which is related to employees' initiatives inside organizations. It covers both motives and barriers to start entrepreneurial activities while being employed by another employer and further development opportunities including possible synergy effects between the employing organization and the intrapreneurial unit. From the first impression, a high ranking of a country, based on intrapreneurship, means the fear of failure to start a business individually and manage the risk alone; however, it also calls for the innovation performance in employing organizations, where organizational structures and management techniques support employees' initiatives. Although entrepreneurship, based on respondents, is sufficiently encouraged, employees in Lithuanian companies that apply 'From top to bottom' decision making model not always feel the support from their employers getting permissions to use resources, knowledge and connections. Having the propensity of the public to use modern technologies, social relations, a social image of entrepreneurs, opinions about the environment, knowledge and skills, perceptions of the work security, the liberty in realizing

ideas or the uncertainty avoidance identified as main social and cultural norms-related factors, intrapreneurship should continuously be encouraged via the education and training, the media, governmental programs and policies as well as the financial support.

Owners should remember that employees-intrapreneurs (largely involved in the generation and commercialization of innovative ideas; having the motivation to start business separately or 'under the roof of an employer'; using, if possible, current or previous employers' technologies, employing current or ex colleagues; using colleagues' financial support and personally investing; applying personal and colleagues' experience and managing or not their risk) are not parasites in the eco-system of organizations. They can contribute with a great value-added, given the organizational structure, management techniques and innovation climate in favour for the intrapreneurship phenomenon.

There should be a more ingenious attention paid to cultural and social norms, as they directly and indirectly affect organizations' strategies, citizens' behaviour and attitudes, consumers' preferences and demands as well as complex and unique social relations in different economies. The beginning of important changes should begin at the beginning stage of the development of social and cultural norms of each country. Therefore, such factors as the early education on intrapreneurship should be emphasized and all the positive contributions from the employees' entrepreneurship examined.

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**ANNEX 1. INTRAPRENEURSHIP INDEXES**

<b>Construct</b>	<b>Index</b>	<b>Measures</b>
<b>1. TASK</b> Level of task innovation present in the organization	Task Innovation Index	<ul style="list-style-type: none"> <li>• Identification, development and exploitation of new ideas;</li> <li>• Level of new product / service introductions;</li> <li>• Improvement or revision of current products services;</li> <li>• Improvement of quality of current and future products / services;</li> <li>• Demonstration of employee initiative;</li> <li>• Level of competition with other organizations.</li> </ul>
<b>2. INDIVIDUALS</b> Level of intrapreneurial employees in organization	Intrapreneurial Employee Index	<ul style="list-style-type: none"> <li>• Intrapreneurial qualities of employees;</li> <li>• Employee attitudes towards change, risk and failure;</li> <li>• Willingness of employees to embrace new opportunities;</li> <li>• Levels of innovative and creative employees;</li> <li>• Employers' ability to deal with uncertainty.</li> </ul>
<b>3. STRUCTURE</b> Level of structural flexibility in organization	Structural Flexibility Index	<ul style="list-style-type: none"> <li>• Flatness of organizational hierarchy;</li> <li>• Level of permission required to perform tasks;</li> <li>• Decentralisation of organizational structure;</li> <li>• Flexible career paths;</li> <li>• Recognition of lower level employees;</li> <li>• Division of labour tasks;</li> <li>• Span of control in organization;</li> </ul>
<b>4. POLICIES</b> Level of incentive policies present in organization	Incentive Policies Index	<ul style="list-style-type: none"> <li>• Policies encouraging creative and innovative approaches;</li> <li>• Reward systems for intrapreneurial behaviour</li> <li>• Level of punishment / reward for taking calculated risks;</li> <li>• Percentage of time available for working on feasibility of idea;</li> <li>• Availability of intra-capital.</li> </ul>

Construct	Index	Measures
<p><b>5. LEADERSHIP</b></p> <p>Level of intrapreneurial leadership in organization</p>	<p>Intrapreneurial Leadership Index</p>	<ul style="list-style-type: none"> <li>• Presence of leadership in organization;</li> <li>• Innovativeness and charisma of leader;</li> <li>• Leaders knowledge of the environment and competition;</li> <li>• Encouragement of teamwork;</li> <li>• Encouragement of open discussion and negotiation;</li> <li>• Encouragement of intrapreneurial philosophy in organization.</li> </ul>
<p><b>6. CULTURE</b></p> <p>Level of intrapreneurial culture within the organization</p>	<p>Intrapreneurial Culture Index</p>	<ul style="list-style-type: none"> <li>• Evidence of interdependence and team work;</li> <li>• Level of power distance / authoritarianism;</li> <li>• Clearness of organizational vision;</li> <li>• Acceptance of uncertainty;</li> <li>• Attitude towards failure;</li> <li>• Awareness of future opportunities;</li> <li>• Encouragement of lifelong learning;</li> <li>• Recruitment of intrapreneurial employees;</li> <li>• Encouragement of innovation and creativity and calculated risktaking.</li> </ul>

Source: Hill, M. E., 2003, p. 58.

## MERGERS AND ACQUISITIONS WERE NOT A SOLUTION TO THE LIQUIDITY AND CAPITAL REQUIREMENTS OF GREEK BANKING SECTOR

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### ABSTRACT

**Purpose** - The purpose of this paper is to examine the impact of mergers and acquisitions on liquidity and capital adequacy of Greek banking sector during 1996-2004 when a large number of bank mergers and acquisitions took place and were completed.

**Design/methodology/approach** – By measuring liquidity and solvency with four financial/accounting ratios, of a sample of 26 Greek commercial banks during 1996-2004 and analyzing data of current Greek banking sector, we find interesting results about liquidity and capital adequacy of Greek banks.

**Findings** - Results indicate that liquidity and solvency ratios of Greek commercial banks during 1996-2004, deteriorate after merger deal but most of ratios (three out four) deterioration is not statistically significant.

**Practical implications** – Mergers and acquisitions during past (1996-2004) was not a solution to improve liquidity and capital adequacy requirements.

**Originality** – The paper presents an analysis of the impact of mergers and acquisitions on liquidity and capital adequacy of Greek banking sector and shows possible strategies to banks to improve current position.

**Keywords:** Banks, M&As, Operating Performance, Liquidity, Capital Adequacy, Greece

## 1. INTRODUCTION

One of the most important changes that have taken place in the Greek financial system since the mid-1980s is related to mergers and acquisitions of Greek banks. This was the result of Globalization and Europeanization of the Greek Financial System.

Globalization, as well as the process of financial integration within the European Union, leads to modernization of the Greek financial system, with interest rate deregulation, liberalization of cross-border capital movement and abolition of direct credit controls. The Greek financial system was deregulated in the mid – 1980s. Before that, it was over-regulated, as a result of the extensive government intervention in credit allocation, since the early 1950s. After 1987, the Greek financial system started to change. Before 1981, the Greek Central Bank used to impose limitations on commercial banks' credit expansion and interest rate ceilings. Two state-owned banks, National Bank of Greece and Commercial Bank of Greece, dominated almost the whole Greek banking sector. The 1989 Second Banking Co-ordination Directive gave banks the opportunity to operate as universal banking institutions, extending their business into financial activities other than traditional ones, such as insurance and investment services. Cost cuts, restructuring, mergers and acquisitions, followed the Greek banking industry after 1992. Greek banks started to internationalize their activities while at the same time competition and profitability increased.

The growing and more complex competition increased in the Greek banking sector as a result of a more liberalized regulatory framework, the emergence of new financial intermediaries and new information technologies. The process of globalization changed the Greek banking landscape and spurred the largest wave of mergers and acquisitions (M & As) so far.

In our study we are examining the period 1996-2004 because during 1996-2004 a large number of bank mergers and acquisitions took place and were completed. An analysis of the impact of mergers and acquisitions on liquidity and capital adequacy of the Greek Banking Sector is an interesting field especially during current economic crisis in Greece.

The next section of the paper provides a theoretical and empirical discussion of mergers and acquisitions. Section 3 presents the data and the methodologies used. Finally, section 4 provides the empirical results, while section 5 offers some concluding remarks.

## 2. THEORETICAL AND EMPIRICAL UNDERPINNINGS

The theoretical literature of mergers and acquisitions can be divided into three major categories. The first category includes synergy or efficiency, in which total value from the combined firms is greater than the sum of values of each firm. Increased value arises from increased efficiency (output or input) and increased market power (Berger, 1995; Goldberg & Rai, 1996). Hubris is the second category and it is the result of winner's curse, causing bidders to overpay while value is unchanged (Roll, 1986). The third category comprises those in which total value is decreased as a result of mistakes or managers who put their own preferences above firm's (principal-agent problem), "building empires" for self-interest opposed to the self-interest of the principal and the shareholders (Jensen, 1989; Hughes et al., 2003; Bliss & Rosen, 2001; Fogelberg & Griffith, 2000).

The empirical evidence concerning the evaluation of mergers and acquisitions is based on five different types of analysis namely, production functions, cost functions, use of accounting data, the efficient frontier approach and event studies (Matthews & Thompson; 2005).

Cornett & Tehranian (1992), examined the post-acquisition of large bank mergers between 1982 and 1987. They reported that the merged banks outperform the banking industry. Rezitis (2008), using a stochastic output function, found that the effects of mergers and acquisitions on technical efficiency and on total factor productivity growth of Greek banks are rather negative. Noulas (1997), examined productivity growth of Greek banking industry for 1991 and 1992, using the Malmquist productivity index and the Data Envelopment Analysis method (DEA) and found that, although productivity has increased for state and private banks, the sources of this growth are different. Siriopoulos and Tziogkidis (2010), examined the efficiency of Greek commercial banks through the period 1995-2003 and especially the reaction of banking institutions after significant events such as M&As, privatizations and the crisis of the Athens Stock Exchange in 1999, using DEA. They found that the Greek banking sector operated efficiently on average during the destabilization period.

Spathis, Kosmidou & Doumpos (2002), using multicriteria methodology (M.H.DIS and UTADIS) investigated the endogenous factors of Greek banks from their financial statements over the period 1990-1999, identifying financial ratios that affect classification of banks according to their size. Evidence indicated that large banks are more efficient than small ones. Also using the Promethee method to evaluate the performance of commercial and cooperative banks in Greece, Kosmidou & Zopounidis (2008), found that commercial banks tend to increase their accounts, to attract more customers and ameliorate their financial

indices, thereby becoming more competitive and maximizing their profits. Halkos & Salamouris (2004), applying a non-parametric technique (Data Envelopment Analysis) and exploring financial efficiency ratios for the period 1997-1999, found that the higher the size of total assets, the higher the efficiency of Greek commercial banks.

Mylonidis & Kelnikola (2005), using event study approach and a 20 days event window before and after announcement date for the years 1999-2000, showed that mergers create value on a net aggregate basis. Also by using operating performance methodology they found no evidence of performance gains resulting from bank mergers.

Athanasoglou & Brissimis (2004), employed operating performance methodology on revenue, cost, profit and productivity ratios in the pre-merger and acquisition period 1994-1997 and post-merger and acquisition period 2000-2002. They showed that merger and acquisitions positively affect merged banks' profitability as well as cost efficiency.

### 3. DATA AND METHODOLOGY

In our research, we use Operating Performance Methodology by following Pilloff (1996). The merger-related change in performance variable has been calculated as the difference between pre-merger adjusted performance for the consolidated bank involved in merger and post-merger performance for the same bank. Balance sheets, annual reports and financial statements were found on ICAP Database, Hellenic Bank Association, daily economic newspapers, banks' websites and banks' accounting departments.

Following Pilloff (1996), liquidity and solvency variables are examined with the use of 4 financial-accounting ratios, such as:

#### Liquidity Ratios

1. Total loans/Total deposits
2. Total loans/Total assets
3. Cash plus reserves plus securities/Total assets

#### Solvency Ratio

1. Total equity/Total assets

We apply the operating performance model specified above to an unbalanced panel of Greek banks studied over the period, 1996-2004, including a total sample of 26 Greek commercial

banks (11 banks were involved in mergers and acquisitions activities and 15 banks as non-merged). Greek co-operative banks and branches of foreign banks are excluded. We investigate whether merged banks are following a different pattern of efficiency change than non-merged banks. For this reason, a merged institution is treated as a different bank from the institution that existed before the merging process.

Our study includes information on six cases of mergers and acquisitions (5 banks were involved as acquirers and 6 banks as targets) that meet the following criteria, as stated by Pilloff (1996): a) merger was the primary transaction in which both the bidder and target were involved during the period from at least one year before the merger year to at least one year after it, with maximum two years before and after, b) during this period, no other merger was announced by either party, c) the regulator did not encourage or assist the acquisition. We limit the empirical analysis to the unconsolidated statements of commercial banks in order to reduce the possibility of introducing aggregation bias in the results. All currency variables are expressed in millions of Euros, in 1995 real terms and corrected for inflation (deflated by the Wholesale Price Index published by the National Statistical Service of Greece). A total of 19 (about 35.1 per cent) of the banks were observed during the 9 years.

The hypothesis tested is:

$$H_1: \Delta WR_x \neq 0 \quad \text{and} \quad H_0: \Delta WR_x = 0$$

where  $\Delta WR_x$  is the weighted relative difference in variable x. The relative size according to total assets of bidders and targets, by using t-test or t-student is:

$$t(\Delta WR_x) = \frac{\Delta WR_x}{\frac{S(\Delta WR_x)}{\sqrt{N}}}$$

where  $S(\Delta WR_x)$  is standard deviation of weighted relative difference in variable x and N is number of mergers and acquisitions.

#### 4. EMPIRICAL RESULTS AND DISCUSSION

In Greece, employment in banking sector and number of bank branches has increased for the period 1996-2004 (Table 1), which reflects the dynamic of the banking sector and its growth. Also shows that banking services and products in Greece were distributed through the traditional way via branches, despite technological progress.

Table 1. Total number of employees and bank branches in Greek banking sector

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Employees	48,029	48,165	51,213	49,902	53,655	52,628	52,962	54,184	52,533
Bank branches	2,192	2,296	2,520	2,455	2,748	2,794	2,922	2,939	2,885

Source: Hellenic Bank Association

Liquidity ratios illustrate how a bank can meet its liabilities from acid assets, exposure at loans and share of loans to total assets. Results from two out three liquidity ratios (Table 2) deteriorate after merger deal, but they are not statistically significant. Only “cash plus reserves plus securities/Total assets” deteriorates after merger deal, and it is statistically significant.

Solvency ratio or capital adequacy ratio, illustrate banks’ viability in the long run and indicate the source of funds (capital from shareholders, profits etc) that support operation (Table 3). “Total equity/total assets” of merged banks is lower from that of non-merged banks. Also the ratio deteriorates after merger deal but it is not statistically significant at 5% and 10%.

Table 2. Liquidity Ratios

	Total loans (except loans to banks)/Total deposits				Total loans (except loans to banks)/Total assets				Cash plus reserves plus securities/Total assets			
	Pre-merger	Post-merger	Average Difference	t-statistic	Pre-merger	Post-merger	Average Difference	t-statistic	Pre-merger	Post-merger	Average Difference	t-statistic
Average Bidders	19.8%	44.5%	8.7%	1.6	16.9%	38.6%	7.4%	1.9	19,4%	24,3%	-5,6%	-2,3
Average Targets	15.387%				13.8%				11,2%			
Average Non-merged banks	51.7%				40.8%				23.5%			

Table 3. Solvency Ratio

	Total equity/Total assets			
	Pre-merger	Post-merger	Average Difference	t-statistic
Average Bidders	0.05	0.07	-0.00	-0,60
Average Targets	0.02			
Average Non-merged banks	0.11			

Finding show that during 1996-2004, liquidity and solvency ratios deteriorate after merger deal but most of ratios (three out four) deterioration is not statistically significant. Liquidity ratios deteriorate after merger deal but two out three ratios are not statistically significant. Only “cash plus reserves plus securities/Total assets” deteriorates after merger deal and it is statistically significant.

Also solvency ratio to measure accounting capital adequacy deteriorates after merger deal but it is not statistically significant.

Results indicate that liquidity and solvency ratios of Greek commercial banks during 1996-2004, deteriorate after merger deal but most of ratios (three out four) deterioration is not statistically significant.

## 5. CONCLUSIONS

The purpose of this paper is to examine the impact of mergers and acquisitions on liquidity and capital adequacy of Greek banking sector during 1996-2004 when a large number of bank mergers and acquisitions took place and were completed. Finding show that during 1996-2004, liquidity and solvency ratios deteriorate after merger deal but most of ratios (three out four) deterioration is not statistically significant. Liquidity ratios deteriorate after merger deal but two out three ratios are not statistically significant. Only “cash plus reserves plus securities/Total assets” deteriorates after merger deal and it is statistically significant.

Also solvency ratio to measure accounting capital adequacy deteriorates after merger deal but it is not statistically significant.

As results show, mergers and acquisitions during 1996-2004 were not a solution to improve liquidity and capital adequacy.

Finally, we must bear in mind the limitations of relying on operating performance, because operating performance measures are subject to measurement problems (e.g. use of different accounting rules), are vulnerable to manipulative and discretionary choice of accounting rules, and the appropriate time lag in measuring performance improvement is not clear.

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## ANALYSING RISKS ASSOCIATED WITH EXTERNAL QUALITY ASSESSMENT IN HIGHER EDUCATION: A CASE STUDY ON ROMANIAN HIGHER EDUCATION SYSTEM

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### ABSTRACT

"Should we not have to teach (Should we not have students), we could do a lot better on quality." This bitter ironic remark has been heard in every state funded or independent university in Romania for some years now.

It points out that complying with the demands of the current quality assurance system generates adverse effects on the quality of teaching and research.

The paper analysis the mechanisms by which quality constructs lacking validity, obsolete cultural models or conflicting interests may disrupt on-going academic work and trigger such adverse effects on quality of education programs. The analysis was carried out using the experience accumulated in Romanian Higher Education. Conclusions do not necessary apply to other education systems but may serve as a *caveat* on incumbent risks.

Among the risks identified by the paper are the following: a) Using a faulty construct on quality of education; b) Setting irrelevant and even detrimental quality standards; c) Depleting financial resources of universities; d) Depleting time, creativity and motivation resources of universities; e) Lowering capability of higher education institutions to respond to identified training and research needs; f) Raising levels of institutional anxiety and incertitude; g) Lowering attractiveness of higher education teaching and research; h) Restricting capability of managers to function as models for younger members of faculty or students; i) Allowing assessment judgements to be influenced by conflicting interests of competing institutions or individuals; j) Encouraging dishonest strategies to boost scientific productivity; k) Discouraging cooperation and communication between competing universities, departments or faculty members.

**Keywords:** Higher education, Quality of education, Quality standards, Quality of education assessment risks.

## **PROBLEM STATEMENT AND PURPOSE OF THE STUDY**

The Law for Quality in Education was passed by Romanian Parliament in 2006 (Parlamentul României, 2006). The Romanian Agency for Quality Assurance in Higher Education (ARACIS) has been established within one month and became active in conducting quality assessment sessions beginning with the 2006-2007 academic year.

*The longer* this system was active in "assuring" quality, *the more frequent* have been formulated critical remarks on the quality of higher education. Such remarks came even from a Commission appointed by the President (România educației, România cercetării, 2007), and from President of Romania himself.

We have in a number of studies (Lisievici, 2009; Lisievici, 2011) analysed the impact of the quality assurance system on the Romanian Higher education and pointed out that it did not live up to its professed intentions.

We have found that this quality assurance system favoured control versus support, uniformity versus diversity, centralization versus academic freedom. We have also found that it diverted large financial, human and time resources from teaching, scientific activity and research. Instead of promoting an "evaluation culture", it generated a culture of preparing documentations and reports and rigging procedures for better scoring. Last but not least it did not provide support that would have been instrumental related to the demands is formulated.

We concluded that setting up a quality assurance system for higher education is not a risk free enterprise and that compiling a list of such risks might be useful.

This study builds on the previous findings to explicitly identify risks associated to setting up a quality assurance system.

## **IDENTIFIED RISKS**

### *Using a faulty construct on quality of education*

In both the provisions of the Law on Higher Education Quality and ARACIS methodology, the same construct is being used to define the quality of education: Quality means meeting the „expectations” of the “beneficiaries” **and** the “quality standards” (Parlamentul României, 2006, ARACIS, 2006, E).

Here we have at least two major problems: most international reports and even domestic publications on the quality of education (OECD, 1989, Lisievici, 1997, Lisievici, 2009) prefer to use the term "needs" instead of "expectations". Expectations involve *cognitive skills* like perceiving accurately, values clarification, making accurate predictions and sound decisions. The existence and levels of development of such skills become critical for the quality of expectations. Expectations might also be unreasonable, irrational, immoral or antisocial.

Secondly, "Quality standards" have not been developed starting from "Expectations" of beneficiaries, thus lowering the "construct validity" of the whole quality assessment process. Furthermore, no evidence is provided to show that observing "quality standards" leads to superior quality.

*Setting irrelevant and even detrimental quality standards and performance indicators for quality of education*

Performance indicator B.2.1.1. (ARACIS, 2006, E) states that, in order to demonstrate a good quality of a program of study, at least 70% of the graduates should find employment consistent with the level of their studies within two years from graduation. This vision seems consistent with a centrally planned state economy rather than with a free enterprise market economy. A free market economy would encourage graduates to use entrepreneurial skills in order to develop their own businesses and *become employers*.

This is just one of a long list of examples that suggest how persistent are the thinking patterns of the communist model of society, and how detrimental their impact is, not only on the quality of education.

*Depleting financial resources of universities*

The ARACIS methodology and subsequent regulations ask for an external quality assessment visit and a favourable decision on accrediting a program of study *before* a university may be allowed to enrol students for it.

For a postgraduate program, ARACIS would usually set an enrolment limit of 50 students per program. Out of the fees that an independent university *might collect*, should a program be accredited, 35-38% would be used in advance to cover the fees for the external quality assessment visit.

Having an independent university pay 35-38% out of the money that it *may or may not collect* for the first year from students of a program that *may or may not be accredited* does not seem to help improve the quality of education.

*Depleting time, creativity and motivation resources of universities*

The image bellow shows the documentation a university has to prepare for the domestic external quality assessment agency, for just *one program of study* (left – seven volumes with more than 1,500 pages), in contrast with the documentation prepared for a quality assessment visit of a team from European Universities Association for the accreditation of a whole university (right, less than 250 pages, annexes included).

*Plate 1. Documentations prepared according to ARACIS versus EUA requirements*



Generally, one set of self-assessment documents that should be submitted to the domestic external quality of education assessment agency amounts to 1,500 pages for a program of study. The volume of documentation for a University is even larger.

An average Faculty with 3-5 programs of study may have to prepare 2 - 3 such applications every year, as it may want to launch a new graduate or postgraduate program, to have accredited one that has already been authorised five years before, to obtain a better ranking for one that has already been accredited with "Limited confidence" grade, or finally, to renew accreditation after five years for another program. This would require about 5,000 pages of documentations be prepared every year, containing new documents, documents with formats revised by the quality assessment agency or updated documents.

The amount of work involved is huge and has a significant negative impact on time and talent management, creativity, motivation and institutional ethos.

*Lowering capability of higher education institutions to respond to identified training and research needs*

It may take months of hard and resource consuming efforts to prepare just one 1,500 pages application in order to have a new program of study authorised. Additional time will be lost waiting for the new academic year to begin and (eventually) enrol students. It is not uncommon to have all the work and prospective fees lost, while the idea will be used by competitors.

*Raising levels of institutional anxiety and incertitude*

In Romania, external quality assessment is not used as a basis for recommendations to improve education quality, but rather as a basis to decide on continuing or discontinuing the existence of programs of studies or even higher education institutions (ARACIS, 2006, E). Both grades allocated to programs of study or institutions and also consequences associated to grades *do not take into account the sources of funding*, for example budget allocations or tuition fees collected from students.

This generates a high level of institutional anxiety and incertitude. Faculty members become ever more preoccupied of their future occupational status.

*Lowering attractiveness of higher education teaching and research*

Faculty members see the content of their activity change to include ever larger sections of writing documentations and reports for quality assessment agency. There are indications that such components may occupy up to 60% of job related time (Lisievi, Ticuşan, Todor, 2012).

Apart from wondering about having a job in the near future, faculty members begin to wonder if their jobs are worth keeping.

*Restricting capability of managers to function as models for younger members of faculty or students*

Heavily involving the teachers in management positions in writing documentations and reports and preparing for visits from various external quality assessment teams, forces

managers to “delegate” their teaching responsibilities and become vulnerable on both professional and moral levels.

Chancellors and Deans sending their Assistants to teach is rather commonplace in Romania and is certainly not conducive to a sound academic climate.

In the real life, such persons are being paid for teaching they do not have time to deliver, while junior faculty members do not get paid for teaching they actually do.

*Allowing assessment judgements to be influenced by conflicting interests of competing institutions or individuals*

In Romania it is generally accepted that free competition and initiative are desirable and that the state is a poor administrator, *with the notable exception* of the education sector. Representatives of state funded universities feel they are entitled to a superior status and may use their position in assessment teams to consolidate this perception.

There has recently been an attempt to nominate the Chancellor of an independent university as Minister of Education. A large number of professors from state funded universities protested, arguing that there is a chance that support for independent universities from the government might eventually increase. Finally, the nominated Minister of Education had a state funded university background.

*Encouraging dishonest strategies to boost scientific productivity*

The need to score better in quality of education assessment generated, among other things, an increased pressure to publish in top international scientific journals. This led to setting up groups of 5-10 or more academic staff members using the following strategy: Each group member will prepare and submit a scientific paper to an international science journal, including *all the other members* of the group as co-authors. By the laws of probability, there will be a dramatic increase in the chances for every member of the group to score points as first author or co-author.

There seems to be a very recent development of this approach: Informal small groups of experts or consultants started to produce and sell ISI publishable papers. “Investing in one’s CV” has become a key phrase for people willing to use this strategy in order to climb to senior positions in universities.

*Discouraging cooperation and communication between competing universities, departments or faculty members*

Freely exchanging information and ideas is one key component of academic life. Misdirected and misused quality assessment in Higher education may generate communication blocks, status competition and conflicts and disseminate the idea that one's University will do better should competing universities cease to exist. The very essence of university may be as such corrupted.

## DISCUSSION AND CONCLUSIONS

The idea of assuring quality in Higher education by setting up set of criteria and standards and then verifying to what degree the universities align to them seems, at first sight, reasonable and indeed very tempting.

However, "standard" and "standardization" are rather associated with uniformity, with efficient mass production, while quality is rather associated with creativity, diversity and freedom. High quality products of any kind are frequently "personalized", "custom made" or "client tailored". Having all the higher education institutions look alike and behave alike is an approach that is counterproductive from the quality point of view. Programmes of study that could appear of little relevance for the current social awareness may prove of extremely high value fifteen years from now.

Moreover, creativity and intuition are difficult to measure, before the culture system is ready to understand and accept the elements of novelty. We *cannot* measure what does not yet exist, nor processes leading to the creation of yet non-existent skills, competencies or academic qualifications.

The "Nutty Professor", usually the most creative and respected by the students does not fit into this quality assurance paradigm.

Attempts to boost the face validity of quality assessment and assurance by generating an ever larger number of standards and performance indicators will only lead to have the system collapse under the weight of activities not directly related to teaching and research.

Using a top-down strategy in setting up and implementing a quality assessment and assurance in Higher education will increase the number of potential risks.

The main risk will always be to obtain results that are completely opposed to the ones intended, by depleting institutional resources and deteriorating organizational climate, motivation and morale.

Such risks should always be acknowledged and assessed before, during and after putting in place a quality assurance system.

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## CORPORATE SOCIAL RESPONSIBILITY AND STAKEHOLDER STRATEGIES: THE IMPACT IN RISK MANAGEMENT

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### ABSTRACT

Nowdays, Corporate social responsibility has been studied by several authors, some of them focus in stakeholder theory, which has been proposed by many authors such as Freeman, 1984; Mitchell et al., 1997; Kaptein and Van Tulder, 2003 and Aguinis & Glavas, 2011. These studies have identified some relationships between financial results, management and development of business strategies. One of these strategies identify, is related to how the groups of interest impact in risk management and particularly in reputational risk in the organizations. This paper seeks to identify the theoretical framework related to these two variables (interest groups and reputational risks). Besides, the future study will focus in an emerging market country.

**Keywords:** Corporate Social Responsibility, Stakeholders and Reputational Risk.

### INTRODUCTION

Corporate social responsibility (CSR) has become important in the strategic planning of businesses in the productive sectors such as mining and agriculture (Serenko and Bontis, 2009; Wagner, Lutz, and Weitz, 2009; Wartick and Cochran, 1985 Wood, 1991 and 2010; Werther and Chandler, 2006). These plans of CSR produce positive impacts on the business community and encouraging sustainable social and economic development in time (Galán, 2006).

It is noted that the presence of CSR in the extractive industries and production has been important in recent years, but only recently is being incorporated in the financial sector (Peloza, 2009, 2011, Lindgren, et al., 1999) to Because of the different social damage it has caused financial crises.

A review of literature shows two lines of research that are addressed in this document (Wartick, 2002; Fombrun and Van Riel, 2002, Dalton and Croft, 2003) and are applied to Peruvian financial entities. First, measure the impact of CSR on social and economic development of the community (Garriga and Melé, 2004), and secondly the importance of CSR in building corporate reputation (Rayner, 2003; March and Shapira, 1987).

The main aspect is about the impact and scope generated because, if the company decides to incorporate CSR into their strategic planning from the point of view of stakeholders, that is, considering all stakeholders associated with the company, then the perception of stakeholders on the actions and commitments of the company is positive, which strengthens the business reputation and reduce reputational risk.

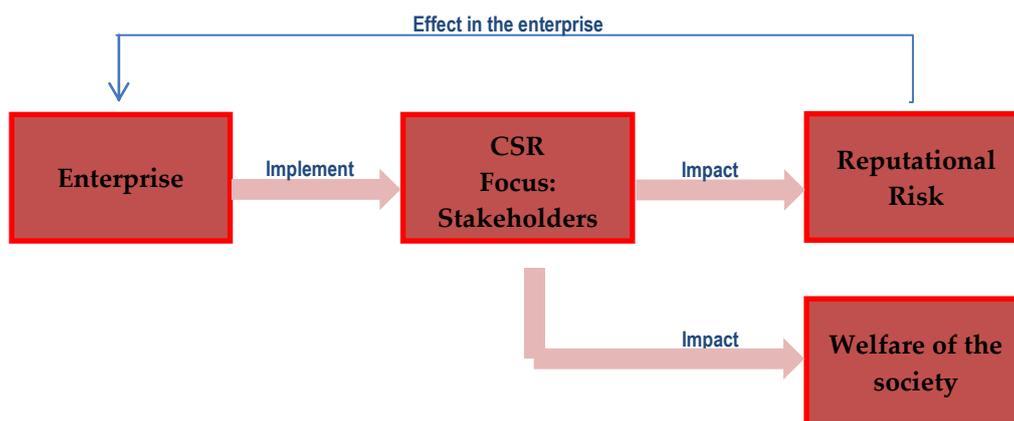
Also, two theories hold this research: the first is the theory of CSR from a viewpoint of stakeholders (Freeman, 1984; Mitchell et al., 1997; Kaptein and Van Tulder, 2003; Aguinis and Glavas, 2012), the second is the theory of corporate reputation and reputational risk associated (Marcus and Nichols, 1999).

Figure 1 shows the relationship between CSR and reputational risk. First, the implementation of plans under the focus of CSR stakeholders will have a significant impact on reputational risk and welfare of the community.

When considering all stakeholders associated with the company, then seek CSR plans intereres align with the business community, allowing these plans to meet the priorities of the community. At alcanzarce above reduces the probability of a particular interest group has not been considered, which will strengthen corporate reputation and reputational risk associated decrease.

Second, reputational risk will affect the welfare of the company as they have a lower risk of reputational this is expressed in better benefits for shareholders.

**Figure 1:** CSR and Reputational Risk



Source: done by the autor

## LITERATURE REVIEW

The literature review is based on two theoretical pillars. The first is the theory of corporate social responsibility. In this theoretical framework emphasizes the vision of CSR stakeholders. The second is the theory of business reputation, which is associated with reputational risk.

### **Theory of Corporate Social Responsibility**

Corporate social responsibility is the continuing commitment of business to contribute to sustainable economic development, improving the quality of life of its employees and their families and the local community and society at large (World Business Council for Sustainable Development - 2000 (WBCSD)).

According McElhaney (2009), corporate social responsibility is defined as a business strategy that is integrated with core business objectives and core competencies of the company. In addition, the author indicates that CSR is designed to create business value.

The concept of corporate social responsibility is not new (De Bakker et al., 2006), but as an idea had already been taken into account in the early part of the twentieth century, the modern study was pioneered by Howard R Bowen et. al. (1953) who suggested that companies should take into account the socio-economic consequences of their decisions.

From the nineties and is not considered to corporate social responsibility as an isolated phenomenon within the company but cuts across the different areas of the organization (Manen, 2001).

Carroll et. al. (1979, 1991, 1999) establishes four levels of corporate social responsibility, as shown below (see figure 2).

**Figure 2:** Carroll's Pyramid



**Source:** Carroll et al, (1991)

Drucker (1996) complements this view by stating that each organization must assume full responsibility for the effect it has on their employees, the environment, customers and anyone or anything that extent, this is considered CSR<sup>24</sup>. Based on the authors revised corporate social responsibility can be defined as how to manage or lead a company or organization in a manner that meets or exceeds expectations ethical, legal, commercial and public expectations that society has in relation to companies.

In short, according to the literature reviewed, CSR involves the simultaneous fulfillment of economic responsibilities, legal, ethical and philanthropic. In addition, CSR must take the business to make a profit, obey the law, be ethical and CSR behaves as a good corporate citizen. The following table shows research and studies realized on the basis of corporate social responsibility (see Table 1).

**Table 1:** Researches about the relationship between CSR and strategy and stakeholders

Studies on the relationship of CSR to Strategy	
Mc Williams et al. (2006)	Develop a conceptual framework are strategic implications of CSR
Studies of the relationship between corporate social performance and financial performance	
Ullmann (1985)	Tri-dimensional model: Stakeholder Power, strategic position and economic performance
Orlitzky et al. (2003)	Theory on corporate social and financial performance.
De Bakker et al. (2005,2006)	They established an analysis of 30 years of research based on the relationship between CSR and corporate financial performance.
Critical analysis of the influence of corporate social performance and financial performance corportivo connection	
Rowley & Berman (2000)	Conditions under which groups of participants perform their actions to influence the company

**Source:** Different authors

**Elaboration:** Own

Aligned with Garriga and Melé (2004), theories of CSR presents four common dimensions: benefits, political action, social demands and ethical values. Under this premise, the authors classified the theory in four blocks as the emphasis each theory does in any of the four dimensions: instrumental theories, political theories, integrative theories and ethical theories.

<sup>24</sup> Drucker, P. La gestión en tiempos de grandes cambios. Ediciones Gestión 2000 S.A. 1996, p. 83.

### **Instrumental Theories.**

Under this approach the company is seen solely as a tool for wealth creation, and social activities as a means to economic performance. In this group of theories include two approaches (Friedman, 1970, Windsor, 2001; McWilliams and Siegel, 2001, Carroll, 1979).

The first refers to the maximization of shareholder value as the supreme criterion for assessing corporate social activities.

The second focuses on strategies for competitive advantage. This latter group of theories presents three approaches:

The first approach is the social investment in a competitive context (Roman and Slopes, 2008; Sen et. Al., 2001). Advocates of this approach argue that investment in philanthropic activities can be used to improve the context of a firm's competitive advantage as it usually creates social value than they can create individual donors or government.

The second approach is the perspective of the firm and dynamic capabilities based on natural resources (De Pelsmacker et al., 2005; Obermiller et al., 2009). This approach holds that a company's ability to achieve better results than its competitors depends on the interaction of human, organizational and physical over time and organizational and strategic routines by which managers acquire these resources, the modified , integrate and combine to generate new value-creating strategies.

Finally the third approach focuses on the strategy for the base of the economic pyramid (De Matos and Rossi, 2006; Narwal and Sharma, 2008), in which some authors see an opportunity to innovate more than a problem. One way of addressing this issue is disruptive innovation: products or services that do not have the same capabilities or conditions as those used by customers in conventional markets and, therefore, may not be introduced for new or less complicated between nontraditional customers with a low production cost and adapted to the needs of the population.

### **Integrative theories**

In these theories the company focuses on capturing, identifying and responding to social demands. This claim social legitimacy and greater acceptance and social prestige. This group includes the management theories of social affairs, the principle of public accountability, the management of the groups involved (stakeholders) and corporate social action (Freeman, 1984; Mitchell et al., 1997; Kaptein and Van Tulder, 2003; Basu and Palazzo, 2008).

**The management of socio-economic issues**, defined as the processes by which the company identifies, evaluates and responds to social, economic and political factors that may significantly affect (Barone et al, 2000).

**The principle of public responsibility.** This principle holds that appropriate business behavior derived from relevant public policy, including the general pattern of social direction reflected in public opinion, emerging issues, legal requirements and formal execution or enforcement practices (Bowen, 1953).

**The management of the groups involved (stakeholders)**, a people-oriented approach that influence or are influenced by policies and corporate practices. Its advantage is the increased sensitivity of the firm to its environment, but also a better understanding on the part of the agents of the dilemmas facing the organization (Aguinis and Glavas, 2012, Agle et. Al., 1999; Andriof et.al. , 2002; Baro, 2011).

### Reputational Enterprise Theory

In the literature there is a range of definitions of corporate reputation, however, they all share one thing in common: that the expectations and perceptions of the stakeholders involved with the company determine the degree of reputation for this. The following table is indicative of the main definitions of business reputation.

**Table 2:** Corporate Reputation Definitions

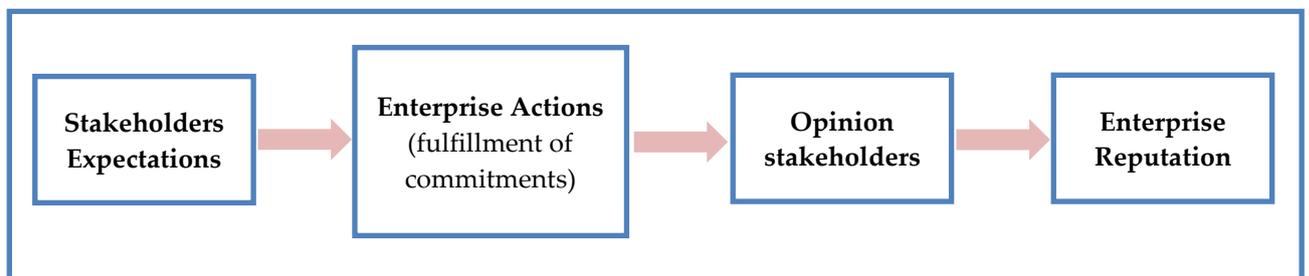
Author	Definition
Wartick (2002)	Adding perceptions of each of the participants on how the organization responds and meets the demands and expectations of the stakeholders of the organization.
Fombrun & Van Riel (2002)	Collective representation of past actions and results that describes the company's ability to deliver this value to various internal and external stakeholders.
Chun (2005)	Sum of the values that stakeholders attach to the company, based on their perception and interpretation of the image that the company communicates and behavior over time.
Ferguson, Deephouse y Ferguson (2000)	Knowledge of the true characteristics of a company and the emotions they feel towards it stakeholders.
Villafañe (2002)	Recognition that the <i>stakeholders</i> of an organization make corporate behavior through the degree of compliance with its commitments in relation to their customers, employees, shareholders and the community.

**Fuente:** Garicano (2011)

It is hoped that the various stakeholders have different interests and different expectations, so that corporate reputation depends on crossing those expectations with actual experiences resulting from compliance or non-compliance of the commitments made by the company.

In this regard, the company should consider in their strategic planning principles that will address the relationship of this with the stakeholders involved. By knowing the company, the interests of all stakeholders, then plans to undertake corporate social responsibility may contemplate all those needs (interests). This will allow the perception of stakeholders on the actions of the company is good, which helps to improve the reputation of the company (see figure 3).

**Figure 3:** stakeholders expectations and corporate reputation



**Elaboration:** own

In line with the above, corporate reputation is the result of confronting what the company is committed to do, and what really makes and the view of the stakeholders in this regard. This means they must align objectives and the values CSR declared by the company, with the behaviors and actions developed by this and the expectations of stakeholders.

### **Reputational Risk**

Reputational risk can be defined as the possibility of loss or decline in the reputation of an organization in a way that adversely affects the perception that the social environment has on it, and to be an effect of direct or indirect loss in the value of a company (Rayner, 2003; March and Shapira, 1987; Bebbington, 2007).

Reputational capital, understood as the reputation earned or accrued until today, is influenced by the interaction between the companies with interest groups (stakeholders). Thus, this reputational capital is created when managers convince employees to work with commitment, to consumers to buy their products and investors to buy their shares; grows

when managers convince analysts and media to praise the company and recommend its units, and finally destroyed when stakeholders lose confidence in the managers, products, expectations or jobs.

In line with Vizcaino (2010), reputational risk can be classified into two types:

The first is situational reputational risk, which is characterized as immediate, that is, it is impossible to anticipate RSC him to control the situation (Marcus and Nichols, 1999). For example, a terrorist attack.

The second is expected reputational risk, to which the company can anticipate RSC to plan communication strategies to employ in order to minimize the consequences. For example, a company that plans to close a plant communication campaigns carried out in good time to explain the reasons and try to minimize adverse reactions.

## **CSR AND REPUTATIONAL RISK**

Reputational risk can be defined as the possibility of loss or decline in the reputation of an organization. This loss of reputation affects the perception that the social environment (including stakeholders) has on the company producing direct or indirect loss in the value of the company (Rayner, 2003; March and Shapira, 1987; Bebbington, 2007).

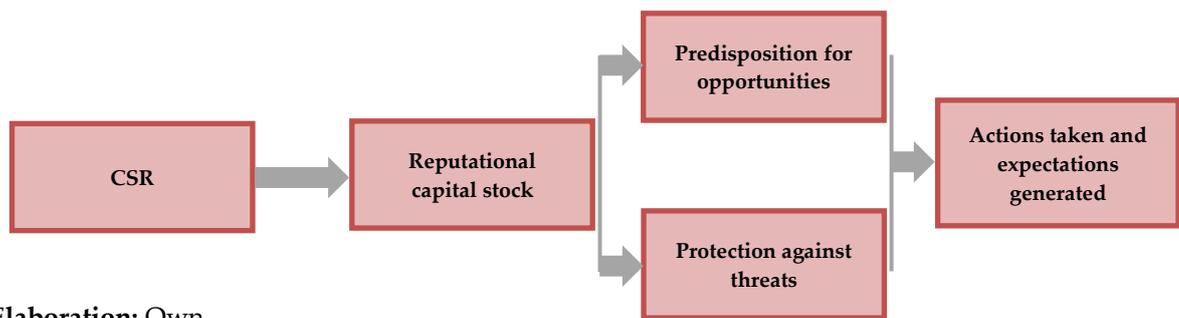
Vizcaino (2010) indicates that reputational risk can be classified into two types: the first is the reputational risk or immediate situational, that it is impossible to anticipate, such as a natural phenomenon (earthquake), which could affect the normal operation of the company. The second is the expected reputational risk to which the company can anticipate CSR activities in order to minimize the consequences. For example, a company that plans to close a plant communication campaigns carried out in good time to explain the reasons and try to minimize adverse reactions.

As above, CSR has an impact on reputational risk. Since the company's reputation depends on the perceptions of stakeholders, then each of them is a source of risk to be managed through the company CSR plans. In addition, the company should manage their relations in respect of these stakeholders (Pfeffer and Salancik, 1978; Turban and Greening, 1997; Wagner et. Al., 2009).

CSR is part of a cycle through which companies generate reputational capital, manage reputational risk and improve their performance. Companies invest in corporate social responsibility, which generates a reputation capital stock that is used for two purposes: firstly, it is a launch pad for future opportunities and, on the other hand, current safeguards

assets, acting as buffer against the losses (Knox and Maklan, 2004; Ruiz, 2012). Through CSR programs is given cycle consistency and managed the reputational risk (see Figure 4).

**Figure 4:** CSR and generated expectations

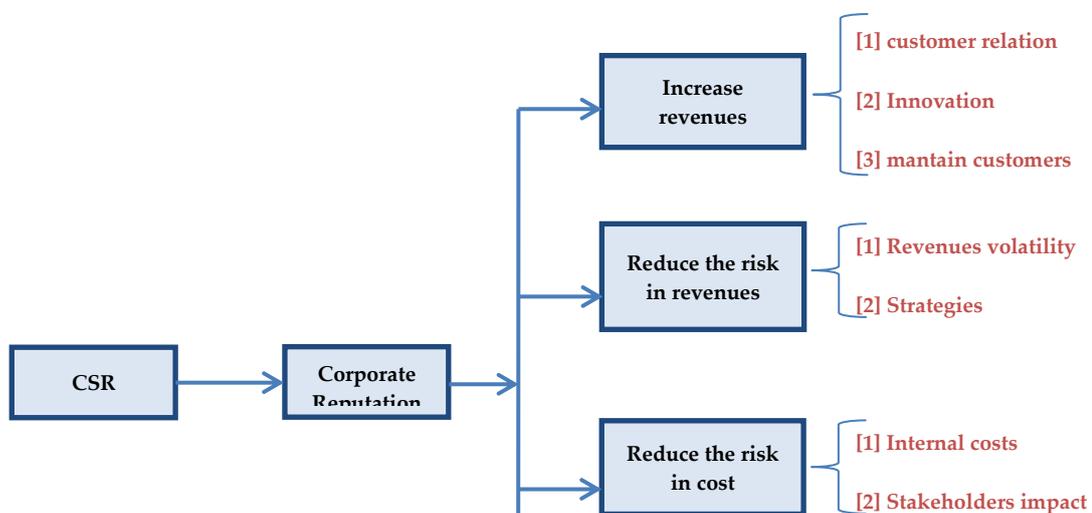


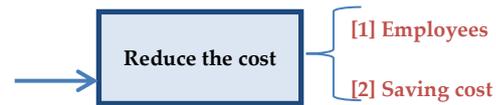
Elaboration: Own

CSR is part of a cycle through which firms generate reputational capital, manage risk and improve their performance reputation. Companies invest in corporate social responsibility, creating a stock of reputational capital that is used for two purposes: firstly, it is a launch pad for future opportunities and, on the other hand, current safeguards assets, acting as cushion against losses. Through CSR programs gives consistency to the cycle and manages reputational risk (see figure 4).

According to Knox and Maklan (2004), the final effects of CSR on corporate reputation pueden divided into four categories: earnings, risk associated with the loss of earnings, cost risk and cost reduction (see figure 5).

**Figure 5:** Effects of the relationship between CSR and corporate reputation





**Resource:** Knox y Maklan (2004)

**Elaboration:** Own

## COMMENTS

The research will study the groups of stakeholders corporate social responsibility (CSR) strategy and the impact in reputational risk. It also can analyze the risk management (RM) from the perspective of standards such as COSO ERM II and ISO 31000 guidance and to what extent the GI impact on GR.

One contribution of this work is that it will consolidate not only the number but the types of stakeholders or "stakeholders" of the Peruvian financial sector companies.

Today, CSR has been studied and has been adopted in various organizations, but the importance of considering the stakeholders of an organization, in the management of risks is a rarely explored.

The implications that this work are large because it represents the beginning of an investigation that should allow detailed knowledge variables and factors that determine the behavior of interest groups, but the connections with organizational risk and their management in of financial markets.

Furthermore, it is expected that this work will consolidate standardization systems that are characterized by involving your group interested in developing internal plans to improve service and ensure business continuity, this being part of risk management.

A review of literature shows three important conclusions. The first is that CSR has a positive impact on the reputation of the company. This finding not only theoretical (between different conceptual approaches) but also empirically. However, found that research in this field are mainly oriented towards developed countries. This is important because it opens a line of research that involves the application of the theoretical framework of CSR and Corporate Reputation (CR) in developing countries.

Another conclusion is that among the various approaches to corporate reputation, which emerges as one who considers the perceptions of all stakeholders is the relational school. This is important because it allows integrating theories related to the RSC. From the literature

review found that this aspect has not been addressed the relationship between CSR and the CR from a stakeholder perspective.

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## Z – ALTMAN REVIEW. THE CASE OF BEVERAGE COMPANY IN LATAM

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### ABSTRACT

In recent years, the growth in beverage industry has been important. Overall, statistics show that Latam companies have presented a good financial performance. However, this performance could be highly questionable and, questions like what is going to happen in the next years in the industry or how likely a failure or bankruptcy could be experimented and needs to be answered. So, in order to answer those questions, an analysis is done by Ivan Vonne, a senior analyst.

The method applied to this assessment is the Z-Score method developed by Altman in 1968. The literature review helped us to identify three types of Z-score, one developed by Edward Altman in 1968 called “Z-Score Model”, the other improved by Edward Altman in 1984 called “Company and Country Risk Models” for private companies and the last one improved by Altman, Hartzell y Peck in 1995 called “Emerging Market Scoring Model” (EMS Model) for non-manufactured companies and emerging market credits.

The paper, focus in a Beverage Industry. One company has been identified with operations in Peru and this company listed its equity in the Bolsa de valores de Lima (BVL, for its acronym in Spanish). The paper has an introduction about the Z- score literature, then it has an explanation about the Beverage industry in Peru and finally, the paper include the Z-score values of the company between 2009 and 2012.

**Keywords:** Beverage industry, financial strategies, financial statement analysis, Ratios, Z-score.

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\* The case was prepared with the collaboration of Miguel Angel Condor and Joselyn Kelly Avelino

## 1. INTRODUCTION<sup>25</sup>

The Company “**Peruvian Beverage Inc**”<sup>26</sup> has decided to evaluate its performance in the previous periods in order to know the efficient level of the company’s operation in that time. In that way, the Chief Executive Officer (CEO) of Peruvian Beverage, Carlos Eley, has asked to his senior analyst, Ivan Vonne, to carry out a deep assessment of the company’s operation and know if it is possible that in the future the company will face negative trends.

With the aim to fulfill the assessment, Mr. Vonne will have to collect all available and necessary information that will be required to complete it. Due to the fast development of the market, Vonne plans to finish it in the next 20 days. In the same way, Mr. Vonne is bearing in mind the development of the industry to avoid any kind of mistake.

In addition, Peruvian Beverage, as other companies in the same industry, listed its equity in BVL (Bolsa de Valores de Lima) and, reports its financial statement to Superintendencia del Mercado de Valores–SMV (capital market regulator). Besides, the audited information is also available in the SMV web page.

In this way, Mr. Vonne requested a distress meeting, where the data gathered will be reviewed and some future projects will be discussed and beared in mind. The meeting was on January 10<sup>th</sup> of 2013 and was made up by Mr. Vonne, Carlos Eley (Financial area CEO of Peruvian Beverage) and Ronald Pantia (Vice-president of Peruvian Beverage).

During the meeting, Mr. Pantia introduced a brief history about the company performance, how they have grown since it was founded a long time ago. Likewise, he mentioned some successful agreements and failed projects that have been experienced. Despite of the good results in last year, Mr. Eley mentioned some financial distress recently experienced. In addition, Mr. Vonne talked about the Z-Altman Model, and explained who used it, how it works and how efficient it could be for the analysis.

## 2. LITERATURE REVIEW

The Z - Score model is the distillation into a single measure of a number of financial ratios duly elected, weighted and aggregated. If the derivative Z - Score result exceeds a calculated

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<sup>25</sup>Class &Asociados S.A., Pacific Credit Rating.

<sup>26</sup>The name of the company was changed for the case.

score, the firm is classified as financially healthy, if it is below the cutoff, is typically seen as a potential failure (Altman, 1968).

Besides, Altman (1968) explains that the selection of the independent variables, Altman initially joined a group of 22 ratios that were applied to both subsamples of firms companies.

The selection of these ratios was based on the following three criteria:

- a) Because of its popularity in the literature,
- b) Relevance to the study power,
- c) For the innovative way that some ratios presented in the analysis.

Likewise, the 22 ratios were reduced to five factors that mediate: profitability, activity, liquidity and solvency.

For Altman, five factors were shown to be the best combinations for discriminating between bankrupt firms and companies without bankruptcy. However, this author indicated no basis to split into five categories your model, and if in fact these categories were the most representative at large and independent to predict bankruptcy.

In addition, the model was originally developed to analyze only industrial companies (construction and manufacturing), on the other hand it was applied to different models developed for retail and service businesses. As Peek & Rosengren (1996) recognize "is easy to identify a troubled bank at the time of its bankruptcy.

The Z - score Model, for some reason, seems to generate a lot of emotion and trying to prove they really work (Morris, 1997). However, much of the concern about its use is based on a misunderstanding of what is and what is not and what it is designed to do and not to do.

A brief explanation of the three Z - Altman models are going to be presented in next paragraphs:

- **Z-score Model.**

The final discriminant function is as follows:

$$Z = 0.012X_1 + 0.014X_2 + 0.033X_3 + 0.006X_4 + 0.999X_5 \text{ — — — — — (I)}$$

**Where**      $X_1$      =Working capital / Total assets  
                   $X_2$      =Retained Earnings / Total assets

$X_3$	=Earnings before interest and taxes / Total assets
$X_4$	=Market value equity / Total liabilities
$X_5$	=Sales / Total assets
$Z$	= Overall Index

$X_1$  — *Working capital/Total assets*. This ratio, often found in studies of corporate problems, is a measure of the net liquid assets of the firm relative to the total capitalization. Working capital is defined as the difference between current assets and current liabilities. Liquidity and size characteristics are explicitly considered.

$X_2$  — *Retained Earnings/Total assets*. This measure of cumulative profitability over time was cited earlier as one of the “new” ratios. The age of a firm is implicitly considered in this ratio. The incidence of failure is much higher in a firm’s earlier years.

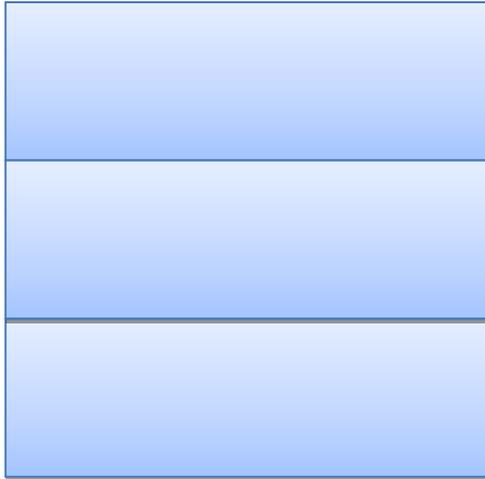
$X_3$  — *Earnings before interest and taxes/Total assets*. This ratio is calculated by dividing the total assets of a firm into its earnings before interest and tax reductions. In essence, it is a measure of the true productivity of the firm’s assets, abstracting from any tax or leverage factors.

$X_4$  — *Market value equity/Total liabilities*. Equity is measured by the combined market value of all shares of stock, preferred and common, while debt include both current and long-term. The measure shows how much the firm’s assets can decline in value (measured by market value of equity plus debt) before the liabilities exceed the assets and the firm becomes insolvent. It also appears to be a more effective predictor of bankruptcy than a similar, more commonly used ratio: Net worth / Total debt (book values).

$X_5$  — *Sales/Total assets*. The capital turnover ratio is a standard financial ratio illustrating the sales generating ability of the firm’s assets. It is one measure of management’s capability in dealing with competitive conditions. This final ratio is quite important because, as indicated below it is the least significant ratio on an individual basis. In fact, based on the statistical significance measure, it would not have appeared at all.

*Source: Altman (1968)*

In next Graphic, we can observe the solvency area. If the result is under 1.80 (Distress zone) the company is susceptible to bankrupt. If it is between 1.80 and 2.99 (Grey Zone) it is likely that the company will not bankrupt. If it is above 2.99 the company is highly probably to continue in the market and with good financial health.

**Graphic N° 1 – Solvency Area (I)**

- **The Z-score estimated for private firms**

In 1984, Altman edited 20 articles which tried to improve his model to measure the firm's risk. In that way, a lot of studies were carried out in countries highly industrialized such as Germany, Australia, France, Italy, United Kingdom, Japan and Israel. Finally, Altman called this new method as "Company and Country Risk Models". (Ibarra, 2001).

The final discriminant function is as follows:

$$Z = 0.717X_1 + 0.847X_2 + 3.107X_3 + 0.420X_4 + 0.998X_5 \text{ --- (II)}$$

<b>Where</b>	<b>X<sub>1</sub></b>	=Working capital / Total assets
	<b>X<sub>2</sub></b>	=Retained Earnings / Total assets
	<b>X<sub>3</sub></b>	=Earnings before interest and taxes / Total assets
	<b>X<sub>4</sub></b>	=Book value of equity / Total liabilities
	<b>X<sub>5</sub></b>	=Sales / Total assets
	<b>Z</b>	= Overall Index

*X<sub>1</sub>* — *Working capital/Total assets*. As in the original or first formula of Altman, this ratio shows the value of the company according to the total assets level. Most of the companies relate this results to its liquidity performance. As we mention previously, working capital is defined as the difference between current assets and current liabilities.

*X<sub>2</sub>* — *Retained Earnings/Total assets*. In recent years, this measure of cumulative profitability was considered one of the most important ratios for firms. Here we consider how long the company has stayed in the industry. It's likely to failure in a firm's earlier years.

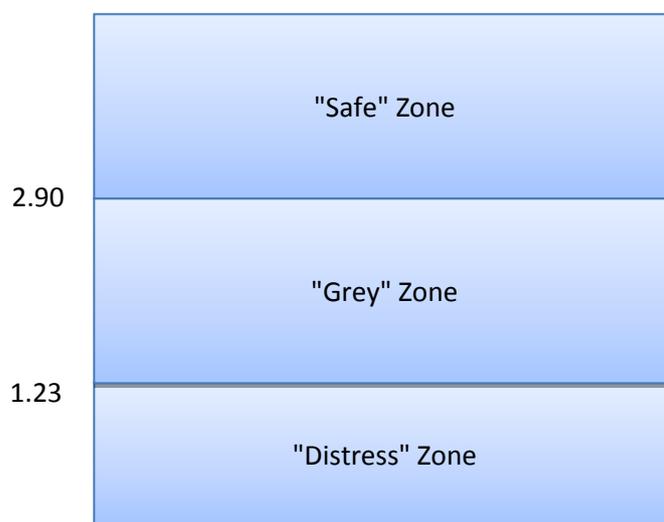
$X_3$  — *Earnings before interest and taxes/Total assets*. This ratio is a measure of the true productivity of the firm's assets, independent of any tax or leverage factors. So, it can show a more accurate result if accounts, such as interest and taxes that are related to liabilities, are not considered.

$X_4$  — *Book value of equity/Total liabilities*. Much of the firms do not have place in market stock. So, these kinds of firms cannot be assessed by ratio of Market Value equity. That is why after some studies, Altman figured out that consider the book value of equity will allow any kind of firm to be assessed under the new Z – Score model.

$X_5$  — *Sales/Total assets*. The return on assets (ROA) gives an idea as to how efficient management is at using its assets to generate earnings. However, this ratio is considered a weak ratio for the formula, because it barely is able to discriminate as a ratio.

In next Graphic, we can observe the solvency area. If the result is under 1.23 (Distress zone) the company is susceptible to bankrupt. If it is between 1.23 and 2.90 (Grey Zone) it is likely that the company will not bankrupt. If it is above 2.90 the company is highly probably to continue in the market and with good financial health.

#### Graphic N° 2 – Solvency Area (II)



- **The Z-score estimated for non- manufacturer industrial and emerging market credits.**

In 1995, during investigations with Hartzell and Peck, Altman adapted his model to emerging markets in order to bring forward a new global predictive indicator sole for this kind of markets. This new indicator was called "Emerging Market Scoring Model" (EMS Model).

“The final discriminant function is as follows:

$$Z = 6.560X_1 + 3.260X_2 + 6.720X_3 + 1.050X_4 \text{ — — — — — (III)}$$

<b>Where</b>	<b>X<sub>1</sub></b>	=Working capital / Total assets
	<b>X<sub>2</sub></b>	=Retained Earnings / Total assets
	<b>X<sub>3</sub></b>	=Earnings before interest and taxes / Total assets
	<b>X<sub>4</sub></b>	=Book value of equity / Total liabilities
	<b>Z</b>	= Overall Index

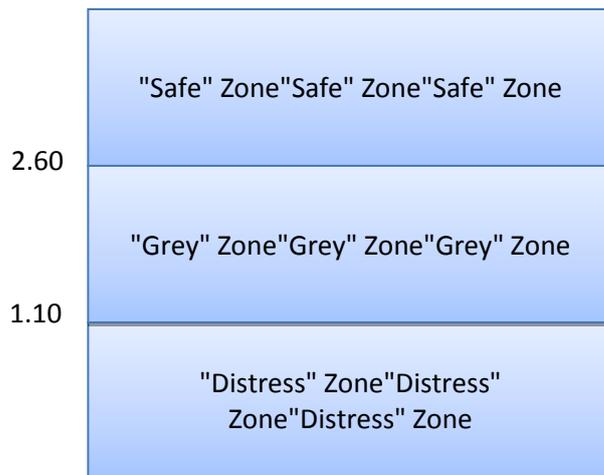
*X<sub>1</sub>* — *Working capital/Total assets*. This ratio measures the capital that the company owns and how well it is distributed in their assets. According to this ratio, investors can follow the performance of the company assessing the asset-s behavior.

*X<sub>2</sub>* — *Retained Earnings/Total assets*. This ratio measures the firm's ability to accumulate earnings using its assets. A higher ratio is preferable because it indicates that the company is able to retain more earnings. However, it is also related to the investors, because here the company discuss if earnings must be distributed or not.

*X<sub>3</sub>* — *Earnings before interest and taxes/Total assets*. Earnings before interest and tax (EBIT) to total assets ratio indicates a proportion between the measure that shows company's profitability and company's assets. In short, it represents general profitability of the company's assets.

*X<sub>4</sub>* — *Book value of equity/Total liabilities*. The book value of equity represents the equity of shareholders (from a balance sheet perspective) less the preferred stock. So, this result shows the value of the equity according to level of debt and the financial strength of the company just with the equity.

In next Graphic, we can observe the solvency area. If the result is under 1.10 (Distress zone) the company is susceptible to bankrupt. If it is between 1.10 and 2.60 (Grey Zone) it is likely that the company will not bankrupt. If it is above 2.60 the company is highly probably to continue in the market and with good financial health.

**Graphic N° 3 – Solvency Area (III)**

### 3. PERUVIAN BEVERAGE INDUSTRY<sup>27</sup>

The availability of information in the industry is considered an important point for any kind of investment, and also it's even more important for the legal and regulatory aspects.

The food processing industry in Peru is made up of:

1. **Water treatment:** Water main component in the production of beverages. It is mainly obtained from underground wells. This is brought under to a purification and sterilization process, which uses a chemical treatment and various stages of filtration.
2. **Preparation of syrups:** At this stage, sugar and water are mixed, and "simple syrup" is obtained. Then, this is filtered at low pressure to remove impurities. Syrup essence is added to it. This last step gives the finished syrup.
3. **Mix, carbonation and filling:** More water is added to the finished syrup. Then, it is drifting towards hermetic tanks, where it is cooled and saturated with carbon dioxide. In this way, the mixture is ready to move to the filling machine, where it proceeds to bottling. The product, that reaches the filler, is pumped into the bottles, which are sealed with tight lids.
4. **Development of bottles:** The soft drink industry uses two types of containers: returnable and non-returnable. Investment in machinery is higher in the case of bottled of returnable containers, since it is necessary additional production lines to control the quality of them. It is estimated that the cost of installing a production line of returnable containers is 4 to 5 times more expensive than the one for a line of non-

<sup>27</sup>Class & Asociados S.A., Pacific Credit Rating

returnable containers. However, despite of the initial investment is more expensive, these containers are more profitable in the mid-term, depending on the rotation that is giving to the complete returnable packaging. Note that in addition to the initial investment in machinery, there is an investment in the container package. Thus, the greater the number of rotations that give this package, less the amount to amortize on each rotation. It is important to indicate that at this stage there are high production quality controls, which generate additional costs.

5. **Inspection, packaged and palletized:** filled and capped bottles are inspected in two ways: i) electronic inspectors to automatically separate the defective bottles and ii) with illuminated displays that allow visual inspection and manual separation of defective bottles. The bottles, which pass inspection, enter a machine that puts them in their boxes to finally make them to order on the platforms.
6. **Storage and transport:** The mentioned platforms are stacked neatly and then be carried by trucks. Finally, trucks distributed platforms with soft drinks to the determined points of sale.

As shown in Table 1. Sales level of the company and Figure 1. Evolution of sales level of the company and annually growth in percentage, there has been a continual growth since 2005. This increase reflects a possible tendency towards growth in the next years.

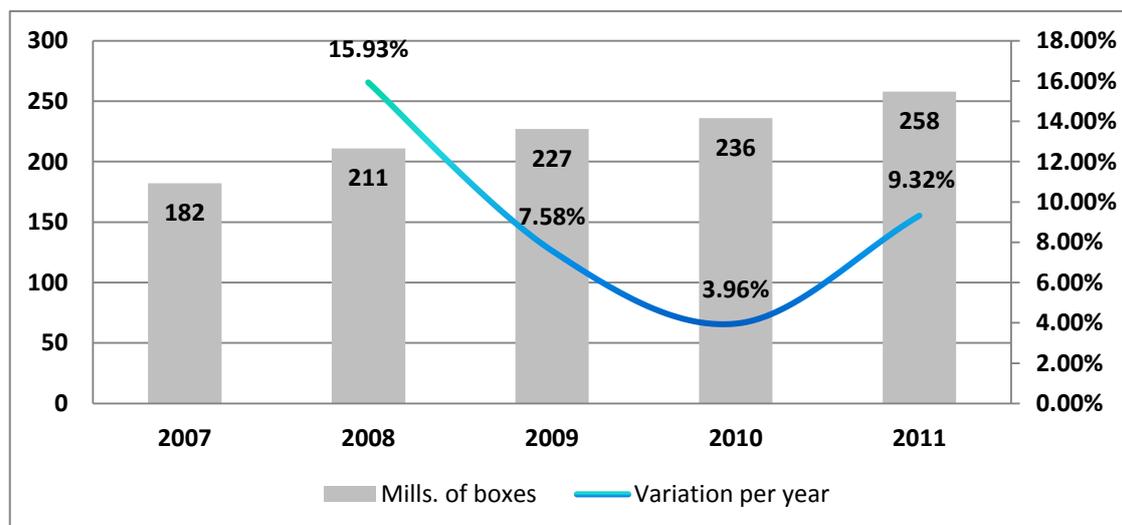
**Table N° 1 - Sales level of the company**

Year	2007	2008	2009	2010	2011
Mills. of boxes	182.00	211.00	227.00	236.00	258.00
Annually growth	—	29.00	16.00	9.00	22.00
Growth 11/10	9.32%				
Average variation	9.20%				

Source: Firm's annual report 2011

The Figure N° 1 - Evolution of sales level of the company (in millions of boxes) and annually growth in percentage files the amounts of boxes sold between the periods 2007 and 2011. In addition, as we can observe there is a growing trend in those 5 years assessed what means that the company is getting strong in the industry. However, the evolution per year had cut back on between the periods 2008 and 2010 and slightly increased in 2011.

**Figure N° 1 -Evolution of sales level of the company (in millions of boxes) and annually growth in percentage**



*Source: Firm's annual report 2011*

#### 4. FIRM'S BACKGROUND AND OPERATIONS

Ivan looked interested in the explanation of industry. Nevertheless, he pointed out the importance of understanding company operations and knowing completely its financial situation in last periods.

First, he reviewed the information from BVL's web page ([www.bvl.com.pe](http://www.bvl.com.pe)), SMV ([www.smv.gob.pe](http://www.smv.gob.pe)) and the one provided by the firm. In those websites, he found relevant information about financial statements, cash flow and quotations of the diverse instruments that currently belong to the account.

It's important to mention some important facts of firm's history that belong to the firm Peruvian Beverage.

Peruvian Beverage inc. was founded by public deed in November 3 of 1928. The firm assumed the activities developed by Carbonated Beverages Factory established in 1910.

The principal activity of the firm is the development, bottling, distribution and sale of soft drinks, carbonated water, pulp and nectar. The company applies franchising to certain trademarks owned by companies related to the Group. When the company acquired shares of LATAM Bottler Company, in January 2004, the company became the exclusive bottler in the country.

Sales of the Company's products are made primarily to distributors in Lima and other cities within the country.

With respect to Stock market, the November 23, 2011, the Company entered into the international bond issue under rule 144A of the Securities Market Law of the Foreign Market for an amount of U.S. \$ 320 million to a rate of 6.75% and maturing on November 23, 2021. The earnings from this issuance were used internationally to restructure its liabilities and to finance its investment plan.

### Commercial Management

The carbonated beverage segment is the most important in terms of sales volume, meanwhile the other categories have been showing higher growth rates in recent years, representing, in liters, 77% of sales volume and water categories, nectars and isotonic accounted for 16%, 4% and 1% by volume, respectively.

Our market share in the products we produce and sell at the end of 2011 was as follows:

**Table N° 2 – Products participation**

Participation	Line of Products
67.30%	Carbonated beverages
46.20%	Nectars
39.50%	Water
21.90%	Isotonic
15.50%	Energizing

*Source: Firm's annual report 2011*

The company has a market share of 67.30% carbonated beverages, about 6 times the share of its nearest competitor which has 12.20% of the market. It maintains leadership in the category.

This important market share is achieved in a scenario in which the company is recovering the value of the category, through the activation and marketing strategies that are being implemented by the company. Worth mentioning, the percentage of the market value of drinks was achieved in 2011, which shows the quality of our products that are preferred despite of its higher cost.

## **5. FINANCIAL STATUS**

The financial information selected was obtained from the Peru Beverage's financial statements, which appear in its notes to the quarterly financial statements of the years 2010, 2011 and the first two quarters of 2012.

As we can observe in the Chart N° 2 – Assets composition 2012, there has been a reduce in accounts such as “Cash and equivalents” and “accounts receivable from related entities”. These minimal variations explains the reduce in last quarters of the total currents assets. On the other hand, the Non-current Assets has increased its value, what is mainly explained by the recurrent increase in accounts such as “Investment properties” and “Property, Plant and equipment (net)”.

**Chart N° 2 – Assets composition 2012**

<b>Assets</b>	<b>31/03/2012</b>	<b>30/06/2012</b>	<b>30/09/2012</b>
<b>Current Assets</b>			
Cash and equivalents	196,408	149,207	125,262
Other financial assets	148,460	166,491	161,957
Commercial accounts receivable (net)	151,239	149,099	169,619
Other accounts receivable (net)	24,561	31,616	29,832
Accounts receivable from related entities	68,485	69,720	31,131
Inventory	279,068	227,375	248,510
Prepaid expenses	14,268	12,761	11,703
<b>Total Current Assets</b>	<b>882,489</b>	<b>806,269</b>	<b>778,014</b>
<b>Non-current Assets</b>			
Other accounts receivable	21,613	21,539	21,556
Investment properties	112,062	111,964	157,438
Property, Plant and equipment (net)	1,133,268	1,154,553	1,182,556
Intangible assets (net)	1,223	1,079	904
Goodwill	305,555	305,555	305,555
Other Assets	2,177	1,926	1,954
<b>Total non-current assets</b>	<b>1,575,898</b>	<b>1,596,616</b>	<b>1,669,963</b>
<b>TOTAL ASSETS</b>	<b>2,458,387</b>	<b>2,402,885</b>	<b>2,447,977</b>

Source: Superintendencia del mercado de valores

In the following Chart, Chart N° 3- Liabilities composition 2012, the firm shows an increase in the account “Other Financial Liability” which seems to double from March to September. Besides, “Commercial accounts payable” represents around 40% of the Total Current Liability.

However, this last result explain less than the half of the Total Liability, since Total No current Liability is represented almost completely by “Other Financial Liability” which has been cut back on in less than a million in September.

**Chart N° 3 – Liabilities composition 2012**

<b>Liability and equity</b>	<b>31/03/2012</b>	<b>30/06/2012</b>	<b>30/09/2012</b>
<b>Current Liability</b>			
Other Financial Liability	36,424	47,879	75,669
Commercial accounts payable	280,904	290,168	308,821
Other accounts payable	121,207	94,506	111,068
Payable to related parties	117,483	80,172	67,493
Provisions	80,272	71,428	80,339
Liabilities for income tax	6,428	8,442	11,524
<b>Total Current Liability</b>	<b>642,718</b>	<b>592,595</b>	<b>654,914</b>
<b>Non-current liability</b>			
Other Financial Liability	1,031,294	1,006,537	970,578
Commercial accounts payable	2,930	0	0
Other accounts payable	0	20,250	18,053
Liabilities for income tax	38,968	37,828	39,597
<b>Total No Current Liability</b>	<b>1,073,192</b>	<b>1,064,615</b>	<b>1,028,228</b>
<b>Total Liability</b>	<b>1,715,910</b>	<b>1,657,210</b>	<b>1,683,142</b>

Source: Superintendencia del mercado de valores

What Chart N° 4 – Equity composition 2012 doesn't show much changes in last periods. Moreover, Capital maintains a recurrent level as well as Investment stock and Others Capital Reserve.

Favorably, the Accumulated profit has increased in last quarters. In addition, its structure is highly represented by the account "Capital" with more than 50%.

**Chart N° 4 – Equity composition 2012**

<b>Equity</b>	<b>31/03/2012</b>	<b>30/06/2012</b>	<b>30/09/2012</b>
Capital	580,981	580,981	580,981
Investment stock	71,966	71,966	71,966
Others Equity Reserve	13,819	7,266	7,500
Others Capital Reserve	8,682	8,682	8,682
Accumulated profit	67,029	76,780	95,706
<b>Total Equity</b>	<b>742,477</b>	<b>745,675</b>	<b>764,835</b>

As we can see in Chart N° 5 – Financial statement, in last quarters, the company filed a continual growth. However, it looks like in the first three months the company had a high sales level than in the others. Besides, "Cost of sales" represents around 67% of the Total common income activities.

It's important to highlight the same behavior in the "Net income of the exercise" as the "Total Common Income Activities". Also, it's important to mention that the company shows a high increase in the account "Difference exchange rate".

Chart N° 5 – Financial statement 2012

	31/03/2012	30/06/2012	30/09/2012
<b>Total Common Income Activities</b>	<b>558,808</b>	<b>1,024,787</b>	<b>1,485,033</b>
Cost of sales	-377,480	-694,518	-1,006,562
<b>Gross profit</b>	<b>181,328</b>	<b>330,269</b>	<b>478,471</b>
Selling and distribution expenses	-92,698	-177,344	-264,471
Administrative expenses	-22,309	-42,803	-66,108
Other operative income	10,999	22,902	29,389
Other operative expense	-21,018	-40,625	-69,595
<b>Operating profit</b>	<b>56,302</b>	<b>92,399</b>	<b>107,686</b>
Financial income	1,591	3,144	7,023
Financial expenses	-20,149	-43,940	-64,293
Difference exchange rate	10,441	12,490	44,325
Net income from participation	0	0	0
Net Book value	257	1,266	-442
<b>Income before taxes</b>	<b>48,442</b>	<b>65,359</b>	<b>94,299</b>
Income taxes	-19,497	-26,663	-36,677
<b>Net income of the exercise</b>	<b>28,945</b>	<b>38,696</b>	<b>57,622</b>

## 6. CALCULATION OF TWO MODELS OF Z-SCORING

The Z-scores used have the following structure:

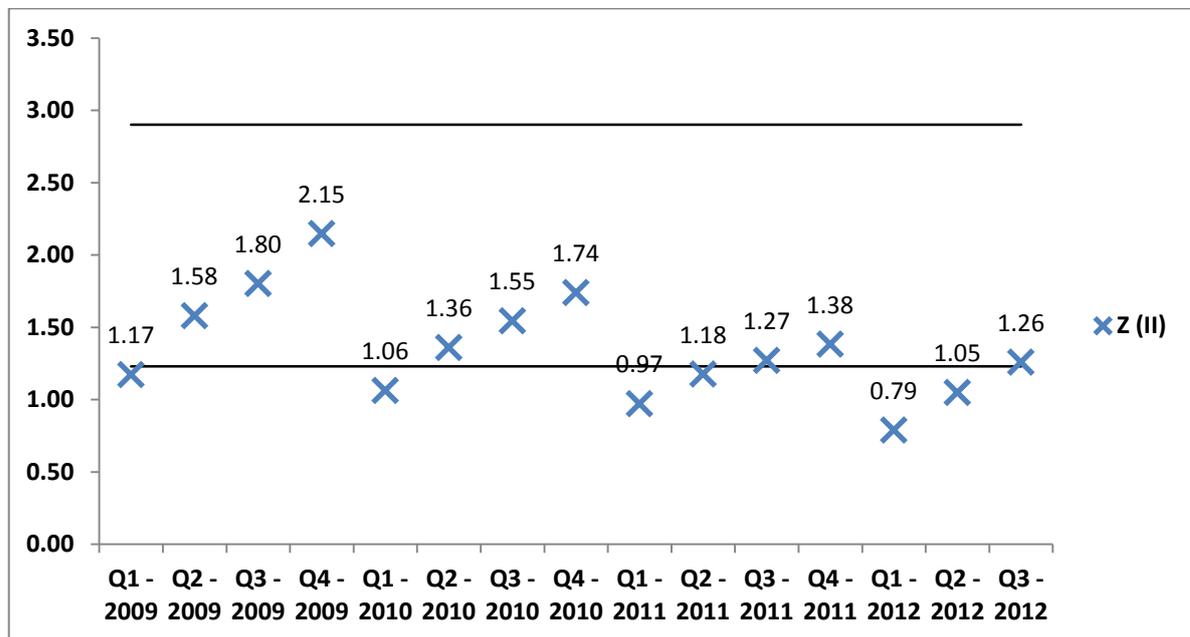
- **The Z-score estimated for private firms**

Using the formula (II) we have the next results:

**Table N° 3 – Results of Formula (II) from 2009 up to September 2012**

Period	Z (II)
Q1 - 2009	1.17
Q2 - 2009	1.58
Q3 - 2009	1.80
Q4 - 2009	2.15
Q1 - 2010	1.06
Q2 - 2010	1.36
Q3 - 2010	1.55
Q4 - 2010	1.74
Q1 - 2011	0.97
Q2 - 2011	1.18
Q3 - 2011	1.27
Q4 - 2011	1.38
Q1 - 2012	0.79
Q2 - 2012	1.05
Q3 - 2012	1.26

Figure N° 2 – Results evolution of Formula (II) from 2009 up to September 2012



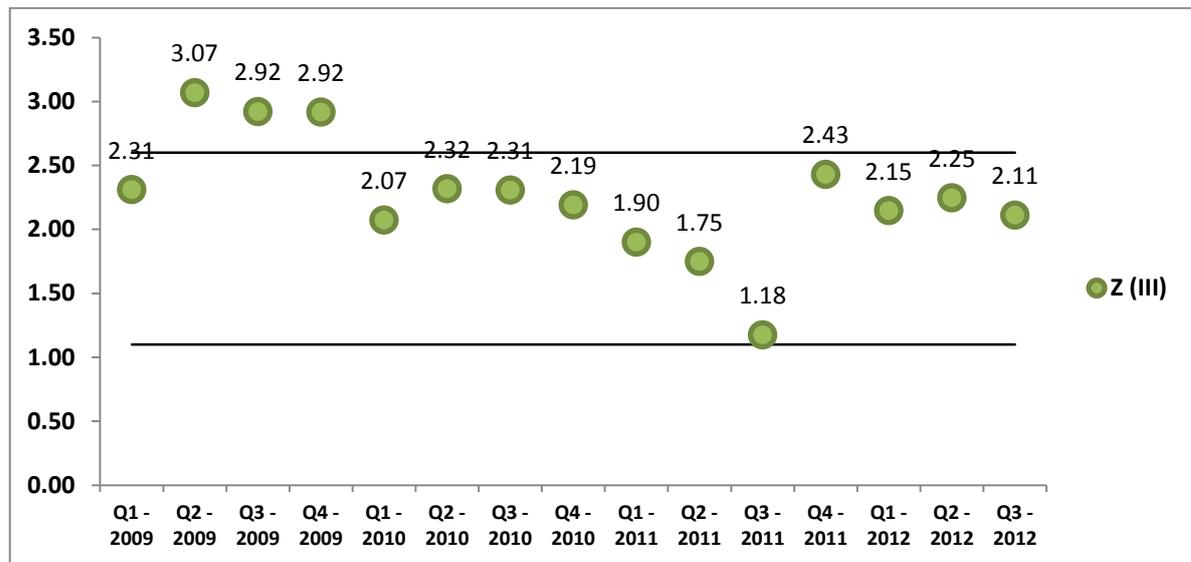
- The Z-score estimated for non- manufacturer industrial and emerging market credits.

Using the formula (III) we have the next results:

Table N° 4 – Results of Formula (III) from 2009 up to September 2012

Period	Z (III)
Q1 - 2009	2.31
Q2 - 2009	3.07
Q3 - 2009	2.92
Q4 - 2009	2.92
Q1 - 2010	2.07
Q2 - 2010	2.32
Q3 - 2010	2.31
Q4 - 2010	2.19
Q1 - 2011	1.90
Q2 - 2011	1.75
Q3 - 2011	1.18
Q4 - 2011	2.43
Q1 - 2012	2.15
Q2 - 2012	2.25
Q3 - 2012	2.11

Figure N° 3 – Results evolution of Formula (III) from 2009 up to September 2012



## 7. LIMITATIONS OF THE MODEL"

In a country like Peru, the financial figures may not reflect the reality of the business; it is possible that some data can be manipulated. The model itself can be a partial evaluation of any company as it only looks at financial data, and does not assess other important indicators such as market share, customer satisfaction, employee satisfaction, and other productivity indices, which are important for a further evaluation of the possibility of bankruptcy.

## 8. COMMENTS AND CONCLUSION

The credit scoring model developed by Altman is very useful in emerging markets, because it considers information that it is easy to access for the financial institutions. Besides, the formula II should be used with close information (ending year) in order to avoid problems with the results. The formula I could be used with quarterly information.

This paper investigates the Z score in a Beverage company over the time period 2009 – 2012 using yearly and quarterly observation intervals. About the company, the bankruptcy is not a real problem. In all case, the Z value is between the ranges called "Grey Zone" with a tendency to move to "Safe Zone"

A following study could be include more companies (for instance the companies listed in the Lima Stock Exchange Index) in the same country and compare it with others, for instance using MILA.

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## ANNEX

## ANNEX N° 1 – BALANCE SHEET AT DECEMBER 2009 (THOUSANDS OF DOLLARS)

Assets	31/03/2009	30/06/2009	30/09/2009	31/12/2009
<b>Current Assets</b>				
Cash and equivalents	924	62,001	81,076	31,940
Other financial assets	0	0	0	0
Commercial accounts receivable (net)	55,438	56,490	63,342	71,493
Other accounts receivable (net)	21,480	24,306	29,486	28,371
Accounts receivable from related entities	28,442	25,859	25,671	65,415
Inventory	211,628	181,851	146,049	139,765
Prepaid expenses	6,058	4,667	3,523	1,543
<b>Total Current Assets</b>	<b>323,970</b>	<b>355,174</b>	<b>349,147</b>	<b>338,527</b>
<b>Non-current Assets</b>				
Other accounts receivable	22,042	20,374	21,418	13,462
Investment properties	4,404	5,171	6,049	7,323
Property, Plant and equipment (net)	505,239	499,471	568,965	610,104
Intangible assets (net)	32,417	30,593	30,524	29,651
Goodwill	305,555	305,555	305,555	305,555
Other Assets	1,486	1,540	1,455	1,520
<b>Total non-current assets</b>	<b>871,143</b>	<b>862,704</b>	<b>933,966</b>	<b>967,615</b>
<b>TOTAL ASSETS</b>	<b>1,195,113</b>	<b>1,217,878</b>	<b>1,283,113</b>	<b>1,306,142</b>
<b>Liability and equity</b>				
<b>Current Liability</b>				
Other Financial Liability	96,038	84,245	94,891	94,293
Commercial accounts payable	156,008	100,402	121,774	153,089
Other accounts payable	63,076	62,387	62,834	62,424
Payable to related parties	48,228	46,386	36,831	25,659
Provisions	30,891	31,602	33,002	39,665
Liabilities for income tax	23,957	19,574	21,528	26,143
<b>Total Current Liability</b>	<b>418,198</b>	<b>344,596</b>	<b>370,860</b>	<b>401,273</b>
<b>Non-current liability</b>				
Other Financial Liability	261,689	337,168	358,688	339,845
Commercial accounts payable	0	0	0	1,383
Other accounts payable	1,606	1,606	1,606	0
Liabilities for income tax	39,215	38,975	38,975	39,034
<b>Total No Current Liability</b>	<b>302,510</b>	<b>377,749</b>	<b>399,269</b>	<b>380,262</b>
<b>Total Liability</b>	<b>720,708</b>	<b>722,345</b>	<b>770,129</b>	<b>781,535</b>
<b>Equity</b>				
Capital	580,981	580,981	580,981	580,981
Investment stock	71,966	71,966	71,966	71,966
Others Equity Reserve	2,436	5,522	12,263	14,482
Others Capital Reserve	4,450	4,450	4,450	4,450
Accumulated profit	-185,428	-167,386	-156,676	-147,272
<b>Total Equity</b>	<b>474,405</b>	<b>495,533</b>	<b>512,984</b>	<b>524,607</b>
<b>TOTAL LIABILITY AND EQUITY</b>	<b>1,195,113</b>	<b>1,217,878</b>	<b>1,283,113</b>	<b>1,306,142</b>

Source: Bolsa de valores de Lima

## ANNEX N° 2 – BALANCE SHEET AT DECEMBER 2010 (THOUSANDS OF DOLLARS)

Assets	31/03/2010	30/06/2010	30/09/2010	31/12/2010
<b>Current Assets</b>				
Cash and equivalents	6,956	22,571	24,724	38,988
Other financial assets	0	0	0	0
Commercial accounts receivable (net)	86,603	69,071	84,743	96,499
Other accounts receivable (net)	11,496	26,760	58,401	57,560
Accounts receivable from related entities	61,013	61,522	65,073	91,084
Inventory	183,765	167,613	171,043	205,319
Prepaid expenses	4,613	4,542	3,400	1,572
<b>Total Current Assets</b>	<b>354,446</b>	<b>352,079</b>	<b>407,384</b>	<b>491,022</b>
<b>Non-current Assets</b>				
Other accounts receivable	13,593	13,454	17,515	16,693
Investment properties	8,199	11,614	11,034	9,264
Property, Plant and equipment (net)	630,556	646,217	700,004	733,057
Intangible assets (net)	28,084	24,997	27,541	8,565
Goodwill	305,555	305,555	305,555	305,555
Other Assets	1,585	1,795	1,832	1,586
<b>Total non-current assets</b>	<b>987,572</b>	<b>1,003,632</b>	<b>1,063,481</b>	<b>1,074,720</b>
<b>TOTAL ASSETS</b>	<b>1,342,018</b>	<b>1,355,711</b>	<b>1,470,865</b>	<b>1,565,742</b>
<b>Liability and equity</b>				
<b>Current Liability</b>				
Other Financial Liability	104,352	93,826	131,168	127,000
Commercial accounts payable	140,243	143,387	159,051	205,927
Other accounts payable	65,268	55,056	54,887	72,807
Payable to related parties	70,466	57,149	53,366	72,510
Provisions	46,983	49,598	49,199	60,977
Liabilities for income tax	17,798	5,099	7,071	10,785
<b>Total Current Liability</b>	<b>445,110</b>	<b>404,115</b>	<b>454,742</b>	<b>550,006</b>
<b>Non-current liability</b>				
Other Financial Liability	330,217	376,960	407,007	397,278
Commercial accounts payable	894	894	894	685
Other accounts payable	0	0	0	0
Liabilities for income tax	37,853	40,853	40,543	32,242
<b>Total No Current Liability</b>	<b>368,964</b>	<b>418,707</b>	<b>448,444</b>	<b>430,205</b>
<b>Total Liability</b>	<b>814,074</b>	<b>822,822</b>	<b>903,186</b>	<b>980,211</b>
<b>Equity</b>				
Capital	580,981	580,981	580,981	580,981
Investment stock	71,966	71,966	71,966	71,966
Others Equity Reserve	-10,601	-6,513	16,156	35,130
Others Capital Reserve	4,450	4,450	4,450	4,450
Accumulated profit	-118,852	-117,995	-105,874	-106,996
<b>Total Equity</b>	<b>527,944</b>	<b>532,889</b>	<b>567,679</b>	<b>585,531</b>
<b>TOTAL LIABILITY AND EQUITY</b>	<b>1,342,018</b>	<b>1,355,711</b>	<b>1,470,865</b>	<b>1,565,742</b>

*Source: Bolsa de valores de Lima*

### ANNEX N° 3 – BALANCE SHEET AT DECEMBER 2011 (THOUSANDS OF DOLLARS)

Assets	31/03/2011	30/06/2011	30/09/2011	31/12/2011
<b>Current Assets</b>				
Cash and equivalents	15,029	7,512	22,489	352,334
Other financial assets	0	0	0	0
Commercial accounts receivable (net)	106,407	124,310	137,834	152,551
Other accounts receivable (net)	28,992	35,751	32,487	39,849
Accounts receivable from related entities	83,435	89,966	97,114	79,464
Inventory	223,854	220,815	215,559	204,356
Prepaid expenses	4,519	4,864	4,527	11,790
<b>Total Current Assets</b>	<b>462,236</b>	<b>483,218</b>	<b>510,010</b>	<b>840,344</b>
<b>Non-current Assets</b>				
Other accounts receivable	16,452	16,352	16,353	21,037
Investment properties	8,942	8,950	8,904	7,301
Property, Plant and equipment (net)	769,176	806,623	887,245	1,117,692
Intangible assets (net)	12,350	15,378	17,913	29,956
Goodwill	305,555	305,555	305,555	354,958
Other Assets	1,413	2,832	2,545	2,416
<b>Total non-current assets</b>	<b>1,113,888</b>	<b>1,155,690</b>	<b>1,238,515</b>	<b>1,533,360</b>
<b>TOTAL ASSETS</b>	<b>1,576,124</b>	<b>1,638,908</b>	<b>1,748,525</b>	<b>2,373,704</b>
<b>Liability and equity</b>				
<b>Current Liability</b>				
Other Financial Liability	70,902	159,452	294,980	46,742
Commercial accounts payable	243,643	228,812	223,313	277,639
Other accounts payable	85,350	70,216	79,371	84,956
Payable to related parties	76,137	77,615	77,535	93,919
Provisions	50,666	51,654	51,578	61,936
Liabilities for income tax	17,333	7,214	10,654	12,635
<b>Total Current Liability</b>	<b>544,031</b>	<b>594,963</b>	<b>737,431</b>	<b>577,827</b>
<b>Non-current liability</b>				
Other Financial Liability	390,095	401,498	381,464	1,029,321
Commercial accounts payable	195	0	0	0
Other accounts payable	0	195	195	0
Liabilities for income tax	30,343	33,573	32,587	76,547
<b>Total No Current Liability</b>	<b>420,633</b>	<b>435,266</b>	<b>414,246</b>	<b>1,105,868</b>
<b>Total Liability</b>	<b>964,664</b>	<b>1,030,229</b>	<b>1,151,677</b>	<b>1,683,695</b>
<b>Equity</b>				
Capital	580,981	580,981	580,981	580,981
Investment stock	71,966	71,966	71,966	71,966
Others Equity Reserve	29,112	29,138	28,828	12,857
Others Capital Reserve	4,450	4,450	4,450	4,450
Accumulated profit	-75,049	-77,856	-89,377	19,755
<b>Total Equity</b>	<b>611,460</b>	<b>608,679</b>	<b>596,848</b>	<b>690,009</b>
<b>TOTAL LIABILITY AND EQUITY</b>	<b>1,576,124</b>	<b>1,638,908</b>	<b>1,748,525</b>	<b>2,373,704</b>

Source: Bolsa de valores de Lima

## ANNEX N° 4 – BALANCE SHEET AT SEPTEMBER 2012 (THOUSANDS OF DOLLARS)

Assets	31/03/2012	30/06/2012	30/09/2012
<b>Current Assets</b>			
Cash and equivalents	196,408	149,207	125,262
Other financial assets	148,460	166,491	161,957
Commercial accounts receivable (net)	151,239	149,099	169,619
Other accounts receivable (net)	24,561	31,616	29,832
Accounts receivable from related entities	68,485	69,720	31,131
Inventory	279,068	227,375	248,510
Prepaid expenses	14,268	12,761	11,703
<b>Total Current Assets</b>	<b>882,489</b>	<b>806,269</b>	<b>778,014</b>
<b>Non-current Assets</b>			
Other accounts receivable	21,613	21,539	21,556
Investment properties	112,062	111,964	157,438
Property, Plant and equipment (net)	1,133,268	1,154,553	1,182,556
Intangible assets (net)	1,223	1,079	904
Goodwill	305,555	305,555	305,555
Other Assets	2,177	1,926	1,954
<b>Total non-current assets</b>	<b>1,575,898</b>	<b>1,596,616</b>	<b>1,669,963</b>
<b>TOTAL ASSETS</b>	<b>2,458,387</b>	<b>2,402,885</b>	<b>2,447,977</b>
<b>Liability and equity</b>			
<b>Current Liability</b>			
Other Financial Liability	36,424	47,879	75,669
Commercial accounts payable	280,904	290,168	308,821
Other accounts payable	121,207	94,506	111,068
Payable to related parties	117,483	80,172	67,493
Provisions	80,272	71,428	80,339
Liabilities for income tax	6,428	8,442	11,524
<b>Total Current Liability</b>	<b>642,718</b>	<b>592,595</b>	<b>654,914</b>
<b>Non-current liability</b>			
Other Financial Liability	1,031,294	1,006,537	970,578
Commercial accounts payable	2,930	0	0
Other accounts payable	0	20,250	18,053
Liabilities for income tax	38,968	37,828	39,597
<b>Total No Current Liability</b>	<b>1,073,192</b>	<b>1,064,615</b>	<b>1,028,228</b>
<b>Total Liability</b>	<b>1,715,910</b>	<b>1,657,210</b>	<b>1,683,142</b>
<b>Equity</b>			
Capital	580,981	580,981	580,981
Investment stock	71,966	71,966	71,966
Others Equity Reserve	13,819	7,266	7,500
Others Capital Reserve	8,682	8,682	8,682
Accumulated profit	67,029	76,780	95,706
<b>Total Equity</b>	<b>742,477</b>	<b>745,675</b>	<b>764,835</b>
<b>TOTAL LIABILITY AND EQUITY</b>	<b>2,458,387</b>	<b>2,402,885</b>	<b>2,447,977</b>

Source: Bolsa de valores de Lima

**ANNEX N° 5 – INCOME STATEMENT AT DECEMBER 2009  
(THOUSANDS OF DOLLARS)**

	31/03/2009	30/06/2009	30/09/2009	31/12/2009
<b>Total Common Income Activities</b>	<b>390,173</b>	<b>708,263</b>	<b>1,019,199</b>	<b>1,389,891</b>
Cost of sales	-257,189	-481,564	-707,031	-948,995
<b>Gross profit</b>	<b>132,984</b>	<b>226,699</b>	<b>312,168</b>	<b>440,896</b>
Selling and distribution expenses	-61,361	-116,675	-169,779	-228,585
Administrative expenses	-13,976	-27,220	-41,990	-57,808
Other operative income	9,322	20,420	37,739	65,343
Other operative expense	-11,766	-27,841	-49,200	-92,411
<b>Operating profit</b>	<b>55,203</b>	<b>75,383</b>	<b>88,938</b>	<b>127,435</b>
Financial income	8,898	22,553	38,517	44,810
Financial expenses	-18,765	-25,416	-36,107	-51,540
Difference exchange rate	0	0	0	0
Net income from participation	36	803	1,682	2,955
Net Book value	-725	-125	-418	-627
<b>Income before taxes</b>	<b>44,647</b>	<b>73,198</b>	<b>92,612</b>	<b>123,033</b>
Income taxes	-21,379	-31,888	-40,592	-61,609
<b>Net income of the exercise</b>	<b>23,268</b>	<b>41,310</b>	<b>52,020</b>	<b>61,424</b>

*Source: Bolsa de valores de Lima*

**ANNEX N° 6 – INCOME STATEMENT AT DECEMBER 2010  
(THOUSANDS OF DOLLARS)**

	31/03/2010	30/06/2010	30/09/2010	31/12/2010
<b>Total Common Income Activities</b>	<b>419,597</b>	<b>760,990</b>	<b>1,087,128</b>	<b>1,496,563</b>
Cost of sales	-280,310	-530,259	-767,272	-1,049,028
<b>Gross profit</b>	<b>139,287</b>	<b>230,731</b>	<b>319,856</b>	<b>447,535</b>
Selling and distribution expenses	-69,975	-128,467	-186,195	-251,628
Administrative expenses	-17,039	-32,725	-48,496	-64,138
Other operative income	8,465	28,143	62,209	75,016
Other operative expense	-17,168	-40,739	-69,479	-108,910
<b>Operating profit</b>	<b>43,570</b>	<b>56,943</b>	<b>77,895</b>	<b>97,875</b>
Financial income	1,761	2,848	4,073	5,661
Financial expenses	-7,856	-15,779	-24,780	-36,863
Difference exchange rate	4,281	6,106	9,673	6,435
Net income from participation	898	1,279	2,323	0
Net Book value	-637	-2,606	-3,778	-4,529
<b>Income before taxes</b>	<b>42,017</b>	<b>48,791</b>	<b>65,406</b>	<b>68,579</b>
Income taxes	-13,534	-18,339	-22,990	-31,891
<b>Net income of the exercise</b>	<b>28,483</b>	<b>30,452</b>	<b>42,416</b>	<b>36,688</b>

*Source: Bolsa de valores de Lima*

**ANNEX N° 7 – INCOME STATEMENT AT DECEMBER 2011**  
(THOUSANDS OF DOLLARS)

	31/03/2011	30/06/2011	30/09/2011	31/12/2011
<b>Total Common Income Activities</b>	<b>455,078</b>	<b>840,841</b>	<b>1,239,545</b>	<b>1,724,007</b>
Cost of sales	-323,473	-610,227	-907,510	-1,232,002
<b>Gross profit</b>	<b>131,605</b>	<b>230,614</b>	<b>332,035</b>	<b>492,005</b>
Selling and distribution expenses	-72,367	-145,615	-219,088	-299,060
Administrative expenses	-16,495	-33,036	-50,663	-64,426
Other operative income	22,838	36,850	52,364	66,950
Other operative expense	-12,884	-27,634	-46,420	-79,416
<b>Operating profit</b>	<b>52,697</b>	<b>61,179</b>	<b>68,228</b>	<b>116,053</b>
Financial income	1,878	2,981	4,276	5,742
Financial expenses	-11,546	-21,965	-30,369	-65,395
Difference exchange rate	1,825	7,349	3,724	19,629
Net income from participation	0	0	37	0
Net Book value	-3,566	-3,687	-6,763	-7,985
<b>Income before taxes</b>	<b>41,288</b>	<b>45,857</b>	<b>39,133</b>	<b>68,044</b>
Income taxes	-13,763	-16,800	-21,514	-40,205
<b>Net income of the exercise</b>	<b>27,525</b>	<b>29,057</b>	<b>17,619</b>	<b>27,839</b>

Source: Bolsa de valores de Lima

**ANNEX N° 8 – INCOME STATEMENT AT SEPTEMBER 2012**  
(THOUSANDS OF DOLLARS)

	31/03/2012	30/06/2012	30/09/2012
<b>Total Common Income Activities</b>	<b>558,808</b>	<b>1,024,787</b>	<b>1,485,033</b>
Cost of sales	-377,480	-694,518	-1,006,562
<b>Gross profit</b>	<b>181,328</b>	<b>330,269</b>	<b>478,471</b>
Selling and distribution expenses	-92,698	-177,344	-264,471
Administrative expenses	-22,309	-42,803	-66,108
Other operative income	10,999	22,902	29,389
Other operative expense	-21,018	-40,625	-69,595
<b>Operating profit</b>	<b>56,302</b>	<b>92,399</b>	<b>107,686</b>
Financial income	1,591	3,144	7,023
Financial expenses	-20,149	-43,940	-64,293
Difference exchange rate	10,441	12,490	44,325
Net income from participation	0	0	0
Net Book value	257	1,266	-442
<b>Income before taxes</b>	<b>48,442</b>	<b>65,359</b>	<b>94,299</b>
Income taxes	-19,497	-26,663	-36,677
<b>Net income of the exercise</b>	<b>28,945</b>	<b>38,696</b>	<b>57,622</b>

Source: Bolsa de valores de Lima

## EXPLORING THE ANTECEDENTS OF BRAND EQUITY IN SERVICE INDUSTRY

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### ABSTRACT

Previous researches are calling for more studies exploring the interaction effect of Aaker's (1991) brand equity dimensions and other variables on brand equity. Therefore, this study aims to contribute to the existing body of knowledge by examining the effect of seven variables on brand equity perceived by consumers. Findings reveal that brand loyalty, brand identification, trust, brand personality and brand awareness are the variables that have a greater impact on brand equity. Based on our findings, brand managers should be aware of the importance of building a brand regarding the way they communicate the features of the brand.

**Keywords:** brand equity, brand identification, perceived quality, trust, brand loyalty, brand awareness, brand associations, brand personality

### INTRODUCTION

Brand loyalty has been a frequent research topic in marketing, special after works of Farquhar (1989), Keller (1993) and Aaker (1991). The concept of brand equity is often related to the Farquhar's approach (1989), which defines it as added value for the company, for the delivery, or for the consumer. Aaker (1991) defines as the sum of assets that are associated with the brand name, such as awareness, loyalty, perceived quality, as well as other proprietary assets. To Kapferer (1998), brand equity is a reflection of the consumer and a mental image of proposed values (brand identity). Keller (2003) claims that the basis of brand equity lies in brand knowledge and its positive associations. De Chernatony (2003) defines as a process, both internal and external to the organization, of offering a value proposal represented by the brand. Although in all these definitions the idea that brand equity adds value to the good or service emerges.

Previous researches have examined the effects of other variables on brand equity and its consequences (e.g., Yoo, Donthu & Lee 2000; Nam, Ekinici & Whyatt 2011; Loureiro & Miranda 2011). Nevertheless, to the best of our knowledge, no study has examined the

strength of the influence of brand identification, brand personality and relational variables on perceived brand equity in different consumption situations. The call for study the interaction effect of Aaker (1991) brand equity dimensions and other variables on brand equity has been pointed out in previous researches (e.g., Yoo, Donthu & Lee 2000; Nam, Ekinci & Whyatt 2011). Therefore, this study intends to contribute to the existing body of knowledge by examining the effect of seven variables on brand equity perceived by consumers.

The remainder of this paper is structured as follows. The next section presents the theoretical background of brand identification, brand personality, brand equity and the core assets of brand equity as proposed by Aaker (1991). Thereafter, the methodology of an empirical study is described, the findings are presented. Finally, the conclusions, limitations and suggestions for further research are drawn.

## **THEORETICAL BACKGROUND**

### **Core assets of brand equity**

According to Aaker (1991) and Keller (1993) there are four core assets of brand equity: perceived quality, brand loyalty, brand awareness and brand associations. More specifically, Aaker (1991) identifies four major consumer-related bases of brand equity and Keller (1993) proposes a knowledge-based framework for creating brand equity based on two dimensions: brand awareness and brand image, which integrate brand associations.

Yoo, Donthu & Lee (2000) demonstrated that the level of brand equity is related positively to the extent, to which brand quality, brand loyalty, brand associations and awareness are evident in the product (e.g., athletic shoes, camera film, and colour television sets). High perceived quality would drive a consumer to choose the brand rather than other competing brands. Therefore, to the degree that brand quality is perceived by consumers, brand equity will increase.

The concept of perceived quality has been broadly studied in the field of relationship marketing. Zeithaml (1988) defined perceived service quality as the customer's assessment of the overall excellence or superiority of the service. Grönroos (1984) defines service quality as an overall perceived judgment. Thus, perceived quality has been considered as an overall evaluation of the service. Despite Aaker's (1991) study recognises perceived quality as one of the components of brand equity, it does not specify whether this refers to goods or services and what dimensions should be considered. Therefore, in order to contemplate perceived quality for services, this study consider two dimensions: physical (functional) quality and staff quality (e.g., Ekinci, Dawes & Massey 2008; Grönroos 1984).

**H1:** Perceived quality has a positive effect on brand equity.

Brand awareness/associations are related to the strength of the brand node or trace in memory, as reflected by consumers' ability to identify the brand under different conditions (Rossiter & Percy 1987; Keller 1993). These awareness/associations represent the favourable, strong, and unique associations in consumer' memory. Brand associations and brand

awareness are positively related to brand equity because they can be a signal of quality and commitment and they help a buyer consider the brand at the point of purchase, which leads to a favourable behaviour toward the brand.

**H2:** Brand associations have a positive effect on brand equity.

**H3:** Brand awareness has a positive effect on brand equity.

Several researchers highlight that high brand equity is associated with high brand preference and loyalty (e.g., COBB-WALGREN, RUBLE, & DONTU 1995; Devlin, Gwynne & Ennew 2002, DE CHERNATONY, HARRIS & CHRISTODOULIDES 2004). The Chang & Liu's (2009) model empirically supported that brands with higher levels of brand equity would generate higher levels of customer brand preference. In turn, higher customer brand preference was associated with more willingness to continue using the service brand. Brand loyalty makes consumers purchase a brand routinely and resist switching to another brand. Hence, to the extent that consumers are loyal to the brand, brand equity will increase (Yoo, Donthu & Lee 2000).

**H4:** Brand loyalty has a positive effect on brand equity.

### **Trust**

Trust has been studied primarily in the context of relationship marketing (e.g., Doney & Cannon 1997; Ganesan & Hess 1997; Morgan & Hunt 1994). Morgan & Hunt (1994, p.23) conceptualize trust "as existing when one part has confidence in an exchange partner's reliability and integrity". ROUSSEAU, BITKIN, BURT, RONALD & CAMERER (1998, p. 395) defined trust as a "psychological state comprising the intention to accept vulnerability based on positive expectations of the intentions or behaviours of another".

In their seminal work Ambler (1997) presents trust as an affective and not a cognitive, analytical construct which can be a proxy for brand equity. Hence, trust in a brand can positively influence brand equity.

**H5:** Trust has a positive effect on brand equity

### **Brand personality**

Since celebrities started to endorse brands, personification of brands has existed. These people help marketers position their brands because they lead the consumer to identify themselves with the celebrity. It has long been recognized that brands, as any person, could have personality (Azoulay & Kapferer 2003). In literature it is claimed that we must discuss brand personality since individuals chose a brand the same way they chose a friend. Researchers go deeper, stating that individuals tend to attribute facets of personality to brands, talking frequently about them. As Aaker (1997) points out, brand personality is the set of human characteristics associated to a brand. Later, Azoulay & Kapferer (2003, p.151), improve this definition classifying brand personality as "the set of human personality traits that are both applicable to and relevant for brands". This improvement comes from the evolution of the studies associated to psychology and social sciences that concluded personality is described by traits that differ from cognitive aspects of the person, or from his or her skills and abilities (Azoulay & Kapferer 2003).

Jennifer Aaker (1997) developed the widely known brand personality scale, which identifies five possible dimensions or “sets of human characteristics associated with a brand” (p. 347), such as: Sincerity, Excitement, Competence, Sophistication and Ruggedness. These five dimensions are built based on the ‘Big Five’ human personality structure (Norman 1963; Tupes & Christal 1958) and include fifteen ‘facets’. However, this scale created by Aaker (1997) has been criticized. Azoulay & Kapferer (2003) argue that the scale is based on a loose definition of personality. GEUENS, WEIJTERS & DE WULF (2009) postulate that the scale includes characteristics such as ‘upper class’ which confuse ‘brand personality’ with ‘user profiles’. So, Geuens, Weijters & De Wulf’s (2009) five-factor, twelve-item measure of brand personality is organized to contain only personality items and, as matched to Aaker & Fournier’s (1995) scale, shows higher affinity to the ‘Big Five’ personality model. Alpatova & Dall’Olmo Riley (2011) research compare the two brand personality scales in their concise and operational versions (15 items versus 12 items for Aaker & Fournier’s (1995) and Geuens, Weijters & De Wulf’s (2009) scales respectively). Their results support Geuens, Weijters & De Wulf’s (2009) scale, which could be used for any product category and for analyses on an industry, individual brand and respondent level. Therefore, this study follows the Geuens, Weijters & De Wulf’s (2009) scale.

Taking into account that individuals associate themselves with those who have traits in common, it is logical to associate themselves with brands with which they identify. Hence brand equity “derives from the set of brand associations and behaviors that have been developed towards the brand” (Delgado-Ballester & Munera-Alemán 2005, p.188) it is possible to understand that brand personality may exercise a positive influence on brand equity.

**H6:** Brand personality has a positive effect on brand equity

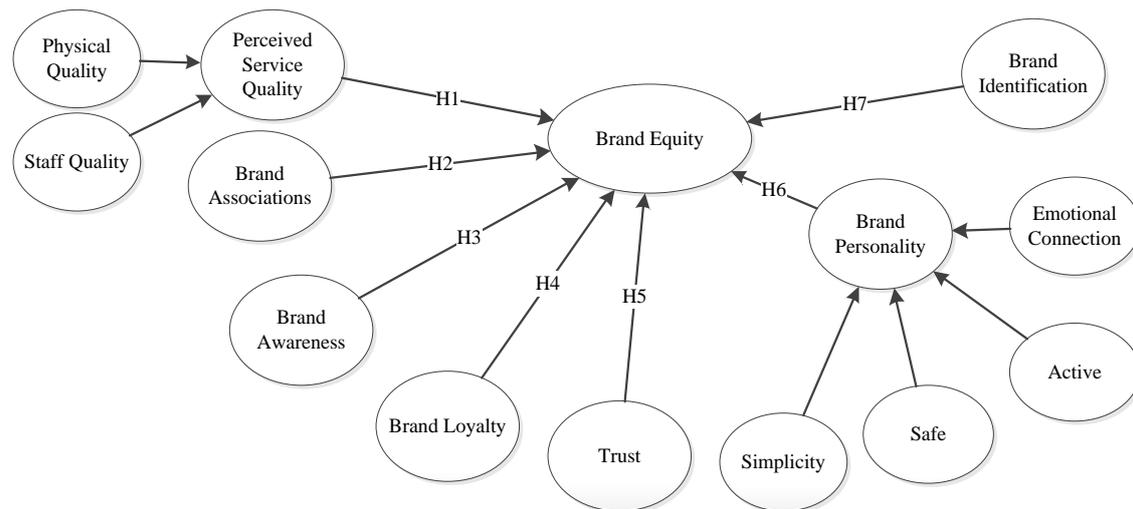
### **Brand identification**

From the organizational identification theory emerges the idea explaining why an individual becomes a member of a social group. Therefore, an individual tend to be part of a social group in which he/she feel identified and belonging (Mael & Ashforth 1992). Accordingly, consumers define their social identity by buying brands or associating with brands (Del Rio, Vazquez & Iglesias 2001). When the brands have a good reputation among the group to which the consumers belong or aspire to belong, they positively value those brands (Long & Shiffman 2000). Brand consumption also differentiates a consumer’s social identity from other social identities (KIM, HAN & PARK 2001).

Hence brand identification allows the consumer to integrate or dissociate with the group which constitute their social circle. Therefore, a consumer who identifies him/herself with certain brand will has more willing to stay close to that brand and will have proud to promote the brand and thus the perceived brand equity will increase.

**H7:** Brand identification has a positive effect on brand equity.

The model show in Figure 23 depicts the effect of seven variables on brand equity perceived by consumers.



**Figure 23: Hypothesized Model**

## METHODOLOGY

### Measures

This study focuses on an empirical research with the sample target of the consumers of supermarkets, electricity and mobile communications brands. This choice was made thinking about the brand equity in service sectors.

In order to test the hypotheses previously defined, an online questionnaire was elaborated to be answered by consumers of those brands. Once made, it moved to the pre-test stage with the purpose of verifying the clarity of the sentences. Before collecting data a pre-test was made with a sample of ten students. Their suggestions were accepted and introduced in the questionnaire in order to keep it more clear (Walsh & Beatty 2007). The questionnaire has 41 items and each respondent was invited to answer the questions according to Likert scale from 1 (completely disagree) to 5 (completely agree). The items followed a random order so that the consumer did not associate the items to a specific construct.

The constructs were measured with multi-item scales. Brand equity was measured by using a scale from Yoo & Donthu (2001) and Lassar (1995). The perceived quality, brand identification were measured by using an established scale from Nam, Ekinci, Whyatt (2011). Brand personality was measured with a scale based on Aaker (1997), Geuens Weijters, De Wulf (2009) and Lin (2010). The construct brand loyalty came from the study of Yoo & Donthu (2001). Trust was measured by using 5 items based on paper of Delgado-Ballester & Munuera-Alemán (2005). In what concerns to brand awareness, this was measured by using a scale from Loureiro & Miranda (2011). Brand association is based on Azoulay & Kapferer (2003) and Chang & Chieng (2006) (see Table 13).

Construct	Item	Source
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Construct		Item	Source
Brand Associations	AS1	I think x service method is modern.	Azouly & Kapferer (2003); Chang & Chieng (2006)
	AS2	x has a professional and well trained staff.	
	AS3	x uses a modern design in their facilities.	
	AS4	Materials associated to x are visually appealing.	
Brand Awareness	BW1	Some characteristics of x come quickly to my mind.	Loureiro & Miranda (2011)
	BW2	I can recognize x among other competitors.	
	BW3	I can quickly recall the symbol or logo of x.	
Brand Loyalty	L1	x is my first choice	Yoo & Donthu (2001)
	L2	I consider myself to be loyal to x.	
	L3	Next time I will choose x	
Trust	T1	My overall trust in the products (good/service) of x is high.	Delgado-Ballester & Munuera-Alemán (2005)
	T2	x seems to be very helpful with regard to the interests of consumers.	
	T3	I consider the company and people who stand behind x to be very trustworthy.	
	T4	I believe that x does not take advantage of consumers.	
	T5	I have more confidence on the service of x.	
Perceived quality - Physical	QPh1	The quality of the facilities of x is extremely high.	Nam, Ekinci, Whyatt (2011)
	QPh2	From x I can expect superior performance	
	QPh3	The quality of the products (good/service) of x is extremely high.	
Perceived quality - Staff	QS1	Employees of x listen to me.	Nam, Ekinci, Whyatt (2011)
	QS2	Employees of x are helpful.	
	QS3	Employees of x are friendly.	
Brand Identification	BI1	When someone criticizes x, it feels like a personal insult	Nam, Ekinci, Whyatt (2011)
	BI2	If a story in the media criticizes x, I would feel embarrassed.	
	BI3	X reflects my personal lifestyle.	
Brand Equity	E1	I am proud of use (good/service) x.	Yoo & Donthu (2001); Lassar (1995)
	E2	Even if another brand has the same features as x, I would prefer x.	

Construct		Item	Source
	E3	If there is another brand as good as x, I prefer x.	
	E4	If there was a brand like x it would be smart not to change.	
Brand Personality - Safe	PSa1	I consider x honest.	Aaker (1997), Geuens, Weijters, De Wulf (2009) and Lin (2010)
	PSa2	I feel safe when I bought any product (good/service) of x.	
	PSa3	I see x as reliable for me.	
	PSa4	I feel secure when I consume something from x.	
Brand Personality - Active	PA1	X is dynamic.	Aaker (1997), Geuens, Weijters, De Wulf (2009) and Lin (2010)
	PA2	The marketing campaign of x is dynamic	
	PA3	X is active	
Brand Personality - Emotional Connection	PE1	X is tough to overcome.	Aaker (1997), Geuens, Weijters, De Wulf (2009) and Lin (2010)
	PE2	X makes me feel sentimental.	
	PE3	For using x I feel that everybody accepts me.	
Brand Personality - Simplicity	PS1	X is always simply	Aaker (1997), Geuens, Weijters, De Wulf (2009) and Lin (2010)
	PS2	I think x is charming.	
	PS3	x is ordinary in values it transmits.	

**Table 13: The questionnaire's construct, items, and sources**

### Sample characterization

The online questionnaire was accessible from April 5<sup>th</sup> to May 31<sup>st</sup> of 2012. University students (from several universities in Portugal) were instructed to recruit five people to fill out the survey. Four of these five people had to be non-students and represent a range of ages, genders, and professions (based on method of Walsh & Beatty 2007). The data collection process lasted eight weeks. 152 people answered to the supermarkets brands questionnaire, 100 people answered to the electrical brands questionnaire and 163 answered to the telecommunication questionnaire in a total of 415 responses. Globally, most respondents fell into the 26–35 age group.

### Data Analysis

A structural equation model approach using Partial Least Squares (PLS) was employed to test the hypotheses proposed in the current study. PLS is based on an iterative combination of the principal components analysis and regression (Chin 1998). PLS employs a component-based approach for estimation (Lohmoller 1989). PLS also places minimal restrictions on the sample's size and residual distributions and support formative factors (Chin 1998; Wold 1985).

In general, PLS is appropriate for explaining complex relationships because it avoids two problems such as inadmissible solutions and factor indeterminacy (Fornell & Bookstein 1982). In the present study, a non-parametric approach called bootstrapping was used to assess the precision of the PLS estimates and support of the hypotheses. 500 samples sets were created to obtain 500 estimates for each parameter in the PLS model (Fornell & Larcker 1981; Chin 1998). TENENHAUS, VINZI, CHATELIN & LAURO (2005) proposed a global measure of goodness of fit (GoF) for PLS path modeling, which ranges from 0.00 to 1.00.

## RESULTS

A PLS model should be analyzed and interpreted in two stages. First, the measurement model or the adequacy of the measures is assessed by evaluating the reliability of the individual measures, the convergent validity, and the discriminant validity of the constructs. Then, the structural model is evaluated. In order to evaluate the adequacy of the measures, the current study used the aggregated data sets collected from offline and online stores, since the comparisons of the measure models for desegregated data do not show statistical differences. Item reliability is assessed by examining the loadings of the measures on their corresponding construct. Item loadings of scales measuring reflective constructs should be 0,70 or more, which indicates that over 50% of the variance in the observed variable is explained by the construct (WETZELS, ODEKERKEN-SCHRÖDER & VAN OPPEN 2009). In this study we verified that all item loadings exceed 0,70.

All Cronbach's alpha values are above 0,7, and all composite reliability values in Table 2 are above 0,8. All constructs are reliable since the composite reliability values exceed the threshold value 0,7. The measures demonstrate convergent validity as the average variance of manifest variables extracted by constructs (AVE) are above 0,5, indicating that more variance of each indicators are explained by their own construct. In order to be discriminant among the construct, the square root of AVE should be greater than the correlation between the construct and other constructs in the model (Fornell & Larcker 1981). Table 2 shows that this criterion has been met.

	Mean	C.R.	Alpha	AVE	1	2	3	4	5	6	7	8	9	10	11	12
1.Association	3,5	0,918	0,889	0,691	<b>0,831</b>											
2.Awareness	3,6	0,856	0,765	0,665	0,619	<b>0,815</b>										
3.Equity	2,9	0,908	0,864	0,711	0,572	0,477	<b>0,843</b>									
4.Trust	3,2	0,881	0,831	0,597	0,683	0,613	0,672	<b>0,773</b>								
5.Active	3,6	0,913	0,858	0,778	0,657	0,662	0,514	0,649	<b>0,882</b>							
6.B.	2,3	0,880	0,796	0,711	0,269	0,238	0,676	0,580	0,287	<b>0,843</b>						

identification																
7.Emot.con- nection	2,7	0,855	0,751	0,664	0,362	0,350	0,699	0,647	0,404	0,651	<b>0,815</b>					
8.B. loyalty	3,0	0,937	0,898	0,832	0,574	0,603	0,681	0,630	0,550	0,517	0,619	<b>0,912</b>				
9.Physical	3,5	0,869	0,798	0,623	0,619	0,695	0,671	0,616	0,603	0,443	0,581	0,688	<b>0,789</b>			
10.Safe	3,4	0,923	0,888	0,749	0,628	0,638	0,622	0,641	0,670	0,471	0,527	0,608	0,683	<b>0,866</b>		
11.Simplicity	3,4	0,877	0,789	0,704	0,613	0,677	0,607	0,696	0,678	0,470	0,548	0,610	0,634	0,617	<b>0,839</b>	
12.Staff	3,4	0,914	0,860	0,781	0,676	0,608	0,548	0,678	0,619	0,298	0,304	0,492	0,670	0,632	0,623	<b>0,884</b>

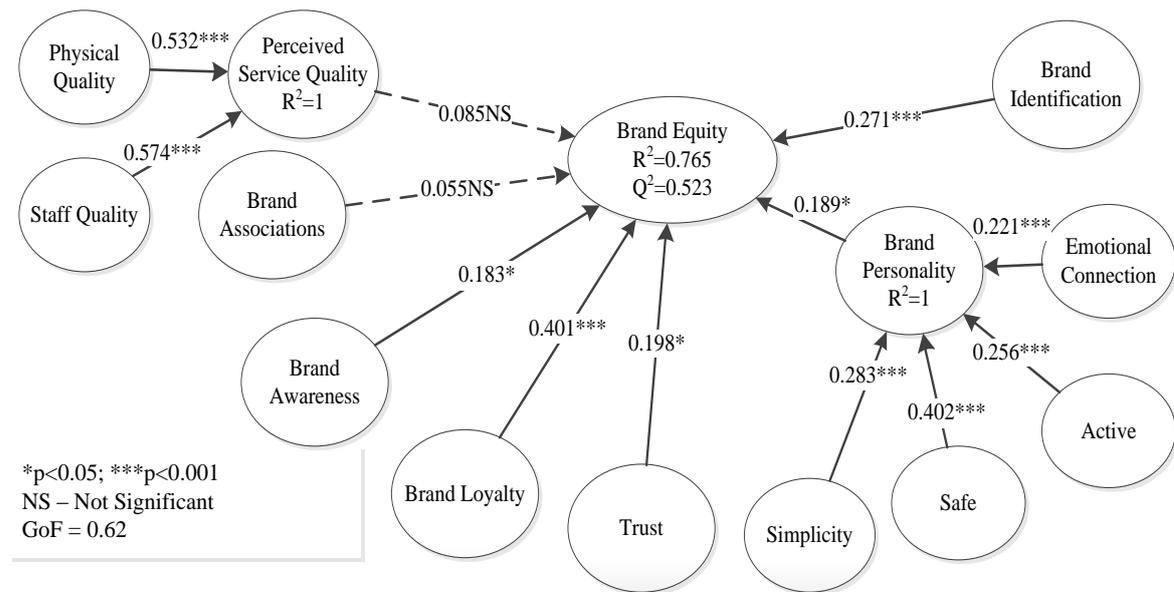
C.R. – composite reliability: AVE – average variance extracted

Diagonal elements in the 'correlation of constructs' matrix are the square root of AVE. For adequate discriminant validity, diagonal elements should be greater than corresponding off-diagonal elements.

**Table 2: Measurement model and test for discriminant validity**

The structural results are presented in Figure 2. All path coefficients are found to be significant at the 0.010 or 0.050 levels, except two: the relationship between perceived service quality and brand equity and brand associations and brand equity. Therefore, H1 and H2 are not supported.

However, as models yielding significant bootstrap statistics can still be invalid in a predictive sense (Chin 1998), measures of predictive validity (such as  $R^2$  and  $Q^2$ ) for focal endogenous constructs should be employed. The value of  $Q^2$  (chi-squared of the Stone-Geisser Criterion) is positive, so the relations in the model have predictive relevance (Fornell & Cha 1994). The model also demonstrated a good level of predictive power ( $R^2$ ), especially for brand equity, as the modeled constructs explained 76.5% of the variance in brand equity. In fact, the good value of GoF (see Figure 2) reveals a good overall fit of the structural model.



**Figure 24: Structural Model**

## CONCLUSIONS AND IMPLICATIONS

This study contributes to the body of literature on consumer-based brand equity in two ways. Firstly, we drawing based on past literature a model to analyze the effect of seven variables on brand equity. Specifically, a conceptual model was proposed where, perceived service quality, brand personality, brand loyalty, brand identification, trust, brand associations and brand awareness are suggested as antecedents of brand equity. Thus, our study is the first attempt to measure the strength of assorted relational variables, and variables related with identification and personality on brand equity. Secondly, this study gives insight to support the proposed model in service industry.

The strength of the effect of brand loyalty and brand identification on brand equity is greater than the effect of other five variables analyzed. As Yoo, Donthu & Lee (2000) highlight, brand loyalty means that consumers purchase a brand routinely and resist switch to another brand. Hence, to the extent that consumers are loyal to the brand, brand equity will increase. More explicitly, when consumers have the good/service as their first choice, consider themselves loyal to a certain brand and intend to buy that brand in the next purchase, then the predisposition to have proud of use the service, prefer the brand instead of other brand with the same service and thought that consume that brand is better than another increase. As Long & Shiffman (2000) mention when the brands have a good reputation among the groups to which the consumers belong or aspire to belong, they positively value those brands. Therefore, a consumer who identifies him/herself with certain brand will tend to stay close to that brand and will have proud to promote the brand and the perceived brand equity will increase. Moreover, a consumer who feels a criticize to a brand like a personal insult, and feels embarrassed when see the media criticizes the brand and think that the brand reflects

him/her personal lifestyle is more likely to have proud of the brand, and prefer that brand instead of others.

As we have already seen, according to Aaker (1991) and Keller (1993) there are four core assets of brand equity: perceived quality, brand loyalty, brand awareness and brand associations. More specifically, Aaker (1991) identifies four major consumer-related bases of brand equity and Keller (1993) proposes a knowledge-based framework for creating brand equity based on two dimensions: brand awareness and brand image, which integrate brand associations. In our study, the results reveal that of this four constructs, brand loyalty and brand awareness are the only two with significant effect on brand equity. So, the loyalty to the brand, manifested by behaviours of first choice and next choice, keeps a central aspect to favour the brand equity. But, despite the importance of brand loyalty an even the brand awareness in our results, the perceived service quality and brand associations have importance, too.

In what concerns to the strength of the influence of brand identification, brand personality and trust on perceived brand equity, brand identification exercises a stronger effect on brand equity. So, consumers who feel embarrassed or a personal insult when is brand is criticized by someone or somewhere, and feels like the brand reflects his/her lifestyle, are more likely to have proud of the brand, and prefer that brand instead of others.

The current study is developed in a country living an economic crisis, where consumers tend to choice, more than ever, motivated by the price. In such conditions consumers are more willing to switch based on price. Even so, brand managers should be aware that brand loyalty and brand identifications can be very powerful in leverage the brand. Therefore, managers should be very careful when relate to their customers and communicate the identity of the brand in a way that goes directly to the core feeling, lifestyle and way of being of the consumers. Establish a good relationship, bonds, between consumers and their brands and demonstrate respect for the consumers' problems are essential to keep them, more than lower prices, even in time of crisis.

#### **Limitations and Further research**

This studies present several limitations which can be regarded as avenues for future research. First, the study was conducted just in services. Although the choice of these service brands have been planned intentionally, in a forthcoming research it can be extend to other brands or to brands of the same sector of activity in order to make comparisons between sectors.

Second, the data collected for the survey was limited to Portugal, using a snow ball process. Despite this technique is used in marketing field, especially in exploratory studies, we should be careful in generalization.

Third, the instruments used to measure the constructs can be improved or even expanded to consider other dimensions and other variables influencing the brand equity.

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## INVESTIGATING THE IMPACT OF INTERNET USAGE AND ACCEPTANCE ON ACTIVE AGEING AMONG OLDER ADULTS

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### ABSTRACT

Population ageing is a general and growing phenomenon that poses significant challenges to society and governments in most European countries. To attenuate the challenge of demographic ageing, public initiatives have been launched to encourage older adults to remain active and to improve their quality of life. The use of ICT in general and the Internet in particular can be considered as an important facilitator of modern life. The purpose of this paper is to examine the potential role of the Internet on promoting active ageing by applying the Unified Theory of Acceptance and Use of Technology (UTAUT). Findings from this study demonstrate that the use and acceptance of the Internet as assessed by the UTAUT's dimensions have a positive impact on active ageing.

**Keywords:** ICT; Internet; UTAUT; Active ageing; Older People

### INTRODUCTION

Population is getting older in most Western societies, posing demographic and socioeconomic challenges to society and public authorities. Recent data estimates that the number of people over 65 will reach 25% by 2020 while the number of people over 85 will triple by 2050 (European Commission, 2010). Resulting from a historical combination of declining fertility and falling death rates, which lead to an increase of life longevity (Walker, 2009), population ageing is leading societies to remarkable changes, particularly noticeable in the family, the labor and the market structures, as well as the individual itself (Powell and Cook, 2009). Thus, allowing older people to remain active and independent, as well as being valuable to society reflects an emerging awareness towards active ageing (European Commission, 2009). Against this background, ICTs in general and the Internet in particular can have an important role in achieving these goals by increasing the quality of life of older people (Gilhooly *et al.*, 2009; Czaja and Lee, 2007). The European Commission recognizes that ICTs can help older

people to overcome isolation and loneliness as it increases possibilities for reinforcing family and community ties, as well as extending social networks (European Commission, 2010).

Although extant research has examined the driving factors of Internet adoption among the elderly (Eastman and Iyer, 2004; Hough and Kobylanski, 2009), despite some exceptions (Gilhooly et al, 2009), few studies have analysed the role of ICTs in general and the Internet, in particular, as a mechanism to promote the active ageing process. Therefore, the purpose of this study is to examine the extent to which the use of the Internet by older adults impacts on the active ageing process.

## LITERATURE REVIEW

### *Active ageing in the information society*

The notion of active ageing emerged as part of the policy framework conceived by the United Nations and the World Health Organization (WHO) to address the demographic, economic and social challenges posed by an increasingly older population. Defined as “the process of optimizing opportunities for health, participation and security with the goal of improving life quality as people grow old”, active ageing is a complex notion often considered as a “new paradigm” of ageing (Stenner *et al.*, 2010) which has assumed, particularly in Europe, a distinctive approach (Walker, 2009). According to the definition provided by the World Health Organization (WHO, 2002), active ageing integrates *health, social participation* and *security of older citizens* as fundamental pillars.

As recognised by the Council of the European Union in the program *Ageing Well in the Information Society* (European Union, 2010), the use of ICT based products and services allow ageing citizens to live longer independently, and will provide opportunities for enhancing safety, security and healthcare. This is in line with other authors, who sustain that ICTs plays an undeniably role in the promotion of an active participation of elderly in society by allowing better health care (increasing life expectation and decreasing health costs); extending people active life in work; increasing productivity and lowering down costs with pensions; increasing social participation; reinforcing civil society, supporting independence; facilitating people involvement in social networks and also contributing to strength family and community ties (Hazer e Sanli, 2010).

According to Alm, Gregor and Newell (2002) ICT applications can benefit older adults in the following dimensions: i) Communication and social connectivity (technologies such as e-mail, video-call, and social networks can reduce loneliness and isolation); ii) Access to services and information (technologies provides access to: shopping online, public and social services without leaving home while minimizes eventual mobility constraints); iii) Promotes learning along life (technology stimulate the mind, which is a fundamental goal to achieve active ageing); iv) Tele-homecare and telemedicine (the availability of electronic systems and communication technologies can reduce long distances); v) Promotes activity and productivity (technologies may encourage and allow older adults to remain active for a longer period of time). Thus, technologies in general and the Internet in particular can enhance the quality of life of older adults, particularly by increasing social participation, decreasing levels of anxiety and depression, and improving cognitive skills (Slegers et al, 2012).

#### *The Technology acceptance model (UTAUT)*

Pew and Van Hemel (2003) maintain that there are many factors that may influence technology acceptance by old adults and, consequently, affect its success in the market. It is generally recognized that there are different believes and stereotypes associated to old adults capacities and their reluctance to change is likely to lead to negative attitudes concerning the use of new technologies. However, as Cazja (1997) demonstrated, older adults are usually receptive to the adoption of ICTs as long as they perceived them as useful, feel that they are easy to use and have adequate training (Pew and Van Hemel, 2003).

It seems worth noticing that technology adoption has been studied in several different ways by numerous authors over the years. The TAM model (Technology Acceptance Model) (Davis, 1989) has its origin in the theory of reasoned action (TRA) developed in a seminal work by Fishbein and Ajzen (1975). In essence, this model theorizes that the use of a technology is influenced by two major beliefs: perceived ease of use (PEU) and perceived usefulness (PU). While PEU can be defined as the degree to which a person believes that using a technology will be free of effort in a sense that he/she does not expect major physical and mental difficulties, PU refers to the prospective user's belief that using a particular technology will enhance individual performance (Davis, 1989). The proposed model originally developed by Davis (1989) represented an important theoretical contribution to understanding user behavior and acceptance of an information system, more precisely of a computer (Malhotra and Galletta, 1999).

Over the years, several acceptance TAM models were developed changing the original model proposed by Davis (1989). More recently, Venkatesh *et al.* (2003) have developed the so called Unified Theory of Acceptance and Use of Technology (UTAUT). Due to its capacity to integrate the different models of technology acceptance, the UTAUT model offers an important contribution to understand technology use and acceptance by proposing four key dimensions, designated as *performance expectancy, effort expectancy, social influence and facilitating conditions* (Venkatesh, *et al.*, 2003).

Therefore, for the purpose of the present study, the UTAUT model will be applied to assess the impact that ICT plays on active ageing (integrating the dimensions of health, security and social participation). With respect to the UTAUT model, Effort Expectancy is defined as “the degree of ease associated with the use of the system” (Venkatesh, *et al.*, 2003: p.450) and reflects the extent to which older citizens feel comfortable and find the Internet easy to use. Therefore, the following hypotheses covering the three dimensions of active active are proposed:

*H1: Effort expectancy will have a positive effect on Social Participation.*

*H2: Effort expectancy will have a positive effect on Health Care.*

*H3: Effort expectancy will have a positive effect on Security.*

Social Influence is defined as “the degree to which an individual perceives that important others believe he or she should use the new system” (Venkatesh, *et al.*, 2003: p.451). It relates to others’ opinions about the Internet adoption. Thus, the following research hypotheses are offered:

*H4: Social Influence will have a positive effect on Social Participation.*

*H5: Social Influence will have a positive effect on Health Care.*

*H6: Social Influence will have a positive effect on Security.*

Finally, Facilitating Conditions are defined as “the degree to which an individual believes that a technical infrastructure exists to support use of the system” (Venkatesh, *et al.*, 2003: p.453). In other words, it relates to environmental barriers or availability of resources that older adults may perceive in relation to the Internet use. Therefore, the following hypotheses are suggested:

*H7: Facilitating Conditions will have a positive effect on Social Participation.*

*H8: Facilitating Conditions will have a positive effect on Health Care.*

*H9: Facilitating Conditions will have a positive effect on Security.*

## **RESEARCH METHODOLOGY**

The present study employed mainly a quantitative methodological approach, which was complemented by qualitative data in order to provide a more thorough account of the topic under study. The questionnaire was pre-tested on a small sample of older adults. These participants were invited to highlight any ambiguities or difficulties concerning the instrument of analysis while providing further suggestions for the questionnaire improvement. This procedure allowed the assessment of face and content validity. After the pre-testing stage, the questionnaire was personally delivered to a convenience sample in two senior universities located in two major northern Portuguese cities (Oporto and Braga). This approach proved to be particularly convenient due to ease of accessibility and cost-effectiveness. A total of 106 usable questionnaires were collected.

With regard to the measurement scales, the Internet acceptance was operationalized by using the UTAUT scale, which relies on four core constructs, namely, *Performance expectancy*, *Effort expectancy*, *Social influence* and *Facilitating conditions* (Venkatesh, Morris, Davis and Davis, 2003). Due to the nature of the study's population, we have decided to exclude the construct *Performance expectancy*. The behavioral intention, considered as the dependent variable was measured by the intention of older adults in using the Internet along the three dimensions of active ageing: social participation (8 items); health (7 items) and security (3 items). These items were measured through a five-point Likert-type scale (ranging from 1= Not very important; 5= Very important).

## **ANALYSIS AND DISCUSSION**

The data was analyzed using SPSS 18.0 and PLS with SmartPLS 2.0 (Ringle, Wende, & Will, 2006). Although the measurement and structural parameters were estimated together, a PLS path modeling approach was analyzed and interpreted in two stages: 1) the assessment of the reliability and validity of the measurement model; 2) the assessment of the structural model. First, reliability and validity of measurement scales were examined. All composite reliability values exceed .70, evidencing a good level of internal consistency in the responses (Nunnally

& Bernstein, 1994). Similarly, the AVE for all constructs was satisfactory (above .50) (Bagozzi & Yi, 1988). Overall, measurement scales showed both unidimensionality and conceptual consistency. The standardized loadings and their associated *t*-values were also examined. Convergent validity is revealed by the large and significant standardized loadings. With regard to discriminant validity, we tested whether all the construct inter-correlations were significantly different from 1, and that the square root of AVE was greater than the variance shared among the latent constructs (Barclay, Thompson, & Higgins, 1995). All latent constructs satisfied this condition (Table 1).

	Mean	SD	R <sup>2</sup>	1	2	3	4	5	6
1. Effort Expectancy	3.45	0.69	-	<b>0.88</b>					
2. Social Influence	3.13	0.74	-	-0.16	<b>0.57</b>				
3. Facilitating conditions	3.35	0.74	-	0.68	0.11	<b>0.64</b>			
4. Social participation	2.54	0.80	0.23	0.26	0.31	0.35	<b>0.69</b>		
5. Health	2.27	1.01	0.30	0.39	0.28	0.44	0.56	<b>0.81</b>	
6. Security	2.38	0.89	0.36	0.32	0.42	0.42	0.60	0.78	<b>0.90</b>

Notes: the diagonal (in bold) shows the square roots of the AVE; (-) Exogenous variable

Table 1: Variable means, standard deviations and correlations

Finally, in order to test the hypotheses previously formulated, the structural model was estimated. To test the weights' significance the bootstrapping technique was used. Goodness-of-fit in a PLS estimation is demonstrated, according to Chin (1998), by strong factor loadings (or correlations), significant path coefficients (higher than .2), and high R<sup>2</sup> values. In the present study, the proportion of the total variance (R<sup>2</sup>) of each endogenous variable explained by the model is 0.36 for security, 0.30 for health and 0.23 for social participation (Table 1). To assess predictive validity of the model constructs, each construct was blindfolded. The Stone-Geisser test results indicated that the model shows good predictive validity (Q<sup>2</sup> > 0). A Q<sup>2</sup> greater than zero implies that constructs have predictive relevance. Among nine potential relationships six are statistically significant (Table 2).

Path Coefficients	Sample mean	Standard	t
	(bootstrapp)	Error	Statistics
H1:Effort Expectancy→Social	0,216	0,115	1.80

participation			
H2:Effort Expectancy→Health	0,319	0,106	2.97**
H3:Effort Expectancy→Security	0,263	0,095	2.77**
H4:Social Influence→Social participation	0,349	0,075	4.45**
H5:Social Influence→ Health	0,307	0,085	3.54**
H6:Social Influence→ Security	0,450	0,071	6.26**
H7:Facilitating cond.→Social participation	0,170	0,135	1.29
H8:Facilitating cond.→ Health	0,202	0,104	1.96*
H9:Facilitating cond.→Security	0,200	0,109	1.78

\* $p < 0.05$ ; \*\* $p < 0.01$

Table 2: Path coefficients

It seems relevant to notice that the social influence dimension is the only dimension that has a significant impact on the three dimensions of active ageing (social participation, security and health). As previously mentioned, the social influence comprises three major sub-dimensions, such as: image, social factors and subjective norm. Overall, the data support the hypotheses H4, H5, and H6. Concerning effort expectancy, which is associated with the degree of perceived ease of use and usefulness of the system, the data supported its impact on two of the three dimensions of active ageing (Health and Security). Thus, H2 and H3 are supported. The only dimension which was not supported was the relationship between effort expectancy and social participation leading to rejecting H1. With regard to the Facilitating conditions dimension, the data evidences a significant and positive impact on the health dimension, therefore, supporting H8. By contrast, H7 and H9 are not supported.

## CONCLUSION AND IMPLICATIONS

The present study lends support to the view that ICTs in general and the Internet, in particular helps older adults in promoting active ageing by providing cognitive and rewarding activities and increasing their quality of life. Findings from this study demonstrate that the use and acceptance of the Internet assessed by the UTAUT's dimensions (effort expectancy, Social Influence and Facilitating) have a positive impact on Active ageing (Social participation, Security and Health). These results are consistent with the literature which emphasizes the pervasive dominance of Technology in social interactions. Yet, to generate real value in people's lives, the Internet needs to be effectively accepted and used by its potential users (Venkatesh, *et al.*, 2003). The study presents valuable implications for both public decision makers who need to conceive appropriate policies to facilitate Internet use and acceptance, and to marketers who need to customise their offerings to this relevant population segment.

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## CORPORATE GOVERNANCE OF NON-PROFIT ORGANIZATIONS- THEORY AND PRACTICE

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### ABSTRACT

The main aim of the paper is to contribute to the development of the theory and practice of the corporate governance of non-profit organizations. The methodology is based on comparison of the main parameters of corporate governance of for-profit vs. non-profit organizations. The main parameters were extracted from the basic literature sources describing the corporate governance systems of for-profit organizations as well as their characteristics. The characteristics of the parameters for non-profit organizations were refined from the authors' own research. Our data sample is represented by 192 public hospitals in the Czech Republic. They were analyzed as representatives of non-profit organizations. Based on our research we can state that the characteristics of the parameters differ in for-profit and non-profit organizations. In some parameters the characteristics differ distinctively, in others we can observe the tendency to convergence.

**Keywords:** non-profit organizations, public hospitals, characteristics, comparison, future tendencies

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### INTRODUCTION

Corporate governance theory today is concentrated mostly on organizations established to generate profit. Non-profit organizations and their role in the national economy are highly

important and very often underestimated; they create their own theoretical framework for corporate governance and its application. The main aim of this paper is to contribute to the development of the theory of corporate governance of non-profit organizations and to also show its practical consequences.

## LITERATURE REVIEW

The issues of corporate governance are no longer restricted to for-profit organizations. Governance of non-profit organizations has started to be addressed in the last decade (e.g. reviews by Jegers, 2009, Bennington, 2010). The methodology of this paper is based on comparison of main parameters of corporate governance of profit and non-profit organizations and so literature review of both sectors is inevitable. However, literature regarding for-profit organizations is vast and generally known and therefore authors review existing literature of non-profit organizations and due to data sample consisting of public hospitals also hospital governance.

### *Non-profit organizations*

One of the most fundamental distinctions between for-profit and non-profit sectors is the fact, that for the non-profit organization financial considerations, such as increasing shareholder value, form only one dimension of the mission statement (McFarlan, 1999). Non-profit organizations also cannot disburse profits that affect the very nature of non-profit organizations. Another important distinction may be the fact that non-profit organizations do not have real owners (Glaeser, 2003). Governance of non-profit organization differs, because decision-making process is not only influenced by economic interests of shareholders but interests of various stakeholders (Eeckloo et al., 2004).

In for-profit organizations we can see a clear division of the roles of principal as the owner on one side and the agent, hired manager on the other. Their roles are developing and according to Monks and Minow (2011) in the second half of the 20th century we could observe decreasing supervisory activity of the owners towards managers. Mostly from the institutional investors (e.g. pension funds) or widely dispersed minority shareholders, their activity in supervision of managers is unsatisfactory. According to Mallin (2010), the situation is slowly changing. Especially the activity of institutional investors is increasing and their role is transforming from portfolio investors into strategic investors, more actively collaborating with company management in creating company vision and mission, aims and strategy.

Facing the fact that most of non-profit organizations have no owner, it is necessary to identify

the objectives of principals and agents and detect potential agency problems (Du Bois, 2009). Board structure is another important difference between for-profit and non-profit organizations. Architecture of the boards is one of main characteristics of governance systems all around the world. In for-profit organizations we differentiate between two basic systems of organizational design of boards: a one-tier structure with a board of directors and a two-tier structure with a management board and supervisory board (Hilb, 2005). Since a one-tier structure is the predominant system, a majority of research is focused on the responsibilities and roles of the board of directors. Boards of for-profit organizations generally consist of between 8 to 14 directors, while non-profit boards tend to be much larger because they need to represent interests of many stakeholders (McFarlan, 1999).

An inseparable part of governance structure is committees which are responsible for particular areas within board of directors. A financial responsibility and transparency is no longer issue of only for-profit organizations. In the United States Sarbanes-Oxley Act from 2002 applies also to non-profits which are obligated to set up an audit committee out of independent members of the board. However, even in 2004 out of 128 largest U.S. non-profit organizations, 10 of them had not an audit committee and 36 percent of non-profits had audit committee that are not completely independent (Vermeer et al., 2006). Other most frequently observed committees are finance and nomination committees (Callen et al., 2003).

On the other hand, it is important to point out that organizations of both sectors also share similar difficulties. According to Glaeser non-profit organizations have governance problems that resemble the problems in for-profit firms, but are often far more extreme (Glaeser, 2003:39).

#### *Hospital governance*

Due to the fact that our data sample consists of public hospitals, literature namely focused on non-profit hospitals was reviewed as well. Within the governance of non-profit organizations the healthcare sector faces very specific challenges. According to Eeckloo et al. (2007) the term hospital governance refers to “the complex of checks and balanced that determine how decisions are made within the top structures of hospitals”.

Eeckloo et al. (2004) analyze whether and to what extent governance models existing in the corporate world can be implemented in the hospital governance. According to the authors corporate governance can provide a potential frame of reference, nevertheless the unique social aspects of hospitals, including a large diversity of stakeholders and the lack of clear business objectives, have to be taken into account.

Preker et al. (2007) elaborate the theory of agency in the health-care sector. The principal-agent relationship is easily identified in corporate world, while in the health care sector there are several principal-agent relationships on the various levels. *“This relationship exists between government and health funds; private owners and health funds (the private insurance company); private owners and private hospitals; government and public hospitals; health funds and hospitals; health funds and general practitioners; hospitals and hospitals-based doctors; patients and health funds; patients and hospitals; patients and general practitioners; and patients and hospital-based doctors.”* (Preker et al., 2007: 167). It is a rather unique characteristic of health-care sector that various parties constitute several agency relationships and the change in one pair of relationships will affect others. This characteristic is a consequence of non-existing owner in public hospitals as was explained above. The emphasis has therefore shifted to the large diversity of stakeholders (tax payers, patients, GPs, government authorities, health insurers, etc.) (Eeckloo et al., 2007).

The board of directors as a governing body plays a significant role in overall performance of hospital. Therefore, the relationship between characteristics of the board and hospital performance is analyzed similarly to empirical research existing in the for-profit sector. For instance, Jha and Epstein (2009) survey board chairs of 1,000 U.S. hospitals to examine the potential influence of hospitals' board on quality of care. Findings show that fewer than half (44 percent) of the boards rated quality of care as one of their two top priorities and that engaged boards are more likely to be associated with better performance.

## **DATA SAMPLE AND METHODOLOGY**

The adopted methodology is a comparative analysis (Haas, 1962) which is based on comparison of for-profit and non-profit organizations. The main parameters were extracted from the literature sources, describing the corporate governance system of for-profit organizations (e.g. Mallin 2010, Monks, Minow 2011) and the literature review of non-profit organizations. The six following parameters are:

- characteristics of ownership structure
- ways of collecting capital resources
- organization aims and application of agency theory
- application of transaction cost theory
- application of stakeholders theory
- board structure and composition

Our data sample consists of 192 public hospitals in the Czech Republic as the representatives of non-profit organizations. This sample represents all non-profit hospitals in the country.

From the main aim of the paper we can derive the following two hypotheses:

*H1: The characteristics of the parameters of the defined CG system differ in for-profit and non-profit organization.*

*H2: The development of the characteristics of the parameters of both systems tends to convergence.*

## **DISCUSSION AND FINDINGS**

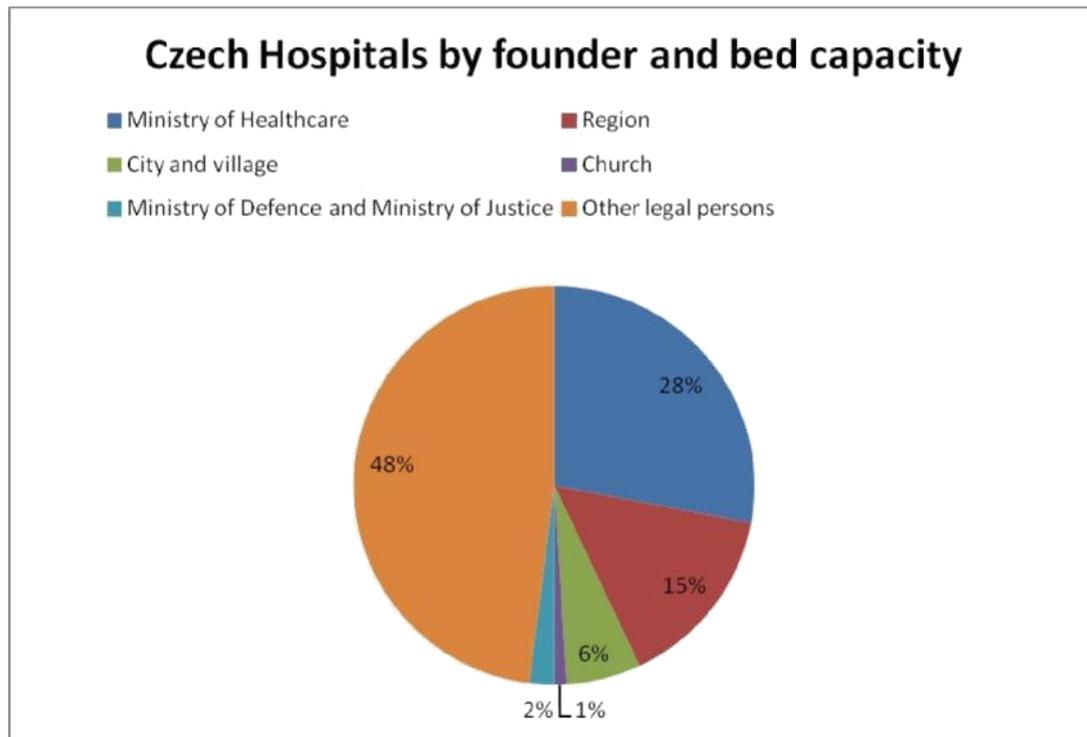
Our findings are concentrated in the following comparative analysis of different parameters.

### *Ownership structure*

In for-profit organizations, the most common situation is when the so-called majority owner(s) is the decisive factor for strategic decision-making. There are two variants of majority owner; either he is closely connected with the bank or institutional investor and thus top management is heavily influenced by external owners, or the shareholders (owners) are broadly dispersed and all power is concentrated in the hands of the chief executive officers or managing director together with the whole board of directors. State ownership is rare, and is concentrated in a few monopoly companies (e.g. railway, post, sometimes strategic energy) and their incidental losses are covered by governmental budget.

In the case of non-profit organizations, i.e. the hospitals in our sample, in almost all cases, the owner is identical with the founder. The structure of the founders of the 192 hospitals is depicted on Picture 1.

In some non-profit organizations, the definition of 'real owner' is often very difficult; the owner is vague or simply does not exist. In these cases, 'real owner' is substituted by a so-called Administrative Owner, who is represented by special bodies (Board of Trustees, Board of Governors). The examples are faculty hospitals, hospitals founded by churches or foundations.



*Picture 1: Czech Hospitals by founder and bed capacity*

#### *Capital resources*

There are two main ways that for-profit organizations acquire the necessary investment capital: either through a capital market (IPO) when an active and liquid capital market exists or through bank credits, when capital market is relatively passive (Mallin, 2010).

Non-profit organizations do not rely on capital market and accumulation of capital by IPO. The usual method of obtaining initial investment capital is through founding organizations, sponsorship and charity, and rarely through bank loans.

#### *Organization aims and application of agency theory*

In non-profit organizations, our findings come to the conclusion that the situation is substantially different from for-profit organizations. Here, generating profit is not the priority goal but there is usually a set of goals, mostly social and partly economic, but as a rule, difficult to quantify.

Due to the unclear characteristics of the owner in non-profit organizations, diversified and

sometimes hardly specified aims result. Economic aims are of secondary importance (e.g. the aim of public university is the highest quality of education).

Non-profit organizations prefer implementation of stewardship theory instead of the agency theory. Stewardship theory is not based on the theory of “economic man” but on psychology and sociology. It comes from the idea that a manager does not follow his individual aims but is fully identified with the aims of the institution, and thus follows primarily its goals. Managerial benefit, in case he follows the company’s goals, is higher than following his own individual goals. Implementation of stewardship theory leads logically towards lower agency costs, because the supervision of managers by the owner is not so intensive. On the other side, however, there is a danger of managers abusing power.

#### *Transaction cost theory*

Transaction costs theory (Coase 1990) is currently mostly applied in corporate governance in two areas, i.e. in agency costs and outsourcing. Agency costs (Jensen, Meckling 1976) are practically used for creation of a mechanism, checking managers if they follow preferentially the interests of stakeholders instead of their own. Transaction costs determine the level when agency costs are still acceptable for the owners and lower than profit from managerial activities. Application of transaction costs theory on the company level was developed mostly by O. E. Williamson (1996), the Nobel Prize winner from 2009. The theory became more popular, mostly as a methodological tool for specification of a company’s optimal border and outsourcing. The method is used mostly for managerial decision-making when they must decide whether to produce a product or service within the organization or to get them from the market.

Unsatisfactory managerial control by the owners and low agency costs can lead to so-called “moral hazard” and an enormous increase of the company’s administrative costs. This problem is often connected with risky behavior of managers without any efficient risk supervisory by the stakeholders. This was not only the case of Enron, Worldcom, Parmalat and others, but also a lot of corporations in Central and East Europe have made similar mistakes. These negative experiences led for-profit companies to have higher level of agency costs. New, more effective, systems of managerial incentives were established. Higher incentives for managers were implemented in the form of higher bonuses, benefits and long-term incentives, e.g. share options.

On the other side, the owners increased monitoring of managerial activities through increasing the number of independent board members, representatives of the employees in boards as well as establishing of board committees for audit, risk management, remuneration, financial and others.

The other aspect of transaction costs theory – outsourcing plays an increasing role in for-profit organizations. It is possible to say that globalization, better communication, logistics and IT create very good conditions for its development.

In governance of non-profit organizations, as backed by the empirical results from our survey, we can state that agency costs are relatively low compared to those in for-profit organizations, and the supervising role is underestimated. The typical consequence of lower costs could be defalcation. Our findings have not found any attempts to do it in Czech hospitals. A possible explanation of the absence of fraudulent behavior of top managers (contrary to the other sectors of a transition economy) is stewardship theory, implemented broadly in non-profit organizations. The same situation with lower agency costs exists with the problem of incomplete contracting, where the ratio of unpredictable situations is much higher. The reason is that non-profit organizations operate in a less stable environment with more complicated relationships and often unpredictable behavior of political bodies on a governmental level.

The empirical data from our research in Czech hospitals show high instability of the political system without necessary consensus of the biggest political parties. This situation leads to substantial changes of the healthcare system with every change of the ruling political party. It happens practically every four years. But similar changes we can observe in other EU countries, as was indicated in the research of our university students (Jezek et al, 2009).

Agency costs in non-profit organizations are still relatively lower compared to those of for-profit organizations. There are still missing committees for audit, remuneration, and risk management. The independent members of the boards are absent; in addition, the representatives of employees in boards and supervisory functions are often underestimated.

The characteristics of the so-called administrative owner influence the original theory of agency costs. The roles of both partners, principal and the agent, are not so clearly defined and their roles are often overlapping. Motivation of managers is sometimes difficult because the organization's goals are difficult to quantify; instead of one clear goal, as in for-profit organizations (profit), there is usually set of different goals. Lack of quantitative criteria leads

to underestimation of the control of managers. The consequences are lower agency costs on one side but the danger of unclear financial transactions and defalcation.

Analysis of implementation of outsourcing in non-profit organizations on our sample of Czech hospitals shows its high importance. Certain activities are outsourced almost as a rule (catering, IT service, certain kinds of maintenance); in addition, outsourcing is spreading into other special areas, e.g. external expert screening of X-ray or CT scanning.

### *Stakeholder theory*

Implementation of stakeholder theory, in which the main aim is to satisfy the expectations of all stakeholder such as customers, suppliers, employees, creditors, central and municipal governments, local community, social groups including shareholders – contrary to stakeholders theory concentrated on increasing the wealth of only shareholders (Mallin, 2010) – is more often in non-profit than for-profit organizations. Shareholder theory is, from its substance, close to the goals of for-profit organizations.

Non-profit organizations prefer stakeholder theory. The main reason for this application is the broad diversity of strategic goals, fulfilling the expectations of different participants. This theory is implemented in two versions. One is a classical version, in which a manager's task is to fulfill the expectations of all stakeholders and keep a very fragile balance among all participants even if their goals are contradictory, e.g. an employee's goal is a higher salary thus increasing costs and a shareholder's goal is higher dividends. The other is the so-called shareholder version of stakeholders theory, in which the managers try to fulfill the primary goal of the shareholders i.e. increasing their wealth through preferential fulfillment of the goals of other stakeholders. This version comes from the idea that e.g. higher salaries for employees contribute to higher efficiency of their work and higher profit, and consequently higher dividends for the shareholders.

Non-profit organizations prefer implementation of the classical version of the stakeholder theory, which is again closer to the substance of their main aims.

### *Board structure*

We already mentioned that there are two basic systems of organizational design of boards: a one-tier structure with a board of directors and a two-tier structure with a management board

and supervisory board. For increasing the efficiency of their activities, both systems create special committees, assisting the boards. Their main task is to prepare data for the board meetings, elaborate the decision-making versions and their analysis. Board members then make the final decision (OECD, 2004). The typical committees are committees for audit, nomination, remuneration, risk, financial, executive.

To increase the supervisory role of the boards, for-profit organizations nominate, as board members, independent members and representatives of the employees. In non-profit organizations, we can find versatile structures as well as other bodies that usually do not exist in the for-profit sector, for example, board of trustees or governors.

The main modification is existence of the board of trustees or governors, which in many organizations substitutes the real owner and acts as administrative owner. In some hospitals, we observed only a supervisory board and management. Only in the hospitals with the legal form of joint-stock companies have we found classical two-tier structures with management board and supervisory board.

We can observe the following main differences between for-profit and non-profit organizations in the board structure: absence of the committees, unclear system of compensation and remuneration of board members, absence of quantitative indicators of the task for managers and board members and remunerations policy based on fulfillment of these indications (base salary, bonuses, benefits).

The main results of the analyses of differences of the systems of corporate governance in for-profit and non-profit organizations are depicted on the table 1.

Organization	Characteristic					
	Capital resources	Ownership structure	Organization aims and application of agency theory	Transaction cost theory	Stakeholder theory	Board structure
For-profit	Markets Banks	Major and minor owners, owner is clearly defined	Principal and agent roles, principal role of owner	Higher agency cost, internal planning, profit growth, importance of	Shareholders theory still dominant	One or two-tier structure, committees, long-term manager motivation of (share options)

				outsourcing		
Non-profit	Bank lends, charity, sponsors	Administrative owner, owner is unclear	Unclear separation of competencies, implementation of stewardship theory, owners role diminished	Lower agency cost, external cooperation, importance of outsourcing	Predominant stakeholders theory	Nonstandard structures, incomplete boards, boards of trustees or governors, committees not existing, low long-term managers motivation

*Table 1 Characteristics of CG by parameters*

## CONCLUSION

In accordance with the main aim of our paper “to contribute to the development of the theory of CG of non-profit organizations and show as well its practical consequences” we tried to specify the main characteristics of the CG parameters in for-profit and non-profit organizations and indicate the similarities and differences in both systems.

The analysis of our sample of 192 public hospitals in the Czech Republic (full sample of all Czech public hospitals) allowed the verification of both of our hypothesis.

Hypothesis H1 “The characteristics of the parameters of the defined CG system differ in for-profit and non-profit organizations” was verified and confirmed practically in all parameters. In some parameters, e.g. “capital resources”, “ownership structure”, “organization aims and agency theory” and “board structure”, the characteristics differ distinctly; in the rest of parameters together with the differences there are some similarities. For instance, in the parameter transaction costs theory it is the characteristic “external cooperation”, or in stakeholders theory “the role of stakeholders” is important for for-profit as well as for non-profit organizations.

Hypothesis H2 “Development of the characteristics of the parameters of both systems tends to convergence” was confirmed only partly, namely in the following parameters: “ownership

structure" tending to higher privatization, "transaction costs" theory with outsourcing and "stakeholders theory" with the tendency of increasing role of different stakeholders.

On the other side in the parameters "ownership structure", "organization aims and agency costs" and "board structure" we indicated high diversity without any tendency to convergence.

## FUTURE DEVELOPMENT

Based on our research, we may formulate the following tendencies for the future development of CG in non-profit organizations. Ownership structure will change in the way that the number of privately owned companies will increase. This tendency we can observe not only in the Czech Republic but almost in all countries. With regard to capital resources, we cannot expect any radical change in the financing of non-profit organizations. The current tendency to rely on charity and sponsors will be more and more important.

In organization aims and agency theory, an increasingly controlling role of administrative owners is expected to prevent abuse of managerial positions for self-interests and moral hazard. In stakeholder theory, we expect continuation of implementation of stakeholder views and an increasing tendency of the institutions toward corporate social responsibility and activities tending to fulfillment of the idea that an institution acts as a "good citizen".

The results of our comparative analysis correlate with the conclusions of other literature sources (Taranenko 2009, Hopt and Hippel, 2010) that in CG of for-profit and non-profit organizations we can observe the development of two relatively independent systems in harmony with the principal factors influencing them substantially. These factors are macro policy, economic and social policy, culture and public opinion. Our analysis, however, also revealed certain elements of convergence in for-profit and non-profit sectors that can indicate higher convergence in the future.

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## TEMPORALITY IN INTERGENERATIONAL TRANSITION: A PROCESS CASE STUDY OF A SMALL BUSINESS

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### ABSTRACT

Family business provide key infrastructure of wealth creation across the globe. One of the most important challenges family businesses face is the intergenerational transition process, an issue that has received considerable attention by scholars from diverse countries. Despite this great interest, academics are still struggling to understand such a process. In this paper we contend that a process orientation can prove a useful tool to shed new light on this phenomenon. In particular we provide a reading of the intergenerational transition through the different meanings actors apply to time. Evidence from a process case study point toward that founders and successors have a different perception of past, present and future and how they shape each other. This helps us to shed new light on the sources of difficulties family businesses face during the intergenerational transition process.

**Keywords:** family business, intergenerational transition, temporal issues, sensemaking, process approach

### INTRODUCTION

Time seems to play a critical role in family business—a form of business that is built to last through generations. Conventional portraits of family business convey the idea that that it is built to last through generations. This explains the interest that intergenerational transition in family business has attracted from family business scholars from diverse countries (Brockhaus, 2004; Litz, Pearson & Litchfield; 2012).

Empirical evidence about this issue is mixed and supports the claim that the majority of family businesses fail to make it to the second generation (e.g., Le Breton-Miller, 2004). In an

attempt to further our understanding of the intergenerational transition process, a host of studies seek new variables able to predict a successful intergenerational transition, We contend that this state of affairs reflects a positivistic mindset that still dominates the field and that has produced a low value added in terms of knowledge of substantive issues surrounding family businesses. In a similar vein, several family business scholars advocate for breaking down the prevailing paradigm of positive rationalist research ontology and epistemology that still dominates the field (Litz, Pearson & Litchfield, 2012) that proceeds by hypotheses testing on large samples, looking for the ultimate dependent, moderating or mediating variable explaining succession. As a consequence, the field seems marred by a set of standardized procedures that allow rigor but sacrifice a deep understanding of such an ambiguous process. Along with Dawson & Hjorth (2012) we call for a more nuanced understanding how organizational processes unfold over time the way they do and we intend to remedy to this state of affairs by proposing a different journey into the intergenerational transition that does justice to the ambiguities surrounding this process. Specifically, we want to put the spotlight on different interpretations of time different actors experience during the process. This paper aims to contribute to family business research by providing a more nuanced understanding of intergenerational transition, by asking “How do actors involved into intergenerational transition make sense of temporality during this process?”. We achieve this aim by investigating the different temporal schemes of actors involved in a intergenerational transition within an Italian small family company. We contend that unraveling the different interpretations of time may shed new light on this process and help us understanding the difficulties actors experience during this process.

The paper is organized as follows. In the next section we provide theoretical background about temporal issues in intergenerational transition. Then we describe the field study. Next we present and analyze findings. Limitations and future directions are provided in the concluding section.

## **READING THE INTERGENERATIONAL TRANSITION THROUGH A TEMPORAL PERSPECTIVE**

In this section we review extant literature dealing with intergenerational transition in family businesses. Then we discuss the role of time in management and organization studies and propose our reading of the intergenerational transition based on the analysis of how the actors involved in the process make sense of temporality.

*Intergenerational transition in family business research*

Family businesses are by their nature temporally embedded, as they are built to last by passing the management and ownership from one generation to another, something that is generally referred to either as succession or as intergenerational transition process. Throughout this paper we use this latter label as we believe it better captures its meaning as well as its dynamic nature, being it a passage from one stage, subject or place to another.

As specified above, literature dealing with the intergenerational transition in family business is abundant.

To make sense of the variety of issues addressed and methods employed, we can classify studies as: 1) seeking to explain performance in family businesses; 2) focusing on the decision-making process; 3) investigating single constructs, such as commitment, or single actors, such as founders or successors; 4) approaching intergenerational transition as a process with the aim of developing a holistic overview.

Within the first category, analysis of the relationship between family issues and performance is a major focus among family business scholars. A range of factors is investigated with an aim to explaining or predicting successful intergenerational transition. Stewart & Hitt (2012) provide a detailed summary of 59 empirical studies published in the 2000s to assess the effects of family involvement on firm performance, concluding that the findings are inconclusive. This could be partly explained by the heterogeneity of family businesses that makes more useful to investigate how family and business factors interact and shape one other and determine a certain performance, as suggested by (Dyer & Dyer, 2009).

The second category comprises studies investigating the decision-making process during intergenerational transition. The main focus in this set of studies is on planning intergenerational transition in an attempt to offer practical guidance on how to make it successful (e.g. Sharma, Chrisman & Chua, 2003). Various scholars have raised concerns about the connection between planning and successful succession (Aronoff, 1998; Lansberg, 1999; Murray, 2003). Here we would like to outline that an emphasis on formulation processes is ill-suited to deal with behavioral factors that actually do affect how the intergenerational transition process evolves over time, above and beyond what has been rationally planned.

The third category varies a great deal, with studies addressing aspects such as communication between founder and successor (Janjuha-Jivraj & Woods, 2002), intra-family conflicts (Levinson, 1971), family cohesion and adaptability (Lansberg & Astrachan, 1994), the gender of actors involved (Harveston, Davis & Lyden, 1997), the role of family identity

(Zellweger, Nason, Nordqvist & Brush, 2013), successors' career expectations (Sharma, 1997), and desirable successor attributes such as commitment (Sharma, & Rao, 2000), analysis of which can be extended to include all the family members (Handler, 1989; Sharma, 1997). Taken together, these studies area step towards a more nuanced analysis of key concepts in intergenerational transition.

The fourth category includes studies addressing the intergenerational transition process in a more holistic way. Miller, Steier & Le Breton-Miller (2003) inductively identify three possible patterns of intergenerational transition—conservative, rebellious, and wavering—and discuss their possible impact on performance. Beyond this substantive contribution, the need clearly emerges for joint consideration of how family issues shape and are shaped by business ones.

The contribution of Cabrera-Suarez, De Saà-Perez & García-Almeida (2001) proceeds in the same direction with an integrative model incorporating the characteristics of the founder and successor (age and gender) as well as the family and the business context. The authors do justice to the multiple, concurrent and sometimes conflicting factors that recursively shape this process. The main flaw of this model is the fact that they focus on founders and successors, while there are several other stakeholders to take into account, such as professional managers, other family members, employees, and customers. All of these play a part in the intergenerational transition process, which is described as one of mutual adjustment by Handler (1990). Lam (2011) further develops Handler's view of intergenerational transition by pointing out that each individual play different roles simultaneously and putting forward the idea of multi-entity roles, which is a step towards comprehension of the ambiguities surrounding this process. In our view, the introduction of time and temporality can shed new light on and to better understand these ambiguities, as discussed below.

#### *Introducing time and temporality in the study of intergenerational transition*

Process scholars have long advocated for the inclusion of time in the analysis of organizational processes (Mohr, 1982; Pettigrew, 1992; Van de Ven, 2007). The word time summarizes a multitude of meanings and it is not surprising that the definition of time is itself ambiguous (Mari and Meglio, 2013). While Ancona, Okhuysen, and Perlow (2001) conceive time as a linear sequence of past, present and future, echoing the Newtonian view of chronological time according to which time flows linearly and independently from human action, other scholars have focused their attention on the ways people experience and make sense of time according to their lifestyles, reference systems and social norms (Chia, 2002).

According to this view, time can be conceived as lived experience that does not exist apart from human consciousness (Gherardi and Strati, 1988).

Today, after Lorenz's and Einstein's accomplishments, these opposing views are reconciled in that measurement methods for time are embedded, and therefore relative, to a specific reference system. A multiplicity of chronological times are thus dependent upon individual perspectives and frameworks. Any organization depends upon coordinating all these different times, but no organization can succeed completely. One way is to posit the existence of an overarching time, which is usually clock time. Another is to try to move to the non chronological notion of appropriate time, such as *kairos*. Still another option is to acknowledge that an organization includes a plurality of times.

An important step towards a deeper understanding of time in organizations, is to focus on temporality, that is to analyze how actors make sense of time in the context of the intergenerational transition. The notion of temporality, as used in this study, implies more than different conceptions of time, being it about the ways in which the passing of time shapes human actions (Hernes, Simpson and Söderlund, 2013). We share this view and we contend that if we persist in treating time as independent of human experience, we risk losing touch with that which makes us human, guides us in moral action, and gives meaning to our lives. More subjective approaches to time tend to see past, present and future as all rolled in together. Focusing the investigation on temporality in the context of intergenerational transition would eventually help us to understand where ambiguity comes from. The choice of our focus is driven by the awareness that "family firms are not only socially distinctive, but comprise a distinct temporal frame, with time particularly relevant for the co-production of sense and order. In these uniquely rich organizational environments, the (inherently mutable) heritage of the past, and the (ever changing) shared projections of the future, are both linked and enacted by actions in the present" (Drakopoulou Dodd, Anderson & Jack, 2013: 35).

## **THE FIELD STUDY**

Our fieldwork approach to this study is case-based and processual (Pettigrew, 1992). In order to capture contextual complexity and depth (Dyer and Wilkins, 1991), we use a qualitative single case-study design (Yin, 1989). Since the focus of the research was on temporality and how actors in family business (founders and successors) experience the intergenerational process through the meaning they attach to time, the study was conducted as an

interpretative inquiry, with the aim of making interpretations from the inside (Brown, 1994, 1995).

The research setting is a small Italian service company operating in Southern Italy. Its core business is selling plumbing and heating materials both as wholesaler and as retailer. The first business accounts for 80% of turnover, while sales to end consumers represent the remaining 20%. 20 full time employees are currently working for the company.

Founded in 1976, the company is run by three shareholders—Luigi, Federico and Mauro—who are fully involved into the day-to-day managerial activities. Luigi is responsible for wholesales, Federico is responsible for retail sales, while Mauro is responsible for finance and procurement. Luigi, Federico and Mauro have no family linkage among them, and their spouses have been kept out of the company. However, they perceive themselves as a family company as they started off the business with the idea of ‘passing the baton’ to their sons or daughters.

As for the data gathering techniques we followed Lincoln and Guba’s (1985) suggestion that qualitative field methods are the best fit to acquire a type of data that is unattainable using other modes of inquiry (Smith, 2001). Such an approach usually delves more deeply into the organizations rather than skimming over their surface (Langley, 2009). We use the label ‘field research’ to describe the study of ongoing organizational life in its naturally occurring settings with first-hand observations from the viewpoint of a particular individual or group (Van de Ven and Poole, 2002). Its distinctive feature is that it takes place in the field in a natural social setting familiar to the subject (cf. Lofland et al, 2006).

We entered the field in “*medias res*”, with the three intergenerational transitions being at different stages of their developments. For this reason, we employed a partly retrospective and partly in real time research approach, with the aim of linking the past to the present and to future. In order to allow the different understandings of past, present and future as well as other temporal categories to emerge, we decided to investigate two units of analysis: the fathers and the sons/daughter(s).

The field work lasted three years, from 2008 till 2010. Access to the research setting was secured by a personal relationship of one of us with Antonella (Mauro’s daughter). This assured the collaboration of informants throughout the research process.

To improve our understanding of the field and the topic of interest a range of data, primary as well as secondary, was collected. Primary data were mainly collected through focused interviews. We interviewed the three founders, the three successors, along with other two siblings. Each informant was interviewed twice or more times, with each interview lasting on

average one hour. All interviews were recorded and transcribed with informants' consent. Furthermore, observations and informal talks supplemented interviews with field notes. Secondary data were mainly a chronology of events traced by one of the founders and minutes from key meetings.

In our analysis, we followed an inductive logic (Glaser and Strauss, 1967). This meant that we had an exploratory approach towards our data and aimed at structuring the data on an ongoing basis from a 'grounded' understanding of the phenomena in question. Our research design allowed us to contrast the linear view of time and different temporalities.

## FINDINGS

In presenting our findings we will focus on the different, often competing, interpretation of time actors experienced during the process. The most important temporalities emerging from our field study are past, present and future and how they shape each other.

Although we recognize that past, present and future are strictly linked and the perception of one influence the perceptions of the other two, we will discuss them separately. We would like to start the discussion from how founders and successors experience the past.

### *Competing interpretations of the past*

From the interviews it clearly emerges there is a different involvement with and attachment to the past. In founders' accounts there is a great attachment to the past, which brings with it a frequent recall of the beginning of their company. They all share the feeling that the past still exerts a great power on the present. This feeling can be best illustrated by the way they all evoke and depict the beginning of the company. They all refer to it as a jump into the unknown, they recall the initial sacrifices, but also the importance of the earthquake in their growth. The past is therefore described as containing difficulties but also opportunities they were able to identify and to exploit. Underlying this feeling is the strong belief that they were building something for their families, and their children in particular.

The past is lived in a different manner by successors .depending on their involvement into the family business during their infancy and youth While Antonella (Mauro's daughter) and Carlo (Luigi's son) were kept out of the business before joining the company, Ludovico (Federico's son) was constantly updated by his father about the company and was regularly brought with him at work. This gives to him a sense of having been there even when he was not involved into the management of the business. This does not result however in a sense of

superiority towards his counterparts (Antonella and Carlo), rather it probably affects the relationship with his father and the way he interprets the past. Besides their involvement, all successors live the past with mixed feelings: on the one hand, it represents the legacy of their fathers and they feel the responsibility to assure continuity to their company, on the other hand it represents a burden as it prevents them to change the ways “things are done around here”. The past is not really over, it is continually re-lived into the present through routines and practices. The ways things are done about here, that is how the present is experienced on a daily basis represents a sort of battle ground where competing frames fight against each other. The present is, as a matter of fact, the result of past choices, and therefore, future choices are constrained by past ones. Under this regard, there is a tension between generations. While founders do not even perceive the need to make changes, the successors believe that changes are urgent and the cost of inactivity is a crisis.

#### *Competing interpretations of the present and the future*

The present is viewed by founders as a transition time, with some processes ongoing but not ready to be completed. From founders' account it clearly emerges that the transition is *in fieri* and it follows its natural course; however, none of them seems to be ready to retire. What seems to be a shared feeling is the willingness to retire but the impossibility to do so, as the successors are not perceived to be ready to “receive the baton”. The present is therefore seen as a “frozen time”, with founders skeptical about successors' capabilities to run the business on their own, and the successors eager to replace their fathers. This reinforces the view of the present as a battle ground as discussed above. The present is, in fact, lived by successors as the outcome of past choices that are in some cases irreversible, thus implying that the range of possibilities are constrained by the founders' past actions. It is exactly in present time that different views emerge. An illustrative case in point is the meaning of speed attached by actors: having something done soon, say a new contact with a supplier or a phone call to a customer may take one month for a founder while just half a day for a successor. This reinforces the idea of the urgency of the change that is perceived by all successors and not understood by founders. This provides in our view an alternative understanding of possible sources of conflicts among generations during an succession process.

The sense of urgency and the compelling need for speed brings with it a different meaning attached to the future. In the context of the intergenerational transition the future is not simply about goal setting for sustaining growth, but also about the timing of the intergenerational transition, that is, the moment when the founders will retire and successors

will replace them completely. Again competing and often irreconcilable sense-making of future emerge. Founders seem to be stuck in the present, with no idea about the right time to retire, and not even a tentative timeline. Successors live this ambiguity with frustration as they perceive that they have fully replace their fathers in the daily management of the business, but feel constrained by their presence within the company. They all feel that as long as their fathers are within the company they are not allowed to implement any change.

## CONCLUSION

In this paper we have provided a different, and more nuanced understanding of intergenerational transition in a small family business. We have achieved this aim by investigating how founders and successors experience past, present and future over the course of the intergenerational transition. The research setting is a small Italian company run by three different shareholders who are “passing the baton” to their sons and daughter. Analyzing the often competing meaning actors attach to temporalities a new understanding emerges of the conflicts between generations in a small family business.

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## RESEARCHING SOCIAL PRACTICES FOR UNDERSTANDING CONSUMPTION

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### ABSTRACT

The social practices lens provides a different perspective to the study of consumption emphasizing its role in social reproduction and changes rather than focusing on individual consumer choices or cultural structures (such as lifestyle), and also because it helps understanding how value is co-created among consumers and firms in innovation process.

So far conceptual and substantive contributions about social practices have been developed neglecting the inquiry around the methodological side. This paper tries to answer the following question: what research methods should scholars use when studying social practices in relation to consumption?

To achieve this aim, secondary data drawing on empirical studies about social practices and consumption are examined. Such a preliminary analysis shows that studying practices and consumption needs a twofold approach: the immersion in the ongoing social activities of some individuals or group, and the across-time perspective. To capture both, a longitudinal field research is proposed as the main inquiry strategy.

Field research means studying the ongoing practice life in its naturally occurring settings, and longitudinal approach helps seeing social practices from a historical developmental perspective.

**Keywords:** consumption, social practices, field research, longitudinal research, brand community

Social sciences have increasingly taken the concept of practice as their focus of study since the eighties. The range and scope of practice theory applications are very broad and include management and marketing studies as well. Scholars within management and marketing communities are turning their efforts to practice theory as a new perspective for advancing

knowledge. A growing number of conceptual and empirical works in accounting, marketing, organization, and strategy witnessed such an investment .

In marketing one of the main application of practice theory is focused on understanding consumption through a diverse lens that highlights it as part of accomplishing social practices. This approach is particularly useful because overcomes the weaknesses of current consumption research privileging either individual consumer choices or cultural structures (such as lifestyle), and also because it helps understanding how value is co-created among consumers and firms in innovation process.

The social practices lens provides a different perspective enabling to see consumption as embedded in social reproduction and changes. Scholars have been so far mainly concerned with the analysis of conceptual and substantive contributions a practice lens can offer, while the inquiry around the method domain remain relatively neglected. If we acknowledge that the concept of practice is a new avenue for understanding consumption culture, it makes sense to ask which specific research methods best fit it. It becomes a relevant question if scholars want to gather data that shed light on the relationship between consumption and social practices.

This is the void this contribution intends to fill, to develop further such a line of research providing a preliminary analysis of data gathering techniques that are best fit to a practice leans. This aim is captured by the following question: what research methods should scholars use when studying social practices in relation to consumption? To achieve this aim the paper provides an overview of different data gathering techniques and suggest a comprehensive framework to guide empirical research inspired by a practice lens.

The remainder of this paper is organized as follows. Firstly, a brief theoretical sketch about practice theory is presented. Then the paper analyzes the implications of applying a practice lens to the study of consumption. Next the paper describes different data gathering method and a proposal of an integrative framework that seasoned and novice researchers could rely upon when conducting a field study.

## **A THEORETICAL SKETCH**

This paragraph offers a brief overview of theories of practice. The complexity of the topic would require a more comprehensive analysis, which is beyond the aim and scope of this paper. For this reason, the paper will attempt to clarify the concept of practice and provide a basic introduction of different theories of practice.

The concept of practice is not easy to grasp as it has diverse theoretical roots (Bourdieu, 1978; Giddens, 1979). This can be interpreted as a sign of versatility and richness of this lens. In an attempt to offer a systematic analysis of such an approach, a fruitful starting point is to draw on a few pieces written by further theorists that help us to navigate into the topic. Specifically, here it is useful to refer to Ortner (1984), Reckwitz (2002), Schatzki (2001, 2012), Shove and Pantzar (2005), and Warde (2005).

Ortner contextualizes the birth of practice theory in the field of anthropology and claims that the translation of Pierre Bourdieu's book published in 1978 marked the call for a more practice-oriented approach. He goes on in describing what happened:

'...a new key symbol of theoretical orientation is emerging, which may be labeled "practice" (or "action" or "praxis"). This is neither a theory nor a method in itself, but rather, as I said, a symbol, in the name of which a variety of theories and methods are being developed.' (Ortner, 1984, p. 127)

Ortner (1984) outlines that despite the great variety of theories of practice, they all share a common orientation based on the following issues: the view of the social world and the Marxist influence. From this one learns that a practice approach is elaborated in opposition to the dominant view of the social world that sees it as ordered by rules and norms, and minimizes the relevance of institutional organization and cultural patterning for understanding social life (Ortner 1984). In other words, practice scholars believe that the social world is produced and reproduced in the past, present, and future and are therefore interested in understanding the mechanisms through which (how) it happens.

The Marxist legacy emphasizes the social asymmetry between actors: this implies that action and interaction are guided by hegemony and symbolic domination. The social world is formed and deformed by "specific realities of asymmetry, inequality, and domination in a given time and place" (Ortner, 1984, p. 149).

The reading of practice theory offered by Reckwitz (2002) is as a type of cultural theory and is focused on explaining the relationship between human action and the social world. He focuses his attention on how the social world impacts on the practice, and how the practice in turn shapes the social world. This brings with it an understanding of the production, reproduction, and change of form and meaning of a given social and cultural world. From this one learns that practice is shaped by the social world through culture. This culture allows and enables people behaviors, yet it is again this culture that restricts and inhibits those behaviors. In sum, practice is a constitutive mechanism of the social world that is reproduced by practice through norms, values, and conceptual schemes that characterized

the ordinary living and little routines in social interactions. Changes in the social world are introduced (Ortner, 1984), alternatively, by a dominated group escaping the prevailing hegemony (that is a countercultural movement) or a failed reproduction (unsuccessful attempts to apply traditional practices).

Taken together these works suggest that a practice is anything people do that has intentional or unintentional political implications because the theory assumes the centrality of domination. The acting units are individual actors and their doings. Both becomes the important points for understanding the unfolding of events and the processes of change of the social world. A practice may have a dual temporal dimension: ad hoc decision making in the short term and plans or programs in the long term. The kinds of action that constitute the object of the theory are pragmatic decision making, active calculating aimed at changing the social world, as well as more routinized behavior that reproduces the social world. The human action, in practice theory, is driven by and accordingly understood by adopting two alternative explanations. The first, a psychological view that is based on individualistic and rational behavior, and the second, a social view that describes actors as concerned with the difficulties of their situations and trying to solve problems posed by those situations.

Social practices become thus the site of the social for practice theory and, consequently, practices are the basic units of analysis. A practice can only exist when the activities involved are performed by people, meaning that social practices have to be enacted.

Schatzki (2001) contributes to a more nuanced understanding of the social practice. More specifically, Schatzki (2001) distinguishes between practice-as-entity and practice-as-performance. The former are formed historically as a collective achievement, the latter highlights the enactments that reproduce and transform the practice over time. Such a distinction is generally accepted by scholars even though different versions are formulated. Ortner (1984), from his side, describes a practice as anything people do (that is doings), while Schatzki (2001, 2012) focuses on a more elaborated concept: an organized nexus of activity where activity is a set of doings and sayings organized by a pool of understandings (knowing how to), practical rules (explicitly formulated instructions), hierarchical structure of end-project-activity, and material entities. Reckwitz (2002) pulls together bodily and mental activities, knowledge, and things. Warde (2005) describes practice's components as understandings, procedures, and engagements. Shove and Pantzar (2005) include meanings, competences, and materials. These qualities of a practice are necessary to perform it and individuals act as carriers or hosts of a practice.

To summarize, the concept of practice, besides the different conceptualizations and underlying perspectives, is a complex phenomenon. It is exactly this complexity that makes this concept so attractive to scholars from a range of disciplines. Such complexity, however, poses methodological challenges, that is, selecting methods suitable to capture and render this complexity. With this observation at hand, the paper moves onto the analysis of different data gathering techniques.

## **APPLYING PRACTICE THEORY TO THE STUDY OF CONSUMPTION**

The adoption of a practice lens, brings with it that consumption is an aspect of social practice since performing a practice requires material artifacts (Ropke, 2009). If consumption is conceptualized as integrated and embedded within social practices, it means studying how things and services are utilized (Harvey *et. al.*, 2001). The focus is on 'doing' rather than 'having' in relation to consumption. An example about the practical use of kitchens clarifies such a perspective:

'The kitchen table is symbolically important for some social groups, it being embedded in practices believed to sustain the moral well-being of the family, intimate relationships and friendships. Its use is subject to objective constraints, such as size of kitchen and number of household members. Other relevant factors reported included the times at which household members return home from work and school, and whether a meal was cooked using raw materials or a pre-prepared meal cooked in the microwave. Such routines and objective constraints influenced whether kitchen tables were deemed important, how they were used and how this affected related social practices revolving around sociality, eating and the organization of domestic routines.' (Harvey *et. al.*, 2001, p. 46).

Consumption is embedded within a given material culture and set of social norms. It follows from practice rather than vice versa (Shau *et al.*, 2009). 'Consumption is not itself a practice but is, rather, a moment in almost every practice' (Warde, 2005, p. 137). The engagement in the practice helps us understanding the nature and process of consumption. Individual pattern of consumption can be explained through the recruitment to a practice and the subsequent commitment to it. Consequently changing forms of consumption may be accounted for as changing positions within practices. The practice theory perspective provides a socio-structural explanation of consumption (Randles and Warde, 2006). This means that consumption is seen as one of vehicles through which social structures (such as class, age, gender and space) are shared, understood, misunderstood or contested. Moreover,

empirical evidence (Shau *et al.*, 2009) shows that consumer's enactment of practices creates value in brand-centered community. Such a collective process of value creation collaborates in the firm's innovation process. Customers and firms co-create value in brand communities and understanding practices that help building better brand partner becomes a key managerial goal. Customer engagement in collaborative value creation impacts on brand equity and firms should develop opportunities to foster such a collaboration. Specifically, studying activities by which consumers create value in brand community practices reveals crucial information for new product development, such as information on customer desires and information on how to best satisfy them. From a managerial perspective, firms should be strongly interested in understanding how to offer opportunities to grow customer competence, that, in turn, increase the likelihood of value creation through practices in brand communities.

## **METHODOLOGICAL IMPLICATIONS IN STUDYING CONSUMPTION THROUGH A PRACTICE THEORY LENS**

How do scholars study social practices and consumption? To answer this question, the paper investigates what are the data gathering techniques scholars have so far employed to study social practice and consumption. To achieve this aim, a set of empirical articles drawing on social practice perspective was selected. Despite the set has no statistical significance, it still provides us with preliminary findings useful to clarify how studies were conducted so far. Such an approach is consistent with the initial contribution that the study intends to offer. The set includes 13 articles published from 1995 to 2012 in five academic journals as shown in Table 1, where they are arranged in chronological order and research methods employed are highlighted. The focus here is solely on data gathering methods used in the study based on what authors described in their article.

The set of articles shows two main features: most of the studies employ more than one data collection method and qualitative research methods are the prevailing approach. Looking into the data gathering techniques employed, it emerges that individual interview is the most used method (11 out of 13 studies), followed by participant observation (6 out of 13 studies) and secondary literature (6 out of 13 studies). In regard to secondary literature, it can be assumed that, despite authors did not mention explicitly this method, they conduct some kind of secondary data collection. Non-participant observation is less frequent in studying social practice and consumption (4 out of 13 studies). Further methods are quantitative approach based on survey (one study employed it with time diary technique)

and focus group (one study). A few studies are partially based on different versions of observation such as video recording, photography, and auto-photography.

Authors and Year	Journal, Volume, and Issue	Research methods
Holt 1995	Journal of Consumer Research 22 (June)	Non-participant observation
Shove and Pantzar 2005	Journal of Consumer Culture 5 (1)	Interview, focus group, participant observation, secondary literature
Cheng et al. 2007	The British Journal of Sociology 58 (1)	Time diary survey
Hand and Shove 2007	Journal of Consumer Culture 7 (1)	Interview
Watson and Shove 2008	Journal of Consumer Culture 8 (1)	Interview, non-participant observation, secondary literature
Gram-Hanssen 2009	Journal of Industrial Ecology 14 (1)	Survey, interview
Shau et al. 2009	Journal of Marketing 73 (September)	Interview, participant observation, non-participant observation, secondary literature
Sandikci and Ger 2010	Journal of Consumer Research 37 (June)	Interview, non-participant observation, secondary literature
Halkier and Jensen 2011	Journal of Consumer Culture 11 (1)	Interview, participant observation, auto-photography
Hargreaves 2011	Journal of Consumer Culture 11 (1)	Interview, participant observation
Magaudda 2011	Journal of Consumer Culture 11 (1)	Interview
Truninger 2011	Journal of Consumer Culture 11 (1)	Interview, participant observation, secondary literature, video recording, photography
Hui 2012	Journal of Consumer Culture 12 (2)	Interview, participant observation, secondary literature

*Table 1 Examples of research methods*

By reading the 13 articles, it also emerges the authors' attempt to uncover the practices through studying doings and sayings of the people involved. Such an approach helps composing practices according to their dual nature of entity and performance. Inquiry in social practice needs description of both basic elements and action performed by practitioners. This means to take into account elements and performance that are spatially and temporally dispersed entities (Schatzki, 2012). Moreover, empirical studies on practices emphasize the social dynamics into which consumption processes are embedded (Halkier and Jensen, 2011) and the individual consumer-practitioner is considered as a place for intersection of a plurality of practices. For example, the daily engagements of any individual

are a search for balance among the different practices in the social organization of time and space. Thereby, work practices, parental practices, transportation practices, food practices, leisure practices and so on can be seen as part of the same everyday life. To understand further social practices, it means to develop the trajectory that each of them develop over time. More specifically, practices have a history conditional upon time, space and social context (Warde, 2005). Thus, practices change their form due to the performance of practitioners that actively contribute to reproduction, reconfiguration and innovation.

It seems clear from both the theory and empirical evidence, summarized in Table 1, that studying practices and consumption need a twofold approach: the immersion in the ongoing social activities of some individuals or group, and the across-time perspective. In order to capture both, the paper proposes a *longitudinal field research* as the main strategy to inquiry social practices within the consumption context.

The label field research describes the study of ongoing practice life in its naturally occurring settings using first-hand observations from the viewpoint of a particular individual or group. Its distinctive feature is that it takes place in the field in a natural social setting familiar to the subject. The word longitudinal implies studying social practices from a historical developmental perspective. It means inquiring about a sequence of events or activities that describe how things change over time for understanding the dynamic of practice life.

Longitudinal field research is characterized by two elements (fieldwork and the prolonged engagement with the research setting) that suggest to collect data preferably by using a multi-technique approach to build evidence that is both broad and deep. This in turn means that going into the field and studying change over time can be conducted by adopting a comprehensive framework based on listening, observing and tracing as data gathering techniques (Mari and Meglio, 2013).

The listening approach is based on interviewing, which means understanding how informants make sense of their actions (Lofland *et al.*, 2006). It means that researchers try to access the internal lives of people and give voice to them through talk as the data source. Interviewing can be conducted at the individual and group levels; ideally, the two levels should not be considered as alternatives, but rather as complementary in cross-validating data.

The observation approach enables close access to and experience of the lives and activities of others (Lofland *et al.*, 2006). It means understanding evolving patterns of daily interaction and behaviour that shed light on the 'how' of practice life. Observation can be participant or

non-participant, according to the role played by the researchers. The former implies that they actually participate in the practice they are investigating. This may happen overtly (that is, acting as a temporary practitioner and asking permission to conduct the fieldwork) or covertly (that is, taking a practitioner role without disclosing the research aims). The latter requires the researchers to observe the phenomena but not take part in them. Moreover non-participant observation involves limited interaction between the people observed and the researchers.

The tracing approach to practice research provides a valuable way of studying key event chronologies spanning long periods of time, records of arguments and justifications, and logs of personal activities and events (Alaszewski, 2006). It takes the form of diaries and archival records, and may contribute to a better understanding of the practice life because it conveys data that are usually difficult to gather through the other approaches. Here, we refer to solicited diaries that fit the research aims rather than unsolicited documents that are already available, such as life histories or memoirs (Alaszewski, 2006). Archival records (Webb *et al.*, 2000) are written materials that can be produced by either public sources (that is, data periodically gathered for purposes other than scholarly ones) or private sources (data from personal archives).

## CONCLUSION

Despite the previous proposal can only scratch the surface of how conduct research about social practices and consumption, it still provides an initial understanding of such a relevant topic. Our understanding of consumption through a practice theory lens need both a conceptual and methodological effort.

A practice perspective is a fruitful avenue for furthering our understanding of consumption that, in turn, increases the comprehension of how value is co-created in brand community practices. The social practice approach promises to offer fresh insight for both scholars and marketers focusing on activities by which consumers engage in practices and create value for them and firms. To fully exploit such a promise, however, it is essential to rely on data gathering techniques that allow for the immersion in the ongoing social activities of some individuals or group, and the across-time perspective. In order to capture both, the paper has proposed a *longitudinal field multi-method research* as the main strategy to inquiry social practices within the consumption context.

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\*Designates an article used in the literature review not otherwise cited in this paper.

## ORGANIZATIONAL INNOVATION IMPLEMENTATION THROUGH INTER-FIRM NETWORKS

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### ABSTRACT

This study untangles the impact on firm's innovation output of inter-firm knowledge interactions regarding network exchanges of managerial (organizational and administrative) knowledge. Specifically, we address how population-level mechanisms of exchange link with organizational-level mechanisms of implementation that lead to the adoption of innovations. The research questions serve to advance understanding of implementation of organizational innovation activities by means of participating in flows of managerial knowledge between firms under contractual relationships and in the absence of formal relationships. The study analyzes data from a complete network of 50 high-technology firms located in a science and technology park. The findings from this social network analysis show that the firms in the study actively engage in the sharing of organizational knowledge. Specifically, the results indicate the positive relationship between firm participation in networks of managerial knowledge and firm's innovation output. Participation in inter-firm knowledge networks appears to be an effective tool for obtaining organizational knowledge as well as for enhancing innovation outcomes.

**Keywords** :Antecedents of organizational innovation; managerial knowledge; knowledge acquisition; inter-firm networks; social network analysis

By participating in knowledge networks, firms are exposed, acquire and share knowledge relevant to their business. Through these knowledge interactions firms introduce different kinds of innovations (Tödtling et al., 2009). One of such forms of knowledge being shared is managerial (organizational or administrative) knowledge. This type of knowledge is critical for organizational learning and innovation (Uzzi & Lancaster 2003). Yet, to this date literature

in organization has not analyzed specifically its role in fostering innovation in organizational systems, structures, and practices. Most research on innovation has been traditionally linked to the acquisition and deployment of knowledge related to new technologies, products or services and focused on large, manufacturing firms and, not until recently, have scholars explored non-technological sources of knowledge (Sammorra & Biggiero, 2008) and their relevance on non-technological innovation outcomes in entrepreneurial, high-tech activities (Hipp and Grupp, 2005).

This lack of research on the topic may be explained, in part, because of the recent interest on aspects related to organizational innovation, conceptualized as *the introduction of a new management practice, process, structure, or technique into the organization that tends to improve the effectiveness or performance of the adopting organization* (Birkinshaw et al., 2008; Birkinshaw and Mol, 2006; Damanpour, 1991). Research has yet begun to uncover the antecedents, nature, and direction of organizational innovation dynamics. Despite substantial recent progress, it is evident that the relationship between managerial knowledge and organizational innovation is a complex, multifactorial process and that many important questions remain unanswered. Specifically: By what means do firms obtain managerial knowledge? How does its acquisition relate to organizational innovation outcomes?

This research intends to assess the relationship between the acquisition of managerial knowledge by means of firm participation in knowledge networks and firm innovation outcomes in the form of implementing organizational innovation initiatives. We intend to contribute to the innovation and social networks fields. Recently, this stream of research has developed a new line of inquiry, applying social network theory and analytical tools to the investigation of inter-firm knowledge flows and innovation decision-making, activities, and outcomes (Martin-Rios, 2012; Sammarra & Biggiero, 2008). We expect that firms taking part in both formal and informal knowledge networks will obtain higher knowledge returns in aspects related to management issues, which in turn will have a positive impact on the firm's ability to organizationally innovate.

We then adopt the social network perspective to analyze empirically how these factors favor inter-firm management knowledge sharing. Furthermore, we look into the relationship between managerial knowledge acquisition and implementation of innovative organizational initiatives by means of a survey questionnaire on organizational innovation practices. This analysis is especially relevant for the successful management of knowledge flows, particularly with respect to the levels of collaboration that are required for independent firms

to actually exchange management knowledge with each other and the expected positive impact of such exchanges on further implementation of organizational innovations.

The organization of this paper is as follows. The first section discusses the conceptual background for inter-firm knowledge networks and provides the analytical framework to be tested in this study. Next is an explanation of the social network research methods, followed by a report detailing the setting in which data on inter-firm knowledge were collected. The results section tests hypotheses regarding the consequences for firms of participating in collaborative inter-firm knowledge networks in terms of both knowledge acquisition and implementation of innovations. I collected complete network data from high-tech firms located in a science and technology park managed by a public university. These data set the stage for general observations on the managerial knowledge exchange dynamics between firms and firms' innovative activity. The final section provides concluding remarks and lines of future inquiry.

## LITERATURE REVIEW

To date, few researchers have delved specifically into inter-firm flow of managerial knowledge and consistent research aimed at elucidating the effect on innovation outcomes for firms taking part in networks where management knowledge sharing may take place is still lacking (Martin-Rios, 2013). The paper's conceptual model addresses the transactional (formal) and embedded (collaborative) components of management knowledge sharing (see Figure 1). This model proposes that managerial knowledge flows across organizational boundaries for various reasons. It identifies potentially positive consequences for firms that participate in inter-firm managerial knowledge networks. Our study suggests that by participating in knowledge networks, firms try to satisfy certain knowledge needs related to their business activity, which in turn drive their organizational innovative initiatives.



**Figure 1** Theoretical model

We propose that acquiring organizational knowledge is essential for organizational innovation initiatives to happen. One way firms can reap the required knowledge is by establishing relationships with other firms. The nature of those relationships can be either formal (i.e., contract mediated) or informal (i.e., collaborative, non-contract mediated). Collaborative interactions may lead to opportunities of multiple knowledge exchanges (Oliver, 2004). Thus, collaborative dynamics are associated with the establishment of interactive ties that potentially foster knowledge exchange, and specifically organizational knowledge. Therefore, this paper proposes that firms are more likely to engage in exchanging organizational knowledge with those firms with whom they have formal ties, as in the case of commercial agreements, and collaborative agreements. Accordingly,

*H1. Ceteris paribus, the existence of formal agreements between independent firms is positively associated with managerial knowledge exchange and acquisition.*

*H2. Ceteris paribus, the level of collaborative interaction among independent firms is positively associated with managerial knowledge exchange and acquisition.*

Organizational innovation (also labeled managerial, management, or administrative) is an important source of innovation with potential impact on the success of firms. By its very nature, this is the less discrete, more intangible, and organization-specific part of processes innovation (Damanpour, 1991). Its relevance is revealed in the growing amount of research on the subject (Mol & Birkinshaw, 2006; Vaccaro et al., 2012; Armbruster et al., 2008). Scholars contend that implementing organizational innovations is difficult as it questions existing practices and processes, as well as ingrained assumptions on the way things are (Birkinshaw et al., 2008). For this reason it is important to identify the way firms obtain knowledge about new organizational aspects, which in turn, may result in innovation initiatives (Sammarra & Biggiero, 2008). Accordingly,

*H3. Firms that obtained managerial knowledge via participation in formal or informal knowledge networks are more likely to implement management innovation activities.*

## METHODS

The relational nature of the research questions under study determines this paper's focus on social network data. In this study, network data aims to capture the actual inter-organizational dynamics of HRM knowledge flows. Social networks have proven to be a powerful tool for understanding social dynamics and social structures tied to one or more types of interdependency. A network consists of a set of nodes (individuals, groups, organizations) with links representing specific types of relationships between them (Wellman, 1983). Links between pairs of nodes may represent a wide range of connections with one or multiple objectives (e.g., information acquisition and knowledge exchange). Social network analysis studies either *whole networks* (also known as *complete networks*) or *personal networks* (also known as *egocentric networks*). While the former of these refers to all ties that contain specific relations within a defined population, the latter indicates any ties that an agent may have—such as "personal communities". One of the main challenges when studying networks is to adequately specify their boundaries (Gulati, 1995). For the purposes of this study, I chose a complete network of firms, and the network I selected was not based solely on formal contractual relations (e.g., strategic alliances or subcontracting relationships). Rather, the focus is on a network based on multiple ties and a common affiliation within a technological community.

### *Research Setting*

Science and technology clusters or "parks" emerged in the US in the 1950s in an attempt to increase the productivity of high-tech firms. The assumption behind this attempt was that the physical proximity or territorial agglomeration of firms, public administrations, R&D centers, and universities would provide potential benefits for firms. Following their success in the US, clusters spread to Europe in the 1960s and 1970s (e.g., Cambridge in the UK, Sophia-Antipolis in France, or Medicon Valley in Denmark-Sweden), and to Southern Asia in the 1980s and 1990s (e.g., A\*START in Singapore). The science and technology park selected for this research is located in the metropolitan area of Madrid, Spain. Established in the year 2000 by a public university in conjunction with local, regional and national public agencies, the Park serves as a good example of a university park. It not only acts as a business incubator, but has also provided both institutional support for high-tech start-ups and basic services for long-established firms. Overall, the park comprises 38 firms, including start-ups, established

firms, and branches of multinational firms, 12 university spin-offs and developing business ventures, and six R&D centers including publicly funded research institutes, university funded research institutes and R&D consortiums between firms and the university.

### Data Collection

We drew up a questionnaire to map knowledge flow among those people responsible for maintaining relationships with other firms. Assessment of implementation of innovative initiatives was performed with a second questionnaire. By administering two different questionnaires at two different points of time, we avoid response bias. We relied on accepted instrument development guidelines for the social network survey instrument (in particular Wasserman & Faust 1994). Surveys included a complete list of all firms in the Park (a total of 50). This roster method facilitates individuals' recall of typical patterns of interaction and has shown itself to be reliable. We asked each participating firm to mention the organizations with which they had exchanged information during the last year, what was important to them, and how. Relationships within the actual network between actors (firms)  $i$ ,  $j$  and  $k$  can be transactional (based all or in part, on a formal agreement) or embedded (relational ties embedded in social attachments) (Friedman & Podolny, 1992; Uzzi & Lancaster, 2003).

We attempted to call each CEO in the sample by phone so that every organization had a 100% probability of being sampled. After explaining the overall aim of the study, we asked to interview and collect social network data from the most knowledgeable informant (Kumar et al., 1993) who could best assess the type of knowledge diffused and how. In several cases, the CEO referred us to another senior manager who was either formally or informally responsible for managing the firm's day-to-day relationships with other firms. In order to secure this sensitive information, the survey efforts required sponsorship and support from both the regulatory agent and firms located in the park. This survey procedure successfully ensured contact with all of the firms in the park, including spin-offs and consolidated firms.

Fieldwork lasted eight weeks and a total of 41 firms responded to the social network questionnaire, which represents a response rate of 82%. The remaining 9 firms either refused to participate after several telephone calls or could not be contacted. Since the study reports on the dyadic level, respondent firms were asked to report knowledge exchanges with any of the 50 firms of the whole population (by means of census, rather than by sample). Knowledge exchanges can be asymmetric; a firm may report exchanging knowledge with another firm that may not answer the survey. We chose to focus on the knowledge seeker's perception—

the non-missing value (when A answered that exchanged with B although B did not mention A). This was based on the assumption that knowledge exchanges between firms may involve several actors from each firm; so not every instance respondent may recall or be aware of certain exchange instances. The 2,450 ties (50x49) between these firms constitute the network data for the analyses. The firms have existed for an average of 17 years. Ninety per cent are small to medium-sized enterprises (SMEs), while 10 per cent are large enterprises with more than 200 employees and sales exceeding 15 million euros. Twenty-seven of the interviewed firms (74.3%) are in high-technology services, and thirteen (25.7%) are in high- or medium-high technology manufacturing industries.

#### *Dependent Variables*

*Management innovation:* Respondents were asked to indicate the extent to which their firms had been actively involved in any of the following innovation initiatives, as defined from previous research (Armbruster et al., 2008; Birkinshaw et al., 2008; Vaccaro et al., 2012):

- High performance work systems, which includes innovation initiatives in the following human resource practices: mission and corporate values, performance management systems, employee voice, training and development, intranet (employee portal), compensation and rewards, and career and promotion systems.
- Leadership and social responsibility initiatives.
- Business model innovation.
- Reorganization of work processes and structures (e.g. from hierarchical to flat, team-based structure).

The management innovation level of each firm was calculated by taking the average of the 4 items. The management innovation scale is assumed to measure the innovation effort in management or organizational initiatives. Cronbach's coefficient Alpha of this scale was 0.717. Because we used QAP regression analysis, which requires a square matrix, each firm in an implementation level was assigned the value of the group, so a 50x50 matrix was formed. We used this matrix as the dependent variable in the MRQAP analysis. It represents firms' level of implementation of management innovation initiatives between their own group and each external group.

*Organizational knowledge:* To investigate the patterns of managerial knowledge exchange in inter-firm networks, we asked each respondent to indicate “among firms included in the roster, those with whom your firm has shared information on management, organizational or administrative practices and processes in the previous six months”. Examples of the type of managerial knowledge included the following:

- Project management
- Total quality management
- Human resource management
- Finance and budgeting management
- Innovation management
- Production management

A “roster” question format was used. Respondents had to select their answers from a list containing all 50 firms in the Park. There was no constraint on the maximum number of selections that each respondent could make. We then input these data in matrix format to create an *inter-firm organizational knowledge sharing* matrix.

#### *Independent Variables*

*Formal agreement.* The firms had to indicate the extent to which they had formal agreements with other firms in the Park. These agreements could include commercial contracts, co-production, joint contracts or technology exchange agreements; the relationship thus had to be characterized by some formal agreement and to hold some specified right over the result of cooperation (Grandori & Soda, 1995). We then input these data in matrix format to create a formal agreement matrix.

*Collaborative Interaction.* The firms had to indicate the frequency of inter-firm collaboration with which they exchanged managerial-related knowledge with other firms in the Park. We then entered these data in matrix format to form a collaboration matrix.

#### *Control Variables*

*Industry:* We based the control variables on innovation and inter-firm literature (Mol et al., 2007; Sammarra & Biggiero, 2008), which assumes that similarity between firms increases the probability of establishing ties, engaging in certain exchanges of knowledge, and resulting in

innovative outputs. We controlled for the possibility that firms in the same industry may engage in more collaborative ties and more exchange of managerial knowledge than firms in other industries. We split *Industry* into two big groups: first into high-technology services (Industry 1) and secondly, into firms in high-to-medium-high technology manufacturing (Industry 2). Then, we operationalized *Industry* creating a 50x50 matrix, coding each firm as “1” if both organizations in the dyad were in the same industry and “0” if they were in different industries.

*Internationalization*: Since several firms in the sample were international from start-up, they may be inclined to use partners to overcome obstacles to internationalization. We used internationalization to assess the extent to which firms engage in informal sharing of managerial knowledge. As in the case of *Industry*, we created a 50x50 matrix, coding each firm to be a “1” if both organizations in the dyad were operating internationally and “0” if they were operating in different markets.

#### *Analysis and Hypothesis Testing*

We then processed the network data using the UCINET software package (Borgatti et al., 2002). To test the hypotheses statistically we used network regression, specifically the quadratic assignment procedure (QAP) multiple regression technique. This approach permits an analysis of relational data (in sociomatrices) and the results of this analysis can be interpreted in a similar way to the results of ordinary multiple regression. Network data do not satisfy assumptions of statistical inference, because relational data are systematically interdependent and autocorrelation is an inherent problem in this data; therefore, classical regression techniques, like ordinary least square, are not appropriate here. MRQAP provides a better alternative, as it allows direct comparison of matrix-level data and corrects the autocorrelation problem (Krackhardt 1987) and has been applied extensively in previous social network research. MRQAP is a nonparametric statistical algorithm that regresses a dependent matrix on one or several independent matrices. This algorithm first performs a standard multiple regression across corresponding cells of the dependent and independent matrices. Then it randomly permutes rows and columns of the dependent matrix and recomputes the regression. The algorithm then repeats the permutation regression process a high number of times (in this case, 12,000 times) to estimate the standard error for the

statistics of interests. This procedure determines whether the association between two matrices is a random occurrence and helps adjust for the autocorrelation problem.

## RESULTS

As an introduction to the results, Table 1 shows the matrix of correlations among all of the variables in the model. Correlations with the managerial knowledge sharing involving the control variables are virtually nonexistent. Also, several independent variables are correlated with the dependent variable, but within acceptable limits in social networks for their inclusion in a regression model (see for example, Borgatti & Cross, 2003).

**Table 1** QAP Correlation Matrix

Variable	mean	s.d	1	2	3	4	5	6
1 Organizational innovation	1.62	.64						
2 Industry (hi-tech services)	.28	.45	.022					
3 Industry (hi-tech manuf.)	.06	.24	.027	-.158*				
4 Internationalization	.26	.44	.052	-.137*	.121			
5 Formal agreement	.03	.18	.316**	-.003	-.028	-.005		
6 Collaborative interaction	.16	.51	.336**	.026	-.013	.010	.404**	
7 Managerial knowledge	.22	.89	.382**	-.050	.023	.063*	.359**	.408**

\*  $p \leq .05$

\*\*  $p \leq .01$

We then tested hypotheses 1 to 3 by conducting a Multiple Regression QAP (MRQAP) analysis. The coefficients presented in the table are standardized regression coefficients. In Model 1 we only entered the three control variables. The results in Table 2 show that, all alone, the controls have no direct effect on managerial knowledge acquisition. With reference to Model 2, the existence of previous formal agreements between firms ( $\beta = 0.102$ ;  $p < .001$ )

significantly affects managerial knowledge acquisition after controlling for industry and internationalization. Hence, we find full support for hypothesis 1. Furthermore, Model 3 suggests that informal collaborative interactions ( $\beta = 0.064$ ;  $p < .001$ ) are related to managerial knowledge acquisition after controlling for industry and internationalization. These results provide full support for hypothesis 2. The amount of variance explained in Model 4 (39 percent of the variance) indicates that formal and embedded dimensions explain a substantial portion of the variance in the probability of inter-firm flow of managerial knowledge.

**Table 2** Results of Quadratic Assignment Procedure Regression Analysis for Predicting Managerial Knowledge Acquisition

Predictors	H1: Partnership		H2 Relational	Complete model
	Model 1	Model 2	Model 3	Model 4
Control Variables				
Industry (serv)	.015	.021	.009	.014
Industry (man)	.021	.015	.008	.005
International	.022	.015	.007	.004
Network Variables				
Formal agreement		.325**		.167**
Collaborative interaction			.554**	.502**
<i>P</i>	.167	.000	.000	.000
<i>N</i>	2450	2450	2450	2450
<i>Adjusted R</i> <sup>2</sup>	.003	.108	.309	.334

\*  $p \leq .05$

\*\*  $p \leq .01$

Next, we examined the relationship between managerial knowledge acquisition and organizational innovation implementation (see Table 3). Model 6 reveals that the standardized regression coefficients of managerial knowledge acquisition are significant. The amount of variance explained in Model 6 (33.4 percent of the variance) indicates that

managerial knowledge exchanges explain a substantial portion of the variance in the probability of implementation of innovative initiatives in organizational aspects.

**Table 3** Results of Quadratic Assignment Procedure Regression Analysis for Predicting Implementation of Organizational Innovations

Predictors	H3: Organizational innovation	
	Model 5	Model 6
Control Variables		
Industry (serv)	-.007	.003
Industry (man)	-.001	-.006
International	.022	.008
Network Variables		
Managerial knowledge		.105**
<i>P</i>	.000	.000
<i>N</i>	2450	2450
<i>Adjusted R</i> <sup>2</sup>	.064	.338

\*  $p \leq .05$

\*\*  $p \leq .01$

## CONCLUSION

This study aims to disentangle the effect of inter-firm knowledge flow in innovation outcomes related to organizational innovation. We argue that two key properties of inter-firm networks – formal agreements and social embeddedness – play important roles in acquiring organizational knowledge, which is essential for organizational innovation activities to happen. As summary of hypotheses testing for inter-firm managerial knowledge sharing, all our hypotheses are fully supported. They mainly depict how strategic and embedded dimensions, which are relational and instrumental, provide insights into factors determining inter-firm knowledge sharing and implementation of organizational innovation initiatives.

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## THE SUN CUBE STAKEHOLDER MANAGEMENT SYSTEM FOR M&A DEALS IN PMI (POST-MERGER MANAGEMENT)

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### ABSTRACT

The aim of this paper is to present framework of the stakeholder management system for M&A deals, called the SUN Cube. The SUN Cube framework helps to identify the risk of integration and develop communication and engagement strategies for each stakeholder of a combined company. Suggested framework consists of four perspectives:

- **Run rate** is the ability of the stakeholder to take part in corporate constructive development and integration processes;
- **Transparency rate** is the possibility to create a future map for each stakeholder after integration.
- **Multiplication rate** is the rate of possible value maximization for the stakeholder in the neighbor industry after an M&A deal in the considered industry.
- **Transmission rate.** This is a rate that fixes the stakeholder's ability to pass to the new development stage in corporate business development.

Our conclusive hypothesis for further verification is – LESS discrepancy on target and actual results in all four perspectives (run rate, transaction rate, multiplication rate and transition rate) - MORE expecting synergy and integration can be achieved.

**Keywords:** M&A, post-merger integration, synergy valuation, stakeholder management system

## INTRODUCTION

The importance of stakeholder relationship management for successful integration in post-merger management is not doubted, and although interest in stakeholders has grown substantially since Freeman (Freeman, 1984) published his work, we find a lack of papers that address stakeholder relationship management in M&A deals. There is especially a high need for a management system that can be used by M&A practitioners during integration process, because as we know by statistics 50% of M&A deals are not successful and as literature suggests mainly due to pure integration.

Stakeholder approach in post-merger integration in M&A deals comes to the first line management tool in achieving the target synergy results. There is a critical need for metrics which can trace the interests of all stakeholders, because to achieve success in integration it is no longer acceptable for management to focus solely on the needs of one or two stakeholder groups. Donaldson and Preston (Donaldson and Preston, 1995) noticed that the stakeholder theory establishes a framework for examining the connections, if any, between the practice of stakeholder management and the achievement of various corporate performance goals. Madhavan (Madhavan, 2005) in his paper mentions that “the M&A manager needs to manage seven sets of stakeholder expectations well.” He says that all the stakeholders are equally important, and up to 10% of customers can be lost during the integration period and poor stakeholder relationship management.

The aim of this paper is to present framework of the stakeholder management system for M&A deals, called the SUN Cube. The SUN Cube framework helps to identify the risk of integration and develop communication and engagement strategies for each stakeholder of a combined company.

## LITERATURE REVIEW

Much research has been dedicated to strategies for managing stakeholders from the focal organization’s point of view (Savage et al.,1991, Jawahar & McLaughlin, 2001), as well as how stakeholders can affect the decisions of a firm (Frooman, 1999).

Researchers Neely and Adams (2001) describe a new measurement framework called “The Performance Prism” which addresses the drawbacks of the traditional measurement frameworks currently approached by organizations. The Performance Prism encourages

managers to take into account the wants and needs of all stakeholders of an organization, as well as to consider associated strategies, and processes. The creators of the Performance Prism provide three major reasons for the new framework to replace first generation models, such as the balanced scorecard. Firstly, it is not acceptable, nor feasible for the business to focus only on the needs of one or two stakeholder groups. Most existing approaches concentrate on the needs of the owners and the customers of a firm. Other stakeholders such as personnel and suppliers are usually neglected in the performance measurement frameworks. Secondly, the majority of performance measurement frameworks ignore the adjustments that must be made to the strategy of a firm, processes and capabilities in order to meet the stakeholders' needs. And finally, a firm can expect some contribution from its stakeholders. Performance measurement should consider whether stakeholders are delivering what a firm expects to receive.

Analyzed published M&A research in total of 443 papers, Scandinavian Journal of Management (2012) found out a significant transfer of focus from the focal firms in an M&A transaction to an accent on a network perspective to M&A. The question of the value created in M&A transactions through the interactions between M&A focal firm actors on the one hand, and external stakeholders on the other hand has been the center of attention.

Gomes et al. (2013) group pre- and post-merger critical success factors and also emphasize an importance of well-established communication at each stage of the deal and post-merger leadership aimed at effective integration.

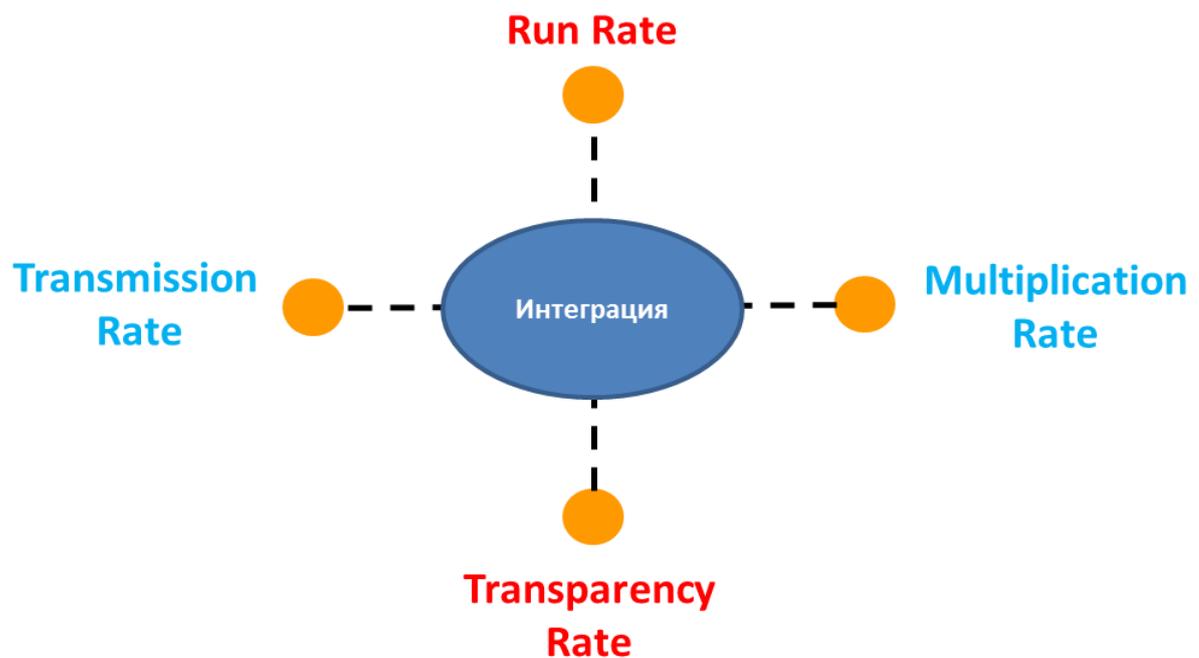
Success factors were also considered by researches Maire and Collerette (2011) who highlighted the factors that led to success in integration based on the case of the merger in private banking sector. According to them, successful integration management mainly rests upon capabilities in communication, organization and change management. As a methodology to manage the process they propose The 6S Watch List which is a framework comprising 6 interconnected areas: Strategy, Social, Structure, Speed, Success and Surroundings.

A model (PMI scorecard) provided by Rues and Voelpel (2012) with which corporate-level executives can balance different action fields, as our conceptual framework, goes in line with the trend of a second generation performance management framework. The authors of the PMI scorecard divide action fields by Strategic integration; Structural integration; Personnel integration; Cultural integration; Stakeholder integration. And they add content orientation:

strategic and structural integration. The major claim of the researches is to balance of the actor and content orientations during the PMI process. From their point of view, from the PMI content perspective, it is crucial to find the right strategic and structural direction in order to secure the best strategic competitive position. From the PMI actor perspective, it is necessary to ensure personnel, cultural, and stakeholder support on behalf of all the actors for the PMI process.

## THE SUN CUBE MODEL

The SUN Cube is a new stakeholder management system which can be used in M&A deals and can be defined in 4 perspectives.



Each perspective is assessed from the angle of different levels of stakeholder. Stakeholder levels are:

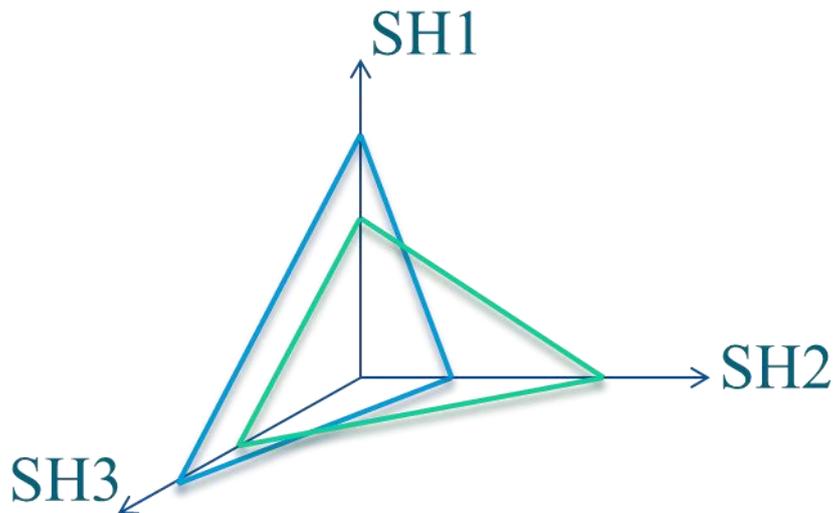
- 1<sup>st</sup> level stakeholders (SH1) – shareholders, top-management and personnel
- 2<sup>nd</sup> level stakeholders (SH2) – clients, suppliers and banks
- 3<sup>rd</sup> level stakeholders (SH3) – all other stakeholders

The SUN Cube scorecard is presented below. It shows target and actual values for each perspective, and perspective is decomposed by stakeholder level. Then the deviation in percentage is calculated, and an action to be taken to improve each perspective is provided.

The maximum target value for all the perspectives is 30, and the minimum is 0. We think that the higher the actual value is, the more controllable and manageable the synergy effects are.

Stakeholder	Target value	Actual value	%	Comment	Actions
<b>Run rate</b>	<b>9</b>	<b>4</b>			
SH1	3	1			
SH2	3	2			
SH3	3	1			
<b>Transparency rate</b>	<b>9</b>	<b>7</b>			
SH1	3	2			
SH2	3	2			
SH3	3	3			
<b>Multiplication rate</b>	<b>3</b>	<b>1</b>			
SH1	1	1			
SH2	1	0			
SH3	1	0			
<b>Transmission rate</b>	<b>9</b>	<b>6</b>			
Shareholders	3	2			
Top-managers	3	3			
Personnel	3	1			
<b>Total by perspectives</b>	<b>30</b>	<b>18</b>			

The target and the actual values can be visualized for each perspective as it is shown below.



Description of SUN Cube perspectives:

**Run rate** is the ability of the stakeholder to take part in corporate constructive development and integration processes. This KPI should mainly exist to test stakeholders' ability and readiness for constructive cooperation in M&A deal execution and integration development. We all know that the majority of M&A deals suffer from the so-called "corporate allergy." This is the case when, during the integration processes, two or more business structures cannot successfully merge and generate synergies from united operations due to failure to meet the interests of stakeholders.

Target and actual values are numbered using the following scale for the degree of stakeholder involvement:

0 – not involved

1 – Stakeholder is informed

2 – Stakeholder is actively involved in PMI team

3 – Decision-making part

**Transparency rate** is the possibility to create a future map for each stakeholder after integration. This is an essential KPI for the CEO to measure and understand how transparent and clear the future after M&A deal is for each stakeholder. Why are we mentioning this? The reason is that without a clear vision about what will happen with the stakeholder after M&A,

his position and controlling stake in the business, it is impossible to move on and accomplish successful M&A deals and post-merger integration. Before an M&A deal, it is highly recommended to create a future map for the stakeholder, which indicates the following information:

- Stake size after integration. This is the definition of the stakeholders' business scale revenue that should be proven after consolidation and integration. When we introduce an M&A deal and choose it as the right opportunity for future business growth, it should be as beneficial for each stakeholder as without M&A.
- Strategic & operational plan for a period of 3 to 5 years with financial and social KPI.

How can we diagnose and assess these KPI? We recommend 2 instruments:

- A specially devised questionnaire disclosing the transparency rate. This is a special form devised for the key stakeholders to be filled in with later analysis of their answers showing whether or not they clearly see the future and their role in the business after integration.
- Personal interviews with stakeholder representatives.

Target and actual values are numbered using the following scale for degree of transparency:

0 – not transparent

1 – transparent in the short-term (up to 6 months)

2 – transparent in the medium-term (from 6 months up to 1 year)

3 – transparent in the long-term (more than 1 year)

**Multiplication rate** is the rate of possible value maximization for the stakeholder in the neighbor industry after an M&A deal in the considered industry. This new specific KPI should help the CEO conducting M&A activity and integration to measure the stakeholders' personal capitalization rate in neighbor industries after the deal. It is true that while working in one industry in which we have core competences, we influence adjacent and neighbor industries that service our business model or invest in us. So in our case, when carrying out M&A, we should understand how this deal with future integration will increase the value of our stakeholders in neighbor markets by giving them extra benefits. This can be pre-look and out-of-the-box thinking. When increasing the value of our stakeholders, we need to be

concerned about their value increase in related and neighbor businesses, where they can also benefit. The existence of multiplication effects can be helpful in developing a communication strategy.

Target and actual values are numbered using the following scale for multiplication effect:

0 – no multiplication effect

1 – existence of multiplication effect

**Transmission rate.** This is a rate that fixes the stakeholder's ability to pass to the new development stage in corporate business development. By understanding the evolution of business values, we can propose 4 stages of corporate management philosophy (figure #2):

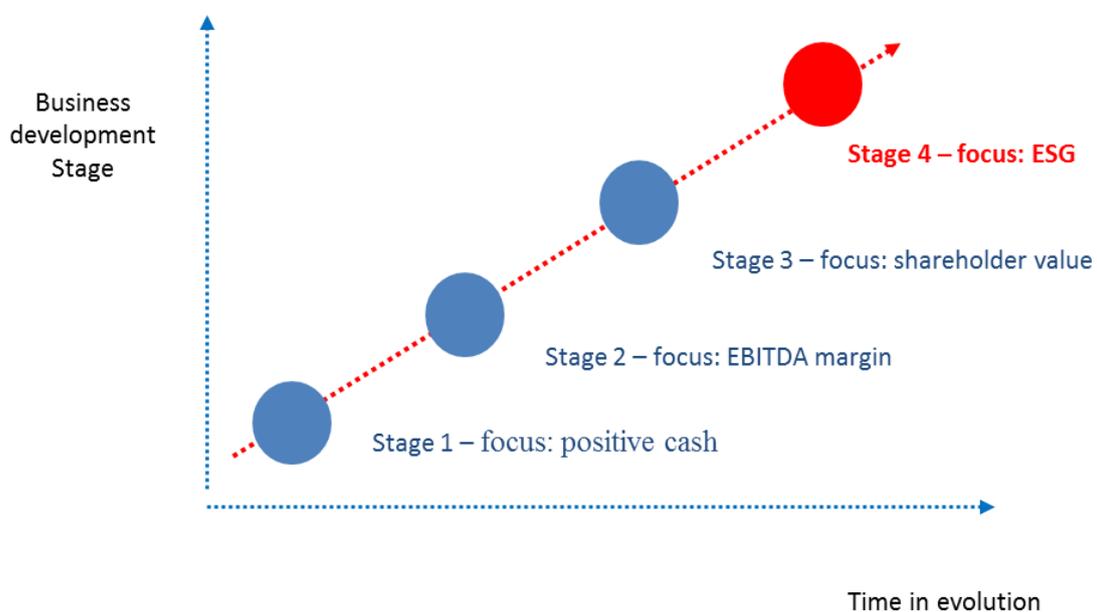


Figure 2. Evolution of business management philosophy

The last stage requires a completely different managerial philosophy of business development. By providing this specific KPI for CEOs, we help them understand the type of stakeholder and the main drivers that bring motivation to possible M&A deals. For the success of future integration, stakeholders should be on the same or similar page in terms of business development approaches, which are essential to create common value and a communication base. This indicator enables the CEO to understand the total stakeholder approach to business and avoid problems in integration. This rate should be measured using the 360C method of analysis, by which we can find out the main stakeholder's focus at the present moment. This KPI can stop M&A and prevent integration due to varying stakeholder

attitudes to business. The more stakeholders are at the same level of business focus and development stage, the better the possibility for future successful integration can be forecast. It is difficult to carry out successful integration if one stakeholder is at the ESG level of development and another is at the first – cash flow. Common understanding and a philosophical approach to developing business brings successful results for integration.

Transmission rate is the only perspective which is analyzed only for first level stakeholders.

Target and actual values are numbered using the following scale for transmission effect:

0 – positive cash flow orientation

1 – EBITDA orientation

2 – Market capitalization orientation

3 – ESG orientation (shareholder wealth maximization through stakeholder wealth maximization)

## **HYPOTHESIS**

Our conclusive hypothesis for further verification is – LESS discrepancy on target and actual results in all four perspectives (run rate, transaction rate, multiplication rate and transition rate) - MORE expecting synergy and integration can be achieved.

## **CONCLUSION**

Stakeholder approach in post-merger integration in M&A deals comes to the first line management tool in achieving the target synergy results. There is a critical need for metrics which can trace the interests of all stakeholders. In this paper we have developed further how the SUN Cube framework can be used in capturing synergies during the post-merger integration process.

Our next paper will be dedicated to methodological improvement of the suggested framework and hypothesis testing.

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## INCOME RETURN VS CAPITAL APPRAISAL: A TEST ON THE ITALIAN REAL ESTATE FUNDS

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### ABSTRACT

**Introduction And Aims:** The overall performance of the real estate funds can be therefore attributed to the capital appreciation and/or the income return. The rent income component, under certain conditions, is the less relevant for the institutional investors that manage a diversified portfolio following a medium-long term strategy.

The Italian property funds market has shown an enormous growth over the past few years, however, little is known about the key drivers of the property funds performance. This research aims to measure the impact of the two performance sources for the funds' performance and to identify the significance level of their main components.

**Methodology:** The paper considers the Italian market for the last decade and analyzes the annual reports of all public real estate funds, separating the appraisal return from the income return. By considering a wide time horizon, the paper evaluates if the role of income return and capital gain respect to the overall performance are more or less influenced by some characteristics of the fund (i.e. asset diversification, concentration, leverage, etc.).

**Findings:** The contribution of the income return and capital growth in the overall performance for the Italian real estate funds is not strictly related and the correlation is significantly lower during the crisis period. Furthermore the main drivers of the two income sources are not strictly comparable.

**Keywords:** Real estate funds, Income Return, Capital appraisal

## 1. INTRODUCTION

Literature about real estate investment vehicles performance evaluation tries to establish the differences between the performance of the underlying asset and the vehicle (Gilberto, 1990) and to point out some problems related to the un-availability of continuous market data for evaluating the price of the asset and the need to define carefully the appraisal value that normally is used instead of the market information (Geltner, 1991).

Real estate investments present unique features that could modify significantly their capability to generate net inflows during the life of the investment and/or to appreciate during the time horizon. Studies proposed in literature consider the relationship between macro-economics variable and overall performance components and demonstrate that income return and capital growth return do not show the same sensitiveness to some macro-economic variables (Le Moigne and Viveiros, 2008).

Empirical evidences show that performance achieved by real estate units could vary significantly among each investment and the difference is more clear if the capital growth is considered instead of the income return (Young, 1994). In fact comparison of real estate income return and capital growth return show that the former is more stable and less variable respect to the latter (Adair et al., 2006).

No studies considered the main features of real estate investment vehicles in order to explain the attribute of the income return or capital growth return to the overall return. Contrary to the REITs structure or other similar real estate vehicles, Italian real estate funds are characterized by rigorous standardization that ensure that the managed portfolio is independent to the asset and liabilities of the real estate fund manager (Biasin, 2003). The study investigates the role of income return and capital growth, without considering the managerial aspects that could bias the evaluation in case of the REITs. The paper evaluates if the income return and the capital growth is influenced by some characteristics of the fund (i.e. asset diversification, concentration, leverage, etc.), trying to give a specific weight to the key elements of the property funds performance.

Results obtained could represent a useful guideline for a portfolio manager in order to construct portfolios that allow to achieve the target performance during the life of the investment and/or at the end of time horizon.

This research is composed by an extended literature review in order to explain the income return and the capital growth for real estate investments through the portfolio perspective (section 2). The empirical analysis considers a sample composed by the Italian retail real estate fund market in the eight years between 2003 and 2010, followed by the methodology adopted, where have been measured the different types of performance and the explaining variables in order to interpret their dynamics and point out the main results (section 3). The last section of the paper comprises the conclusive comments and possible further implications.

## **2. LITERATURE REVIEW**

The overall performance of a real estate investment could be related to the rent income and/or the capital growth of the value of the asset. The trend of the different drivers of the overall performance could be not coherent (Duncan, 2004) and so in order to construct a real estate portfolio is necessary to monitor the features that could impact on each of the drivers.

Looking at the capital growth, a fund manager has to evaluate the concentration of the managed portfolio in order to study the role of big and small properties in the fund. When the number of big real estate units increase (and so the portfolio becomes more concentrated) the risk return trade off could exasperate because of the risk exposure growing more than the expected return (Ziering and McIntosh, 1999)

Considering an international framework, empirical evidences demonstrate that trends in the value of real estate assets are highly integrated and so the choice to diversify internationally do not affect the variability of the capital growth performance (Pagliari et al. 1997). Contrary, the analysis of the effects of diversification among areas inside a country, demonstrates that in the major real estate markets the opportunities related to diversification are higher because the trend of real estate asset prices is significantly heterogeneous (McGreal et al., 2006).

Looking at the income return, empirical evidences in main world markets show that the performance is significantly different on the basis of the sector and the geographical area considered. In the residential sector the geographical features are not easily identified because of the market heterogeneity, instead other sectors (like offices) show more clear patterns (Jackson and White, 2005). Geo-sectorial diversification could be extremely beneficial into selecting the more producing real estate units, especially if the residential investment is underweighted, but there are some empirical evidences that show a significant increase in the

cost related to manage diversified real estate portfolio that could neutralize the benefits related to the diversification (Capozza and Seguin, 1999).

Size of the buildings could affect the ratio between the renting income and costs and normally bigger investments are characterized by better net performance due to the opportunities to rationalize the operative property management expenses through scale economies (Hartzell et al., 1986). The size has to be studied not only looking at the overall size of the investment but also at the number of tenants per building: *ceteris paribus*, the lower is the number of tenants the highest is the income return such as the economic impact of imminent vacancies (Kurzrock et al., 2009)

The size of the real estate investment vehicle represents the overall amount of money available for investment purpose and could affect both the income return and the capital growth of the investment (Baum and Devaney, 2008). Theoretically, the higher size allows to achieve higher level of diversification because of the higher number of buyable real estate units (Chaudhry et al., 2004). Another of the main advantages is the economies of scale on overhead expenses that are normally more significant for larger real estate institutional investors (Capozza and Lee, 1995).

The leverage policy of the real estate investment vehicle could affect significantly the capability to respect contractual payments and dividends expected by subscribers (Giannotti and Mattarocci, 2009). The evaluation of the risk exposure has to consider both the overall level of the debt and the interest cover ratio for each sub-period (Oppenheimer, 2000) in order to evaluate if the spread between cost of financing and return from the real investment is big enough to warrant the layering of the financial risk.

Another proxy, which frequently is correlated with the fund performance, is the level of an aggregate performance index. In a research dedicated to private equity funds, Kaplan and Schoar (2005) demonstrated that funds follow a performance that is close to the performance of the S&P 500. Gompers and Lerner (1998) investigated the aggregate performance and capital flows. The authors found that macroeconomic factors like past industry performance and overall economic performance as well as changes in the capital gains tax or ERISA provisions are related to increased capital flows into private equity. Morrell in 1995 sustained that indices in the property market such as IPD (International Property Databank) play a key role in investment management, from the definition of a fund's investment objectives, to the

setting and implementation of investment strategy, and the evaluation of historic performance.

### 3. EMPIRICAL ANALYSIS

#### 3.1 Sample Description

The sample considers all retail real estate Italian funds in the time horizon 2003-2010 and for each fund have been gathered data about the overall yearly results, the income return and the capital growth return. The choice of the frequency of data is coherently with other studies proposed in literature that demonstrate that some problems exists in identifying a correct measure of the real estate assets value and normally the yearly time horizon allow to reduce the bias related to the appraisal estimates used in measuring the capital growth (Wheaton and Torto, 1989). In order to analyze the determinants of the income return and the capital growth we consider only the existing funds for which annual reports are publically available (Table 3.1).

**Table 3.1: Italian real estate funds' market with annual report publically available**

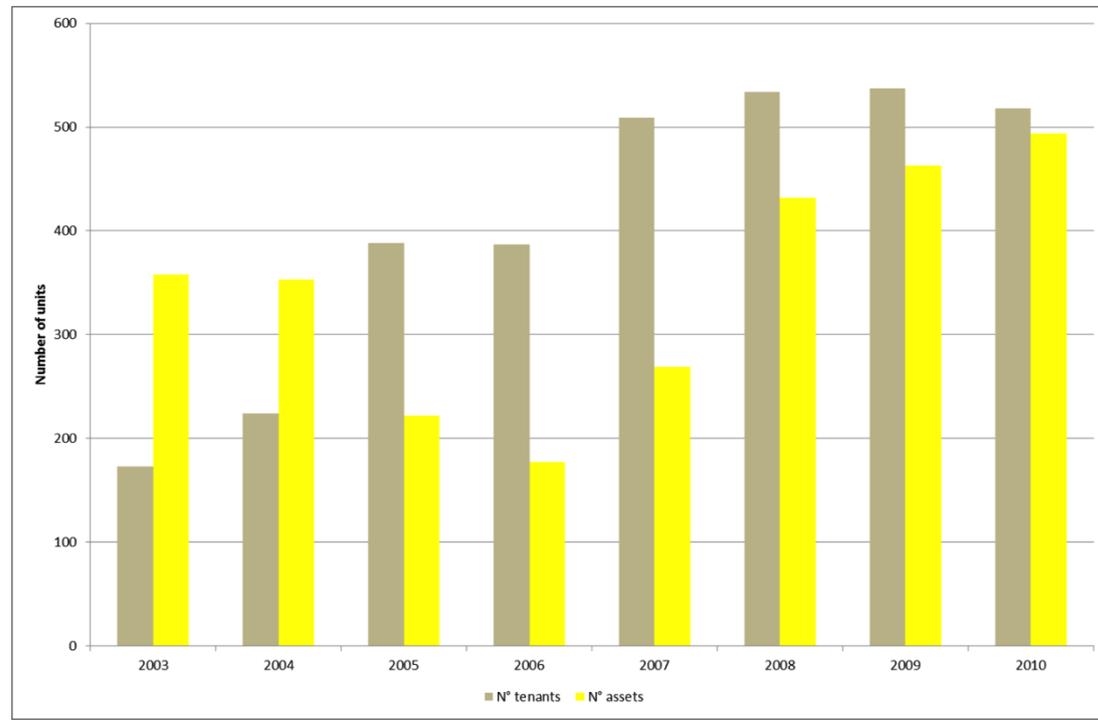
Real Estate Fund	Availability of data	Real Estate Fund	Availability of data
Atlantic 1	2005-2010	Invest Real Security	2003-2010
Atlantic 2 Berenice*	2005-2010	Investietico	2003-2010
Baglioni	2007-2010	Michelangelo	2003-2010
BNL Portfolio Immobiliare	2003-2010	Obelisco	2006-2010
CAAM RE Europa	2007-2010	Olinda Fondo Shops	2004-2010
CAAM RE Italia	2007-2010	Piramide Globale	2003-2010
Caravaggio	2004-2010	POLIS	2003-2010
Dolomit	2005-2010	Portfolio Immobiliare	2003-2010
Estense Grande Distribuzione	2003-2010	Securfondo	2003-2010
Fondo Alpha	2003-2010	Socrate	2008-2010
Fondo Beta	2005-2010	TECLA Fondo Uffici	2004-2010
Fondo Delta	2007-2010	Unicredito Immobiliare Uno	2003-2010
Immobiliare Dinamico	2006-2010	Valore Immobiliare Globale	2003-2010
Immobiliium 2001	2003-2010	* Before 2007 the fund was named Berenice	

**Source: Scenari immobiliari data processed by the authors**

The sample considers 27 funds for the time horizon 2003-2010 and data collected attains the size of the rented unit (square meters) in their portfolio and rentals flows for square meter

paid by each tenant. The overall sample considered includes for each year at least 190 buildings and 180 tenants and the number is growing over time (Figure 3.1).

**Figure 3.1. Number of tenants and assets.**



**Source: Funds' yearly statement processed by the author**

The mean number of tenants for each real estate fund registered a growth rate over the years of the sample, with an exception for 2010. Instead, the number of assets followed a cyclic pattern, demonstrating in part that fund management is more interested to increase the number of tenants (increasing the income return and creating higher diversification levels) than the property assets. All the information related to each tenant and to each asset included in the portfolio are summarized computing some concentration measures for each portfolio managed.

### 3.2 Methodology

In order to analyze the role of the income return and capital growth for Italian real estate funds, a measure of each type of performance is computed starting from the information available on yearly annual report. Following methodologies well established in literature, measures of overall performance, income performance and capital growth standardized

respect to the market value of the real estate portfolio, are computed (Pagliari and Webb, 1995). On the basis of the characteristics of the Italian real estate funds the following formulas are computed:

$$\text{Income Return}_{it} = \frac{\sum_{i=1}^n (\text{Rent}_{it} - \text{Costs}_{it})}{\sum_{i=1}^n \text{MV}_{it-1}} \quad (3.1)$$

$$\text{Capital Growth}_{it} = \frac{\sum_{i=1}^n (\text{MV}_{it} - \text{MV}_{it-1})}{\sum_{i=1}^n \text{MV}_{it-1}} \quad (3.2)$$

$$\text{Overall Return}_{it} = \text{Income Return}_{it} + \text{Capital Growth}_{it} = \frac{\sum_{i=1}^n (\text{Rent}_{it} - \text{Costs}_{it}) + \sum_{i=1}^n (\text{MV}_{it} - \text{MV}_{it-1})}{\sum_{i=1}^n \text{MV}_{it-1}} \quad (3.3)$$

Where

$\text{MV}_{it}$  = the market value of real estate unit  $i$  at time  $t$ . Coherently with the literature available and due to the lack of continuous time series of price for each building, the value is not a market measure but an appraisal one (Hartzell et al., 1987).

$\text{Rent}_{it}$  = payments done in the year  $t$  by the tenants of the  $n$  buildings included in the portfolio.

$\text{Costs}_{it}$  = maintenance cost for the  $n$  buildings included in the portfolio.

The first analysis proposed investigate the relationship between the income and the capital growth, furthermore considers the relationship between the mean value of each return component and measuring the correlation between the yearly value of each type of income.

The measures of returns previously identified are regressed respect to the main explaining variable identified in literature in order to test the different degree of predictability of each return measure such as to identify the main differences in the explaining variables. In formulas:

$$\begin{aligned} \text{Income return}_{it} = & a_{it} + b_1 \text{HHGEO}_{it} + b_2 \text{HHSECT}_{it} + b_3 \text{AUM}_{it} + b_4 \text{Leverage}_{it} \\ & + b_5 \text{Interest coverage}_{it} + b_6 \text{HH Tenant}_{it} + b_7 \text{Ipd}_{it} + e_{it} \end{aligned} \quad (3.4)$$

$$\begin{aligned} \text{Capital Growth}_{it} = & a_{it} + b_1 \text{HHGEO}_{it} + b_2 \text{HHSECT}_{it} + b_3 \text{AUM}_{it} + b_4 \text{Leverage}_{it} \\ & + b_5 \text{Interest coverage}_{it} + b_6 \text{HH Assets}_{it} + b_7 \text{Ipd}_{it} + e_{it} \end{aligned} \quad (3.5)$$

$$\begin{aligned} \text{Overall Return}_{it} = & a_{it} + b_1 \text{HHGEO}_{it} + b_2 \text{HHSECT}_{it} + b_3 \text{AUM}_{it} + b_4 \text{Leverage}_{it} \\ & + b_5 \text{Interest coverage}_{it} + b_6 \text{HH Tenant}_{it} + b_7 \text{HH Assets}_{it} + b_8 \text{Ipd}_{it} + e_{it} \end{aligned} \quad (3.6)$$

where:

$\text{HHGEO}_{it}$  and  $\text{HHSECT}_{it}$  are Herfindahl-Hirsh indexes based on the product line data (Bradley et al., 1998): the former measures the proportion of assets invested in only one sector (Residential, Commercial, Offices, Industrial or Others) and the latter consider the diversification level under the geographical perspective (All Italian regions and foreign countries) in the overall portfolio.

$\text{AUM}_{it}$  (Assets Under Management) is a proxy of the size of the real estate investment fund and represent the overall value of the asset under management at the time  $t$ .

$\text{Leverage}_{it}$  is the ratio between total liabilities and total assets of the fund  $i$  at time  $t$  on the basis of the annual report data.

Interest coverage is the ratio between the interests paid and gross operating income at time  $t$  for the fund  $i$ .

$\text{HH Assets}_{it}$  is the diversification Herfindahl-Hirsh index, based on the value of each asset respect to the overall value of the portfolio at time  $t$  for the real estate fund  $i$ . The measure takes the value one when the real estate fund is not diversified (Capozza and Lee, 1995).

$\text{HHTenant}_{it}$  is the Herfindahl-Hirsh based on the value of rent related to each tenant respect to the overall value of the renting income at time  $t$  for the real estate fund  $i$ . Differently respect to the existing literature (Des Rosier et al., 2009), the relevance of each tenant is not realized

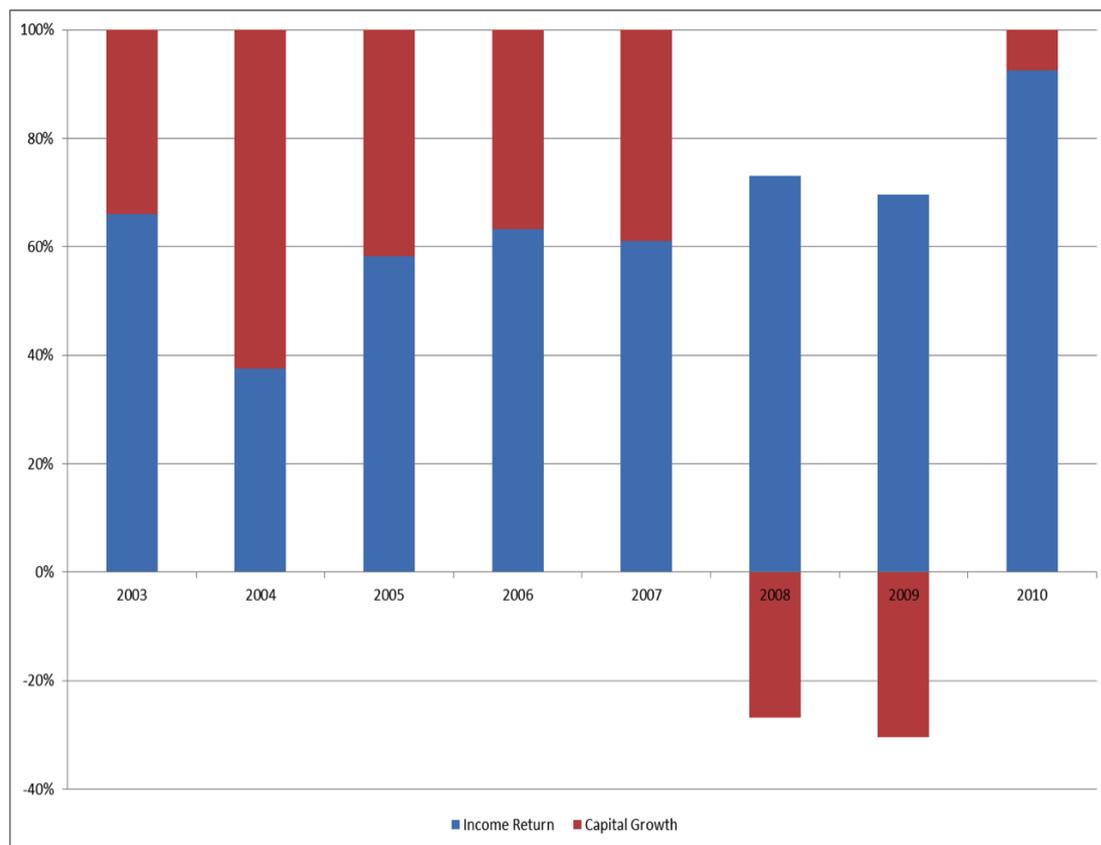
considering the square meters as a proxy for his/her relevance due to the high heterogeneity of the asset in the portfolio and the high variability of rent for square meter contractually established.

$Ipdt_{it}$  represents the index return excluding transactions and development provided by IPD (International Property Databank) for each performance measure, total return, income return and capital growth in time  $t$ .

### 3.3 Results

A preliminary analysis considers the role of the income and the capital growth return for the overall Italian market looking at the annual report of Italian real estate funds (Figure 3.2).

**Figure 3.2: The role of income and capital growth for the overall Italian real estate fund market**

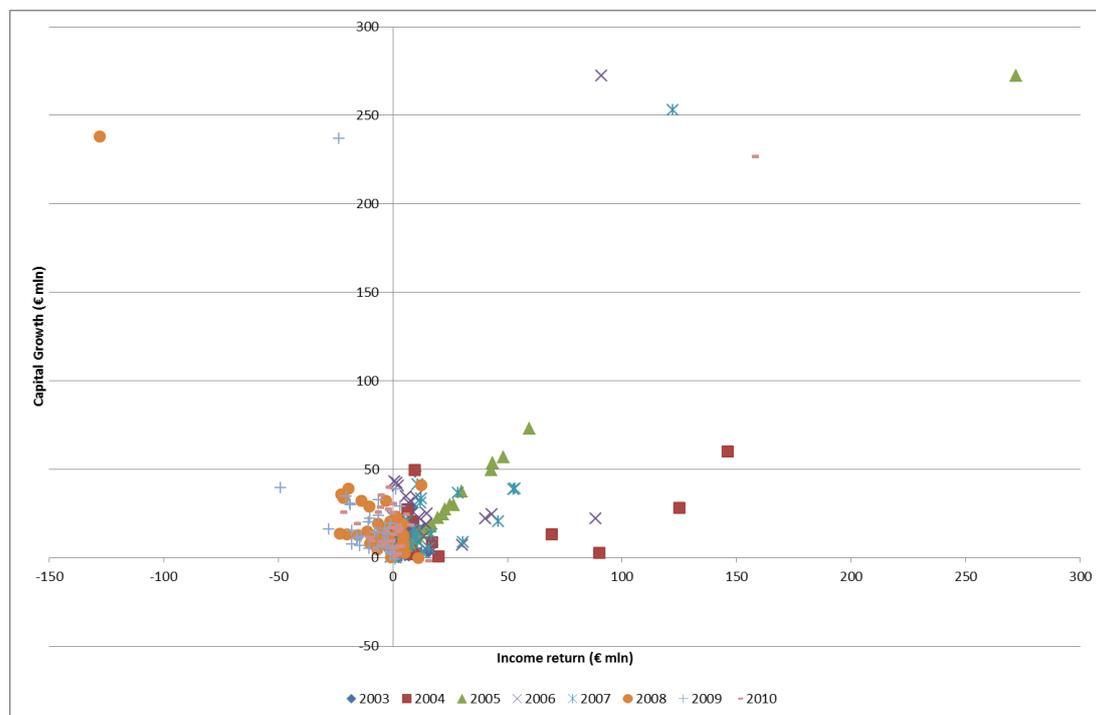


Source: Scenari immobiliari data processed by the authors

Looking at the overall Italian market the amount of net inflows related to renting assets represent (except for the 2004) the main source of income for the institutional investors. The capital growth role in the overall performance for the overall time period is around 35% and due to the crisis in the 2008 and 2009 the capital appreciation contribution to the overall performance is negative.

The relationship between income return and capital growth is heterogeneous among the sample considered and for each real estate fund the ratio between the two measures is significantly different (Figure 3.3). This result underlines the different approach that the fund management may have for each fund.

**Figure 3.3. The relationship between income return and capital growth for each Italian real estate fund (time horizon 2003-2010)**



**Source: Scenari immobiliari data processed by the authors**

Considering separately each real estate fund, the relationship between the yearly income return and the yearly overall return is inspected. Vehicles that are outperforming for the income return (capital growth) show a capital growth (income return) performance lower than the mean value and those funds that present a more balanced return are those that present both low level mean yearly income return and capital growth.

Considering yearly intervals and analyzing the performance achieved by each fund, summary statistics about the mean value, variance and correlation of each return component are computed (Table 3.2).

**Table 3.2: Yearly summary statistics for income return and capital growth of Italian real estate funds**

	2003	2004	2005	2006	2007	2008	2009	2010
Mean income return	0.53	0.50	0.69	0.76	1.09	2.07	26.82	25.71
Mean capital growth	7.75	29.11	26.89	16.76	19.01	-4.1550	-8.72	3.64
Variance income return	0.07	0.11	0.05	0.44	7.12	9.6661	2003.37	1799.37
Variance capital growth	24.74	2002.05	6133.71	532.82	1130.39	603.0236	113.10	1212.87
T-test H0 = mean difference significant	0.00%	0.69%	11.58%	0.03%	0.25%	13.0145%	0.00%	1.85%
F-test H0 = same variance	0.00%	0.00%	0.00%	0.00%	0.00%	0.0000%	0.00%	24.82%
Correlation	-0.20	-0.57	-0.40	-0.15	-0.13	-0.1885	-0.04	0.91
Correlation significance	0.10	0.29	0.20	0.08	0.06	0.0954	0.02	-0.46
Number of funds	14	20	23	31	36	40	36	36

**Source: Scenari immobiliari data processed by the author**

The value of the mean and variance is different among the two sample but only for the variance the two tailed F-test demonstrate a significant difference between the two return components while the t-test fails to identify a significant difference in the mean value. The correlation between income return and capital growth is always negative but the relationship is never significant, demonstrating that the main determinants of each feature are not strictly related.

In order to identify the different features that explain each type of performance, the sample had to be reduced only to the real estate funds for which all information about portfolio composition were available. The analysis proposed is a panel regression model and on the



fits worse is the one constructed on the capital growth for which the trend is only partially explained on the basis of the regressors taken into account and probably the choice to include also some other macroeconomic variable could allow to increase the fitness. The lower statistical significance of the models that includes the capital growth is coherent with some empirical evidences proposed in literature that demonstrates the real estate market performance measurement could be biased from the specific characteristic of the appraisal values used in order to compute the capital growth (i.a. Gilberto, 1988).

The geographical-sectorial concentration affects significantly only the income return. The choice to diversify geographically gives clear margins of profit maximization (the negative sign refers to highly geographically concentrated funds), while the sectorial diversification is penalized because of the predominance of the office sector as the most profitable class in Italian market.

The main explaining variable of the performance achieved by a real estate fund is the amount of asset under management. Independently of the considered component (income return, capital growth or overall return), the higher is the amount of assets under management the higher will be the achieved performance because of the better rental opportunities and appreciation trend that affect the biggest buildings. The relationship between capital growth and size is well documented while the relationship identified between the income return and the size is only theoretically assumed in literature (Capozza and Lee, 1995).

Analyzing the debt sustainability, higher exposures normally affect negatively both the income and the capital growth performance because this choice introduces an extra constraint to the financial planning of the investment (Giannotti and Mattarocci, 2010). The relationship identified is significant especially for the income return when the leverage ratio is taken into account while for the capital growth and the overall return the relationship is not statistically significant.

Considering the tenant concentration, the choice to have some main tenants in the portfolio allows to reduce the cost of managing and monitoring the relationship with tenants. If the default does not occur, this strategy allows to maximize the result rationalizing the cost structure related to the investment done.

Looking at the asset concentration, the choice to diversify allows to obtain more stable return but the cost related to this feature is a reduction of the overall performance (Ziering and

McIntosh, 2000). Data show, a relationship coherent with this assumption but not statistically significant.

Concerning the global index performance it has been pointed out a positive relationship. From the analysis emerged that IPD index just as AUM is statistical significant for income return, capital growth and total return.

#### **4. CONCLUSIONS**

The contribution of income return and capital growth in the overall performance for the Italian real estate funds is not strictly related and the main determinants of their performance are significantly different. The common features that explain both the income and the capital growth are the amount of the assets under management and the global index performance. All the other variables identified in literature could impact differently on each performance component. Alongside the research it has been pointed out a trade off between income return and capital appreciation for the overall performance.

Models constructed on the income return identify a higher statistical significance respect to those constructed on the capital growth and the overall performance. The higher fitness of the model is related not only to geographical and sectorial features but also to the leverage policy and to the tenant concentration.

Studies on the characteristics of real estate units indicate that the capability to produce income and its variation is related to the buildings' age (Pagliari and Webb, 1992). International empirical evidences show also that the geo-sectorial classification could be significantly improved using more detailed databases such as that the results achieved with more detailed classification could vary significantly (Mueller, 1993).

Due to the higher relevance of income return on the overall performance for Italian real estate funds, the model proposed could be interesting for all Italian real estate funds manager. Implications of results obtained attain prevalently the asset allocation of real estate investment funds in order to construct portfolios that allow the profit maximization. On the basis of these results some guidelines on the diversification strategy and on the debt structure could be defined especially for the real estate investment vehicles that are interested to maximize the income return. For the capital growth gains, the only clear relationship identified is with the size of the assets under management. Furthermore the appraisal income,

tends to be more affected by macroeconomic variables as during economic crises it has been observed a clear reduction in its performance. The unexplained return components could be attributed only to funds' manager specific skills/strategies in selecting real estate units with the best perspectives in the appraisal growth.

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## THE VENTURE CAPITALIST-ENTREPRENEUR RELATIONSHIP. EVIDENCE FROM ITALY

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### ABSTRACT

This paper deals with the relationship between the Venture Capitalist and the venture backed company and investigate how it unfolds over time. To achieve this aim, we present evidence from three case studies where we employed a process approach. Our field study is partly retrospective and partly in real time and is based on two rounds of focused interviews with the entrepreneurs and the venture capitalist. Our findings show that several factors play a role, with confidence in the VC being essential to begin the relationship, and trust between the parties to continue it successfully. This relationship is also a learning experience for both parties: while the entrepreneur becomes acquainted with managerial tools to run a business on a daily basis and execute strategic actions, the venture capitalist learns how to effectively scout new attractive business ideas.

**Keywords:** venture capitalist, venture-backed company, innovation, process research

### INTRODUCTION

Venture Capital (also labeled as VC) has increasingly been recognized as an important engine in economic development and as a vehicle for fostering R&D/innovation. Venture Capital is not a new phenomenon, as the modern venture capital industry started modestly, shortly after World War II. As recounted by Gompers and Lerner (2001), the industry struggled through a series of boom-and-bust cycles until the end of the '70s. However, since about 1980, the modern model of syndicated limited partnerships, investing funds largely derived from

pension portfolios, has transformed early-stage finance by increasing the availability of capital to young and risky firms.

Today, Venture Capitalists typically invest, manage, and return institutional investors' money by funding entrepreneurial companies, contributing to their development, and selling their stakes to public or corporate investors (Gompers, 1995; Gorman & Sahlman, 1989). More so than investors in well-established or publicly traded companies, Venture Capitalists actively manage the uncertainty associated with selecting and developing portfolio companies. Although market-wide variations or unexpected developments are difficult to foresee or manage, Venture Capitalists enjoy significant management discretion to reduce company-specific risk and enhance the company-specific returns in their portfolio (Dimov & Shepherd, 2005).

Existing research validates that, in addition to the financial resources that Venture Capitalists transfer to the venture, they add value to, and influence the strategic direction of, their portfolio companies through their involvement (e.g., Fried & Hisrich, 1994; Gorman & Sahlman, 1989; MacMillan, Siegel, & Subbanarashima, 1985 and MacMillan, Zemann, & Subbanarasimha, 1987; Sapienza, 1992; Sapienza & Manigart, 1996). Firstly, Venture Capitalists commit significant tranches of capital to firms with much potential but few assets beyond their founders' intellectual capital and business plans. This is an investment strategy that banks or other financial intermediaries are not organized to undertake. Secondly, Venture Capitalists carry out an extensive due diligence process before deciding in which firms to invest. Thirdly, because the due diligence process is itself iterative, entrepreneurs iteratively improve their business plans and, with the Venture Capitalists, develop a collective vision of how the firm should evolve. Finally, once the investment is made, Venture Capitalist(s) become partners in the venture and commit significant time to each portfolio firm by serving on its board of directors, helping craft overall strategy, assisting in the recruitment of members of the management team, and monitoring the growth of the firm (Large & Muegge, 2008). Because seasoned Venture Capitalists have been involved in a number of start-ups, they can provide valuable advice on avoiding the myriad pitfalls any rapidly growing firm can experience. It should be noted that because Venture Capitalists depend on profitably liquidating their investment within a time frame driven by their own fund's lifecycle, the interests of Venture Capitalists and founders are not always aligned.

A well-established VC community has played a critical role in the birth of entrepreneurial ecosystems across Silicon Valley or Israel in general, and Tel Aviv in particular. The entrepreneurial ecosystem refers to the environment in which entrepreneurship tends to

thrive. In order to create sustainable entrepreneurship, certain elements assume a critical role. Start-ups are most successful when founders have access to the human, financial and professional resources they need, and operate in an environment in which government policies encourage and safeguard entrepreneurship (Isenberg, 2010). Under such conditions, VC plays an active role in financing start ups as well as augmenting the managerial team with resources and capabilities that would be too expensive or time consuming for them to develop internally (Rossi, Thrassou, & Vrontis, 2011). From this one can argue that venture capital is dependent upon both institutional contexts as well as internal resources endowment.

In assessing the current state of research about VC, we can argue that the majority of studies is US-centric (see also Berglund, 2011). This means that empirical findings are related to US institutional conditions. This circumstance could make not meaningful, if not misleading, to apply them to different geographical and institutional contexts. Moreover, the majority of empirical studies is inspired by a variance approach, which is suitable to identify statistically significant correlations among variables, but it is ill-suited to capture how a certain phenomenon evolves over time. This makes useful to investigate how different institutional contexts and internal conditions interact and affect entrepreneurial ecosystems across the globe and how they co-evolve over time.

For this reason, we believe that it is timely and useful to investigate what is the actual role of VC in different geographical and institutional contexts and how the relationship between the Venture Capitalist and the venture-backed company evolve over time by employing a process orientation. This is the substantive and methodological gaps this paper intends to fill, by answering the following research question: How does the relationship between the Venture Capitalist and the venture-backed company unfold over time in different geographical as well as institutional conditions?

To answer this research question we present evidence from three process studies regarding the creation of start-ups, all located in Southern Italy, that enjoyed significant venture capital support. These three deals involve different types of entrepreneurs —one being a brilliant graduate in Drama, Art and Music Studies (DAMS) skilled in computer video; one regarding a large group of researchers affiliated to a university department; and a third one concerning two street-smart building materials wholesalers. These settings constitute, in our view, very different micro-environments, allowing us to explore the multifaceted performances of a specific entrepreneurial ecosystem. Through an in depth study of these three cases we can

provide insights about how, in different environments, creative thinking and bright ideas can be transformed in successful businesses and how venture capital contribute to innovative start-ups. Answering this question will allow us to analyze the venture capital deals as processes and unravel motives, learning mechanisms, and outcomes each party enjoys.

The paper is organized as follows. After a literature review on VC and its role in entrepreneurial ecosystems, we advocate for employing a process approach to the study of start-ups and venture capital deals. Next, we present empirical evidence from three venture capital deals. In the concluding section, we propose our own interpretation to findings, discuss limitations and provide future research directions.

## **VENTURE CAPITAL: THE STATE OF THE ART**

Parallel to the increasing impact of VC on economic growth, the phenomenon has received a growing attention from scholars of different disciplines, spanning from finance to strategic management. Today, there exists already a vast amount of empirical studies, signaling that this is a rather well researched topic. In reviewing these studies we will focus our attention on the substantive issues being investigated and the methods of investigation being employed. For an alternative reading of existing literature, scholars are referred to Berglund (2011) who analyzes CV in terms of what VC knows, what is the value added, and the influence of institutional conditions on its behaviors.

In terms of issues investigated, the received literature about VC has mainly dealt with analyzing the differences between Venture Capital and Corporate Venture Capital to assess their contribution to innovative performance (Dushnitsky & Shapira, 2010; Peneder, 2010) or their effects on entrepreneurial learning (Berglund, Hellström & Sjölander, 2007). Other studies have focused their attention on analyzing criteria for selecting target firms (Levie & Gimmon, 2008) or with the role business plan actually plays in the scouting process (Kirsch, Goldfarb & Gera 2009). Research has also dealt with criteria pushing entrepreneurs to choose venture capital (Valliere & Peterson, 2007). Taken together, these studies signal that much effort has been spent trying to understand the decision to invest for both parties involved in the deal, while considerably less attention has been paid to how VCs actually support venture development once an investment has been made. Some scholars have raised concerns about the conclusiveness of findings emerging from existing research. Under this regard, Wijbenga, Postma, van Witteloostuijn, & Zwart (2003) outline that research on the ability of VC to create value is mainly descriptive with few attempts at theoretical explanation. Moreover, Busenitz,

Fiet, & Moesel (2004) contend that existing studies offer a coarse-grained understanding of VC and fail to conclude whether VCs typically add non-financial value. Empirical studies have also investigated the role of VC in different external conditions. Here we refer to Hargadon and Kenny (2012), who speculate about the possible role VC may play in promoting clean technologies in US, or to St-Pierre, Nomo and Pilaeva (2011), who assess the impact of VC in traditional French and Canadian manufacturing firms on capability development (market capabilities or innovation capabilities, or networking capabilities) or to Pinch and Sunley (2009), who study the role of the VC as knowledge disseminator in high-technology agglomerations. Moreover, other studies focus on patterns of VC in specific industries and geographical areas, such biotechnology start ups in UK (Rosiello & Parris, 2009).

If we are to summarize the current stock of knowledge, we can conclude that VC is not a homogeneous phenomenon; rather, it is contingent upon institutional conditions as well as personal characteristics of the entrepreneur as well as of the Venture Capitalist. Under this regard, Berglund (2011) contends that the majority of the studies aiming at detecting regional differences in VC behaviors are quantitative and fail to offer a deep understanding of VC behaviors in different contexts. We share this view and we contend that in order to improve our grasp of such a nuanced phenomenon it is fruitful to investigate concurrently external as well as internal conditions (the personal characteristic of the entrepreneur and the VC, and their relationship).

Studies analyzing the relationship between the entrepreneur and the Venture Capitalist focus on the possible sources of conflicts between the two parties and their effects on the relationship from the entrepreneur's point of view (Zacharakis, Erikson & George, 2010), or on the goal alignment problem after the deal (Türçan, 2008). These studies suggest that the relationship between the Venture Capitalist and the venture-backed firm remains a black box. Eesley, Hsu and Roberts (2011) attempt to fill this void. They analyze alternative approaches to the study of this relationship. They compare the contribution of literature on firm capabilities and the resource-based view (RBV) (Peteraf, 1993; Barney, 1991; Wernerfelt, 1984) of the firm with the literature on organizational economics Grossman and Hart, 1986; Hart and Moore, 1990). The former view emphasizes the primacy of assembling 'the right assets' while the other focuses on 'organizing assets the right way'. Building on these arguments, they suggest that the value created through what we refer to as the initial idea assets is contingent upon the firm's circumstances and the experience of the founders in creating efficient governance and contracting arrangements. They go on by calling for a more

thorough understanding of when specific types of assets and capabilities are important in driving performance under specific industry conditions.

While we share this view, we believe that to significantly improve our understanding of this “black box” we need to incorporate the temporal dimension in our analysis. We therefore propose that in order to further our understanding of the relationship among the Venture Capitalist, the venture-backed company and the knowledge transfer mechanisms within and between the two actors, a process approach could be a fruitful research orientation as it allows taking into account enabling and constraining influences from inner and outer contexts of the firm (Pettigrew, 1992). In such a way we are able to explore the influence of the Venture Capitalist on eco-systems.

## **THE FIELD STUDY**

Our fieldwork approach to this study is case-based and processual (Pettigrew, 1992). In order to capture both complexity and depth, we use a qualitative case study design (Yin, 1989). “A case study is an empirical inquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident and in which multiple sources of evidences are used” (Yin, 1989: 23).

We analyzed a purposeful sample of three venture capital deals involving the same venture capitalist and three companies running very different business— one being a brilliant graduate in Drama, Art and Music Studies (DAMS) skilled in computer video; one regarding a large group of researchers affiliated to a university department operating in the field of biotechnology applied to human health (red biotech); and a third one concerning a smart manufacturing equipment for mortars and chemical products. Details about the three deals are arranged in table 1. These research settings were chosen as they provide evidence about three different micro-environments, which we could label respectively as “web-based” “knowledge-based”, and as “market-based” . In addition, a personal relationship from one of the authors secured a good access to both the venture-backed companies and the venture capitalist. Informants assured their cooperation throughout the course of the fieldwork.

Regarding the unit of analysis, we decided to investigate both the parties involved in a venture capital deal to understand how general and industry-specific knowledge is exploited by the venture capitalist and how the venture-backed company leverage internal resources and exploit external capabilities supplied by the Venture Capitalist.

As specified above, the units of analysis are two: the venture capitalist, and the venture-backed company. We enter the research settings *in medias res*, with the three deals were still ongoing. We therefore conducted a partly retrospective and partly in real time study.

In order to better understand how the relationship between the two unfolded over time, a range of primary and secondary data was collected. We collected primary data through focused interviews. We carried out two rounds of interviews with founders as well as with the venture capitalist investment manager. The first round of interviews took place in 2011 while the second one in 2013. In interviewing our informants we asked them to provide their own account of the relationship with the counterpart, focusing on issues of interest. These interviews were recorded and transcribed with their consent. Secondary data is mainly made up of internal memorandums from the Venture Capitalist, as well as press releases.

In analyzing data we took inspiration from Langley (1999), for process data analysis strategies, as well as from Miles & Huberman (1994), for qualitative data analysis procedures. “Process data consist largely of stories about what happened and who did what when—that is, events, activities, and choices ordered over time”, Langley (1999: 692) observes, outlining they are messy and ambiguous. We immersed ourselves within the data and we started off collapsing data into a chronological reconstruction of the three different deals. We then moved onto coding our empirical data. By codes we mean “tags or labels for assigning units of meaning to the descriptive or inferential information compiled during a study” (Miles & Huberman, 1994: 56). To create a list of codes we went back and forth between data and theory in an iterative manner. The next step was to identify patterns of codes, that is themes emerging from our data so as to account for both similarities and differences across the three cases.

## FINDINGS

In presenting our preliminary findings, we will use time as a referent point, focusing on key events from initial and informal contacts to the present date. Along the time frame covered by our research—from late 2008 to march 2013—we may identify among three main phases: the pre-deal, the closing, and the post deal. In presenting our findings we will also focus our account on similarities and differences among the three cases.

The pre-deal phase comprises informal as well as formal talks between the two parties, with the Venture Capitalist assessing the business idea and the founding team trying to sell the business idea. This is a crucial phase with several factors playing a role. Despite the

differences among the three cases under investigation, given the lack of specialization of the Venture Capitalist, the relationship seems to follow a similar path. For Personal Factory and Mosaicoon, the encounter with the Venture Capitalist took place through a local incubator. In the Biouniversa case, it was a personal relationship between the investor manager of the Venture Capitalist and the academic team. This relationship has very likely eased a relationship that is generally described as difficult in existing studies, several of which report a bias towards academic spin off (see Munari & Toschi, 2010). In our case, the presence of a professor of strategic entrepreneurship worked as a facilitator between the two parties and helped what he refers to as the “hybridization” of the different types of knowledge and languages.

The different nature of the three business ideas required the VC to seek outside for technical competences during the evaluation process. To achieve this aim another Venture Capitalist, with technical expertise, was involved during the evaluation process. The network of relationships with other Venture Capitalists is therefore the means to access knowledge that it would be too time consuming or too costly to develop internally. This issue is a quite remarkable aspect as compared with entrepreneurial ecosystems where the density of potential entrepreneurs make it possible to achieve a specialization in a certain industry (biotech or nanotech, for example) or a geographical area.

The closing of the deal is perceived as the most difficult moment of the relationship between the two parties. During the negotiation phase, the three entrepreneurs were sensitive to almost all the same issues, although to a different extent. While in the case of Biouniversa the most delicate moment of the closing was the discipline of intellectual property rights, in the Mosaicoon and Personal Factory cases the issues of interests were much focused on the bad deliveries and the degree of autonomy in the daily management of the business.

The closing of the deal means the injection of funds but also the beginning of the entrepreneurial life, the phase during which the business idea is transformed into reality. Contrary to our expectations, although the investment is financed by venture capital, all the founders reported a great sense of responsibility towards the achievement of planned goals. An excerpt from Ugo Parodi Giusino’s interview effectively renders this concept “After the closing, you receive money and you can start running the business, and this is the most enjoyable part of the deal, at the same time you feel the pressure towards the attainment of goals”. This feeling has been described with different words by one of Personal Factory founders, when he recounts what he really learnt from the Venture Capitalist. He refers that the systematic reliance upon planning and controlling was the most important competence

they acquired from the Venture Capitalist soon after the closing of the deal. We found this issue quite remarkable as Personal Factory is a spinoff from a manufacturing company, which is expected to systematically rely upon management by objectives tools. In the Biouniversa case the absolute ignorance of how to run a business was eased by the assistance of the professor of strategic entrepreneurship within the founding team.

The relationship has been described as good and trustworthy by all parties. A tangible proof of this feeling is the second round of funding that has involved all our cases. This is in our view an indirect measure of the Venture Capital success, and of the confidence all our informants share in the effectiveness of this tool. Again an excerpt from the interview with Ugo Parodi Giusino clarifies this issue "The venture capital has been an accelerator of experience and learning. Without it I would have hardly achieved the same goals within such a short time interval". The confidence in the venture capital model has also been mentioned during the interviews with Luigi Tassone (Personal Factory) although with less enthusiasm. And the founding team of Biouniversa expressed the confidence into this tool by claiming that this experience was the door into a world that they would have never even imagined to discover.

In describing their relationship with the Venture Capitalist they all report a positive experience stressing the support in terms of managerial tools supplied, and assistance in identifying the competences and therefore job roles to recruit. Moreover they all report that their initiative gained more visibility and credibility due to the involvement of a Venture Capitalist. They are probably less enthusiastic about the network of commercial partnership they were able to actually access to through the VC involvement, and the assistance in negotiating loans with banks, which is perceived as rather poor by Luigi Tassone.

Looking into the VC's account of how the relationship unfolded over time, we find as much as the same issues reported by entrepreneurs and scientists. The scouting process generally takes place during institutional meetings with incubators or start-up competitions. Besides them, the Venture Capitalist on a regular basis promote and disseminate knowledge about venture capital through workshops and seminars. Interestingly, the investment manager reports that in many instances entrepreneurs are absolute beginners about the potentialities of venture capital. The lack of knowledge about VC might partly explain the low confidence in the VC as a strategic tool to favor entrepreneurship. The issue of confidence is of utmost importance for the Venture Capitalist. According to the investment manager, if an entrepreneur is skeptical about VC, it is very unlikely that first contacts will produce a deal. Even if a venture capitalist devotes its best efforts to explain pros and cons of the tool and

how it works, it is very unlikely that a skeptical entrepreneur turns out as an enthusiastic one. Confidence in VC is therefore perceived as a pre-requisite for both parties to initiate a deal.

As the relationship goes ahead, the VC could have difficulties in assessing the technological merit of the business idea. In such cases, VC can rely on external advisors, who, on a contractual basis, provide them with a competent assessment of the technology or the patent. As specified above, the current development of VC in Italy, and especially in Southern Italy, does not allow specialization into a specific industry or geographical areas. The relationship with external advisors mitigates this problem. The reliance on an external advisor does not prevent the venture capitalist from learning by doing. The experience counts, according to the investment manager, in that it makes the scouting process less time consuming and more effective. Such a learning process is however, still tacit, as no codification activity from previous experiences is carried out nor a repertoire of best practices has been elaborated by the VC team. Therefore, we can conclude that the learning process involves both the venture capitalist and the venture-backed company.

## CONCLUSIONS

In this paper we have advocated for the usefulness of a process orientation as a research strategy to deepen our understanding the relationship between the Venture Capitalist and the venture-backed company in different institutional and geographical contexts. We have provided evidence from three process studies we conducted between 2011 and 2013. Our cases are entrepreneurial start ups all located in Southern Italy, each of them running a different business. The homogeneity of the geographical context and the heterogeneity of businesses allowed us to discern similar/different patterns in how the relationship evolved over time. Our findings suggest that, at least in Southern Italy, Venture Capitalist cannot afford to focus on single industries, such as life sciences or ICT. This poses peculiar challenges to their ability to manage such a diverse range of businesses. They are able to deal with this complexity by relying on an external network of specialized skills on a contractual basis. In terms of knowledge or skills they add to the venture-backed company, the founders all agree that they benefitted from an easier access to institutional relationships and from learning managerial principles. They provide evidence that the relationship evolved positively over time and that the engine was, in the beginning, the confidence in the VC itself, while over time, was the trust in the Venture Capitalists.

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Table 1. The cases under investigation

Venture-backed company	Activity	Typology	Rounds of VC	VC role
Personal Factory	Smart building	Retail company spin off	Two rounds	Still present

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	materials				
Mosaicoon	Computer Video	Start up	Two rounds	✓	
Biouniversa	Biotech	Academic off	Spin Two rounds	✓	

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## EXPLORING THE IMPLICATION OF JUNGIAN NOTION OF ORGANIZATIONAL PSYCHE: FACEBOOK AS A LIVING ORGANISM

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### ABSTRACT

In the frame of a complex psychological theory, the recent research introduced the notion of organizational psyche in organizational psychology. There are instruments and theoretical frames in Jungian psychology to study the underlying purposefulness in organizational psychodynamics. With this perspective, we are introducing the study of Facebook (FB) as a living organism.

We share with several other scholars the view what the human inclination to create an organization is the expression of a deep archetype: that is to say that all organizations share a deep meaning and intentionality that lie beyond the sway of the egos of individual organizational members. The organizational archetype lives at the heart of all organizations making it communality. In view of this theory we ask if the spreading of "share and relate" on social networking is the expression of an actual zeitgeist, an archetype of relatedness with two poles, positive and negative. We explore the studies on FB in order to specify what are the complexes, processes, structure, goals and environment of this particular networking organization that combine to make it unique.

**Keywords:** Facebook, organizational psyche, the archetype of organization

### PROBLEM STATEMENT AND PURPOSE OF THE STUDY

The organizational psyche, like the individual psyche, is what organization seeks to become, the unfolding of its potential, and the movement towards integration and wholeness. The organizational self, like the individual, is anchored in its birth process, its reality and myth.

The enfolding of the organizational intrinsic self is filtered through the task system which defines its identity and survival. At the core of life forces, the archetypal Self analogous with the individual psyche, gives orientation and meaning and “serves as a significant source and as the channel of organizational energy. It embodies much of an organization’s innate capacity for wholeness” (Corlett & Pearson, 2003, p.19).

Building upon Jung's work, Carol Pearson has studied a system of archetypes that put a human face on the meaning structures that are correlated with success and fulfillment today. Studying archetypes and their expression in organizational psyche can make us better understand inter-individuals dynamics and the unseen triggers inside organization; increase communication between conscious and unconscious processes; trigger a greater sense of meaning and fulfillment in organization’s life; inspire and motivate people; cope more effectively with difficult people and difficult conditions; have greater flexibility to respond to the challenges of life; be more effective within our workplace and community context; have greater flexibility to respond to the challenges of social and economic life.

In this perspective, we treat FB community like a vivid and open organization. The archetype of an organization points the organization towards what it can become, proving a blueprint for the wholeness. The members of the FB organization collectively and unconsciously carry the characteristic archetype of organization into the psychodynamic life of organization and it becomes imperfectly manifested through them and their actions individual and collective, conscious and unconscious. The members of FB as a real actual phenomenon are sharing the same basic archetypal psyche.

FB was meant to be a social utility that connects people with friends. The FB creator embodied three ways to connect: like, comment, and share; each one pulls the person to express. Statistics on what people likes, prefer; a kind of finding people with similar opinions or rejecting the dissimilar ones. The commentaries gives the person the satisfaction of joining/and find people with similar attitudes, or to be taken into consideration, or to argue. There are events to organize, photos to share and comment, thinks to discover, ways of moving around the world without effectively moving. No other social community has been that booming ever than FB.

The Organizational Self expresses four life forces in two bipolar opposites: to nurture and develop people versus to achieve results, and to transform and innovate by learning versus to

maintain by stabilizing. The focus of this paper is to observe if these directions are active in FB phenomenon.

## **COMMON STUDIES AND STATISTICS ON FB**

Initial research on social media's effects on human interaction has revealed the problem of the development of antisocial behavior, narcissism and all kinds of negative attitudes of bullying and manipulating enhancing negative emotions. Lately, studies revealed quite different tendencies, around more constructive attitudes, like empathy and compassions, learning and nurturing warm emotions. In view of these data, the paper intended to discover the basic unconscious archetype that used the opportunity of networking in organizing people around a specific unconscious actual need. We will analyze some of the recent studies on FB with the aim of exploring the psychic tendencies underneath the FB's organizational life to answer some cardinal questions as: have those who use FB more frequently less of a connection to real life? Is their self esteem low? Is the need for popularity versus loneliness the active drive? Is this belongingness a general need for: acknowledgement, attention, appreciation, and acceptance? We take as a fact that people are spending valuable time in their personal life maintaining relationships with people they don't really meet, perhaps to the exclusion of the offline friendships!

Some recent statistics shows that there are around 800 million people on FB, and on average, we will share 415 pieces of content on FB each year, upload 196 hours of video and send countless emails. There are now over 2.8 billion social media profiles, representing around half of all internet users worldwide. Overall, there are millions of people willing to share and belong to a huge organism.

## **DATA ANALYSIS**

*Is belongingness a general need for the big four A: acknowledgement, attention, appreciation, acceptance?*

When considering why social media networks flourish, we have to start first to take into consideration human nature. It is human nature for people to want to connect with others. Social networking is an easy way for people to reach out and connect with other people, a

possibility to find like-minded people, to exchange ideas, to express. Now a days, social media have changed the way connect with each other. And this can have both a positive and negative impact of our self-esteem and sense of self.

One psychological topic of research was addressing the idea that social networking may enrich the interpersonal lives of persons who struggle to make social connections giving the opportunity for self-disclosure (which is a necessary component in the development of intimacy). A topic of research was if the FB could be especially beneficial for people with low self-esteem, who are normally hesitant to self-disclose and who have difficulty maintaining satisfying relationships. One larger research was dedicated to explore the self esteem hypothesis in connection with reduced perceived self-disclosure when posting on FB, and thus encouraging people with low self-esteem to express more openly. In three studies, Forest and Jood (2012) examined whether such individuals see FB as a safe and appealing medium for self-disclosure, and whether their actual FB involvement enabled them to join social rewards. They found that although people with low self-esteem considered FB an appealing opportunity for self-disclosure “the low positivity and high negativity of their disclosures elicited undesirable responses from other people”.

With the flourishing/globalization of the Internet, there comes important changes in how people think, share, become friends with and relate to one another in a very short time. Persons involved in FB/social networking, are, interacting in ways we never thought we would have in real life, and due to the fact that it is possible to make true, genuine and long-lasting relationships with like-minded people online, the difference between what constitutes a real friendship with a virtual one become somehow outdate. FB gives us access into another person's mind, so far as that person makes public their thoughts, ideas, feelings and desires. At times, we are perhaps more honest online, and especially on social networks, than we are in real life.

Some studies suggest that we are exactly the same on FB as we are in real life, but it is not necessarily the case. We might actually be even more of who we are online than in real life. FB proves to be in a very short time both a space of freedom as the people are free to be, to say and act whatever they think and feel. That is precisely the first question FB asks us when we go to our profiles, and the second invitation is to like, comment and share. We not only share information we also embody the medium itself and we cannot detach what we say on FB

from FB itself. The entire concept of communication shifts as the medium itself is the message (Eler, 2012).

FB statistics indicate that young people spend hours online each day, and their abilities to multitask and communicate are often misunderstood by older generations. Other statistics indicate that professional people use FB to confront opinions or and form professional networking. Some tested hypothesis is that people who are less popular or charismatic in the real world may somehow "compensate" for their lack of charm by over-indulging in virtual social networking sites with hundreds or thousands of connections/friends; they, unsurprisingly, spend more time in the virtual world than in the real world.

#### *Negative side effects*

Some of the negative side effects of FB use for young people that Rosen (2011, 2007) cited include: cyber bullying, addiction, sexuality, virtual friendships, and development of narcissism in teens that often use FB. The author points some indicators of the presence of other psychological disorders, including antisocial behaviors, mania and aggressive tendencies, in teens who have a strong FB presence; increased absence from school and likelihood of developing stomach aches, sleeping problems, anxiety and depression, in teens who "overdose" in technology on a daily basis, including FB and video games; lower grades for middle school, high school and college students who checked FB at least once during a 15-minute study period; lower reading retention rates for students who most frequently had FB open on their computers during the 15-minute study period. His findings were based on a number of computer-based surveys distributed to 1,000 urban adolescents and his 15-minute observations of 300 teens in the act of studying.

#### *Inducing empathy in real life*

Paradoxically, one of the more interesting findings from Rosen's research was the development of "virtual empathy": teens are developing the ability to show virtual empathy for distressed FB friends, and that empathy is actually well-received by friends, positively influencing their mood. This virtual empathy, Rosen says, can manifest into their real world. In this perspective FB contribute to improve adolescent emotional intelligence and socialization skills.

#### *Personality traits disclosure*

There are studies upon people in social networking exploring the personality traits. Traits like extraversion, emotional intelligence, and Machiavellianism have been explored in connection with involvement in social networking: extraversion, which accounts of the tendency to be socially involved, influence on others, be socially active; emotional intelligence, which enables people to identify and handle emotional states in themselves and other people, and to develop harmonious and nurturing "relations; and, Machiavellianism defined by collecting meaningless friends, people who may be "useful" from a career or self-interest perspective (Chamorro-Premuzic, 2010).

Two studies examining how personality traits are reflected in FB presented connections between the Big Five personality traits and self-reported FB-related. For example, extraversion predicted not only frequency of FB usage (Study 1), but also engagement in the site, with extraverts (vs. introverts) showing traces of higher levels of FB activity (Study 2). As in offline contexts, "extraverts seek out virtual social engagement, which leaves behind a behavioral residue in the form of friends lists and picture postings" (Gosling & al, 2011). These results suggest that, rather than compensating for their offline personality, FB users appear to extend their offline personalities into online FB involvements.

## **HOW ARE THE TWO ARCHETYPAL AXES EXPRESSED IN FB**

*The need to nurture and develop people versus achieving results.*

There are studies focused on how people use FB. In a recent survey, an international sample of 1,026 FB users (284 males, 735 females) completed an online survey about their FB activity. Females, younger people, and those not currently in a committed relationship were the most active FB users, and there were many age-, sex-, and relationship-related main effects.

In terms of gender comparison, females spent more time on FB, had more FB friends, and were more likely to use profile pictures for impression management. Women and older people proved to engage in more online family activity. The data shows that relationship status had an impact on the FB activity for males, but little effect on the activity of females (McAndrew & Jeong, 2012)

The need to transform and innovate by learning versus maintaining by stabilizing.

More studies focused on the use of FB in academic and professional communities. Research on the potential of FB for improving student performance outcomes is just the beginning. A

study counted twenty-one journal articles that have empirical research studies on the use of FB for teaching and learning; most of the studies reported in the literature being descriptive and are conducted in higher education settings. Results show that the use of FB makes a difference in the students' affective outcomes. The authors suggest that more empirical research on effective use of FB for teaching and learning should be conducted in the future (Woo & al., 2011).

FB is emphatically a social network site, but the actual trends using it for teaching are increasing. A large study was dedicated to the role of FB and other social networking sites in education. Does FB threaten academic success? One research particularly indicates that FB-ing students may perform better than their unwired peers (Ellison, Steinfield, and Lampe 2007). Given increasing numbers of students on FB, there are increasing the ways the universities develop to enter that space.

A review conducted by Hew, 2011, focused on presenting a detailed account of the participants FB usage profile or the extent to which users are engaged in FB activities. The findings are organized into three sections that cover the major topics of current research: (a) students FB usage profile or extent of FB use (e.g., time students spend on FB each day, students motives for using FB, as well as various factors that may affect these usage profiles), (b) the effects of FB use (e.g., effects of FB self-disclosure on teacher credibility, effects of FB use on student social presence and discussion, and effects of FB on students academic performance), and (c) students attitudes toward FB. So far, the analysis concluded that FB has a little educational use, that students use FB mainly to keep in touch with known individuals, and that students tend to disclose more personal information about them on FB; hence attracting potential privacy risks upon them.

Paradoxically, as some studies blame the social networking phenomenon for increasing failure rates at universities, universities are simultaneously exploring ways to engage students via that medium. One study explores FB as an interactive point of engagement to support student transition to the university, even if it questions the ethics of using FB and recommends that it be used only as an additional point of engagement (Woodley, Meredith, 2012).

Educators and others are interested in the effects of social media on college students. A study in 2012 is using in particular a large sample (N=2368) of college students to examine the relationship between frequency of FB use, participation in FB activities, and student engagement. Student engagement was measured using different methods: a 19-item scale

engagement, time spent preparing for class, and time spent in co-curricular activities. The data indicate that FB use was significantly negatively predictive of engagement scale score and positively predictive of time spent in co-curricular activities (Junco, 2012).

## CONCLUSION

FB flourishing over a relatively short time triggered a lot of research, studies, and surveys. Apparently there are about 3,702,363 entries when ask about studies on FB ([www.mendeley.com](http://www.mendeley.com)).

This study explores the deep psychological needs that made FB a huge and attractive organization. We tried to explore if in its actual form it behaves like a vivid organism which triggered much more than the initial rationale. It develops from a social networking to enter in virtual every domain of modern world: professional discussion, academic teaching, business and marketing.

Which of the four life forces as bipolar opposites are answered by FB content?

In terms of benefits in networking, the two archetypal axes are congruent with the FB realities. The archetypal impulse to nurture and develop is fulfilled by developing contacts and relationships, FB forums that sustain a strong contact no matter space or time. The equivalent need to achieve results is fulfilled by exposure in forums to promote and draw attention to personal cause, or business and brands. The archetypal impulse to transform and innovate is expressed by opportunities for new/ future business, and to learn from experienced professionals. The equivalent need to stability is expressed in meeting the likeminded people with whom you may come together to discuss common interests.

FB behaves stirring the creativity and imagination of people from different cultural background, aims and personality traits. The deepest fears and the most cherished imaginings could eventually be meeting using the networking opportunities on FB. Underneath the movement there is energy with double poles: creating connections in the service of enhancing empathy and understandings, and using the messages to subtly control minds. The first direction could create a larger loving community in the service of preserving the planet, in the second could serve a enslaving in fears and manipulative. The more recent studies show a growing tendency toward creativity and education, as the need to transform and innovate by learning becomes manifest.

The second axe seems to develop more around the need to nurture and develop people who had less power in terms of social and political decisions.

As with living organisms, FB express the basic needs of the planetary development, and contains and express every bit of human psychic structure and behavior: adaptive and coping versus neurotic and pathological, conscious an intentional versus unconscious and unintentional, Logos and Eros as order and compassion, versus Prejudice and Power, and more, the tendency to escape human's control and develop along lines that preserve life on the planet.

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## LINKING ENTREPRENEURIAL ORIENTATION TO EXPORT PERFORMANCE: THE ROLE OF INTANGIBLE RESOURCES AND DYNAMIC CAPABILITIES

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### ABSTRACT

Understanding the determinants of international performance, and in particular, export performance is key for the success of international companies. Research in this area focuses mainly on how resources and capabilities allow companies to gain competitive advantage and superior performance in external markets.

Building on the Resource-Based View (RBV) and the Dynamic Capabilities Approach (DCA), this study aims at analysing the effect of intangible resources and capabilities on export performance. Specifically, this study focuses on the proposition that entrepreneurial orientation potentiates the attraction of intangible resources, namely relational and informational resources. Moreover, we propose that these resources impact export performance both directly and indirectly through dynamic capabilities.

**Keywords:** Export performance, RBV, DCA, entrepreneurial orientation, relational resources, informational resources.

### INTRODUCTION

Internationalization is a strategic option that contributes to the expansion and growth of entrepreneurial companies. International markets may be particularly competitive and export manager need to compete to the best of their ability (Morgan, Vorhies and Schlegelmilch, 2006). The ownership of strategic resources allows companies to gain competitive advantage. Recent studies have changed the focus of tangible resources to

intangible resources which have been shown to be more important from the strategic point of view and more relevant to business performance and success (Morgan *et al.*, 2006; Bakar and Ahmad, 2010). Moreover, research has focused on the dynamic capabilities as a source of sustainable competitive advantage (Teece, Pisano and Shuen, 1997; López, 2005; Teece, 2007; Wu, 2010), endowing the theory of resources and capabilities with a more dynamic approach.

Drawing upon the RBV and the DCA, this study aims to evaluate the interaction between entrepreneurial orientation and export performance, by examining the mediating effect of intangible resources (available for the international market) and dynamic capabilities.

The relevance of this subject is mainly due to the need for companies to understand the process that will enable superior performance in terms of exports. Although export performance has been object of a vast number of studies, it remains one of the of the least understood and most contentious areas of international marketing (Katsikeas, Leonidou and Morgan, 2000).

## **THEORETICAL FRAMEWORK**

### *Resources and capabilities*

The RBV draws upon the premise that strategic resources and capabilities enable companies to gain competitive advantage (Wernerfelt, 1984; Barney, 1991). Resources are tangible or intangible assets the company owns, controls or has access to in a semi-permanent basis (Helfat and Peteraf, 2003). There are different types of resources widely recognized in the literature, such as technological, financial, human, physical and organizational resources (Loane and Bell, 2006; Bakar and Ahmad, 2010). For Wernerfelt (1984), the concept of resource is limited to the attributes that increase the company's efficiency and effectiveness. Furthermore, resources should have some ability to generate profits or avoid losses (Miller and Shamsie, 1996). In this sense, the resources not only refer to the company's assets but also their capabilities (Henderson and Cockburn, 1994).

Capabilities refers to the firm's ability to perform a coordinated set of tasks, using organizational resources, in order to achieve a specific result (Helfat and Peteraf, 2003). For Amit and Schoemaker (1993), capability refers to the firm's capacity to mobilize resources, generally in combination, using organizational processes, to a desired end effect.

The RBV is based on the assumption that a firm's resources/capabilities must be rare, valuable, irreplaceable and difficult to imitate elements (Barney, 1991). Dhanaraj and Beamish

(2003), have studied three sets of resources and capabilities which influence and/or reinforce corporate strategy in external markets, namely entrepreneurial orientation, organizational resources and technological intensity. Their study confirmed that this set of strategic resources and capabilities has a positive impact in export activities and performance. Recently, research in this area has privileged the role of dynamic capabilities as source of sustainable competitive advantage (Teece *et al.*, 1997; López, 2005; Teece, 2007; Wu, 2010).

### *Entrepreneurial orientation*

Covin and Wales (2012, p. 677) refers that “the phenomenon of an entrepreneurial orientation as a driving force behind the organizational pursuit of entrepreneurial activities has become a central focus of the entrepreneurship literature and the subject of more than 30 years of research”. Miller (1983) states that an organization with entrepreneurial orientation bets on the innovation of products and/or markets with some risk and acts proactively before its competition. For Lumpkin and Dess (1996, p. 136), entrepreneurial orientation “refers to the processes, practices, and decision-making activities that lead to new entry”.

Miller (1983) proposes that entrepreneurial orientation comprises three fundamental dimensions: innovation, risk taking and proactiveness. Lumpkin and Dess (1996) put forward two more dimensions to characterize the entrepreneurial process, namely, competitive aggressiveness and autonomy. Thus, according to these authors, the main dimensions that characterize an entrepreneurial orientation include a tendency to act autonomously; a willingness to innovate and take risks; a tendency to be aggressive toward competitors and proactive in terms of market opportunities. However, literature indicates that the dimensions most commonly used in research are: innovativeness, proactiveness and risk taking (Kropp, Lindsay and Shoham, 2008; Al-Swidi and Al-Hosam, 2012). According to Miller (1983), only companies that have a high level in all three dimensions of entrepreneurial orientation (innovativeness, risk taking and proactiveness) would be considered potentially entrepreneurial.

### *Informational resources*

For Anand, Glick and Manz (2002) knowledge refers to any information, belief or ability that firms can incorporate into their activities. The main barrier to the

internationalization of small businesses is the lack of knowledge (Loane and Bell, 2006). The effective use of relevant, accurate and timely information is an important means to address many of the problems faced by firms operating in foreign markets (Katsikeas and Morgan, 1994). For these authors, knowledge is a resource referring to the acquisition and dissemination of information/knowledge about customers, competitors, distribution channels and export market. According to Grant (1996), knowledge is in fact the most important asset of a firm competitive.

### ***Relational resources***

Relational resources consist of the networks between the company and external entities such as customers, suppliers, competitors and government institutions (Davis and Mentzer, 2008). These resources are based on relationships, understood as promising sustainable competitive advantage, in that resources are distributed asymmetrically between firms, imperfectly mobile, difficult to imitate and have no substitutes available (Barney, 1991). Currently, the struggle for competitive advantage in a globalized economy increasingly revolves around the value of firms' networks (Davis and Mentzer, 2008). However, a firm must establish relations not only in terms of expected performance, but also for the improvement of capabilities that allow for the development of other resources (Arndt, 1979).

### ***Dynamic capabilities***

Several authors consider that the theory of resources and capabilities does not adequately explain how companies achieve competitive advantage in fast moving business environments (Teece *et al.*, 1997; Eisenhardt and Martin, 2000). In these business landscapes, technological change is fast, the nature of the markets and competition is difficult to determine and time-to-market is critical (Teece *et al.*, 1997). In versatile markets, capabilities must be dynamic, namely the firm must have the capability to renew competencies to continually ensure the consistency between the business environment and strategy.

Research focus has been focusing on dynamic capabilities as a source of sustainable competitive advantage (Teece *et al.*, 1997; Eisenhardt and Martin, 2000; Teece, 2007). For Teece *et al.* (1997, p. 515), the term dynamic refers to the "capacity to renew competences so as to achieve congruence with the changing business environment". These authors define dynamic capabilities as the firm's ability to integrate, build and reconfigure internal and external competences to quickly respond to changes in the current business environment. Given its

relevance, the theoretical approaches on recent dynamic capabilities have contributed to the distinction between capabilities and other resources available within companies (Teece *et al.*, 1997; Makadok, 2001) and a broader view of the theory of resources and capabilities.

### *Export performance*

With the steady increase of business and international competition, understanding the determinants of international performance, mainly exports, has become particularly important, contributing to the development of several studies in this area (Sousa, Martínez-Lopéz and Coelho, 2008). However, the lack of a comprehensive theoretical basis for explaining export performance makes it difficult to integrate the results of different studies in a coherent body of knowledge (Morgan, Kaleka and Katsikeas, 2004; Sousa *et al.*, 2008). Sousa *et al.* (2008) conducted a literature review between 1998 and 2005, and concluded that considerable attention has been given to the determinants of export performance, contributing to the theoretical and practical advances in this field. However, according to these authors, the literature on the export performance presents itself as fragmented (consisting of numerous studies that characterize the adoption of a variety of analytical and methodological approaches); different (to investigate a considerable number of different determinants of export performance) and inconsistent (different reports, often contradicting the findings on the influence of various determinants of export performance, cause confusion and misunderstanding regarding the factors that significantly affect performance).

Morgan *et al.* (2004) confirm that export performance is strongly correlated with the positional advantage of the firm in the international market and that this is directly related to the availability of resources and capabilities for external markets. Similarly, Dhanaraj and Beamish (2003) concluded that resources are good predictors of export strategy (operationalized in terms of degree of involvement in foreign markets).

Sousa *et al.* (2008) analyzed measures of export performance, and concluded that despite the large number of measures of export performance (about 50), only a few were frequently used, namely: export intensity (share of exports in total sales), growth of export sales, export profits, export market share, satisfaction with export performance in general and perceived export success. On the other hand, measures less used were return on investment, quality of relationship with the distributor, customer satisfaction, and satisfaction with quality product/service compared to their competitors.

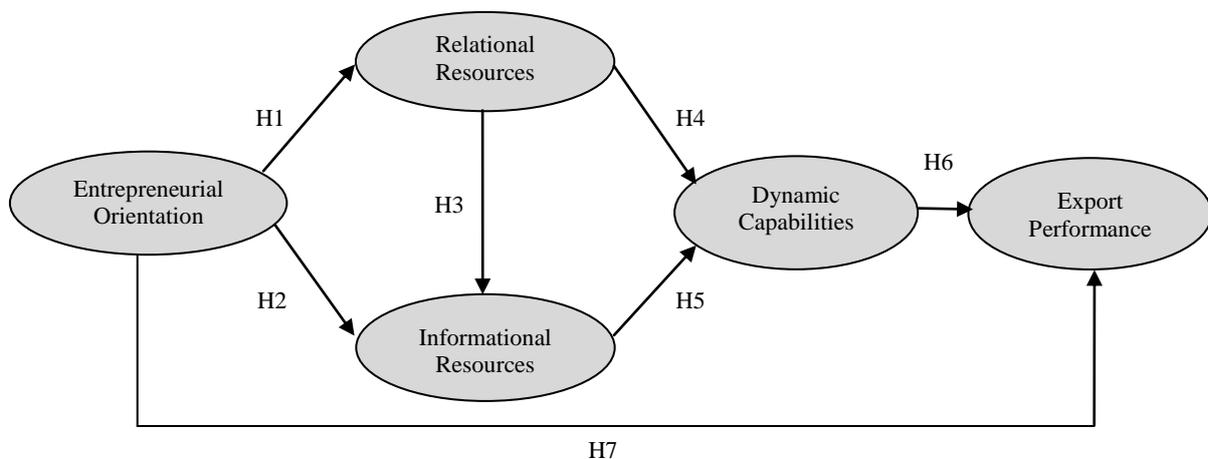
Another important aspect in the study on export performance is the unit of analysis. Katsikeas, Leonidou and Morgan (2000) and Sousa *et al.* (2008) find that most of the studies

analyzed used the company as the unit of analysis (export performance evaluated in the context of overall business activities in foreign markets); while for Cavusgil and Zou (1994) the unit of analysis in research in export performance should be “export venture”, defined as the combination of a single product or product line exported to the main market (Lages and Montgomery, 2004) as firms can have more than one product or product line, and each may have a different impact on export performance (Sousa *et al.*, 2008). The focus on “export venture” contributes to a more accurate assessment of the factors associated with superior performance in terms of exports (Piercy, Kaleka and Katsikeas, 1998).

## RESEARCH MODEL AND HYPOTHESIS

Drawing upon the theory of the RBV and the DCV, this study aims to examine the relationship between different intangible resources and capabilities (entrepreneurial orientation, intangible resource and dynamic capabilities) in export performance. Specifically, we focus on the role of entrepreneurial orientation in the attraction of the intangible resources (relational and informational resources) and in the role of such resources in the development of dynamic capabilities. So, this study also aims to evaluate the impact of these resources and capabilities in international business performance, assessing how and to what extent these resources and capabilities influence export performance. Finally, the study aims to assess the mediating effect of intangible resources and dynamic capabilities between entrepreneurial orientation and export performance. Figure 1 presents the proposed research model and hypothesis.

Figure 1. Research model and hypothesis



## METHODOLOGY

### *Research design and measures*

This study uses the questionnaire method, which is consistent with the majority of the studies in the literature in the field of export performance (Sousa *et al.*, 2008). The questionnaire was applied online due essentially to the short response time regardless of respondents' location (Ilieva Baron and Healey, 2002).

The questionnaire includes two parts. The first part refers to information about the firm and its export activity and the second one consists of questions related to entrepreneurial orientation, intangible resources (informational and relational resources), dynamic capabilities and export performance (Table 1).

Table 1. Measurement scales used in the questionnaire

<b>Construct</b>	<b>Dimensions</b>	<b>References</b>
Entrepreneurial orientation	<ul style="list-style-type: none"> <li>• Innovation</li> <li>• Proactiveness</li> <li>• Risk taking</li> </ul>	Covin and Slevin (1989)
Intangible resources	<ul style="list-style-type: none"> <li>• Informational resources</li> <li>• Relational resources</li> </ul>	Morgan <i>et al.</i> (2006)
Dynamic capabilities	<ul style="list-style-type: none"> <li>• Dynamic capabilities</li> </ul>	Wu and Wang (2007)
Export performance	<ul style="list-style-type: none"> <li>• Export performance</li> </ul>	Okpara (2009)

In this research the unit of analysis used was "export venture" and the study was conducted with Portuguese exporters. The choice of a single country is consistent with the literature (Sousa *et al.*, 2008). Additionally the option for Portuguese firms is relevant given the country's economic situation and its strong dependence on exports (Sousa and Bradley, 2006; Lisboa, Skarmeas and Lages, 2011).

Given the high number of exporting companies listed in the Portuguese official statistics body (17,330 firms listed in National Institute of Statistics), we focused on exporting firms in the northern region (6,653 records). This is also consistent with the literature in that several studies restrict the analysis to certain regions of one country (Sousa *et al.*, 2008). The link to the online questionnaire was sent via e-mail to the 1,780 firms' senior managers and/or leaders of export activity in the database which had provided this address. Miesenböck (1988) considers that these managers are the most likely to respond to the questionnaire, given their direct involvement and responsibility in the export decisions. Moreover, Sousa *et al.* (2008) find that the data from most studies in this area were obtained from export managers.

During data collection, started in November of 2011 and ending in February of 2012, a total of 293 questionnaires were received, 265 of which were usable, representing a response

rate of 19.4% and 18% respectively, which is quite satisfactory since the average response rate of top management is between 15% and 20% (Menon, Bharadwaj, Adidam and Edison, 1999). The final sample includes only companies whose respondent confirmed to be responsible for the company's international activity.

Data analysis was conducted using SPSS (version 19) and LISREL (version 8.8).

Since the majority of responses were collected after follow-up, differences between groups were assessed. We compared the means for the respondents in the first group (first quartile) and second group (fourth quartile) for all variables included in the conceptual framework using Mann-Whitney U test, which is recommended when the distributions do not meet the criteria of normality (Nachar, 2008). Results show that although most of the late responses averages are higher than those of the initial responses, the differences are not statistically significant ( $p > 0.05$ ).

## RESULTS

The results are based in the responses provided by 265 exporting companies from various industries in the north of Portugal (44 companies are from the textile industry, 18 from the shoe industry, 15 from industrial equipments and products, 14 from house and furniture, 13 from the home apparel, and the remaining from various other industries).

To test the causal relationships between different constructs we used structural equation modeling (Hair, Anderson, Tatham and Black, 1998; Bentler, Bagozzi, Cudeck and Iacobucci (2001).

The analysis of the measurement model was evaluated in terms of constructs unidimensionality, reliability and validity (convergent and discriminant) (Table 2).

Table 2. Measurement model results

Construct and items	Standardized loading
<b>Relational resources</b> (CR=0.90, AVE=0.74)	
Strength of existing customer relationships in this export market.	0.82
Duration of relationships with our current distributors in this	0.85
Closeness of existing customer relationships.	0.91
<b>Informational resources</b> (CR=0.92, AVE=0.80)	
Export market information.	0.91
Customer knowledge in this export market.	0.89
Knowledge of competitors in this export market.	0.87
<b>Dynamic Capabilities</b> (CR=0.95, AVE=0.81)	
Resource integration capability.	0.87
Resource reconfiguration capability.	0.93
Learning capability.	0.94
Ability to respond to the rapidly changing environment.	0.86
<b>Entrepreneurial orientation</b>	
<b>Innovation</b> (CR=0.87, AVE=0.71)	0.78

The past 5 years, the company has launched very new lines of	0.82
The past 5 years, the company changes in product or services lines have usually been quite dramatic.	0.86
<b>Proactiveness</b> (CR=0.82, AVE=0.64)	0.82
In dealing with its competitors, my firm typically initiates actions which competitors the respond to.	0.72
In dealing with its competitors, my firm is very often the first business to introduce new products/services, administrative techniques, operating technologies, etc.	0.80
<b>Risk taking</b> (CR=0.87, AVE=0.71)	
In general, the top managers of my firm have a strong proclivity for	0.80
In general, the top managers of my firm have owing to the nature of the environment. Bold. wide-ranging acts are necessary to achieve	0.93
When confronted with decision-making situations involving uncertainty, my firm typically adopts a bold, aggressive posture in	0.78
<u>Factors of first and second order</u>	
Innovation – Entrepreneurial orientation	0.64
Proactiveness – Entrepreneurial orientation	0.76
Risk taking – Entrepreneurial orientation	0.57
<u>Correlation factor</u>	
Innovation- Proactiveness (R <sup>2</sup> =0.41)	0.64
Innovation- Risk taking (R <sup>2</sup> =0.18)	0.43
Proactiveness - Risk taking (R <sup>2</sup> =0.20)	0.45
<b>Export Performance</b> (CR=0.92, AVE=0.79)	
We have achieved a rapid growth in our export activities in the last	0.93
We have expanded our operations in the last three years.	0.93
<u>Overall the performance of our firm has been very satisfactory.</u>	0.81
Notes: CR = Composite Reliability; AVE= Average Variance Extracted; All loadings are statistically significant at $p < 0.001$ .	

In order to test the proposed hypotheses the structural model was estimated. The analysis of the parameters confirm the fitness of the model ( $\chi^2_{(97)}=168.90$ ),  $p < 0.05$ , CFI=0.99, GFI=0.93, NNFI=0.98, RMSEA=0.05). We present in Table 3 the hypothesis testing results and in Table 4 the means (M), standard deviations (SD), and correlations.

Table 3. Hypothesis testing results

Parameters	Standardized loading	t-value	R <sup>2</sup>	Hypotheses	Results
Entrepreneurial orientation – Relational	0.28	3.52*	0.08	H1	Supported
Entrepreneurial orientation – Informational	0.23	3.23**		H2	Supported
Relational resources – Informational resources	0.48	7.37*	0.34	H3	Supported
Relational resources – Dynamic capabilities	0.38	5.92*		H4	Supported
Informational resources – Dynamic	0.41	6.42*	0.48	H5	Supported
Dynamic capabilities – Export performance	0.29	4.81*		H6	Supported
Entrepreneurial orientation – Export	0.45	5.68*	0.35	H7	Supported

\* $p < 0.001$ ; \*\* $p < 0.01$ .

Table 4. Means, standard deviations, and correlations

	M	SD	1	2	3	4	5
1. Export performance	4.60	1.62	1.00				
2. Dynamic capabilities	4.74	1.15	0.40	1.00			
3. Informational resources	5.04	1.17	0.34	0.61	1.00		
4. Relational resources	5.28	1.00	0.30	0.60	0.54	1.00	
5. Entrepreneurial orientation	4.03	1.47	0.52	0.25	0.36	0.28	1.00

All correlations are significant at the .05 level

Results show that (1) entrepreneurial orientation enhances the attraction of intangible resources, including relational resources and informational resources, (2) the presence of intangible resources is an important factor in the development of dynamic capabilities and (3) dynamic capabilities impact the export's performance. Furthermore, (4) entrepreneurial orientation impacts exports' performance.

Additionally, we have tested the mediating effect of intangible resources and dynamic capabilities. The significance of the mediating effect was tested using *Aroian* test (Baron and Kenny, 1986). Results confirm that entrepreneurial orientation has a significant indirect impact in dynamic capabilities through intangible resources. The indirect effect of entrepreneurial orientation in dynamic capabilities through relational resources is 0.11 (0.28x0.38;  $p < 0.01$ ;  $Z = 2.97$ ). The indirect effect of entrepreneurial orientation in dynamic capabilities through informational resources is 0.09 (0.23x0.41;  $p < 0.01$ ;  $Z = 2.83$ ). The indirect effect of intangible resources in export performance is 0.11 (0.38x0.29;  $p < 0.001$ ;  $Z = 3.70$ ) and the indirect effect of relational resources in export performance through dynamic capabilities is 0.12 (0.41x0.29;  $p < 0.001$ ;  $Z = 3.80$ ).

## DISCUSSION AND CONCLUSION

This study proposes and tests a model according to which entrepreneurial orientation has a positive influence in intangible resources, namely informational and relational resources, and in the development of dynamic capabilities, which mediate the effect of entrepreneurial orientation on export performance.

Based on the responses to an online questionnaire for top managers of 265 exporting firms, we validated all direct relationships of the model and confirmed the mediating effect of intangible resources and dynamic capabilities in export performance. Specifically, we found that entrepreneurial orientation contributes to the attraction of intangible resources, that relational resources boost the development of knowledge and that these two types of intangible resources influence the development of dynamic capabilities. These results are consistent with previous studies in this area (Morgan *et al.* 2004; Wu, 2006; Wu and Wang, 2007) and with Morgan *et al.* (2004) argument that resources and capabilities are interrelated. The impact of resources in dynamic capabilities confirm Wu (2006) and the proposition that

resources are antecedents of the development of capabilities (e.g., Morgan *et al.*, 2004). The influence of dynamic capabilities in export performance is consistent with the results of Wu (2006) and Wu and Wang (2007) in their study with technological companies and internal market performance. Finally, H7, referring to the impact of entrepreneurial orientation in performance is consistent with a large number of studies (e.g. Miller, 1983; Covin and Slevin, 1989; Covin, Slevin and Covin, 1990; Lumpkin and Dess, 1996).

Export performance is positively affected (directly and indirectly) by entrepreneurial orientation, intangible resources and dynamic capabilities. Furthermore, dynamic capabilities, also mediate the relationship between intangible assets and export performance. Intangible resources have a significant mediating impact in the relationship entrepreneurial orientation e dynamic capabilities.

As with most studies, this research is not without limitations. First of all, there are limitations derived from the potential bias caused by the sample size and measurement. In this research, in line with previous studies, we used Likert scales 1 to 7 to evaluate the constructs, so that the majority of the answers are based on the subjective judgment of the respondents. Although a strong use of subjective measures to assess the performance of exports has been identified in previous studies, we must admit that some responses may not reflect the actual situation of the level of resources and capabilities available to “export venture” and the performance of exports. Additionally, although email is a commonly tool used, we cannot generalize the results to the total population, as the sample includes only companies form the north of Portugal.

It may also be argued that evaluating the different variables in this study based on the opinion of one respondent per firm may not accurately reflect the reality of companies, as more than one person may be involved in decision-making especially in large companies (Leonidou and Katsikeas, 1996).

In broad terms, the results of our study stress the importance of dynamic capabilities, which play a catalyst role both in the relationship between intangibles resources and entrepreneurial orientation as well as in the relationship between intangibles resources and performance. This conclusion partly validates criticisms to limitations of the RBV to explain firm’s competitiveness. In fact, without the ability to achieve new resource configurations as environmental conditions shift (Eisenhardt and Martin, 2000), resources are clearly insufficient conditions for competitive advantage. A clear understanding of how companies develop differentiated dynamic capabilities is paramount for managers, public bodies and researchers aiming at contributing for or firms’ competitiveness and performance.

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**MEASURING SERVICE QUALITY, BRAND IMAGE, PERCEIVED VALUE, CUSTOMERS' SATISFACTION AND BEHAVIOURAL INTENTIONS IN THE HOTEL INDUSTRY: A STUDY OF THE HOTELS IN THE NORTH OF PORTUGAL**

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**ABSTRACT**

Nowadays one of the biggest challenges for managers in the hotel industry is to provide and sustain customer satisfaction. While the reasons for the initial visit to a hotel may be due to factors partly outside of the control of hotel managers, the ability to create a satisfactory experience for the guest remains, to a considerable degree, in the hands of both the management and the hotel staff. It is vital for managers of hotels to have a good and clear understanding of exactly what the guests want. The crucial point of customer satisfaction is to identify the important attributes, considered by customers as their needs and expectations.

The main objective of this work is to propose the application of SERVQUAL in evaluating the perceived quality of service offered by hotels in the North of Portugal. The proposed conceptual model aims to analyze if: (1) the perceived service quality (five dimensions of SERVQUAL) directly contribute to customer satisfaction, customer-perceived value and brand image; (2) the brand image and customer-perceived value directly contribute to customer satisfaction (3) the brand image directly contribute to customer-perceived value; (4) the customer satisfaction directly influences the intention to return and WOM recommendation (Word-of-Mouth communication intention) and (5) the intention to return has a direct impact on WOM recommendation. This research is of particular interest to the literature on the hotel industry and to the practitioners, since there are no studies in this field which apply to the Portuguese hotel industry.

**Keywords:** Service quality; customer satisfaction; behavioural intentions; Hotel Industry; Portugal

## INTRODUCTION

The hotel industry has in the last decades assumed a preponderant role in the Portuguese economy similar to that of other European countries. In this sense, and facing the socio-economic context the country is experiencing, hotels can significantly contribute to the sustainable development of the economy, as they represent the crux of the tourism industry. The manager of a hotel is able to successfully make the visitors feel at home, generates important income sources and simultaneously promotes the development of complementary industries (Ming-Horng, Jih-Lian, Yi-Chou and Chung-Lin, 2012). To do so, managers should consider how to attract customers as part of their management strategies, in order to remain competitive in the industry. The way to achieve a competitive sustainable advantage resides in providing a high quality of service which results in satisfied costumers (Shemwell, Yavas and Bilgin, 1998) and customer retention (Callan and Kyndt 2001).

In the literature, there are several studies that assess the service quality, brand image, perceived value and satisfaction, which have been recognized as the antecedents to behavioural intentions (Sumaedi, Bakti and Yarmen, 2012; Ryu, Han and Kim, 2008; Oh, 1999)

In this context, the main objective of this paper is to propose a methodology that allows for the examination of the antecedents and consequences of customer satisfaction, in the hotels in the North of Portugal. We specifically intend to present a conceptual model which aims to assess whether the overall service quality, in conjunction with brand image and perceived value, promotes customer satisfaction, intent to return and recommend services.

In this paper, after a review of the main literature on service quality, customer satisfaction and their behavioural intention, which also gives a brief description of the hospitality industry in the North of Portugal, we propose the conceptual model and research hypotheses, ending with the presentation of the methodology and the contribution of the research.

## THEORETICAL BACKGROUND

### **A brief description of the hospitality industry in Portugal**

The government of Portugal considers the hotel industry and tourism as a high-priority sector for the development strategy of the country. Portugal is one of the main tourist destinations in the world, therefore making the tourist sector a strong economic source for the national economy, namely at the level of wealth creation, investment and employment. In addition, the sector also has the function of boosting the development of complementary economic activities and in the same context, contributes significantly to the balance of current accounts which can, and should be expanded according to the National Tourism Strategic Plan of 2013 (Ministry of Economy and Employment, 2013).

It was in the nineteen seventies, when tourism had a strong growth at the international level, that Portugal became interested in the phenomenon of tourism. Notwithstanding, Portugal has had a strong increase in tourism from the 1980's and has maintained a positive growth, as can be verified in Table 1.

Table 1 - Guests and Bednights for 2006-2011 in Portugal (in millions)

Indicators	Years						
	2006	2007	2008	2009	2010	2011	AAGR
<b>Guests</b>	12.4	13.4	13.5	12.9	13.5	14	
<b>Average Annual Growth Rate</b>	-	8.1	0.7	-4.4	4.7	3.7	2.5
<b>Bednights</b>	37.6	39.4	39.2	36.5	37.4	39.6	
<b>AAGR</b>	-	4.8	-0.5	-6.9	2.5	5.9	1.1

**Source:** Figures compiled based on data from Statistics Portugal

As Table 1 indicates, the number of guests and bednights increased between 2006 and 2011 to an average yearly rate of 2,5% and 1%, respectively.

The principal international source markets of tourism in Portugal, from data of 2011, are the European countries. The United Kingdom is in first place, with a market share of about 16%, followed by Spain, Germany, the Netherlands and France. Two of the countries from the American continent, The USA and Brazil, are in the top 10 of the principal source markets. Brazil has a market share of approximately 3% and the USA of 1,5%. It needs to be mentioned that the national market has a share of 34% (Table 2).

Tourism is a sector which is greatly beneficial to the economy of the country. In Table 3, a gradual increase in revenue is shown, between 2006 and 2011. It is worth stating that, during this period the average annual increase of tourist revenue was 4,3%; business profits only

increased by 2,1% yearly, due to the pressure by tourists because of more choices available to them.

Table 2 - Top 10 Source Markets in 2011

Source Markets	Bednights	Market
Portugal	13499	34.10%
United Kingdom	6268	15.80%
Spain	3470	8.80%
Germany	3388	8.60%
The Netherlands	2003	5.10%
France	1929	4.90%
Brazil	1023	2.60%
Italy	922	2.30%
Ireland	865	2.20%
The USA	613	1.50%

Source: Figures compiled based on data from Statistics Portugal

Table 3 - Tourist Revenues and Total Profit - 2006-2011 (in millions of Euros)

Indicators	Years						
	2006	2007	2008	2009	2010	2011	AAGR
<b>Tourist Revenues</b>	6672	7393	7440	6908	7611	8146	
<b>AAGR</b>	-	10.8	0.6	-7.2	10.2	7.0	4.3
<b>Total Profit</b>	1741	1944	1965	1764	1808	1910	
<b>AAGR</b>	-	11.7	1.1	-10.2	2.5	5.6	2.1

Source: Figures compiled based on data from Statistics Portugal

As indicated in table 4, the rates of occupancy and the RevPar decreased during this period and have settled at 52% and 33 €, respectively, in 2011.

Table 4 - Room occupancy rates and RevPar for 2006-2011 (Rates and Euros)

Indicators	Years						
	2006	2007	2008	2009	2010	2011	AAGR
<b>Room occupancy rates</b>	57%	59%	57%	52%	51%	52%	
<b>AAGR</b>	-	2.0	-2.0	-5.0	-1.0	1.0	-1.0
<b>RevPar</b>	33 €	37 €	37	32	32	33	
<b>AAGR</b>	-	12.1	0.0	-13.5	0.0	3.1	0.3

Source: Figures compiled based on data from Statistics Portugal

Due to the fact that the Portuguese government believes the hotel industry and tourism represent a high-priority sector for the development of Portugal and, also based on the numbers from tourism, which unequivocally indicate that the hotel industry has shown positive growth during the past years, it is considered that the focus on service quality may

be the indispensable road that will serve as the “trampoline” for its sustainable development, and consequently the Portuguese economy.

### **Service Quality**

Service quality has assumed a major role both in public and private institutions, as an indispensable requirement to client/guest satisfaction. There are two basic ways to define quality: one from the viewpoint of the service provider and the other from the client's perspective. The quality from the customer's perspective is the central objective of this study because it reorients the hotel managers to the customer/guest's needs. Firstly, it should be noted that the measurement of service quality is an important area of academic and scientific interest, which has assumed special prominence after the contribution of various authors (Parasuraman, Zeithaml and Berry 1985). These authors, who represent the American school, have designed an instrument for measuring quality of service, called SERVQUAL. Initially, the proposed model incorporated 10 dimensions of quality (tangibility, reliability, responsiveness, professionalism, courtesy, credibility, security, access, communication and customer understanding). However, these dimensions were revised and subsequently reduced to five (Parasuraman, Zeithaml and Berry 1988). The dimensions of courtesy, credibility, security, competence and communication have led to a new dimension: assurance, while the dimensions of understanding/knowing customers generated the dimension of empathy. A. Parasuraman *et al.* (1988) suggested the following definitions for the five dimensions:

- Tangibles: Physical facilities, equipment and appearance of personnel;
- Reliability: Ability to perform the promised service dependably and accurately;
- Responsiveness: Willingness to help customers and provide prompt service;
- Assurance: Knowledge and courtesy of employees and their ability to inspire trust and confidence;
- Empathy: Caring, individualized attention the firm provides its customers.

SERVQUAL measures service quality from the customer's perspective of customer perceptions, through the amplitude of the discrepancy that exists between the expectations and perceptions of customers. Cronin and Taylor (1992) view that the validity of the use of expectations in the SERVQUAL model was called into question when consumers had no well-formed expectations and developed the SERVPERF scale which consists of the same 22

"items" of SERVQUAL, although centered only in measuring consumer perceptions regarding the quality of service. Despite the criticisms of SERVQUAL (Buttle, 1996; Cronin and Taylor, 1992), it remains the most widely used theoretical framework for measuring the quality of services so that, in the literature there are numerous studies that apply the SERVQUAL scale to assess quality of services across physical (Donnelly, Hull and Will, 2000; Mukherjee and Nath, 2005) and in digital environments (Pinho, Macedo and Monteiro, 2007, Wang and Tang, 2003). Despite the diversity of studies in many fields, in this study, SERVQUAL will be applied to the physical environment of hotels in the North of Portugal in a similar manner as that of other studies realized at an international level, in the area of the hotel industry (Khattab and Aldehayyat, 2011; Oh, 1999).

### **Customer satisfaction**

Customer satisfaction is the outcome of the customer's perception of the value received in a transaction or relationships, where value equals perceived service quality, compared to the value expected from transactions or relationships with competing vendors (Blanchard and Galloway, 1994; Heskett, Sasser and Hart, 1990; Zeithaml, Parasuraman and Berry 1990). According to Gundersen, Heide and Olsson (1996), the crucial point of customer satisfaction is to identify the important attributes, considered by customers as their needs and expectations. As Valdani (2009) points out, enterprises exist because they have a customer to serve. The key to customer satisfaction lies in identifying and anticipating customer needs and especially in being able to satisfy them. Enterprises which are able to rapidly understand and to satisfy customers' needs, make greater profits than those which fail to understand and satisfy them (Barsky and Nash, 2003; Dominici and Guzzo, 2010). In order to be successful, especially in the hotel industry, managers must concentrate on retaining existing customers by implementing effective strategies towards customer satisfaction and loyalty, since the cost of attracting new customers is higher than the cost of retaining existing ones (Dominici and Guzzo, 2010).

### **Brand image**

The concept of brand image has been widely studied by researchers in the area of marketing (Sahin and Baloglu, 2011; Kim and Kim, 2005). For Kim and Kim (2005, p. 549), a "brand symbolizes the essence of the customers' perceptions of the hospitality organizations". In

accordance with Sahin and Baloglu (2011), brand image is defined as the perception of customers about a brand or a product labeled with that brand. Different authors consider brand image as an important component of strong brands (Aaker, 1996; Kapferer, 1997) and a determinant in the obtainment of competitive advantages (Lim and O’Cass, 2001).

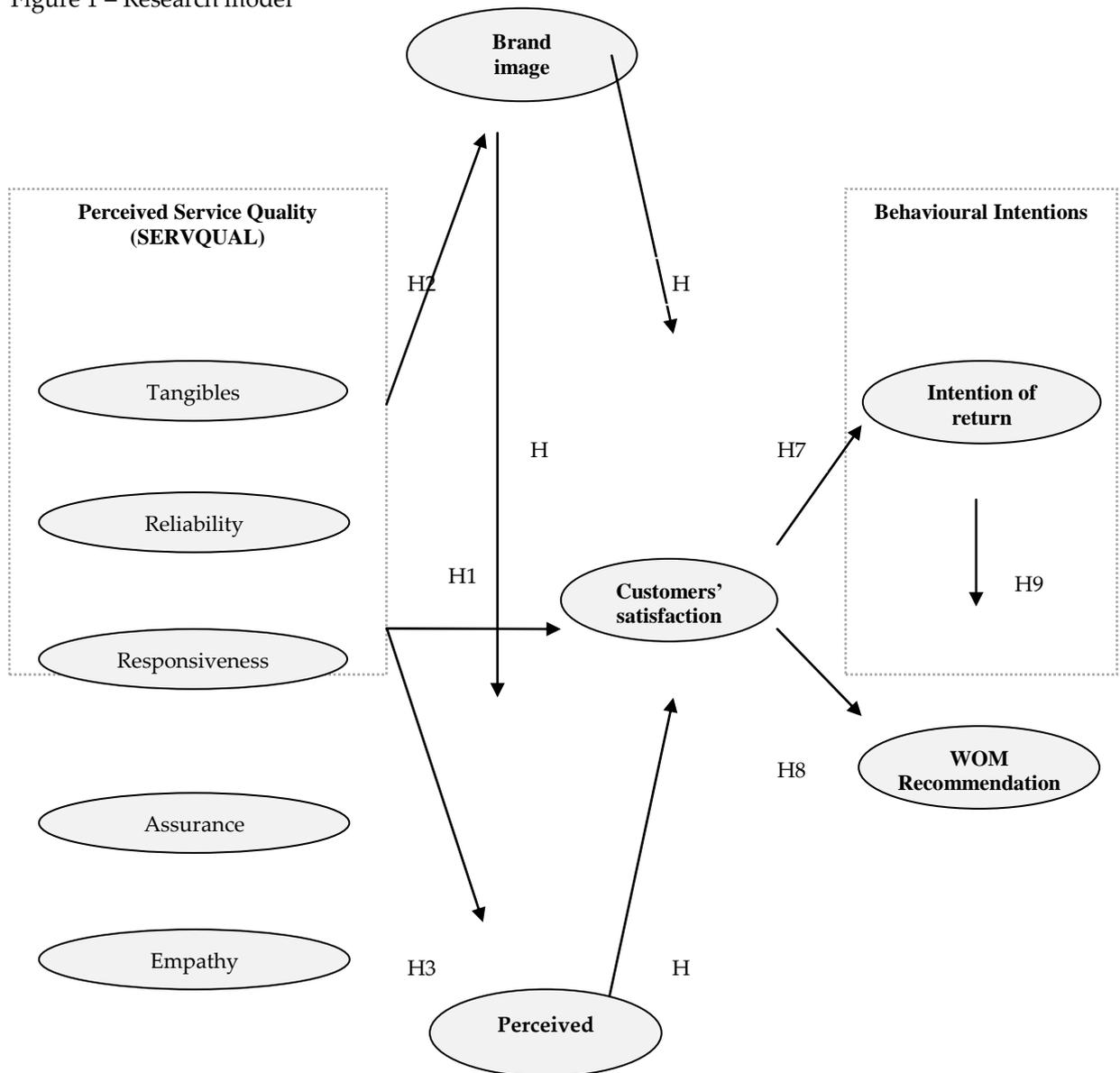
### **Perceived value**

In the area of marketing, value is evaluated in the customer’s perspective (Dodds, 1991). Zeithaml (1988, p. 14) defines customer value (or customer-perceived value) as “the customer’s overall assessment of the utility of a product based on perceptions of what is received and what is given”. For Wang (2010, p. 254), “a customer’s perception of the value received from a service provider could motivate the customer to patronize the provider again”. In the conceptual model proposed by Zeithaml (1988), perceived value is a direct antecedent to the decision to purchase and a variable which directly depends on the perceived quality of service. Oh (1999) develops a model which adds perceived price as a variable antecedent to the perception of value and customer satisfaction, repurchase intentions and WOM recommendation as consequential variables.

### **Behavioural intentions**

The literature suggests behavioural intentions as a construct which permits the evaluation of customer loyalty (Yang and Peterson, 2004). These are behaviours related to the intention to repurchase and even to the intention of recommending the product/service (Zeithaml, Parasuraman and Berry, 1996; Clemes, Gan, Kao and Choong, 2008; Lai and Chen, 2010; Sumaedi *et al.*, 2012). Customers frequently develop an attitude toward purchasing based on a prior service experience or, still, this attitude can also be influenced by previous information, based on the image of the hotel in the market and even by word of mouth (WOM recommendation) (Ryu *et al.*, 2008). In this sense, Chen and Tsai (2007) defined behavioural intentions as the visitor’s judgment about the likeliness to revisit the same destination or the willingness to recommend the destination to others. Based on this definition, behavioural intention in this study may be described as a stated likelihood to return to the hotels in the North of Portugal and to recommend the hotels to family, friends and others in the future.

Figure 1 – Research model



## CONCEPTUAL BACKGROUND AND HYPOTHESES

The aim of this study is to, as Figure 1 indicates, propose a model that consists of evaluating the impact of: (1) service quality on customer satisfaction, brand image and customer-perceived value; (2) brand image on customer-perceived value; (3) brand image, customer satisfaction and customer-perceived value on behavioural intentions (intention to return and WOM recommendation) and (4) intention to return on WOM recommendation.

The hotel unit managers should focus their attention on customer/guest service quality evaluation as they must have actual knowledge that the service quality perceived by the client meets their expectations, as contended by Parasuraman *et al.* (1985, 1988). The main

objective of this study is to test the conceptual model shown in Figure 1, which includes four research hypotheses, as explained below.

The relationship between service quality and satisfaction has not been consensual in the literature as several authors argue that, on the one hand, both concepts are identical, while others consider them as distinct (Dabholkar, 1995; Dabholkar, Shepherd and Thorpe., 2000; Oliver, 1993). According to Dabholkar (1995), while evaluation of service quality is essentially cognitive, for its part, satisfaction integrates both cognitive and affective components. This author claims that these two concepts are distinct for recent consumers of a product. However, in the long run, the affective dimension tends to be blurred and to that extent, the concepts tend to overlap. Meanwhile, Ngobo (1999) also reinforces the distinction between perceived quality and satisfaction level of the three dimensions. Assuming that these two concepts are distinct, a question that immediately arises relates to the order of their occurrence in the mind of the consumer and as such, the causal relationship between them. In this regard Dabholkar *et al.* (2000) argue that, most investigators traditionally hold that consumer satisfaction results from a particular consumer's experience of a service which leads to an evaluation / attitude on the overall quality of service over a given period of time (Parasuraman *et al.*, 1988). Recently, however, the reverse situation has stood out as the most relevant. This position is particularly evidenced by Oliver (1993) who suggested that the quality of service should be an antecedent to consumer satisfaction irrespective of the experiential or the time factor. Similarly, Cronin and Taylor (1992) analyzed the effect of these concepts in both directions and concluded that the quality of service perceived exerts a greater impact on customer satisfaction than otherwise. Recently, several authors have considered service quality as an important antecedent to satisfaction (Pinho *et al.*, 2007; Ekinci, Dawes and Massey, 2008; Zhang and Prybutok, 2005; Chiou, Droge and Hanvanich., 2002; Saleh and Ryan, 1991). Most studies assessing the relationship of service quality on customer satisfaction demonstrate the existence of a statistically significant level in studies of the hotel industry.

Moreover, the literature suggests that perceived service quality positively influences perceived brand image (Oh, 1999) and the perceived value (Ryu *et al.*, 2008)

In line with this, and based on SERVQUAL, the following hypotheses are proposed in the present study.

**H1:** The perceived service quality by the customers has a positive influence on their satisfaction.

H<sub>11</sub> – The higher the tangibility, the greater the degree of the customers' satisfaction.

H<sub>12</sub> – The higher the reliability, the greater the degree of the customers' satisfaction.

H<sub>13</sub> – The higher the assurance, the greater the degree of the customers' satisfaction.

H<sub>14</sub> – The higher the responsiveness, the greater the degree of the customers' satisfaction.

H<sub>15</sub> – The higher the empathy, the greater the degree of the customers' satisfaction.

**H2:** The perceived service quality by the customers has a positive influence on perceived brand image.

**H3:** The perceived service quality by the customers has a positive influence on perceived value.

The study of image has received increasing attention in the literature on marketing (Chen and Tsai, 2007; Ryu *et al.*, 2008; Wu, Yeh and Hsiao, 2011), since it affects the individual's subjective perception (Chen and Tsai, 2007). In the area of hospitality, Ryu *et al.* (2008) confirm that the image of a restaurant positively and significantly influences the perceived value. Thus, this study proposes the following hypothesis:

**H4:** The brand image perceived by the customers has a positive influence on the perceived value.

The relationship between image and perceived value on customer satisfaction has gained little attention in the hospitality literature (Ryu *et al.*, 2008). These authors have evaluated the impact of the image of a restaurant and perceived value on customer satisfaction and they found a positive and significant relationship between these constructs. In this sense, we intend to propose the following hypotheses:

**H5:** The perceived brand image by the customers has a positive influence on their satisfaction.

**H6:** The perceived value by the customers has a positive influence on their satisfaction.

In reviewing the literature, we have found that marketing services have extensively researched behavioural attitudes (Sumaedi, *et al.*, 2012; González *et al.*, 2007; Ryu *et al.*, 2008; Oh, 1999; Dabholkar, 1996; Zeithaml *et al.*, 1996). Several concepts have been examined as antecedent factors to behavioural intentions, such as service quality (Brown, Churchill and Peter, 1993; Zeithaml *et al.*, 1996) and satisfaction (Sumaedi, *et al.*, 2012; Oliver, 1999). According to Liang and Zhang (2011, p. 156), “*it is generally believed that satisfaction leads to repeat purchases and positive WOM recommendations*”, assuming that if customers are satisfied with a product/service, they are more likely to continue to purchase it, and are more willing to spread positive WOM. Thus, we propose our seventh and octave hypotheses:

**H7:** Customer satisfaction positively influences intention to return.

**H8:** Customer satisfaction positively influences WOM recommendations.

According to Nadiri and Hussain (2005, p 471), “*service quality promotes customer satisfaction, stimulates intention to return, and encourages recommendations*”. Oh (1999) found a positive and significant relationship between intention to return and WOM recommendations. In this study we intend to uphold the following hypothesis:

**H9:** Intention to return positively influences WOM recommendations.

## METHODOLOGY

A questionnaire will be designed as the survey instrument, which will include all the constructs of the proposed model, and used to investigate the hypotheses of interest. The questions in the questionnaire will be based on a review of the literature in the area of the hotel industry (Table 4).

Table 4 - Measurement scales

Construct	Dimensions (items)	References
Perceived service quality	Tangibles; Reliability; Responsiveness; Assurance; Empathy	Khattab and Aldehayyat (2011)
Brand image	Brand image	Kim and Kim (2005)

Perceived value	Perceived value	Adapted from Ryu <i>et al.</i> (2008)
Customer satisfaction	Customer satisfaction	Khattab and Aldehayyat (2011)
Intention to return	Intention to return	González, Comesaña and Brea (2007)
WOM recommendation	WOM Recommendation	Oh (1999) and Gonçalez et al. (2007)

This study will be applied to customers from a sample of hotels in the North of Portugal during the months of November and December 2013. Data analysis will be conducted using statistical software (version 19) and LISREL (version 8.8). To test the causal relationship between different constructs, we will use the structural equation model, given that the theoretical model includes the complex relationships between latent variables measured with different items that are presented simultaneously as independent and dependent variables.

## CONTRIBUTION OF RESEARCH

The customer satisfaction process allows for significantly increased revenue from hotel units by obtaining higher occupancy rates and a better return on investments. With this in mind, the manager needs to know the real customer service needs and expectations, so that the service is tailored to the customer's satisfaction, in order to retain them and attract potential new customers.

*Thus, this study proposes to develop and analyze a conceptual model that aims to explain the relationship between the five dimensions of SERVQUAL, brand image, perceived value, customer satisfaction and behavioural intentions (intentions to return and WOM recommendation).*

*Based on research conducted in bibliographic data bases, we have identified a gap in the literature about the hotels in Portugal, which relates to the knowledge of the factors affecting customer satisfaction and behavioural intention. It is hoped that this research will contribute to the development of the literature, politicians (wealth creation, economic growth, etc.) and managers of hotels (the survival and growth of hotel companies). From a practitioners' point of view, the understanding of the factors that influence customers' satisfaction and behavioural intentions, on the one hand, may contribute to the hotel manager's development when establishing strategies and contribute to the improvement of services*

provided by the hotel and consequently increase profit, market share, and improve return on investment (Hackl and Westlund, 2000).

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## MANAGING INTERNATIONAL BUSINESS CONSTRAINTS THROUGH CORPORATE DIPLOMACY: AN ILLUSTRATIVE CASE STUDY

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### ABSTRACT

Globalization has dramatically altered the landscape of international business. Consequently multinational corporations have increased their role, as well as their responsibility, within society thus facing the rising demands of the environment in which they operate, especially when engaging with foreign markets. A growing need has emerged for multinational corporations to be able to respond to this new, wider network of relationships that comprises old and new forms of international business constraints, which increasingly impact the performance of multinational corporations. Thus the question is how corporate diplomacy can be used as a management tool, whereby, if integrated into the overall strategy of the organization, it can help overcome and manage international business constraints that multinational corporations face today when operating abroad. The challenge, therefore, is assessing the ability of corporate diplomacy to build bridges between market and non-market environments, in order for multinational corporations to achieve their goals more efficiently.

**Keywords:** corporate diplomacy, international business constraints

### INTRODUCTION

One of the main areas within international business, since work began in this field has been the study of theoretical frameworks and business practices that can help businesses overcome the intrinsic costs and risks they bear when engaging with foreign markets (cf. Hymer, 1960; Zaheer, 1995). Additionally, internationalisation models that also aim to reduce this problem using different approaches (Johanson & Vahlne 1977, 1990 and 2009; Johanson & Mattsson, 1988; Håkansson & Snehota, 1989; Hadley & Wilson, 2003, Schweizer *et al.*, 2010).

In the meantime studies in diplomacy have been increasingly related to economic issues (*e.g.*, economic diplomacy), and more recently to specific business practices of international firms, corporate diplomacy (Saner *et al.*, 2000; Steger, 2003; Saner & Yiu, 2005; Mulddon Jr., 2005; Sarfati, 2009). These focus on the problems that multinational corporations have to face regarding their relationships with the surrounding environment in which they operate, both market and non-market players, due to the growing impact they have on the actions and subsequently the performance of international business.

The aim of the this paper is to contribute to the literature regarding the application of corporate diplomacy in resolving the problems faced by corporations when engaging with foreign markets, in order to evaluate how this management tool can help international companies overcome, manage and minimize restrictions on conducting business internationally.

## LITERATURE REVIEW

International business constraints have two main scopes, liability of foreignness and liability of outsidership. Corporate diplomacy is a recent concept that can help businesses overcome those liabilities when engaging with foreign markets and by doing so, achieve their goals more efficiently.

### *International business constraints*

Hymer's (1960, published 1976) seminal work was responsible for the creation of the modern theory of international operations for large corporations. According to him, firms have additional costs when operating in a foreign market in comparison to local companies (Zaheer, 1995). These are the *costs of doing business abroad*. Thus, foreign firms have location disadvantages *vis-à-vis* local firms, which means that, by default, they have a lower chance of profitability and therefore of survival.

According to Hymer's (1960) theory, it is possible to identify three basic types of costs incurred by a firm operating in a foreign market: first, *costs of acquisition and communication of information in general* (*i.e.*, resulting from differences in culture, language, and the political, economic and legal environment, in addition to travel, transportation and coordination over distances and across different time zones.); second, *costs originating from less favourable*

*treatment given by governments of the host country (e.g., protectionist policies); third, costs and risks arising from fluctuations in exchange rates (e.g., monetary policies).*

Zaheer (1995), following Hymer's (1960) theory, coined the term *liability of foreignness* (LOF), which arises from costs of doing business abroad, *i.e.*, from the differences in the environment on multiple levels (political, economic, social, cultural, etc.), alongside the challenge of management across physical distances.

One of the most relevant internationalisation theories, that attempts to minimize the risks and costs that companies face in internationalisation processes, is the Uppsala Model (Johanson & Wiedersheim-Paul in 1975; Johanson & Vahlne, 1977, 1990).

This model consists in the firm's increasing involvement in international operations, which progresses via an interaction between, on the one hand, an increase of knowledge about overseas markets and operations and, on the other, a growing commitment of resources to foreign markets. The main goal being to minimize the fundamental factor associated to the internationalisation process: uncertainty (Johanson & Vahlne, 1990).

Strong emphasis is placed on *experiential knowledge* that can only be achieved through experience, which allows firms to perceive the possibilities of present and future endeavours.

According to this model, firms begin the internationalisation process by choosing the markets which they feel closer to in relation to psychological distance, *i.e.*, all the factors inhibiting the flow of information from and to the market such as differences in culture, business practices, education, language, etc. (Johanson & Vahlne, 1977).

The main limitation in the internationalisation process is the lack of knowledge, specifically experiential knowledge, at an international level, that can only be achieved by the firm itself (Johanson & Vahlne, 1977, 1990).

Håkansson & Snehota (1989) change the emphasis; away from the manner the firm assigns and organizes its internal resources, towards the way its own activities and assets relate to those of the other parties constituting its environment. This means that the firm is immersed in its context and therefore its actions are significantly constrained and consequently it is not an entirely independent entity.

The network model of organisation–environment interface is based on the continuous exchange of relationships between a limited number of players (suppliers, competitors and

customer) that create a series of links. As such, the network is a series of relationships between different organisations that, by being connected to each other, are able to share their specific knowledge in a win-win perspective.

The theory of internationalisation in industrial systems using the network approach of Johanson & Mattsson (1988) is based on the fact that the firm is dependent on resources controlled by other firms.

The success of a firm is, therefore, dependent on its relationships with suppliers, distributors, clients, public organisms, etc., alongside other firms. Thus there is an interdependence between the firm and other firms, and several other actors, so it is implicit that firms are mutually benefitted within the network, and therefore the firm uses network contacts to leverage their competitive advantages as well as minimise its costs and risks when engaging with foreign markets (Johanson & Mattsson, 1988).

This means that, when knowledge can flow, the firm gets to know the community and the community gets to know the firm. This is an osmosis process that reflects the increasing importance of the firm to be able to deal with its external environment and all its stakeholders - market and non-market related - because they are, in fact, a central component of business management in the XXI century.

Three basic types of knowledge are needed by firms within this process, according to Eriksson *et al.* (1997): *internationalisation knowledge*, *foreign institutional knowledge* and *foreign business knowledge*, the latter strongly related to the firm internationalisation knowledge, which concerns the understanding of foreign competition, distribution channels, business contacts, customer's needs and sales developments.

In line with network approach research Johanson & Vahlne (2009) revisited their original concept shifting their focus from the market view (Johanson & Vahlne, 1990), to the network view. Thus all aspects related to knowledge, learning, creating, trust and commitment building are now developed in this most recent view.

The authors now claim two main arguments based on the business network view: first, the existence of *liability of outsidership*, stating that markets are relationship networks in which businesses are linked to each other, and as such *insidership* in relevant networks is a precondition to successful internationalization; second, that relationships provide learning,

alongside trust building and commitment, which are indispensable requirements for internationalisation conquests (Johanson & Vahlne, 2009).

In brief, according to the revisited Uppsala Model of Johanson & Vahlne (2009), the contemporary business environment is made up of networks, so it is fundamental for firms to approach the business environment with this new perspective, so the liability is no longer of foreignness but of outsidership, *i.e.*, of not belonging to the network.

According to Schweizer *et al.* (2010) the decision maker, entrepreneur, faces *Knightian uncertainty*, *Marchian goal ambiguity* and *Weickian enactment*, therefore there is a need for the firm be intertwined in a network of relationships, in order to manage all these factors. This is done by engaging in exchange processes, the basis being experiential learning, and in doing so sharing resources, increasing commitments, building trust, etc., in order to reduce its risks and leverage its opportunities, in this case, by becoming international. Basically, *what happens happens in relationships*.

### ***Corporate diplomacy***

However it was only with the research carried out at the turn of the century by Saner *et al.* (2000) and Steger (2003) amongst others, who brought new breath into the subject, portraying initial corporate diplomacy, in title of his work, as a *core competency for global companies* and the final corporate diplomacy as *the strategy for a volatile, fragmented business environment*.

Saner *et al.* (2000) state that for international businesses to improve their effectiveness they should develop their own form of diplomacy, as an integrated function inside the organisation.

Corporate diplomacy management is imperative to deal with foreign country expectations, multiple pressure groups and international conflict demand, thus the need to link core businesses and the demanding political environment in which firms operate (Saner *et al.*, 2000).

Therefore Saner and Yiu (2005) describe corporate diplomacy as the management of interfaces between international corporations and their multiple business (clients, investors, employees, unions, etc.) and non-business counterparts (civil society organizations, media, political parties, governments, NGOs, etc.).

Hence corporate diplomacy is a nuclear skill in order to prevent confrontations (Steger, 2003) that will inevitably originate unpredictable losses at multiple levels for the company, as well as ensure a sustainable and long-term favourable external environment in each country where the multinational corporations do business.

In light of the above Steger (2003) characterises a setting where companies operate with *goldfish bowl transparency* where perception is reality and if there is trouble, wherever in the world they operate, this can have a global impact on the entire organization.

Nowadays international businesses need a *licence-to-operate* that is dependent on corporate diplomacy (Steger, 2003).

Steger's more recent research, amongst others (Amann *et al.*, 2007), describes corporate diplomacy as "the attempt to manage the business environment systematically and professionally, to ensure that business is done smoothly, with an unquestioned license to operate and an interaction that leads to mutual adaptation between corporations and society in a sense of coevolution" (p. 34).

Führ & Paixão (2009) portray corporate diplomacy as a process of permanent interaction of the corporation with its external environment pursuing their interests, its main focus being the internationalisation process, through the increasing engagement with foreign markets. The difference between corporate diplomacy and corporate social responsibility is clear. The former's main goal being to advance the business interests of the corporation abroad (viewed as a strategic management tool), and the latter's to apply social, environmental, ethical human rights into the business's operations (viewed as citizenship responsibility).

In this context corporate foreign policy is viewed as a business strategy to manage international stakeholders (Sarfati, 2009), and should be addressed from four basic angles (Sarfati, 2007): market, government, society and information, all of which affect the value chain of the corporation, regarding both primary (*e.g.*, marketing and operations) and support activities (*e.g.*, human resources and infrastructures).

In conclusion, international corporations can no longer rely only on market dimensions, they need to incorporate non-market elements into their overall strategy in order to be able to address the multiple actors that constitute the environment in which they operate and that increasingly affect their performance. Thus the need arises for their own form of diplomacy in

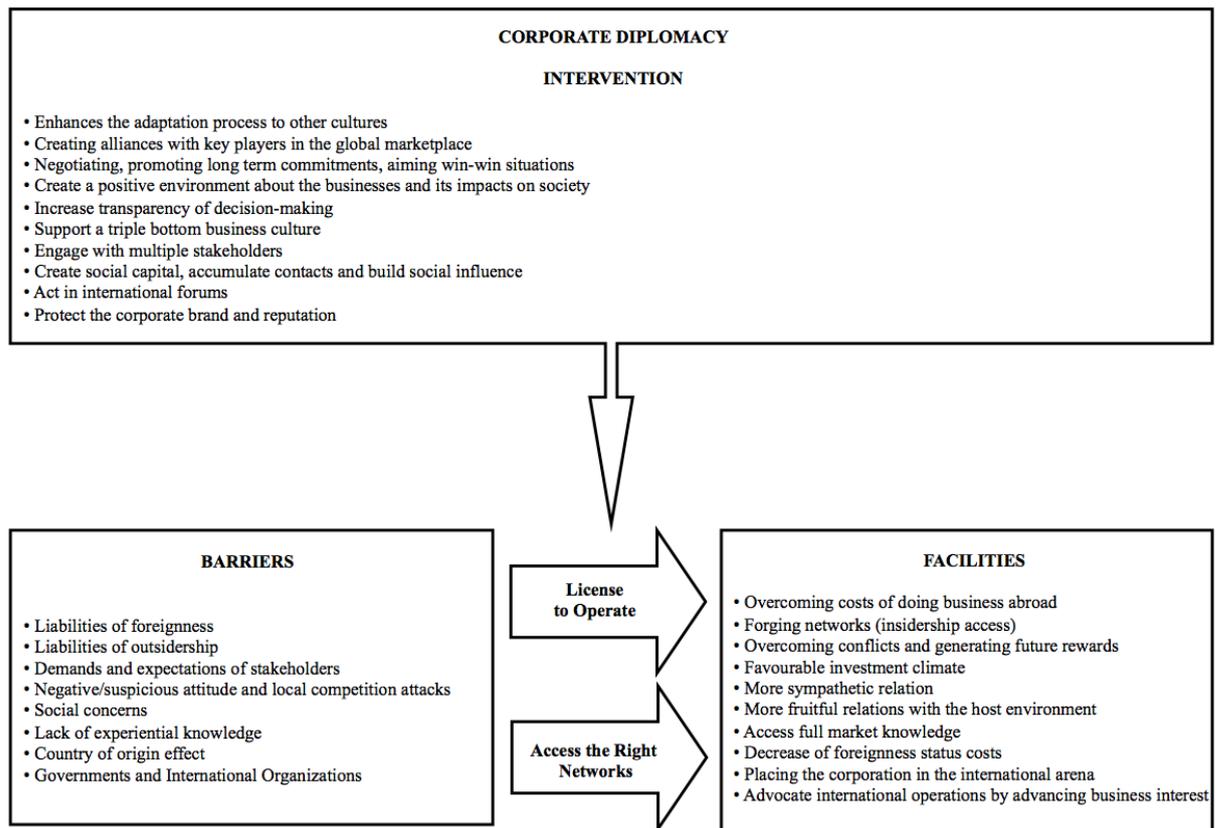
order to manage and overcome the new challenges of doing business in the global marketplace.

*International business constraints vis-à-vis corporate diplomacy*

Internationalisation can bring benefits to enterprises, but simultaneously generates disadvantages *vis-à-vis* indigenous firms, in the words of Hymer (1960), *costs of doing business abroad*, followed by Zaheer (1995) *liability of foreignness*, *i.e.*, that local firms have more and better access to market information, are more rooted in the local environment and do not face foreign exchange risks, so there is a need to overcome them.

When engaging with foreign markets, in addition to *liability of foreignness*, firms also face *liability of outsidership*. In other words by considering the business environment as networks of relationships there is a need to be within those networks in order to access the knowledge of the foreign environment that the network compiles and shares, and in doing so be more equipped to overcome international business constraints.

Nonetheless changes in the business environment and advances in the theoretical framework of internationalisation models, the evolution from firm view to industry view and more recently to an holistic view which includes the entrepreneur (Johanson & Wiedersheim-Paul, 1975; Johanson & Vahlne, 1977, 1990 e 2009; Johanson & Mattsson, 1988; Håkansson & Snehota, 1989; Hadley & Wilson, 2003; Schweizer *et al.*, 2010), together with business practices associated to the internationalisation processes, one constant remains, which is the need to cope with the foreign environment.



Today goes further beyond market-related interactions (customers, suppliers, competitors, etc.), and is increasingly more concerned with non-market interactions (local communities, pressure groups, trade associations, media, etc.), which indicates the need for a greater emphasis on relationships where corporate diplomacy can play a major role in helping companies overcome the identified international businesses constraints.

As you can see in Figure 1, corporate diplomacy focuses on the barriers (ex: country of origin effect, demands and expectations of stakeholders, social concerns, etc.) that firms face when engaging with foreign markets through the use of different tools that can help them overcome the intrinsic international business constraints of doing business abroad.

## METHODOLOGICAL CONSIDERATIONS

However the related literature review and several concepts regarding the subject are not suitable to achieve the goals purposed by this paper. Hence there is the need for an exploratory study using a qualitative methodology, through a case study, in order to comprehend and explain the complex social process that is corporate diplomacy.

Therefore the primary source of information was a semi-structured personal interview (Rebelo, 2013), in the form of a non-intrusive questionnaire. The aim of which was to obtain information about the relevance of corporate diplomacy in the international business environment where the business operates, alongside corporate reports, media information, etc., in order to extend the data available, and consequently triangulating, which ensures the quality of the data and all the information. It's all about the case that best helps to understand the problem and the research question framed and that aims to raise questions and opinions of the participants (Creswell, 2010).

This tool enables the gathering of rich empirical data when the phenomena studied is not a standardized practice that can be evaluated by a given number of pre-established variables. Thus it aims to promote a narrative regarding the subject (Eisenhardt & Graebner, 2007), becoming a relatively spontaneous lecture, an expression of what the subject lived, in relation to something (Bardin, 2009).

One of the features of qualitative research is that it allows and is the best way to examine a real-life context, especially when the boundaries between phenomenon and context are not yet clear. Here the data collected should not be recorded in a narrative-writing approach but in a note-taking approach, *i.e.*, should be organised around the central subjects with data elements and not in random narratives (Yin, 1981).

The two main reasons for selecting this firm were, firstly, the basic condition of being international, and secondly, due to its sector, pharmaceutical, following one of the few empirical studies related to this field - Saner and Yiu (2005) about the largest Swiss Pharmaceutical and Agro-Industrial companies (ex: Roche and Novartis) - given the potential wide range of multiple stakeholders and thus the benefits of the practice of corporate diplomacy.

The connections that could be perceived, given the sector in case, where to: governments (national and foreign), governmental bodies (ex: health ministers, patent registration), regulators (ex: drug administration's), networks (corporate and institutional), international agencies (ex: World Health Organization), non-governmental organizations (ex: consumer rights), activists (ex: regarding test protocols), etc.

## **CASE STUDY - BLUEPHARMA**

Bluepharma is located in the city of Coimbra (Portugal), and started activity in 2001. It began following the acquisition, by a group of professionals connected to the sector, of a former industrial unity belonging to the German multinational Bayer, after the decision to close its operations in Portugal. At the time the unit was responsible for the production of aspirin (Bluepharma, 2013).

Coimbra is very important to Bluepharma as it is also home to the University of Coimbra (with more than 7 centuries of history). The University represents a strategic asset to the company due to its source of knowledge (ex: research centres) and the capability to educate highly qualified professionals related to the area (Bluepharma, 2013).

Bluepharma's mission consists in offering high quality pharmaceutical products at competitive prices, to improve the quality of life of the population alongside diminishing the external deficit of the country in this sector (Bluepharma, 2013)

The company's has 3 main business areas: producing pharmaceutical drugs for their own and other companies, research and development alongside registration of pharmaceutical drugs and marketing of generic pharmaceuticals (Bluepharma, 2013).

Bluepharma's work has been increasingly acknowledged at an international level with multiple awards (ex: INSEAD Entrepreneurship Award for 2011/2012) and recognitions (ex: FDA approval in 2009) (Bluepharma, 2013), which explains its growing international presence, covering all world continents, opening this year its first branch in Mozambique (Santos, 2012).

To date it deals with 30 countries, chiefly in Europe, United States of America, Southeast Asia and Latin America, with foreign markets representing approximately 70% of its total sales, with around 60 products currently on the shelf (Rebelo, 2012b).

Following the research conducted, the main players in the Bluepharma's stakeholders universe were identified, both at an internal (national) and external level (foreign). At an internal level were the networks, governmental bodies and the community. The first related to their business strategy, the second to their sector and the third to their origin/location. At an external level was the perception of the country, by international players, of the sector's capability - beyond the existent industry *per se* (production) - of in-house resources regarding technology, knowledge and human resources.

At an external level the international business constraints faced by Bluepharma were related to the foreign perception of the country's abilities regarding the pharmaceutical sector as a whole, beyond the production capability, regarding three main pillars: technology, knowledge and human resources.

One can consider three vectors in this process of engagement with international markets: presence in international forums (ex: international specialised trade fairs), communicating (ex: publishing newsletters) and operating through the group sector (ex: cluster dynamic), where the key bottom-line is to be obtain a reputation following the work that was accomplished throughout the years.

By covering all these angles the firm was able to, among other things:

- forge networks (insidership access), therefore overcoming liabilities of outsidership;
- reverse the country of origin effect (foreign perception), opening new windows of opportunities besides *production per se* (ex: R&D projects);
- create alliances with key players in the global marketplace, and thus access key market knowledge (marketing intelligence), effective experiential knowledge and promote long-term commitments aiming for win-win solutions;
- strengthen the corporate brand, aiming to gain increasing international recognition for their entire range of expertise (eg.: registration of pharmaceutical drugs), alongside overcoming suspicious and negative attitudes due to being a newcomer in the international marketplace;
- become a player in the international arena, by participating in international organisations and forums, advocating their business interests.

At an internal level, it is very clear that networks lie at the heart of its business strategy and development through, among others institutional (eg.: University of Coimbra) and corporate associations (eg.: COTEC, Portugal Ventures). In the words of Bluepharma founder and CEO, Paulo Barradas, today's success does not lie in the secrecy but in sharing Rebelo, 2012a).

Another form of network also indentified, and very important to ensure continuous innovation, crucial to the business' survival, is through the creation of new international business ventures, that mainly originate academic spin-offs (ex: Luzitin), by providing capital and know-how to them. Despite being small enterprises they have strong potential due to the

fact that they are highly knowledge intensive their main goal being to break new frontiers in the field that could have global market potential.

The second national stakeholder identified was governmental bodies, namely AICEP (Portugal Global - Trade & Investment Agency), the main goals of which are to capture foreign investment and promote companies abroad in their internationalisation processes or export activities. This is carried out namely through participation in state trade missions (which involves another group of stakeholders, government, usually foreign/economic Ministers alongside the Prime-Minister and the President), participation in international fairs and by providing marketing intelligence about foreign markets (AICEP, 2013).

Regarding this actor, the involvement of Bluepahrma can be considered exhaustive, with participation in regular initiatives abroad promoting the sector in case. This is highly regarded by the organisation, due to involvement of a board member, responsible for internationalisation processes, supported by a specific division of the firm for this purpose: business development.

This enables the organisation to be in the front line of the efforts to promote the national economy, and in this case, the pharmaceutical sector in particular, by promoting private businesses in overseas markets (ex: Venezuela, in 2009, alongside other firms, headed by the Prime-Minister). As can be seen clearly there is a positive endgame as the success of the corporations will have a positive impact on the country's economy (ex: through more taxes, diminishing the trade balance deficit by increasing exports, etc.).

The third internal stakeholder identified was the community, and the reason for that lies in the origin of Bluepharma, Bayer's decision to close down its operations in Portugal. In doing so it would strongly impact three areas: employment, knowledge and market accessibility.

Regarding employment, it was possible to keep the operation firstly then to increase it after a few years, thus preventing hundreds of skilled labourers from losing their jobs. This is especially significant in a country that has witnessed their industrial base being wiped out in recent years, as the globalisation of production has provided a cheaper and skilled work force in other parts of the world.

Concerning knowledge, it was possible to build a bridge between the academic (University of Coimbra) and the economy (Bluepharma), by taking advantage of all the investment made in highly skilled labour (ex: pharmacists, researchers, etc.). Therefore it was able to leverage all

those assets, and not lose them through, for example, emigration processes, *i.e.*, brain drain, a negative force that also affects the country's economy and development.

In relation to market accessibility, the fact that in-country-production of drugs, and namely of generics, was possible became a strategic guideline of Bluepharma. Through price it was able to provide wider access to medicines, and therefore benefit the community as a whole, especially in a market where price has increasingly been a crucial factor in the population's access to health care in recent years, due to the economic downturn, alongside the effect of the aging population, especially in the western hemisphere.

Given the sector in case (pharmaceutical), the importance of the stakeholder *government* is crucial. They define the rules of the game within the marketplace (heavily regulated), where a single comma in a decree can make or break a market, as acknowledged by the CEO of Bluepharma (source), hence the perceived strong relations of this specific player.

Consequently, in order to avoid being viewed as lobbying or positive discrimination, there was a clear and strong detachment of any kind of relation in this context, and even tough criticisms of businesses that rely on government and government officials in order to prevail in the marketplace.

That said and acknowledged, it's clear however that all those in this sector need to have strong, good and continued links to this specific stakeholder. Despite not being in the value chain of the business, it has a very strong impact in the performance of the organisation - regardless of the intrinsic competitive advantages of the firm, *i.e.*, price, quality and capability to address market demand that must exist upstream - and thus the importance of the practice of corporate diplomacy, not as a *bottom-line* management tool but as a *support* management tool.

## CONCLUSION

Nevertheless the main finding, that undoubtedly stands out within the research conducted, *i.e.*, the identification and importance of the main stakeholders of the firm (networks, governmental bodies and the community, alongside government), was the reaction to the concept, and above all, the praxis of corporate diplomacy, and by default the acknowledgment of the importance of the multiple stakeholders in the operations/results of the firm. It was, at first, very much defensive.

The perspective, of this reaction, was one of recognition of the existence and importance of engaging with all the various stakeholders, however that this is not the core of the firm's strategy and much less the reason for the success of the business. This is due to its internal competences (in the case in question stated as strong leadership, response to market needs, competitiveness and quality), viewing thus corporate diplomacy as a way to enhance these sustainable competitive advantages and never as a way to build upon them.

That said, there is a significant need, in the case in question, for the firm to clearly detach itself, in a first approach, from the relevance/impact of stakeholders, specially the non-market related, because the corporations image could be viewed very negatively in two distinctive ways: firstly, that the firm relies on the ability to engage with stakeholders (eg.: governments), which in turn enables it to make business; secondly: that the firm is affected by the action of stakeholders, that they interfere in their operations and subsequently in their results, *i.e.*, that the firm is dependent on external actors.

It is clear, in our view, that in reality all firms promote engagement with multiple stakeholders, that have more or less impact in the organisation's life, from governments (ex: law making) to the media (ex: good press). This assumption must be, on the one hand naturally acknowledged, following the 21<sup>st</sup> century intricate economic international environment, and on the other hand, be addressed professionally, *i.e.*, through the praxis of corporate diplomacy as an management skill, among many others, that integrated into the corporation's strategy enables it to be more efficient in achieving its goals.

The practice of corporate diplomacy clearly implies that there is a business, and that the business has core competences that enable it to be a player in the global marketplace. Thus the praxis of corporate diplomacy must be viewed as one, among others, management competence that an international corporation must possess in order to achieve, more efficiently, its full potential in the global economy, by engaging with all multiple stakeholders, market and, increasingly, non-market related, that have the potential to affect the organization bottom-line, in open and transparent relations. It is more damaging to try to minimise this context than by acknowledging it

As this a single case study, no inferences can be drawn from it, so there's a need to address several cases over several sectors, supported by a confirmatory study.

However more than derive generalisations, various viewpoints for analysis and a first analysis network relating 2 theories, that until now had remained separate, arise. (corporate

diplomacy vs international business constraints). Thus corporate diplomacy can be understood to be a very useful tool for companies to overcome certain obstacles in the internationalisation process. This is the main development that needs to be looked into deeper, in the future.

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## THE MANAGING AND STAGING OF FOOTBALL MATCHES IN THE ENGLISH PROFESSIONAL FOOTBALL INDUSTRY: AN EVENT LIFECYCLE APPROACH

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### ABSTRACT

Purpose: Although the English professional football industry has attracted considerable academic interest in relation to the tragedies and disasters which occurred at matches during the twentieth century, the bulk of this work has focused on the historical, social and economic factors which contributed to these events. As result a clear and coherent picture of the current state of event management practices in the industry is underdeveloped. This represents an important lacunae not least because of the identified health and safety issues but also for the effective and efficient development of the professional nature of English professional football. Such a model will be valuable for a range of stakeholders: stadium managers, security stewards, police authorities and not least fans and players. This paper aims to produce a clearer understanding of football match event management practices by developing and applying a Football Match Event Lifecycle Model.

Design/methodology/approach: This paper adopts an interpretivistic approach to generate primary field data which complements secondary data drawn from relevant literatures to produce and develop a Football Match Event Lifecycle Model. Primary data gathered from semi-structured interviews and non-participant observation is used to develop the model.

Findings: The results indicate that the Football Match Event Lifecycle Model is a potentially useful model and provides a valuable insight into the key processes involved in staging football matches. Moreover, it is an effective evaluative framework to explore and assess contemporary football event management issues.

Originality: This paper initiates the process of addressing an under-developed area in football event management. It develops a football event lifecycle model which

explores the processes and issues involved in the staging of English professional football matches.

**Keywords:** events management, football match event lifecycle model, planning, organizing, controlling, monitoring, evaluation, feedback and leadership

## INTRODUCTION

A substantial amount of the work relating to the staging of English professional football matches focuses upon the dramatic, tragic and poignant disasters that occurred in the industry during the twentieth century. During this period thousands of supporters were injured and over 270 people died in stadium disasters in Britain (Inglis, 1987; Johnes, 2004; Walker, 2005; Smith and Elliott, 2006). The response of key stakeholders, governments, governing bodies, football clubs and supporters, was one of slow progress and relative inaction and consequently the staging of football matches remained unchanged for much of the twentieth century. As a consequence, event management practices were severely underdeveloped. A point emphasized by Gratton and Henry (2001: 67) who, when analysing the Hillsborough tragedy, described it as ‘...a failure in the stadium event system.’ Given this observation it is surprising that scholarly activity in this area has not generated a comprehensive insight into the management practices required before, after and during the staging of a football match. At best works have produced only a fragmented picture.

In summary, although particular stadium management issues have attracted considerable academic interest, works have been focused upon the tragedies which befell the industry during the twentieth century. Analysis of the historical, social and economic factors which contributed to these events has been extensive; however, a clear and coherent picture of the current state of event management practices in the English professional football industry is missing. This paper aims to clarify the current state of football match event management practices by firstly developing, and then applying, a Football Match Event Lifecycle Model. The intention is to respond to an undeveloped space in football event management literature. The argument below aims to explore and contextualise materials that will work to provide information for a range of officials involved in the planning and managing football events.

## LITERATURE REVIEW

The literature pertaining to the staging of football matches is dominated by accounts of the crises and disasters that occurred during the twentieth century. However, it was the tragic deaths of ninety-six Liverpool supporters in 1989 at the Hillsborough Stadium, and the subsequent Taylor Report, that acted as a catalyst for change. The requirement for all-seated accommodation in the top two divisions resulted in a large scale programme of building works (Elliott *et al.* 1999:20-21). Money diverted from the levy on the football pools was made available to the Football Trust, which in turn channelled the funds to clubs to facilitate stadium redevelopment (Ford and Heatley, 1994: 21). Johnes (2004: 144) estimated that over the period 1990-97 the rebuilding of football stadia in England, Wales and Scotland cost £500 million, £150 million of which was provided by the Football Trust.

Despite significant tangible evidence of change, Elliott and Smith (1999: 101) advise caution when attempting to assess the full extent to which clubs had progressed. They explored safety issues and crowd management in the early post-Taylor period and concluded that ‘...the football industry in the UK has learnt little from the disasters that occurred during the latter part of the 1980s and beyond.’ Here the inference is that football clubs have continued to miss opportunities to develop their event management practices. This is an interesting, if not contentious, comment given that since the recommendations of Taylor Report were implemented the English football industry has not witnessed any form of disaster approaching the scale of Hillsborough. Clearly, this could be due to good fortune; however, because a coherent picture of the true state of event management practices within the industry is lacking Elliott and Smith’s claim cannot be accurately assessed. Before moving on to explore contemporary event management practices it is necessary to briefly consider key aspects of the event management literature.

### *Event Management Literature*

Although the practice of sport event management dates back to the ancient civilisations of Egypt, Greece and Rome, progress towards establishing the activity as a fully-fledged management function has been very slow (Elliot and Smith, 1993; Korstanje, 2009). Consequently the planning and implementation of events draws upon other, more well established management disciplines (see Masterman 2004; and Van Der Wagen 2007; Bowdin *et al.* 2010). In the remainder of this section the key contributions of Project Management, Service Operations Management and Logistics Management are considered.

### *Project Management*

The field of project management has begun to emerge as an effective contributor to the management of events. This is emphasised by Van Der Wagen (2007: 193) who suggests that as events management matures it is increasingly adopting sophisticated project management techniques. Likewise, Emery (2003: 277) suggests that ‘...events management draws heavily upon the more well-developed discipline of project management’. Wild (2002: 257) explores this point further and argues that it is perhaps to be anticipated that there is a resonance between event and project management because ‘An event is a project, since it is a finite activity in terms of the time spent in its duration and in the use of resources.’

According to O’Toole and Mikolaitis (2002:23) adopting a project management perspective when staging an event is advantageous because it offers a systematic approach that makes the management of the event explicit and encourages stakeholder accountability. However, on a more cautionary note, Bowdin *et al.* (2010: 285) argue that, traditionally, project management techniques are dependent upon clearly defined, stable environments and consequently they may be unsuitable for some types of events where there is a high degree of uncertainty and complexity (e.g. festivals). To remedy this problem they advocate avoiding management inertia by having a flexible project management approach with limited procedures and formality.

Emery (2003:277-79) also recognises the unique challenges posed by events management. His work focuses on sports events and he emphasises that in this context event management ‘...can be clearly viewed as a specialist type of project management, albeit a particularly complex one.’ Emery synthesised his observations into the Life-Cycle Events Model shown in Figure 1.



processes of planning, organising, leading and evaluation. Clearly, Emery's framework has value in describing and analysing the life-cycle which a 'one off' event passes through over time. However, in the context of staging a football match the model has elements which are of little or no relevance. For example, for a football match the Pre-Event stage would not include the 'ideas and feasibility' and the 'bidding process' elements. A further weakness of the model is that it does not adequately capture the importance that feedback has in informing all phases of the next match. In essence, Emery's model does not capture the repetition involved in the process and does not emphasise the importance of feedback.

#### *Service Operations Management*

From the Service Operations Management perspective the event organisation is seen as a system that transforms inputs (i.e. resources) into an output (i.e. the event) (Tum *et al.* 2006: 19). Organisational success is directly linked to the efficiency and effectiveness of the transformation process (Yeomen *et al.* 2004: 28). In keeping with this approach Slack *et al.* (2009: 27) suggest that resources can be classified as either transformed resources or transforming resources. The former are the resources that are treated or converted in some way and the latter are the facilities (buildings, equipment, plant and technology) and staff (operatives, supervisors and managers) who maintain the operation.

In the context of football, clubs use transforming resources, such as the stadium and players, to produce an output, the match, and as a consequence of this process the emotions (i.e. physiological aspects) of supporters are changed. The aim of the football club is to utilise transforming resources to deliver the event experience in the most effective and efficient way possible.

#### *Logistics Management*

Some theorists advocate adopting a logistics approach when planning and staging events. For example, Bowdin *et al.* (2010: 353), highlight that logistics has become a specialised area in mainstream management studies and that the discipline has a valuable contribution to make to the practice of events management. They go on to emphasise the complexity of staging an event and argue that the traditional approach to logistics management requires adaptation when applied in an event management context. Viewed from this perspective the organisation delivering the event is responsible for supplying the customer (i.e. engaging in effective marketing, providing tickets, managing entry and exit to the venue etc), supplying

the product (i.e. ensuring that key staff – performers, players, officials – attend) and supplying the venue (i.e. ensuring that it is fit for purpose) (Bowdin *et al.* 2010: 359-60).

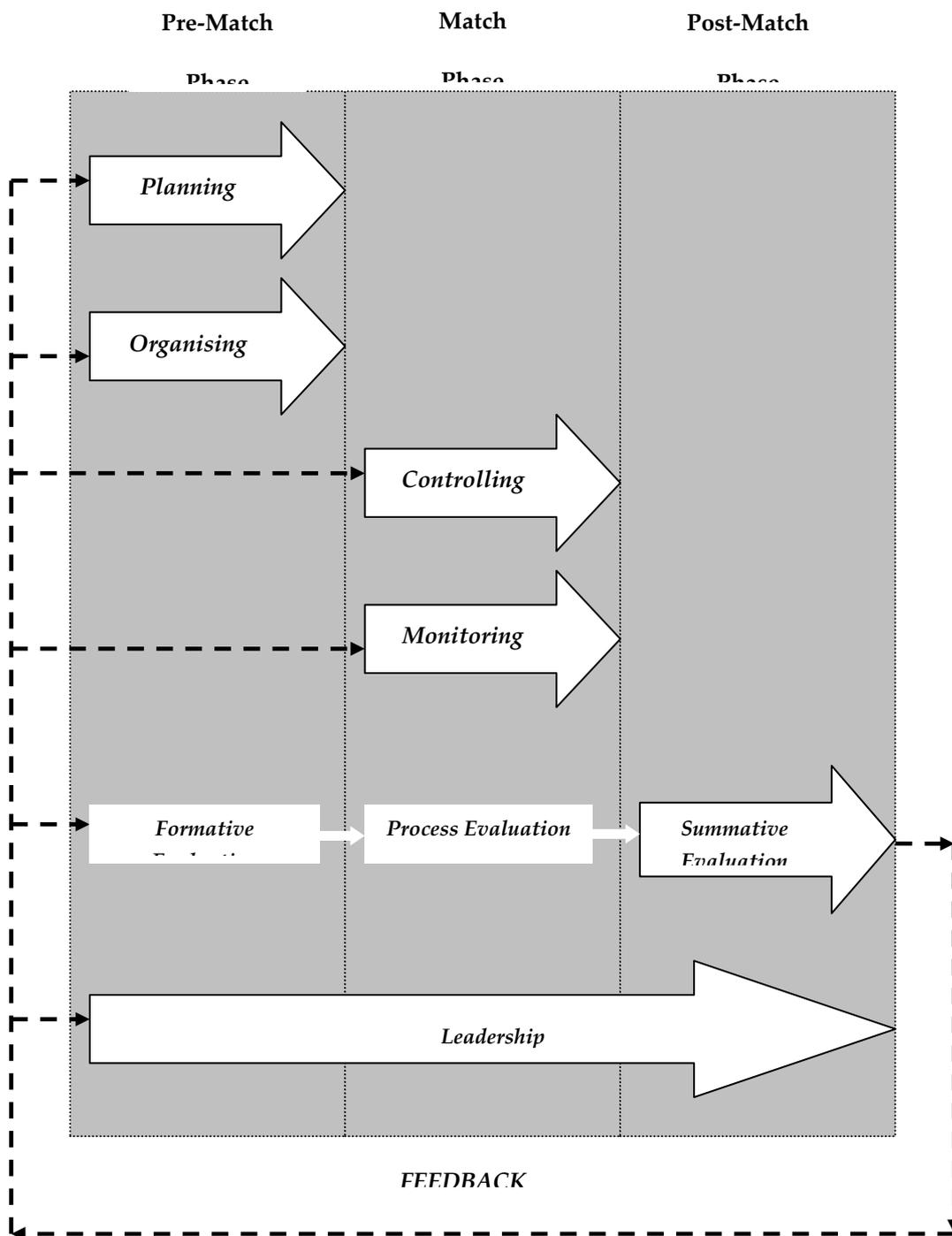
Westerbeek (2005: 196-97) concurs with this and goes on to comment that:

‘In the event management scenario this [the logistics approach] involves establishing coordinated systems, which ideally permit effective and efficient flows of people, information and other resources around the event venue...The ultimate aim must always be to create a safe secure environment for all..’

In summary, three perspectives on the management of events have been considered. From the project management perspective the event is seen to progress through a series of stages and key management activities are ascribed to each phase. The service operations approach emphasises that organisations are engaged in the transformation of inputs into outputs. In the context of sports events this involves using ‘transforming resources’, such as the stadium and players, to influence the emotions of supporters. The emphasis is on providing an experience. The logistics approach focuses upon the movement, or flow, of resources to, from and around the event venue. A key element of the approach is the management of safety and other forms of risk.

Although each approach has some value in helping to develop understanding of how a football match should be staged it is important to note that none of perspectives adequately capture the fundamental characteristic of staging an event of this type. Namely that a football match is both a single event and one of a series of very similar events for which standard procedures and processes can be put in place. In order to address this gap the remainder of this section draws upon these theoretical perspectives and synthesises them in order to develop a Football Match Event Lifecycle Model.

*Figure 2: The Football Match Event Lifecycle Model*



This model encompasses the key elements involved in staging a football match. It is valuable on two counts. Firstly, it clearly shows the interrelationship between the key management functions of pre-match, match and post-match operations. Secondly, because the model is depicted as a lifecycle which relies upon on-going evaluation and feedback, it emphasises that football matches are repeat events which provide clubs with an opportunity to refine and develop their event management operations. In the following sections the model is deconstructed and each phase is, and its associated management functions are, discussed.

### **Pre-Match Day Phase**

The key management activities that take place during this phase are planning and organising. The importance of these functions is highlighted by Van Der Wagen (2007: 181), who comments that '...planning and organisation are the key elements that determine the success of an event.'

#### *Planning*

A number of theorists emphasise that planning is the bedrock on which successful event management is established. For example, Emery (2003: 271) argues that '...planning pervades all aspects of event management'. Tum *et al.* (2006: 25) insist that

'Detailed planning must take place prior to the implementation of the event. No event should take place without planning. If plans are made in advance and communicated well, then the event will be effective and efficient in its delivery. The greater the amount of time taken at this stage the better the event will be.'

The notion that time is an important aspect of planning activity is also highlighted by Van Der Wagen (2007:196), who observes that 'The nature of the event business is that most of the time is spent in planning and very little is spent in the execution phase.' In order to meet the challenge of successfully delivering an event in a timely and efficient manner planning activity must result in the formulation of written plans. Such plans are evidenced in a number of areas.

For example, Bowdin *et al.* (2010: 376) advocate that operational plans, which incorporate contact lists, site maps, running orders, evaluation sheets and emergency plans should be produced and issued to all of those working at an event in the form of an Event Manual. In the case of the Emergency Plan they argue that that this should be compiled from major incident and disaster plans and that procedures, demarcation of duties and the allocation of responsibilities should be agreed in writing with all relevant parties (emergency services, venue managers etc.) during the planning stage. Tum *et al.* (2006: 160) also focus upon the need for effective contingency plans and emergency planning. They argue that these should be integrated plans of action that are communicated to all those involved in staging the event.

#### *Organising*

Watt (1992: 25) suggests that organising involves

'The activities to be accomplished towards achieving the end objectives; the gathering together of these activities into relevant structures; and allocating the achievement of objectives, through these activities, to the appropriate groups or individuals.'

Here organising is shown to be the activity that structures and coordinates organisational effort. It is inextricably linked to planning and is necessary if plans are to be implemented (Westerbeek, 2005: 34). However, given the importance of this activity it is surprising that, according to Torkildsen (2010: 479), many event organisations are deficient in their ability to organise. He comments

'Unfortunately with many event organisations, the structures are poor and without coordination. The result is that informal dealings flourish...misunderstandings and miscommunications abound leaving many parts of the planning process to flounder.'

### **Match Day Phase**

This is the implementation, or delivery, phase of the event. From a managerial perspective the focus here is monitoring and controlling the plans and organisational activity developed in the pre-match stage.

#### *Controlling*

Tum *et al.* (2006: 242) suggest that control is vital to successful events management because it '...keeps plans in line'. Cole and Kelly (2011: 225) directly link control to planning and organising. They comment

'If planning represented the route map for a journey, then organising represented the means by which one could arrive at the chosen destination. We can now add that controlling ensures that the travellers know how well they are progressing along the route, how correct their map is, and what deviations, if any, they need to make to stay on course.'

Cole and Kelly's comments offer an interesting perspective on the control of an event. The analogy that controlling is a vital part of progressing through a journey is congruent with the logistics approach to event management. Effective control is a vital element of this process. For instance control mechanisms, such as queue management systems and security procedures (e.g. accreditation passes for events staff to control access to sensitive areas of the event) are essential elements of an organisation's risk management strategy. Bowdin *et al.*

(2010: 298) also advocate a range of additional control methods, including reports and meeting, project status reports and delegation. Tum *et al.* (2006: 243) offer a similar perspective, but in keeping with Bowdin *et al.*'s advocacy of delegation, argue that events staff should be empowered so that '...control is exercised by each person at the lowest level possible' and consequently 'The event is then within the remit and authority of the staff responsible for it.'

### *Monitoring*

Closely allied to the activity of controlling is monitoring. Bowdin *et al.* (2010: 414) suggest that 'Monitoring is the process of tracking an event through the various stages of implementation.' Here the emphasis is on evaluating the progress of different aspects of the event in order to make corrections if planned objectives are not being met (Westerbeek, 2005: 36). For instance, in the context of a sports event, monitoring may take the form of tracking the progress of supporters to and from the venue. Use of modern technology, such as closed circuit television, enables event organisers to quickly identify potential problems that may hinder the movement of supporters (e.g. traffic congestion). Early detection facilitates the use of appropriate control mechanisms, such as contingency plans.

### **Post-Match Day Phase**

This phase begins after spectators have left the venue and clear away activities are completed. The primary focus of this stage of the lifecycle is effective evaluation. The Football Match Event Lifecycle Model shows that evaluation occurs at each stage of the event process; however, it is during the post-match phase that formative and process evaluation are synthesised with summative evaluation in order to generate feedback. This is then utilised to inform the staging of future events. Evaluation and feedback are very closely linked, consequently in this section both elements are considered together.

### *Evaluation and Feedback*

According to Tum *et al.* (2006: 239) 'Evaluation gives event organisers the opportunity to look back on what has happened during the event, correct all that may not have gone as planned and build on what went right.' In terms of the timing of evaluation Tum *et al.* (2006: 241) observe that '...it is most common for evaluation to occur after the event.' However, they go on to suggest that to be effective evaluation must encompass all aspects of the event. This is congruent with the view of Torkildsen (2010) who advocates ongoing evaluation which is

present at each phase of the event lifecycle. Getz (2012: 363) develops this further and suggests that event organisers should institute three types of evaluation. He suggests that during the pre-event stage formative evaluation should be used to inform the later phases of the event. During the implementation, or delivery stage, he advocates process evaluation. This is derived from the monitoring of activities during this phase. Finally, he emphasises that in the post-event phase summative evaluation is necessary in order to gain an understanding of the overall success, or otherwise, of the event. Indeed, Bowdin *et al.* (2010: 371) explain that an event is not over until summative evaluation is complete.

In order to engage in meaningful evaluation feedback has to be gleaned from key stakeholders throughout the lifecycle of the event (Masterman, 2004: 83). Moreover, Westerbeek (2005: 42) argues that those events organisations which regard themselves as being engaged in continuous improvement must interpret feedback constructively in order to progress and develop.

### *Leadership*

Leadership is the generic management activity that spans all phases of the model. In the context of events management effective leadership is regarded as being an essential success factor and involves integrating the needs of the individuals and teams operating within the organisation, with the specific requirements of the event (Westerbeek, 2005: 34; Bowdin *et al.* 2010: 34). Here the focus is upon developing a unity of purpose and ensuring that teams and individuals function effectively in order to achieve the tasks that make up the event lifecycle. The successful leader aims to achieve the best possible fit between available resources and the objectives of the event.

In summary, given the absence of a comprehensive evaluation of event management practices associated with staging contemporary football matches, extant event management, and associated, literature has been used to develop The Football Match Event Lifecycle Model. In the section following on from the Methodology the model is evaluated using primary data gathered from semi-structured interviews and non-participant observations.

## **METHODOLOGY**

The research adopted an interpretivistic approach that utilized in-depth semi-structured interviews and non-participant observation. Interview data were gathered from four senior

key informants working in the English professional football industry (two Stadium Managers, a Local Authority Licensing Official and the Managing Director of a Sport and Leisure Risk Management Company). The sample was small, in part, due to access issues. Gaining access within English senior professional football contexts is notoriously difficult. This is due to the celebrity aspect of contemporary football and the fact that clubs are solicited by many approaches and offers to engage with them in a range of ways. Clearly, this will have implications for the possibility of generalizing extensively from the findings. Therefore, the intention here is to provide a focal study that seeks to develop insights from an in-depth – in situation case-type study rather than a broad and widely encompassing survey.

Interviewing began in July 2007 and ended in June 2009. Interviews lasted between sixty and ninety minutes and were tape recorded and later transcribed. Once complete, transcripts were returned to interviewees for approval. A semi-structured interview approach was deemed to be the most appropriate method because it enabled contributors to ‘tell their own story’, thereby enabling the interviewer to gain a more comprehensive understanding of the participants’ ‘world’ (Bryman and Bell, 2011: 477; Barbour and Schostak, 2005: 42-44; Polonsky and Waller, 2010: 131; Easterby-Smith *et al.* 2008, 88; Gray, 2009: 373). To this end, only a small number of pre-prepared questions were used during this interview phase. Here the aim was to encourage participants to provide a rich picture and consequently it was important to adopt a highly flexible approach which allowed interviewees to digress if necessary. The need for this type of flexibility was emphasised by Polonsky and Waller (2010: 106). They commented that ‘The method chosen should match the degree of flexibility you require in terms of informational needs’ and went on to explain that in ‘...exploratory research, you may need a method that provides room for respondents to give answers that the researcher may not have anticipated.’

Non-participant observation was undertaken in two English Championship football clubs: Club A and Club B. Observations conducted at Club A took place on an annual basis over a period of three years. On each occasion the researcher was given access to the key business functions of the club and consequently was able to develop a comprehensive understanding of how the organisation operated. Additionally, by working closely with the Chief Executive he was able to develop a valuable insight into managerial, cultural and structural aspects of the club.

Observations were organised differently at Club B. Here the researcher was able to shadow the club’s Stadium Manager over a six-hour period on a match day. This again provided a

valuable insight into the operations and activities of a football club. Shadowing enabled the researcher to observe a practitioner operating a 'real' world situation.

According to Saunders *et al.* (2009: 290) observation enables the researcher to attempt '...to get to the root of 'what is going on' in a wide range of social settings.' However, they argue that there are three inherent problems associated with this approach: subject error, time error and observer error. Subject error involves observing subjects who are not typical examples of the phenomena under investigation. In both clubs the potential for this error this was reduced by selecting subjects who are established practitioners in their areas of operation. For example, Club B's Stadium Manager was an experienced member of staff who had been in post for a number of years. In terms of time error, the risk here is that observations take place at an untypical time which does not provide a valid picture of the phenomena under investigation. Here again, the risk of this occurring was negated by observing stadium management on the day of a 'routine' game. Observer effects occur when the behaviour of the subject is influenced by the presence of the observer. Here the advice to the observer is 'to melt into the background' and thereby have as little involvement with the subject as possible. This was heeded and as a result, for instance, during the shadowing exercise in Club B the researcher resisted the impulse to ask questions, avoided eye contact with the subject and when sitting in the Control Room ensured that he was positioned as discreetly as possible.

The interview transcripts and the notes generated from observations were analysed through intensive reading and rereading in order to allow prevalent themes, issues and phraseology to crystallise. This process, combined with the overall approach to the research, acknowledged and embraced issues of reflexivity in the research recognising the relation and impact of the researcher on the researched and vice-versa.

## **RESULTS & DISCUSSION**

This section synthesizes The Football Match Event Lifecycle Model with primary data. Here the constituent parts of the pre-match, match and post-match phases outlined above are used to evaluate the data.

### **Pre-Match Day Phase**

#### *Planning*

Interviewee A (2007), a Stadium Manager at a Championship club, indicated that pre-match planning was an important activity. He explained that several planning meetings take place in the week prior to a match. He related that

'We've got a match tomorrow (Saturday) against Stoke and we had a briefing meeting last Thursday with the police. The police ask "What particular unique occurrences are happening at this game, as far as the club is concerned?" and I brief them. For instance, fans from other clubs may be travelling through or near to our city. On occasions, you may get supporters from neighbouring clubs who may want to try and converge around the ground. So, it's quite vital really for us to know what likely problems may occur on any particular day, and that meeting covers all that.'

Interviewee A also outlined the detailed planning that takes place forty eight hours before a game. At this time he conducts a 'Preview Meeting'. This involves bringing together the commercial and catering departments, the club's security company and club's Press Officer in order to '....prepare everybody for what they might expect and it has the effect of raising the 'ante' a little bit – to get the adrenalin running a little bit better – it is a good way to prepare.' Here the focus is clearly upon briefing the key departments, and staff, within the club in order to guard against complacency and to ensure that all parties are prepared effectively. Again, this indicates that planning is comprehensive and is based upon effective communication. Interviewee B (2009), a Local Authority Licensing Officer, corroborated Interviewee A's comment that a preview meeting was an important part of the planning process. He also mentioned the importance of contingency planning. He commented that 'Clubs have contingency plans, they have a format for dealing with potential problems, for example power cuts etc.' Interviewee A (2007) also explained that contingency planning was an important aspect of his role. He related that the club employs a Deputy Safety Officer on a part-time basis. The individual is fully trained and works with Interviewee A on a match day. In the event of him not being able to perform his role (e.g. because of sickness) his deputy can step in and take over.

### *Organising*

Interviewee A (2007) and Interviewee C (2007), Stadium Manager of a Premier League club, both emphasised that organising the resources of their respective clubs was an essential, time consuming and challenging activity. Interviewee A (2007) explained that his role required him to be involved in organising activities that spanned the entire structure of the football

club. He outlined how one of his duties was to organise the on-going maintenance of the stadium and explained that he had to organise not only the repair of broken items, such as terrace seating and sanitary ware in the toilets, but also the cleaning and tidying of the stadium. In order to further explain the span of his organisational responsibilities Interviewee A (2007) went on to outline how he also has to organise the briefing of stewards on a match day. He commented

‘I brief the Steward Supervisors, who in turn cascade information to their teams. We have 250 or so stewards so it is quite a big operation. I meet the Supervisors at 12.40pm when we have a 3 o’clock kick off. I tell them what I have learned from the police and I outline any potential issues that they may need to be aware of.’

The breadth of Interviewee A (2007) responsibilities was further demonstrated when he explained how he was responsible for organising the safe passage of players to and from the car park. He said ‘The protection of players has become an issue over the last couple of games. I have had to change where they park and organise bringing them in through a new gate.’

Interviewee C (2007) explained how his organisational skills are challenged by the unique environment in which he operates. He commented

‘We are forever working to deadlines. So whereas your deadlines in an office block may slip by a week and it’s annoying, but not desperate. If we slip by a week – we don’t open the stadium and it gets noticed! The problem with football is that quite often how you start is how you carry on all the way through.’

This comment is interesting because it emphasises the need for clubs to have effective systems in place at the beginning of the season. Since procedures are repeated fortnightly, and opportunities to make alterations are limited, it is important that procedures are ‘fit for purpose’.

### **Match Day Phase**

#### *Controlling*

Interviewee A (2007) offered a valuable insight into control at a football match. He said

‘Since Hillsborough, the responsibility for safety in a football ground is that of the club. The police work in partnership to support the club, but the only time that they

will take decisions is if an incident occurs inside the ground and they believe that they need to take full control. Then they will formally do so - a note will be made on the log and control will be handed over.'

The log is a 'live' document that is created during the pre-match phase and then updated during the match and post-match phases. Key incidents are recorded and the account is used to inform the writing of post-match reports and is also retained for use in the event of litigation and other legal proceedings.

During the match Interviewee A is located in the Control Room. He explained that, aided by technology (i.e. CCTV, radio communication etc), he '...runs match day from this room...' For example, he can speak directly to all stewards via a radio link and he can control the flow of spectators into the ground.

He explained that 'There are all sorts of things impacting upon safety now, and a lot of it is about getting greater control of spectators.' He outlined how the club had recently replaced their turnstiles with a 'smart card' system. He went on to say that this facilitates the control of spectators in number of ways. Firstly, in terms of flow, if a part of the stadium is reaching capacity the system warns operators in the control room and entrances can be quickly closed. He said

'I can look at the main Stand and know precisely how many people have come in at any time. For instance, if we did have a forged ticket problem, it might not be apparent until all of a sudden that screen was flashing at me - it starts to flash at 90 per cent and then becomes more intense if it's getting up to 97 or 98 per cent. I would look outside using the CCTV and if there were massive queues I would say to operator "Shut the entrance, there's something wrong!" - The last thing we would want is the Hillsborough situation where we've got more spectators in the stand than we should have.'

A second aspect of control is the use of a smart card system which can be used to prevent banned spectators from entering the stadium. Interviewee A (2007) commented

'If someone stands up and starts making racist comments or swearing or throwing punches we can make decisions ...if we suspend him all I have to do is deactivate his card. That's the power and control that you've got over spectators, and if you want to keep the place safe then that's absolutely vital.'

The extent of control was further illustrated during the non-participation observation conducted at Club B. On arrival the researcher was issued with an accreditation pass and was instructed to wear it at all times. This was signed personally by the Stadium Manager and enabled access to all areas. The researcher was assured that without this pass he would not be allowed to move freely around the stadium. This claim was not tested; however, by issuing the pass the club is clearly attempting to control access and movement around the ground.

Clearly, from an events management perspective the control of spectators has become more sophisticated. The desire for a safer environment has resulted in more extensive control measures being introduced by clubs. However, on a cautionary note Interviewee C (2007) explained that some control issues remained. He contrasted his Premier League stadium with that of Wembley, the English national stadium, and he argued that regular fans who attend his stadium every fortnight were more difficult to control because they quickly become familiar with their surroundings. He commented that 'Regulars don't follow signs – they go the quickest way that they've found. So you suddenly find people popping up in various places where they shouldn't be.'

### *Monitoring*

Interviewee A (2007) gave a comprehensive outline of the various ways in which he monitors the progress of the event. For instance, he explained how CCTV systems enabled the monitoring of spectators as they made their way to the stadium. He said:

'You can literally watch away fans on their journey up the motorway, into the city centre and on to the Stadium. When the police helicopter is up it has a direct down link that streams images into this Control Room...if for instance there's a crash on the motorway and supporters are delayed this may present a safety risk ...By monitoring what's happening we could consider delaying the kick-off.'

A further perspective on monitoring was also provided by Interviewee A when he outlined how the stadium's sophisticated fire alarm system operated. He explained

'We've recently upgraded our fire alarm system...if a detector activates it will give you its precise location. We can quickly dispatch a steward to investigate and monitor the situation. Very, very quickly in this control room we're going to have a

full knowledge of what the problem is as soon as it gets brought to our attention. That wasn't available before...it's a lot better'

### *Post-Match Day Phase*

#### *Evaluation and Feedback*

Interviewee B (2007) emphasised the importance of evaluation and demonstrated that he evaluated operations during each phase of the lifecycle. For instance, he explained that in one corner of the ground a hotel was being built. Prior to each match the progress of the development and its impact on the management of match day operations had to be evaluated. He commented that:

'The development of the hotel, the footprint of where they're operating alters match by match. Everybody needs to know how the project is developing – for instance it may be that it is going to affect the exit routes for the emergency vehicles if they have to attend the stadium. Things alter match by match.'

In terms of evaluation during the match phase Interviewee A related that he engaged in process evaluation by touring the stadium on a match day. He explained:

'On match day morning I get here at 6.30 am or 6.45 am –and I spend the first two or three hours touring the stadium. I check all the voids under the stands and make sure that nobody's shoved a box full of papers in there, for instance. We have TV platforms - I check all the platforms to make sure that nobody's been interfering with them. I make sure signage is where it should be. I do a lot of double checking and I tick them off as I do them. Somebody else, one of our maintenance team, checks that all of the entry and exit gates are operating correctly. This is all part of the big build-up on a match day.'

In the post-match phase he explained how summative evaluation is utilised. He said:

'At the end of the game, once all the spectators have left, the stewards will comb every aisle. The Steward Supervisors have a de-brief sheet to report any damage, any problems, and any issues. I get that sheet within 24 hours. I use the sheets to brief our maintenance team to ensure that things are repaired pretty quickly for the next game.'

These accounts show that interviewee A uses formative, process and summative evaluation to generate feedback which is used to inform future practices and procedures.

In summary, evaluation and feedback have been shown to be essential elements of the events management lifecycle. The Football Match Event Lifecycle Model emphasises this by clearly demonstrating how formative, process and summative evaluation are used to generate feedback, which in turn is then used to inform the management practices associated with each stage of the process. This approach provides a valuable insight into the way that clubs have become more flexible and responsive. The move to undertake on-going evaluation and gather feedback indicates that the club is prepared to respond to calls for change and consider the implementation of new initiatives.

### *Leadership*

Both interviewee A (2007) and interviewee C (2007) explained that their role required them to display effective leadership skills. For instance, along with his role as Stadium Manager interviewee C also acts as the Duty Safety Officer on a match day. He commented that 'It all comes down to me. But everybody is very responsible, even the Directors ask whether they can or can't do things on match days.'

He contrasted this situation with what he encountered when he first joined the club in 1987. Suggesting that leadership was deficient he said

'In the past, you had a Safety Officer but it used to be the Chairman, a Director or the Club Secretary but it wasn't clear what job spec or background this person needed – it was usually the one who had had one less drink because they were the person responsible for safety.'

He also provided a valuable insight into the difficulties of coordinating the various groups and individuals within the football club. He recounted a particularly difficult time after the club had moved to its new stadium. He said

'Everybody wanted everything done there and then. I went to Heads of Department meetings – and I was bombarded with problems. It got so bad that I went to the MD and said "Can I bring a baseball bat to the next management meeting?", and he said "Why?" and I said "Well people might just as well hit me with it and I can get it over with!" But to be fair to him, he then sat down and said "Look, we will not get anywhere if we don't all work together and from then on it started to get better.'"

This account highlights the importance of effective leadership. With the help of the clubs Managing Director, interviewee C was able to overcome initial difficulties and proceeded to display effective leadership skills by effectively coordinating and integrating task, individual and team needs.

Similarly, interviewee A (2007) also displays effective leadership skills. For example, he leads the various planning meetings that take place prior to the staging of matches and he emphasised the need for all of the key people involved in staging the match to be brought together in order to discuss relevant issues. His awareness of the motivational potential of such activities was illustrated when he commented that they ‘...raised the ante a little bit’ and that they got ‘...the adrenalin running a bit better.’

In summary, effective leadership has been shown to be an essential component of the staging of a football match. Those who take responsibility for managing the event must display effective leadership skills and must be supported by senior staff within the club. The accounts provided by interviewee A and interviewee C indicate that club owners and directors have been prepared to delegate their power and influence; however, in the case of interviewee A the process appears to have gone too far because senior staff have attempted to abdicate, rather than delegate, responsibility.

## CONCLUSION

In conclusion, unlike much of the football related events management literature this paper does not focus primarily upon the tragedies and disasters that occurred at football matches in Britain in the twentieth century. Rather its aim has been to develop a clearer understanding of contemporary regular event football match event management practices. This has been achieved by drawing upon mainstream event management, and associated, literature to develop a Football Match Event Lifecycle Model.

Application of the model has illustrated its usefulness in evaluating pre-match, match and post-match event management activities and associated issues. In particular, the model provides a framework that facilitates the systematic evaluation of the key areas of event planning, organising, controlling, monitoring evaluation, feedback and leadership. Initial results suggest that there is congruence between the way that the football clubs stage their matches and the advice and guidance emanating from contemporary event management literature. Given the limited scope of the primary data considered in this study (i.e. a

relatively small number of interviewees and observations of event management practices at two football clubs) this is an interesting preliminary finding and suggests that the model should be developed further by applying it to a broader range of football clubs. Indeed it is anticipated that the next phase of the evolution of the model will involve a more extensive study which encompasses a larger number of football clubs and also an assessment of the model's suitability for application in other event management contexts.

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## MANAGERIAL APPROACH TO CULTURAL PPP

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### ABSTRACT

In the last two decades, Public - Private Partnership (PPP) has become an economic phenomenon and contributes significantly to the infrastructure projects in many countries. Cultural Heritage Management (CHM) is very important for cultural maintenance, and especially for museology.

The museums are of the greatest exponents of the culture of each country and contribute to the enhancement and promotion of the cultural heritage of each place. The cultural heritage is defined as the set of cultural goods. Thus, the use of PPP is imperative, as this model is closely linked to cultural market.

The challenge for this paper is to examine whether PPP is one of the key management tools for culture. In order to avoid possible failures, the management of such partnerships should be careful and, also, should be based on the dynamism of people employed in the management of PPP model. Although PPP is a legal tool, in fact it is a variation of contracts of concession, without abolishing them.

The contract concession, which is an administrative contract, is also important, as public law relationship is created and the privileges of public sector take precedence over private sector.

New public management (NPM), includes techniques mainly from the private sector, which are applied to the public management in order to increase performance on public services. In the NPM the administration of "contracting out" not only provides the possibility to a vehicle to burden the state budget less but also makes the simple viewer an active member. The NPM is another tool of modern society and its needs.

**Keywords:** Public - Private Partnership (PPP), PPP contracts, Cultural PPP, Cultural Heritage Management (CHM), Contracting out, Culture, Heritage, Museums, hypothesis, modernization

## **INTRODUCTION: BACKGROUND AND LEGAL DIMENSION OF PPP**

PPP agreements are adequately specified and differ in a number of dimensions, such as law, ownership, abilities, products, end users and finally Risk and Revenue dimension (Venieris, 2007).

The term “Public - Private Partnership” (PPP) refers to forms of cooperation between public and private sector with a view to ensure funding, construction, renovation, management and maintenance of an infrastructure or service (Institute of Economic Structures 2005). In modern times this institution (PPP) emerged as an economic tool for governments in late 1980 (Kaissis A., 2006).

The contribution of PPP in the European market is of paramount importance, as it emerges as an economic phenomenon, especially when the government cannot undertake the execution cost. The execution of large projects in the UK in 1980 is an important one. Then, the example of France is characterized by the construction of projects with the method of partnerships in the fields of education, health, transport, security and building facilities. Hence, Decree 2004-559 in France established a new type of contract, the contract Public – Private Partnership Sector, which is characterized as administrative, due to global character, prior assessment, common undertaking of risks, and correlation between private pre-financing and diversified public payment (Maniatis, 2011, 2012).

Generally, special attention should be given to the study, the management of such project, at risk and limitation, if not prevention, of failures. (Galiotou and Maniatis, 2012). The field of influence, the development and promotion of public interest groups are main parts of PPP (Feilden 1998).

PPP should be treated as usual capital investments of government as it is vital, considering the inability of economies to finance major infrastructure projects with public funds. Countries such as Portugal, Spain and the Netherlands in Europe, as well as Australia, U.S.A and Canada, improved infrastructure and services through PPP (Graeme Hodge και Carsten Greve, 2005).

The law that determines the legal status and operation of PPPs is 3389/2005, which establishes two new bodies, the Inter-Ministerial PPP Committee and the Special PPP Secretariat. This law allocates the projects, that are constructed by PPP, in contributory or non-contributory and determines the procedure for the evaluation and approval of PPP projects. Also, it sets the warranty in contests and ensures a healthy and legitimate competition. European Union law dispositions complete the legal framework. It has been

recognized in the European level, that the use of PPP could contribute to the implementation of European Transport Network (Delitheou et al., 2010).

Particular attention should be given in the legal framework for PPP in Greece, in order to avoid malfunctions as in the case of the Paediatric Hospital in Thessaloniki. Nevertheless, it is argued that there should be an international law for the success of PPP, worldwide (Galiotou and Maniatis, 2012).

## **HERITAGE AND CULTURAL PPP**

The balance between old and new, past and present, historical cultural memory and contemporary creation has been compromised (Lavvas and Karavasilis, 2003). Heritage can be benefited in the present, as it can be preserved for future use (MacDonald & Jolliffe, 2003). Cultural Heritage Management (CHM) is a major issue and a global phenomenon. CHM is the process of actions for the care of cultural heritage, which requires appropriate management strategies. Historically, the public sector, and not the community, undertook the case of inventory, upkeep and protection of heritage (Boniface, 1998, Jansen-Verbeke, 1998, du Cros, 2009).

CHM is an integral part of cultural heritage preservation, restoration, museology, and also, archaeological, historical and architectural research. CHM is based on the model of Environment Council of Australia and New Zealand, and is linked to the strategic management of the recognition of heritage sites, allocation of resources, protection, preservation and maintenance. The successful development of CHM should clearly establish the strategic management challenges. If a nation has an effective CHM strategy, then it should create an organization that will be responsible for strategy implementation, recognition, appreciation, protection, preservation, presentation and maintenance. The most important level of CHM model is the presentation of cultural heritage sites to the public, through which there may be economic benefits and promotion of regional economies. To this point, the need for creation of PPP arises, which is closely related to the cultural industry (Jurėnienė and Radzevičius, 2012).

Besides cultural heritage, landscapes are also protected by the Environment Code, to which Heritage Code refers. Urbanization has induced the need for protection of urban sets, historical neighborhoods and not just separate buildings. In order to avoid complete destruction of settlements, the Law of 4<sup>th</sup> August 1962, known as Malraux Law, created the protected sectors. It could not be omitted that the first law relating to the archaeology dates

back to 1941. Greece is characterized by particular archaeological sites. In comparison with Greece, the laws of France focus on modern architecture and not only on heritage (Maniatis, 2011). Generally, in Greece cultural heritage is protected by Law 3028/2002, while in France by Decree 2004-178.

Cultural PPP aim to the attainment of cultural equipment such as entertainment halls, theaters and libraries. Two successful examples of cultural PPP is the Theatre Archipelagous in Berpignan of France and the National Museum of Cultures of Europe and Mediterranean, in Marseille of France (Maniatis, 2012).

Generally, the contribution of PPP in culture is limited, when only 14% of projects are related to cultural heritage, while in Greece we do not yet have a successful example (Vassilakou and Maniatis, 2012).

The PPP model is based on the idea of outsourcing cultural and heritage sector responsibilities, such as the management and maintenance of museums. The dissolution of partnership is often the result of conflicting values between the two parties (interest in culture and heritage – interest in profit). When the private sector is interested to make profit and suspect that it will recover its investment after a long period, it can easily decide to discontinue the cooperation. Although this is one of the traps of PPP model, it is argued that the problem is not the models that are used by museums, but the dynamism of individuals employed in the management of these models. Thus, museums should consider: the passion of individuals for the museum operation, which is vital for the success or failure of the museum. There is a strong need for high level motivations and trained people with all necessary skills for the museum operation, but also with a vested interest in culture and heritage. In order the potential of this model to be exploited, the importance of the cultural heritage, the objectives and the opportunities that it can bring should be clearly defined. Moreover, governments should review the tax system for companies and individuals who contribute (eg donation of money, property, art and book collections, jewelry, etc.) to the creation and development of culture and heritage of their country. This would encourage the private sector and private sponsors of arts, culture and heritage to invest more in the development and maintenance of culture and cultural heritage institutions, such as museums (Nkosinathi G. Tomose, 2008).

## PPP CONTRACTS AND MANAGEMENT

The management of a PPP case could give several opportunities, but the risks that should be resolved are more than those of a common project. (Galiotou and Maniatis, 2012)

Risk management is a process which aims, firstly, to avoid negative outcomes and, secondly, to identify emerging opportunities through the identification, analysis and response to significant risks on an ongoing basis. When a project team engaged in a risk management process should develop an action plan, so as to limit the probability of a risk happening or the consequences of a risk when it happens.

The risks of projects could be shared out in three ways: a) Transferred risks (risks transferred to the private sector), b) Retained risks (risks retained by the public sector) and c) Shared risks (risks shared between the private and the public sector) (Li Bing et al., 2005).

In the risk management process, identification, analysis, and management plan, should be involved in all of the above three types of risks.

The following table presents the three types of contracting out, in other words, the contracts between the public and private sectors, analytical Public works, Public Private Partnership and Concession. A very characteristic Concession project was the construction of the Channel Tunnel between England and France.

These three types are compared to each other for the duration, character (reciprocal or not), funding and repayment, functions and risks undertaken by each side.

Public works	Public Private Partnership	Concession
Short term contract	Mid-term or long term contract	Mid-term or long term contract
Usually selected for non-reciprocal scopes	Usually selected for non-reciprocal scopes	Usually selected for reciprocal scopes
Funding is carried out exclusively by the state	Funding is ensured by the private sector by the bank	Funding is ensured by the private sector by the bank
The repayment of the private sector is done by the public sector	The repayment of the private sector is done usually by the public sector, through or by both the users and the public sector	The repayment of the private sector is done usually by the users.
No risk for the private sector after the completion of the project	Task allocation between the public sector and the private one	Task allocation between the public sector and the private one

*Table 1: Contracting out*

SWOT analysis is a strategic planning tool used to analyze the internal and external environment, based upon current market conditions and anticipated future trends. The following analysis SWOT illustrates the strengths, the weaknesses, the opportunities and the threats of the cultural PPP.

Strengths	Weaknesses
Effective use of state assets to the benefit of all users of public services	Lack of understanding and acceptability in Public Sector
Improvement of service capacity	Risk of rising unemployment
Financial discipline	Working of force of two different legal status
Experienced workforce	Conflicting external influences
Improvement of location	Lack of Capital Funds
Energy partnerships	Old Infrastructure
Greater efficiency in the use of resources	Problem of decision making/ Bureaucracy
Gain in private know- how	Loss of (political) influence of the public sector
Speedy, efficient and cost effective delivery of projects	
Opportunities	Threats
Development of local financial markets	Lack of support from the Government to the private sector
Development of local labor markets	Lack of the accessibility from the private sector to the Government
Focus on cultural development issues	Legal malfunction
Challenge for investment	Increasing completion risks
Public Relations	Limited financial support
Increasing willingness to cooperate in a European and international level	Dependence on stability of political, economic and legal environment
Potential challenge for instance sponsorship	Insufficient capacities in technology based education
Co-operation with NGOs and small cultural companies	Inaccurate preliminary evaluations in the PPP pro suction
Expansion of marketing strategy	

Table 2: SWOT ANALYSIS

Public management is a merger of the normative orientation of traditional public administration and the instrumental orientation of general management" (Perry and Kraemer, 1983). The "New Public Management" (NPM) school of thought has influenced public management reform and introduced new managerial practices that put more emphasis on the market and transform the bureaucratic structures of public organizations. Generally, this movement could be seen as a transformation from public bureaucracy to one model of more flexible administration. When it began, in 1980, with emphasis on cost cutting, efficiency increases and straightforward "managerialism", this efficiency drive implied increased financial controls, more "command and control" systems and asserting management control over professions and workers. NPM in the Greek Public sector arrived

relatively slowly and still is in progress comparing to other countries such as UK, New Zealand, and Switzerland etc. (Philippidou et al., 2004)

## EXAMPLES AND CASE STUDIES OF PPP MANAGEMENT

The examples below illustrates how the PPP projects are carried out all over the world. These projects secure, provide and enhance the cultural sector. The target of the following case studies is to evaluate realized projects, to show common requirements and learnt lessons in PPP.

Examples of the PPP	Results
The case of "Royal Armouries Museum Leeds", United Kingdom	The failure of the PPP contract was due to limited demand compared with the prediction, limited building capacity and the high prices.
The case of "Palace of Versailles", France	The failure was in ticket software, which was unstable and unsatisfactory.
The case of Maropeng, Johannesburg, South Africa	The failure was the expensive ticket fare and the position of Maropeng.
The case of "Soesterberg military museum", Netherlands	As part of the agreement, the private partner undertakes to ensure the protected landscape elements and in return for his investment will retain all income from visits to museum
<i>Table 3: Examples of the PPP</i>	

### A) The case of "Royal Armouries Museum Leeds", United Kingdom

In December 1993, a sixty-year duration PFI contract was signed, between the Royal Armouries and the private company "Royal Armouries International plc (RAI)" for the construction, operation and custody of the new museum in the UK, in Leeds. The RAI would completely undertake the risk and revenue from visitors, parking and restaurant services. Important goal of public authority was to take care of promotion, new items acquisition, personnel supply for maintenance of items. The private partner undertook to build the new museum at a fixed price, participate in the cost, the operation and the maintenance of the building. When the museum opened, March 1996, began with losses because the number of visitors was lower than it was expected, so it was not able to cover the operating cost. Thus, in July 1999, after warnings from bankers of RAI and Bank of Scotland, the Armouries revised its agreement with RAI and assumed the responsibility for the museum operation. The Ministry of Culture was to help with 10,000,000 pounds to save the museum from definitively closing. The failure of the PPP contract was due to limited demand compared with the prediction (about 60% of expected levels during the first year of operation and 35% in 1999), limited building capacity (provision for 1,300,000 visitors annually with an average visit

duration 2.5 hours, while the number of visitors was from 600.000 to 650,000, with an average real visit duration 4 hours), and also high prices despite the warning of consultants (Legrand, 2005).

### **B) The case of “Palace of Versailles”, France**

Failed example of PPP contract is the Castle of Versailles in France, the gardens of which are included in the "World Heritage List". During the contract the major failure, by the private sector, was in ticket software, which was unstable and unsatisfactory. By the end of the contract, the public Foundation of Museum and National sector of Versailles, took over the management of tickets reservation by using new technology systems (Maniatis, 2012).

### **C) The case of Maropeng, Johannesburg, South Africa**

The Maropeng museum, in Johannesburg of South Africa, had public funding from Gauteng Provincial Government and managed by the Maropeng Africa Leisure (Pty) Ltd. Also, the University of the Witwatersrand (Wits) is responsible for some of the activities, as Maropeng participates actively in running the exhibits. Maropeng operates under the PPP model. Private sector covers operating and maintenance costs of the museum and faces the dilemma of achieving a balance between social obligations (to be recognized as a viable social institution) and economic sustainability. 75 to 80% of their budget is spent on salaries, leaving 25 and 20% for operation and maintenance costs. The total number of Maropeng visitors is about 82,000. In South Africa, less money is spent on social capital than in countries like the U.S.A and the United Kingdom. When someone carries the model in South Africa, they should think that tax incentives for individuals and businesses in order to support the museums are not as many as in the U.S.A and United Kingdom. This prevents further operation of PPP model, as well as private companies that invest in this model pay a lot of money for taxes, even if it is for public benefit. According to visitor numbers, Maropeng was one of the museums with the largest number of visitors in 2007. The expensive ticket fare and the position of Maropeng (outside the city, accessibility only by car) were proposed as limiting factors for locals to visit the museum. Public transport is not very attractive, and the taxi leaves someone few kilometers away from Maropeng. It seems that the museum is designed more for international tourists and a minority of South Africa citizens. The high number of visitors, has to do with the fact that it is something more than a permanent exhibition, but it is also an entertainment center. The PPP model has problems in its application and it has even threatened the stability of the museum. The Maropeng facing

problems of sustainability, and its commercial operators declared bankruptcy in 2007 due to severe operational losses. This is a kind of problem that arises when there are two or more partners with different interests trying to create a relationship with different values (Nkosinathi G. Tomose, 2008).

#### **D) The case of “Soesterberg military museum”, Netherlands**

In 1968, the Air Force Museum was founded at the birthplace of the Dutch Aviation, Soesterberg, with initiative of the Air Force personnel. In 1980, it was transferred to "Kamp van Zeist", and then returned to the airport Soesterberg, where it has become part of «'Defence museum complex». The Military Aviation Museum presents the history and development of the Dutch Air Force and its activities. A large area will be designated for exhibitions and events and the existing infrastructure will be used in part. Because of the special position in the heart of Heuvelrug, it will focus on the conservation and development of natural features, and even more on the sustainability of the project. The new museum includes workshops and warehouses, approximately 50,000 sq.m. and remains under the control of the Ministry of Defence. The Ministry of Defence outsources the project and Rijksgewebouwendienst (Government Buildings Agency) ask for offers on behalf of Ministry Defence, with a partnership contract for 25 years, while property rights will remain in the public sector. Duties include exhibition spaces, halls, offices, public spaces and the outdoor spaces. As part of the agreement, the private partner undertakes to ensure the protected landscape elements and in return for his investment will retain all income from visits to museum (such as ticket sales, parking, advertising, franchising contracts etc.). The project refers to a long-term contract between public and private sector, where the private partner, apart from the risks of project revenues, is also responsible for the development of program activities (Cf. N.N., 2011).

## RIGHTING THE RIGHT TO MUSEUMS

*«The museum is a place of free access to culture»*

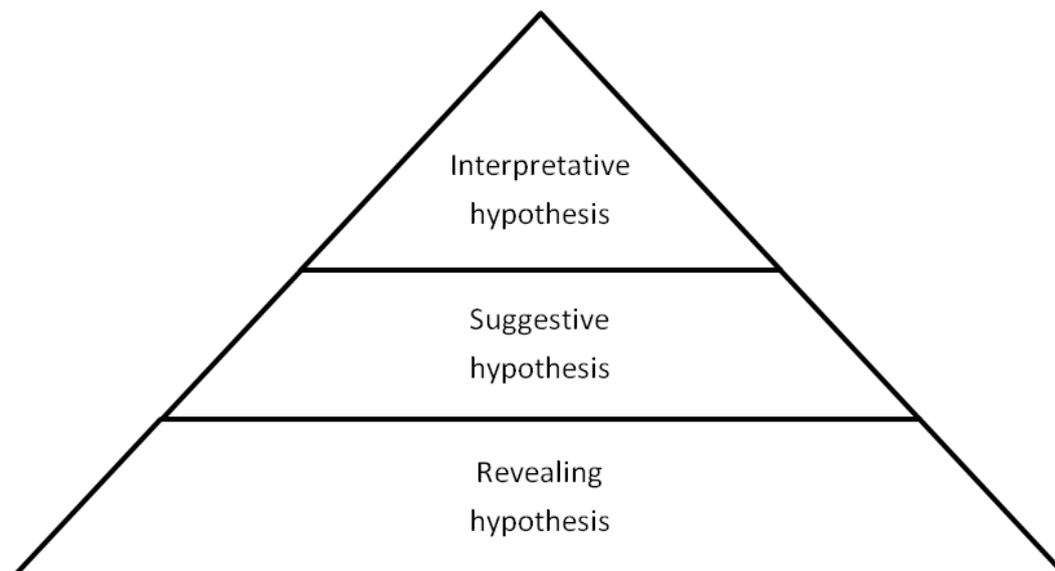
*Georges Henri Riviere*

According to the International Council of Museums (ICOM), the formal definition of museum is "a permanent institution, non-profit organization at the service of society and of its development, open to the public, which has the task of collection, study, retention, disclosure and items exhibition of human culture and environment with a view to study, education and entertainment."

In ancient times, the museum was a place, in which the arts, literature, music, poetry, philosophy and dancing were nourished since it was a "mosque" that had been dedicated to the worship of Muses.

The historical evolution of museums seems to be intercepted 160 years ago. The museum is a philosophy, a way of things' cooperation and process, but also a way of creating new worlds through the use of theatrical things, producing relationships and bridging worlds. Museums since their foundation are a theoretical practice, that is a philosophical, ideological and semiotic practice. It is time to reevaluate not only this that has been forgotten or put aside, but this, that was repulsed and is still repressed. Besides, this is confirmed by the words of a modern philosopher Giorgio Agamben: *«This is especially needed, if we want the artwork to regain its original position»*. Moreover, the history of art and museology are based on the active art dismemberment, the commercialization and the weakening of dangerous forces that exist in art. The position of the viewer towards the items in a museum collection should be active, and provide place for dialogue, discussion and debate. Nevertheless, it is noted that museums, today, remain immobilized and without progression. (Preziosi, 1999).

In the following pyramid, we figure out the distinction and hierarchy of cases, involving all stages of museum exhibits. The revealing hypothesis, is located on the basis of the pyramid, refers to excavations. The next phase is the suggestive hypothesis that has to do with the public display of exhibits. Finally, of crucial importance, the interpretative hypothesis at the top of pyramid, emphasizes the importance and need for a space for democratic dialogue.



*The archetype faction of "hypothesis"*

## CONCLUSION

Despite the controversies that are encountered during the implementation of PPP, it is concluded that PPP is a new legal tool for state to acquire infrastructure in order to exert social and cultural policy.

The cultural management through PPP aims, among others, to the continuous efforts in order to preserve the cultural and social cohesion that connects the past with the present and future. Museums are "cells" of democracy, so dialogue should be promoted, so their function should have as target the interests of society and the constitutional principle of freedom of art, and not to maximize the profit. Democracy is based on dispute and dispute is based on interpret. However, a major challenge would be grant the main function of museums with a view to improve services quality and enhance public rights, through the PPPs.

We ascertain that visiting museums can contribute effectively to the sustainability as also to the development since they will be able to sponsor other activities at the same time in favour of the citizens and the society, such as archaeological excavations.

The "contracting out" is a tool of a manager, an economist, an administrator. Law defines the framework but the politician will decide when and if it will be applied. We notice that a lot of politicians are afraid to apply it and specifically the private participation in vehicles of Public Sector. That way cultural organizations cease to be weights of the state budget since the sponsorship will be accomplished by the society itself.

Through "New Public Management" (NPM), an attempt for the modernation of the museum mission must be made, so to become a multipurpose cultural center. Everyone has the right to culture and, ideas must be evolved. Museums must not remain a "museum piece" but be seen as a challenge for another kind of civilization!...

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## DESIRABLE CODE OF CORPORATE GOVERNANCE FOR NON-LISTED COMPANIES – AN EXPERIENCE FROM PAKISTAN

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### ABSTRACT

The code of corporate governance was introduced in 2003 for compulsory compliance by the companies listed on the stock exchanges in Pakistan. The code was devised as an enforcement mechanism giving powers to the stock exchange to delist companies not complying with the code. There has been an on-going debate whether this code could benefit all corporate entities in the country to curb corruption and undesirable practice in the corporate world whether listed or not. This paper looks into the legal structure present at the moment, areas of improvement and the present situation of non-listed and listed entities. This paper also proposes to make a case for observance of the code of corporate governance by non-listed companies/ corporate undertakings. The study is both analytical and empirical based on primary data collection of randomly selected corporate entities in Pakistan. The study also establishes whether complying firms have higher premier in their performance as empirically determined in Pakistan for listed companies (see Nishat and Mir, 2005 and Shaheen and Nishat, 2006). The research also evaluates the possible impact of proposed legislations on shareholder confidence, minority shareholder rights, transparency and financial health of companies.

**Keywords:**Corporate Governance, Small companies in Pakistan, Company Law, Non-Listed Companies Legislation, SECP Codes of Governance

### INTRODUCTION

The aim of corporate governance is to align as closely as possible the interest of individuals, corporations and society. Corporate governance ensures transparency, justice, sustainable financial performance, access to external finance and foreign investment, increased shareholders' trust, fair treatment of the shareholders in a company, nation and economy. Efficient corporate governance practices result in healthier financial performance, reduced and controlled risk, better confidence of shareholders and investors and greater productivity. An effective and efficient corporate governance framework depends on the legal, regulatory, business and institutional environment.

To develop a market economy and a civil society in transitioning economies like Pakistan, the concept of corporate governance plays a very important role. This is primarily why we find a growing interest in the country for corporate governance. The Pakistani market is dominated by ownership concentration, cross-shareholdings, pyramid structure and the dominance of family business. However, driven by market leaders, suggestions related to enhancements are being pitched to attract foreign investments to help in the sustainable development of Pakistan, enhance the performance of the stock exchange, increase the transparency in financial reporting – in turn protecting shareholders' rights and encouraging healthier financial activities. Despite the growing interest, there is a surprising lack of consensus about why corporate governance is important.

The Securities and Exchange Commission of Pakistan (SECP) has been constantly attempting to foster investor confidence. Since its inception in 1999, it has been a major player involved in encouraging good corporate governance and creating an air of increased transparency and accountability in the corporate sector. The SECP also aims to safeguard the interests of all stakeholders, especially the minority shareholders. Financial reforms during the 1990s have influenced the pattern of capital structure, dividend policy, risk premia, and compliances to corporate governance (Nishat, 1999).

The SECP published its first Code of Corporate Governance in March 2002 which was subsequently incorporated in the listing regulations of the three stock exchanges and is now applicable to all public listed companies. The initiatives of SECP resulted in the creation of a public-private partnership in the form of Pakistan Institute of Corporate Governance (PICG) in 2004. With an aim to provide all major stakeholders an institutional platform to jointly study governance practices and identify the problems, PICG remains responsive to the external environment while coming up with a combination of legislation, facilitation, culture change, social values and changes in areas it found the necessity. The quest continued and in 2006, the Pakistan Corporate Governance Project (PCGP) was launched to improve corporate governance practices in Pakistan.

Since 2002, a number of corporate governance reforms have been undertaken globally. These reforms in areas including legislative reforms, stock exchange governance rules, corporate governance guidance and principles. Serving as a source of motivation for Pakistan, some of the major reforms undertaken include the OECD Principles of Corporate Governance, the Basel Committee on Banking Supervision (BCBS) Guidance on Enhancing Corporate Governance for Banking Organizations and the Sarbanes-Oxley Act in the United States.

The extent to which these global reforms are helping the cause in Pakistan is evident from the World Bank ROSC Report on Corporate Governance for Pakistan (2005) which highlights the encouraging improvement in the level of organizational compliance to the corporate codes despite initial resistance. More encouraging is the fact that the transformation has been led by market leaders including multinational companies, banks and notable family controlled corporations which are constantly creating more transparent and modern corporate governance structures. Increasingly, companies are arranging orientation seminars for their boards.

Despite the growing interest, most of the research in the area of corporate governance is done for developed economies due to the rich availability of data. In the absence of similarly active markets or corporate controls (Bohren and Odegaard, 2001), many developing economies like Pakistan are characterized by relatively weak investor protection and corporate law enforcement.

Earlier the link between corporate governance structure and the firm performance in Pakistan was empirically tested (Mir and Nishat, 2004). Poorly governed organizations exhibited lower operating performance, lower valuations and ultimately paid out less cash to their shareholders. On the other hand, better-governed firms had higher operating performance, higher valuations and paid out more cash to their shareholders (Shaheen and Nishat, 2006). Better managed firms also provide creditors confidence of more effective controls and financial process, effectively reducing the cost of debt for these organizations (Anderson et al. 2004). Shaheen & Nishat add to this literature by showing that firms with board sizes of between six and 15 have higher returns on equity and higher net profit margins than do firms with other board sizes. This could be applied to non-listed companies, whether having the code of corporate governance regulate than would inspire confidence in the company.

## **CORPORATE GOVERNANCE FOR NON-LISTED COMPANIES IN PAKISTAN**

Companies Ordinance (1984) defines a listed company as a company or a body corporate or other body whose securities are listed, that is allowed to be traded on a stock exchange. Companies that choose not to fulfil this criteria are non-listed companies.

Due to the special needs that they may have, non-listed firms are sometimes viewed as requiring a separate set of corporate governance principles (Saidi, 2005). On account of the large variances found in the structures of non-listed companies, differentiating the recommendations for corporate governance in non-listed companies can be difficult. For the set of recommendations, it is assumed that every entrepreneur tries to bolster their own business rather than vesting the benefits of the business with themselves only.

The Code of corporate governance and Companies Ordinance outline the duties of the Board of Directors. These include taking decisions and making strategic choices in matters of prime value, including approval of the strategy, ensuring that the management and the shareholders take the initiatives which fall within their authority only. They are also responsible for appointing and giving advice to and succession planning for the managing director, the executive committee and the management. They have to supervise the financial and operational controls by means of an internal control system and delineating the dividend policy which afterwards is submitted for approval to the general meeting. They are also in-charge of protecting the interests of the company in the event of crisis and conflict.

The task of the board of directors must be distinguished from those of the general meeting, the management and the executive committee. The general meeting is competent for changing the capital structure, appointing and dismissing the directors, approving the annual

accounts, setting the dividend and so on while the management is entrusted with the operational running of the enterprise and the implementation of the strategy. The executive committee can be transferred power of the board of directors.

#### *Balanced and independent composition of the Board of Directors*

The code recommends the inclusion of non-executive directors even in non-listed companies according to the size of the organization. The outside directors are full-fledged directors charged with the fulfilment of tasks entrusted to the Board of Directors by working with the other directors. This collegiality entails that – with the exception of the committees – one must avoid meetings at which not all directors are present.

The outside directors benefit the system in a number of ways. They help provide an objective view of the enterprise, give impartial advice and increase discipline and the sense of responsibility with regard to reporting. They can play a major role in crisis situations, watch over the succession of the managing director and share their networks and relationships with the enterprise. They also provide for experience and knowledge transfer.

#### *A high-performance (Senior) Management*

In this code, the senior management should be defined as the group of all executive directors, the members of the executive committee (or management committee) and of the top management, in which one strives for optimal collegiality.

#### *Principles for involved shareholders*

In order to achieve the long-term strategy, the enterprise must be able to rely on shareholders who are prepared to make a professionally justified, but long-term personal commitment, adopt a coherent vision of the enterprise and are prepared to turn over the direction and supervision to qualified bodies.

#### *Role of the shareholders*

In the non-listed enterprise, shareholders are responsible of defining the values and monitoring that they are respected, defining the vision of the enterprise, establishing the financial objectives concerning growth, risk, profitability and liquidity of the share, appointing the board of directors and establishing the playing rules for their mutual interactions, whether or not in the form of a shareholders' agreement.

#### *Promoting shareholder involvement*

The Board of Directors (BoD) must enhance shareholder involvement, focusing minority shareholders as well, by taking actions that could include periodicals and timely communication of identical information to the shareholders. The BoD should also formulate recommendations that protect the continuity of the enterprise by making it more attractive for external stakeholders.

The Code should distinguish between the stakeholders such as bank and any other financiers, suppliers, customers, personnel, outside advisor(s) and the government .

In the interest of the continuity of his enterprise, an entrepreneur must also develop a vision about his relationship with the aforementioned stakeholders. These Codes help the enterprise optimize business performance and discourage any opportunism.

These Codes also provide a wide array of benefits. Bar associations and other private interest groups can draw on their own resources when participating in the drafting process. The participation in such a reforms project for corporate governance comes with high costs. However, the reputational benefits coming along with the creation of such a code make people place higher value to such participation.

Contrary to statutory laws, the drafting process involves disinterested lawmakers and experts who have their key concern in the attached reputation and enrichment of legal expertise. Since these experts attach more importance to values, the drafters of corporate governance codes will be less inclined to create value-decreasing statutes.

Unlike statutory laws, which rely more on politically oriented decision-makers, the corporate governance codes rely on technical input from experts and produces a coherent set of rules that reduce opportunistic behaviour in the longer run. The codes facilitate the production and implementation of "best practice" principles and helps in meeting the needs of distinct firms as well as introducing norms that reflect the ever-changing dynamics of the business environment.

An effective corporate governance framework in banking sector can allow emerging markets demand that non-listed companies comply with the respective code as part of the process of credit rating and risk assessment (Berglöf and Claessens 2004; Saidi 2005). The downside to this approach could be increasingly complex regulations and overstretched regulators at the banking sector end. To overcome such a challenge, it would be more appropriate if policymakers direct their focus on flexible company law legislations that enhance private ordering and make it possible to emulate the most efficient contractual corporate governance mechanisms.

### *Financial accounting*

Business participants usually prefer an organizational structure that defines the ownership form, contractual terms and internalized norms. Such a framework also paves way for the corporate governance framework for non-listed firms. The question then is choosing the most appropriate legal organisational form.

The most common organizational structure in the world is that of a limited liability company (55% of the businesses worldwide and 90% in OECD countries). In emerging and transitional markets too, this remains the most preferred form of business for non-listed companies. For such companies, the often mandatory periodic publication of the company's annual reports is the primary source of public information. These reports, however, sometimes may exhibit laggings when it comes to complete and transparent disclosures. The direct and indirect transactions between the company and the controlling shareholder can also affect the accuracy of the financial reports. IAS 24 and other accounting standards are increasingly being applied in various economies to reduce such cases. Disclosure should be limited to what is material, in other words to those elements which are significant for an assessment of the financial statements.

#### *Minority shareholders*

Publicly held companies are generally characterised by many small shareholders who are mostly interested in the share price and lack the expertise and competency to take part in the decision-making process. It is for this reason that for such companies, providing residual rights of control to shareholders would be a costly activity. However, the company law here allows shareholders an *ex ante* incentive to make incentives of financial capital while delegating the residual rights to management, thus separating ownership and control. This, however, does not entirely deprive the shareholders of every control right within the firm as they are provided with the right to information, dividend, the right to elect and remove managers and the right to veto substantial asset purchases or sales initiated by the managers, such as mergers and acquisitions.

In addition to this, the company also provides adequate framework to address concerns related to the organizational structure and the working of internal groups including aspects of decision making, representation nature and reaction to unforeseen problems.

#### *Internal governance structure: board and management*

Limited liability companies can be considered as a legal organisational form providing a differentiated management and control structure in which shareholders elect directors and participate in certain fundamental decisions while the Directors establish policy, select managers, perform monitoring functions, and act as the firm's agents.

A number of authorities lie with the controlling shareholders including the distribution of cash and property to confer benefits on shareholders, deciding on dilutive share issues and interested transactions, allocation of corporate opportunities and business activities, right to selective disclosure of non-public information (*e.g.* Johnson *et al* 2000; Choi and Talley, 2001).

In order to ensure that the separation of controlling power from shareholders does not give undue share of power to controlling shareholders, the company law helps to align the interests of both stakeholders (controlling and minority shareholders).

#### *Fiduciary duties*

Case law sometimes assumes that limited liability companies and partnerships are functionally similar and that entrepreneurs choose the former to take advantage of limited liability and tax benefits. This encourages advocates to propose modifications of exit rules for non-listed companies to enable the participants to enjoy the same exit options as found in partnerships. The argument also extends to the idea that such closely held firm settings encourage shareholders to owe each other a strict fiduciary duty of good faith and loyalty.

However, due to the vague nature, any breach of fiduciary duties may not be identified by an outside party, such as a court, consequently assisting in preventing opportunism to a limited extent (Easterbrook and Fischel, 1986). Having a prophylactic function, fiduciary duties can be found to foster the development and internalisation of trust and norms in a particular business relationship.

In limited liability companies, fiduciary duties for managers include taking assistance in matters of the company from a prudent person who manages his own affairs of equal gravity and being loyal to the company and limiting opportunistic or negligent behaviour. The fiduciary relationship extends to the shareholders as well.

Some scholars are of the opinion that strict and broader fiduciary duties could lead to counterproductive behaviour as well. In this view, broad fiduciary duties could encourage parties to engage in over monitoring at the expense of productivity (Talley 1999)

#### *Enforcement of the duty of loyalty*

It is often argued that having a set of fiduciary duties implemented without an independent and high quality judicial system can lead to results that are not desirable (Pistor and Xu, 2002). Transitional and developing economies often lack the required judicial system, and thus, improvement in the existing judicial system in such economies is of prime importance. The gap exists due to inadequate expertise, precedents and financial resources. Without the necessary improvements, the proposal could do more harm than good.

It is thus, essential, to have a narrow and clearly defined formal set of legal rules to define the scope of the duty of loyalty and related expectations from the business participants in the short and long term (Kaplow 1992). The law could define the roles of directors as caretakers and custodians keeping a check on opportunistic transactions.

Though appropriate, the law could cause a financial burden on smaller non-listed companies due to the associated costs (Saidi 2005). Some may even view these legal and corporate instruments as disproportionate and over-regulatory. These factors might impede the development of an efficient supply of legal rules for a range of firms. The cost involved

includes aspects like increased information costs, uncertainty, distortions in the signalling function of the corporate governance framework, decreased coherence of terms, erroneous gap-filling by courts and negative spill-over effects.

Considering that the associated costs may outweigh the derived benefits, it would only be wise to have a separate reform project for such companies (Saidi 2005). This will create a set of “delinked” corporate governance frameworks that are more suited to companies according to their needs. Development of such a set of Codes will be more beneficial for small non-listed companies which are characteristic of developing and transitional economies. It will, thus, help develop such markets in a better and managed way.

*Briefly explained: the code for non-listed companies*

Black and Kraakman (1996) have proposed an approach to drafting of company law. The approach in itself is self-enforcing. Although designed for publicly held companies, a related approach can be implemented for limited liability companies successfully. The proposed law has the potential to increase the available information for the shareholders (including minority shareholders) and create lesser reliance on judicial interpretations which are not very developed in transitional and developing economies.

For success in the longer term, the code should indicate all the transactions that would need prior approval and also the formal procedure for carrying out transactions. The proposed code offers participants a set of default terms that provide a practical framework and eliminates any associated cost burden. It also provides the business partners the flexibility to react and mould according to socio-economic changes. The proposed code also helps legal decision-makers, like courts, a simple and coherent set of terms making the legislation not only acceptable and low-cost corporate governance framework but also a simple tool for conflict resolution. The supply of clear and simple rules will arguably be regarded as value-enhancing (Easterbrook and Fischel 1991).

*Public versus private information*

Transparency and adequate disclosures are essential to discourage opportunism and promote trust in the corporate governance system. Mandatory financial disclosures of balance sheets, income and cash flow statements and external auditor reports are generally published for the benefit of shareholders and to provide confidence to minority shareholders particularly. The question then remains about the accuracy and reliability of the disclosures. The business form legislation should be implemented and administered by governmental lawmakers to promote trust and transparency. Pro rata distribution rights, pre-emptive rights and information rights must ideally protect minority shareholders. The lawmakers should focus on clear and simple fall-back provisions in the legislation for non-listed companies (Masten, 1988; Ayres and Gertner 1989). In this manner, not only the transaction costs will be reduced by the necessary

flexibility to amend the corporate contracts in view of changing socio-economic landscape will also be there.

## RESEARCH METHODOLOGY AND DATA

The study is based on primary data collected through personnel interviews of 150 non-listed companies in Pakistan during February to July 2007. A structured questionnaire was prepared in consultation with legal practitioners and business community. A random sampling methodology was used to ensure representation of various categories of respondents which included non-listed firms operating in various businesses registered with Chamber of commerce. After scrutinizing and editing, 120 valid questionnaires were included in the analysis of awareness of corporate governance among non-listed companies in Pakistan.

## DISCUSSION OF RESULTS

The respondents were covered from both manufacturing and services sectors. The number of directors reported by the non-listed companies varied from 2 to 8. However, the 28 percent reported as 3 directors each in their firm. 17 percent firms indicated less than 3 directors, thus qualifying as private firms. The remaining 55 percent reported number of directors as more than 4. According to the Companies Ordinance 1984, private, public listed and public non listed companies should have minimum of 2, 3 and 7 directors respectively. Private companies is defined as an entity which restricts the right to transfer its shares, limits the number of its members to fifty other than employees and prohibits any invitation to the public to subscribe for the shares (Companies Ordinance, 1984).

The desirable mix of board of directors includes a balance of executive and non-executive directors representative of the minority interests as well (Code of Corporate Governance, 2012). Only 10 percent of the respondents indicated a need to comply with such requirements. Out of 120 respondents 85 percent reported about the management awareness of the corporate governance regulations as applicable in Pakistan. Most of these respondents who indicated their awareness of applicability of corporate governance in Pakistan indicated that it will increase effectiveness in audit control, (76 percent); corporate disclosure (72 percent); and improved financial reporting (78 percent).

Only 35 percent of the respondents foresee a need for a Code of Corporate Governance for non-listed companies similar to one applicable to listed companies in Pakistan. They indicated that as a result of corporate governance application the audit control, corporate disclosure and financial reporting will be improved. The other factors which would be improved included compliance, risk management, approval procedures and documentation. About 60 percent of the respondents indicated that their management is voluntarily following some of the requirements of the corporate governance regulations and practices which included mainly control, documentations, and compliances. In all more than 40 percent

respondents agreed that following the corporate governance best practices resulted in achieving principles of transparency, accountability, independence and social responsibility in corporate culture of Pakistan. About 40 percent of the management respondents consider the cost of implementation of corporate governance in their firms would be costly business for them.

## **SUMMARY AND CONCLUDING REMARKS**

In the segment of transitional and developing economies, the implementation of clear and judicially strong rules is costly and with the state of legislative system not ideal. However such codes are required for businesses to operate effectively. While the discussion on the need of such set of principles has gained momentum in such markets, the focus has largely remained publicly held large-sized firms. Considering that most of the companies in developing and transitional economies are smaller non-listed companies, a more systematic corporate governance approach is needed in this segment.

The aim of this paper was to analyse the needs of non-listed companies in Pakistan. We looked at the current legal structure and legal requirements for listed companies and recored the views of non-listed companies on whether these requirements are desirable for non-listed companies. This paper also tried to analyse different mechanisms for corporate governance system, their associated effectiveness and role that such a framework could play in non-listed companies. From a general consensus, it can be observed that rights and interests of minority shareholders and the opportunistic behaviour by controlling shareholders are two pressing issues that need a resolution.

It was also argued that a single legal framework is not suitable for across the board implementation for non-listed companies. The code needs to be flexible regarding nature of business operation and cost factors associated. This will lead to effective businesses that are better organized and managed effectively and also help enhance shareholder confidence and protect their rights

On the empirical level, majority of the participants showed their desire for some form of a code for reasons such as improved transparency, better audit controls and procedures, documentation and disclosure. There were concerns regarding the cost of compliance with the code, if such a code was issued.

We can therefore conclude that the majority of the executives of non-listed companies agree with the need for some form of code of corporate governance but there is room for discussion regarding the from this code needs to take and whether compliance will be a legal requirement or at the discretion of the company.

The way forward for research would be to investigate into the most suitable form of a soft code for the non-listed companies and whether some requirements be mandated by the Company Ordinance requiring an amendment in the legislation. Change in the legislation can fill the void by focusing more on corporate governance reforms in such markets where

smaller non-listed companies are dominant in terms of presence and as foreign investment recipients. The research also highlights that company laws can improve the performance of such companies by creating a set of processes to counter opportunistic behaviour.

The corporate governance codes form soft law that can easily translate into hard law constraints. Disclosure and transparency form key elements in any corporate governance system. The enforcement approach is another approach that aims to protect non-listed company investors. Investors are likely to switch to this mechanism if other gatekeepers are insufficient.

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**INVOLVEMENT OF ENTERPRISES AND SECTORS OF  
ECONOMY IN THE DESIGNING AND IMPLEMENTATION  
OF THE NATIONAL QUALIFICATIONS FRAMEWORK:  
EXPERIENCE OF LITHUANIA**

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## **ABSTRACT**

### **Purpose**

The goal of this paper is to disclose the systemic institutional pattern of the involvement and participation of the enterprises and sectoral stakeholders in the designing and implementation of the Lithuanian Qualifications Framework (further named as LTQF) and national occupational standards. This goal is achieved by outlining the main groups of factors that define involvement of enterprises and sectors of economy in the designing and implementation of the LTQF and the analysis of the cases of the involvement of the two sectoral stakeholders (Association of the Chemical Industry and the Association of the Engineering Industries of Lithuania) in these processes

### **Design / methodology / approach**

The research is based on the meta-analysis of the previously executed researches on the skills development in the enterprises, literature review, documentary analysis and interviews with representatives of the two associations of enterprises and policy makers.

### **Findings and originality / value**

From the point of view of theoretical novelty and significance this paper provides new systemic and holistic insight to the institutional patterns of the involvement and participation of business in the development of the national system of qualifications. The practical importance of this paper is defined by the provision of useful policy learning materials for the development and facilitation of business involvement in the implementation of the National Qualifications Frameworks, occupational standards and related instruments.

**Keywords:** National qualifications framework, Lithuanian Qualifications Framework, occupational standards, sectors of economy, human resource management, human resource development

## INTRODUCTION

Designing and implementation of the National Qualifications Frameworks (further named as NQFs) and occupational standards nowadays present very important trend of the national policies related to qualifications in many countries. Introduction and implementation of the NQFs and learning outcomes based occupational standards, as the instruments for management of qualifications in the system of education and in the labour market started in the UK in the eighties of the XXth century (development of the national qualifications framework of Scotland in the beginning of eighties, introduction of the National Vocational Qualifications in England in 1985 etc.), afterwards spreading to the English speaking countries worldwide. It is widely recognised, that the designing and implementation of the NQFs in the continental Europe was largely influenced by the European Qualifications Framework for Lifelong Learning and European Higher Education Qualifications Framework (Dublin descriptors) – the instruments of so called Copenhagen and Bologna processes - the European Union strategies for the development of the vocational education and training, higher education and lifelong learning and their contribution to the competitiveness of economies and human resources. The European Qualifications Framework (EQF), formally adopted by the European Parliament on 23 April 2008, is designed to offer a facilitating framework for comparing qualifications in different countries and NQFs are supposed to be referenced to, and aligned with, the EQF. Designing of the competence based Lithuanian Qualifications Framework (further named as LTQF) started in 2006 and the descriptors of the Framework were approved in 2010.<sup>28</sup> In the context of the introduction and implementation

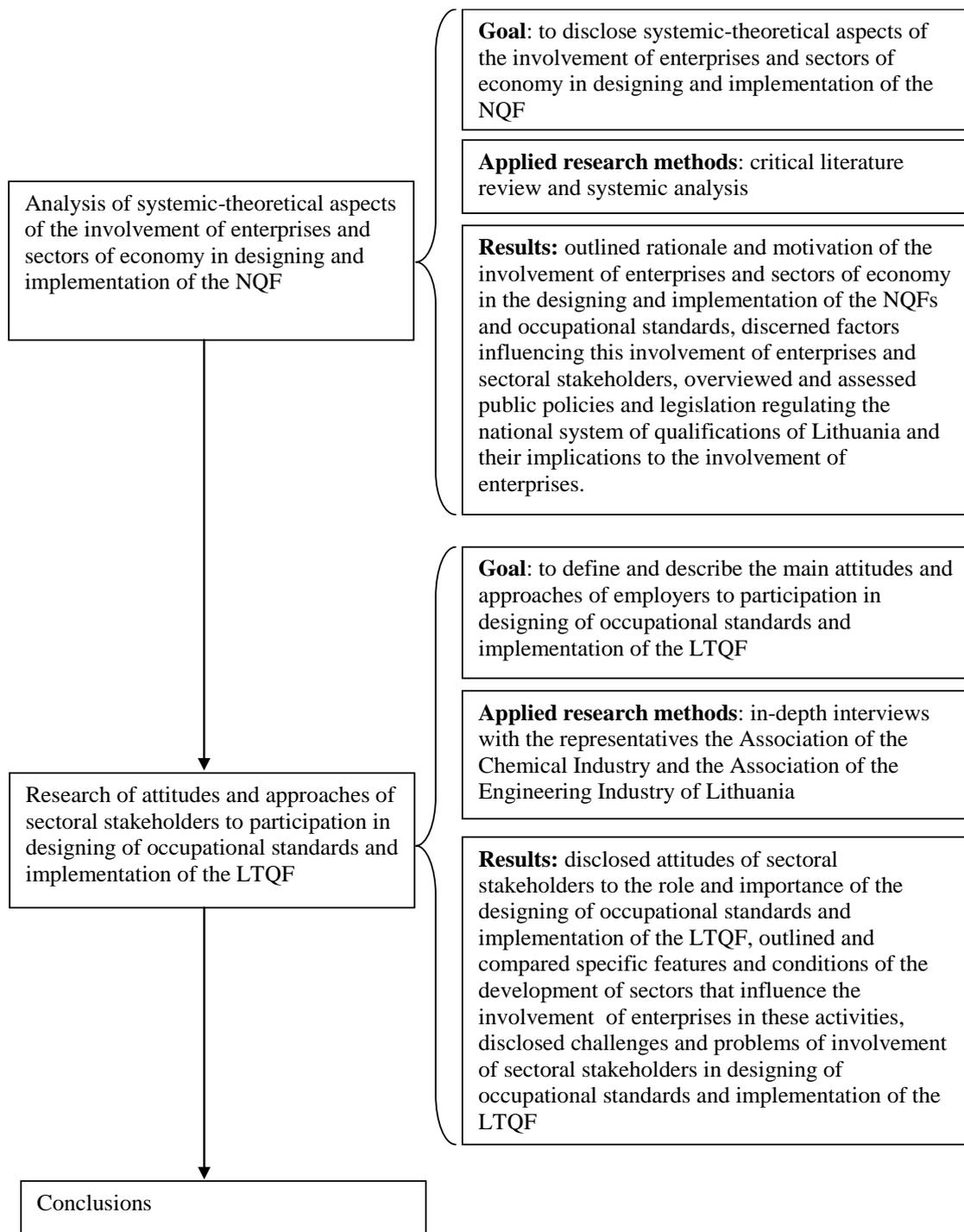
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<sup>28</sup> This framework is comprehensive and has 8 levels: the first 2 levels comprise unskilled and low skilled qualifications based on the key skills acquired on the workplace, levels 3 and 4 comprise skilled vocational qualifications, which are acquired in the VET schools or by independent learning in the workplaces and also demand general education, level 5 qualifications comprise of higher sets of vocational knowledge, skills and competences enabling to operate and manage technological work processes and technologies and acquired through independent continuing training and work experience, levels 6-8 comprise qualifications and degrees acquired in higher education and correspond to the Bologna Framework levels. The structure and contents of descriptors are based on the specifications of the activities – autonomy, complexity and changeability and the requirements of competences posed by these specifications.

of the NQFs qualifications tend to be understood by governments as standardised forms of recognition of acquired knowledge and skills with little regard for the differences in how qualifications are interpreted and approached by individuals and socio-professional groups, including enterprises and business stakeholders. Looking from this perspective the role and functions of qualifications, as well as of the different instruments related to usage of qualifications in the labour market highly depend on the involvement of enterprises and sectors of economy in their designing and implementation. The involvement of enterprises and sectors of economy in designing and implementation of the NQFs and the standardised descriptors of qualifications (further called occupational standards) largely influences the trust of learners and stakeholders in these instruments, thus defining their functionality. This involvement also presents the challenge and problem for the policy makers dealing with the different reforms and development of the national systems of qualifications. It requires to understand the factors and conditions that define effective involvement and participation of business in the development of national system of qualifications.

The goal of this paper is to disclose the systemic institutional pattern of the involvement and participation of the enterprises and sectoral stakeholders in designing and implementation of the LTQF and national occupational standards. This goal is achieved by outlining the main groups of factors that define involvement of enterprises and sectors of economy in the designing and implementation of the LTQF and the analysis of the cases of the involvement of the two sectoral stakeholders (Association of the Chemical Industry and the Association of the Engineering Industries of Lithuania) in these processes. The paper concludes with proposal of the principal model explaining the specificities of this involvement and its further role in the national system of qualifications of Lithuania.

The research is based on the meta-analysis of the previously executed researches on the skills development in the enterprises, literature review, documentary analysis and interviews with the representatives of the two associations of enterprises and policy makers. There were used the data of the previous qualitative studies about the skills development approaches in the industrial enterprises of Lithuania executed in the period of 2008-2010 and based on the exploratory case studies on skills development by interviewing managers and human resource managers of enterprises. In addition there were conducted comprehensive face-to-face interviews with the representatives of two associations of industrial enterprises responsible for the issues related to human resource development and qualifications.



**Fig. No.1. Stages of research**

From the point of view of theoretical novelty and significance this paper provides new systemic and holistic insight to the institutional patterns of involvement and participation of business in the development of the national system of qualifications. The practical importance of this paper is defined by the provision of useful policy learning materials for development

and facilitation of the involvement of business in the implementation of the NQFs and related instruments.

## **1. SYSTEMIC-THEORETICAL ASPECTS OF INVOLVEMENT OF ENTERPRISES AND SECTORS OF ECONOMY IN THE DESIGNING AND IMPLEMENTATION OF THE NQFS AND OCCUPATIONAL STANDARDS**

### **1.1. Rationale and motivation of the involvement of enterprises and sectors of economy in the designing and implementation of the NQFs and occupational standards**

NQFs are the national policy instruments, facilitating optimisation of the exploitation and usage of qualifications in the country through different impacts: increasing consistency of qualifications, improving their transparency for individuals and employers, increasing currency of single qualifications, broadening of the range of recognised learning forms, establishing a national/external reference point for qualifications standards, clarifying of learning pathways and progression, increasing portability of qualifications in the labour market, enhancing greater coherence of national reform policies related to qualifications, creating a stronger basis for international cooperation, understanding and comparison of qualifications, enhancing realistic expectations of learners and users of qualifications (Changing qualifications, 2011). These instruments are developed from a national decision to establish a common framework of qualifications to strengthen commonality across different qualifications by specifying qualifications in terms of standards, levels and outcomes (Allais, Raffe, Young, 2009).

Why enterprises and sectors of economy should be interested to take part in the designing and implementation of the NQFs and other related instruments, such as occupational standards? We can presume, that the rationale and motivation of their participation should be based on the following functions and features of these instruments:

1. Applicability and usage of NQFs and occupational standards in the human resource management and development strategies of enterprises. Here the enterprises and sectoral stakeholders consider, to what extent, where and how they can use the NQF and occupational standards as instruments in the concrete functions of human resource management

(recruitment, selection, assessment or performance, organisation of continuing training and skills development of staff, assessment of performance, wage setting, etc.). For example, human resource managers of enterprises may intend to use NQF level descriptors or occupational standards as reference materials for the screening and selection of candidates in recruitment, for the designing of the continuing vocational training and skills development programmes or for the assessment of performance. If such motives prevail, then the representatives of enterprises and sectors would see ensuring the practical application of these instruments for the different human resource management practices and processes as the priority of their involvement in their implementation.

2. Increasing institutional power of enterprises and sectors in the systems of education, employment and industrial relations. In this case the enterprises and sectoral stakeholders seek to establish themselves and strengthen their positions in the different decision making processes influencing the development of the systems of education, employment and industrial relations. National Qualifications Frameworks and occupational standards provide quite convenient platform for enterprises and sectors of economy to increase their influence over these processes. Looking to the current reforms of qualifications in the different countries there can be noticed the changing role of employers in the reforms of qualifications. Allais, Raffe and Young (2009) indicate, that the shift from the institution-based approach to learning outcomes-based approach in the reforms of qualifications reflects strive to change the power and autonomy of the stakeholders of the system of qualifications by decreasing the power and autonomy of providers of training and increasing the power of 'users' of qualifications – employers and learners. Employers increase their role by becoming the main providers of information on the skills needs, raising many issues about the readiness and willingness of employers to take part in these processes, as well about the perspective orientation of their perceived skills needs. The interests of the enterprises and their representatives to participate in the implementation of the NQFs and occupational standards might be also related to their intentions to exercise bigger control or to influence the spheres of the usage of qualifications, especially in the wage setting or workforce migration.

3. Importance of the National Qualifications Frameworks and occupational standards for the strategies of the human resource management and development in the sectors of economies. Enterprises and sectoral stakeholders in the context of economic globalisation and increasing international competition might consider the NQFs and national occupational standards as the measures that can be used for the strategic development of human resources in the sectors with the active involvement of the public systems of vocational training and higher

education. For example, the sectoral approach in development of the national occupational standards can be important to ensure long-term preparation of skilled workforce for the sector.

## **1.2. Factors influencing involvement of enterprises and sectoral stakeholders in the designing and implementation of the NQFs and occupational standards**

Having considered the rationale of enterprises and sectoral stakeholders to take part in the designing and implementation of the NQFs and occupational standards now we can turn to the nature and contents of this involvement. Referring to the theories of varieties of capitalism and institutional development we presume, that the involvement of the enterprises and sectoral stakeholders in these processes can be defined by the following factors:

- dominating competition strategies of the enterprises and their impact to the skills needs;
- existing institutional patterns of social dialogue and wage bargaining in the sectors and national economy;
- public policies and legislation regulating the national system of qualifications.

Further there are analysed general theoretical aspects of these factors looking into how these factors influence the participation of enterprises and sectoral stakeholders in the implementation of the LTQF and designing of national occupational standards.

*Dominating competition strategies of enterprises, resulted skills needs and their implications to the involvement of enterprises and sectoral stakeholders in the designing and implementation of the NQFs and occupational standards*

The competition strategies of enterprises influence their skills needs and, in turn, the interests of enterprises and sectors of economy in the implementation of the NQF and occupational standards. If the enterprises choose to compete on price and low labour costs, they would hardly be interested in the instruments and measures aimed to improve the skills potential of the present and future employees. Moreover, such enterprises may perceive NQFs and occupational standards as the instruments for the national regulation of the quality of workforce skills and competences, that limit access of unskilled and low-skilled workforce to many occupations and workplaces enhancing the skills development and, subsequently,

raising the skills level and costs of workforce. Only for these reasons the enterprises competing on price and low labour costs would abstain from (if not oppose to) the standardisation of qualifications on the national level and their ranking with the help of NQF. Competition which is based on the quality and high added value of products and services facilitates different attitudes of enterprises, because such competition usually demands proactive approaches in such fields as recruitment, staffing and human resource development. Here the NQFs and occupational standards can be perceived by the enterprises as helpful instruments in seeking to satisfy current and future skills needs. Mixed approaches in competition, when the enterprises apply differentiated competition strategy based on price and quality in the different business activities may lead to the differentiation of attitudes towards the participation of enterprises in the designing of occupational standards and implementation of the NQF. For example, such enterprises could be highly interested to contribute to the designing and development of standards for higher qualifications that are needed for the strategies of competition based on quality, but could abstain from the standardisation of qualifications in the lower skilled occupations, because it is not favourable for the human resource management adapted to the competition on low labour costs. What could be the impact of the increasing pressure of economic globalisation on enterprises to compete both on price and quality due to the global „price and quality“ revolution (Brown, Lauder, Ashton, 2011) ? First of all, it could increase the interest of enterprises in occupational standards and the NQFs, because in such circumstances the enterprises face a big challenge to get and sustain high-skilled human resources at the most competitive price and costs. Standardisation of qualifications by NQFs and especially occupational standards can help to attract and train needed human resources in more rational and economic way. The need to compete both on price and quality also makes enterprises more dependent on the public systems of initial vocational education and higher education in securing the provision of high skilled workforce. However, other responses of the enterprises to these challenges could be expansion of outsourcing and shifting of the workplaces (including those requiring high skills) to the countries of cheaper workforce, what can decrease their interest in the implementation of the NQFs and occupational standards. In the countries that receive outsourced workplaces (to some extent it is also pertinent to Lithuania) the demand for skilled and highly skilled workforce can increase, subsequently fostering the interest of enterprises and sectors in the occupational standards and the NQFs.

Looking to the competition strategies of the enterprises of Lithuania there can be noticed rather strong domination of the strategies of competition based on price and low labour costs.

According to the statistical data of „Statistics Lithuania“, in 2012 *almost a quarter of full-time employees of accommodation and food service enterprises and one fifth of full-time employees of other service activities enterprises earned the minimal monthly wages (over the year, their number dropped by 9.5 and 5.2 percentage points respectively). The greatest number of full-time employees earning the minimal monthly wage was recorded in wholesale and retail trade (20.3 thous.), education (13.6 thous.), and manufacturing (13.2 thous.) enterprises, since the majority of employees in the whole economy work in the said activities (Statistics Lithuania, <http://www.stat.gov.lt>).*

Domination of the competition strategies based on low labour costs has been largely defined by the various factors of economical and institutional development, especially by the specificities of the transition to the market economy with the top-down formation of capitalist relationships, when the former political-bureaucratic elite took important part in privatization process. As it is noticed by Norkus (2008), such pattern of privatisation did not bring new capital or managerial competences and caused the processes of economic involution which manifested itself as decline of industry, technological downgrading of the production, when enterprises which former produced high technology or high quality products which can be competitive in the export markets shifted to the production of primitive products for the local market. Other important factor was domination of the enterprise organization as company limited by shares, that did not create any additional incentives and interests of the owners to compete on the quality and to invest in the competence development of the employees (Norkus, 2008). Besides, many enterprises faced different challenges related to the shortage of financial resources and difficulties in accessing the European markets.

The enterprises responded to the challenges of market competition in the different ways that had different implications to skills development. For example, big industrial enterprises, which were leading producers of certain products in the Soviet Union (sectors of shipbuilding, chemical industry, food industry, etc.) used **to sustain and further develop their activities in the same field as before restructuring**. They seek to compete in the international markets by improving the quality and choice of products and offering attractive prices. However, competition on price creates big challenges in the sustaining skilled workforce. For example, the sector of shipbuilding constantly experiences the poaching and shortage of skilled employees and face important difficulties to sustain production of ships. To deal with this situation, shipbuilding enterprises orient their production to the building of specialised high quality ships and invest in the modern production technologies. However, the lack of skilled workforce in some cases makes shipbuilding enterprises to shift from the

shipbuilding to the subcontracted production of sub-assemblies and units requiring lower skills levels (Zavackienė, 2010). Quite often the enterprises, that sustain and further develop their activities in the same field as before economic restructuring perform the training mostly reacting to emergence of different immediate needs and requirements, such as changes in technology or legal requirements. Training and skills development are considered as source of costs which can be cut in case of necessity or unfavourable economic situation. For example, economic recession in 2009-2010 drastically cutted the own funding of training of employees in many enterprises. Shortages of skilled workforce and increasing competition for the skilled human resources due to emigration and EU integration push these enterprises to be more active in the training of new employees (establishment of enterprises training centres in the shipbuilding) and 'to import' workforce in order to remain in business.

Concerning the ways of provision and development of skills, reactive approach to training and constant skills needs enhances application of traditional and economic ways and methods of skills development, which ensure operative provision/acquisition of skills and do not require big investments and organizational efforts (eg., on the job training). Constant important shortage of skilled labour and mismatch between the needs of workplace and profile of skills provided in the initial VET and higher education institutions sometimes force these enterprises to take active part in the initial training by establishing their own training centres (shipbuilding enterprises) or signing concluding agreements with the VET and higher education institutions in the field of apprenticeship, practical training etc.

Exploitation of the outcomes of skills development and their impact to the performance of these enterprises are limited by comparatively high mobility of workforce and fluidity of staff. Constant shortage of skilled workforce sharpened by the dynamic changes in the products market also force these enterprises to focus on the short-term provision of skills, largely ignoring their long-term impacts to the performance of enterprise.

Other enterprises decided to improve their competitive positions by *introducing new products and services*. **Shift to the new products and services** during the economic restructuring depended on many different factors, such as loss of the former markets and customers, changed needs of the market, technological changes and breakthroughs. The shift to the production of new products and services sometimes is based on the enterprising initiatives of managers to find new promising niches of activities which can be developed by using existing skills, competences and experience of employees, as in the case of one enterprise working in the production of equipment for food and chemical industry. In the

Soviet period this enterprise produced industrial laundry equipment. Collapse of the Soviet planned economy and shift to free market brought significant challenges such as the loss of the former customers and users in the former Soviet Union and Central and Eastern Europe and facing new demands of market in terms of quality and quantity of products. Enterprise tried to find new markets and to converse to the production of the new products, where would be possible to apply existing technological competences and know-how. Analysis of the available technological competences, such as mechanical processing and welding of stainless steel, designing of equipment, etc. helped to identify new field of activities, in which these competences and know-how could be applied – production of the equipment for food, beverage and chemical industry. This shift to the new products also implied important changes in the organization of production – transfer from the standardised serial production to the production of customised and non-standard products. There appeared wider range of work situations due to the increased variety of product types and specifications. Production of non-standard products required higher developed capacities of operators to make operative decisions about quality assurance, solution of different operative technological problems. It also required more intensive consultations and cooperation between the workers and engineers, designers and other specialists and facilitated development of related functional skills and knowledge.

Skills development needs in these enterprises depend on the following factors:

- 1) The extent to which available pool of skills can be applied in the production of new products or can be used as a basis for reskilling or upskilling of workforce according to the new production needs. Shortage of skilled workforce and limited competition capacity for the skilled workforce in the European or global labour market make these enterprises very dependent on the available pool of skills (the case of production of equipment for food industry).
- 2) The type and origin of the know-how needed for the introduction of new products, as well as accessibility of this know-how.
- 3) The type of new products and new production. For example, transfer from the standardised serial production, which was very common in the planned economy to more customized and non-standard products increased the needs of transferable practical knowledge and skills due to the widening of the range of work operations and increased variety of product types and specifications.

Introduction of the new products and services requires accumulation and sustaining of the pool of related new knowledge, skills and competences in the enterprise. This new pool of knowledge, skills and competences is constantly accumulated through the measures of continuing training, work experience, international contacts and exhibitions, technological cooperation with customers and suppliers. Very often it is concentrated in the small groups of employees, then disseminating this know-how and skills to the other employees at the needed extent. This is also a case in the analysed industrial enterprise producing equipment for food industry. Such approach of the exploitation of know-how and skills provides bigger safety for the know-how and human capital of enterprise in the context of increasing poaching and workforce migration.

**The shift from the former production of original products to the subcontracting** was quite typical for many industrial sectors, such as shipbuilding and textile. In many cases production for subcontracting constituted only a part of the activities of enterprises besides the production of their original products or provision of services. Outsourcing and subcontracting was one of the principal possibilities for the industrial enterprises to enter the new markets of Western Europe and to develop the “western” direction of their exports, ensuring the means for survival in the market.

Shift from the production of original products to the subcontracting amongst other reasons can also be caused by the shortage of skilled workforce. As it was mentioned before, in the sector of shipbuilding emigration of skilled workforce and its shortage in the local labour market made some enterprises to abandon the production of ships and to shift to the production of different subassemblies on the subcontract basis. In this case many enterprises choose the option to adapt its production process to the downgraded skills level of human resources instead of searching the ways to upgrade the skills with the measures of continuing training or skills development. Skills development approaches in such enterprises also depend on the level of added value and skills requirements related to the complexity of subcontracted products and services. Outsourced production of simple, low added value products usually do not bring new know-how and do not require skills development. If the outsourced production is more complex and different from the original production it can bring new know-how and enhance development of more proactive approaches of enterprise in the skills development. Sometimes outsourcing includes extensive transfer of know-how and skills from the contractor to subcontractor by implementing systemic and comprehensive

training measures. It can essentially change the approaches of such enterprises to training of employees enhancing emergence of the new cultures of training and learning.

The main factor, which influences skills development needs in this case is the contents of outsourced activities (complexity) and features of outsourced products. In case of outsourcing of low added value production there are exploited existing skills without any significant needs and requirements of new knowledge and skills. If subcontractors succeed to get the orders of more complex products and services requiring higher skills, there usually emerge new skills needs together with better possibilities of provision and it's funding. For example, outsourcing enterprise organises the training of the employees of subcontractor, or higher revenues from the subcontracting permit to invest in training. In this case there is also a clear domination of the skills development needs of enterprises over personal skills development needs of employees, because skills needs and contents of training usually are very closely related to the requirements and specifications of subcontracted production.

**Skills development in the new enterprises working in the high skills sectors (biotechnological industry, mechatronic industry).** Many enterprises in the high skills sectors established themselves in the initial stage of the economic restructuring and transition in the first years after the re-establishment of independent state. These enterprises were established by the young entrepreneurial engineers or researchers, seeking to develop and market new intellectual products and services. In some sectors these enterprises emerged from the former institutes of scientific research established in the Soviet period. This is a case of the enterprises in the biotechnology sector, which originated from the departments of the institute of scientific research of applied enzymology established in Vilnius in 1975. These enterprises experienced fast growth and development, many of them today are acquired by the leading international companies. The emergence of new high skills sectors implied development of new occupations related to development and implementation of innovations and innovative products.

Attitudes and approaches of these enterprises to skills development of employees are proactive and strategic. Special attention is paid to the cooperation between enterprises and higher education institutions in the field of internships and career design of the students and graduates.

Creativity and open mindedness of employees to the new ideas and possibilities is one of the most important qualities for these enterprises. Therefore in human resources recruitment and development these enterprises prefer to 'get' from the educational institutions widely

educated and open minded people with solid and rich knowledge base and then to help them to acquire needed specific skills and competences in the work process and through on-the-job training.

Skills development in these enterprises is oriented to the generation and implementation of different innovations. The initiatives and autonomy of employees in skills development are very important features. Demand of initiativeness, creativity and open-mindedness in creation and implementation of innovations sometimes lead to the preference of recruitment of the new employees rather than retraining and upskilling of the existing pool of human resources. As it was noticed by the representative of enterprise working in the field of mechatronics, in case of emergence of the new field of activities it is much more advantageous to hire new employees from the graduates of educational institutions, rather than to retrain and upskill available employees. First of all, graduates are much more open minded to new ideas, they do not have any reservations or precautions, which are shaped by the professional experience and continuing training. Therefore they are more creative and easier accept new knowledge and new ideas.

Skills development needs in these enterprises are related to the processes of research and development. Skills needs very often develop in parallel to the creation and implementation of different innovations. Therefore, skills development needs in these enterprises correlate with the needs of the new sources of knowledge and ideas. The importance of solid knowledge base and creativity for the activities in these enterprises enhance their cooperation with universities in the organisation of internships, equipping of laboratories, etc. For example, there is developed strong cooperation of the biotechnological enterprises with the universities in the field of organization of studies, practical training of students, even co-funding of studies. However, the current regulations of admittance to higher education studies permitting the candidates to apply in parallel for the different study programmes, according to employers, do not facilitate enrollment of motivated students and have detrimental effect on the quality of studies.

These enterprises in their human resource development prefer those ways of skills development which are favourable for generation and development of new ideas and their implementation. Some enterprises send their specialists for training to foreign countries or foreign experts are invited to the enterprise for the purpose of training, as it was admitted by the representative of the biotechnology enterprise. Another important source of learning is visiting of the different exhibitions, trade fairs and scientific conferences, which is very

favourable for the emergence and development of the new ideas and innovations. Special attention is given to the development of key skills and extrafunctional knowledge, such as entrepreneurship, know-how in economy and management. Scientific staff and engineers often lack this kind of knowledge and skills and it limits their capacities to create and implement innovations. The outcomes of skills development are used in the creation and implementation of the innovations. Dissemination of acquired know-how and ideas is very important factor for the emergence and development of new ideas. Therefore these enterprises implement different measures for the dissemination of know-how and experience. For example, in the interviewed enterprise of biotechnology, the know-how acquired in the continuing training and different conferences are disseminated and shared through reporting of participants of these events.

Despite of intensive competition for high skilled specialists in the international labour market these enterprises do not experience important losses of human resources, because they succeed to create attractive jobs and careers for high skilled employees.

To summarise there can be outlined the following implications of the above analysed strategic approaches of competition to the interests and possibilities of enterprises to involve in the designing and implementation of the LTQF and occupational standards:

Strategies of competition	Interests of enterprises to involve in the designing and implementation of the LTQF and occupational standards	Implications to the possibilities of enterprises to involve in the designing and implementation of the LTQF and occupational standards
Strategies of big industrial enterprises to sustain and further develop their activities in the same field as before restructuring.	Dominating reactive approaches to training focussing on the solution of the current challenges and problems of human resource management imply the focus of interest of these enterprises on the immediate usage of the LTQF and occupational standards for effective solution of the current problems in the fields of staffing and recruitment. The lack of visibility of possibilities for immediate and concrete usage of these instruments for the solution of existing skills shortages seriously hampers	Focus of management only on the current challenges and problems of human resource management limits the possibilities of enterprises to engage in the development of more strategic and long-term oriented measures, such as qualifications frameworks of occupational standards. Very limited financial and human resources of the enterprises limit their possibilities participate in the designing and implementation of the LTQF and occupational standards and require additional support from the

	<p>the interests of these enterprises to participate in their designing and implementation.</p>	<p>state.</p> <p>One of the most important external challenges for the involvement of such enterprises in the designing of occupational standards and LTQF is uncertainty on how these instruments that enhance workforce mobility will influence the practices of poaching of skilled workforce in the internal and international labour market.</p>
<p>Strategies of competition based on the shift to the production new products and/or provision of the new services.</p>	<p>Longer-term orientation to the management and development of human resources increases the interest of enterprises in the occupational standards and the LTQF. Their interest is also related to the needs of the new skills and qualifications and their availability in the labour market. In order to rise their interest it is important to demonstrate how and to what extent the occupational standards and the LTQF will help to expand the supply of skills and qualifications in their fields and activity, as well as to ensure the quality of these skills and qualifications.</p>	<p>Implementation of such strategies of competition requires significant investment of financial, human resources and time. Intensive activities and exploitation of the available human resources can limit the possibilities of the representatives and experts of such enterprises to participate in the designing and implementation of the occupational standards and the LTQF.</p>
<p>Strategies of competition based on the shift from the former production of original products to the subcontracting.</p>	<p>Depends on the type and features of the subcontracted products and services. If the subcontracting is based on the lowest possible labour costs and the exploitation of the available pool of skills in the enterprise, this strategy would enhance enterprises to abstain from the development of occupational standards and the LTQF, because these instruments enhance skills development and, consequently, can facilitate increase of labour costs. If the subcontracting involves execution of the complex orders and requires new skills and</p>	<p>The scarcity of financial and human resources limits the possibilities of these enterprises to be more actively involved in the designing and implementation of the LTQF and occupational standards. The state support (especially financial) is very important to get these enterprises involved.</p> <p>Other important limitation could be fastly changing profiles of skills needs of workforce due to the changes of activities implied by the diversity and change of products and services produced for contractors. Such instability could make the identification and forecasting of</p>

	qualifications, it can increase the interest of enterprises in the occupational standards and the LTQF.	skills needs very complicated. It could also make enterprises more interested in the „modularised“ and flexible qualifications.
Strategies of competition typical for the newly established enterprises in the high skills sectors	The interest of these enterprises in the occupational standards and LTQF can be limited due to the fact, that their human resource management and development strategies are very individualised and based mainly on the bilateral cooperations with the universities and research institutions. If the occupational standards and the LTQF are viewed primarily as the measures for the state regulation of qualifications, it can significantly reduce the intentions of these enterprises to contribute to their development. Besides, the activities of such enterprises very often are strongly dependent on the different international standards and regulations of qualifications and skills. For this reason the extent of links and references of occupational standards to international qualifications and the referencing of LTQF to the international sectoral frameworks of qualifications can be very important factors increasing the interest of these enterprises to cooperate.	One of the main factors, that limit the possibilities of these enterprises to contribute to the development of the occupational standards and the LTQF is that they are very few and not representative in terms of number of employees in the national economy. It permits for these enterprises to solve their human resource problems by direct bilateral cooperation with the universities and research centres reducing the need for the national level instruments related to qualifications. Other limiting factors are related to the specific features of the work processes in these enterprises, that hinder the possibilities of standardisation of knowledge, skills and competences. The important role of creativity and innovations in the activities of these enterprises also contradict to the standardisation and rigidity implied by learning outcomes or competence based occupational standards.

*Table No. 1. Implications of the above analysed strategic approaches of competition to the interests and possibilities of enterprises to involve in the designing and implementation of the LTQF and occupational standards*

Competition and human resource management strategies have both enhancing and suppressing influence to the interests and intentions of enterprises to participate in the designing of occupational standards and implementation of the national qualifications

framework. Other important factor is the variety of institutional patterns of social dialogue and wage bargaining.

*Existing institutional patterns of social dialogue and wage bargaining in the sectors and national economy and their implications to the involvement of enterprises and sectoral stakeholders in the designing and implementation of the LTQF and occupational standards*

Analysing existing institutional patterns of social dialogue and wage bargaining in the sectors and national economy in Lithuania there can be outlined the following typical features:

- decentralised and individualised wage-setting process;
- weak organisation of trade unions and employers organisations with the shortage of human resources and expertise, that are needed for the participation in the processes and policies related to qualifications and training;
- absence of sectoral agreements or arrangements, that would regulate designing, provision and awarding of qualifications;
- formal social dialogue the national level through the established tripartite councils and institutions.

*Decentralised and individualised wage-setting process* is based on the individual negotiations between employers and employees. Collective bargaining in wage setting is almost absent. It is strongly related to the domination of the liberal market paradigm in the human resource management of the enterprises leading to rather high extent of poaching of skilled employees and low incentives to invest in the continuing vocational training and skills development. Highly strenuous and complicated industrial relations demand trade unions to invest almost all their efforts and human resources to the negotiations with employers in the field of wages, labour security and work conditions. For this reason the questions related to education, skills and qualifications become secondary in the agendas of trade unions activities (Tūtlys, Spūdytė, 2011)

*The organisation of trade unions and employers organisations* is weak and the bodies representing these stakeholders lack human resources and expertise, that are needed for the participation in the processes and policies related to qualifications and training. It leads to fragmented and unsystemic participation and involvement of these stakeholders in the sectoral and national administration of skills formation system and qualifications. Employers' organisations and enterprises usually have more power than trade unions in the

fields and issues related to employment, qualifications and skills development, but they often lack the expertise and know-how in this field. It implies very different capacities of stakeholders to participate in the designing of occupational standards and implementation of the LTQF. In turn, the different capacities of stakeholders to participate in these processes will require, that some stakeholders would temporarily take the responsibility to represent and defend interests of the other social groups (usually not represented by these stakeholders), which can not be sufficiently represented in the process of the reforms of national system of qualifications. For example, state authorities are expected to represent and defend the interests of employees in the implementation of the LTQF until the trade unions will be ready to take over these responsibilities. It means stronger orientation to the centralised national approach in the process of implementation of the LTQF and other instruments of the national system of qualifications with smaller responsibilities of sectoral stakeholders. Looking from the other side, there is also a high probability, that the involvement of the above mentioned sectoral stakeholders and, consequently, strength of the referencing of VET and higher education curricula to the sectoral needs will be very diverse and depending on the specific situation of sectoral labour market (supply and demand of skilled workforce), as well as on the experiences of the sectoral stakeholders in the fields of VET and higher education. Thus, the involvement of employers and trade unions in the designing of occupational standards and implementation of the LTQF is expected to be more active in the sectors with bigger deficit of skilled workforce and more rich experience of the participation of stakeholders, such as the sector of international freight transport, engineering industry, light industry.

There are no *existing sectoral agreements or arrangements, that would regulate designing, provision and awarding of qualifications*. The sectoral employers' organisations also do not execute skills needs analysis or forecasts. For this reason the involvement of the sectors in the implementation of the LTQF and occupational standards will be ensured and sustained only by the formally and purposefully established new institutional structures, such as below analysed Central Professional Committee and sectoral professional committees.

Although *formally the social dialogue is present at the national level through the established tripartite councils and institutions*, the above mentioned weakness of the social partners (especially trade unions) enhances development of rather centralised approaches with the strong role of the Government in the management of the system of qualifications. It leads to the excessive bureaucratic and controlling attitudes of responsible state institutions and can risk jeopardising effective long-term implementation of occupational standards and

descriptors of the LTQF as instruments trusted and used by the enterprises and sectoral stakeholders.

Industrial relations systems of post-socialist countries and societies can be characterised by the same types of structural, regulatory and institutional asymmetries of industrial relations outlined by Regini (Winterton, 2007). However, the origin and contents of these asymmetries are rather specific, as well as the implications of these asymmetries to the involvement of social stakeholders in the designing of the occupational standards and implementation of the National Qualifications Frameworks.

*Structural asymmetry between labour and capital in the industrial relations* in Lithuania is expressed as domination of capital in the industrial relations. The implications of this domination to the designing of occupational standards and the LTQF are twofold. From the one side, it increases the importance and role of employers in defining the needs of skills and qualifications, leading to the expectations of their active participation in designing of occupational standards and implementation of the LTQF. From the other side, domination of employers in industrial relations and weak influence of trade unions in the field of skills development and qualifications create favourable conditions for the low pace human resource management and development strategies based on the sustaining of the status quo in the field of skills and qualifications of workforce, competition on the low labour costs and low incentives to invest in training and skills. In these conditions the involvement of employers and enterprises in the implementation of the national policy instruments for development of human resources becomes very dependent on the presence of immediate skills needs of enterprises and challenges or obstacles in satisfaction of these needs. If the present skills needs are satisfied or can be easily satisfied by the enterprises themselves, the incentives of enterprises to take part in designing of occupational standards and implementation of the LTQF will be low.

*Regulatory asymmetry in the labour market caused by the imperative role of state* is important in the most post-socialist countries due to the undeveloped social partners, lack of mutual trust and agreement between these partners what seriously limits their capability to regulate industrial relations and labour market. There can be noticed certain combination of the strong formal regulatory role of state and big influence of employers in the industrial relations, when the state plays rather ambiguous role – from the one side, it seeks to contribute to the

defence of rights and interests of employees through the labour legislation and social policy, from the other side it seeks to support the employers and attract investors in implementing liberal economic agendas. As it is noticed by many researchers, in this light occupational standards and NQFs can be regarded by the Government and stakeholders as attractive instruments, that can help to regulate many complex questions of employment, social policy and education access without requiring strong direct regulation from the state (Young, Allais, 2009; Grugulis, 2007). However, such regulatory assymetry can significantly increase the influence of state and employers in the designing of occupational standards and NQFs.

*Institutional assymetry in the labour market and industrial relations* derived from the tendency for rule and practices to endure is rather weak in the post-socialist countries, because the real influence of the formally established tripartite institutional settings is low due to the lack of expertise, experience and capacities of stakeholders. The endurance of rules and practices of institutions is also weak due to the transitional character of the institutional models of industrial relations and labour market. It did not create conditions for the continuity of the development of institutions and implied rather abrupt changes of institutions and rules of their functioning. Many institutions and institutional settings were established through policy borrowing. For example, many tripartite institutions in Lithuania were established by policy borrowing from Germany and Nordic countries. The local socioeconomic and cultural context has restricted it's effective functioning. One of the main implications of this situation for the involvement of employers in the designing of occupational standards and implementation of the national qualifications framework is the adaptation of the schemes and approaches of social partnership used in the other countries. The model of social partnership *in design of qualifications and professional standards is shaped by applying the experience of different countries – UK, Scandinavian countries, France, Germany etc.* The main factors, limiting the policy borrowing in this field are the costs effectiveness of the borrowed examples and their suitability for the small country. If the example of social partnership in designing of occupational standards implies complex and costly schemes and mechanisms of cooperation and includes requirements of private investment or co-investment of employers, it becomes unattractive and difficult to apply.

### **1.3. Public policies and legislation regulating the national system of qualifications of Lithuania and their implications to the involvement of enterprises in the designing of**

### occupational standards and implementation of the Lithuanian Qualification Framework

The measures of public policies and legislation regulating the national system of qualifications in Lithuania are strongly directed to the solution of the existing skills mismatches in the labour market.

Labour market of Lithuania today is characterised by large asymmetries between the supply and demand of skilled workforce and rather deep structural unemployment, when even in the situation of high unemployment enterprises can not find suitable skilled human resources and look for the possibilities to recruit specialists from abroad. According to the data of Statistics Lithuania, the share of unfilled workplaces decreased with growing unemployment in the period of economic crisis, but now increases again:

Year	2008	2009	2010	2011	2012
Unemployment level %	5,8	13,7	17,8	15,4	13,2
Free workplaces (% from the total workplaces)	1,7	0,5	0,6	0,9	0,9

Table No. 2. Unemployment level and share of free workplaces in Lithuania. Source: Statistics Lithuania (<http://www.stat.gov.lt>)

Other feature of the Lithuanian labour market is rather high level of over-qualification, when about one fourth of the university graduates have to occupy the workplaces demanding vocational qualifications. It is obvious, that the current employment situation does not facilitate effective usage of the human resources in the labour market and does not lead to the development of the human capital in society.

How the foreseen institutional model of the implementation of the LTQF and introduction of occupational standards match the above described features of the involvement of social stakeholders in the national system of qualifications? This question can be answered by

comparing the outlined features of the social dialogue with the requirements for the involvement of stakeholders posed by the public policy decisions of the implementation of the LTQF and introduction of the occupational standards.

Foreseen institutional model of the implementation of LTQF and introduction of occupational standards is based on the tripartite principle of involvement of social stakeholders. There is also centralised coordination of the functions and cooperation of stakeholders. Under the order of Ministry of Education and Science there has been established the Central Professional Committee, consisting of the representatives of employers organisations, chambers, trade unions organisations, providers of the initial VET and higher education and government bodies. The order of the Minister of Education and Science foresees the following main functions of the Central Professional Committee (Valstybės žinios, 2010):

- initiate the drafting of the legal acts needed for sustaining and development of the national system of qualifications and the discussing of the laws and legal acts regulating the system of qualifications;
- provide counselling for the Qualifications Regulation Body (Centre for Development of Qualifications and Vocational Training) on the issues of qualifications and skills needs;
- approve the establishment of sectoral professional committees and to advice the number of members of these committees;
- define the priority sectors of economy for the formation of the system of qualifications (for the designing of occupational standards);
- advice the Qualifications Regulation Body (Centre for Development of Qualifications and Vocational Training) concerning the designing of occupational standards and referencing of qualifications to the EQF;
- initiate updating of the LTQF;
- discuss the disputable questions concerning formation and development of the system of qualifications and provide solutions;
- approve the annual plan of designing of qualifications prepared by the Qualifications Regulation Body (Centre for Development of Qualifications and Vocational Training);
- advice concerning the accreditation of the competence assessment bodies;
- discuss the strategic issues and questions of the system of qualifications.

Most of the functions of this Committee are related to advisory role with rather limited influence for the decision making in the field of designing of occupational standards and implementation of the LTQF.

The sectors' professional committees (17) are established referring to the principle of competence of members and not to the principle of balanced tripartite partnership. These committees consist of the representatives of employers, Professional organisations, trade unions, providers of VET and higher education, Government bodies. The main responsibilities of sectoral professional committees consist of (Valstybės žinios, 2010):

- ensuring the conformity of qualifications to the needs of a given sector (together with the Qualifications Regulation Body);
- providing advice to the Qualifications Regulation Body concerning the sectoral qualifications and related competences;
- defining priorities for the designing of occupational standards in the sector;
- providing advice to the Qualifications Regulation Body concerning the designing of occupational standards;
- approving the designed occupational standards or VET standards;
- approving the initiation and designing of the curricula of formal VET leading to the acquisition of qualification;
- evaluating the conformity of the VET curricula to the requirements of occupational standards and VET standards;
- providing advice to the Qualifications Regulation Body concerning the continuing training of VET teachers .

Looking to the principles of the establishment of these committees, their roles and responsibilities there can be noticed the attempt to combine the centrally state regulated approach in the implementation of the LTQF with the delegation of responsibilities to the sectoral stakeholders. The main decision making and coordinating power belongs to the Centre for Development of Qualifications and Vocational Educations as Qualifications Regulation Body.

It also indicates more or less top-down way of the involvement of sectoral stakeholders in the processes of designing of occupational standards and their referencing to the LTQF.

This approach in principle matches the needs of the current situation, when due to the insufficient development of capacities and expertise of employers, trade unions and other stakeholders the Governmental institutions and specialised bodies have to play more important role not only in the coordination of activities, but also in providing know-how and

expertise. Such institutional model implies a bit passive roles of employers because they do not have important responsibilities related to sustaining of established institutional bodies and development of their functions. The funding of established institutional framework for the implementation of the LTQF and occupational standards only from the state budget could also impede the development of the co-ownership of these instruments shared by the state and different social stakeholders.

From the other side, the existing legal and institutional arrangements of the designing of occupational standards in Lithuania are open for the initiatives of the employers and other stakeholders to participate in this process. As it was expressed by the interviewed representative of the Centre for Development of Qualifications and Vocational Education - institution responsible for the coordination of the designing of occupational standards and implementation of the LTQF:

*The possibilities will be provided to all stakeholders, but the initiative to take part in the design of qualifications should come from the stakeholders (trade unions) themselves. We can not impose anything from above, if there are no initiatives from the trade unions themselves. Employers already expressed their initiatives and interest.*

There is quite wide agreement and consent amongst policy makers, that employers must play the key role in the process of design of qualifications. It is rather generally accepted, that qualifications are designed and assessed by the world of work, referring to the existing and future needs of the professional activities. This idea is rather clearly expressed both in the concepts of qualifications and competences, as well as in the conceptual design of the descriptors of the Lithuanian Qualifications Framework. It is foreseen, that the system of occupational standards will consist of the sets of qualifications structured according to the needs and requirements of the sectors. It will require to undertake sectoral approaches in analysing the structure and contents of the existing systems of occupations and qualifications. Designing of qualifications is planned to follow the hierarchical structuring of qualifications by using levels descriptions of the LTQF. The Government decree of the 4th of May 2010 No.535 on the approval of the level descriptors of the LTQF foresees, that „13. *By following the order prescribed by law, there can be introduced sub-levels of qualifications related to the experience of professional activity in order to enhance the professional development of employees.*“ (Valstybės žinios, 2010). This legal statement permits to sectoral stakeholders to establish their ‚sub-levels‘ of the LTQF in cases, when the qualifications in the practices of human resource management and development of the sector are structured in different way, than the structure of levels of the LTQF. This clause of the government decree opens the possibility for

the sector-based implementation of the LTQF, when the ‚placement‘ and referencing of qualifications to the LTQF levels is executed following the needs and requirements of activities in the sector and practices of human resource management and development in the sectors.

The endurance and systemic involvement of enterprises in the designing of occupational standards also depend on their participation in the provision of training and assessment of competences. The role of sectoral stakeholders in the provision of training and qualifications can be significantly increased by the introduction of apprenticeship in the initial VET. The law on Amendment of the Law of Vocational Education and Training issued in 2007 legally introduced apprenticeship as the pathway of initial VET. It provides the legal possibilities for enterprises to become responsible for the provision of both theoretical and practical training. Enterprises can sign the contracts with schools for the provision of theoretical training. This form of training is still on the experimental phase and not yet implemented, because most employers, especially small and medium size enterprises are not yet capable nor ready to take all the responsibility (including funding) for this strand of vocational training. Successful introduction of apprenticeship in the separate sectors could become important factor enhancing stronger participation of enterprises in the development of the system of qualifications.

## **2. PARTICIPATION OF ENTERPRISES IN THE DESIGNING OF OCCUPATIONAL STANDARDS AND IMPLEMENTATION OF THE LTQF - ATTITUDES AND APPROACHES OF SECTORAL STAKEHOLDERS**

The attitudes and approaches of sectoral stakeholders to involvement in designing of occupational standards and implementation of the Lithuanian Qualifications Framework were researched by interviewing representatives of the sectoral employers associations in the chemical industry and engineering industry. There were interviewed the representatives and experts of the Association of the Chemical Industry and the Association of the Engineering Industry of Lithuania.

Interview questions addressed three main issues:

1. Sector specific reasons and rationale for the involvement and participation of enterprises in the designing of occupational standards and implementation of the LTQF.

2. Experience of the sectoral organisations and enterprises in the sector in the field of designing and implementation of the instruments for national or sectoral regulation of qualifications.

3. Obstacles and problems for the active involvement and participation of enterprises in the designing of occupational standards and implementation of the LTQF.

Research disclosed, that in general the involvement and participation of the enterprises and sectoral stakeholders in the designing and implementation of the LTQF has been very limited so far due to the following reasons:

1) In the process of designing of the Lithuanian Qualifications Framework back in 2006-2008 the enterprises and sectoral organisations were involved to a very limited extent. There was obvious lack of discussions of the proposed projects of the qualifications framework in the sectoral employers organisations and the sectoral perspectives and attitudes to designing, provision and awarding of qualifications were not considered. Very few experts of human resource management from the enterprises were involved in the process of designing of the LTQF descriptors thus limiting consideration of the human resource management practices and problems in setting the contents and structure of LTQF descriptors.

2) Although the suggested approach of the implementation of the LTQF and occupational standards is strongly oriented to sectors, sectoral stakeholders see no concrete measures and resources for their involvement and participation in these processes. It leads to very episodic and fragmentary role of sectoral associations and enterprises in the designing of occupational standards and implementation of the LTQF.

3) There is a lack of clearly defined agenda and programme of the implementation of the LTQF with the foreseen sources of funding and human resources with clearly defined functions of enterprises and sectoral associations.

The research also disclosed certain sector related specificities of the attitudes of sectoral organisations that are discussed below.

### **2.1. Chemical industry**

According to the interviewed representative of the Chemical industry association, the interest of involvement and participation of this sector in the development of occupational standards and implementation of the LTQF is not based on the specific short-term skills needs of the

enterprises or skills shortages, but rather on the understanding the importance of these instruments for the long-term human resource development of the sector.

Today chemical industry in Lithuania does not experience shortage of skilled employees due to many different factors.

First of all, big industrial enterprises of this sector evolved from the vast industrial complexes that influenced emergence and development of the towns and urban communities in the Soviet period (before 1990). Today these towns and urban communities are less dependent on the survived big enterprises, but still they influence comparatively low turnover of employees due to the limited choice of workplaces in the other sectors and enterprises. Most of the big chemical enterprises work effectively and profitably and are capable in offering competitive wages and salaries to their employees. The enterprises in general are satisfied with qualifications and skills of employees, that correspond to the work process requirements.

Secondly, the shortages of skills and qualifications in enterprises are satisfied through their direct contacts and cooperation with the education and training providers. The sector of chemical industry has developed a kind of it's own system of training of specialists based on the direct cooperation between the enterprises and training providers. Enterprises conclude the contracts with initial VET providers, universities and their students, pay the grants and sholarships to those students in return for their obligation to work in these enterprises after the graduation. In this way their main task is to motivate young people to choose the careers that correspond to the needs of enterprises. Besides, big enterprises of the sector have their own training centres. For example the training centre of the concern *Achemos grupė* is responsible not only for the continuing vocational training and skills development of the employees, but also for the initial vocational training of the needed skilled workers, when there are no other providers of needed qualifications in the national system of initial VET.

There are many foreign capital enterprises in this sector and the decisions about development of these enterprises, implementation of technological and organisational innovations and satisfaction of skills needs are taken abroad. Very often these enterprises satisfy their needs of skilled human resources by bringing employees from abroad, especially in case of high skilled employees. In this way they become independent from the national system of initial VET and higher education in their human resource management.

Some challenges for the designing of occupational standards in this sector are created by the contents of work processes. The work processes in the chemical industry can be characterised

by the stability of technological processes and rather narrow uniqueness (specificity) of workplaces in the companies. It leads to the bigger attention of human resource management to the development of specific workplace related knowledge and skills making serious obstacles for designing the descriptors and standards of qualifications. Narrow specificity of occupations and their strong dependency on the unique technological processes and workplaces in the enterprises significantly increase the variance of work processes by making standardisation of qualifications very challenging and expensive undertaking. There is also a fear, that the standardisation of qualifications on the national level can create additional obstacles for the low-cost 'import' of the workforce from the third countries, if the occupational standards will be applied as measures for the regulation of the workforce quality.

Analysing the main obstacles and problems that impede the participation of sector's enterprises in the designing of occupational standards and implementation of the LTQF, the interviewed representatives of the Association outlined the following ones:

1. There is a lack of understanding of the need and importance of these instruments for the human resource management of enterprises. Current human resource management processes and practices in these enterprises do not demand such instruments.
2. The enterprises can not or do not wish to invest their assets and resources in the development of these instruments and they do not see the guarantees of public funding in this field.
3. The designing and implementation of the national occupational standards is too complex and time consuming activity, what makes it too rigid in the face of fast technological and organisational change in the sector. For this reason it could be difficult to persuade enterprises to support this activity, because they can satisfy the human resource needs in more simple way - by 'importing' needed specialists from abroad, especially from the cheaper workforce countries.
4. Enterprises do not notice, that their involvement and participation in the designing of occupational standards and implementation of the LTQF is regarded as important by the state institutions that coordinate these projects.

## **2.2. Engineering and machinery production industry**

As it was noticed by the interviewed representative of the Association of the Engineering Industry of Lithuania LINPRA, the skills shortages are one of the most important problems

influencing the strategical development of the engineering and machinery production industry in Lithuania. There can be noticed the shortage of skilled workforce of all levels of qualifications:

*Today the industry is capable to deliver high quality services of production and manufacturing to the foreign buyers, but is still not capable to create own products that provide higher added value. It means, that the current state of skills of workers and middle level employees is sufficient enough to achieve competitive quality of subcontracted products and production services (it does not mean that there are no shortages of skilled or medium skilled workforce), but the shortage of high skilled specialists who create the new products (engineers, product designers, product managers, etc.) in many enterprises does not permit to seek for the strategic breakthrough from subcontracting and execution of production services to the production of their own innovative and high quality products.*

LINPRA takes active measures to solve the problems of skills shortages and notices some trends, which permit to expect the positive change of the situation. For example, it participates in the national project for the development of technological competences of vocational teachers from initial VET schools and lecturers of the universities of applied sciences, where employers play important role in defining these competences.

The interviewed representatives notice various ambiguities and controversies concerning the role of employers in defining competences and learning outcomes, because the priority of employers and their associations in this field is rather strongly contested and questioned by the providers of education and training. One of the main debated issues is the influence of employers and providers of education and training in defining the skills needs and contents of curricula. The vocational teachers in Lithuania have rich experience and expertise in curriculum design, because they have had wide autonomy in this field. Therefore, they also have rather strong opinion about the contents of vocational curricula and it's reference to the skills needs. Representatives of employers succeeded to find common positions with VET teachers when discussing the issues of skills needs. As it was expressed by the interviewed representative, *although there were some tensions and disagreements with the representatives of initial VET about who and how should define the training and skills needs of teachers and trainers we succeeded to find effective compromise.* In case of universities the situation is more complicated:

*Our influence in defining learning outcomes in the higher education curricula is very much limited by the strong autonomy of universities, especially what regards curriculum design and organization of studies. Despite the fact that some universities are the members of our association, our possibilities to transmit our skilled needs to the design of the study programmes are very narrow.*

What regards the standardization of qualifications in the engineering sector, the interviewed representative outlined the following issues:

1. The contents of the work processes, that are typical for the engineering industry is very much universal and to some extent even identical in the different countries due to the similarity of the applied technologies and approaches of work organization. It creates opportunities to use the standards and descriptors of qualifications developed in the other countries for designing of the occupational standards in Lithuania. Specificities of the work processes in the enterprises of Lithuania are very few and these are not significant, when considering the universal trends of the technological and organizational development of the work processes in this sector (automation of production, development of nanotechnologies, etc.). It implies the importance of the analysis of profiles and descriptors of qualifications used in other countries, as well as research of the common trends of the technological and organizational development of work processes when designing occupational standards. From the one side, it requires to apply the higher expertise of researchers, but from the other side it decreases the weight of the information obtained by interviewing the experts from the enterprises of sector and the need of such information.

2. One of the typical features of qualifications in the engineering sector is high level of their internationalisation. There can be mentioned the initiatives of the European Federation of the National Engineering Associations FEANI in establishing the EUR ING title designed as a guarantee of competence for professional engineers, in order to facilitate the movement of practicing engineers within and outside the geographical area represented by FEANI's member countries and to establish a framework of mutual recognition of qualifications in order to enable engineers who wish to practice outside their own country to carry with them a guarantee of competence (<http://www.feani.org>). Other example of international qualifications can be found in the field of welding. Here the European Welding Federation and the International Institute for Welding) achieved to harmonise national standards and qualifications offering different types of international welding qualifications and certifications (Cedefop, 2012). Due to high level of internationalisation of the qualifications in this sector, the interest of the Engineering Industry Association of Lithuania is to ensure, that the designed occupational standards could be smoothly referenced to the existing European and international standards and regulations that regulate qualifications in the sector:

*It is absolutely necessary to ensure strong integration of our qualifications in the European structures and frameworks of engineering qualifications. This is necessary in order to ensure the quality and*

*international recognition of engineering qualifications provided in Lithuania, as well as to facilitate their attractiveness for learners and to enhance the quality of skills and competences of our employees. Of course, it can also create additional possibilities for the emigration of the holders of such qualifications, but the isolation of qualifications or „invention“ of country-specific qualifications or standards can not solve the problem, because it would enganger international competitiveness of the enterprises.*

For the same reason LINPRA would support the idea of European sectoral framework of qualifications in engineering, metalworking and machinery production. Meanwhile the Association is ready to cooperate in the designing of occupational standards and implementation of the Lithuanian Qualifications Framework. Association is ready to delegate the experts from the sector for the designing of occupational standards and development of the national curricula of vocational education and training. However, for these activities external (public) funding is needed.

## **DISCUSSION AND CONCLUSIONS**

We have outlined three main groups of factors that influence involvement and participation of employers in the designing of occupational standards and implementation of the LTQF:

- Factors related to the competition strategies of enterprises and their influence to the human resource management and development strategies and practices.
- Factors of existing networks, practices and patterns of social partnership in the field of initial vocational education and training and higher education in Lithuania.
- Factors of state policy in the field of human resources planning, labour market and education.

Dominating competition strategies and patterns in the enterprises, especially competition on price and low labour costs present a lot of challenges for the involvement of enterprises in the development and implementation of the national level human resource development instruments, such as occupational standards and LTQF designed to enhance competitiveness and quality of human resources. It is related to the direct contradiction between the mentioned designation of these instruments and the interests of enterprises that compete on price. These contradictions not only reduce the interests of enterprises to take part in the designing and implementation of these instruments, but also, when such enterprises are

involved, may increase the orientation of occupational standards and the LTQF to the satisfaction of the current skills needs and reduce their power to enhance skills development of human resources. The shift towards the competition on quality and innovations change the attitude of enterprises to the skills needs increasing their interest to have and to use above mentioned instruments in their human resource management practices, as well as to gain more power and influence in the cooperation with the education and training providers. It implies, that the designing of occupational standards and implementation of the LTQF should seek of higher involvement of enterprises competing on price and innovations.

Existing institutional patterns of social dialogue and wage bargaining in the sectors and national economy in Lithuania are characterised by decentralised and individualised wage-setting process, weak organisation of trade unions and employers organisations, absence of sectoral agreements or arrangements, that would regulate designing, provision and awarding of qualifications and overly formal social dialogue on the national level through the established tripartite councils and institutions. Such situation inevitably increases the regulatory and coordinating role of state in the designing of occupational standards and implementation of the LTQF. Increased role of state, as a compensation of the weaknesses of social dialogue could be effective in the short term perspective, because it may enhance more smooth and quick decision making process and may help to defend better the interests of the groups, that are represented in the social dialogue by the weaker and less influential stakeholders (eg., interests of employees). However, in the longer perspective the strong influence and regulatory role of state may discourage and demotivate social partners from more active participation in designing of occupational standards and implementation of the national qualifications framework. It may also narrow the space for the development of their know-how and experience in these fields. For this reason it is very important to make efforts in the capacity building of social partners in the designing of occupational standards and implementation of the LTQF, what would permit to delegate them more responsibility in this field.

State policy in the field of human resources planning, labour market and education is strongly oriented to the issues and problems of labour market and existing skills mismatches. The institutional model of the implementation of LTQF and introduction of occupational standards foreseen by the policy makers is based on the mix of the openness of these instruments to the needs and interests of stakeholders, tripartite principle of involvement of social stakeholders and centralised coordination of their functions and cooperation. There

can be noticed the attempt to combine the centrally state regulated approach in the implementation of the LTQF with the delegation of responsibilities to the sectoral stakeholders. While such approach in principle corresponds to the above discussed state of the social dialogue and capacities of social stakeholders to contribute to the designing of occupational standards and implementation of the LTQF and might be effective in the short run, it may also lead to the embedding of the passive attitudes and secondary roles of employers in this process (especially in the maintenance of these instruments) in the longer perspective.

Research disclosed the feeling of sectoral stakeholders, that they were largely ignored in the initial stages of the designing and implementation of the Lithuanian Qualifications Framework, especially missing more comprehensive discussions about these instruments and their contents within and between the sectors. It also disclosed rather different attitudes and approaches of sectoral stakeholders to involvement in designing of occupational standards and implementation of the LTQF. When the sector does not experience significant challenges in the field of skills and human resources or when these challenges and problems are being sufficiently effectively solved inside the sector by the efforts of sectoral organisations, enterprises and providers of training (as in case of chemical industry), there is no big interest in the national instruments of human resource planning and management in the short-term perspective. In this case involvement of sectoral employers' organisation in the designing of occupational standards and implementation of the national qualifications framework is more based on the understanding the importance of these instruments for long-term human resource development and from the other side it is based on the interest to sustain and increase the influence of sectoral stakeholder in the national policies related to skills development. The attitude of enterprises to the standardisation of qualifications and their structuring with the LTQF is very reserved and to some extent pessimistic, seeing from these instruments more threats and risks than the benefits. On the contrary, when the sector faces significant skills shortages or when there is a clear understanding of the necessity to improve and upgrade of the existing structure and contents of skills of workforce seeking to achieve technological and economical breakthrough (as in the case of engineering and machinery production industry), the sectoral stakeholders are much more interested to take part in the designing of occupational standards and implementation of the LTQF. In this case sectoral employers organisation regards these instruments and their utility from the perspective of the long-term strategies of human resource management and development. The attitude of sectoral stakeholders to the occupational standards and LTQF is more optimistic and

proactive, especially stressing the importance of the strong integration of designed qualifications with the existing international and European frameworks of qualifications in order to enhance international recognition of local qualifications and trust in these qualifications and human resources.

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## AN INTUITIONISTIC FUZZY APPROACH FOR AUTOMATIC EVALUATION AND COMPARISON OF ONLINE TEST ANSWERS

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### ABSTRACT

During the last decade we have witnessed multiple dramatic changes in the human behavior and practices due to the extremely expansive proliferation of the Internet technologies. One of the key technologies that has generated crucial changes was the introduction of Learning Management Systems. We find evidence from almost every university web site that a lot of the subjects are thought not only in a standard face-to-face mode but are also suggested as an e-learning content. Respectively the academic community is attracted by the opportunities to research the multiple domains that are impacted. This paper presents an approach for expansion of a learning management system with the goal to make it select an optimal learning path that is customized according to the specific behavior and performance of the user. The algorithm that is used implements elements from the theory of the intuitionistic fuzzy sets which are very appropriate for modeling of human perceptions and behavior.

Keywords: Intuitionistic Fuzzy Sets, Learning Management Systems, Intelligent learning, Similarity Measures.

### I. INTRODUCTION

The successful carrier or business initiative in the contemporary knowledge based economy is almost always predetermined by active and consistent learning endeavors. However the high intensity of the professional and social life as well as the flood of the novel knowledge to be acquired make the task for personal development more and more complex. Multiple of the business and the educational institutions have adopted the e-learning as a core method for knowledge management. The expansion is observed in the rate of adoption and utilization of e-learning in all of its kinds (ITC, 2012). Nowadays one electronic learning environment

provides not only one-way but also two-way and multi-way interaction between tutors, learners and the e-learning content. The dynamics of user behavior is a subject for research of multiple studies (Macfadyen L. P., 2010), (Black E. W., 2008), (Huang Y., 2008), (Canales A., 2007). There are multiple publications and groups also in Bulgaria that focus on different LMS-related research domains (Tuparova D., 2007). Some of the studies (D. Denev, 2006), (P. Phobun, 2010) target to develop a guided learning process customized to each user based on assignment of the user to pre-defined models of learning or to algorithms that monitor his activity. Another domain for research is the grading process - how the e-learner is assessed on the basis of his activity in the system or/and on the basis of some examination. There are also suggestions that are based on the apparatus of the intuitionistic fuzzy sets (IFS) (Shyi-Ming Chen, 2013) however most of the methods imply human involvement in the appraisal process.

This paper suggests an approach for automatic assessment of the intermediate tests which are usually given to the e-learner in the milestone locations of an e-learning course. The results on these intermediate tests are often used just by the learner for self-assessment. However our goal is to use them as checkpoints that the LMS will use in order to determine if the user is ready to continue forward with the next topic in the course or he/she should go back and do some more reading on the previous subjects. The suggestion is based on an extension of the e-learning system with utilities that capture and store intuitionistic fuzzy data. We propose an algorithm to assign intuitionistic fuzzy grades to the intermediate test results based on additional information that we collect during the answering process. The intuitionistic fuzzy grades measure how much was the learner confident in his answers. Such an extension of the standard assessment of an answer as true or false provides an opportunity for a better suggestion for the next step in the course. Moreover as a future work this approach could be extended to support also the final assessment of the student.

## II. PRELIMINARIES

In (Atanassov, 1999) Atanassov defines an intuitionistic fuzzy set (IFS)  $A$  over a finite universal set  $E$  as an object having the following form:

$$A = \{ \langle x, \mu_A(x), \nu_A(x) \rangle \mid x \in E \},$$

where the functions  $\mu_A: E \rightarrow [0, 1]$  and  $\nu_A: E \rightarrow [0, 1]$  define the degree of membership and the degree of non-membership of an element  $x \in E$  to the IFS  $A$ . The following condition holds:

$$0 \leq \mu_A(x) + \nu_A(x) \leq 1.$$

Larger values of  $\mu$  denote higher degree of set membership while larger values of  $\nu$  denote lower degree of set membership. The set  $E$  is called universe of discourse. The value of  $\pi_A(x) = 1 - \mu_A(x) - \nu_A(x)$  represents the degree of hesitation (or uncertainty) associated with the membership of an element  $x \in E$  in the IFS  $A$ . We call this value intuitionistic fuzzy index (or degree of non-determinacy / uncertainty) of the element  $x$  to the IFS  $A$ . If  $\pi_A(x) = 0$ , for all  $x \in E$ , then the IFS  $A$  is reduced to a fuzzy set.

The IFS theory is very appropriate for modeling of human behavior as it usually implements some degree of hesitation. We have identified opportunity to measure the uncertainty of learner's confidence while he answers the intermediate test questions in an e-learning course.

The empirical data collected from the process of learning in a virtual environment are stored in an Intuitionistic Fuzzy Relational Database System (IF RDBMS) (Kolev B., 2005), (Kolev B., 2005). The data are analyzed by utilizing specific operators over the intuitionistic fuzzy records that are considered as elements from the universe over which are defined the intuitionistic fuzzy sets (IF sets).

The paper is organized as follows. The next section presents architecture of the system. The following one exposes the algorithm that is used to define an IF set for the purposes of this study. The fifth section gives an overview of the method that is used to evaluate an intermediate test and to appraise if the current knowledge of the learner is good enough to continue with the successive course topics or he/she should be brought back to read again a previous chapter of the material.

### III. ARCHITECTURE OF THE SYSTEM

The authors have decided to use as a LMS Moodle due to several reasons: it has a GNU General Public License; it is widespread in Bulgaria and worldwide; it is among the most

advanced learning management systems. The empirical data collected from the process of learning in the Moodle environment are stored in a relational database management system (RDBMS). Due to the specific requirements the RDBMS should have been able to store and process IF data. Moodle was installed over an instance of the relational database management system PostGre because there is a module which is an IF extension of the PostGre RDBMS that implements operations from the IFS theory. Thus it facilitates the storage and the analysis of IF data.

#### **IV. ASSIGNMENT OF THE INTUITIONISTIC FUZZY DEGREES TO THE ANSWERS OF THE TEST QUESTIONS.**

Each learning course usually consists of several topics that learning objects (LO) (Gerard, 1967). Apart from the subject-matter and the practice items each learning object should have also intermediate and final tests to evaluate what the student has learned. We suggest an approach for automatic assessment of the intermediate tests and use the assigned grades to determine the next topic that will be presented to the learner – a new one or an old one that should be revisited.

An intermediate test is usually composed of several questions. The Moodle LMS presents opportunity to choose between different types of questions. For the algorithm it is not important which type of question is used. The important thing is that a question has to be filled in for some limited time. The student is informed that he has a time limit to provide the answer however the specific time is not presented to him. As each question has a different difficulty its assigned time limit is different. One question is considered as one element from the universe of disclosure used to define an intuitionistic fuzzy set  $A_{ij}^m$  for an intermediate test:

$$A_{ij}^m = \{ \langle x, \mu_{A_{ij}^m}(x), \nu_{A_{ij}^m}(x) \rangle \mid x \in E \}$$

Where  $i$  is an identifier for the student,  $j$  denotes the chapter of the course (i.e. is identifier for the test) and  $m$  states the attempt that the student is doing for this test. The membership and non-membership degrees are assigned when the student answers a question. When the answer is correct the membership degree is set initially to 1 and respectively when the answer is not correct the non-membership degree is set initially to 1. Next we calculate the hesitation degree  $\pi_{A_{ij}^m}(x)$  and correct the initial values of the membership or non-membership degree. The hesitation degree is calculated on the basis of

the time that the student has spent on the answer of a question. We have conveyed a preliminary survey on a group of 75 students to find out the sample of answering times for each question. We consider that the hesitation degree  $\pi_{A_{ij}^m}(x)=0$  if the answer to a question  $x_p$  is correct and the response time is within the interval  $[0;t_p^{avg}+\sigma_p]$  where  $t_p^{avg}$  is the average time and  $\sigma_p$  is the standard deviation for the answering time of the correct answers for the question  $x_p$  received from the preliminary survey. If the answer is provided slower than we assign a hesitation degree different than zero and respectively lower the membership degree - the bigger is the time spent on an answer, the bigger is the hesitation degree. The exact formula that is used for the calculation is:

$$\pi_{A_{ij}^m}(x_p) = \frac{|t_p - t_p^{avg} - \sigma_p|}{t_p^{max} - t_p^{avg} - \sigma_p} * 0.5,$$

where  $t_p$  is the answering time to the question  $x_p$  in the current attempt of the student and  $t_p^{max}$  is the maximum available time for this question. Then the initial value of the membership degree is corrected by subtracting the value of the hesitation degree:

$$\mu_{A_{ij}^m}(x) = 1 - \pi_{A_{ij}^m}(x)$$

As the answer is considered correct the membership degree varies in the interval  $[0.5;1]$  and the hesitation degree – in the interval  $[0;0.5]$ . Respectively when the answer is wrong the hesitation degree denotes the fact how much this wrong answer means that the student does not know the correct answer. We consider that if the student has provided a reply within the interval  $[0;t_p^{avg}+\sigma_p]$  he/she was sure that the provided answer is the correct one. Respectively if the reply has taken longer time the student was more hesitated. Thus for the non-correct answers the initial value of the non-membership degree is corrected:

$\mu_{A_{ij}^m}(x) = 1 - \nu_{A_{ij}^m}(x)$ . In the framework of these admissions the non-membership degree could take a value in the interval  $[0.5;1]$  and the corresponding hesitation degree falls again in  $[0;0.5]$ .

## V. EVALUATION OF AN INTERMEDIATE TEST

Upon a completion of an intermediate test the system has generated IF degrees for each of the questions and the respective IF set was defined. For example, if the test is composed of 5 questions then its respective IF set is:

$$A_{ij}^m = \{ \langle x_1, \mu_{A_{ij}^m}(x_1), \nu_{A_{ij}^m}(x_1) \rangle, \langle x_2, \mu_{A_{ij}^m}(x_2), \nu_{A_{ij}^m}(x_2) \rangle, \langle x_3, \mu_{A_{ij}^m}(x_3), \nu_{A_{ij}^m}(x_3) \rangle, \langle x_4, \mu_{A_{ij}^m}(x_4), \nu_{A_{ij}^m}(x_4) \rangle, \langle x_5, \mu_{A_{ij}^m}(x_5), \nu_{A_{ij}^m}(x_5) \rangle \}$$

We consider that the totally correct answer set of an intermediate test has the following IF set associated:

$$A_j^{best} = \{ \langle x_1, 1, 0 \rangle, \langle x_2, 1, 0 \rangle, \langle x_3, 1, 0 \rangle, \langle x_4, 1, 0 \rangle, \langle x_5, 1, 0 \rangle \}$$

We need to compare the two sets  $A_j^{best}$  and  $A_{ij}^m$  to measure how much the specific answer set of the given attempt of the intermediate test is close to the totally correct answer set. To do that we employ a technique from the IFS theory for calculation of a similarity measure between two IF sets. We use the similarity measure defined in (Boyadzhieva D., 2010) as follows:

$$\psi_q^{n,s}(A, B) = \frac{(\delta_{q,B,A}^{n,s} + 1 - \delta_{q,A,B}^{n,s})}{2}$$

where  $q=\{1,2,3\}$  is the index that designates the norm,  $n=\{1,\dots,34\}$  is the number of the negation,  $s=\{',''\}$  designates the first or second type of subtraction for the given negation,  $A$  and  $B$  are the concrete IFSs that are compared,  $\delta_{q,A,B}^{n,s}$  denotes the respective subtraction of the two IF sets  $A$  and  $B$ .

We have chosen  $q=3$  which is the norm  $\eta_{3,A}(x) = \frac{\mu_A(x) + 1 - \nu_A(x)}{2}$ ,  $n=1$ ,  $s=\{'\}$  and thus we could rewrite the formula like this (just to note that for the first IF negation the first and the second types of subtraction coincide):

$$\psi_3^{1,'}(A, B) = \frac{(\delta_{3,B,A}^{1,'} + 1 - \delta_{3,A,B}^{1,'})}{2}$$

As a result of the calculation of the similarity measure we could say which one of two compared IF sets has better intuitionistic fuzzy degrees and to know the extent of similarity.

In our case it is clear that the IF set  $A_j^{best}$  will be the one with better intuitionistic fuzzy degrees however on the basis of the specific value of the similarity measure we will be able to say how much similar is the current answer set for an intermediate test to  $A_j^{best}$ . We have to note that the similarity measure is a crisp value and thus it is easy to set a marginal value that will differentiate what the LMS will suggest to the learner – to continue with the next topic or to revisit a previous one. The following properties hold for similarity measure  $\psi_q^{n,s}(A, B)$ :

- a)  $0 \leq \psi_q^{n,s}(A, B) \leq 1$
- b) If  $\psi_q^{n,s}(A, B) < 0.5$ , then the IF grades of the set  $A$  are better than those of the set  $B$ .
- c) If  $\psi_q^{n,s}(A, B) > 0.5$ , then the IF grades of the set  $B$  are better than those of the set  $A$ .
- d) If  $\psi_q^{n,s}(A, B) = 0.5$ , then the IF grades of the sets  $A$  and  $B$  are equal.

The algorithm that is implemented in the LMS of this study uses as a first IF set of the two to be compared the  $A_j^{best}$  set. Thus we could fell in cases b) or d) of the above ones and the similarity measure will be always less than or equal to 0.5. The values closer to 0.5 mean that the student has scored better. We have to note also that the worst similarity measure within the specified admissions is 0 – it happens when the answers to all questions are wrong and they have been provided within a time that does not exceed one standard deviation of the mean. When all questions are wrongly answered but all these answers have been provided at the last possible moment of the time given the similarity measure is 0.125. This number designates that the current answer set is far from the best answers but it also incorporates the information that the student was not confident in these wrong answers – i.e. he/she needs to revisit the previous topic but probably he/she already knows more than the student whose answer set has a similarity measure 0.

For example let's calculate the similarity measure for the first attempt of the first intermediate test performed by the student with id 23. Table 1 lists the records that represent this answer set. The respective membership and non-membership degrees that are assigned to each answer are presented in columns mship and nmship.

	mship double precision	nmship double precision	student_id bigint	question_no smallint	attempt_no smallint
1	0.7	0	23	1	1
2	0	0.5	23	2	1
3	0	0.2	23	3	1
4	0.5	0	23	4	1
5	0.6	0	23	5	1

Table 1. Records that represent the first attempt to the first intermediate test by a user with id 23.

The query that is presented on Listing 1. is executed from within the LMS against the IF database. There are several functions that implement operations from the IFS theory and are available in the IF module that extends the PostGre database (NORMS3, diff1).

```

select      AVG(NORMS3(d1."mship",    d1."nmship"))    as    d1_distance3_1,
AVG(NORMS3(d2."mship", d2."nmship")) as d2_distance3_1,
      (AVG(NORMS3(d2."mship",    d2."nmship"))+1-AVG(NORMS3(d1."mship",
d1."nmship")))/2 as similarity
from (select question_no, MSHIP, NMSHIP from ifs_interm_quiz1_best
      diff1
      select question_no, MSHIP, NMSHIP from ifs_interm_quiz1_attempts where
student_id=23 and attempt_no=1) as d1,
      (select question_no, MSHIP, NMSHIP from ifs_interm_quiz1_attempts where
student_id=23 and attempt_no=1
      diff1
      select question_no, MSHIP, NMSHIP from ifs_interm_quiz1_best) as d2;

```

Listing 1. The query that is executed to calculate the similarity measure between the IF set constructed for the attempt presented on Table 1 and the IF set  $A_1^{best}$ .

The similarity measure is  $\psi_3^{1'}(A_1^{Best}, A_{23,1}^1) = 0.305$ .

We have decided that 0.33 is a good marginal value against which the system will compare the similarity measure in order to decide what step to suggest to the learner. Thus the similarity measure 0.305 will make the student go back in the course. Let's see a few more of his next attempts to pass the intermediate test. Table 2 presents the second attempt to the first intermediate test of the same user.

	mship double precision	nmship double precision	student_id bigint	question_no smallint	attempt_no smallint
<b>1</b>	0.5	0	23	1	2
<b>2</b>	0	0.5	23	2	2
<b>3</b>	0	0.5	23	3	2
<b>4</b>	0.5	0	23	4	2
<b>5</b>	0.5	0	23	5	2

Table 2. Records that represent the second attempt to the first intermediate test by a user with id 23.

The similarity measure for this attempt is  $\psi_3^{1'}(A_1^{Best}, A_{23,1}^2) = 0.275$ . Looking at the IF degrees in Table 2 we could conclude that the student has pondered too much on each question and that's why the similarity measure is lower than the one assigned to the first attempt although the proportion of correct/non-correct answers is the same.

Table 3 lists the data collected during the third attempt of the same user for the same test.

	mship double precision	nmship double precision	student_id bigint	question_no smallint	attempt_no smallint
1	0.7	0	23	1	3
2	0	0.1	23	2	3
3	0	0.2	23	3	3
4	0.8	0	23	4	3
5	0.7	0	23	5	3

Table 3. Records that represent the third attempt to the first intermediate test by a user with id 23.

The similarity measure for the third attempt is  $\psi_3^{1'}(A_1^{Best}, A_{23,1}^3) = 0.345$  which is greater than the threshold value 0.33 thus the LMS suggest to the student to go to the next section.

## CONCLUSION

The paper has suggested a new way for automatic test evaluation in a LMS framework employing principles from the IFS theory. The method is able to capture the confidence of a learner based on his answers to questions provided to him by the e-learning environment. The assessment of the intermediate tests is used to suggest the next right step for the specific user at the specific state. The grade that is received could designate that the student should be brought back in the course and reread some of the material. As the decision is taken on the basis of both intuitionistic fuzzy degrees there could be situations when the student has answered correctly a substantial number of test questions but due to the fact that his/her answers were not pointed out with a high confidence the user is sent back to revisit the previous chapter of the course. Analogously there could be cases when a lower number of questions have been answered correctly but because the system has detected high confidence

the user is allowed to continue forward. A further scope for research could be to extend the application of this method to other milestones in an e-learning course or to include other tacit features of the user behavior in the learning management process.

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## MULTISKILLING IN THE HOSPITALITY INDUSTRY IN SOUTH AFRICA AND ADJACENT COUNTRIES

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### ABSTRACT

As the southern African Hospitality Industry strives to become globally competitive, multiskilling is increasingly pursued as a means of increasing employee competitiveness. This study assesses the current state of multiskilling and explores some ways in which practical initiatives could be taken further to promote multiskilling and make it more effective. The purpose of the paper is to ascertain the current state of affairs in hospitality operations in a sample of five southern African countries using both quantitative and qualitative approaches. It also stresses the vital importance of developing effective multiskilling opportunities and practices. Some practical ideas are provided to assist in this regard. Multiskilling at the level of the industry is an ongoing process and a huge challenge and it relies on the passion for the industry of all employees and other stakeholders. The study also concludes that all hospitality industry managers have an invaluable role to play in the promotion of employee multiskilling which cannot be over-emphasised, failing which there will be a negative impact on the efficiency and effectiveness and ultimately profits of hospitality industry enterprises in southern Africa.

**Keywords:** hospitality industry, flexibility, staff utilization, multiskilling, efficiency, southern Africa.

### 1. INTRODUCTION

The hotel industry and the effective management of the human resources are of huge economic importance for South Africa and the immediate region, especially given that the number of international arrivals is increasing annually although it is not always as much as was expected. The literature suggests that multiskilling is considered to be an effective operational strategy to resolve concerns including insufficiently qualified employees and the high employee turnover rates that plague the industry. However, the question arises as to

how relevant multiskilling is in Hospitality businesses *per se*. One key question is whether hotels do use multiskilling. Another key question is in which areas precisely, should hospitality operations seek to multi-skill employees, if at all and if so does it lead to greater efficiency. There is clearly a need for hotels and industry players to leverage on technology, and to skill their workers to be able to handle multiple tasks, and thus also to streamline their operating processes. This article analyses why multiskilling is critical but often fails in its quest to assist hospitality companies to obtain a strategic competitive global advantage. In similar vein to what happens in most countries, skill development across the board is undoubtedly a significant factor in determining the competitive advantage of South Africa and since she is undoubtedly the tourism giant of the region, her industry was focussed on in particular in this research.

Hospitality is part and parcel of the tourist industry and tourism is the fourth largest generator of Gross Domestic Product (GDP) in South Africa after mining, manufacturing and quarrying (Taal, 2012. [www.lrs.org.za](http://www.lrs.org.za)). Hotels and other forms of accommodation operate in what is really an unpredictable global environment. There are large fluctuations on both the supply and demand side. Most of the customers emanate from the ranks of business and recreational travellers who seek accommodation in either hotels, guest houses, bed & breakfast enterprises, inns, time-sharing of apartments at certain resorts, eco-friendly nature and game lodges, camping sites caravan sites or other overnight accommodation. This also impacts on the food and beverage sector which includes restaurants, coffee shops, tearooms, fast food outlets as well as a wide range of catering services. The hospitality sector has grown rapidly over the last few years and it is now one of the fastest growing sectors in the economy.

In 2008 South Africa, like many other countries, was affected by the global recession. However in the latter part of 2011, the hospitality market suddenly began to suggest signs of improvement (CATHSSETA, 2010). The summer 2011-2012 season was the strongest it has been for a number of years. Clearly the impact of the FIFA World Cup 2010 cannot be underestimated. South Africa has also been promoted as a desired global convention destination and the country is guaranteed at the least, 200 international conferences during the next few years, which should attract approximately 300 000 visitors. After the FIFA World Cup 2010, the number of travellers continued to soar, rising by 4.3% to 13.77 million. Given this increase the number of foreign overnight visitors is projected to increase by at

least a 4.6% compound annual rate to attain some 10.45 million by the end of 2016 (South African hospitality outlook: 2012-2016 PricewaterhouseCoopers Inc. [www.pwc.com/za/hospitality-and-leisure](http://www.pwc.com/za/hospitality-and-leisure)).

In South Africa in 2009 the hospitality and tourism sector generated R179 billion of economic activity and 45 000 jobs through direct employment and just over one million jobs, representing 7.6% of the total employment of South Africa (Taal, 2012. [www.lrs.org.za](http://www.lrs.org.za)). However, in the South African context, a major human resource challenge facing the hospitality industry, is the high staff turnover rates. This also constitute one of the key issues affecting service quality delivery. Unfortunately large number of employees consider hospitality work to be a pass-through to a job in a different and higher level industry, rather than as a life-time career commitment. There is also low morale and poor motivation levels which are decisive contributory factors to the high employee turnover (CATHSSETA, 2010). The need to develop appropriate retention strategies is imperative if this predicament is to be at all solved. One effective approach could be the multiskilling of employees as a means of motivating, incentivising and encouraging them to stay in the industry as a lifelong commitment. Ottenbacher and Gnoth (2005) argue that the effectiveness of a hotel's approach to managing employees is a critical source of sustainable advantage-hence, employees must be highly skilled and even multi-skilled. By multiskilling employees, hotels' can benefit from increased levels of productivity, greater service quality provision, and higher levels of employee retention. From the employees point of view, they are empowered with new skills and generally benefit from greater job satisfaction, increased remuneration, and greater opportunity for promotion (Riegel, 2002).

Veldsman (1994) has suggested that a diagnostic process be followed in ascertaining what an organisation needs to do to achieve effective transformation into a highly competitive global environment. What can be done to make an organisation more effective and efficient, and how can employees be made more competent and capable of meeting the ever-changing needs of organisations is now critical to success (Stalk et al, 1992). Each organisation is of necessity, required to clarify the criteria in terms of which business is conducted including *inter-alia*, quality of service, speed, innovation, cost and responsiveness (Galbraith & Lawler, 1993). There are no immediate panaceas for the ills plaguing organisations and so consideration must be given to the relative influence of remedies that are sought which would satisfy the criteria of the organisation. What is critical is that the strategic intent,

architecture and employees in the organisation must be carefully considered before any value-adding remedy is implemented. While the benefits of training are not immediately linked with financial performance, hoteliers in South Africa must be made to understand that employee training and especially multiskilling has benefits on service quality that in turn, influences both the competitiveness and financial performance of their operation. Remedies must be sought to improve profitability and multiskilling is for example, one such remedy intended to extend the range of skills of individual employees so as to improve their labour flexibility as they seek to react to workplace changes that affect them and the employer (Clark, 1989). A flexible multiskilled employee base has been identified as the most significant contributor to the development of human resources in reaction to a world in which there are many competitive, technological and labour supply pressures (Kalleberg, 2001; Knox & Walsh, 2005)

## 2. DEFINING MULTISKILLING

To lay a foundation in which this discourse can take place, it is necessary to define the term 'multiskilling' which is viewed from a number of diverse perspectives. Generally speaking, multiskilling is the attainment of supplementary task-related skills and knowledge, which empower an individual to perform a broader range of tasks and functions within any organization. Cordery (1989, p.13) states that: "Programmes of multiskilling generally involve workers on a particular occupational, craft or skill category progressively picking up the capability to perform additional tasks, usually performed by workers in another functional or occupational area within the organisation". There are three distinct types of multiskilling. Firstly, there is Cross-skilling, which relates to the acquiring of skills of a similar level of complexity but beyond the usual boundaries of the traditional operations. Secondly there is Vertical multiskilling which relates to the acquiring of extra skills at a higher level of difficulty, and thirdly, there is horizontal multiskilling which relates to acquiring other skills which are similar in levels of complexity (Wood, 1993). It is important to ascertain if employers know the exact competences they expect from the employees and only when their expectations match their perception, does service quality result which ultimately benefits the guests and the business (Ladkin, 2005).

Multiskilling is considered to an important tool to assist hospitality industry operations to cope with problematic environmental changes but a return on investment in it is only

possible if employee needs in the workplace are correctly identified and if employees are truly committed to, and passionate about their work. However, according to Ingram & Fraenkel (2006), despite the fact that multiskilling can improve service quality, it may also to an extent lower productivity by reducing the number of “point of service” staff. Training for multiskilling benefits hospitality operations, as the employees in attendance are capable of performing other tasks in shifting situations (Huang & Cullen, 2001). It also leads to greater economic success, enhanced productivity and greater profit margins, and more importantly lower levels of employee turnover in an industry that is plagued by inordinately high turnover rates of employees especially in peak seasons (Marchante, Ortega, & Pagan, 2006). Many hotels try to bridge the skill gap by taking on either part-time or casual employees (Lai & Baum, 2005). Multi-skilled employees are able to serve a business in a wider range of operational areas which cut across traditional occupational boundaries. by having an increasing pool of skills and concomitant loss of emphasis on job demarcation (Matias-Reche & Fuentes-Fuentes, 2006).

### **3. WHY MULTISKILLING IN THE HOSPITALITY INDUSTRY?**

Multiskilling indicates practical ways in which existing employee workforces can be rationalised through optimally utilizing them so that employee costs can be operationalised, thus leading to greater efficiency and greater profits. Flexible employment practices and the integration of culturally diverse workforces in the hospitality industry are relatively new trends that can cause considerable challenges and opportunities for many countries in the SADC region. The manner in which these issues are handled strategically is becoming a vital issue for human resource managers in hospitality operations to consider. This is particularly relevant given that it is expected that the total number of travellers to South Africa will rise to 16.85 million by 2016, representing a 4.1% compound annual increase from 2011. This increase in travel and tourism will stimulate growth in the hospitality industry in the next five years and hospitality operations will have to have effectively skilled employees in place. In order to meet the demand of providing service quality excellence, employees will need to be multi-skilled. Central to the notion of multiskilling will be the development of formal enterprise-based skills training initiatives that will make provision for both horizontal and vertical skilling. Powell and Wood (1999) state that one of the most noteworthy problems in the hotel industry worldwide is the “brain drain” since the skills and qualifications gained in hotel sectors are effortlessly transferable to others. A continual and steady economic growth

rate both locally and abroad will hopefully assist the average hotel occupancy rate to improve and this is expected to increase by 9.1% to 62.1% in 2016, boding well for the industry (South African hospitality outlook: 2012-2016 PricewaterhouseCoopers Inc. [www.pwc.com/za/hospitality-and-leisure](http://www.pwc.com/za/hospitality-and-leisure)). Consequently, employees should acquire the requisite skills which will eventually allow them to perform all the required tasks of a number of jobs both within and without their current functional areas of operation, when the need arises to do so. Competence in a variety of skills is desirable but employees should be given incentives so as to motivate them to acquire extra skills. Multiskilling will enhance the capabilities of employees and serve to strengthen the employers competitive advantage. Not only the employees, management and the organisation will benefit from multiskilling, but customers and guests will also benefit because of the quality of products and services received (Sommerville, 2007). Some operations refer to multiskilling as cross training. This ensures the employees obtain knowledge and skills from other departments and increases their ability to adjust to be able to work in these departments at short notice if and when a need arises, or as a matter of course (Walker, 2007).

Multiskilling is used by many international hotel groups as well as local and regional groups to enhance the skills of employees and also serves the role of grooming them for supervisory positions and is thus also linked to monetary incentives. Consequently when employees upgrade their skills their salaries are also upgraded. There is of course the primary notion of focussing on quality service provision. The multiskilling training of employees together from diverse departments cultivates a team spirit and this promotes higher operational efficiency as the various departments coordinate their activities especially during peak tourism periods. When information and skills are shared across departments, new skills are taught and knowledge is increased and so an effective learning culture is the result. Multiskilling is thus generally perceived to be a very cost-effective way to enable hotels to deal with the cyclical discrepancies in the demand for seasonal employees (Baum, 2006). Multiskilling, cross deployment and the use of the latest technology are generally at the pinnacle of the initiatives that most hotels are looking at to increase the levels of productivity of their employees.

It is important that the competency and skill levels of all multiskilled trained employees should be uniform so that no function is lacking in terms of guest expectations and service quality provision. A major benefit of multiskilling across hotel departments for example, is that allows flexibility of employees and provides supervisors with extra time to allocate team

members important and pressing tasks especially when large amounts of guests are expected. The ongoing success of hospitality operations in general relies heavily on the efficient and effective implementation of daily operations (Hrebiniak, 2005). According to Hinkin and Tracey (2000), employee turnover in the hospitality industry has been one of the biggest concerns for a number of years and it results in high direct expenditure as well as intangible costs (Woods and Macaulay 1989). The direct expenditure includes the administration costs of regular employee resignations, attracting new and efficient employees and recruiting and selection as well as seasonal hiring. The intangible costs comprise lost-man-hours, sub-standard service quality provision, and especially very low morale which all adversely affect a hotel's reputation if left unchecked (Hinkin and Tracey, 2000). Riegel (2002) maintains that high employee turnover is the outcome of an intricate chain of factors, including job satisfaction and organisational commitment to maintain an employee base. There is no doubt that hotels in particular, but also other hospitality enterprises, need to vigorously promote a culture in the workplace which promotes the notion that when employees assume positions that they do so on a permanent basis. Long-term employment must be promoted as the required and preferred option by especially managers as only in this way can a strong internal labour market develop.

Many employees leave since they feel they do not have the required skills and they thus become unhappy at work and seek other forms of employment which appear more rewarding and attractive to them (Mobley, 1982). Hinkin and Tracey (2000) explain that poor supervision and training, badly planned working environments, as well as poor rates of compensation cause the high rates of attrition in the industry workforce. Cheng and Brown (1998) explain that hotels need to effectively induct and socialise employees as this is generally not happening in hotels worldwide. Furthermore they require training and personal development that highlights the desire of a company to invest in their employees which in turn should lead to an increase in employee commitment and to job satisfaction in general. Multiskilling training can help reduce employee turnover rates since employees will increasingly find meaning in their work and be able to cope with challenges on a day-to-day basis. Employees will become more creative and innovative and be satisfied even though their salaries and conditions of employment may not be as they desire them to be (Kelliher & Riley, 2003). Heskett *et al.* (1990) propose that service organisations need to 'become employers of first choice...develop and retain such people through...ministering'. This notion is furthered by Schneider and Bowen (1993) who explain that the customers'

experience is the central issue in appreciating service quality provision. Their research also advocated that the solution to managing the customer's experience of service quality provision is to manage employees' experiences in their place of employment. Hence where multiskilling is in place, employees more likely to be positive and more receptive to customers and their needs and wants. Multiskilling empowers employees and helps them to better understand their work in the broadest sense and it encourages self-confidence and self development. They are able to learn a wide range of problem solving skills and generally makes them more productive. In terms of managerial benefits, it aids in the maintenance of desirable standards and makes it easier to identify possible promotion candidates. It also leads to improved profitability and reduces the risk of accidents at work and violations of safety issues. Wastage is minimised, especially in food and beverage operations.

Boella and Goss-Turner (2005) state clearly that any organisation's primary objective is to provide service quality. This necessitates that all employees must initially be carefully selected, sufficiently trained, and motivated to be committed to service quality provision. Multiskilling will essentially better equip the employees to provide more effective and efficient service, but also allow for service which is more personalised and which makes a difference to the guests' perceptions and experiences. Where there are job vacancies, these can also be promptly filled by multi-skilled employees and this facilitates both the sideways and upward mobility of employees from one post to a different one (Matias-Reche & Fuentes-Fuentes, 2006). Multi-skilled employees are able to move with ease from one task to another as they are skilled to perform a variety of jobs and participate in decision-making and thus add value to the organization as a whole (Kalleberg, 2001). Based on personal experience, there appears to be a chronic shortage of skills in many hospitality staff and this possibly suggests that these are not imparted to employees during their training. In other words the requisite skills are lacking and this invariably impacts negatively on the industry. Davids and Fredericks (2004, p.6) state that multiskilling is the acquirement of skills, knowledge, competency, and experiences, which empower the individual to perform tasks beyond the scope of their immediate job requirements. Multiskilling thus endows the organization with highly flexible and adaptable employee, and thus provides for a more greatly skilled team of employees. Haas, Rodriguez, Glover, & Goodrum (2001) state that productivity in organisations can be increased by 5% or more where multiskilling exists. There is also a possible 35% reduction in total hiring of employees as a result of multiskilling and the financial benefits of this aspect are thus clear.

Essentially, competent employees contribute to enhanced customer satisfaction amongst other things (Nwenre, 2005). Employees should have a range of skills and attitudes that affect a major part of their jobs (Nwenre, 2005) which impacts on service quality excellence. The literature suggests that employees who are functionally flexible through the effective practice of multiskilling are far less likely to be part of a high turnover rate of staff (Hoque, 2000; Kelliher & Riley, 2003). Consequently multiskilling training can lead to greater functional flexibility and thus help hotels to often vexing and difficult labour market. Research has shown that especially five star hotels are always seeking to improve their internal labour market through making improvements in skills training provisions and employee career development programmes (Knox & Walsh, 2005) and so, multiskilling training is commonly utilised in the hospitality industry in southern Africa. It is viewed by many managers as a labour deployment strategy that enhances the productivity of employees (Nankervis & Compton, 2006).

#### **4. WHICH SKILLS ARE REQUIRED?**

A number of researchers have explained that in diverse countries the employers may expect employees' to possess a different set of skills in the workplace. Cotton (2002) has isolated a number of skills and competences that hospitality employees are expected to have, including people management, persuasion, communication, relationship-building, planning and organizing, analyzing information, decision-making skills, commercial acumen and flexibility. In addition to a set of desired skills being taught, there is also a need for example, to develop attainable career paths for employees so as to increase employee commitment. This will also aid in the drive to retain employees who are well qualified. A number of skills are desirable, but Gilmore and Gregor (2001) have recognized that characteristics such as integrity, honesty, adherence to an ethical code of conduct, suitably attired employees, fairness, respect and harmonious working relationships are important skills to impart. Being punctual, careful, reliable and trustworthy were also considered to be appropriate professional behaviours. Multiskilling would undoubtedly provide for the acquisition of valued skills, but this is only possible if the job design, work organisation, management commitment and empowerment to use the skills obtained are in place. The absence of these aspects will impact negatively on the outputs of the multi-skilled employee who is thus wasted. Of course, all required skills are fine-tuned by learning and constant practice and

interaction with other employees. Teamwork is another crucial skill in hospitality and should be part of multiskilling and cut across departments if there is to be a sustainable quality of service. Multiskilling also offers front-line managers the prospect of learning new skills and provides for job variety. Organizations tend to be more productive where there is labour flexibility. This also allows hotels to manage in service environments that are unstable due to a plethora of impacts from the macro-environment. Multiskilling should initially encompass employees from middle management down to the most basic levels in each of the departments of a hotel, including the front desk, housekeeping, laundry services, engineering, stewarding, culinary or food and beverage service and even security and health and safety aspects.

Managers also require multiskilling in both technical and generic aspects of work. In a nutshell, managers should possess the knowledge and skills that enable them to function effectively. The generic managerial competences allude to a manager's ability to self-regulate and self-control themselves in their job development. Many managers are also unable to meet their responsibility for training and skilling of staff because they themselves lack the knowledge and skills required to be effective trainers. Managers lack competence in skills and knowledge and this is a huge gap in their technical ability. Especially financial management and computer skills were found to be lacking according to Agut *et al.* (2003) in a study of Spanish hotels. Other skills requiring attention through multiskilling, included communication and motivational skills, understanding of the hotels mission and vision, and the expectations and behaviour of different types of guests. People management skills were also found to be lacking as were problem solving, control of information and decision-making. Food and beverage skills and other functional skills such as housekeeping and customer care were also in need of a revamp. Agut *et al.* (2003) also found that all employees, irrespective of rank, lack even the most basic understanding of the levels of service expected by all guests but especially international guests.

As a work philosophy, on-the-job training is an intrinsic aspect of multiskilling. It requires outlays of time, effort and financial investment. It is important that the entire process be carefully monitored and evaluated on a regular basis. A positive attitude on the part of employees is required for success and they should desire the acquisition of new skills and an opportunity to grow in the workplace. However for this to happen there should be a 'primary' multiskilling conducted in the same discipline where the employee currently serves

and in which he or she has displayed ability. This means that specialisation is not watered down but rather that the quality of service is improved. Employees must be tangentially empowered to act on guest needs and wants even though what they are asked to do is not be directly related to their job description.

Employees also require a measure of autonomy, responsibility and should be given regular feedback relating to their newly acquired skills. Research conducted by Burgess and Aitken (2004) in their survey of employers ascertained that functional skills, conflict resolution skills, computer skills and basic good work habits were the expected skills employees should possess. Additionally, they also made known what were considered to be chronic skills shortfalls including chef skills, kitchen control, general housekeeping, management techniques, sales techniques and most importantly customer service quality provision. The latter skill is rated as having the greatest impact on a business as a result of multiskilling consequently this skill as well as others should be imparted by industry. Only when employees have attained thorough skills, will quality service improve. After the reviewing of a total of 18 hotels ranging from 4 star -5 star ratings, other skills were also identified by the researcher as requiring training. There should also be a focus on the development of skills in areas such as language, non-verbal communication and business etiquette, adaptation skills, cultural skills, host culture values and stress management. Language usage and service quality provision were especially found to be lacking and in need of urgent training. It is desirable that at a moments notice, employees should be able to step forward to perform functions outside their disciplines in other departments.

## **5. SERVICE QUALITY PROVISION**

Service quality is the primary factor which creates competitive advantage in the hospitality industry. Consequently, any operation that does not make efforts to continually improve its service quality will certainly lose ground. All hospitality operations are service-oriented and so, service quality provision is a major concern. Service quality is defined as the gap between the customer's expectation of a service and the customer's perception of the service actually received (Boella & Goss-Turner, 2005).

Service delivery is often variable and difficult to standardize due to the personal nature of the contact between a customer and an employee. Employees may often vary in interpretation of what precisely a customer is asking, but even though service may be intangible, its quality is reflected across five broad dimensions: tangibles (appearance of physical elements),

reliability (dependability, accurate performance), responsiveness (promptness and helpfulness), assurance (competence, courtesy, credibility and security), and empathy (easy access, good communications and customer understanding) (Boella & Goss-Turner 2005, p. 297). The five dimensions of service quality that are mentioned here, originate from the SERVQUAL (Parasuraman et al., 1985, 1988) service quality measurement instrument. It is thus important that multiskilling at least attempts to standardize the intangible elements of the average service encounter to an extent scripting what employees' say, and so training must essentially include words and phrases that are likely to be used in service provision. Customer expectations of service quality are an important definition aspect of service quality when these are set against the experiences of the service (Lashley, 1997).

## **6. LANGUAGE SKILLING**

Language training is very important since many South Africans speak English as a second language. Efforts should thus be made to teach employees simple phrases or terms that have subtle meanings. Many terms in indigenous languages have no English equivalents, so knowledge of their approximate meanings will serve the purpose of saving much time in explanation in dealing with especially customers. A hotel employee speaking English relatively well will invariably make a good impression on customers and will also forge stronger ties between him/herself and the management. Improved language proficiency is thus critical. Service interactions involve a variety of critical incidents where employee responses are fundamental to a customer's satisfaction or otherwise with a service provided. In this context, language usage and understanding is critical.

## **7. FUTURE OF THE SOUTHERN AFRICAN HOTEL INDUSTRY AND CHALLENGES**

Much optimism prevails in the industry and as a result various companies in the sector are seeking to refurbish and expand their properties. The Hospitality Partners Association issued a report in February 2012 in which they stated that a number of international brands seeking a foothold in Africa through South Africa. The large groups including Accor, Starwood and Hilton have announced aggressive development plans in Sub-Saharan Africa in particular (Taal, 2012). The hospitality industry in South Africa, and across the globe, is a labour-intensive industry and working conditions are hampered by often extensive and irregular working hours. This is of course exacerbated by relatively low wages and a for the most part

a lack of job security which permeates the entire industry (SA Tourism, 2007). CATHSSETA (Culture, Arts, Tourism, Hospitality and Sports Sector Education and Training Authority), maintains that Hospitality is a sector that employs the highest percentage of black people, and in excess of 70% of employees are black. The majority of them are in the lower skilled occupational categories so it is evident that multiskilling is even more crucial. In fact 30% of labour in the hospitality sector in South Africa is classified as unskilled. The Department of Labour is the primary department for national skills development in South Africa. The National Skills Development Authority (NSA) and its extensive network of 24 Sector Education and Training Authorities (SETAs'), including the CATHSSETA, deals with skills development within specified sectors such as hospitality. The Department of Education also has a directive for curriculum development, schooling and other educational institutions. Thus, there is thus essentially a close relationship between education and skills development of hospitality employees in South Africa and adjacent countries since many students and employees from these countries come to South Africa to further their studies and careers. CATHSSETA thus plays a facilitation and co-ordination role between industry and higher education institutions to align education with the many needs of a burgeoning industry.

The South African hospitality sector engaged just over 112 000 employees in 2010, and this is a steadily increasing number according to the CATHSSETA. In the CATHSSETA hospitality sub-sector, business is represented by a number of employer associations including, Culinary Arts Association of South Africa (CAASA), Federated Hospitality Association of South Africa (FEDHASA), Housekeepers Association of South Africa (HASA), National Accommodation Association of South Africa (NAASA) Restaurant Association of South Africa (RASA) and South African Chefs Association (SACA). These are employer organisations and each one is a key skills development stakeholders. Many of them are active in CATHSSETA ranging from board to chamber committee level and each of them provides sub-sector specific expertise, knowledge and input into all CATHSSETA skills development initiatives and projects which are undertaken. The efforts of these role-players is noteworthy but more needs to be done.

CATHSSETA states that there is a shortage of skilled people in general to fill certain positions such as for example Operational Managers, Pastry Chefs and Head / Executive Chefs. Skills shortages in other vacant positions do not necessarily exist because there are no skilled people to take up the positions but because they do not have the additional skills that are required for such positions. In other words there is a lack of industry specific skills and this

also includes Trainers / Facilitators. CATHSSETA has also determined that qualifications to address the scarce and critical skills in the Hospitality sub sector do exist for all levels ranging from Senior Management positions to even the most basic occupational levels. The problems that were identified with the Hospitality related qualifications were in most cases with the packaging of course material and course content lacking essential aspects for the industry which result in skills gaps for the future employees who acquire these qualifications. There are thus a large number of challenges that hamper the provision of skills in the hospitality sector (CATHSSETA, 2010). There is also a skills mismatch in that the qualifications available within the hospitality sub-sector for example, have a relevant title but the content is not what the industry requires in a particular occupation. For example a qualification in Hospitality Management has different course content to what its title reflects and far greater emphasis is spent in such a course on Food and Beverage operations and management is sidelined. Such aberrations make multiskilling even more critical.

Productivity needs to improve in the industry and employee speed and outputs require re-energising. Strategies must be devised which consider an aging workforce and existing workers must be encouraged to boost their adaptability and hunger for learning new skills. Ways need to be sought to consider the needs of especially women who are wives and mothers in the workforce who are expected to work very arduous shifts in many cases. It is clear that in the years lying ahead, the majority of the workforce will comprise non-traditional employees, many emanating from other SADC countries. The challenge is to teach them the latest technology and to skill them in as many operational areas as possible. Without such training and skilling, it is unlikely that the increased expectations of more demanding customers will be satisfied as they use hospitality products and services that cost them money. Quality service provision will continue to be an issue that will also have a direct impact on multiskilling trainers.

## **8. METHODOLOGY**

A quantitative methodology was adopted in this research (Neuman, 2006). However, aspects were qualitative, i.e. investigating the perceptions of employees on multiskilling initiatives in the hotel industry. A qualitative approach is, according to Creswell (2003) appropriate for an exploratory and descriptive study. It was thus deemed appropriate to use an extensive exploratory survey to gain required information (Frazer & Lawley, 2000). The main purpose

of quantitative research is to determine the quantity or extent of a phenomenon, in this case multiskilling, in the form of numbers. The research may be a single investigation or a range of informal studies intended to provide background information. The aims of the research investigation were communicated to the respondents as comprehensively as possible as well as the anticipated consequences (Brynard & Hanekom, 2008). This exploratory research would assist in diagnosing the dimensions of multiskilling use and would thus enable successive research projects to be accurate. The survey was intended to acquire information about the opinions of employees and their attitudes or even previous experiences by asking them questions and tabulating their answers. The goal was to establish the views of a large population by surveying a sample of the population namely, hospitality employees. This was thus in a sense a normative survey. The primary research question was to ascertain whether or not training for multiskilling was common in the hospitality industry. The survey would also test the extent to which multiskilling led to organizational efficiencies and which skills were needed the most.

Sample size is generally an issue of concern for the researchers in quantitative research due to the cost and efficiency involved in the research (Ruane, 2005). A non-probability convenience sample was chosen as there were respondents that were easy for the researcher to access-this is often referred to as an available subjects sample. A priori power analysis was used to ascertain the sample size as this ensured that the researcher did not waste time and resources carrying out a study which has very little chance of finding a significant effect, and also ensured that time and resources were not wasted by testing more subjects than was necessary in order to detect an effect that would be similar to that uncovered by surveying a larger population. The sample selected was however, representative of the larger population and included all the elements of the population. Males and females were included from a multi-cultural population of approximately 10 000 employees and the number of respondents was 450. The desired sample size of this research was 450 samples as suggested by De Vos *et al* (2002), which were collected through the participation of the eighteen, 4-star and 5-star hotels in southern Africa that were willing to participate in this research. The processes the researcher was testing were assumed to be so basic and universal that they could be generalized beyond such a narrow sample. Employees from eighteen hotels were thus surveyed in this research, in countries including South Africa, Zimbabwe, Swaziland, Mozambique and Namibia of which seven were part of international chains.

The sample population consisted of front-line managers in the industry including supervisors and managers who work in or across the departments of food and beverage operations, front office, human resources and housekeeping. The sampling scale focused on eighteen, 4-star and 5-star hotels because they were considered to be investing considerably more in training as a quality measure when compared to other hotels. The survey questionnaire was emailed to the possible respondents as this is a common method to survey members of any organization (Zikmund, 2003). Such a survey in the hospitality industry may expose the gaps in education and training and therefore be used to identify the competencies required in the industry that lead to employee empowerment, better quality service provision and may also encourage employees to remain in an industry where employee turnover rates are high.

The questionnaire used in this research was a standardized, multi-client attitude and usage study which contained 20 questions relating to multiskilling (see Figure.2). Respondents had to answer questions relating to multiskilling in their place of employment. The respondents were selected from a range of business cards and names and emails provided by managers who were willing to be involved, and were in the possession of the researcher, as well as a personal database, consisting of names and e-mail addresses of other relevant hospitality employees. Each of the respondents was sent an e-mail explaining the nature of the research as well as a request to participate by responding to the 20 questions. They were also assured that their responses would remain anonymous- thus it is more likely that they would be more truthful than they would be in a personal interview when addressing sensitive issues. A major weakness of research using a survey is that it depends on self-report data and there is often intentional deception on the part of respondents. There is also the problem of questions that are poorly worded and possible memory lapses by respondents.

## **9. MEASUREMENT**

The questionnaire comprised general questions in regard to employee personal details, using both nominal and ordinal scales. The survey also covered questions highlighting age and gender (Brace, 2004). Questions relating to employee multi-skills training actions in their place of employment were also posed, followed by questions which were aimed at obtaining employee attitudes and perceptions to this training, if any. Yes/No responses were required as well as marking options with an X. There were also basic questions requiring short written responses and listing statements in order of importance.

The survey covered questions which were piloted to a sample of ten employees in a preliminary investigation. Comments and criticism of the pilot group were noted and carefully considered in the final choice of survey questions. The result of the preliminary investigation thus highlighted where modifications were required so that the final survey could be acceptable and this helped to ensure that data obtained would be both valid and reliable. The survey had to be couched in language which was intelligible to all respondents.

The Statistical Package for the Social Sciences (SPSS) was used to examine the accuracy of the data since this allowed results to be analyzed, and frequency and percentages were used to show a direct and understandable analysis which increased the reliability of the results. SPSS thus provided a measurement of internal consistency (reliability) of the test items called Cronbach's alpha. The higher the correlation among the items, the greater the alpha. The high correlations implied that high (or low) scores on one question were associated with high (or low) scores on other questions asked in the questionnaire. In this case, the Alpha was 0.78, indicating that the questionnaire was perfectly reliable. Most of the participants were thus consistent in the way they responded to the various questions, the scale thus yielded consistent results and was considered reliable. This was an interesting find since the respondents were from diverse educational backgrounds and were expected to have very different views.

## 10. DEPENDENT VARIABLES

Two dependent variables i.e. the response that was measured, were examined in this study namely the rate of response of the respondents and the quality of their responses. These variables were thus the presumed effect and refers to the status of the outcome in which the researcher was interested.

**Number of valid responses**

**The response rate=** \_\_\_\_\_

**Total no. of respondents approached**

A high response rate is likely to reduce biases, however one not overlook other types of bias which cannot be overcome by achieving a high response rate. Where self-completion surveys

are completed it is highly likely that potential respondents with low literacy levels will not respond. However, in this study there were 382 valid respondents for subsequent analysis since 68 respondents did not respond. The response rate was thus 84.88%, which is a fair response rate, but it still does not guarantee that the results were totally free of bias. The researcher thus only considered the percentage of questionnaires that reached the respondents, and e-mails that were undeliverable were excluded.

The researcher tried to increase response rate by phoning or faxing those to whom e-mail was undeliverable. The length and difficulty of the survey was also minimized and the format was simple, ensuring questions are not ambiguous and had clear instructions. In ascertaining response quality the comprehensiveness and correctness of the responses was considered (Goetz *et al.*1984). The former was measured by the number of non-opinions provided by respondents as well as the number of partly finished questionnaires.

Bias was also considered as an important factor. All design for data collection in surveys' for example, is to an extent biased in that it will, systematically, exclude less favourable responses and inadequate survey design may sometimes result in biases. One such bias issue in this survey questionnaire was that it was in the English language and not translated into each of the official languages of South Africa and so a language barrier bias may have existed to an extent. To reduce bias, the researcher thus asked simple questions and very few were open-ended.

Generally, the measurement was estimated to be both reliable and consistent and will not likely change every time when the testing is the same with the same subject. The measure measured what it intended to analyze and was thus valid in that the relationship between the test and behaviour of the respondents was similar.

## **11. RESULTS AND FINDINGS**

The collection of the data took place from August 10, 2012 to November 15, 2012.

The profile of the respondents demonstrated a gender balance of 53% male (n=203) and 47% female (n=179) respondents. Some 30.36% (n= 116) of respondents were between 18 and 25 years of age, while 40.05% (n=153) fell in the age range of 26–45 years, 29,5% (n=111) were in the range of 46–64 years. Only 0.5% (n=2) of the respondents were over 65 years of age.

In terms of educational attainment, 27.48% (n=105) completed higher education, 6.8% obtained a mid level of education (n=26), and 65.7% (n=251) only had minimal education.

On average, it took respondents 8 days to complete and return the questionnaire.

In total, 450 e-mails were sent out. 68 of those e-mails were undeliverable, which left 382 usable e-mails, from which we received 382 completed questionnaires. This yielded a net response rate of 84.88%. Previous hotel or hospitality industry experience was found to be as follows: 11 employees had 0-2 (2.87%) years experience, 144 had 2-6 years experience (37.69%), 119 had 7-10 years (31.15%) experience and 108 had greater than 10 years (28.27%) experience. A total of 85 employees (22.25%) were in their current employment for less than one year. 194 (50.78%) were at their place of employment for over a year and 81 (21.20%) for more than 5 years, while 22 (5.75%) were at work more than 10 years.

Of the 382 respondents, 344 (90.05%) were in the middle to low levels in the hotel hierarchy, while 38 (9.95%) were in the upper management levels. A total of 319 (83.5%) of the employees responded that they had some form of limited training on an irregular basis including a little multiskilling in the sense that they had exposure to different tasks in their department or that they underwent brief alternation in other departments. A total of 31 (8.11%) stated that training was regular and included multiskilling training actions for their functional area or department and to an extent included other functional areas as well and that alternation to other department was involved and for longer duration. Based on comments made by some employees, multiskilling training appears to have been conducted when it was believed that there would be a shortage of appropriate employees to perform certain tasks and when there were high employee turnover rates, and this was just before peak seasons. Effectively serving guests and satisfying their needs, language proficiency and interpersonal communication were identified as the most common areas in which skills were trained. Despite 105 employees indicating that they had university or college education in hospitality, many felt they were not adequately trained during their university education and that their levels of on-the-job competence were limited. Since the hotels selected had somewhat different Standard Operating Procedures (SOP) this made multiskilling and re-training necessary. This highlights the need for higher education providers to provide more efficient training for their students while at university or college and also emphasises the importance of a Work

Integrated Learning component in any course related to the hospitality industry. 68% (259) felt that skills training activities enabled them to work in different functional areas and were thus more flexible. The employees who believed they were multiskilled believed that they were able to produce higher service quality than their colleagues who were not multiskilled. These employees were able to respond promptly to individual guest needs.

The initial training received was considered to be simply routine by 279 (73%) of employees while 33 (8.6%) felt it was important and 28 (7.3%) felt it was necessary. 42 (10.9%) respondents maintained that multiskilling was simply not important to them. The frequency of multiskilling training was also varied. A total of 23.29% of employees reported daily training of about one hour per day including multiskilling, 41.88% once a month for between 1-3 days, 23.82% once per annum for about a week, 8.6% twice per annum for about 6 days in total or more but not more than 8 days.

The respondents indicated that their multiskilling training involved mainly professional training, customer services and dealing with guests requests as well as language skills and attitudes to work. They stated that the multiskilling was used to assist them to receive knowledge and skills sets on work conducted in other departments. For example, some waiters reported that they were trained and multiskilled in housekeeping operations or as security or health and safety employees. Generally, most of the respondents praised the level of multiskilling training they received and believed training to be useful and well planned. Others felt that the training was part of their everyday work and were annoyed at having to remain after hours in many cases, to re-learn aspects of work in other departments that they already had training in. A greater diversity in training was desirable and it would be prudent of managers to take note of the complaint that very often, training was considered by some respondents to be time consuming and not at all building their self-confidence or developing them in any way.

A total of 87.17% of all respondents stated that training was mandatory and 96.85% said they did not need to apply for multiskilling. An amount of 95.54% reported that multiskilling training was conducted in-house and 93.19% were multiskilled by existing hotel employees at supervisory levels or higher. Some 99.21% stated that training was important to them and that they felt empowered by it and were also motivated to perform even better in the workplace. This was especially true for food and Beverage department employees in the

sample group studied. Multiskilling was found to cover, although in varying degree, aspects such as basic language skills, technical skills, conflict resolution, interpersonal skills, IT skills, self-initiative, motivation, marketing, geography and appropriate industry grooming and product knowledge. There are clearly many gaps that are not covered by higher education providers that require attention. Hospitality businesses as well as higher education providers have failed to teach students the appropriate values of professionalism and discipline in the workplace.

The responses to satisfaction with multiskilling in the workplace were varied considerably as indicated in table 1 below.

Table 1. Levels of satisfaction with multiskilling in the workplace

Item:	Response % n=382
I am very satisfied with multiskilling training	12.56%
Multiskilling training is okay	40.57%
No response (neutral)	15.96%
Not satisfied with multiskilling training	19.10%
Other eg. Intend to leave anyway	11.78%

The questions as to how multiskilling can be improved and the employees personal opinions as well as which skills were deemed necessary by them yielded interesting results as per table 2 below (a sample of the most representative answers were used). The importance of employee motivation is thus also a consideration as identified in both the literature and in the respondents replies in this study.

Table 2. How can multiskilling be improved?

Multiskilling training must be made longer	52.44%
The trainer is not adept at imparting knowledge although he/she has the skills-they should thus be trained to train	47.98%
Employees should be asked if they wish to	18.55%

obtain skills in other department areas of operation and not be forced to attend	
There is too much theory in the training	37.23%
Employees in higher level positions get more training than me	18.80%
Management has high expectations of training	33.28%
There should be repeat training to help employees master skills	41.09%
Management needs to communicate more with employees on skills needs	22.45%
I believe I already have the skill so the multiskilling training is a waste of time	08.66%
It can help managers to better evaluate my performance and I can be promoted	19.06%
The training reduces the likelihood of accidents	09.78%
The training has improved my ability to offer quality customer service	16.46%
Multiskilling helps the organisation more than me	30.85%
It is not important at all to me- I am just being 'used' by the company	35.90%
IT skills are what I need the most	18.88%
I need more customer service skills	31.50%
I need language skills in English	20.17%

Employees should be guided to a realization that improving themselves is the main aim of multiskilling while it also solves staffing problems that may arise and ultimately leads to greater guest satisfaction and thus higher profits for the company. A carefully designed multiskilling training programme, enough relevant communication and appropriate and effective multiskills facilitation training are important if hotels are to minimise the possible negative effects of multiskilling as perceived by numerous employees. It was clear that Front-Line Managers were more the most pleased with multiskilling raining provision and were the

most satisfied in their jobs. Employees who felt that they were multiskilled were more job satisfied than those who believed they were not multiskilled. This shows that effective multiskilling training should increase job satisfaction by providing employees with meaningful challenges and highly monotonous and repetitive work is limited (Kelliher & Riley, 2003). Job satisfaction can be increased through the use of multiskilling training as it enhances the employees' need for development and this can be a critical moderating factor when it comes to deciding on whether or not to stay at the same company.

Almost 20% of multi-skilled employees felt that they were more likely to be promoted than the non-multi-skilled employees. Promotion opportunities for employees are undoubtedly enhanced through multiskilling and it also to an extent, provides a career path for employees who acquire new knowledge and skills which provides them with greater opportunities (Armstrong, 2006). Organizational efficiency appears to be better supported by multiskilled employees when compared to non-multiskilled employees (Ottenbacher, Gnoth, & Jones, 2006).

## **12. RECOMMENDATIONS**

There are a number of vital interventions that hospitality enterprises can employ to transform the industry to become more multi-skilled and thus more effective and efficient. A major challenge for the hospitality sector is getting hotels to change from being overly labour-intensive. They will need to have employees who can not only perform single job functions, but who can assume cross-functional roles. Essentially, they will need to be multi-skilled. Once employees have gaining greater competency from multiskilling training, it is conceivable that they could obtain higher salaries. Manpower must in any event be optimized and a drive must be made to introduce a range of labour-saving IT systems and other relevant technology and innovation that will free employees to assist with other tasks. Job functions and roles will need to be re-designed so that employees can be multi-skilled and be deployed where they are needed the most at short notice. For example, front-desk employees could thus be trained to serve in restaurant operations. A doorman could double as a security officer. An HR manager could take care of VIPs on Executive Floors. Valet parkers and reservation agents can collaborate to prepare a banqueting hall after a function with 500 guests at lunchtime, for an international function with over 1000 guests for dinner. Waiters can assist in the laundry and a restaurant manager of a restaurant operating only at night can

assist with reservations in the morning. A valet service can be done by housekeeping employees. Food and beverage staff can serve as registrars for a conference. All maintenance employees can be cross-skilled in plumbing, electrical work and general carpentry.

Multiskilling of employees is a great way to curtail costs and increasing guest satisfaction with service provision. Where a company has huge budgets, it would be wiser to stick with the idea of specialisation but in the current global economic meltdown this is less and less an option for the foreseeable future. Such labour flexibility can augment organizational productivity in response to a tentative service setting. Multiskilling training makes the retention of hospitality employees more likely. The literature suggests that job enrichment and alternating in functions leads to greater employee retention and minimizes their turnover (Brotherton, 2004). Multiskilling indicates to employees that they can develop their career in their current place of employment and this tends to attract them to remain at their work longer thus increasing labour retention. *“The introduction of multiskilling and/or generic working can give an organization greater efficiency and also provide job enrichment for its workers”* (Akhlaghi & Mahony, 1997). Multiskilling also leads to improved level of interdepartmental communication and greater empathy between employees and thus promotes solidarity in the workforce.

### **13. CONCLUSIONS**

The basis of this research was the principle of confidentiality and anonymity. It was ascertained that in each hotel investigated, there were problems relating to multiskilling training per se. Multiskilling is invaluable in the hotel industry since it is a very cost-effective method to assist businesses to face the many employment challenges that are posed in the current global industry. Multiskilling does away with departmental boundaries and promotes and fosters a spirit of teamwork, which leads to better levels of service quality provision. The research provides a set of guidelines about the benefits of multiskilling training of hospitality industry employees. Multiskilling is likely to be the most cost-effective tool to aid hotels to come to grips with the issues of insufficiently qualified and unskilled employees. It is suggested that multiskilling can make employees more flexible and efficient and able to cope with the variety of functions relating to hotel operations. Employees are empowered with additional skills and capabilities which allow them to cope within what is

often a volatile environment. It will also to an extent, serve as a shield given the inordinately high employee turnover rates that are exhibited in the industry. This exploratory study has identified that most 4-star and 5-star hotels in Gauteng and some of those in other countries involved in the study, have adopted multiskilling for their employees. Hotels will undoubtedly benefit from multiskilling as service quality provision, organizational productivity and efficiency, and especially retention of employees are more likely as a result of it. The maximum effect of multiskilling is improved service quality provision and this is critical since better levels of service quality usually lead to greater profits. Critically, organizational performance in this essential service sector is greatly enhanced. Multiskilling training when used as a cost-reduction strategy, has the potential to facilitate and lead all employees to enhanced productivity and efficiency (Kelliher, et al., 2000; Pan, Nickson, & Baum, 2005).

Appropriate employee training in multiskilling initiatives are the critical factors which promote the provision of service quality consequently, hotels that multi-skill employees should provide training which focuses on employees' professional attitudes and behaviours in the workplace, especially relating to guests (see figure 2). In this way, a strategic competitive advantage is obtainable as guests will experience the differences, advantages and benefits of opting to stay at a particular hotel. Multiskilling offers hotels a major benefit, in that it empowers employees to handle what are often unpredictable service situations. This is especially true for front-line managers who supervise employees in daily operations. Organizational productivity is generally improved and staff-turnover is reduced due to multiskilling as it is likely to increase job satisfaction and offers some direction in an employee's career path. Thus employee training and skill development in a number of departments is critical for hotels' wishing to enhance service quality, reduce the cost of labour, and increase general productivity. Multiskilling, if carried out effectively will empower employees and motivate them to offer superior quality service provision. More importantly, it will reduce absenteeism and minimize employee turnover. Line managers play a vital role in delivering and developing a service-oriented culture in their area of operation and beyond, on a day-to-day basis.

When designing a multiskilling programme, hotel managers in the southern African region should draw on the varied experiences of other hoteliers and this will increase the potential for success. Where possible, modules should be developed which are in line with the National

Qualifications Framework (NQF) and which are in line with the CATHSSETA needs. This will make any training transferable to other employers and also encourage employees to be more positive about undergoing multiskilling training.

This research which was essentially a mixed methods approach, has hopefully provided some data against which similar and more detailed quantitative studies can be compared for a more meaningful analysis of multiskilling in the hospitality industry. Further studies could involve the interviewing of all employees and even guests and would undoubtedly enhance our knowledge on the issues at hand. The findings of this research will be reported to industry so as to stimulate the development of the practice of effective and sustainable multiskilling training.

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## Appendix 1

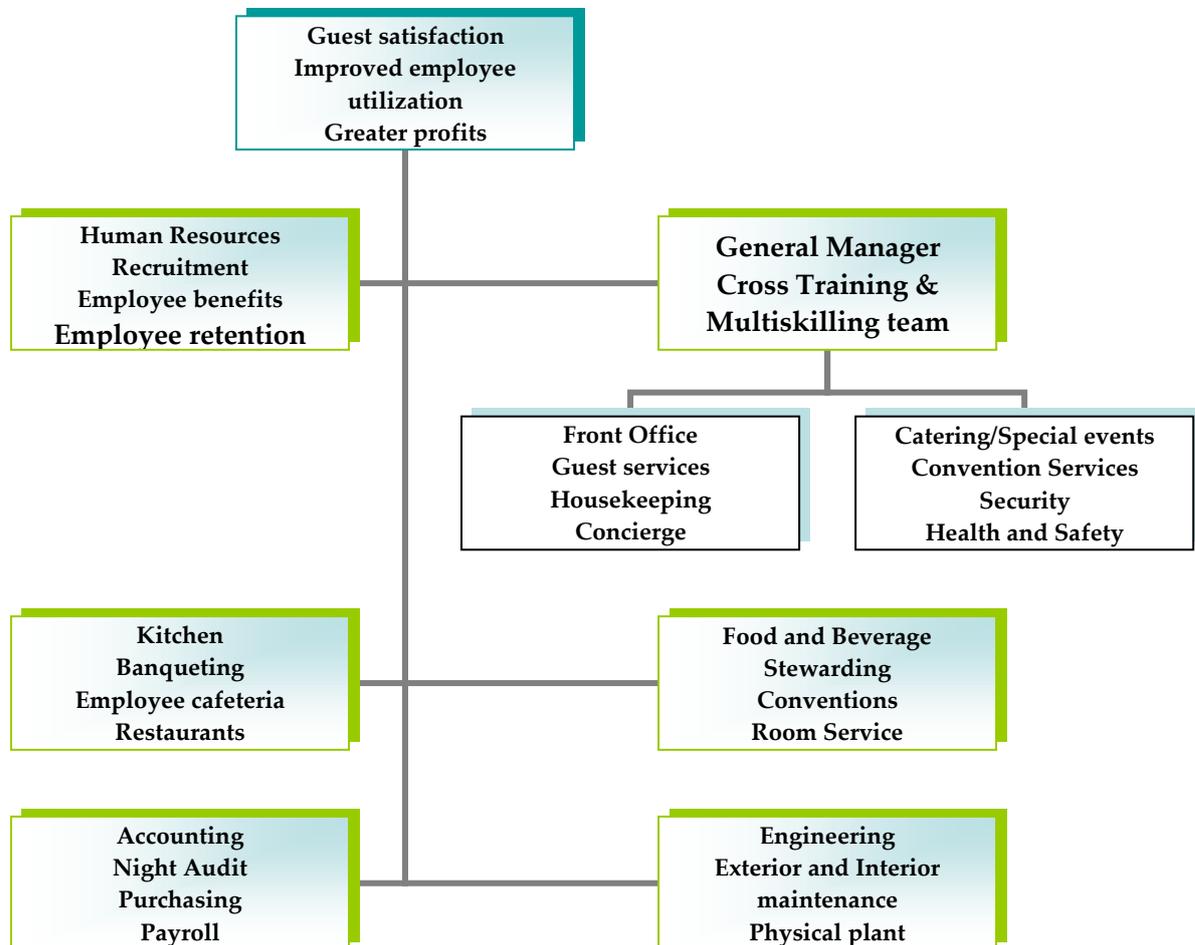
**14. QUESTIONS FOR HOTEL MANAGERS TO CONSIDER RELATING TO MULTISKILLING TRAINING**

1. What are the main human resource issues that plague your hotel ?
2. Why is there a problem?
3. What strategy can you adopt to minimize the risk associated with the problem/s you face?
4. What should you focus on in managing your employees training?
5. Is your current multiskilling training truly effective?
6. What can you do in training to create and sustain a strategic competitive advantage?
7. Do you have the right employees in each department?
8. Are there policies in place for the multiskilling of employees?
9. Do employees have attainable career paths?
10. Are you abusing or empowering employees?
11. Are you recruiting suitable employees?
12. Do you offer orientation programmes for new employees?
13. Are training plans in place which include training needs, goals, and objectives?
14. Do you request staff to attend or force them to attend multiskilling training?
15. Do you evaluate the acquired knowledge and skills that multiskilling provides and is it part of your performance appraisal for employees?
16. Do all employees' competences depend on skills acquired during training?
17. Does quality of service depend on the competencies developed in multiskilling training?
18. Do newly appointed graduates from Universities of Technology and other higher education institutions have the requisite skills for your business?
19. Do you actively assist Higher Education providers to provide students for industry with the required skills by taking part in advisory panels on curriculum design?
20. Are graduates adequately skilled?
21. Do you plan and conduct regular multiskilling training programmes?
22. Do you pay a fair wage for the job?
23. Is multiskilling training for front-line managers only?
24. Do you believe that multiskilling training should increase organizational productivity in the hotel industry
25. Is multiskilling training needed but seen as a threat as it is associated with increased promotion in an industry with limited upward mobility?

26. Will multiskilling training lead to increased organizational efficiency?
27. Do you think that only upmarket hotels should emphasize multiskills competence?
28. Is your service aligned with the expected guest and industry standards?
29. Do you provide incentives to employees who undergo multiskilling training?
30. Do you effectively identify employees' strengths and weaknesses?
31. Have you ever tested employee attitudes towards the notion of multiskilling?
32. If you have a high employee turnover rate, why is this so according to exit interviews, assuming that the latter are in place?

## APPENDIX 2

Figure 1. Hotel organizational structure incorporating multiskilling



## Appendix 3

Figure 2.

### EXPLORATORY RESEARCH SURVEY QUESTIONNAIRE

#### Multiskilling in the hospitality industry

Dear Sir/Madam

This is a questionnaire for an exploratory study on multiskilling in hotels, which considers various aspects of the employee training especially multiskilling.

Definition of multiskilling: This is obtaining additional task-related skills and knowledge, which empower you to carry out a broader range of tasks and functions within your organization.

You are not in any way obligated to do this survey however your participation will be greatly appreciated.

Your responses will remain anonymous and you will in no way be compromised.

Kindly complete the questionnaire as truthfully as possible.

Thank you for your understanding and time and effort.

**Please download, complete then scan the completed document and email back to the sender.**

1. Gender: Male \_\_\_\_\_ Female \_\_\_\_\_ (place an X where appropriate)

2. Age: 18-25, 26-45, 46-64, >65 (circle which applies to you)

3. Have you had prior hospitality education: (e.g. at school, college, FET, University, other.)

Please specify, \_\_\_\_\_

4. Previous hotel working experience: 0-2 year, 2-6 years, 7-10 years, >10 years (circle which applies to you)

5. How long have you been employed in this hotel? Less than 1 year, More than 1 year, more than 5 years, more than 10 years (circle which applies to you)

6. Your current position: \_\_\_\_\_ (e.g. front desk manager, chef, housekeeper)

7. Did you have company training when you were first employed? Yes No (circle which applies to you)

If yes, what was the duration? \_\_\_\_\_

If no, you can skip question 8.

8. What was the nature of the training you received?

\_\_\_\_\_

9. How was the first training you attended? Important, Necessary, Just routine, Not really important Why? \_\_\_\_\_

10. How often do you undergo training held in the hotel?

Just once in the beginning when work started, Once a year, Twice a year, Once a month Daily basis (circle which applies to you) and for how long? or...

Other, \_\_\_\_\_

11. Have you been multi-skilled in any way? Yes No (circle which applies to you)

12. If \_\_\_\_\_ yes,  
elaborate: \_\_\_\_\_

12. Is the training in the hotel mandatory or optional (circle which applies to you)

13. Do you have to apply for the trainings? Yes No (circle which applies to you)

14. Where was the training held?

15. Who conducted the training (You may select multiple choices by underlining them)?

Lecturer hired from outside , Senior Manager, Supervisor, Trainers, line manager, Other,

16. Is such trainings important in the industry?

(Please number them in the order of most important to the least important.

e.g. 1=most important, 2=second important, 3= third important etc.)

Motivates employees and helps them perform better

Empowers employees

Encourages self-development & self-confidence

Management team can evaluate employees' performance

Sustains a positive attitude towards customer service

Shows commitment to skill employees

Improves communication between management and employees

Reduces accidents and safety violations

Helps organizational development Introducing new technologies in time

Unimportant

17. Are you satisfied with the multiskilling training in the hotel? Very satisfied, It's okay,

Neutral, Not satisfied at all, other,

18. How can the multiskilling training be improved if at all?

19. What is your personal opinion concerning multiskilling

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20. Which skills would you like to be taught that you are deficient in? (list up to three)

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Thank you very much for your co-operation!

## PPP AND CULTURAL SPONSORSHIP LAW AND MANAGEMENT

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### ABSTRACT

The School of Thought of New Public Management puts the stress on contracting-out. If contracting-out, exemplified by the traditional-type public works and services contracts and by concession and its variant, Public - Private Partnership (PPP), is the principal methodology for public constructions and services, it may be backed up by supporting contracts, such as donations and sponsorships. As a result, a legal and managerial approach to this operational whole consisting in a double synergy (PPP and its catalyst in form of a funding “partnership”) is recommendable. Non-reciprocal scopes of public policy related to social fundamental rights fit in with corporate social responsibility, so PPP to sponsorship respectively.

**Keywords:** Contracting-out, PPP contracts, Concession, Cultural Sponsorship, New Public Management, Market economy, Cultural Heritage, Excavations, Antiquities looting, Coverage with earth.

### INTRODUCTION: FUNDING MECHANISMS FOR PUBLIC PROJECTS

The state is in need of resources to accomplish its mission, so it has tested both obligatory ways and optional ones of fundraising. Obligatory ways consist mainly in imposing taxes and levy of money but the so-called “Conservative Revolution”, inaugurated by Thatcher in 1979 and by Reagan in 1980 in the United Kingdom and in the USA respectively had other priorities. This neoliberal recipe for public economy *inter alia* put the stress on privatization of public companies as well as on reduction of income taxes and public fees (Cañagueral, 2011). In this context, the New Public Management is a contemporary theoretical approach to the way of change of Public Administration. It started in the United Kingdom, expanded initially in the United States of America and Australia and then in Scandinavia and elsewhere in

Western Europe. It refers to the tendency of adopting the principles and values of the private sector in order to meet financial objectives and goals (Kalogirou and Maniatis, 2012).

Another way of fundraising, in ancient times obligatory and then merely optional, is sponsorship.

The state has diachronically made use of the concession of technical works and services to the private sector, let alone the fact that the similar mechanism of Public - Private Partnership (PPP) has recently constituted a worldwide trend (Patrikios, 2009).

On account of this methodology of private-centered optional fundraising for public activities, *we suppose that PPP needs enhancement through the sponsorship mechanism, exemplified by the cultural sponsorship contracts.*

## **PPP LAW**

PPPs are not regulated by specific EU law but by national legislations. In fact, any contract in which a public entity entrusts the provision of an economic activity to a private contractor, should be subjected to rules and principles, such as transparency, equal treatment, proportionality and mutual recognition. It is recognized that the methodology for implementation of PPPs can vary, depending on the nature of a given project and local concerns. (Nikolopoulou, 2012).

In general, PPPs are agreements between the public sector and the private one on providing public infrastructure, community facilities and relevant services, through allocation of various risks. The motivation of the use of this model varies but generally it involves financing, designing, construction, operation and maintenance of public infrastructure and services. (Ministry of Municipal Affairs Canadian, 1999)

Some common features of PPPs according to the Green Book of the European Commission are the following:

- Long-term relationship between parties.
- Risk-allocation between the public sector and the private one.
- The private sector financing (the project in some cases may be substantially completed by public funds)

- The public services and ultimate regulatory responsibility remain in the public sector.
- Project distinction based on the way of the repayment of the private sector.

Upon the way of the private contractor's repayment, the PPP scopes may be reciprocal or not. Reciprocal projects implicate the full or partial repayment through the reciprocal charges of end-users and, as a result, the correspondent risk of the private entity ("sponsored PPPs"). They are exemplified by transport projects (ports, airports, railways etc), environmental ones (water supply, sewerage, waste management) etc.

Non - reciprocal projects are repaid directly by the public sector ("administrative PPPs") and are usually related to social fundamental rights of citizens and social policy for schools, hospitals, museums, cultural activities etc.

Although cooperation between the state and the private companies may offer micro-economic benefits permitting execution of a project that provides value for money and meets public interest objectives, the recourse to PPP cannot be considered as a miracle solution for the state facing budget constraints. Empirical research has demonstrated that, for each project, it is necessary to assess whether partnership offers real value added against the rest contracting-out alternatives, such as outsourcing and mainly traditional-type public technical works and services contracts as well as concessions.

## **NEW PUBLIC MANAGEMENT**

Governance is the administration of public affairs conducted by a central directing institution, the government. There is no uniform model of governance, particularly on account of the fact that the movement of New Public Management seems rather apprehensive as for the reformative methodology to adopt. The principal movements of this preeminent School of Thought are the currents of the economy of the market and of participation and reinforcement (Maniatis, 2006).

The first current, which prevailed in the United Kingdom and in Australia, has caused decentralization through the creation of specialized services. These services function on the basis of productivity targets under the direction of managers frequently coming from the

private sector. Furthermore, certain systems of attachment, going from the reciprocation to the productivity of public servants have been institutionalized. As far as possible, administrative processes are replaced by the market mechanisms. For instance, coupons are in use for the participation in various programs while internal markets have been generated in the public sector of health.

A considerable alternative, more popular in Northern America and in certain states of Europe, is less related to the market economy, to which it is in opposition as long as it turns down the universal primary role of markets mechanisms for the delivery services. On the one hand, it encourages the active participation and the contribution of the working population to the bureaucratic processes and, on the other hand, it put the stress on active participation and the reinforcement of the citizen in his relations with the executive power. This current recommends the reduction in the number of levels of hierarchy in the interior of services, the elimination of certain intermediary echelons of administration and the systematic encouragement of initiatives of lower grade public servants. Besides, it implicates the creation of institutions specialized in the aid of public services users and of citizens in total, gives advice to the public and familiarizes it with the aims and the procedures of various services. In the United States, the reinforcement of the lowest echelons of bureaucracy has been realized since the beginning of the 21th century (Spanou, 2001). An interesting aspect of this current has to do with the European integration. It is about the application of directives as sources of the European Union Law. This intrinsic to the European integration legal tool needs its transcription in each legal order of the states involved. The pressure of the directives on the political and administrative system of the states makes the competent public employees more conscious of the insufficiency of the executive power and consequently they supply them with a notable argument to reinforce their own institutional position against the politicians and perhaps to counterbalance the pressures of meritocracy.

Anyway, severe criticism has been raised against the New Public Management for various reasons. For instance, as for the market economy current, the use of methods and technologies by the public servants, whose the attention was diverted from the rules and the processes towards the results and the performance should not be disconnected from values that the creation of these rules aimed at safeguarding. The technological and economic automation of the state should not be duplicated in the form of normative autonomy as for the social needs and the rights of public services users. The participation and reinforcement model should not imitate the anachronistic cases of socialization of the management of the

public enterprises on account of the fact that the workers' approach is usually far away from the one of private individuals. The model of "Citizen – Client" of public services, particularly of public enterprises, is in principle recommendable, so a kind of combination of the two currents of New Public Management emerges.

## **PPP AND NEW PUBLIC MANAGEMENT**

As for the relationship between PPP and New Public Management, it is to pay special attention to the fact that PPP is above all an institutional case of Management serving legally consecrated public purposes. Indeed, the institutionalization of PPP is not merely a way of cooperation between the state and the private companies but it may be considered as the inversion of the bad practices of both state and society, well exemplified by earthed-up monuments. Coverage with earth constitutes a controversial issue, particularly widespread in the archeological practice (Maniatis, 2013). First of all, sites under legal archaeological excavation, unguarded due to the lack of resources, are proved to be the field of antiquities looting, as it happened in the site of Archontikon in Greece in 2011. As states make use of the coverage with earth as a "mortgage" for an on-the-field research, to be accomplished by the future generations of archaeologists, some private individuals take benefit from it as a "mortgage" for illicit excavations of the current era. As a result, a finding emerges, consisting in the counterbalancing dynamic of criminality against the controversial practice of Public Administration. So, administrative and private practices result in a homogeneous total, particularly in the countryside. Besides, states set the bad example to citizens as in the urban fabric they frequently do not authorize the unearthing of localized monuments and so they deny the citizens' right to monuments according to the principle of sustainable development, in virtue of par. 1 and 6 of art. 24 of the Greek Constitution. This practice has recently exemplified by the antiquities under the Ypapanti square of Kalamata, accidentally discovered and unearthed in 1960, earthed-up about six months later on the usual pretext that there are no resources for the necessary programmed excavation and still kept in the earth in spite of the recent decision for the square!

What has not been realized is that the dynamic of private individuals' criminality against the State that is the owner of the ancient monuments corresponds to controversial practices of the Public Administration like this. Concretely, owners of immobile things, particularly in the urban fabric, have the tendency of deciding to earth up the findings of cultural interest. This is confirmed mainly when they desire to proceed to building works, a case in which

complicity of the building contractors may occur. A town or a city may include even unknown, by the State and the public, underground tunnels including eventual monuments, admittance that does not constitute merely an “urban legend”.

To sum up, coverage of monuments with earth serves various state purposes, such as facilitating and acceleration the execution of public constructions, fundraising and protection of monuments from of looting while private individuals also make use of it illegally, for instance to go on with their own constructions or by committing antiquities looting. So, there is an informal “Public – Private Practice” (or “Partnership” by improper use of the term), with a negative impact for heritage, instead of the potential use of the PPP legal tool for the protection of heritage and the promotion of culture. So, the PPP institution is symmetric to the informal and criminal phenomenon of bad Public – Private Practice in combination, namely of ... Public – Private Partnership. As a result, it may be considered as an example of the principle of proportionality, let alone in its perfect development because not simply a proportional (symmetrical) institution but a homologous one (in the form of synergy between the public sector and the private one) has emerged against the comparable tradition of bad practices.

Furthermore, PPP contract model is historically connected with the Conservative Revolution, particularly in the United Kingdom, and exemplifies the tendency of contracting out for state activities. In this sense, PPP corresponds to one of the major dimensions of New Public Management and, according to some experts, even to its essence (Lane, 2000). Contracting out has become, since the beginning of the 1980s, a part of the big program of the New Public Management. More concretely, in the first phase of this School of Thought, the priority consisted in privatising public activities whilst since the second part of the 1990s contracting out has been the preferable solution for various reasons. The institutionalization and the application of the PPP contract model is incorporated into this historical development.

So, PPP exemplifies the current of market economy, given that neoliberal policy is inspired by the private sector way of constructing and operating, although it implies also some elements of the other current, such as the simplification or even the inversion of the hierarchical pyramid.

## **CULTURAL SPONSORSHIP LAW**

Definitions of sponsorship, like the ones of PPP, vary and the practice has been described as *“an investment in cash or in kind activity, in return for access to the exploitable commercial potential associated with that activity”*. Sponsorship of sport is now very big business and as the value of rights fees inflates, companies are increasingly eager to achieve a return on their investment particularly in the economic downturn. Companies have to ensure that the sponsorship is a congruent fit with the sponsee, that objectives are realistic and clear, and that the sponsorship is re-evaluated over its life span. Finally, it is more important than ever to evaluate and manage risk and to ensure that legal protection is in place from the outset (Fabien, 2010).

The cultural heritage in a wide sense comprises the cultural heritage itself, having to do with ancient monuments and archaeological sites, and the architectural one, consisting in listed buildings and uses of buildings as well as in traditional residential complexes. It constitutes a relatively modern scope in the field of the public law, worldwide. For instance, it is explicitly protected by the ad hoc paragraph 6 of article 24 of the Greek Constitution, besides the general protection of the environment, the cultural one included, in paragraph 1. Although the Constitution makes no explicit reference to sponsorship, L. 3525/2007 regulates this autochthonous ‘function’ according to the ancient Greek term meaning a financial duty imposed by the state, of financing cultural activities. It is to pay special attention to the fact that several countries have recently adopted a law relevant to these contracts, just like they did almost simultaneously for PPP contracts. This is the case of Greece that in the aforementioned law defines cultural sponsorship as a pecuniary or non-pecuniary economic benefit consisting in kind, immaterial goods or services, for the enhancement of concrete cultural activities or purposes of the sponsee (Maniatis and Kapralou, 2012).

Sponsors’ motive is to strengthen their corporate image through the identity of social responsibility. Besides, they may also take a profit from the consequent tax exemption that is in use in most countries of the European Union and of North America and allows to big carriers of cultural goods and activities to back up their mission just as their own sponsors are facilitated to accomplish their commercial mission in a competitive way, so in conformity with the New Public Management current of market economy.

The underlying motivation of cultural sponsorship combines the two opposite poles: interests, on the one hand, and ideals, on the other hand. The tough interests for a sponsorship are often colored by softer reasons, such as personal fondness, attachment to and familiarity with culture on behalf of people in business. Some of these intentions are benign and legitimate, others not so spotless. One reason for mapping and analyzing types and

motivation of private involvement in culture is that this practice helps make successful policies vis-à-vis private partnership.

Anyway, in the Greek legal order sponsors are defined as physical or legal persons, regulated by private law, proceeding to cultural sponsorship. Sponsorship has been institutionalized as a formal contract, namely in form of private contract document, producing mutual obligations for the parties. Indeed, the sponsor is supposed to offer money, services, materials or immaterial goods to the recipient in order to back up a concrete cultural purpose or activity while the sponsee is supposed to notify publicly the sponsor's offer. Anyway, the sponsor acquires no right to interfere into the form or the content of the activity on the matter, in virtue of the principle of the independence of the sponsee. Thanks to this incompatibility, the recipient remains the unique responsible for his policy, like the public partner that is the master of the PPP project from scratch.

L. 3525/2007 classifies sponsors in the following categories, on the basis of financial criteria:  
a. Great Sponsor, b. Sponsor, c. Supporter, d. Friend.

## **THE QUESTION OF CORRELATION OF CULTURAL SPONSORSHIP WITH PPP**

Literature on PPPs sometimes makes use of the term "sponsored PPP" against "administrative PPP" but in a sense quite different from the legal sense of sponsorship. In this context, sponsored PPP declares the PPP case, in which the cost of providing the service is jointly borne by the users of the services and the government through a capital subsidy, not wholly borne by the Public Administration (administrative PPP). On the contrary, the question of correlation between sponsorship, in the proper use of the term, and PPP is not only legally unregulated but also almost fully original in the level of scientific research. Indeed, just a recent research has proposed this idea on account of the French successful paradigm of cultural sponsorship (Vassilakou and Maniatis, 2012). Cultural sponsorships in France have been particularly successful, consisting even in rewards for information to the authorities investigating crimes related to heritage and artistic treasures. However, this approach may be enriched by the datum that the French system of funding culture consists in a strong public intervention, reinforced by the tax-policy, and in a relatively mediocre sponsorship. So, it appears to be strictly the opposite to the USA system, in which funding is based on a variety of private initiatives.

The aforementioned research considered, in this context, the correlation, in law as well as in practice, of sponsorship contracts to the PPP ones as highly recommendable. So, it concluded that national PPP legislations, such as the French law and the Greek one, could include a detailed reference to sponsorship or the interested states could adopt a single law including PPP contracts and sponsorship ones.

The proposal of that research is reinforced by a historical argument related to public infrastructure and to cultural goods. Indeed, both contractual types are not only new in the legislative level but also comparable within the following scheme of the history of management of the public infrastructure and the cultural goods (particularly heritage), from 18<sup>th</sup> century on, in the western world, mainly in France:

PHASE OF THE PERIOD 18 <sup>th</sup> C. -21 <sup>st</sup> C.	PUBLIC INFRASTRUCTURE MANAGEMENT (PROGRESS TO OPERATIONAL PRIVATIZATION)	(PUBLIC) CULTURAL HERITAGE AND ARTS MANAGEMENT (CREATION AND GROWTH OF THE MUSEUMS BRANCH OF THE PUBLIC SECTOR)
1	STATE MONOPOLIES	ROYAL COLLECTIONS & BUILDINGS (PALACES)
2	CONCESSIONS	CULTURAL HERITAGE AND ARTS PUBLIC MUSEUMS ENDOWED WITH FORMER ROYAL COLLECTIONS AND BUILDINGS (PALACES)
3	CONCESSIONS AND THEIR NEW VARIATION: PPP CONTRACTS	CULTURAL SPONSORSHIP CONTRACTS AND CONCESSION CONTRACTS AND PPP CONTRACTS FOR CULTURAL ACTIVITIES AND MUSEUMS

Table 1: Phases of public infrastructure and cultural heritage management (18<sup>th</sup> c.–21<sup>st</sup> c.)

Anyway, correlation of sponsorship and PPP is also supported by the argument of their joint potential spiritual character. Sponsorship may be proved to be quite beneficial for PPP contracts, even in the PPP pre-contract procedure, consisting in the conception of the idea and the preliminary assessment of the PPP scope. In other words, sponsors could back up the crucial preliminary stage, mainly by non-pecuniary sponsorship.

## CONCLUSION: THE SPONSORSHIP AS A POTENTIAL CATALYST FOR PPP

To sum up, the sponsorship in general, as exemplified by the cultural sponsorship version, is not incompatible with the comparable innovation of the PPP model. On the contrary, in principle it is worth correlating in law as well as in practice these two modern types of financing the state scopes, particularly in the sensitive domain of culture. If contracting-out is the principal methodology for public constructions and services, it may be backed up by supporting contracts, such as donations and sponsorships. As a result, a legal and managerial approach to this operational whole consisting in a double synergy (PPP and its catalyst in form of a funding “partnership”) is recommendable. Last but not least, non-reciprocal scopes of public policy related to social fundamental rights fit in with corporate social responsibility, so PPP to sponsorship respectively.

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## GREEN WOODEN FURNITURE. DETERMINATION OF MARKET TRENDS AND TENDENCIES IN GREECE AND CYPRUS DURING ECONOMIC CRISIS

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### ABSTRACT

The present paper explores the tendencies of Greek and Cypriot furniture manufacturers to produce and/or dispose eco-friendly furniture in relation to relevant market trends based on consumers' intentions, production costs and prices. The study seeks to draw attention to the critical factors which will impact decision making on such products development within the severe crisis. 85 specially constructed questionnaires were selected in 2012, which were further elaborated and statistically analyzed with SPSS ver 17.0.

The results indicate an increasing interest of both Greek and Cypriot consumers for eco-friendly furniture, defining certain target-groups. Eco-furniture production will increase production costs at a rate of 11-15%. On the other hand, consumers are willing to pay a higher price of no more than 7-11% for eco-furniture.

Factors which constitute major concerns for enterprises in order to decide the turn to eco-furniture can be categorized into three groups: economic and investing, firm resources and marketing.

**Keywords:** *Green Wooden Furniture, Furniture Markets, Greece and Cyprus Furniture enterprises, Market research, economic crisis*

## 1. INTRODUCTION

### 1.1 *Green wooden products*

Nowadays, environmental and ecology issues constitute an imperative concern for a major part of the global population and entrepreneurs (Allen and Malin 2008; Schaper 2002; Larson 2000; Adeoti 2000). There is a relatively growing trend towards both production and purchase of “green” products and services even during the economic recession (Nidumolu et al 2009; Chamorro et al 2009; Bleischwitz et al 2009).

For the purposes of the present study, we define as “eco-furniture” or “green” furniture, a product of furniture designed to minimize the environmental impact during its whole life-cycle (Albino et al 2009; Baumann *et al.*, 2002) and thus furniture with characteristics of environmental compatibility, taking into consideration all the stages in furniture life-cycle (Alhola 2008; Progetto Life, 2005).

The number of companies interesting on environmental performance which address their environmental effort early in the supply chain is increasing (Frondelet et al 2007; Epstein and Roy 2006). Concepts such as design for environment, eco-design, extended producer responsibility and product stewardship are becoming more and more common in corporate culture (Santolaria et al 2011). Design for environment has been defined as the systematic process through which products are designed in an environmentally conscious way (Fiksel, 1996), while for eco-design the environment becomes a co-pilot in product development (Brezet and van Hemel, 1997).

### 1.2 *Goal and scope definition*

The practical motivation for this study arises from the continuously intensified competition on international markets and the question of ways for wood products industry to maintain its competitiveness in these markets. The core aim of the present research is to explore the viability of the ecological furniture niche markets in Greece and Cyprus. More specifically, we investigate the current demand on ecological furniture, manufacturers’ estimates on the increase of production costs and the prices relevant customers are willing to pay. Finally, particular emphasis lays on the analysis of the factors that will support decision-making of Greek and Cypriot enterprises in order to incorporate ecological furniture into their current activities.

## 2. LITERATURE REVIEW

### *2.1 Eco-furniture market. Creating value for customers through innovation*

Many observers claim that pressures of global competition, the fragmentation of markets into smaller segments, and the rapid pace of change in many industries indicate that companies' product development capabilities are crucial determinants of business success (Brown & Eisenhardt, 1995; Schilling & Hill, 1998).

The European Union is one of the largest producers, traders and consumers of wood products in the world (European Commission, 2012). The furniture industry is basically an assembling industry which employs different raw materials (wood as well as metals, plastics, leather etc) to manufacture different products. At present, the European furniture industry has a strong image worldwide thanks to its high level of quality, not only at a technical level, but also at an aesthetical one. However, there is a growing concern about the environmental effects derived from goods production and use as well as on how they are disposed of at the end of their life cycle (Humphrey and Schmitz, 2001). Several eco-labels have developed criteria for furniture. The demands in eco-labeling arise on the basis of a lifecycle perspective (Swedish EPA, 2002). Eco-design or Design for Environment (DfE) refers to the systematic incorporation of environmental factors into product design and development and may play an essential role (Tukker et al., 2000).

The decision in new products development, such as eco-furniture constitutes one of the basic issues of the company's business strategy in order to gain a significant market share. Nowadays, the furniture sector is paying special attention on environmental and innovative concerns due to the aim of distinguishing its products from other competitors as well as its entrance into the emerging market of green products (González-García et al. 2012).

On the other hand, marketing scholars and practitioners alike highlight the central role of customer perceived value, or customers' overall assessment of the utility or worthiness of an offering in impacting their purchase decisions (Anderson, 1995; Gao, Sirgy, & Bird, 2005; Woodruff, 1997). For the enterprises, being able to provide high product quality and value for customers has been considered a key element for improving competitiveness (Lindgreen and Fynstra, 2005; Sweeney and Soutar, 2001). Several studies conclude that "environmental friendliness" has a major influence on furniture purchase decision and customers are willing to pay an extra 2 - 16% for eco-labeled furniture (Papadopoulos et al. 2010; Veisten 2007). Thus they give the opportunity to manufacturers to capitalize on their ready access to

sustainable, commercially cultivated timber sources to strengthen their position (Morris and Dunne 2004).

Starting from this premise of the importance of environmental issues as strong drivers for innovation along with unexpected changes in markets (such as markets during crises), new product development and innovation projects are facing obstacles of several kinds (Damanpour, and Gopalakrishnan 1998). This limitation is especially salient in adoption contexts involving expensive, discontinuous, and technologically complex innovations, where the stakes, costs, and risks are particularly high. In such decision contexts, manufacturers' innovation value assessments naturally take place in high risk situations (Gao et al. 2012). Awareness of the competitive advantage of an eco-furniture product, which encompass not only the environmental aspects but also other aspects such as product quality and consumer satisfaction, could temper any hesitations in related investments (Park and Tahara 2008; Penttinen 2005).

## **2. RESEARCH METHOD**

The primary data collection and elaboration followed the methodology of gathering, processing and editing according to the basic principles of marketing research (Gordon and Langmaid, 1988; Tull and Hawkins, 1990; Doyle, 1998; Aaker et al. 2004; Siomkos and Mavros 2008). Questionnaires were specially constructed for the purpose of the study with short and precise questions. The research was conducted by skilled researchers who addressed directly the entrepreneurs or executive members of the firms by personal face-to-face interviews.

The questionnaire was divided in three groups of 34 questions in total. The first group contained 9 about the profile of each firm. The second group contained 19 questions about the production and marketing of ecological furniture. The third group entailed 6 close-end questions about general aspects regarding consumers' ecological sensitivities such as protection of the environment, green marketing and question on production and marketing difficulties in Greece and Cyprus.

The study was conducted during 2012. We collected data from a random sample of 85 questionnaires; 36 Greek furniture enterprises, 25 Cypriot ones and 24 sectoral experts and relevant institutes in Greece and Cyprus. 91 questionnaires were collected representing approximately the 10% of the total sectoral population. A pilot questionnaire was applied in

five enterprises in Greece and Cyprus. The pilot research enabled the reformation and improvement of the questionnaire according to Dillman (2000).

Data were processed and analyzed using the statistic package SPSSWIN ver 17.0 and all the related tests of Frequencies, Descriptives, Crosstabs, Analysis of Variables Independency using chi-square criterion, Correlation analysis and Analysis of variance - T-test were made (Norusis, 2007; Howitt and Cramer, 2003).

The construct validity was based on the test of unidimensionality of the elements constituting each factor, as well as the content validity of each factor separately. We used Factor analysis according to the method of Principal Component Analysis. Regarding the content validity of the research variables, the statistical factor of Cronbach's Alpha was used (Siomkos and Vasilikopoulou 2005, Chantzoudis *et al* 2009, Sarigiannidis *et al* 2009).

### 3. RESULTS

It is rather interesting that although most firms (73.5%) know the benefits of adopting the EU ecolabel, only a 16.4% has adopted some kind of eco-labeling and only recently. In fact retailers are more related to eco-labeling and tend more to use it for their products than furniture manufacturers (Pearson  $X^2 = 5.153$ , Cramer's  $V = 0.306$  at a significance level  $> 90\%$  Approx. Sig= 0.076).

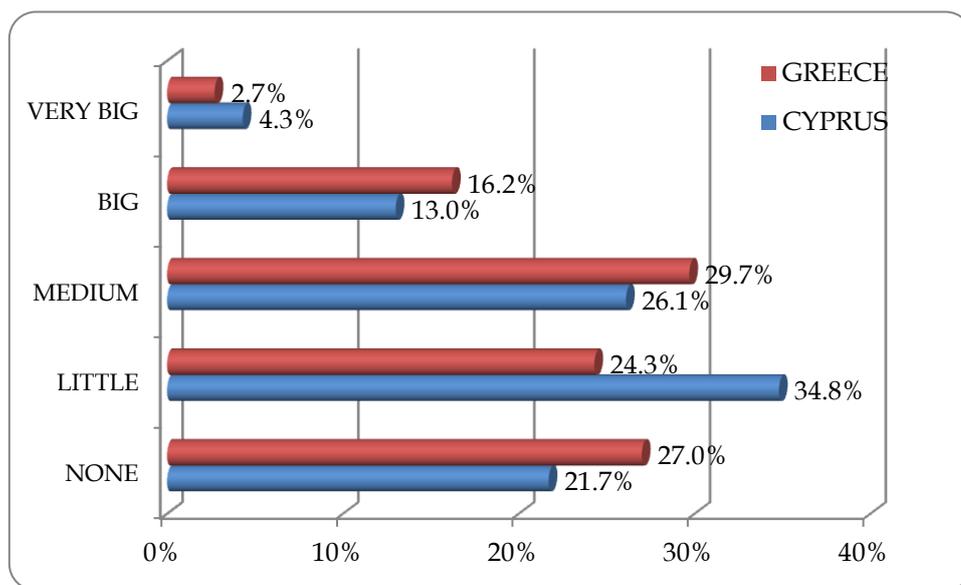
In spite of the severe economic crisis in Greece and Cyprus, the sampled firms admit that consumers in their majority are moderately or very little interested in ecological furniture or woodworking in general (54.0% and 60.9% respectively, Figure 1). A percentage of 18.9% and 17.3% respectively are conscious consumers of the above product categories and can constitute the ideal target groups.

The  $X^2$  control revealed that this interest is statistically significantly related to the number of company employees (Pearson  $X^2 = 25.808$ , Cramer's  $V = 0.392$  at a significance level  $> 95\%$  Approx. Sig= 0.011). This indicates that bigger companies have customers who are more sensitive to ecological issues and, by way of consequence they are more interested in buying eco-furniture.

Besides the rather negative current attitude, firms estimate that ecological furniture will increase prices at about 15% in average in relation to conventional furniture in Greece and at

about 11% in Cyprus with a significant statistical relation of price increase percentage and country of sales (Pearson  $X^2 = 12.700$ , Cramer's  $V = 0.389$  at a significance level  $> 95\%$  Approx. Sig= 0.013). A further analysis showed that manufacturers estimate a price increase of 15.5% and retailers of 12%.

Interestingly enough statistical analysis indicated that the smaller the employees number, the bigger the price increase as estimated by company managers (Pearson  $X^2 = 32.677$ , Cramer's  $V = 0.437$  at a significance level  $> 99\%$  Approx. Sig= 0.001).

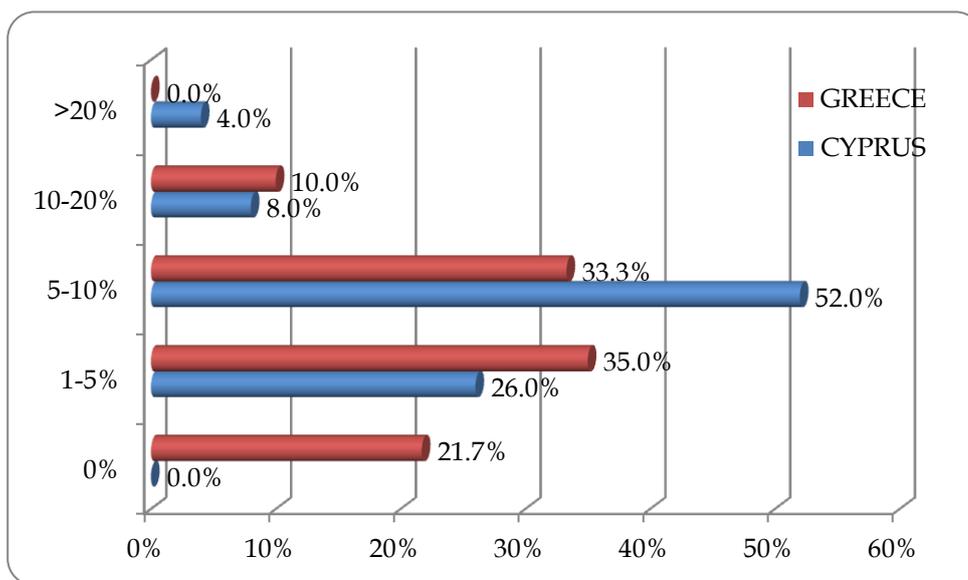


**Figure 1.** Tendency of sampled firms' customers to buy ecological furniture or other ecological wooden products

An important question of the research referred to the intention of consumers to buy ecological furniture by paying an additional amount of money compare to conventional furniture. Cypriot entrepreneurs believe that their customers would be willing to pay an average of 11% more money in order to buy eco-furniture. Therefore, it seems that entrepreneurs and consumers' estimations converge regarding the added value of eco-furniture. On the contrary, Greek consumers seem reluctant to pay an additional amount of more than 9%. This results to a difference of 6% between suggested prices of suppliers and customers. A relevant research of Papadopoulos et al. (2010) denoted that Greek consumers are willing to buy eco-furniture at prices of only 6% higher than the ones of traditional furniture. A significant percentage of 21.7% has declared that they will not pay more to buy any type of ecological furniture. This was rather expected due to the severe financial and public debt crisis in Greece (Figure, 2).

Crosstabs analysis confirmed further that bigger companies have customers who are more sensitive to ecological issues and are more interested in buying eco-furniture. This customers' percentage is significantly related to a) the firms' turnover (Pearson  $X^2 = 33.066$ , Cramer's  $V = 0.395$  at a significance level >95% Approx. Sig= 0.033) and b) the number of employees (Pearson  $X^2 = 17.592$ , Cramer's  $V = 0.318$  at a significance level >95% Approx. Sig= 0.040).

Greek and Cypriot target groups present some differences. Greek potential consumers of eco-furniture are mostly women (86.8%), between 25-34 years old (63.2%), married with one or two children (68.4%) and academic background (68.4%). They are freelancers (52.6%) with a monthly income of 2-3,000 € (47.4%). They usually have a house of 100-150 sq.m. (39.5%). Cypriot potential consumers of eco-furniture are women (60.0%), between 25-34 years old (40.9%), married with one or two children (41.2%) with a monthly income of 2-3,000 € (36.4%). Yet, they are high school graduates (47.6%), work in private sector (33.3%), and they have bigger houses than Greeks (150-200 sq.m., 44.4%).



**Figure 2.** Percentage of additional charge of eco-furniture that sampled firms' customers are willing to pay.

### 3. 1. Issues of concern

Table 1 presents insights and speculations provided by the entrepreneurs who participated in this research regarding eco-furniture production or retail investments and relevant decision-making. More specifically, they question issues on preconditions and information needed to eliminate risks regarding green marketing and certified sustainable wood promotion.

Greek wood and furniture entrepreneurs' major concerns refer to the business risk and the size of uncertainty that the company encounters in case of choosing a green marketing strategy as well as the size of the new investment. These two factors were ranked first and second (4.29 and 4.11 respectively with 5 to be the most important). In the mid of severe economic crisis and lack of liquidity it is rather normal for Greek companies to be very conscious on the type of new investments. On the contrary Cypriot firms (*we remind that the research was contacted before the severe crisis in Cyprus*) did not show any anxiety against new investments. Current developments verify our former assumption that there would be a 1.5 -2 year time lag of the consequences of the economic and fiscal recession in Cyprus (see Papadopoulos et al., 2012). At the time of the research, Cypriot firms were more concerned on a) Prospective price, guarantees, potential discounts, and economic supplies of the products (3.76) and b) raw materials, trademarks, packaging, size, colors and product view in general (3.71).

<i>a/α</i>	Questions regarding certified wood	Importance	
		Greece	Cyprus
1	business risk and size of uncertainty	4.29	3.50
2	Investment size	4.11	3.68
3	Prospective price, guarantees, potential discounts, economic supplies of the products	4.00	3.73
4	Questions on raw materials, trademarks, packaging, size, colors and product view in general	3.95	3.76
5	Best ways for fund sourcing: own funding, borrowing, leasing etc	3.84	3.71
6	What will be the variable cost and how will fix cost be charged? What about promotion and production costs?	3.68	3.68
7	What will be the process and the time needed to replace conventional wood with certified wood?	3.62	3.26
8	Do consumers, market conditions and competition allow for such changes?	3.45	3.22
9	Can existing production facilities, know-how etc support this new business concept?	3.45	3.23
10	Can existing resources (sales, channels, human capital etc) support this new business concept?	3.34	3.17
11	What is the optimum production quantity?	3.30	3.62
12	Which are the specific distribution channels and the relevant intermediaries' networks?	2.81	3.14

**Table 1.** Concerns on production and launching of certified wood (importance rating from 5 to 1 with 5 to be the most important)

Since all the 12 above factors of Table 1 seem to relate to each other, a Pearson correlation analysis was conducted. The results are presented in Table 2. Some factors which present a positive relation to each other at a significance level of 0.01 when a firm turns to production or sales of eco-furniture are:

- a) The bigger the business risk and the size of uncertainty, the bigger is the concern on a) the investment size (Pearson correlation coefficient = 0.617) and b) the source of the capital needed (Pearson correlation coefficient = 0.581).
- b) The more consumers, market conditions and competition allow for the ec-furniture development, the more willing firms are to invest on production capacity, process equipment, know-how etc and produce eco-furniture (Pearson correlation coefficient = 0.599).
- c) The more the market pressure for changing from traditional to certified wood as a raw material to eco-furniture, the bigger the price of final products. In parallel, guarantees and economic supplies will also increase (Pearson correlation coefficient = 0.523).
- d) The higher the new investment size a) the sooner the firm will decide and replace traditional with certified wood (Pearson correlation coefficient = 0.611) and b) the higher the price of the final products. In parallel, guarantees and economic supplies will also increase (Pearson correlation coefficient = 0.567).
- e) The higher the variable and fixed costs as well as the costs of production and promotion of eco-furniture, the higher the product price, guarantees and economic supplies will also increase (Pearson correlation coefficient = 0.517).

Additionally, at a significance level of 0.05, raw material, trademarks, packaging, size, color and product view in general will impact the distribution channels and more specifically the intermediaries networks (Pearson correlation coefficient = 0.464). This results was also evident in our former research (Papadopoulos et al., 2011).

The reliability test (Cronbach's Alpha = 0.815) of the above concerns' importance and the relevant decision making indicates that the deterministic variables (responses) are concrete and reliable structures, capable to contribute to the measurement of the factor they belong to. Factor analysis after the factor matrix rotation showed three major factors: financial and investment factor (variables 10, 11, 9, 12, 4, 8 of Table 1), company resources according to the market demand (variables 2, 1, 3 of Table 1), marketing (variables 5, 6, 7 of Table 2). These 3 factors have quite high eigenvalues which reach the 63.2% of the total variation.

Cronbach a (Alpha) are 0.858 for the first factor, 0.584 for the second and 0.719 for the third one. Besides the relatively low reliability of the second factor, the total reliability is quite high and significant (Siomkos and Vasilokopoulou 2005).

<i>Variables</i>	Pearson correlation coefficients											
	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	<i>6</i>	<i>7</i>	<i>8</i>	<i>9</i>	<i>10</i>	<i>11</i>	<i>12</i>
1. Do consumers, market conditions and competition allow for such changes?	1											
2. Can existing production facilities, know-how etc support this new business concept?	.599*	1										
3. Can existing resources (sales, channels, human capital etc) support this new business concept?	.284*	.397**	1									
4. What will be the variable cost and how will fix cost be charged? What about promotion and production costs?	.273*	.255*	.241*	1								
5. What is the optimum production quantity?	.043	.063	.100	.356*	1							
6. Which are the specific distribution channels and the relevant intermediaries' networks?	.174	.277*	.261*	.310*	.464*	1						
7. Questions on raw materials, trademarks, packaging, size, colors and product view in general	.118	.024	.046	.284*	.274*	.417*	1					
8. Prospective price, guarantees, potential discounts, economic	.294*	.253*	.169	.517*	.216	.274*	.420*	1				

<i>Variables</i>	Pearson correlation coefficients													
	1	2	3	4	5	6	7	8	9	10	11	12		
supplies of the products														
9. What will be the process and the time needed to replace conventional wood with certified wood?	.310*	.240*	.133	.359*	-.022	.077	.165	.523*	1					
10. Investment size		.207	.116	.034	.469*	.074	.071	.251*	.567*	.611*	1			
11. Best ways for fund sourcing: own funding, borrowing, leasing etc			.315*	.161	.227*	.357*	-.015	.150	.179	.494*	.585*	.674*		
12. business risk and size of uncertainty				.292*	.325**	.253*	.362*	-.077	.000	.098	.353*	.433*	.617*	.581*

\*\* Correlation is significant at the 0.01 level (2-tailed).

\* Correlation is significant at the 0.05 level (2-tailed).

**Table 2:** Pearson correlation coefficients of concerns on certified wood production and disposal

#### 4. CONCLUSIONS - PROPOSALS

Besides the rather severe consequences of the crisis on the Greek and Cypriot companies, eco-labeling and the related social responsibility are considered by them as very important. There is an increasing trend towards eco-labels for furniture and harmonization with the statutory ones be EU. However we should mention that none of them is totally suitable for all market sub-sectors and market criteria (European Commission 2008).

On the other side the analysis indicate a moderate to minor trend towards eco-furniture both in Greece and Cyprus. This is due to the severe economic crisis which caused a significant fall of the buying power (mainly in Greece for the time being). Customers of big companies seem to be more interested in eco-furniture; they are mostly women over 35 years old with high educational level and a monthly income of 2 to 3,000 €.

Price is a major determinant of the buying decision. Consumers report willing to spend an additional amount of 6 and 11% in Greece and Cyprus respectively on eco-furniture (compared to conventional furniture).

However, eco-furniture can constitute a significant competitive advantage for both Greek and Cypriot firms, especially after the recovery of the long-lasting recession. This is due to their focus on sensitive environmental issues and the arising markets of green products. Nedmark (1998) had even then indicated that firms which use environmental friendly raw-materials are able to improve their products and facilitate entrance in relevant markets. "Green Entrepreneurship" is according to recent literature (Trigkas et al 2011; Nikolaou et al. 2011; Rodgers, 2010; Zisis 2003) among the most important contemporary types of entrepreneurship. It regards the environmental dimension as an opportunity instead of a threat offering differentiation and affecting performances in positive ways.

The main obstacle that seems to exist is the business risk that such a turn to eco-furniture production and/or selling can cause. Yet, existing relevant cases indicate that this risk can be eliminated by a proper market research and a thorough analysis of certain factors which according to the present research are a) financial and investing factors, b) existing resources according market demand and c) effective marketing of the relevant firms. Considering that risk is inevitable in any type of investment, decision making is quite important and should be based on strictly organized methods and practices in order to be effective. Quoting Jim Rohn (2011) «*You cannot make progress without making decisions*», especially in difficult market conditions as the existing ones.

A major contribution of the present research is that it can constitute a useful basis for policy makers at governmental and institutional level in both Greece and Cyprus to encourage close collaborations of companies to academia, design and research centers for the sustainable development of the sectors through the eco-friendly practices and relevant innovations. In 2004 such an action took place in Finland (Finnish Furniture Panel, 2005; Nissinen and Parikka, 2007). A significant result of that project was the development of extensive networking which assisted the diffusion of information as well as of a pertinent culture on eco-products. There are many other actions which show the growing importance of the issue (Ecosmes, 2005; Nordic Eco-labeling, 2003; GRIP, 1998). A similar Greek research project, named e-furniture develops e-collaborations among non-competitive wood and furniture companies (<http://inflab.kard.teilar.gr/e-Furniture/index.php/en/>).

The present research is the first at Greek national level to question the significance of eco-wood and furniture products. It seems that it has indirectly contributed to eco-furniture culture development, since it has caused a fruitful brainstorming among sectoral entrepreneurs and offers solutions to the existing "cul-de-sac". We consider the changing of the entrepreneurial culture as the most important issue in order to achieve the turn to green entrepreneurship. According to the known Indian writer Pantatzali of the 3rd century B.C. *"When you are inspired by high aims and exciting plans, then your thoughts cast off, your brain transcends limitations, your consciousness is widened at all directions and you find yourself in an new, bright world full of miracles. The sleeping powers, your abilities and talents come to life and you find out that you are somebody greater than what you could ever imagine to be"*.

The present research has its certain limitations. Further research could extend to the exploration of the preferences, trends and specific buying attitudes of eco-furniture at certain sub-sectors as well as the strategic positioning of the relevant firms (a relevant study of AUEB, Avlonitis 2011).

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## MARKETING PUBLIC RELATIONS: A CASE STUDY IN THE ADVERTISING SECTOR IN CYPRUS

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### ABSTRACT

This article responds to the lack of sufficient data related to Marketing Public Relations (hereinafter MPR). A literature review revealed that there is very limited published evidence regarding MPR despite its growing importance primarily due to the heightened power of word-of-mouth communication and consumer-generated marketing. Through in-depth personal interviews, an empirical investigation within the Advertising and Public Relations agencies sector in Cyprus, shows that practitioners have started to place emphasis on the use of MPR as they see it as being equally effective but less expensive than advertising in achieving primarily marketing objectives such as launching new products in the market, re-positioning brands, building brand reputation and increasing sales.

**Keywords:** Marketing Public Relations, Promotional Mix, Advertising, Cyprus, Case Study.

### INTRODUCTION

The paper sheds light onto the underlying principles and practice of MPR based on the perceptions and experiences of managers and practitioners of advertising and PR agencies in Cyprus. The overarching goal of the study was to generate knowledge and enhance understanding related to the MPR concept. Specifically, the research study aimed to explore the following objectives:

The study aimed at achieving the following objectives:

1. Identify the key ideas of MPR as perceived by the practitioners studied
2. Determine the factors that led to the growth of MPR
3. Identify the relationship between MPR and Integrated Marketing Communications
4. Identify the relationship between MPR and advertising
5. Uncover the tools used by the agencies studied to implement MPR
6. Find examples of local MPR campaigns
7. Identify whether there is a 'debate' between marketing and PR regarding the concept of MPR
8. Determine the relationship between MPR and CPR

In order to study the concept of MPR the researchers used a qualitative research approach since the aim was to build knowledge by being based on the perceptions, attitudes, preferences and experience of practitioners working in the advertising and PR sector in Cyprus. Data was collected from thirteen advertising and PR agencies based in Nicosia, the capital of Cyprus, from a total of thirty seven agencies that were members of Cyprus Advertising Agencies Association. The researchers interviewed practitioners working in executive positions ranging from general managers, managing directors, client service directors, strategic marketing planners and heads of PR departments. The study revealed that the local agencies studied integrate MPR in their promotional mix in an effort to enhance and complement their advertising strategy. The study's findings revealed that the majority of practitioners interviewed do not use the 'MPR' term per se in practice, although they implement the concept. Although the literature reviewed revealed that there is a debate between marketing and public relations, in practice the practitioners integrate these disciplines in the various campaigns that they undertake. In the practitioners' view the separation of marketing and PR could lead to misunderstanding, confusion and ineffectiveness. The agencies studied often integrate MPR in their promotional strategies in an effort to complement the other promotional tools especially advertising. The study revealed some examples of local MPR campaigns which showed that MPR tools can be used in creative and unique ways to enable the agencies to create a 'buzz' and favorable publicity for the brand.

## LITERATURE REVIEW

The term *marketing public relations* was coined in the 1980s in an effort to distinguish the use of public relations techniques in achieving marketing objectives from the general practice of

public relations (Harris and Whalen 2006). It is an 'all encompassing' term integrating concepts and tools from public relations, marketing, advertising and research. Harris stipulates that its growth was supported by the recognition of its intrinsic value by business executives and the ability of PR professionals to develop PR campaigns in support of marketing strategies. MPR is a late 20<sup>th</sup> century phenomenon with a wide coverage in the public relations, advertising and marketing press. It is a tool often used to complement and extend the reach of advertising in reaching niche markets where it may be expensive to advertise. It is also used at certain periods in the product's lifecycle in order to generate interest and excitement. MPR can also enhance the impact of personal selling by instilling trust and long-term relationships with the customers. It can provide that linkage with the customer that nourishes loyalty and continued usage. When the concept emerged, it was considered to be product publicity, integrated in the public relations effort has evolved into a package of techniques and tools that aim at increasing a company's sales of its products a services. Armstrong and Kotler (2009) stipulate that a number of marketing tools classified as consumer-generated marketing (CGM) have evolved over time, one of which is MPR, in which consumers voluntarily create and share messages and other brand exchanges themselves. The literature reviewed refers to these messages and exchanges as word-of-mouth and buzz. The essence of MPR is that it requires the marketer to hand over his or her promotional message to an intermediary in order to reach the ultimate customer. The intermediary will then voluntarily pass a message about the firm and its products to their audience of businesses or consumers.

Today nearly a billion people use the Internet and subsequently communicate instantly with others. They are able to retrieve and analyse information about people and organisations instantly with a desire to share the information with others. Enabled by internet-driven new media consumers have become 'intermediaries' and have the power to filter the message (Papasolomou and Melanithiou 2012). This 'new' trend has forced businesses to widen their promotional mix and incorporate new as well as social media alongside traditional media. Businesses are realising the importance for adopting more interactive ways to develop a two-way brand relationship with their customers and prospects. They cannot afford to ignore the power of social media that puts the user in a new role – that of a connector. The user has the power to share information with others, influence others and even take the role of an "opinion leader" who can potentially enhance or destroy the reputation of a brand. The 'new' emerging environment has led to marketing strategies that use the fundamental ideas and tools of public relations in innovative approaches, fostering interactions between

organisations, products, consumers and the media. MPR is in the spotlight due to the recent 'explosion' of the use of social media. According to Kitchen (2010), MPR has a potential to be a leading tool in integrated marketing communication due to the general ability of public relations (PR) to contribute in achieving marketing objectives.

Henry (1995, p. 3) defined MPR as: "a comprehensive, all-encompassing public awareness and information program or campaign directed to mass or specialized audiences to influence sales or use of a company's products or services." Harris and Whalen (2006, p. 7) postulate that MPR refers to "the use of public relations strategies and tactics to achieve marketing objectives." According to Kotler (2003), MPR plays a significant role in the process of launching a new product as well as in the repositioning of a mature product; it can build interest in a product category, influence specific target groups, defend a product which experiences public problems and build the corporate image in a way that reflects favourably on its products/services. Kitchen and Pappasolomou (1997) emphasized the effectiveness of MPR in winning consumers' trust, celebrating special occasions and sponsoring special events and programs. Giannini (2010) posits that MPR has the potential to enhance the visibility of products and organizations, inform stakeholders in relation to issues that are critical to the organization, influence public opinion favorably towards the organization as well as encourage trial of products and increased usage.

Giannini (2010, p. 4) defines MPR as: "any program or effort designed to improve, maintain, or protect the sales or image of a product by encouraging intermediaries, such as traditional mass media, the electronic media, or individuals, to voluntarily pass a message about the firm or product to their audience of businesses or consumers." A few studies have been carried out in order to identify the degree of awareness of the business sector regarding MPR. One of these is the study carried out by Duncan (1985) according to which MPR is especially effective in building brand awareness and brand knowledge whilst it breaks through clutter and complements advertising by increasing the credibility of messages.

The literature reviewed also revealed that there is a debate between the PR and marketing discipline. From the marketing point of view, PR is often viewed as a part of the marketing communication mix (Kotler, 2003). Kitchen (1997) on the other hand argues that PR has the ability to create a favourable environment for organizations which cannot be created by marketing management tools. Kitchen and Pappasolomou (1997) also state that while marketing ensures the creation of exchange between the organizations and their target

markets, PR tries to influence the various publics of the organisation that have an impact on its success.

## **LITERATURE REVIEWED CONCLUSIONS- THEORETICAL GAPS**

The theoretical part of this research has shown that the MPR concept is under researched despite its growing popularity. The literature reviewed revealed that there is a very limited literature on the MPR topic (Kitchen and Pappasolomou 1997; Pappasolomou and Melanthiou 2012). There appears to be a number of matters regarding the concept that demand further research. Firstly, identify the key ideas underpinning the concept as perceived by the practitioners. The literature revealed that there is a lack of consistency in the way MPR is viewed and defined by researchers (practitioners and academics). Secondly, there is a need to enhance understanding in relation to the factors that contribute to the growth of MPR. Thirdly, there is limited evidence regarding the way in which MPR is practised, the tools used and how these are implemented. Finally, there is not adequate knowledge in relation to how MPR is interrelated and integrated with advertising and the other promotional tools in an integrated marketing communication program.

## **METHODOLOGICAL ISSUES**

Daymon and Holloway (2002) explored the suitability of qualitative research in the public relations and marketing communications field. Qualitative research enables a researcher to be mindful and to understand the lived experience of a phenomenon (Fill, 1999). Since the aim of the present study was to shed light onto the practice of MPR in the specific sector the adoption of a qualitative research approach rather than a quantitative research method was justified. The qualitative research approach enabled the researchers to uncover and study perceptions, attitudes and experiences of practitioners in relation to the MPR concept since the existent literature revealed that the knowledge and understanding regarding MPR is limited. According to Daymon and Holloway (2002), qualitative research is mostly associated with an *interpretive* paradigm which enables the researchers to understand social reality from the point of view of the research participants. The interpretive paradigm guided the present research study since the aim was to understand MPR through the interpretations and experiences of practitioners.

The researchers adopted a case study approach to exploring the experiences and perceptions of practitioners in relation to MPR as is implemented by advertising and PR agencies in Cyprus.

According to Daymon and Holloway (2002 p. 105), "case study is an intensive examination, using multiple sources of evidence, of a single entity which is bounded by time and place".

Yin (2003) claims that the importance of case studies has rapidly grown along with the need to understand complex social phenomena since it enables a researcher to investigate in depth the characteristics of real-life situations such as organizational and managerial processes, individual life cycles, and international relations. According to Daymon and Holloway (2002, p.105), the purpose of the case study is "to increase knowledge about real, contemporary communication events in their context". This was in fact the case with the current study; understanding the way the advertising agencies sector implements MPR.

For this research study, the researchers studied 13 advertising and PR agencies in Cyprus. This number represented approximately 40% of the total 37 advertising and PR agencies registered with the Cyprus Advertising Agencies Association. Daymon and Holloway (2002) emphasized that it is unusual to study more than four cases since with every additional one the advantages of multiple case design tend to diminish. However, because the present study was the first to explore how a specific sector implements MPR it was perceived as essential to incorporate more agencies in the study to ensure an in-depth and detailed exploration. The initial aim was to gain the access to at least 4 agencies, however, during the actual data collection process the researchers realised that there was a need for more agencies in order to collect the necessary data. The idea of not specifying the final number of cases in the beginning of the research is supported by Yin (2003) who claimed that the choice of the units of analysis could be revisited and adapted during the data collection process.

In the data analysis the researchers used *cross-sectional indexing* or *coding* by which the researcher applied a set of indexing categories systematically to the data collected (Mason, 2002). The main rationale behind the cross-sectional indexing was to get a systematic overview of the scope of data collected. Moreover, through categorizing and indexing, the data became easily retrievable for further purposes and, more importantly, this processes also enabled the researcher to assess whether the data collected addressed the research questions.

In the following table, the codes which were generated from the data collected by the researcher are summarized.

**Table 1: Codes generated from data analysis**

MPR definition	MPR objectives	Successful MPR campaign
MPR vs. CPR	MPR & other tools & IMC	Unsuccessful MPR campaign
Importance of MPR	MPR vs. Advertising	New trends in MPR
Ideas behind MPR	MPR within organization	Future of MPR
MPR tools	MPR terminology	MPR vs. Cyprus typical factors

By comparing the codes to the research questions, it is clear that the codes reflect the thematic areas of the research questions. This demonstrates that the data collected lead to the solution of the research problem, thus answering the research questions.

## EMPIRICAL RESEARCH FINDINGS

According to a study by media monitoring company Matrixmedia, advertising revenues in Cyprus have seen a year-on-year decrease. The study revealed that there has been a 25 per cent drop in advertising last year. Television's advertising revenues have also seen a year-on-year drop. TV revenues dropped from € 325m to € 293m. Advertising revenues for print media dropped from € 76m in 2011 to € 58m last year (Matrixmedia, Cyprus Mail, 2013). According to Matrixmedia, the media advertising pie is traditionally divided between TV, press and radio with 70 per cent going to TV, 20 to print and 10 to radio. The result of falling revenues for TV and print has seen media owners carry out a series of layoffs and salary cuts to delay closure. The negative developments in the media sector have had a direct impact on the marketing communication strategies adopted by advertising agencies. AA have started to redesign their marketing communication by shifting some of the emphasis placed on advertising on MPR.

### 1. Key MPR ideas

The study's findings revealed that the majority of practitioners interviewed do not use the 'MPR' term in practice, although they implement the concept.

"The understanding and interpretation of various terms depends greatly on each organisational culture and the terminology used in each organisation. We do not use the term MPR. We recognise the tactics that relate to MPR by designing a specific strategy or activity. However, if we used the term MPR it would be confusing."  
(Executive Director)

"It is not important what terms you use as long as you use the correct words. I think PR is common sense. A client wants to generate awareness, change perceptions, create knowledge and you need to work with these objectives. Whether you say MPR or CPR... Especially in a place like Cyprus, you are still going to use similar tools in different ways that would make your 'words' come true." (PR Agency Director)

The practitioners interviewed identified the following ideas as the ones that underpin the MPR concept:

- MPR directly or indirectly contributes to the achievement of marketing and sales objectives
- MPR enables companies to promote the products/services in a trustworthy way
- MPR makes the media and the public interested in a cause, product or service
- MPR prepares the public for news
- MPR has the ability to create favourable perceptions towards brands
- MPR encourages favourable word-of-mouth communication

**Table 2: MPR definitions given by practitioners**

Job Title of interviewees	Verbatim Quotations
1 Digital and PR Manager of a communications agency	"MPR is a PR activity which helps the company to achieve its marketing and/or sales objectives either directly or indirectly, through the projection of the company's image and key messages via the mass

	media.”
2 Executive Director of an advertising agency	“MPR includes tools for achieving the marketing objectives.”
3 Head of a PR department of a communications agency	“MPR is a way of promoting a client without using above-the-line promotion.”
4 Managing Director of an advertising agency	“MPR is an activity organized and planned to cultivate the grounds for a product/service. In other words, to make consumers interested in a product/service and to prepare the market for them. MPR is the effort to create inventions to attract the audience.”
5 Client Service Director of a communications agency	“The whole PR is about having relations with different publics. It is a unique communication tool when you identify your target groups and how your strategy will reach these target groups all the time. Then, when talking about MPR, the target group is mostly customers.”
6 Executive Director of a brand building agency	“MPR is a way, function, of a company that aims at increasing the social capital of a brand by creating favourable perception.”

## 2. The factors that led to the growth of MPR

The practitioners interviewed believe that today’s consumers are more informed, educated, sophisticated and even critical of the promotional techniques used by companies. This highlights the importance of using MPR that has the potential to instil trust and create a favourable environment for the communication process to take place. The study revealed the following as the key factors that have enhanced the importance of the MPR concept in the local market:

- a. Advanced technology and telecommunications that enable customers to be more informed about brands and share word-of-mouth communication faster
- b. Smaller promotional budgets
- c. Fragmentation of media which makes it more difficult to reach target audiences
- d. Increasing competition in the advertising and PR sector in Cyprus which forces local agencies to adopt more efficient and unique marketing communication techniques and approaches

Some of these factors corroborate the current MPR literature (Kitchen and Pappasolomou, 1997; Zyman, 1999; Seitel, 2001; Kitchen, 2010; Kotler, 2003; Broom, 2008; Giannini, 2010).

The interviewees claimed that MPR is an important marketing communication tool due to its ability to effectively achieve the following goals:

- Building the relationships with customers on the basis of a face-to-face interaction and two-way dialogue
- Generating awareness and brand recognition
- Making media interested in the promotional campaigns thus creating credibility for the products/services and brands
- Communicating a key message about the products/services to target audiences in a way which does not always appear as a promotion
- Differentiation from the competition

### **3. MPR and Integrated Marketing Communication**

The local practitioners often integrate MPR in IMC campaigns in order to achieve maximum exposure and effectiveness. The practitioners interviewed share the view that MPR should be incorporated in all the promotional campaigns. Currently MPR is given a secondary role and not a leading role which is usually given to advertising. There is a wide recognition and appreciation of the importance of combining and integrating promotional tools to achieve maximum exposure. None of the promotional tools alone can achieve the desired outcome. Instead, the tools need to be combined in order to strengthen each other. The combination of the tools depends always on the client's requirements, preferences and the objectives of a campaign according to which the communication strategies are designed.

MPR's growing popularity in the local advertising and PR sectors is due to its ability to create media and market receptivity. This popularity is due to the fact that MPR allows practitioners to integrate marketing and PR tools in innovative and creative ways to foster interactions between organisations, brands, media and publics. MPR manifests itself as a recommendation from a friend, or an enthusiastic claim about a brand from a happy and satisfied customer. This results in higher credibility than other promotional messages or tools like advertising and direct selling, and makes the message more

trustworthy and believable. In many instances MPR messages are spread voluntarily and consumers perceive them differently than other types of promotion. Both the media and consumers become 'partners' in the firm's efforts to create a buzz about brands. The study revealed that MPR is often integrated in IMC programs that focus on launching a new product or service with the aim of preparing the market, creating awareness and giving information. It is also used in brand building campaigns in order to achieve brand awareness and create brand loyalty.

"MPR is a very important tool and it has an important place in integrated marketing communications. Advertising campaigns should have a preceding MPR campaign which prepares the public for news, creates awareness, and informs the public about the brand. MPR should complement and support the advertising function." (Director of an advertising agency)

"Advertising is decreasing in importance since it does not encourage interaction with potential customers...the target customers are not passive receivers. They want interaction with the sellers. MPR creates two-way communication - a dialogue which is crucial for the success of the communication process." (Executive director of a brand building agency)

#### **4. MPR and Advertising**

MPR appears to have a complementary and supportive role to traditional promotional tools, especially advertising. Although the practitioners interviewed believe that advertising is still perceived as the most important promotional tool by local clients, they are recognising the fact that the impact of advertising can be strengthened if it is supported by MPR. A number of factors were put forward by practitioners:

- Advertising alone does not guarantee the success of the communication process
- MPR enhances two-way communication
- MPR is more credible and trustworthy than advertising
- MPR can create a buzz about the brand and hence, pave the way for advertising
- MPR does not require extensive promotional budgets

“Advertising is decreasing in importance since it does not encourage interaction with potential customers...the target customers are not passive receivers. They want interaction with the sellers. MPR creates two-way communication - a dialogue which is crucial for the success of the communication process.” (Executive director of a brand building agency)

“MPR is a very important tool and it has an important place in integrated marketing communications. Advertising campaigns should have a precedent MPR campaign which prepares the public for news and then the advertising is more effective in combination with MPR. But still, MPR is a complementary function...Advertising itself is still growing in Cyprus, not declining. Even though PR discipline grows too, it will never reach the growth rate of advertising.” (Director of an advertising agency)

“Advertising is decreasing in importance as it is a process that communicates a message to prospective clients whilst the consumers remain passive. Advertising interrupts the natural social environment where a dialogue is crucial.” (Executive director of a brand building agency)

## 5. MPR tools

The local advertising and PR sector combines and implements various MPR tools in order to achieve a number of MPR objectives primarily to generate media coverage and word-of-mouth communication. MPR is practised in the local market through the following tools in order to achieve specific objectives

**Table 3: MPR tools used by local agencies**

MPR tools	MPR Objectives
Press release	<ul style="list-style-type: none"> <li>• To get media coverage</li> <li>• To create awareness for the product/service/brand</li> <li>• To reach large audiences</li> </ul>
Press conference	<ul style="list-style-type: none"> <li>• To create media interest in a specific cause/event</li> <li>• To enhance publicity</li> </ul>
Events, presentations, exhibitions, road shows	<ul style="list-style-type: none"> <li>• To generate publicity</li> <li>• To build relationships with customers</li> <li>• To strengthen awareness through entertainment and education</li> </ul>

Seminars	<ul style="list-style-type: none"> <li>• To educate the public in relation to a product/service</li> <li>• To generate publicity</li> <li>• To reach narrower market segments</li> </ul>
Anniversaries	<ul style="list-style-type: none"> <li>• To remind target publics about the product/service/brand</li> <li>• To generate publicity</li> <li>• To maintain interest</li> </ul>
Extraordinary events (Guerrilla MPR)	<ul style="list-style-type: none"> <li>• To create strong awareness about a product/service/brand</li> </ul>
Social Media	<ul style="list-style-type: none"> <li>• To share information</li> <li>• To engage customers and others with the brand</li> <li>• To create a 'buzz' about the brand</li> </ul>
Newsletters, publications	<ul style="list-style-type: none"> <li>• To promote the image of companies and their expertise</li> <li>• To build awareness regarding companies and their activities</li> </ul>
Competition	<ul style="list-style-type: none"> <li>• To build interaction with publics</li> <li>• To create awareness</li> </ul>
Sampling	<ul style="list-style-type: none"> <li>• To encourage trial</li> <li>• To build demand</li> </ul>
Spokespersons, brand ambassadors, interviews	<ul style="list-style-type: none"> <li>• To influence public opinion</li> <li>• To generate trust and aspiration</li> </ul>

The study revealed that the practitioners interviewed combine different MPR tools in order to reach their target audiences as well as generate media coverage, publicity and word-of-mouth communication. Some of the tools are used on a regular basis, for example, press releases, publications, and articles while other tools such as events, seminars and competitions are implemented on an ad hoc basis.

## 6. Local MPR campaigns

The present study showed that the local agencies use MPR when they launch new products/services in the market, reposition existing ones, and in B2B marketing. The study revealed that MPR campaigns have been in use in the local market since 1999. Harris and Whalen (1995) referred in their work to MPR campaigns that were launched to introduce new products such as Gillette Mach 3, Pfizer Viagra, Toyota Prius and the Harry Potter books and movies. The agencies studied gave the following examples of local successful MPR campaigns:

- *Launching the Lay's Sensations crisps*
- *Re-launching of Galaxy chocolate*

- *Introducing McDonald's Fruit Cup*
- *Promoting the services of a local law firm*
- *Launching a national distribution centre*
- *Mini Cooper Art campaign*
- *Launching the Nissan X Trail*
- *Introducing Pfizer Viagra in the local market*

To illustrate the MPR campaigns above, let us provide more detail information regarding the "Lay's Sensations" campaign where the key objectives were to introduce the new product range, to build awareness and to support sales. The MPR campaign for launching the new product range of Lay's had one challenging characteristic, namely targeting only adults who were interested in the strong flavours of the product. In order to emphasize this well-defined target group and to communicate the key message to the target audience, the agency designed a series of provocative posters which were not appropriate for a younger audience. There was a need to structure the message in a careful way and ensure that the audience will not accuse the company of using inappropriate promotional techniques. The solution was found in the use of MPR. The agency sponsored a Jazz night where only adults and media were invited. The posters were placed at the venue. The entertainment was guaranteed by the street artists who were creating the replicas of the posters' images on the spot with the use of the product's ingredients (salt and pepper). The interaction with the audience and media was achieved by encouraging them to create their own designs with the product's ingredients. Moreover, the media were given a press kit with information about the brand, the new product range and copies of the posters. The original and creative idea of combining the MPR tools generated a widespread publicity and product awareness.

## **7. The debate between marketing and PR regarding MPR**

The research study's findings revealed that the majority of interviewees perceive PR and MPR to belong to the marketing discipline. What was highlighted was that the two functions should be complementary to each other and integrated in order to achieve organizational objectives. This finding corroborates with some of the literature review findings (Kitchen and Papasolomou, 1997; Broom, 2009). However is in contrast to the perception postulated by some academics such as Hart (1995), Cameron et al., (2008), and

Harris and Whalen (2006) according to which marketing and PR are perceived as distinct disciplines.

The majority of practitioners placed MPR under the marketing umbrella.

“The entire PR activity belongs under marketing so consequently MPR should be placed under the marketing umbrella too. Even when you design your PR strategy, it has to be guided by marketing. Despite this, I believe that marketing alone is not sufficient any more to get your product or service out to clients. You need PR.” (Head of the PR department of a communication agency)

#### **8. MPR versus Corporate Public Relations (CPR)**

The study showed that the agencies studied appear to use both MPR and CPR. MPR aims at achieving marketing objectives through building relationships with customers and media while CPR is used to support the corporate image by forming relationships with different stakeholders. In contrast to the literature review findings (Kotler, 1986; Harris, 1993; Harris and Whalen, 2006), the majority of practitioners interviewed pinpoint to the fact that these functions are in theory distinct but in practice they are often combined into an integrated marketing communications campaign. MPR and CPR are viewed and treated as complementary to each other. This finding supports the findings that emerged from an earlier study carried out in the UK PR consultancy sector according to which practitioners integrate both CPR and MPR in their campaigns (Kitchen and Papasolomou, 1997).

## **CONCLUSION**

MPR is one of the concepts which have emerged and have enhanced the marketing communications mix. Its potential lies in the credibility which is created through media endorsement and word-of-mouth communications which subsequently build trust and strong relationships with an organization's audiences. It encompasses a variety of tools which can be integrated in different creative ways without any limitation. The inclusion of social media in the portfolio of MPR tools adds greater potential and flexibility to the concept and makes it even more popular and critical in integrated marketing communication campaigns.

The present study shed light onto how local advertising and PR agencies implement the concept. Even though the term *marketing public relations* is not used by the practitioners interviewed, the key ideas of the concept are implemented and form an integral part of many marketing communication campaigns. In practice, local professionals do not differentiate between MPR and CPR, the two terms are treated as synonymous and play a complementary role to each other. MPR has the potential to complement advertising and enhance the marketing communication efforts of businesses by using social media, stimulating word-of-mouth communication, getting media endorsements and creating a 'buzz' about products and services. It incorporates and combines many tools one of which is social media that enhance its potential, flexibility and creativity.

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## HUMAN RESOURCE MANAGEMENT: 'CONTENT', 'PROCESSES', OR 'PERCEPTIONS'?

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### ABSTRACT:

This paper introduces a comprehensive conceptual framework as a means to compensate for the failure to recognise the complexities in capturing a complete picture of how an HRM system may add value to employees and organisations. This is achieved by highlighting the immense differences that exist when examining HRM as 'content', as 'processes' and as 'perceptions'. The paper reviews relevant - key studies and debates on their approach towards HRM (in regards to the three key elements mentioned in the title). In essence, this review indicates that while studies examining HRM as 'content', 'processes' and 'perceptions' independently proliferate, attempts to bring these three interrelated areas together are limited. Also, by reviewing particular case studies, it becomes obvious that while HRM policies may be in place, this does not imply that they are effectively enacted by line managers or that they are interpreted by employees in the desired way.

**Keywords:** Strategic HRM, Analytical HRM, Content, Processes, Perceptions

### INTRODUCTION

Endless publications analysing the different perspectives on SHRM and the way that these are associated with organisational performance dominate libraries' bookshelves. In essence, chasing the 'big research' concept, many in this field have strived to identify and justify the way that HR policies and practices influence organisational performance; as if this is the ultimate and only aim of HRM. Throughout these endeavors however, vital aspects are downgraded and critical links are often bypassed.

In fact, many mostly concentrate on the way that the HRM 'content' (i.e. the policies and practices) operates. Others, alongside this focus, suggest that it is equally important to examine the 'processes' organisations employ for operationalising managerial initiatives and policy intentions. Yet, for another group of researchers, exploring HRM both from the

'content' and 'process' angles is not enough. For them, it is equally important to explore managerial actions from the standpoint of those they are meant to influence. Within this spectrum of literature, attention is given to the degree to which managerial rhetoric is converted into workplace reality.

The aim of this paper is to introduce a conceptual framework as a means to compensate for the failure to recognise the complexities and difficulties in capturing a comprehensive picture of how a complete HRM system may add value to employees and organisations. This is achieved by drawing attention to three distinct, but at the same time related notions: the 'content'; the 'processes' and the 'perceptions' of HRM.

## **THE 'CONTENT' OF HRM**

The term 'content' in the field of HRM is regularly used to denote the various HR policies and practices that are designed to support employees' efforts for accomplishing their responsibilities (Bowen and Ostroff, 2004). These are built based on a particular strategic focus and are guided by organisational goals and values. Discussion regarding the 'content' of HRM fits well with the Strategic HRM (SHRM) literature since, by definition, one of the most important aims of SHRM is to achieve strategic fit, an orientation mainly expressed through the 'matching concepts' – horizontal integrations and vertical alignments. The former terms is used to denote the efforts to pursue 'best practices' and fit these into coherent bundles (i.e. universal models); whereas the latter discuss the importance of matching HRM strategies with business plans (i.e. 'best fit' – contingency models) and designing HR practices according to the unique characteristics of organisations' workforce (resource-based views – 'HR architecture').

In more detail, the 'universal' model is based on the assumption that there is a universal way of managing and one 'best' way for practicing HRM. The basic belief is that 'the more organisations adopt and implement these practices the clearer the payoff will be in terms of performance improvements' (Bach, 2005: p8) and that all firms (no matter their size; structure; type of industry; country etc.) experience performance improvements and enjoy important benefits by only investing in 'best practices'. These positive outcomes are reinforced by formatting these 'best' HR practices into coherent bundles that have the potentials to produce better results rather than if these were implemented individually.

Yet, these claims are not accepted without criticisms (see Truss et al., 2012). For the 'contingency' supporters, 'to claim that a bundle of best practice HRM is universally applicable leads us into a utopian cul-de-sac' by ignoring momentous forces both internal and external the organisation (Purcell, 1999: p36). According to this 'best fit' model, HRM varies between organisations and it should be designed to manage people 'across different jobs, workplaces, companies, industries, societies and cultures' (Boxall et al., 2008: p4). Mainly, this model assumes that HRM is a particular field of study rather than a distinct style of management and there is no 'ideal' set of universal practices. On the contrary, numerous contextual forces influence management's decisions regarding HRM.

However, the limitations of this orientation (i.e. deterministic assumptions; neglecting the importance of dynamics and the process of change etc.), and particularly the fact that it mainly follows an 'outside-in' orientation has led researchers to an alternative approach to HRM. Following an 'inside-out' perspective, the 'HR Architecture' idea mostly concentrates on organisations' internal resources and more particularly draws attention to the 'human capital' factor and their competencies and intellectual capabilities (Allen and Wright, 2008).

Briefly, the core implicit assumption of this resource-based view is that investments on HRM should be done according to the different types of workers employed within organisations. This emphasises the importance of having an 'HR architecture' (Lepak and Snell, 1999), whereby different HR policies and practices are targeted to different occupational groups (always according to their distinct needs, responsibilities and roles). As Hutchinson & Purcell (2007: p9) nicely summarises, 'different types of employees have different needs and respond in different ways to HR policies, with the obvious logic of the need for different type of HR systems, including rewards and training, learning and development for different types of employees'.

Of course, beyond the above models, new and updated ways for analysing HRM appear in the literature, offering a unifying framework and resolving the tensions between the three dominant models. For example, adding on the ideas proposed by some dominant authors in the field, Pavlou (2012) articulates his thoughts for a 'Core Plus Context' (CPC) specific approach to HRM. This proposition builds on Boxall's & Purcell's (2011) suggestions to consider 'best fit' elements to be at the 'surface level' and 'best practice' components at the

'underpinning layer' of SHRM. Similarly, through the lenses of CPC, Pavlou (2012: p1279) builds on the RBV notion and adds to the 'table stakes' argument by stressing the necessity 'for developing HRM systems 'tailored-to-the-organisational reality' and for establishing a particular strategic focus that will differentiate the organisation from competition'.

## **THE 'PROCESSES' OF HRM**

As useful as the above discussion may be, it lacks some essential 'ingredients'. One of the most important shortcomings is that 'much writing about HRM at the strategic level has tended to assume that the vertical and horizontal dimensions are sufficient' (Gratton and Truss, 2003: p76). Apart from the work done by a handful of researchers; a limitation of many previous investigations is that they are mostly concentrated on the 'content' of HRM. But, beyond the content, there are also those who give more weight to 'processes' aspect of HRM. Within this spectrum, focus falls on the 'how'; thus investigating the actual procedures adopted in order to put HR strategies and managerial plans into operation.

Using the term 'process', Bowen and Ostroff (2004) emphasise how the prescriptive HRM models (i.e. the 'content' of HRM) can be designed and administered effectively. In order for this to be achieved, the authors introduce the notion of a 'strong situation' which can be achieved when the HRM system is perceived as high in distinctiveness, consistency, and consensus (p208). By enriching these three key constructs, the authors elucidate nine metafeatures of an overall HRM system that, if met, have the potentials to foster a shared meaning and develop consistency in employees' understanding (since the HRM content will unambiguously communicate the intended messages).

One way for better appreciating 'how' this consistency may be achieved, is to investigate the way that seniors' intended HR policies are put into effect mostly by line managers. Actually, the distinction between the intended and implemented HR practices draws attention to the gap between the espoused HR policies and their enactment; a gap that may create discrepancies in the workplace, both horizontally and vertically. Among others, this brings line managers at the forefront, who have the power to influence, deliberately or not, the process of converting HRM policies into practice.

For ensuring that HRM policies are implemented consistently throughout different levels, it is vital to realise the importance of integrating line managers in this process. This issue is considered by Armstrong (2006), who recognises that the success of the policies initiated by the HR specialists lies with line managers. For the author, while the 'HR proposes, the line disposes' (p97), meaning that eventually, line managers are those who will determine the degree to which HR practices will be effective or not. The same belief is also expressed by Hutchinson & Purcell (2003: pvii), who state that 'the way in which they interpret and use the policies and practices designed by HR professionals has become an important determinant of the success or failure of those practices'.

In handling HR issues, line managers unavoidably exercise a certain degree of discretion. If they decide to use their own discretion and initiative not to convert seniors' intentions into actions, the consequence is that promoted policies will remain only in theory. Of course, beyond line managers' discretion, there are also other factors that may influence the way that line managers carry out their HR responsibilities. Although there are many aspects that may restrain organisations to operationalise their intended plans, for this paper of particular importance is how line managers may inhibit this process.

Rejecting the assumption that all managers, at all levels and departments will uniformly follow a given strategy without any variations, the suggestion is that line managers, due to several reasons, may 'block' this process. Many research endeavours have reached the conclusion that line managers may act as a barrier for the successful realisation of the desired HRM policies (e.g. Harris, 2001, Redman, 2001) and have also considered the several forces that may hinder line managers' effectiveness (see Hall and Torrington, 1998, Hutchinson and Purcell, 2007, Hutchinson and Purcell, 2010, Larsen and Brewster, 2003, Marchington, 2001, McGovern et al., 1997, Whittaker and Marchington, 2003).

Among these studies, perhaps the one done by Hutchinson & Purcell (2010) within the NHS best summarises the main point related to line managers' role. Concerning with line managers' effectiveness in delivering HRM, the authors focused on identifying their role, their own reality and experiences. They established and explained the main factors inhibiting line managers' ability to successfully deliver HRM. Heavy workload; role conflict; poor background HR skills and knowledge; inadequate training; pressures for focusing on short-term priorities; divided loyalties; competing priorities and lack of commitment to HR

objectives combined with the lack of management's support comprised a mix of factors suppressing their effectiveness in carrying out their HR role.

## **THE PERCEPTIONS OF HRM**

The profound interest for allocating greater HR responsibilities to line managers call for reevaluating and measuring how effectively HRM is being delivered. One way to achieve this is by exploring how employees experience and perceive these HR-related activities. Thus, beyond looking at the 'content' and the 'process' of HRM, attention should also be given to the way that seniors' intentions and line managers' implementations are ultimately perceived by non-managerial employees. In essence, the aim within this spectrum is to explore 'how well' HR practices are delivered to the workforce. The main argument is that simply having in place high commitment HR practices does not guarantee they are implemented effectively. For gaining a complete picture, it is essential to also account the views of those at the 'receiving-end' - the recipients of any HRM-related effort.

Concerning with this issue and in order to examine the degree to which 'practices were practiced', Edgar & Geare (2005) measured the effectiveness of HRM from employees' perspective. By emphasizing the importance of allowing employee voice to be heard, one of the authors' conclusions is that it is necessary for researcher to evaluate HR practices by their perceived quality and not only by their quantity. Similarly, by focusing at the ward level, Veld et al. (2010) examined the way employees perceived the intended HRM strategic goals and if their perceptions generated the desired effects. Their outcomes are of course interesting, as they show deviations between intended HRM (i.e. policies and declared strategies) and perceived HRM as conveyed by the ward level.

Without a doubt, examining the way by which employees perceive HRM activities, discrepancies emerge. This is because most of the time they will not perceive managerial attempts as the organisation initially planned. These indications are reinforced by the study of Khilji & Wang (2006) which offers great insights regarding this point. The authors' paper makes a clear distinction between the HR practices intended by the organisations and those actually implemented. Credence to these findings is also provided by other studies, such as the one of Liao et al. (2009) who examined the disconnection between what organisations in general say they do as formal practices and what employees actually experience at the

workplace. By differentiating these two levels (i.e. management's versus employees' perspectives) the authors revealed substantial differences.

The case seems to be that 'employees may not always perceive the objective existence of certain practices as the organisation intends' (Allen et al., 2003: p103) and their perceptions may not be in line with organisational objectives. Actually, the concerns raised long ago by Brewster et al. (1983) for a distinction between 'espoused' and 'operational' policies; and more recently by Legge (2005) for differentiating between rhetoric and reality are of great importance here. Of course, the management may dictate investment on high levels of EIP and communication practices, but in reality, the focus given on schemes facilitating related practices may be marginal. Similarly, organisations most of the times declare that they are strong supporter of quality training and development practices. Yet, by evaluating employees' views, it is possible that training provided is judged to be irrelevant or not supportive for improving their competencies. Undoubtedly, such cases generate the belief that management's declarations are just rhetoric, rarely converted into reality, something that negatively impacts on employees' perceptions.

Summarizing, the preceding review reveals the importance of evaluating both managerial members' opinions and beliefs regarding HR policies and practices, but also the necessity to investigate how workers, from their own perspective, experience and perceive the HR practices offered to them. Accordingly, there is the need to investigate the degree to which managers' and workers' views regarding HRM coincide or differ.

### **CONCLUDING REMARKS: HRM 'CONTENT'; 'PROCESS' & 'PERCEPTIONS': AN 'ANALYTICAL' APPROACH TO HRM**

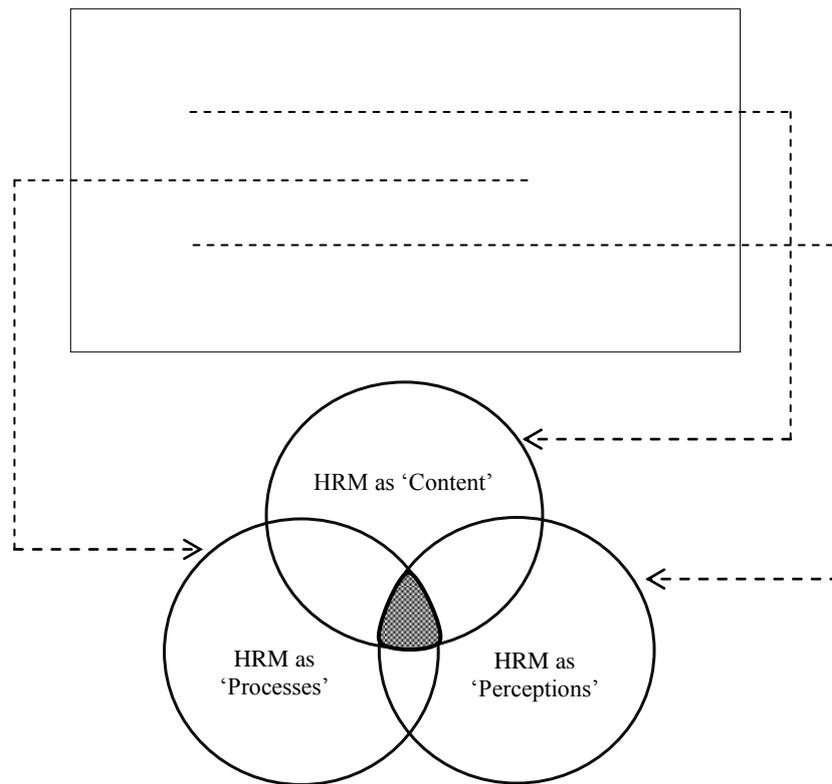
This paper briefly explored HRM from the 'content', 'processes' and 'perceptions' perspectives. The main objective was to assess the pragmatic nature of HR practices rather than only the stated policies. The conclusion reached is that when evaluating the value of HRM, it is not enough to remain at surface measures, which capture at best the quantity and frequency of schemes operated by the organisations. This implies the need to distinguish between espoused policies (intentions) and actual practices (implementations). Moreover, to gain a real feeling of the impact that HRM has, essential are also the perceptions of non-managerial employees who are considered to be the 'consumers' of the different practices.

The basic belief is that the truth about HRM lies beyond the senior managerial members and can be found closer to those who are really affected by the implementation of these policies.

This paper articulates the necessity for a multilevel conceptual framework and calls HRM researchers to equally explore what organisations do and why (i.e. the content); how they do it (i.e. the process); and for whom and how well (i.e. the perceptions). According to Boxall and colleagues, this conceptual framework represents an Analytical approach to HRM (AHRM). Accepting the fundamentals of AHRM, researchers are able 'to identify and explain what happens in practice' (Boxall et al., 2008: p4). This is because this approach to HRM has a triple focus. Beyond trying to understand the nature of the various HRM policies / strategies and the way these can develop invaluable capabilities to the workforce, it also highlights the key role of line managers for their successful implementation. Moreover, this concept draws attention to the actual impact of HRM, not only as sought by the organisation and managers, but by also integrating the voice of non-managerial employees into the argument.

As seen in Figure 1 below, concerning with 'what the management does and why', this paper has investigated the 'content' of HRM and the forces shaping its operation at the workplace. Concerning with 'how HRM process work', the focus was on line managers' role in bringing HR policies into life and the barriers that may inhibit their efforts. Lastly, investigating the 'for whom and how well' aspect, focus has shifted to non-managerial employees, thus concentrating on the way they experience and perceive HRM.

In the literature, there are studies with several focus areas / objectives which base their conclusions on senior members' suggestions (i.e. CEOs, HR directors, senior managers) and official / formal organisational documents; others focusing exclusively on line managers and others downplaying the role of the line and exploring HRM from employees' viewpoint. Of course, there are also studies which incorporate these levels of analyses and provide a more comprehensive picture of how HRM may have an impact on employees and organisations. It is within this spectrum of research that this paper rests.

**Figure 1:** A Comprehensive / Multilevel Conceptual Framework

The originality and value of this paper lies in the fact that it builds on the idea of 'Analytical HRM' and advocates the necessity for a multilevel conceptual framework, stressing the importance for HRM researchers to equally explore the 'content'; the 'process' and the 'perceptions' of HRM. Collecting information only for one of these aspects is insufficient, offering a partial understanding. The key message is that HRM should not be evaluated only as policies; as processes, or as perceptions. None of these on their own are sufficient. For this particular paper; it is all about how these are linked together.

## LIMITATIONS & FUTURE RESEARCH

This paper should be taken as an effort to introduce a more critical approach and to develop an analytical conceptual framework. As such, it solely focused on bringing forward key theoretical debates by drawing on existing studies in the related fields. Consequently, the preceding discussion is based on literature review and does not integrate any empirical information or data derived from fieldwork research. The aim was to build a multilevel conceptual framework and highlight the need for future researchers to account for the 'multivocality' within organisations and the necessity to accommodate the views of everyone affected by and involved in the operation of HRM. Nonetheless, these ideas and propositions

were applied by the author through a case study methodology and the fruitful outcomes that will be presented in a forthcoming publication / research-based paper.

Future research efforts pursuing this 'multiple –lenses' approach have the potentials to add to our existing knowledge by not only remaining on the 'content'; 'process' and 'perceptions'; but also seeking to identify how these perceptions may influence their outcomes (i.e. in terms of attitudes; behaviours and eventually their performance). Connoisseurs of this field can immediately realise the call for future research endeavor related to the widely debated issue of 'Black Box' or 'Holy Grail' regarding the relationship between HRM and organisational performance. In essence, this proposition relates to the causal chain of HRM, aiming to draw attention to the critical steps that are necessary to be achieved if HRM is to have an understood and 'tangible' performance outcome (see the models offered by Marchington and Wilkinson, 2012, Purcell and Kinnie, 2008, Purcell et al., 2009).

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## **E-COMMERCE AND MOBILE COMMERCE FOR FASHION BUSINESS**

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### **ABSTRACT**

Mobile Commerce has already begun to have applications in for trade of fashion brands. Collections of Fashion Design were developed for this new trading platform. The materials, profiles and product categories impact the success of sales through Smartphones and Tablets.

The purpose of this study is to examine the collections of fashion design apps of brands and retail chains (available on iPhone and iPad) from the point of view of materials, style and product categories. It is concluded that elastic materials such as knitwear, dresses and t-shirt are privileged,. Pants have the lowest incidence in consumers. The preference attributes associated with mobile commerce depends upon piece variety, multiplicity of style and possibility to coordinate. There are differences in gender that are due to easiness of accessibility, piece personalization, professional advice, videos collections and social networks links and share. Female consumers give more importance to fashion attributes such as satisfaction and comfort, followed by function, while men prefer comfort, followed by satisfaction and, after that, quality. This study concludes that mobile marketing allows customer interaction with brand in a fun way, which in creases customer loyalty.

**Keywords:** Mobile Commerce; E-commerce; Fashion Business; Fashion attributes; consumer preferences; Iphone; Ipad

## INTRODUCTION

An increasing number of consumers are making every year purchases online of clothes and sports goods. From 2006 to 2009, the number of Internet users who ordered goods or services in the previous year grew from 47 to 54 per cent and in Europe27 increased 10 percent (European Commission report, 2010).

The purchase categories preferred by around 140 million Europeans ordering online every year are changing over time. Travel and accommodation remain the most popular category among services, and clothes and sports among goods. In Europe27 the fifth category to online purchasing, in 2010, consisted of films/music or books/magazines/e-learning material or computer software (24%), followed by holidays (21%). Clothes and sports goods (19%) occupy the third category. Figure 1 and figure 2 show the percentage of individuals that make online purchases of clothes and sports goods for the most important countries and for different age consumers in e-commerce (Eurostat, 2012).

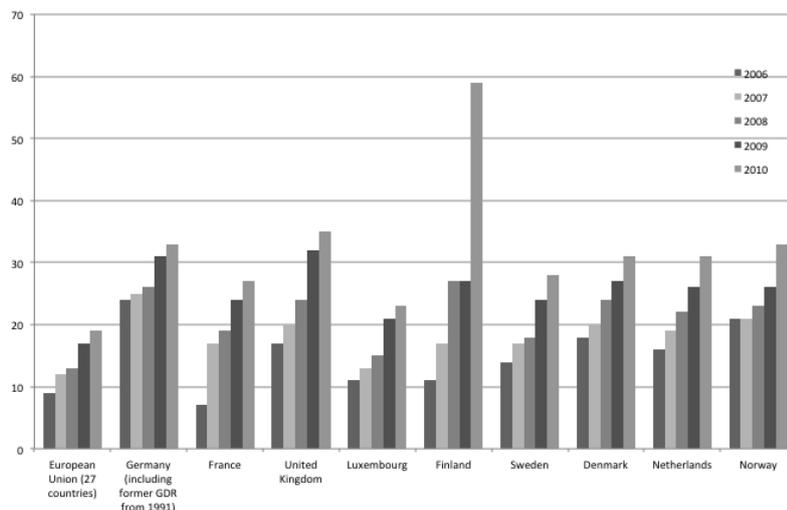


Figure 1 - Percentage of individuals that make online purchases of clothes and sports goods by country (Source: Eurostat, 2012)

A survey that used a sample of 1,500 people, in United States (November of 2011) concluded that smartphone and tablet apps are not consumers' preferred channel for browsing or shopping: just 4 percent of connected consumers like to use branded apps, whereas 87 percent prefer to use websites (including mobile web sites). The purchase is primarily done

with the objective to find the best price, using either the smartphone or tablet. The consumer also considers more fun and exciting to purchase using the tablet platform than smartphone or PC platforms.

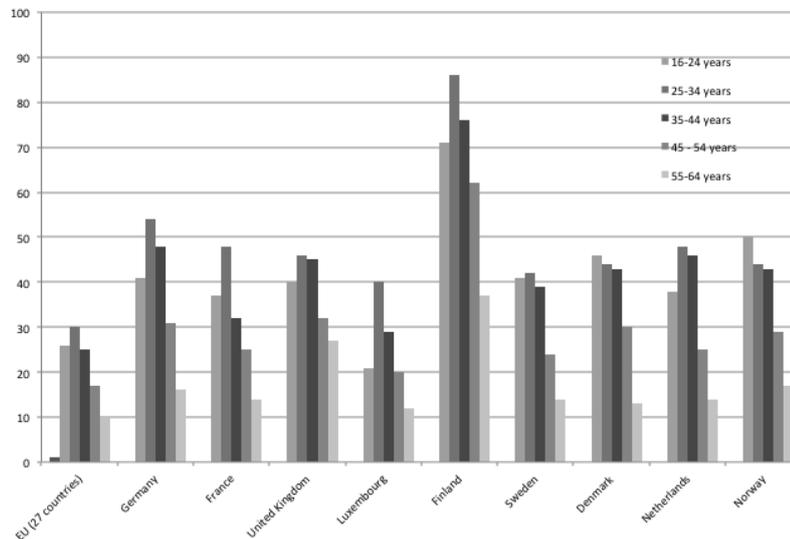


Figure 2 - Percentage of individuals that make online purchase of clothes and sports goods by age (Source: Eurostat, 2012)

This type of consumer is expected to increase by 49%, next year, the volume of purchasing through tablet platform in contrast with only 19% through smartphone. The motivations for shopping with iPad are convenience, browsing and ease of transaction. The year 2011 is focused in apps of brands, but the research by Zmag/Equation Research projects that in 2012, Facebook will be the preferred shopping platform. In accordance with eMarketer reports, it is envisaged that mobile commerce sales will grow over four-fold in the next years, from about \$7 billion in 2011 to \$31 billion in 2015.

In 2010 the business transaction volume of purchases of textiles and clothing on the Internet were estimated in 2.9 billion in France, representing about 9% of total apparel sales. The clothing purchase occupy third position in mobile commerce and the total consumer in mobile commerce represents 0,005% of the total of consumer retail, being e-commerce 2,8% (Journal du Textile, 2011).

Ko *et al.* (2009) explored the potential of consumer technology adoption model in examining structural relationships among mobile commerce characteristics, perceived value and intention to adopt mobile shopping for fashion products in Korea.

Kim, Chan, and Gupta, (2007) concluded that the consumer perception of value is a significant variable to determine actual behavior intentions, rather than their attitude toward the act of using technology in the mobile commerce context.

The results of study of Kim *et al.* (2009) showed that the consumers' shopping intentions via mobile technology are positively influenced by attitude toward mobile commerce, subjective norm, and perceived enjoyment. Retailers may target fashion leaders or early adopters in mobile commerce to promote their new applications.

### *Design Attributes of Fashion Products*

There are several individual and collective factors that interfere on the purchasing decision, such as the brand of a given fashion product as many consumers make purchases by influence of a designer or company brand. Brands are perceived in differences ways, but cost, uniqueness, utilitarian or fashion image are important factors (Salomon and Rabolt, 2009).

Quality is another factor to which consumers pay more attention (Acharya and Elliot, 2003; Hanf and Wersebe, 1994). The design is an important motivation for purchasing and consumption of fashion. In a garment, consumers give more and more relevance to aesthetical appearance, like the line, look, among many others. The characteristics or attributes of fashion products also influence purchasing, since they interfere on the value, style and quality of product (Hong *et al.*, 2002; Wickliffe and Psysarchik, 2001).

Of the visual attributes, aestheticians believe silhouette to be the most important, because it "frames" an object in its surroundings. Line also interacts with color, to emphasize or deemphasize silhouette and shape (DeLong 1987, Eckman and Wagner, 1994).

Product comfort is also an important attribute as consumers wish comfortable products to satisfy specific needs. The usefulness is also a factor that consumers have in mind when buying garments, because, for example, they buy a garment that combines with their existent wardrobes, and they make their choices also considering aspects such as durability and easy care. The product novelty is a factor that fashion followers have into consideration, in each season they renew their wardrobes, and they look for innovation in their wearing way.

Price is a rational factor that much influences the purchase of a product since consumers consider a better product the one with better price (Hanf and Wersebe, 1994). The acceptance

of a product is reached when there is equilibrium between value and price that the consumer is willing to pay for it. In general, the consumer considers a low price product the one that is outdated or with low quality.

May-Plumlee (2006) pointed out thirteen universal evaluative criteria in clothing products. Dutton (2006) shows that the products' attributes of styling, brand, price, place, production and fiber content have a significant effect on the buyer intention of the consumers in a range of age between 15 to 25 year-old. Pereira *et al.* (2009) used the same attributes to study the valorization of the apparel attributes according to the influence of the advertising level on the buying behavior.

### *The Fashion Designer of the future*

Clothes are not divorced from social context (culture, group association, social situation, immediate body space, person characteristics (i.e, age and gender), kinetic interaction, garment/body interaction and the garment itself (Damhorst, 1985). The last one is subdivided by garment pieces (skirts, pants, jackets, dress, etc...); the finishing and the condition of material. The perceptual elements within the design of a garment can vastly create different images and impressions. The visual image resulting from the manipulation of design elements (line, space or area, shape or form, color, pattern, texture of material, apparent weight, fiber and odor). Principles of design, that is the arrangement of the design elements, to create harmony, unity, rhythm, balance, emphasis and proportion (Davis, 1996; Jones, 2005, Salomon and Rabolt, 2009). Nowadays, the best fashion design has a need for arrangement of the design elements that are appealing to the consumer of the digital era.

The work of Fashion Designer for 21<sup>st</sup> century need to reevaluate the requirements of product use and consumption that include problems focused on environment, sustainability, and societal concerns (Palomo-Lovinski and Faerm, 2009); the new designer needs to consider the internet platform, find the way to connect the designer's and brand values to the social and environment challenges (moving toward a sustainable lifestyle and economy) facing our civilization (Benson and Fine, 2011). Eundeok and Kim (2009) conclude that the design and product development processes would rely heavily on computer and digital technology. As a result, the role of technical design would be increasingly important. This heavy reliance on computers was predicted to lead to increased production of relatively simple designs that could be efficiently executed by computer. This is one way for reducing the consumption of

raw material and to achieve sustainable processes. Black (2007) also, in his work with a research cluster, concluded that the potential for emerging technologies and digital fashion contribute to a more sustainable future. Today the fashion designers need to create Fashion based is those principles, and to adapt to new ways of business, that include digital platforms and global aesthetics diversity.

### *The Attributes in E-Commerce and Mobile commerce*

The success of the e-commerce and mobile commerce depends on the type of goods and services to acquire. Thus, for sensorial products such as clothing, jewelry or accessories, which are experienced through one or more of the five senses (e.g. touch, sight, smell), the consumers' ability to examine merchandise before purchasing is substantially limited, even when an online shopping site has video or audio capacities. Online retailers of fashion sites have attempted to capitalize on the advanced unique virtual shopping environment using 3D Flash sites, electronic dressing rooms and fashion-conscious virtual personal shoppers to guide users (Stockport et al., 2001). Other attributes and factors such as transaction/cost and incentive programs, along with demographic variables (gender, income and number of children) were important predictors in determining the intention to purchase clothing, jewelry, or accessories via the Internet. Incentive program mediated the relationship between education level and online purchase intention, concluded Kim and Kim (2004) in their work. Mobile commerce marketers should progress toward a "customer-centric" strategy by focusing on instrumental personalization of mobile shopping sites design and implementation (Fan and Poole, 2006; Lee and Park, 2006; Kim and Lee, 2009) in order to delight profitable customers. Ha and Stoel (2009) concluded that the web site quality plays a significant role in consumers' adoption of e-shopping and has four dimensions: (1) web site design, (2) customer service, (3) privacy/security, and (4) atmospheric/experiential and shopping enjoyment and trust. Ha and Stoel (2009) say that the customers are not only web users with trust/safety and information needs, but also shoppers with service and experiential needs. The key points suggested by Gatford (2010) are consistency and flexibility; mobile commerce makes it possible for customers to get what they want wherever they are, not relying on proximity to a real life store or their computer or internet connection. They want familiarity with the store/website they already know and the option to customize their purchasing experience. Providing stock details and reservation ability, SMS reports about delivery status, are all ways to give the customer full control and to in turn encourage them to

put their full trust in mobile commerce. Butcher (2010) suggests that the mobile commerce platform addresses merchants' need for a new channel that will broaden their loyalty through gift programs, mobilization of sales and marketing to reach customers anytime, encourage purchases and build a stronger brand affinity. According to Butcher (2010), there is much consumer interest in using mobile for tasks such as discount vouchers, finding stores and checking stock levels before they go to the store. Now that most luxury brands have accepted that the internet is a powerful tool for commerce and that social media provides an opportunity for a new kind of brand engagement, along comes another technological wave that will feed the ongoing digital revolution in fashion, and take it mobile. Some brands in the Luxury Fashion Market at mobile commerce refer that good smartphone apps offer an intuitive User Interface (UI) where design is critical. Useful features that address the mobile use cases and don't simply replicate what a website might do in a stationary computing environment. Other feature is to be fun either as utility or a game. Also they incorporate mobile metrics and an analytics package into the app to make informed decisions around app improvements and future releases. An application must be more than a product shop window and this may include using the device's camera/video capture, location-detection capabilities, accelerometer or mobile screen itself. The app is used as an engagement channel with social media tools, location-based search and commerce, if appropriate, to expand the market and build a digital dialogue with consumers (Amed, 2010).

### *The iPhone and iPad*

The launch of the iPhone revolutionized the mobile phone market (Kim *et al.*, 2005). According to eBay, one item is purchased every two seconds using eBay mobile app, with apparel, auto parts, cell phones/accessories, sporting goods and collectibles ranking as the top five categories of purchased items. A new era of commerce is arriving and, with it, a need for several studies. Thus, the main objective of this paper is to study the attributes apps for iPhone and iPad fashion products, study the consumer buying behavior according to the gender and to understand the apps attributes most valued by consumers in mobile commerce. To attain this objective three research questions were presented:

- 1) What are the best apps for iPhone and iPad in fashion products?
- 2) According to gender, what is the type of goods and services that are bought by the consumer using mobile commerce, taking into account his experience in e-commerce?

3) According to gender, what is the importance given by the consumer to attributes when consulting fashion products using smartphones?

The subsequent hypotheses are set out:

H<sub>1</sub>: There are significant differences in the type of goods and services bought by the consumer in mobile commerce according to gender.

H<sub>2</sub>: There are significant differences in the attributes valued by consumers that use smartphone platform to purchase fashion products according to gender.

This paper is organized as follows: After the introduction to the topics, the methodological aspects are described in the second section. In the third section the main results are presented and in the fourth one the main conclusions are drawn.

## **METHODOLOGY**

These studies focus on two particular platforms, Apple's iPhone and iPad. This particularization was made due to four reasons: the market size, the number of applications developed for mobile commerce of fashion products included in the Lifestyle group, the portability of equipment and the motivation to fashion products are considered (Katz and Sugiyama, 2006). Users of the iPhone can draw applications to their devices via the iTunes store. The offer is divided into 20 categories. This work focuses on the applications included in the Lifestyle category, because there is no sub-category of retail for clothes or fashion. Only in US was created, in September 2011 to celebrate the Fashion Week and promote fashion-related apps, a new App Store section named "Fashion: Apps for the Clothes -Minded".

Thus we select a set of applications associated with the following categories in fashion retail industry. The consulting took place from November 2011 and throughout 2012. From the total apps found in the iTunes store using the search "Bestsellers in Lifestyle" a set of 12 apps were obtained from 8 countries. An analysis table was constructed. In the second part of the work we developed a survey to obtain results on some aspects of mobile commerce in Portugal (Portuguese fashion industry has for many years been known for its quality and low-cost production, but designers face a larger challenge when it comes to being recognized as a fashion center (Soares, 2011).

The nonrandom sampling technique was used, i.e. the population selected to constitute the sample depends, partly, on the researcher's judgment. Beyond this sampling technique it was also deployed the snowball sampling process. A questionnaire was sent by e-mail to all the contacts on the researcher's mailing list living in the country (Portugal). Next, was disseminated it by the snowball technique for successive contacts of first respondents. The study sample comprises 570 respondents for smartphone and internet platforms. Concerning the answers obtained from the surveys, they were measured according to the Lickert scale (1 to 7). Data were exported to the SPSS 17.0 software in order to develop a statistical analysis. To obtain the answers to the research questions, descriptive and multivariate statistics were used.

## RESULTS: MOBILE COMMERCE APPS FOR BUYING AND KNOW ABOUT FASHION

In this work we choose the top apps based in the classification of iTunes store in category of lifestyle for 8 countries. The obtained results from the research done are presented in Table 1 and Table 2. The leader in multichannel apps is eBay, followed by the Amazon mobile. In brand apps, the leader is H&M, followed by Danish Trendsales. In fashion magazines, the leader is Cosmopolitan UK. From this analysis, the fast fashion brands are the most preferred in the top 10 Best Sellers.

Table 1 Bestsellers free apps in fashion products for iPhone in 2012

USA	United Kingdom	France	Filand
ebay	ebay	ebay Mobile	H&M
Amazon Mobile	Amazon Mobile	Vente-privee.com	Cosmopolitan UK
Nordstrom	New Look Fashion	ELLE Magazine UK	Ivanity Mirror
Gilt	Next	Showroomprive	ELLE Magazine UK
Zappos	River Island	Amazon Mobile FR	ebay
Walmart	Cosmopolitan UK	Cosmopolitan UK	Zara Shop Online

USA	United Kingdom	France	Finland
AE	ASOS	La Redoute	Bubbleroom
New Beauty Magazine	Debenhams	Zara Shop Online	Amazon Mobile
Zulily	Topshop	H&M	Cubos Fashion
Victoria's Secret	H&M	ELLE	Harper's Bazar UK

Table 2 Bestsellers free apps in fashion products for iPhone in 2012

Germany	Netherlands	Denmark	Portugal
Amazon Mobile	H&M	Trendsales	ebay
Ebay Mobile	Cosmopolitan UK	H&M	Zara Shop Online
H&M	MyMirror	ELLE Magazine UK	Cosmopolitan UK
OTTO	LINDA	Cosmopolitan UK	Amazon Mobile
Cosmopolitan UK	ebay	ebay	H&M
Douglas	Zara Shop Online	ASOS	Bershka
Zara Shop Online	I Love Fashion News	Hairstyle Salon	Mirror
MyBestBrands.de	Cosmopolitan UK	Amazon Mobile	Elle Magazine UK
Spiegel	What to Wear	Harper's Bazar UK	MANGO
Hairstyle Lite	MANGO	Mirror	Pull&Beer

### *Results: Consumer's inquiry results*

In order to put in context this analysis, the consumer profile of respondents was analyzed. Beginning with age, the majority of respondents were between 23 and 29 years old (60 %), followed by the age group ranging from 18 to 22 (18,8 %), then from 40 to 55 (9,4 %) and

finally the 30-40 (7,1 %). In terms of gender, the research sample is by majority represented by women (65 %), with males accounting for only 35 % of respondents.

Regarding the intention to buy fashion items, using the smartphone platform, the following answers were obtained; in the last two years the consumer did not use that platform to purchase fashion products; presently very rarely think in it; in the near future, will do it a few times only, albeit with a slight increase in the average value (see Table 3).

The survey included open questions to obtain some explanations for the answers that are summarized next. Some consumers indicate as main reason for not making purchases using smartphones the lack of confidence in the transaction process as compared to e-commerce. The applications available for the smartphone also exist in e-commerce, prices do not differ, privacy and the screen size is limiting. The low number of consumers who choose to buy via smartphones, identified as the main reason the fun of the transaction in their leisure time with friends, when need a last-minute shopping and to be the quickest way to do it, because there exist apps of brands to which the consumer is sure. Other reasons were after entering a physical store easily they compare prices and products via smartphone and if it is advantageous, they perform the purchase through the smartphone.

When consumers were asked to compare traditional shopping with mobile shopping the answers were; preference to buy expensive fabrics with traditional shopping because of need to touch. Traditional shopping was also preferred for purchasing of jeans and slim trousers. The consumer prefers to buy easy elastic fabrics and knitwear using mobile commerce platforms.

*Table 3. Intension to Buy Fashion products using smartphones*

		Two Years ago	Today	In the future
Men	Mean	1.06	1.45	1.55
	N	186	198	186
	Std. Deviation	.247	.658	.561
Women	Mean	1.07	1.20	1.57

N	348	360	348
Std. Deviation	.254	.401	.592

To answer the second research question, according to gender, what is the type of goods and services bought by the consumer using the mobile commerce, considering his experience about e-commerce? According to gender, regarding the consumer buying behavior of goods and services using the mobile commerce as a function of his experience with e-commerce, the data analysis reveals that men's buying is different in hotels, games, fashion accessories, perfumes/beauty and shoes. In this way, the H1 is not rejected for this type of goods (Table 4 and Table 5).

Table 4. Intention to buy goods and services using the mobile commerce as a function of the experience in e-commerce

		Travel	Hotels	Music/Concerts	Games	Books
	Mean	3.824	4.188	3.235	2.879	3.441
Men	N	204	192	204	198	204
	Std. D.	2.473	2.206	1.976	2.218	2.434
	Mean	3.750	3.583	3.000	1.780	3.237
Women	N	360	360	360	354	354
	Std. D.	2.524	2.407	1.969	1.639	2.342
	F	1.04E+00	1.34E+01	7.95E-06	6.05E+01	2.36E+00
	Sig. (T-test)	3,09E-01	2.74E-04	9.98E-01	3.72E-14	1.25E-01
	Sig. (2-tailed)					
	EVA**	7,38E-01	4.00E-03	1.74E-01	7.90E-11	3.29E-01
	EVNA***	7.36E-01	3.17E-03*	1.74E-01	3.02E-09*	3.34E-01

\*Significant according to a level of significance of 5 %; \*\*Equal variances assumed,\*\*\*Equal variances not assume

Table 5. Intention to buy goods and services using the mobile commerce as a function of the e-commerce experience

		Fashion accessories	Apparel	Customization apparel	Perfumes/ Beauty	Shoes
	Mean	3.176	2.970	2.152	2.324	2.324
Men	N	204	198	198	204	204
	Std.D	2.274	2.101	1.832	1.847	1.941
	Mean	2.617	2.754	2.102	2.017	1.902
Women	N	360	366	354	360	366
	Std.D	2.037	2.088	1.859	1.710	1.698
F		1,45E+01	3.65E+00	6.64E-01	6.63E+00	1.79E+01
Sig. (T-test)		1,58E-04	5.66E-02	4.15E-01	1.03E-02	2.69E-05
Sig. (2-tailed)	EVA**	2,77E-03	2.43E-01	7.62E-01	4.72E-02	7.15E-03
	EVNA***	3.76E-03*	2.44E-01	7.61E-01	5.23E-02*	9.71E-03*

\*Significant according to a level of significance of 5 % \*\*Equal variances assumed;\*\*\*Equal variances not assumed

As purchase intention, men prefer to perform purchases using smartphones primarily for services such as hotel booking, travel, books, music /concerts and only secondarily then to buy fashion accessories. In what concerns the women's intention to purchase with smartphone platform is inferior to that of men in most goods and services and the preferences fall in travel, books, hotels booking, music /concerts, apparel and fashion accessories.

To answer the third research question, according to gender, what is the importance given by the consumer to attributes when consulting fashion products via smartphones? Regards the importance given by the consumer to attributes associated with fashion products in mobile commerce, it appears that there are differences between men and women are: the easy

accessibility to the various application areas /site, ability to coordinate the different pieces, customizing pieces, professional advice, link and share with social networking and video collections. Thus hypothesis 2 is not rejected (Table 6).

Table 6. Differences of attributes when consulting fashion products through the smartphone: iPhone according to gender (t-test)

		Results of t-test							
		N	Mean	Std. D.	Std.Error		F	Sig.	Sig. (2-tailed)
					Mean				
Variety of pieces	Men	180	5.800	1.541	0.115	.031	8.594E-01	2.353E-01	
	Women	294	5.633	1.455	0.085			2.419E-01	
Multiplicity of styles	Men	180	5.800	1.474	0.110	1.872	1.718E-01	1.732E-01	
	Women	294	5.612	1.443	0.084			1.756E-01	
The environment /character	Men	168	4.750	1.907	0.147	4.653	3.151E-02	6.848E-01	
	Women	294	4.816	1.550	0.090			7.012E-01	
The music	Men	174	3.483	1.855	0.141	13.043	3.374E-04	5.088E-01	
	Women	294	3.592	1.643	0.096			5.220E-01	
The ease accessibility to the different applications parts /site	Men	174	4.897	1.498	0.114	1.750	1.865E-01	8.304E-02**	
	Women	294	5.14	1.473	0.086			8.455E-02	
Possibility to coordinate the several pieces	Men	168	4.536	1.960	0.151	13.850	2.225E-04	1.541E-04	
	Women	294	5.184	1.627	0.095			3.350E-04*	
Personalizing pieces	Men	174	4.759	1.837	0.139	10.175	1.520E-03	7.973E-02	
	Women	294	5.041	1.580	0.092			9.203E-02**	
Professional advice	Men	174	4.241	2.000	0.152	13.472	2.702E-04	2.515E-07	
	Women	294	5.122	1.602	0.093			1.246E-06*	

Social networks link and share	Men	174	3.690	2.157	0.164	37.467	1.975E-09	2.198E-02
	Women	294	3.286	1.619	0.094			3.328E-02*
Collection videos	Men	174	4.034	1.926	0.146	15.384	1.011E-04	4.834E-04
	Women	288	4.604	1.527	0.090	.031		1.004E-03*

Legend: Grouping Variable: gender; \*: Significant at a 5 % level of significance; \*\* Significant at a 10 % level of significance

From analysis of Table 7, we can also conclude that, as compared to men, women give less importance in terms of attributes, of a variety of pieces and multiplicity of styles presented in apps. However these are not the most valued attributes by both, among the attributes questioned

Table 7 – Importance ranking of consulting attributes for fashion products through a Smartphone; for man and woman

Rank	Woman preference attributes	Mean	Rank	Man preference attributes	Mean
1	Piece variety	5.633	1	Piece variety	5.800
2	Multiplicity of styles	5.612	2	Multiplicity of styles	5.800
3	Possibility to coordinate	5.184	3	The easy accessibility	4.897
4	The easy accessibility	5.143	4	Piece personalizing	4.759
5	Professional advice	5.122	5	The environment/character	4.750
6	Piece personalizing	5.041	6	Possibility to coordinate	4.536
7	The environment/character	4.816	7	Professional advice	4.241
8	Collection videos	4.604	8	Collection videos	4.034
9	The music	3.592	9	Social networks Link and share	3.690
10	Social networks link and share	3.286	10	The music	3.483

## CONCLUSIONS

The use of smartphones will continue to grow. Forecasts indicate that they will represent 23 % of mobile phone sales in 2013, with about 300 million units sold each year. The addition of 3G and the low price of Internet access from mobile phones, preview that this type of equipment will occupy the first position in the ways of accessing the Internet in 2020. After the development of e-commerce in retailing and fashion products, it is also expected that mobile commerce will start to escalate.

From the analysis of a set of apps for the iPhone and iPad it is concluded that retail companies and brands of fashion products are aware of this new way to conduct business. Nevertheless, fashion category apps are not yet worldwide available in iTunes. An example of the importance of this category is the apps fashion.ebay.com only used for sales of fashion products, offering fashion products with discounts of 70 % on luxury goods at the beginning of each week.

Thus we conclude that from the analysis of this application group there are differences between the portals of e-commerce and mobile commerce, the entertainment is here seen as an asset to the consumer. The success cases in e-commerce are not necessarily the ones that will succeed in mobile commerce. Retail chains and brands have to be alert to cases of success in other areas and to the good practices that are developed by other chains. This study may thus help in a modest way small businesses whose investment needs to expand their network of physical stores would be impossible, to bet on new ways of marketing their products, taking into account all aspects mentioned here. However, we are in the early stage of mobile commerce, particularly in Portugal. The areas of security and privacy need to be improved for the success of mobile commerce. The differences between male and female respecting the preference of attributes for apps are evident, leading to the conclusion that brands should develop different menus and apps for men and women in fashion business. These conclusions can only be validated on a global level after the completion of such studies in other countries. The forecast for the increase of female consumers that use mobile commerce is expected in the short term, observed by the trend obtained in the survey and by the growth in smartphone sales recorded last year. Luxury brands are the first to invest in apps other than their own e-commerce sites and thereby gain market share with mobile commerce, having already complete awareness of the importance of the location factor for the brands, conclusion also obtained by Ghose and Han (2009). According to the study, the location (mobile vs. PC) influences the consumer behavior. A brand has stronger primary effect in

mobile versus PC (18.7 %), and also a stronger local interest for branding in mobile versus PC (more 30 %).

Mobile commerce has many advantages. Mobile marketing allows immediate action, it is very appropriate especially for launching time-limited campaigns, offers or coupons. Instantaneousness of the interaction between consumer and the brand expedites the purchasing process. Not only the brands but also the 21 century Fashion Designer should take advantage of the emerging mobile platforms to reach consumers in a more sustainable manner, more quickly, with a better management of resources and higher interaction and participation of fashion goods consumers.

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## PATTERN-FINDING IN QUALITATIVE DATA - A 17 STEPS PROCEDURE OF MAKING DATA ANALYSABLE

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### ABSTRACT

I have examined or tutored some 500 bachelors theses and some 100 masters theses at several Swedish universities.

Over the past 20 years Swedish secondary school graduates has become less and less apt in mathematics, Mullis, et al. (2009). Due to this development university students mostly chose to make qualitative studies, irrespective if this is the best choice to study the research question or not. Most of them don't even make good qualitative studies. After analysis of the requirements of what is needed, Prahalad's (2006) 'sandbox of innovation', I have developed an abductive method for analysing qualitative data to help the students to get good use of their empirical material, a well-grounded theory, in contrast to the inherent deductive nature of grounded theory. It is suitable for studies based on interviews, focus groups and observations.

As the dataset grows, the method becomes cumbersome, which I don not consider is a big problem, as big qualitative datasets would preferably be analysed by non-parametric statistics, rather than the iterative interpreting qualitative method I suggest here. The method has so far been used to advantage by students in some 15 bachelor and master theses. I also discuss the limitations of the method.

**Keywords:** Presentation and analysis of qualitative information, interviews, focus groups, observations.

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## REQUIREMENTS ON A NEW METHOD

Understanding the world – What is it all about?

Science, whether natural or social science, is about discovering the essence of a phenomenon, "das wesen", (Dietzgen, 1973), (Marx, 1968; 1975), or the "Dasein", (Heidegger, 1954). This means that we have to search for the generalised being of the phenomenon, not individual beings, (Heidegger, 1954:19). "Being does not become accessible like a [my emphasis] being." (Heidegger, 1954:19). "The fundamental subject of research in ontology, as determination of the meaning of being by way of time, is Temporality." (Heidegger, 1954:14). This quest for generalizability makes post-modern claims of the importance of the individual story invalid as a means for scientific devoir, however interesting it might be. But it could of course it could be inspirational in an early stage of the scientific process.

Deduction, induction and abduction

Deductive reasoning means that we view reality through the lenses of our pre-understanding, which means that we do not see anything other than what we already know. The interview guideline is provoking the answer and the observation guideline makes us see what we are looking for, not what we are not looking for.

But the very idea of a tabula rasa approach to science, that we can do inductive research without having a luggage of pre-understanding is absurd.- even with an open "tell me...", the interviewee will respond to whom is questioning. In reality all research must be abductive; must proceed with a conscious awareness of the researchers' own world-view, or views, but still be open for finding the unexpected. We are not only looking at data through the lenses of existing theories, but we are actually also reaping data from subjects that are interesting according to existing theories. However valid the reason for theoretical sampling – research efficiency is such a valid reason – it means that we are looking for the lost key under streetlight, rather than where we lost it. The challenge is not to question existing theories, but to identify *what needs to be explained*. If then existing theories does not explain the identified problem or pattern, it eventually forces a Copernican revolution, Kuhn (1970).

Finding patterns vs. fragmentation, outliers and the absence of patterns

Science is about finding patterns: "Summarize the general pattern you see, retaining only an illustration or two." (Walcott, 1990:67-68). To others it is to refrain from pattern finding (Alvesson & Källström, 2011:40). They even mean that it is really the fragmentation that is

interesting: "The interest in finding (constructing) deviations from patterns implies a search for (opportunities to come up with) fragmentations." (Alvesson & Källström, 2011:42).

A bizarre presentation of the empirical material is to present the integrity of each interview: But scientists are neither storytellers (fiction writers), nor conduits for the interviewee to tell her story. We are supposed to look for an understanding of phenomena, its Dasein; not that of an individual being. We are hence not interested in descriptive statistics of the answers to the individual question. Some researchers describe the answers to the individual questions with descriptive statistics: "7 of the 12 interviewees said..." (As if such description has any significance!); when making the operationalization (or whatever word you prefer) of the theories that you would like to get the perspective on, one would normally have to use several questions to get an understanding of one single concept. So why would one interest oneself for the answer on the individual questions?

The social construction of reality

Researchers "...construct rather than collect data. We don't discover knowledge or theory, and we do not believe that data can be used as reliable informants for what is true or false." according to (Alvesson & Källström, 2011:24-25). Post-modernism do not understand that reality as being a social construction, as (Berger & Luckmann, 1966), but as self-constructed by the individuals. It is evident in much management literature; perhaps most pertinently in branding, where authors regularly seem to think that customers "dress up" their identities with brands. This is the American dream gone wild; supposing that some customers have chosen to be poor, ugly and sick, drinking Coca-Cola and eating McDonald's hamburgers, while we others are beautiful, healthy, partying with Britney Spears and drive a Lamborghini. And presumably the former are as happy as us! And consequently advertisers depict the persons engaging in these unhealthy lifestyles – smoking, drinking beer and colas, eating fast food and ice cream – as extremely fit and healthy.

Grounded theory

"Grounded theory... has become by far the most widely used framework for analyzing qualitative data." (Bryman & Bell, 2011:577). In grounded theory "...data collection analysis, and eventual 'theory stand in close relationship to one another (Strauss and Corbin, 1998:12). Thus two central features of grounded theory are that it is concerned with the development of theory out of data and the approach is iterative, or recursive, as it is sometimes called, meaning that data collection and analysis proceed in tandem, repeatedly referring back to each other." (Bryman & Bell, 2011:576). It derives its theoretical underpinnings from Pragmatism and Symbolic Interactionism, (Corbin & Strauss, 1990:5).

The critique of this approach has emphasised an over-reliance on pure "data" and a neglect of the constructed nature of empirical material, (Alvesson & Sköldbberg, 2009), (Charmaz, 2000), and (Lincoln & Guba, 2000).

"Coding is the fundamental analytic process used by the researcher. In grounded theory research there are three basic types of coding: open, axial, and selective." (Corbin & Strauss, 1990:12). It has been criticised for this theoretically motivated codification of data giving it a deductive character (Alvesson & Källström, 2011:105).

"Grounded theory is very much associated with an approach to data analysis that invites researchers to fragment their data by coding the data into discrete chunks. However, in the eyes of some writers, this kind of activity results in a loss of sense of context and narrative flow (Coffrey and Atkinson, 1996)..." (Bryman & Bell, 2011:583).

"By plucking chunks of text out of context within which they appeared, such as a particular interview transcript, the social setting can be lost." (Bryman & Bell, 2011:588).

In her critic of grounded theory, Charmaz (2000:523), cited after Glaser (2002:8), says: "The constructivist approach also fosters our self consciousness about what we attribute to our subjects and how, when, and why researcher portray these definitions as real. Thus the research products do not constitute the reality of the respondents' reality."

But this idea of science as respecting the respondents' meaning(s) of their reality will only discover their ideology, not the nature of the reality they theorise about.

Grounded theory is in my view mainly *deductive*, as the data is interpreted with *index' operationalized from theory*, hence data is interpreted by previous understanding.

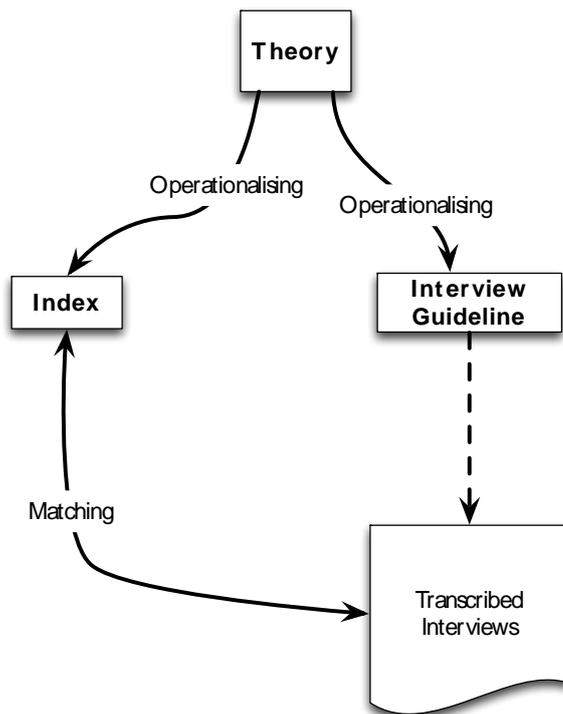


Image 1 Grounded theory, own

#### Research ethics and documentation

We don't know if research falsification has become more common, or just more detected. But especially in medicine and physics a large number of falsifications have been identified the last decades. There is reason to believe that it is even more common in social science, only that it is more difficult to uncover because it is usually not experimental research and hence not possible to independently verify.

The process information should be put in a public depository, normally at the university to which the researcher is affiliated, for verification of the analysis made and for the possible re-interpretation of the data. It is highly unethical that this is not generally made – even without an assumption that some researchers are likely to cheat if they can get away with it. The transcripts of the interviews should be included as attachments to a thesis. For a journal article it should be available as a pdf on demand. I am of the definite opinion that to diminish the risk of research fraud, journals should be obliged to keep primary data for at least 10 years. "...they should display enough evidence for each construct to allow readers to make their own assessment of the fit with theory.", (Eisenhardt, 1989:548). "...although most published qualitative reports provide detailed descriptions of the settings, people, events, and processes that were studied, they say little about how the researcher got the information, and almost nothing about the specific analysis procedures used." (Miles & Huberman, 1984:22).

Summary of the requirements on the proposed Method

The method should allow for

- Generalising, finding similarities and differences between cluster of respondents or observed subjects.
- Primarily findings patterns, not outliers
- Social, not individual construction
- Abduction, neither deduction, nor induction
- Interpretation of data rather than coding data from a theoretical/inductive perspective.
- The transparency of the interpretation

## A WELL GROUNDED THEORY

Outline of the method

Research has to be presented in an abbreviated form, but the absence of standardized procedures for this abbreviation makes it necessary to document the very *procedure* for abbreviation.

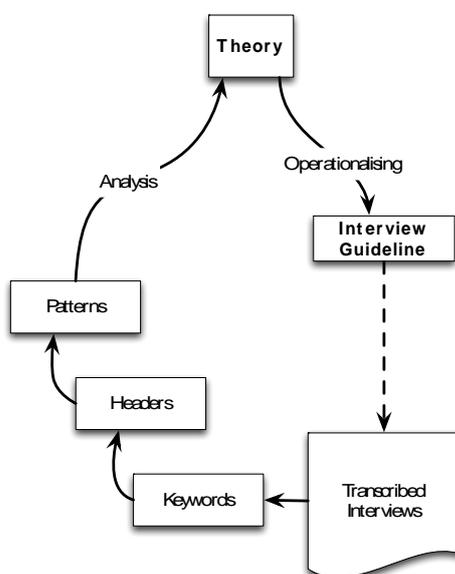


Image 2. The abductive nature of the proposed method, own.

The two methods are compared below for clarity.

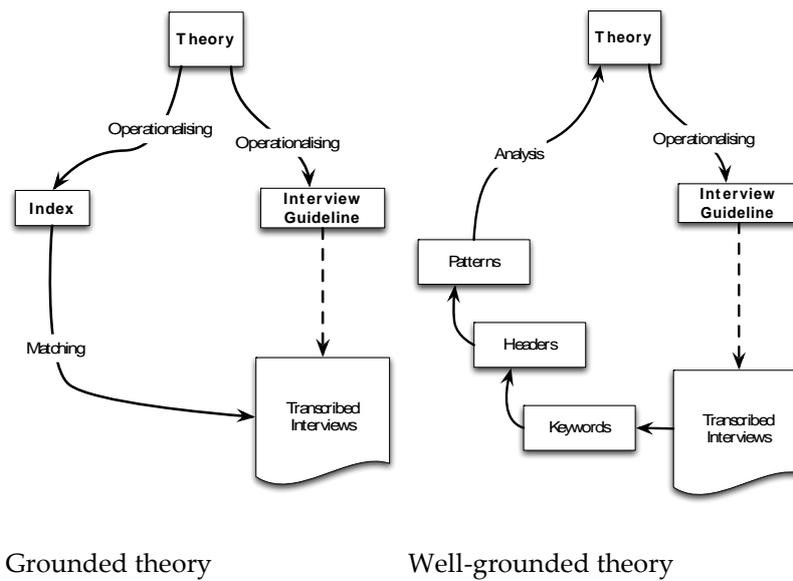


Image 3. Comparison between Grounded theory and our proposed theory

There is no fundamental or qualitative difference between presentation of empirical data and analysis, as the very documentation is an abstraction of reality, based on explicit and tacit processes in the head of the researcher. Noting observations, transcribing interviews, or other such documentation, includes analytical elements. To control this process, it should be made as stepwise and explicit as possible. "Data reduction is not something separate from analysis. It is a part of analysis that sharpens, sorts, focuses, discards, and organizes data in such a way that final conclusions can be drawn and verified." (Miles & Huberman, 1984:23-24). "The trick is to discover essences and then to reveal those essences with sufficient context, yet not become mired trying to include everything that might possibly be described." (Walcott, 1990: 35). "As with data reduction, the creation and use of displays is not something separate from analysis; it is a part of analysis." (Miles & Huberman, 1984:24).

Research has to be presented in an abbreviated form, but the absence of standardised procedures for this abbreviation makes it necessary to document the very procedure for abbreviation.

1. Transcribe the interviews, observations, or focus group Interviews, etc. (hereafter interviews) vary in length between 20 minutes and several hours. The researcher must transcribe the interviews, focus groups or observations. If interviews are conducted in another language than that of the paper, they should be

transcribed in the language they were conducted in and then be translated to the language of the paper.

## 2. Organise the empirical data

Construct a matrix in MS Excel, Numbers, Open Office, etc., with the interviewees as column heads and the questions (observations, etc.) as rows. Then paste the whole answer on each question into the cells. "We have found systematic matrix displays for words to be uncommonly fruitful." (Miles & Huberman, 1984:26). See table 1.

	Respondent	1	2	3	Etc.
Q 1 View of innovation		Yes! If we must grow the relationship between our existing customer and us, we must continue to provide outstanding services and value someone will do it better. Continues improvement important for future growth in our company, we must face the challenge! If we must be seen different in the market we will have offer something different from our competitors.	In this business, innovation is a key to your position in the market. As one of the market leaders in 3PL a continuous need to grow a strong relationship with our existing customer through the delivering of outstanding services that will make us unique. The only way for UPS to be unique has been through its innovative strength that has given it a strong brand name.	Yes! We are very innovative That's right, innovation is the only way for us to come out of commoditisation. We need to grow a strong relationship with our existing customer through the delivering of outstanding services that will make us unique.	

Table 1. Answers from transcribed interviews

## 3. Mark keywords

Go through each answer and mark keywords – only keywords, not whole sentences! The keywords should be understood stand-alone from the whole answer. The more unstructured the interview, the more information must be contained in the keywords. It is important not to choose to simple keywords or value statements (important, good, etc.), as that will tend to eliminate differences between the interviewees. If there are several authors of the paper, they should preferably do this independently and then negotiate the choice of keywords. When the keywords are decided, one goes back to the transcripts and

marks the keywords, so that they can be seen contextualised. Hence, the reader can see if the keywords convey the meaning of the transcribed interviews, observation, etc.

#### 4. Reduce to the keywords

Exclude everything that is not in fat italics [here underlined]. Separate each set of keywords with a slash, "/", so that you can identify the keywords that are related to each other. See table 2.

	Respondent	1	2	3	Etc.
Q 1 View of innovation		Yes! If we must grow the relationship between our existing customer and us, we must continue to provide outstanding services and value else someone will do it better. <u>Continues improvement</u> very important for future growth in our company, we must face the challenge! If we must be seen different in the market we will have offer something different from our competitors.	In this business, innovation is a key to your company position in the market. As one of the market leaders in 3PL a continuous innovation is a responsibility of UPS. As the tough as the competition is today, almost everyone offers the same core product. The only way for UPS to be unique has been through its innovative strength that has given it a strong brand name.	Yes! We are very innovative That's right, <u>innovation is the only way for us to come out of commoditisation.</u> We need to grow a strong relationship with our existing customer through the delivering of outstanding services that will make us unique.	

Table 2. Keywords in transcribed interviews

#### 5. Ascribe generic keywords – headers

Go through the answers of all interviewees on each question and try to find a structure of the keywords, by generic keywords. This step is a first pattern finding. The generic keywords identify similarities between the answers, observations, etc. The generic keywords should be in colloquial language of the same type as the keywords, not theoretical concepts (which would make them indexes). What we suggest here are not theoretical or conceptual codes, but common-language headers, preferably fetched from the interviewees. It is yet not time to detach oneself from "data". It is very important to consider these keywords critically; formulating and re-formulating headers until they are irrefutable,

## 6. Separate the generic keywords

Create sub-rows on each question for the generic keywords. It is usually necessary to leave a last row for odd comments. See table 3 below where the answers on question 1, 'View of innovation' has been separated under two headings, 'Differentiation through innovation' and 'Innovation necessary to stay competitive'.

## 7. Describe the keywords

Write a short description of the substructure of each question, the headings.

## 8. Move the keywords

Leave the original keywords in the cells, but move them around so that they are in the cell corresponding to the appropriate keyword. See table 3.

## 9. Colour the cells

Colour the cells with keywords with a light colour, to make a visual identifier [here grey, but on the computer I prefer yellow]. See table 3.

## 10. Reduce the matrix to keywords

Reduce the matrix to keywords. In a separate column you count the number of answers under each header. See table 3.

	Respondent	1	2	3	Etc.
Q 1 View of innovation	Differentiation through innovation	To provide outstanding services and value	Everyone offers the same core product. The only way for UPS to be unique	Innovation is the only way for us to come out of commoditisation	
	Innovation necessary to stay competitive	Offer something different from our competitors	Continuous innovation is a responsibility – innovation is a key to position your company		

Table 3. Answers reduced to keywords and sorted under headers

## 11. Eliminate odd comments

We would come back to these, the fragments or outliers; they could of course be interesting in themselves, but we now try to identify patterns, worthwhile to analyse.

## 12. Eliminate the keywords

Eliminate the keywords, but keep the headers and the colours in the cells that previously had keywords in them. Re-arrange the sub-rows, so that the header rows with most answers under, each question comes first.

### 13. Move around the columns

Move around the columns (the interviewees, etc.), so that those with similar answers all over are close to each other. The purpose of rearranging the columns (the order in which the respondents are portrayed) is to bring the respondents that are most similar in their global answers next to each other in the matrix. One of my group of master students, (Xu et al., 2011) suggested a rank order analysis to find the second patterns, when due to many interviewees this step became too complicated,

### 14. Finding patterns

Try to find global patterns – groups of interviewees, observed subjects, etc. that over the whole interview, etc., answers in a similar way. The visual identifier helps to identify these similarities. The similarities raises questions as to what might explain these similarities and hence the differences between the groups, constituting the second pattern finding. These patterns are underlying commonalities in common basic assumptions, values, (Schein, 2010), character masks, (Marx, 1976:1064, 1981:956), etc. These patterns are Eisenhardt's (1989:540) cross-case patterns: "This process allows the unique patterns of each case to emerge before investigators push to generalise patterns across cases."

This matrix is put in the empirical chapter of the thesis, with a discussion of every stage of the pattern finding. See table 4.

	Respondent	6	1	2	etc.
Q 1 View of innovation	Innovation necessary to stay competitive				
	Differentiation through innovation				
	To provide value				
Q 2 Working with NSD	Company improvement (product oriented)				
	NSD is equal to innovation				

	Respondent	6	1	2	etc.
	New market Demands (Market oriented)				

Table 4. Keywords replaced with visual identifier

15. Describe the patterns in words

What do you see? Are there similarities or differences between the respondents, observations, etc.?

	Name of Company	DB SCHENKER	UPS	DS V	GEODIES WILSON	Nils Hansson	VSN Åkeri AB	DHL	Åkeri AB Nils Olof Nilsson	Halléns Transport AB	C. G. ERIKSSON AB	Gunnar Karlsson Spedition AB	Brunskog AB	LIEF AB	
Q 1 View of innovation	Differentiation through innovation														5
	To provide value														2
Q 2 Working NSD	Company improvement (product oriented)														7
	NSD is equal to innovation														6
	New market Demands (Market oriented)														2
Q3 Major sources of innovation	All sources of innovation are important														4
	To listen to customers is necessary														7
Q4 Involving the customer in innovation and NSD	Customers consultation														5
	Interaction														4
Q5 Benefits of customers involvement	Observation														3
	Quality														9
	Loyalty/relationship														8
	Understanding customers														7
	Cost														6
Q6 Experience market share as result of customers involvement	Facilitates sales														3
	Lead-time														8
	After sales support														2
	Company learning														2
Q6 Experience market share as result of customers involvement	the theory is similar to our understanding														6
	To satisfy Customers														4

Table 5. Identifying patterns

16. Analysis

In the analysis chapter you work with the patterns and relate them to the theory, by "going backwards" through the operationalization or you induce a proposed theory from the patterns.

17. Do it again!

Throughout the process each step is made in a new sheet. The last sheet is copied to a new sheet and then one continues to work in the next step in the copy. See table 6. This gives the researcher the possibility to go back and revise each step and it makes it possible to reflect on the implicit tacit analysis that is done in each step, because in reality the analysis starts already in the transcription of the interviews. In traditional ways of conducting qualitative research this process is most often unconscious, undocumented, and hardly reflected upon! "One may, however, work with coding in different ways; perhaps do multiple codings, based on re-readings and re-framings of one's position; take incoherences and contradictions seriously; and generally try to open oneself up to experiences of productive breakdowns. But a strict and ambitious codification project, where the faithful representation of data is the key virtue, is very different from the research ideal suggested here." (Alvesson & Källström, 2011:60). "Through multiple readings we increase the chance of encountering/producing unexpected constructions – opening up rather than letting common sense (as in grounded theory) determine 'reality' – and also the chance of establishing that the unexpected is not just the outcome of a specific and narrow way of seeing." (Alvesson & Källström, 2011:34).

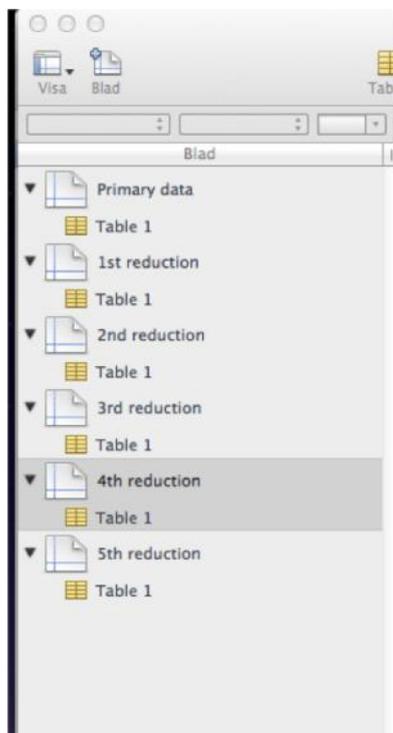


Table 6: The gradual process

## **LIMITS OF THE PROPOSED METHOD – TACIT KNOWLEDGE, LANGUAGE AND SKETCHING**

The method proposed here involves a major effort. You will encounter hurdles as the number of interviewees or observational units grew above 10. Even if you have a big screen you might have to leave the computer and paste it all on the wall. Restructure, reprint, and then again... This method is not an easy road to scientific stardom, but work, hard work. But we believe that this is the road to go – until it is developed further or revolutionised. But for the time being this is what we propose.

One of the major problems in scientific research is that most, human knowledge is tacit. Informants – and researchers – not only (1) do not know, (2) or lie. But they also (3) don not know how to express their knowledge. Vocabularies simply do not simply mirror the world – they produce and conceal as much as they reveal, (Alvesson & Källström, 2011:32). This is not an individual act of production, but an institutional social process. Language does not produce and conceal; it re-produces and even if it conceals, its inherent pretence always includes not only what is "false" understanding, even if fragmented of reality; to be discovered, or uncovered, cf. (Alvesson & Källström, 2011:34).

But tacit knowledge often cannot be accessed by language metaphors. Creativity is the result of associative synopsis in the brain, built on internalization of past experiences and how these have been interpreted and given meaning. The child is essentially born autistic, with an information overload, overwhelming the small capacity of the brain. By experience the associations are built into a grid of pre-understanding that filters sensory information considered as redundant. Not until the grid is fine enough, can the brain start higher mental functions, built on the child's meta-understanding of itself, (Vygotsky, 1934; 1962).

Human experience is diverse and individual. Hence, associations are not the same from one individual to another. Tacit knowledge could be said to be the mass of these associations. And with a rich network of unusual loose link associations, the individual is considered creative by those that do not have the same associations. Even explicit knowledge is also harboured in the brain, where it is embedded in the tacit knowledge, making even the explicit knowledge intrinsically tacit!

Tacit knowledge can be transformed to explicit knowledge through externalisation.

Externalisation is made in written or oral language, visualisation and behaviour. Even with odour, fragrance, scent, and aroma. The externalisation, the objectifying of the subject, makes it possible for the subject to "look at" her tacit knowledge and reflect on it. The "looking at" aspect is evident. Visualisation is a very powerful instrument for the designer, architect, and product developer. The externalised knowledge is however not necessarily immediately understandable to others. It might need interpretation, a transformation into more explicit knowledge, based on a - more - common frame of reference, a more explicit knowledge.

To access tacit knowledge we use the origins of language metaphors – images. These preceded language in human development and seem to be closer to tacit knowledge. "...design know-how, is considered to be tacit and is highly, if not totally, inarticulable." (Wong & Radcliffe, 2000:494) "The fact that drawings are usually accompanied by verbalisations (in the case of the individual designer this would just be unspoken thought) supports the idea that sketches only partially represent ideas in mind. Generally, a drawing act in sketching is not an attempt to represent a solution as such; rather it is a notational device that helps its creator to reason with complex and labile mental structures. (Scrivener & Clark, (1994:114), in (Van Der Lugt (2005:106). These mental images are also called a gestalt.

Our proposed method has its limits. It is occupied with the methodological study of language, whether in a direct or metaphorical form. Pictures (photos, art, etc.) could be interpreted with the help of the method, but the researcher should complement this with using social network analysis, such as e.g. Valdis Krebs InFlow, [www.orgnet.com](http://www.orgnet.com), or brain-sketching with the interviewee, as suggested by (Van Der Lugt, 2005), and many other methods.

## CONCLUSION

After a discussion of the requirements of a good qualitative method, this paper proposes a 17 steps method as a solution to make qualitative data interpretation transparent and as conscious as possible.

It has limitations; the most important are discussed here, but it also considerable advantages. Some 20 of my bachelors and masters students have used it and made substantially better qualitative theses than previous students. I intend to use it in upcoming research.

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## PRIMARY HEALTH CARE SERVICES EVALUATION IN GREECE

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### ABSTRACT

Importance – The concept of patient satisfaction has received significant attention internationally since 1990s (Hamilton et al. 2013; Schoenfelder, T.; Klewer, J. and Kugler, J. 2011; Thomas, et al. 2006; Speigth, 2005; Bredart, 2001; Rahmqvis, 2001; Williams, 1994) mainly in three key areas of research: a) expectations of the services, b) personal preferences, and finally c) realities of the care received.

The purpose of this study is based on a funded project conducted by the Department of Health Economics of the Technological Institute of Athens funded European Social Fund (E.S.F) Ministry of Education, Lifelong Learning and Religious Affairs 2012-2015. It is to identify key determinants of patient satisfaction in Greece. The primary health care in Greece (Noula , et al. 2007), is still lacking behind targets and expectations. Issues like long waiting lists, poor medical and nursing service, and high expectations of patients are consider to be ones of the most important factors that result in negative influence on satisfaction (Tountas et al. 2005; Niakas and Mylonakis, 2005; Papagianopoulou et al. 2008; Pierrakos and Tomaras, 2009).

By taking the above issues into consideration, the scope of this study is to develop a comprehensive conceptual method for measuring the satisfaction experienced of the offered Primary Health Care (PHC) services in Greece.

Design/methodology/approach – The aim of this study was to develop a comprehensive conceptual method for measuring the satisfaction experienced of the offered Primary Health Care (PHC) services in Greece, based on a survey of 500 self-administered questionnaires by random sampling distributed in five hospitals throughout the Attica region during the period of April 2013 to July 2013.

Findings – There are some preliminary results of a pilot research. Many factors have been suggested to influence patient's satisfaction; however there is little consensus at

to which areas of care actually influences overall satisfaction response. Patients stated satisfied with medical care and nursing care. However, the level of satisfaction was found quite low in administrative services as also in facilities. The non-parametric test by Kruskal Wallis, showed that the improvement in the patient's health was statistically significant in the overall satisfaction of health care ( $p \leq 0.001$ ), as was also the satisfaction with medical ( $p \leq 0.004$ ) and nursing care ( $p \leq 0.014$ ).

Practical implications – Results of the present study have implications for health providers aiming at improving the service quality and quality of care.

**Keywords:** Primary Health Care, Services, healthcare quality, public health, Greece.

## 1.0 INTRODUCTION

The purpose of this study is based on a funded project conducted by the Department of Health Economics of the Technological Institute of Athens funded European Social Fund (E.S.F) Ministry of Education, Lifelong Learning and Religious Affairs 2012-2015. It is aimed to identify key determinants of patient satisfaction in Greece. The primary health care in Greece (Noula , et al. 2007), is still lacking behind targets and expectations. Issues like long waiting lists, poor medical and nursing service, and high expectations of patients are consider to be ones of the most important factors that result in negative influence on satisfaction (Tountas et al. 2005; Niakas and Mylonakis, 2005; Papagianopoulou et al. 2008; Pierrakos and Tomaras, 2009).

By taking the above issues into consideration, the scope of this study is to develop a comprehensive conceptual method for measuring the satisfaction experienced of the offered Primary Health Care (PHC) services in Greece. As such, the first session of this paper in progress is dual: first, to provide an historical review of research conducted in the area of patient satisfaction and specifically on patients' evaluation of the health services and secondly to outline and further discuss some key dimensions of patient satisfaction. The remaining of the paper, focuses on patient satisfaction of primary health care in Greece, its main aims and objectives of the project, as well as preliminary findings of the project.

## 2.0 PATIENT SATISFACTION: AN HISTORICAL REVIEW OF THE CONCEPT

The concept of patient satisfaction has been under investigation since 1900. In the beginning of medical science, interest was focused mainly on the treatment of the patient or the relief of their pain. However, in the early 20th century a new concept was introduced to the scientific community concerning the evaluation of not only of the outcome of the illness but also of the care provided. This evaluation resulted in the recognition of the patients rights (Williams, 1994) and the introduction of the evaluation of the provided services by the patient also described as patients satisfaction (Thomas, *et al.* 2006). However, as Gilber and Velloutsou argue (2006), the subjective affective component of the patient satisfaction construct makes its measurement “probably a hopeless quest” and its study is largely flawed as it has lacked precision, at the expense of exact science, with many researchers having undertaken studies of a purely exploratory nature.

Indeed, according to Donabedian (1988), the quality of the provided services has a complex impact on patients care provided and is determined by the following organizational parameters: structure, processes and outcome. According to the study:

- *Structure*: concerns two main levels: a) the individual level which regards the quality of health professionals and b) the hospital level which regards the quality of facilities and medical equipment. In general, structure concerns the features and provision of health services; low structure, nevertheless, does not necessarily mean low quality of health services.
- *Procedures*: refer mainly to information to the patient during, before and after care. It concerns all actions carried out for the provision of services to the patient.
- *Results*: concern the final subjective evaluation of the patient for the services provided regardless of the clinical outcome. It is also a key means of evaluation of health service.

Regarding the historical development of the evaluation of health services, in 1982 Linder-Pelz found out that patient satisfaction was based on the *positive evaluations of distinct dimensions of the health care*. The researcher set five key dimensions in order to determine satisfaction: a) Expectations, b) Value c) Entitlements, d) Occurrences, e) Interpersonal comparisons.

In addition, Ware *et al.* (1983: 254) research identified that: “*estimates of satisfaction are intentionally subjective and attempt to conceive a more personal evaluation, which cannot be formed*”

*through a simple observation of care. Subjectivity is the only power of the satisfaction measurement tools."*

Further research by Meterko et al (1990) argue that the dimensions based on which satisfaction should be assessed are the reception of patients, care by medical and nursing staff on a daily basis, hospital environment and administrative issues relating to hospital cost and discharge procedures. Greeneich *et al*, (1992), have also explored the determinant on patients satisfaction and concluded on the following factors: a) nursing personality characteristics, b) nursing caring, c) nursing proficiency, d) environment and e) expectations.

Speigth (2005) also reported that patient satisfaction is the result of the comparison between the provided care and patients' expectations. Similar is the definition by Bredart (2001) who states that patient satisfaction is the personal perception of the patients of the care provided to them. Indeed, research conducted by the Picker Institute Europe (2002) reveals that the degree of patient satisfaction from health care services depends primarily on the expectations of the services, the patient's personal preferences, and finally the actual care received. To add value to the above concepts and results- despite the fact that they are a good measure of health services evaluation- some quality standards for measuring health services have been developed such as:

- a) The minimum level under which the quality of health services should meet in order to achieve required standards,
- b) The average level; it is the acceptable level of services provided. Although the majority of organizations fall in this level, it requires improvements, and
- c) The ideal level which is the primary objective of any health system and organization.

### 2.1.Dimensions of Patient Satisfaction

The hierarchical model of satisfaction (Dagger *et al.*, 2007) argues that patients perceive quality in 4 dimensions: *interpersonal quality* through interpersonal relationships between the patient and the provider of health services, *technical quality* where the effect referred to in perceived by the patient outcome, *environmental quality* of the facilities and the atmosphere in the space and *administrative quality* on waiting time functions etc.

More contemporary studies (i.e. Chang et al., 2013; Hamilton *et al.* 2013; Schoenfelder, T.; Klewer, J. and Kugler, J. 2011;) argue that patient satisfaction, patient participation in the process of diagnosis, and patient participation in treatment decision-making may have a significant impact on hospital loyalty.

Parasuraman et al., (1988), have shown that users of health services use almost the same assessment criteria regardless of the type of health care provided. As a result, it is worth mentioning the criteria by which patients evaluate the quality of health services. As there is a large number of criteria we will identify the most important ones:

*Socio-economic status:* According to Henschke, *et al.*, 2013), cultural, demographic, and psychological factors influence on satisfaction (With regards to patients' income, current literature argues that higher income is associated with greater satisfaction and better communication with doctors (Bertakis, *et al.* 1991) while people with lower incomes have stated more problems during their stay in hospitals (Rogut *et al.* 1996).

*Health condition of the patient:* Satisfaction is irrelevant to people with chronic illnesses, although the preferences of these patients vary according to their health status. The study of Crow *et al.* (2002) showed that the patients who are more satisfied are those with good health than those suffering from a chronic illness.

*Selection of the service provider:* According to a survey by Crow (2003) the choice of the service provider by the patient is associated with high satisfaction with the health system. Patients who receive health services from a provider they have chosen and pay after the visit are more satisfied than those who are forced to visit a particular entity without having a choice.

### **3.0 PATIENT SATISFACTION WITHIN THE PRIMARY HEALTH CARE (PHC) IN GREECE**

Primary Health Care in Greece (Noula et al., 2007), is still underperforming despite the efforts that have been made over the last decade. It is important to support research efforts towards the formulation of proposals for the development of policies which will upgrade the offered services, especially in the regional level. The demand for public, free health services, particularly primary health Care Services in Greece increases exponentially, following the reduction of income and loss of insurance coverage of households (Benos, 2012). In Greece,

Public Hospitals and Outpatient Departments are the main provider of primary health services especially in urban areas.

More contemporary studies indicate that access to the secretariat services creates negative patient satisfaction. The waiting list, often encountered in urban public hospitals in Greece, has negative influence on satisfaction and hence creates dissatisfaction (Tountas *et al.* 2005). However, the majority of outpatients show understanding about the waiting list when they know the reason about the delays (Niakas and Mylonakis, 2005). The attitude and interest of the nursing staff about the prediction of a disease and the reassurance of the patient plays an important role in outpatients satisfaction. Research measuring satisfaction with health care services in an Athens paediatric hospital showed that improvement in infrastructure is the most important for health services users (Papagianopoulou *et al.* 2008). Another research concerning the Role of Patient Satisfaction in the Development of Health Care Services Marketing showed that people in Athens hospitals for outpatients services had high expectations of health services (Pierrakos and Tomaras, 2009).

### *3.1. Aims and Objectives of the study*

In line with the prevailing theories this research project (Archimedes) also argues that members of local communities should be co-shapers of services in primary care. Therefore, it is very important to produce a health need assessment methodology for the appropriate services and secondly to established a methodology of patient satisfaction evaluation for those services (Pierrakos G., 2008).

Therefore, the main objective of this research is to produce methodological tools to:

- Firstly, evaluate patient satisfaction (users from the Outpatient Department of Public Hospitals) via patient satisfaction rates, in order to assess the clinical care and services provided to patients.
- Secondly, identify the needs of the population with regards to primary health care provided by the local community. As result, Municipalities will be able to develop and offer those health services that will be of value to citizens.

The contribution of this study is to develop a conceptual framework to evaluate patient satisfaction relating to health care services. The ultimate goal is to develop a methodology of evaluating / measuring patient satisfaction and a Standard Operating Procedure document to be used by managers of local health authorities. This study is also aimed at Primary Health

Care Units staff as it will provide valuable know-how on patient satisfaction in relation to the quality of services provided.

The assessment of satisfaction with health services is dynamic, multidisciplinary and based on the hierarchical model of satisfaction (Dagger et al 2007). The research hypothesis problems seeking this research are:

- a) How do patients evaluate the Primary health service users in Outpatient Departments?
- b) What extent these services would improve their health status
- c) What extent the different patients would pay more money in order to get a better health the specific question is “would you be willing to pay ten Euros per visit in order in an anticipation of better health?”

#### **4.0 RESEARCH METHODOLOGY**

This working paper presents the first strand of its research strategy: evaluation of patient satisfaction. In this survey closed-ended questionnaires are used primarily based on following key areas:

- Medical Care evaluation
- Nursing Care evaluation
- Administrative Services evaluation
- Facilities of Outpatients evaluation
- Time and Attendance Service
- Cost of Service
- Overview outpatient services
- Future Use of Services

The approach of the research field in the sense of the localization of the reference population provides the opportunity to identify the differences / peculiarities of local socio-economic and socio-cultural characteristics, also using a structured methodology that ensures the reliability and validity of the measurements during the process of collecting, processing and analysis of data.

##### *4.1. Design of the Sampling Method in quantitative research*

In order to assess the patient satisfaction from the outpatients services in Athens Greece the research focus on the group of patients who visited the outpatient departments of public hospitals demand for primary health care.

Since, however, the available time and cost of the investigation, it was necessary to add a further criterion of accessibility for the researchers. Therefore, population research is a group of patients, users of primary health care public hospitals in Attica. 22% of public hospitals located in the capital region. (NSSG, 2009).

The research team had to decide which hospitals in Attica (accessible population) would constitute the research sample. Conducting research in all 25 public hospitals in Attica was impossible in the time you place the sub-project. For this reason, proceeded to the sample of hospitals with the creation of the sampling frame.

The sampling method used was the stratified random sampling. The sample of the study are outpatients from 8 Hospitals. Four of them are specific disease hospitals and other are general hospitals. The sampling ratio was 1:5 and the response rate was 60% (497 out of 800 questionnaires distributed).

## 5.0 PRELIMINARY RESULTS AND DISCUSSION

This section discussed the pilot study (40 questionnaires) for the purpose of this working paper and on behalf of the Division of Quality Assurance Health of the Ministry of Greece. A Cronbach analysis to assess the internal consistency of the questions showed reliability Medical Care evaluation 0.901, Nursing Care evaluation 0.960, administrative 0.924 and the facilities of Outpatients 0.933 facilities.

It was conducted a correlation analysis between 4 dimensions of satisfaction using the coefficient Spearman. According to the results all the dimensions correlated positively with each other in significant level 0.01 (table 1).

Table 1 : Correlation between 4 dimensions of patient satisfaction.

	Medical Care	Nursing Care	Administrative services	Facilities of hospital
Medical Care	1,000			

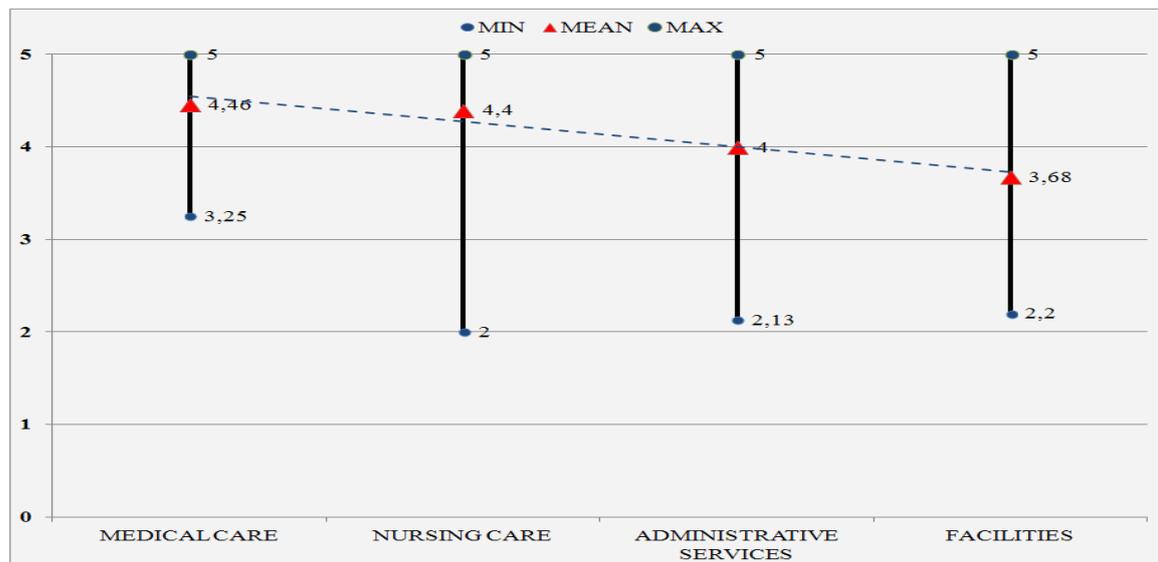
Nursing Care	0,745**	1,000		
Administrative services	0,631**	0,729**	1,000	
Facilities of hospital	0,554**	0,623**	0,771**	1,000

\*\* . Correlation is significant at the 0.01 level (2-tailed).

In addition, the patients were satisfied with health care both before the test ( $4.3 \pm 0.7$ ) and after that ( $4.5 \pm 0.7$ ). Specifically, the patients stated very satisfied with medical care and nursing care ( $4.5 \pm 0.5$  and  $4.4 \pm 0.7$  respectively). Low decrease in satisfaction found in administrative services as also in facilities of hospital ( $4 \pm 0.7$  and  $3.7 \pm 0,7$  respectively).

We investigated the differences between improving health of patients and the overall satisfaction and the four dimensions of satisfaction. Specifically, the non parametric test Kruskal Wallis H, showed that the improve the patient's health influence statistically significant the overall satisfaction of health care ( $p \leq 0,001$ ), as also the satisfaction from medical ( $p \leq 0,004$ ) and nursing care ( $p \leq 0,014$ ).

The majority of patients (40,6%) stated that the general health was *moderate*, while in question «*evaluation of care from outpatient basis to improve your health*» the majority (45,7%) answered *very good*. There was a difference between these means ( $p \leq 0.001$ ),  $t = - 4.773$  C.I.  $-1.58 - -0.63$ , using the t-test.



There was a need to establish the communalities of each question of four factors, so the multi factor analysis was used. Four models of factor analysis were undertaken for the final result

concerning medical care (overall KMO= 0,827), nursing care (overall KMO= 0,890), administrative services (overall KMO= 0,756) and facilities of hospital (overall KMO= 0,754).

From the fourth models the most important factors are:

- Concerning medical care: Quality healthcare outcomes depend upon patients' adherence to recommended treatment regimens and communication they have with physician.
- Concerning nursing care: According to patients' responses, a professional nurse should demonstrate a caring attitude by expressing warmth, interest and empathy toward the patient-client and his/her immediate family and deal with the course of treatment with professional and ethical manner.
- Concerning administrative services: Patients wish to exercise effectively their right to access certain services commissioned by health bodies and professionals with the minimum waiting times and also benefit from fast admittance procedures.
- Concerning facilities of the outpatient department: Good physical environment (i.e. room temperature, waiting rooms and cleanliness) is associated with outpatient satisfaction.

## 6.0 CONCLUSION

According to the above results patient satisfaction is a complex concept that is related to patient's needs and it seems that it is associated with the effectiveness of services provided to the patient (ie administrative services, facilities, organisational support) as well as the physical environment (cleanliness of the premises and room temperature). Moreover, patient satisfaction is related with the health professionals' competence and the interpersonal relationships between the health care staff and the patient. As it clearly comes from the results quality healthcare outcomes depend upon patients' adherence to recommended treatment regimens and communication they have with physician, professional nurse and the behaviour, professional manner and ethical approach of the latter to their patients.

**Direct use of Primary Health Care services**

- **Evaluate the services of Medical Care:**

- The time available for physicians to examine
- The accuracy of the information which the doctor gives you about your illness
- Instructions for medications you should take
- Instructions on the kind of lifestyle you should follow
- Behaviour of physicians
- Communication you have had with their doctors
- The confidence your doctor gives you (about your life)
- ✓ The interest of physicians in addressing your health problems

- **Evaluate the facilities of Outpatients**

- ✓ The cleanliness of the premises
- ✓ Cleanliness in toilets
- ✓ Comfort in waiting rooms
- ✓ Adequacy of premises
- ✓ Room temperature
- ✓ The ambient spaces
- ✓ Facilitate access for people with disabilities

- **Evaluate the services of Nursing Care**

- Willingness of nurses to address your health problems
- Nurses' support to your family and your environment
- Behaviour of nurses
- Communication you had with the nurses
- The confidence Nurse gives you (about your life)
- Support provided by nurses to help you deal with your problems
- The speed with which they performed their duties
- The interest of nurses in addressing your health problems

- **Time and Attendance Service**

- ✓ Time between telephone contact and the date of appointment
- ✓ Time you took from your home to get to the hospital
- ✓ Standby time of the scheduled appointment time until you saw your doctor

- **Evaluate Administrative Services**

- Admittance procedures
- Discharge procedures
- The speed with which the administrative staff perform their duties
- The conduct of the administrative staff
- Ability to keep your waiting time to a minimum
- Consistency in compliance with the appointment for your examination
- The interest of the administrative staff in the smooth implementation of procedure
- Communication you had with the administrative staff
- **Cost of Service**
- ✓ Outpatient ticket examination is high
- ✓ Participation in the cost of the tests is high
- ✓ would you be willing to pay ten Euros per visit if you believed that you would have better health?
-

- ✓ Ease of your orientation (signs, direction lines, signalling)
- ✓ Responsiveness of opening hours to your needs

- **Overview outpatient services**

- ✓ The financial costs paid
- ✓ Improve your health
- ✓ Your satisfaction with the services after your examination
- ✓ Your satisfaction you expect to have before your examination

- **Future Use of Services**

- ✓ Would you like to re-visit the same outpatient?
- ✓ Would you recommend the same to other outpatient clinics visited?
- ✓ Would you prefer to visit private outpatients?

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## A STUDY ON ANTECEDENTS AND IMPACTS OF ENGAGEMENT AND PARTICIPATION IN BRAND COMMUNITIES IN PORTUGAL

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### ABSTRACT

The phenomenon of be engaged and participate in brand communities is not yet well-known. This study carries out a systematic literature review to get the major construct that could explain the mentioned phenomenon and the consequences to the brand. Therefore, the aim of this study is to contribute for a better understanding of antecedents and impacts of engagement and participation in brand communities. Data was collected using an online survey. The link of the questionnaire was sent through the community websites to all registered members of brand communities in study. The major findings reveal that brand relationship quality is an important initiator of the process, together with the brand identification, the presence of other members and satisfaction. Being engaged a member tend to be more active in participating in the community, which in turn improve the brand knowledge, the brand loyalty and word-of-mouth. In future we suggest testing the same model in other contexts, such as other products, countries and comparing between genders.

**Keywords:** brand relationship quality, satisfaction, participation, engagement, identification, brand community, brand knowledge, brand loyalty, word-of-mouth

### INTRODUCTION

Fournier (1998) demonstrates the critical importance of understand the mechanism behind consumer-brand relationships. Indeed, her study proposes a “new theoretical conception of brand personality in a framework that recognizes reciprocal exchange between active and interdependent relationship partners” (Fournier 1998, p. 368). The personality of a brand is a

set of human traits proposed by the consumer based on repeated observation of the behaviours of a brand, thinking as a partner in the relationship dyad (Fournier 1998).

In the relationships built between the brand and the consumer positive outcomes can emerge for both relationship partners. In other words, the consumer can achieve self and social satisfaction when they build and maintain relationships and the brand takes advantages from their loyalty, advocacy and recommendations to others (e.g., Algesheimer, Dholakia & Herrmann 2005; Fournier 1998; McAlexander, Schouten & Koenig 2002; Stokburger-Sauer 2010).

According to McAlexander, Schouten & Koenig (2002, p. 38) “a brand community from a costumer-experiential perspective is a fabric of relationships in which the costumer is situated”. In addition brand communities can help in strengthening consumer-brand relationships (Muniz & O’Guinn 2001). So, the study of brand communities falls within the context of marketing relationship. Consumers with similar norms, values and habits tend to congregate in groups called communities of consumption. A special kind of community of consumption is the brand community, which Muniz & O’Guinn (2001, p. 412) defined as “a specialized, non-geographically bound community, based on a structured set of social relationships among admirers of a brand”. A brand community “is a friendship group of consumers with a shared enthusiasm for the brand and a well-developed social identity, whose members engage jointly in group actions to accomplish collective goals and/or to express mutual sentiments and commitments” (Bagozzi & Dholakia, 2006, p. 45).

Muniz & O’Guinn (2001, p. 413) has proposed three main characteristics of brand communities. First, we have the consciousness of kind, which is “the intrinsic connection that members feel toward one another, and the collective sense of difference from others not in the community”. Second, we have the presence of shared rituals and traditions, which “perpetuate the community’s shared history, culture, and consciousness”. The third indicator of community is a sense of moral responsibility, “which is a felt of sense of duty or obligation to the community as a whole, and to its individual members”.

Several studies around brand communities have been conducted in international context, mainly of those focus the virtual brand communities (e.g. Algesheimer, Dholakia & Herrmann 2005; Stokburger-Sauer 2010). However, studies regarding communities with offline and online existence, particularly in countries such as Portugal, are missed or very few. Our study aims to address this gap. So, we intend to study the Portuguese online brand

communities build around three brands and understand what leads the members to engage and participate in these communities, that is, understand the mechanism that lead consumers to participate in collective activities within the brand communities and what could be the outcomes for brands.

The remainder of this paper is structured as follows. The next sections present the systematic literature review process and conceptual framework and hypothesis. Thereafter, the methodology of the empirical study is described and the results are presented. Finally, the conclusions, limitations and suggestions for further research are drawn.

## **SYSTEMATIC LITERATURE REVIEW PROCESS**

In order to achieve the goal of this research, first we took out a systematic literature review with the intention of building the proposed theoretical model, which was subsequently tested. Therefore, the systematic literature review process uses an automated search to collect information and increase knowledge about the antecedents of participation, engagement and identification in brand communities.

The goal is an identification, documentation and conceptualization for all key analyses in those themes. The EBSCO system accessed through University of Aveiro, containing electronic databases, such as Business Source Complete, Academic Search Complete and EconLit with Full Text, is used to search for information. The main search terms are the following: Identification AND Participation AND Engagement AND Brand Community. The choice of the above mentioned search terms lies on the fact that they are sensitive for the present research topic.

The period considered was from 2006 to 2013. After a broad screen of titles and abstracts and a strict screen of the remaining articles, 9 of them were selected as the most appropriate and relevant to our research topic. The articles analysed are written in English and we included articles with qualitative and quantitative methodology.

### ***Selection Criteria***

The selection criteria of the remaining 9 articles from the screening process are analysed according the following criteria:

- Time frame: We used the time frame from 2006-2013 in order to obtain the more recent investigation in area;
- Language: The paper language must be English due to the language limitations of the researchers;
- Study key-words: We excluded studies that were irrelevant with the research question, through the most relevant keywords;
- Quality assessment: The selected studies will pass the Quality assessment only if they are published within journals that are included at the Harzing quality list of journals. The reason for selecting Harzing quality list of journals relies on the fact that is based on the analysis and ranking of 19 business and management official journal rankings (Mingers & Harzing, 2007). By applying Harzing quality list of journals as a credibility measure, the quality of this paper will raise because it will include studies published within the best journals worldwide. Furthermore, apart from the articles, this study also included grey literature that met all the Quality criteria except their inclusion in the Harzing quality list of journals.

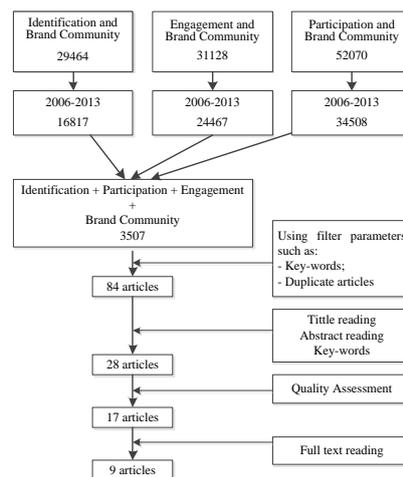


Figure 25: Selection Process

### Data Extraction

In this systematic review, a developed data extraction form was used in order to extract the data from the selected studies and to document the data extraction process. Regarding the elements that have been extracted from the studies concern: General details (Title of the paper, author's name and publication details); Features of the study: (Methodological approach and Central Approaches); and Final Insights. In addition, Annex 14 shows the developed data extraction form along with the data extracted from each of the selected studies. These 9 core articles allow us to find other articles in order to develop the conceptual framework.

## HYPOTHESIS DEVELOPMENT

Based on previous research, our proposed conceptual framework (see figure 2) explores the inter-relationship of antecedents of engagement and participation and explicates the bases and consequences of the brand community's influence on consumers.

As shown in *Σφάλμα! Το αρχείο προέλευσης της αναφοράς δεν βρέθηκε.*, the model depicts brand relationship quality, brand identification, the relationship with other members, satisfaction and degree of influence as the strengths of engage and participate in community. Identification is influenced by the consumer's relationship with the brand which in turn leads to engagement and perceptions of normative pressure. The model also present the consequences of participation, that is, brand loyalty, brand knowledge and word-of mouth.

### *Brand identification and brand relationship quality*

According to Algesheimer, Dholakia & Herrmann (2005) the identification is related with the strength of the consumer's relationship with the brand community, whereby the person recognizes in common in the brand and in himself/herself to be a member, that is, to make sense to "belonging" to the brand community. The common elements involve cognitive and affective components. In what concerns to the cognitive component, identification with brand community includes categorization processes, whereby formulates and maintains a self-awareness of his/her membership within the community, focusing the perceived similarities with other community members and differences with non-members (Algesheimer, Dholakia & Herrmann 2005; Dimitriadis & Papista 2010) Regarding the affective component, identification includes a sense of emotional involvement with the group.

*Brand relationship quality* is the degree to which consumer views the brand as a satisfactory partner in an on-going relationship, according Algesheimer, Dholakia & Herrmann (2005). A "harmonious relationship with the brand can lead consumers to seek out and interact with like-minded consumers who share their enthusiasm" (Algesheimer, Dholakia & Herrmann 2005, p. 23). Therefore, we propose the following:

**H1: Higher levels of brand relationship quality lead to a stronger brand community identification.**

### *Engagement antecedents*

Brodie, Ilic, Juric & Hollebeek (2013) in their study developed a working definition to the concept of consumer engagement in a context of virtual brand communities. They point out

that consumer engagement involves interactive experiences between the brand and the consumers and also experiences among the members of the community. Consumer engagement is a context-dependent, psychological state characterized by fluctuating intensity levels that occur within dynamic, iterative engagement processes and plays a central role in the process of relational exchange (Brodie, Ilic, Juric & Hollebeek, 2013)

Algesheimer, Dholakia & Herrmann (2005) highlight that engagement means the positive influences of be identified with the brand community, which is the consumer's intrinsic motivation to interact and cooperate with community members. Community engagement suggests that "members are interested in helping other members, participating in joint activities, and otherwise acting volitionally in ways that community endorses and that enhance its value for themselves and others" (Algesheimer, Dholakia & Herrmann 2005, p. 21).

Due the overlap between the self-identity of a member and the identity of the group, it is reasonable to consider that this interconnection leads to engagement (Algesheimer, Dholakia & Herrmann 2005; Lee, Kim & Kim 2011; Pai Cheng, Hsin-Yun & Cheng-Kiang 2010). So, we propose:

**H2: Stronger brand community identification leads to greater community engagement.**

*Regarding other members*, this construct means a brand community as social aggregation of brand users and their relationships to the brand. Thus, other members represent a repository of meanings which supply brand community members with their mutual and cultural capital (McAlexander, Schouten & Koenig 2002). Consumers also value their relationships with brand owners and managers. As mentioned before engagement reflects motivation to participate and cooperate with others in a way that creates value for themselves and for others (Porter, Donthu, MacElroy & Wydra 2011). Thereby, we propose:

**H3: Stronger relationship with other members in the brand community, stronger the community engagement.**

Satisfaction is an overall evaluation of the performance, and it is based on prior experiences and is associated with meeting expectations (e.g. Anderson, Fornell & Lehmann 1994; Loureiro & Miranda 2008). Therefore, the consumer engagement process generates satisfaction, but the opposite could also be regarded, this means, a satisfied member is more

willingness to be more deeply engaged (Brodie, Ilic, Juric & Hollebeek 2013). So, the following hypothesis is proposed:

**H4: Community satisfaction has a positive influence on community engagement.**

*Normative pressure antecedents*

Normative pressure means the consumer's perceptions of the brand community's extrinsic demands on a person to interact and cooperate within the community (Algesheimer, Dholakia & Herrmann 2005). The influence of normative pressure from group members is an important element of attitude-theoretic formulations of behaviour (Ajzen 1991; Pai Cheng, Hsin-Yun & Cheng-Kiang 2010). So, we propose that greater identification with the brand community reduces the consumer's perceptions of normative pressure by increasing the overlap between the community's and the individual's norms, values and goals (Pai Cheng, Hsin-Yun & Cheng-Kiang 2010). Thus:

**H5: Stronger brand community identification leads to reduce normative community pressure.**

According to Algesheimer, Dholakia & Herrmann (2005) community engagement and normative pressure are not mutually exclusive. Indeed, higher levels of engagement, though stemming from positive self-endorsed motives, are likely to be connected to greater degrees of conspicuous participation within the community (Algesheimer, Dholakia & Herrmann 2005). Highly engaged members may take on leadership roles, become active and vocal recruiters, advocate positively for the community, and avoid other brand communities (Algesheimer, Dholakia & Herrmann 2005). Such actions are likely to influence the normative pressure. So:

**H6: Stronger brand community engagement leads to reduce normative community pressure.**

*Participation antecedents*

According to Obst, Smith & Zinkiewicz (2002), degree of influence is defined as an individual's need to have some control and influence. The concept of degree of influence is closely related to the concept of self-efficacy; therefore, people that exercise a high degree of influence should be more willingness to engage in the community (Bandura, 1986). As Woisetschläger, Hartleb & Blut (2008) study, we propose that the degree of influence with a group leads to an active community participation and so we hypothesize the following:

**H7: The degree of influence in the community has a positive influence on consumer participation.**

Consider the impact of normative community pressure on the behavioural intentions, the greater the pressure on members to behave according to the brand community's norms and objectives, the more burdensome are the association with and the participation in the brand community (Pai Cheng, Hsin-Yun & Cheng-Kiang 2010). As a result, consumers are less inclined to engage in community-related activities (Algesheimer, Dholakia & Herrmann 2005). So:

**H8: Stronger normative community pressure leads to reduce the brand community participation.**

Community engagement represents the positive and self-instigated aspects of the brand community's influence, so it is likely to be positive to participation (Algesheimer, Dholakia & Herrmann 2005; Pai Cheng, Hsin-Yun & Cheng-Kiang 2010).

**H9: Stronger community engagement leads to stronger community participation.**

#### *Participation Consequents*

Over the years, marketers and firms pay great attentions to involve their consumers in order to be loyal (Bao, Su & Hou 2011). Loyalty can be regarded as an overall attachment or deep commitment to a good, service, brand or organization (Oliver 1999). Muniz & O'Guinn (2001) pointed out that consumers will have more difficulty to leave the brand when are engaged and involved in the community of that brand. Algesheimer, Dholakia & Herrmann (2005) show that a strong involvement in the community leads to a long-term relationship. So, the following hypothesis is proposed:

**H10: Consumer participation has a positive influence on community loyalty.**

According to Woisetschläger, Hartleb & Blut (2008), a favourable word-of-mouth is the likelihood of a consumer positively recommends the product/brand to another potential consumer. Dimitriadis & Papista (2010) argue that several studies have supported the positive path from relational benefits to word-of-mouth. Algesheimer, Dholakia & Herrmann (2005) postulate that the involvement and the participation in a brand community help members to be more willing to say positive words about the product /brand. Thereby:

**H11: Consumer participation has a positive influence on community word-of-mouth behaviour.**

*Brand knowledge* captures the aspects of interest in the brand and the consumer's previous experience lived with it, suggesting that knowledgeable consumers are those more engaged with the brand and the community (Algesheimer, Dholakia & Herrmann 2005).

**H12: Consumer participation has a positive influence on brand knowledge.**

Finally, Algesheimer, Dholakia & Herrmann (2005) also found a positive impact of brand relationship quality on brand loyalty. So, we also regard:

**H13: Brand relationship quality has a positive impact on brand loyalty.**

## **METHODOLOGY**

First the questionnaire containing the items of the constructs and the socio-demographic variables was built. Then, the questionnaire was pre-tested by ten managers and some members of three communities contacted. The brand communities have an offline existence, times to times they organize meetings offline, but they also share thoughts and concerns about the brand online. The communities are managed by Portuguese members but are associated to Renault Clio, Toyota Land Cruiser and VéloSolex bicycles. After the pre-test the questionnaire was prepared online using the tool Google Docs and the link of the questionnaire was sent (through the community websites) to all registered members of brand communities in study. Data was collected during the period of February to April of the year 2011. At the time when the survey started, a total of 5440 users were registered. We collected 342 completed online fulfilled questionnaires, representing a response rate of 6,3%. Of the participants, 11% were female and 89% were male. The sample error is 5,1%.

### ***Measures***

The constructs were measured with multi-item scales. Identification was measured by using a scale from Algesheimer, Dholakia & Herrmann (2005). Satisfaction and the degree of influence were measured by using an established scale from Woisetschläger, Hartleb & Blut (2008). Norms and community engagement was measured with a scale from Algesheimer, Dholakia & Herrmann (2005). The construct other members came from the studies of McAlexander, Schouten & Koenig (2002). Participation was measured by using a scale from

Algesheimer, Dholakia & Herrmann (2005). In what concerns to the outcomes of participation, loyalty was measured by using a scale from Algesheimer, Dholakia & Herrmann (2005), word-of-mouth were adapted from a scale proposed by McAlexander, Schouten & Koenig (2002) and the brand knowledge came from Algesheimer, Dholakia & Herrmann (2005) study. All items were measured by using a 5-Point Likert-type scale and the questionnaire was constructed with 33 items representing the constructs (see Table1).

Construct		Measurement scale	Source
Community Engagement	E1	I benefit from following the brand community's rules.	Algesheimer, Dholakia & Herrmann 2005
	E2	I am motivated to participate in the brand community's activities because I feel better afterwards.	
	E3	I am motivated to participate in the brand community's activities because I am able to support other members.	
	E4	I am motivated to participate in the brand community's activities because I am able to reach personal goals.	
Degree of Influence	GI1	As a member of community, I can influence the community as a whole.	Woisetschläger, Hartleb & Blut 2008
	GI2	I am satisfied with the degree of influence to shape the community.	
	GI3	A single member has the chance to be an active part in the community	
Community Identification	I1	I am very attached to the community.	Algesheimer, Dholakia & Herrmann 2005
	I2	I identify myself with other brand community members and I share the same objectives.	
	I3	The friendships I have with other brand community members mean a lot to me.	
	I4	If brand community members planned something, I'd think of it as something "we" would do rather than something "they" would do.	
	I5	I see myself as a part of the brand community	
Brand Knowledge	K1	When compared to other people, I know a lot about this brand.	Algesheimer, Dholakia & Herrmann 2005
	K2	My friends consider me an expert regarding this brand.	
	K3	I consider myself very experienced with this brand.	
Community Loyalty	L1	It would be very difficult for me to leave this brand community.	Algesheimer, Dholakia & Herrmann 2005
	L2	I intend to stay on as a brand community member.	
	L3	If I am invited to another community brand, I will definitely stay in this brand community	
Brand Word-of-mouth	M1	I would recommend this brand to my friends.	McAlexander, Schouten & Koenig 2002
	M2	If my friends are looking for a brand to buy a product x, I would definitely recommend this brand.	
	M3	I have encouraged other people to buy this brand	
Normative	N1	In order to be accepted, I feel like I must behave as other brand community members expect me to behave.	Algesheimer, Dholakia & Herrmann 2005
	N2	My actions are often influenced by how other brand community members want me to behave.	
Other Members	OM1	I know interesting people because of the brand community.	McAlexander, Schouten & Koenig 2002
	OM2	I feel a certain kinship with other members of the community.	
	OM3	I have interest in contacts with other members of the community	
Community Participation	PA1	I actively participate in the brand community's activities	Algesheimer, Dholakia & Herrmann 2005
Brand Relationship Quality	Q1	This brand says a lot of the kind of person I am.	Algesheimer, Dholakia & Herrmann 2005
	Q2	This brand image and the image I have of myself are similar in many respects.	
	Q3	This brand plays an important role in my life.	
Satisfaction	S1	Overall, this community meets my expectations.	Woisetschläger, Hartleb & Blut 2008
	S2	The content of this community matches exactly with my interests.	
	S3	This community fulfils my need	

Table 1: The questionnaire's construct, items, and sources

## RESULTS

### *Measurement Results*

A PLS model should be analysed and interpreted in two stages. First, the measurement model or the adequacy of the measures is assessed by evaluating the reliability of the individual measures, the convergent validity, and the discriminant validity of the constructs. Then, the structural model is evaluated. In order to evaluate the adequacy of the measures item reliability is assessed by examining the loadings of the measures on their corresponding construct. Item loadings of scales measuring reflective constructs should be 0,707 or more, which indicates that over 50% of the variance in the observed variable is explained by the construct (Wetzels, Odekerken-Schröder & van Oppen 2009). We analyzed the item loading of each item and all of them exceed the value of 0,707.

All Cronbach's alpha values are above 0,7, except for Normative, and all composite reliability values in **Σφάλμα! Το αρχείο προέλευσης της αναφοράς δεν βρέθηκε.** are above 0.8. All constructs are reliable since the composite reliability values exceed the threshold value 0,7. The measures demonstrate convergent validity as the average variance of manifest variables extracted by constructs (AVE) are above 0,5, indicating that more variance of each indicators are explained by their own construct. In order to analyze the discriminant validity, the square root of AVE should be greater than the correlation between the construct and other constructs in the model (Fornell & Larcker, 1981). Table 2 shows that this criterion has been met.

Construct	Mean	C.R	Alpha	AVE	1	2	3	4	5	6	7	8	9	10	11
<b>1.B Knowledge</b>	3,3	0,895	0,829	0,741	<b>0,861</b>										
<b>2.B Loyalty</b>	3,8	0,885	0,808	0,721	0,403	<b>0,849</b>									
<b>3.B identification</b>	3,7	0,906	0,870	0,660	0,320	0,656	<b>0,821</b>								
<b>4.Brelationship quality</b>	3,7	0,883	0,801	0,715	0,606	0,578	0,385	<b>0,846</b>							
<b>5.D of influence</b>	3,3	0,853	0,744	0,660	0,390	0,617	0,659	0,474	<b>0,813</b>						
<b>6.Engage</b>	3,	0,8	0,8	0,6	0,3	0,6	0,7	0,4	0,7	<b>0,8</b>					

<b>ment</b>	5	98	47	88	75	85	52	72	08	<b>30</b>					
<b>7.Normative</b>	2,8	0,830	0,600	0,710	0,191	0,330	0,371	0,256	0,437	0,431	<b>0,843</b>				
<b>8.O Members</b>	3,3	0,869	0,773	0,688	0,293	0,662	0,749	0,371	0,677	0,707	0,389	<b>0,830</b>			
<b>9.Participation</b>	2,7	1,000	1,000	1,000	0,285	0,548	0,657	0,308	0,560	0,696	0,240	0,684	<b>1,000</b>		
<b>10.Satisfaction</b>	3,6	0,887	0,809	0,724	0,415	0,687	0,686	0,554	0,653	0,634	0,395	0,642	0,518	<b>0,851</b>	
<b>11.WofM</b>	4,1	0,949	0,921	0,862	0,455	0,537	0,298	0,730	0,352	0,374	0,167	0,286	0,218	0,480	<b>0,929</b>

Notes:

- C.R. – composite reliability: AVE – average variance extracted
- Diagonal elements in the ‘correlation of constructs’ matrix are the square root of AVE. For adequate discriminant validity, diagonal elements should be greater than corresponding off-diagonal elements.

- Table 2: Measurement model and test for discriminant validity

### **Structural results**

The overall structural results are presented in Figure 2. All path coefficients are found to be significant at the 0,001, 0,01 or 0,05 levels, except for following relationships: Brand identification->Normative, Normative->Participation and Degree of Influence-> Participation. Thereby, all hypotheses are supported except H2, H5 and H8.

All values of  $Q^2$  are positive, so the relations in the model have predictive relevance. The model also demonstrated a good level of predictive power ( $R^2$ ), especially for the Engagement (77,6%) and Participation (50,1%). Overall, the values of GoF statistics reveal that the model has a good fit to the data collected.

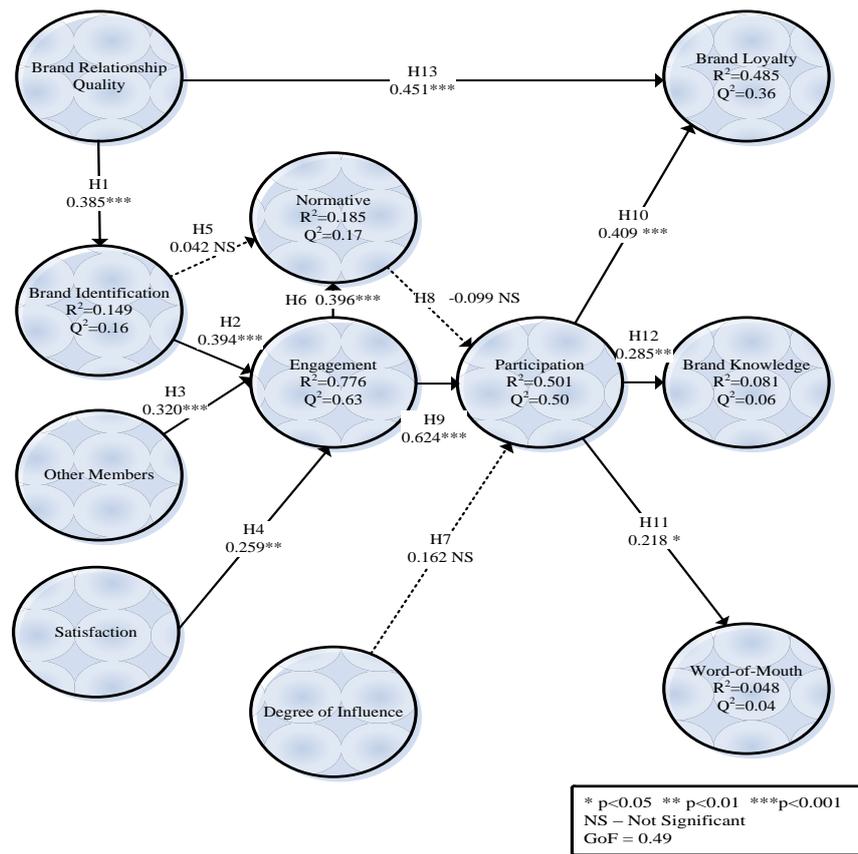


Figure 2: Structural results

## CONCLUSIONS AND IMPLICATIONS

In Portuguese brand communities, as in other countries and as we have seen in other studies (e.g. Algesheimer, Dholakia & Herrmann 2005; Woisetschläger Hartleb & Blut 2008), the participation in the community leads to loyalty, brand knowledge and word-of-mouth. Therefore, participation tends to increase the tendency to stay within the community, to stay positive recommendations about the brand and to improve the knowledge about the brand.

In what concerns of the antecedents of participation, community engagement is the most important motivator to participate in Portuguese communities. The brand relationship quality is important to influence brand identification. Norms has a negative but not significant effect on participation, as expected. The Portuguese members of communities tend to dislike the normative, they don't like behave as other members expected and they don't like to feel that their actions are influenced by other members (through restrictions to act in certain ways), because they understand it as coercive. Brand communities should not have a

set of norms very restrictive and extensive because it can inhibit members to participation in the community. In order to motivate the Portuguese members to participate it is important that they feel motivated to participate in the activities because they feel better afterwards, more able to support other members and reach personal goals. In addition, to engage and involve all members in activities it is also important that the members share the same objectives, they feel friendship, they see themselves as a part of community and that the plans are group plans and not individual plan. In this vein, a brand community should create an environment that allows the interaction among members in order to share plans and goals among all members. By contrast to the Woisetschläger, Hartleb & Blut (2008) study, in the current study the group well-being is more important than the individual satisfaction, or even the degree of individual influence inside the community. To the managers of brand communities we suggest to improve the number of activities that involve the members with one or few objectives shared among them.

Table 3 allow us to compare and better analyse the results of the current study and those of previous studies.

Hypotheses	Relationship	The current study results	Previous studies results
H1	Brand Relationship Quality → Brand Identification	Supported	Algesheimer, Dholakia & Herrmann 2005 – Supported
H2	Brand Identification → Engagement	Supported	Algesheimer, Dholakia & Herrmann 2005 – Supported Lee, Kim & Kim 2011 - Supported Pai Cheng, Hsin-Yun & Cheng-Kiang 2010 – Supported
H3	Other Members → Engagement	Supported	Porter, Donthu, MacElroy & Wydra 2011 – Suggested
H4	Satisfaction → Engagement	Supported	Brodie, Ilic, Juric & Hollebeek 2013 – Suggested
H5	Brand Identification → Normative	Not supported	Pai Cheng, Hsin-Yun & Cheng-Kiang 2010 – Supported Algesheimer, Dholakia & Herrmann 2005 – Supported
H6	Engagement → Normative	Supported	Algesheimer, Dholakia & Herrmann 2005) – Supported
H7	Degree of Influence → Participation	Not supported	Woisetschläger, Hartleb & Blut 2008 - Supported
H8	Normative → Participation	Not supported	Algesheimer, Dholakia & Herrmann 2005) - Supported Pai Cheng, Hsin-Yun & Cheng-Kiang 2010) – Supported
H9	Engagement → Participation	Supported	Algesheimer, Dholakia & Herrmann 2005 - Supported Pai Cheng, Hsin-Yun & Cheng-Kiang 2010 – Supported
H10	Participation → Brand Loyalty	Supported	Algesheimer, Dholakia & Herrmann 2005 – Supported Woisetschläger, Hartleb & Blut 2008 - Supported
H11	Participation → Word-of-Mouth	Supported	Woisetschläger, Hartleb & Blut 2008 - Supported Dimitriadis & Papista 2010 - Suggested Algesheimer, Dholakia & Herrmann 2005 –

			Supported
H12	Participation -> Brand Knowledge	Supported	Algesheimer, Dholakia & Herrmann 2005 - Supported
H13	Brand relationship quality -> Brand Loyalty	Supported	Algesheimer, Dholakia & Herrmann 2005 - Supported McAlexander, Schouten & Koenig 2002 - Supported

Table 3: Comparison between the results of the current study and previous studies

### *Limitations and further research*

Our study focuses in Portuguese brand communities, so careful must be taken when extrapolating our findings to other types of brand communities. As we have seen, the cultural dimension has a relevant importance when we analyse the results. Careful must also be taken when we want to extrapolate the results to virtual or online brand communities, because the communities studied have a physical existence and only uses the online environment to facilitate the some communications with members. We should also refer that we only study brand communities associated with vehicles brands.

Future research should integrate variables that can moderate the suggested relationships between the constructs, such as customer profile, especially the gender. As we have seen, our sample is mainly constituted by males, and we propose to know in future if that fact influences the results. We suggest the application of this questionnaire in other contexts, such as, different products, different countries, to investigate the divergences between the products and to make a cross-cultural study about the participation in brand communities around the world.

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Nr.	Author/s and year of publication	Journal	Methodology Adopted	Final Insights
1	Porter, Constance Elise; Donthu, Naveen; MacElroy, William H.; Wydra, Donna (2011)	California Management Review	Qualitative Approach	Three-stage process that managers can follow to successfully foster and sustain engagement through virtual communities.
2	Schau, Hope Jensen; Muñiz, Albert M; Arnould, Eric J. (2009)	Journal of Marketing	Qualitative Approach	Practices have an “anatomy” consisting of: <ul style="list-style-type: none"> <li>- (1) general procedural understandings and rules (explicit, discursive knowledge);</li> <li>- (2) skills, abilities, and culturally appropriate consumption projects (tacit, embedded knowledge or how-to); and</li> <li>- (3) Emotional commitments expressed through actions and representations.</li> </ul> The authors find that there are 12 common practices across brand communities.
3	Hassay, Derek N.; Peloza, John. (2009)	Journal of No-profit & Public Sector Marketing	Qualitative Approach	A discussion of current marketing practices revealed that while charitable organizations exhibit some aspects of brand community they are not cultivating the sense of community amongst supporters that is necessary to fully realize the benefits witnessed in a true brand community. However, the need to increase overall support and a desire to develop greater loyalty amongst current supporters, demonstrates the relevance of brand community to this sector. Charities have an opportunity to leverage brand communities to enjoy benefits similar to the increased loyalty and sales enjoyed by their for-profit counterparts. Charities looking to gain greater commitment amongst their supporters.
4	Laing, Angus; Keeling, Debbie; Newholm, Terry. (2011)	Journal of Marketing Management	Netnographic methodology	Within the broadening of the health care encounter  To include the virtual parallel encounter, the patient in informational terms shifts from being positioned primarily as a recipient to being a provider and recipient. Given the weight attached by patients to information regarding the experience of living with conditions, such provision represents a significant and influential role.
5	Bagozzi, Richard P.; Dholakia, Utpal M. (2006)	Management Science	Quantitative methodology	In this study of LUGs, where negative, but not positive, anticipated emotions predicted intentions, the findings are similar to those found for online interactions of low-intensity venues reported by Bagozzi et al. (2006). It appears that members of LUGs are motivated by the fear of not gaining the benefits of participating in their LUG rather than the anticipated gain, per se. It may be that it is not so much the expected joy of LUG participation that drives choices as it is that joy and satisfaction are outcomes of participation, much as research in organization behaviour has shown that satisfaction results from performance rather than causes it.
6	Olbrich, Rainer; Holsing, Christian	International Journal of	Quantitative	Social shopping features exert a significant impact, both positive and negative. Tags and high ratings have a positive impact on a click-out. In contrast, the more lists and styles used, the less likely the user

	(2011-2012)	Electronic Commerce	methodology	is to make a click-out. Yet, lists and styles seem to enhance site stickiness and browsing. Moreover, the more direct shopping features that are used, the less likely the user is to conduct a click-out. Increasing transaction costs and information overload could be potential reasons. We also found that community members are more likely to make a click-out than ordinary users. This implies that community members are more profitable.
7	Schouten, John W.; McAlexander, James H.; Koenig, Harold F. (2007)	Journal of the Academy of Marketing Science	Quantitative approach	This study demonstrates that a TCE in the context of a marketer-facilitated consumption activity can strengthen a person's ties to a brand community, delivering a particularly strong form of brand loyalty.
8	David G. Taylor, Jeffrey E. Lewin, David Strutton (2011)	Journal of Advertising Research	Quantitative research	This study's findings suggested that, when SNA delivers content that is consistent with the motivations originally expressed in media uses and gratification theory, consumers were more likely to ascribe positive attitudes toward advertising conveyed to them through an SNS medium. Specifically, when SNA delivered content or impressions that provided entertainment or informational value or offered social value, consumers appeared more likely to respond favorably toward the ad stimuli themselves.
9	Chatterjee, Patrali (2011)	International Journal of Advertising	Quantitative methodology	Show that marketer and consumer-generated brand ads differ in their impact on recommending propensity for high share-of-posts and long-term influencers, and for member and non-member recipients.

*Annex 14: Data extracted from the selected art*

## SUSTAINABLE WINE CONSUMER: MYTH OR REALITY?

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### ABSTRACT

The current literature review tries to shed some light on consumers' interest and attitude towards sustainable wine, examining the real chances that sustainability will become a relevant competitive advantage in the international competitive arena. The study explores and critically discusses the main findings of over 20 scientific and professional articles (and reports) on consumers' attitude and behavior towards sustainable wines, analyzing both organic and environmental-friendly products. Our review confirms that the motives which trigger sustainable wine buying behavior have not yet been deeply analyzed by academics and professionals. Indeed, consumer awareness of sustainable winegrowing and winemaking is currently quite low and sustainable wine is a rather confusing and vague term. However, as consumer awareness grows, the market should see growing acceptance and demand for certified sustainable wines, therefore the industry should develop appropriate marketing programs that guide consumers in identifying and distinguishing these products on the market shelves. Moreover sustainable production enriches and strengthens the relations with political institutions, with consumer associations and social groups sensitive to ethical problems.

**Keywords:** Sustainable wine consumer; Literature review; Organic wines; Environmental friendly wines

### INTRODUCTION

Nowadays, as put by McDonald and colleagues (2006), every time someone makes a decision about whether to purchase a product or service there is the potential for that decision to contribute to a more or less sustainable pattern of consumption. While academic literature is increasingly discussing the core advices to alter consumption patterns to foster sustainable consumption (e.g. Hinton and Goodman, 2010; Jackson and Michaelis, 2003; Mebratu, 1998) a wide consensus has been reached on the fact that food is a prior area in which improvements

are needed (Tukker and Jansen, 2006; Gilg *et al.*, 2005; Seyfang, 2005). In this framework, like other food industries, the wine business has been increasingly impelled by market and regulatory drivers to assess, reduce and communicate environmental and social performances. At the same time there has been growing concern regarding environmental and social problems related to the wine industry, particularly in certain countries with a shorter tradition in winemaking (Australia, New Zealand, U.S.A. and South-Africa). In addition wine companies have realized that sustainability constitutes a means of differentiation, which is crucial for increasing productivity and competitiveness. Consequently, sustainability has developed into a priority in the wine supply chain (Forbes *et al.*, 2009; Gabzdylova *et al.*, 2009).

Despite the above described scenario, the reasons behind consumers' adoption of sustainable practices, attitudes, and intention to purchase sustainable wines remain largely unexplored (Barber, 2010). Or in other words, there appears to be a general interest in sustainability and sustainably produced wines but a lack of clarity on what exactly this means (Berghoef and Dodds, 2011). Alongside whether consumer interests, attitudes and perceptions towards sustainability in general impact buying decisions is still highly disputed (Vermeir and Verbeke, 2006). In addition, the essential concept of sustainable development has many different meanings and interpretations that can even vary robustly (for a detailed review and discussion see Hopwood *et al.*, 2005). Not surprisingly, as demonstrated by the cross-cultural study conducted by Szolnoki and colleagues (2011), it is still very difficult to define the term "sustainability" because not only each country but also each entrepreneur has a different understanding of sustainability in the wine industry. Even today, the term is mainly (or only) associated with the environmental aspects of wine production, neglecting other important issues (i.e. workers rights, community development, etc.). In the same research these authors also reveal that wineries generally agree that consumers are not informed well enough to appreciate sustainable wines. Similarly, other scholars (Gabzdylova *et al.*, 2009) have found that customers' demand was not among the most important drivers of sustainable practices adoption by wineries. Despite this, the wine industry has witnessed a proliferation of numerous voluntary certification standards aimed at insuring sustainable practices (i.e. certified California sustainable winegrowing, Oregon certified sustainable wine, Integrity and sustainability certified in South Africa, Sustainable winegrowing in New Zealand).

The current review tries to shed some light on consumers' interest and attitude towards sustainable wine, exploring the main findings of recent literature and discussing core implications and possible future research avenues. In particular, since no study has

investigated all features of sustainability (social, environmental and economic) we have focused our attention on the most significant academic and professional articles and conference proceedings that have dealt with singular aspects of sustainability (such as organic and environmental-friendly).

The remainder of the paper is structured as follows: the next section presents the background of the study; then a section on organic wine consumers studies is presented; followed by a review of researches on environmental-friendly wine. The subsequent section critically discusses the major findings of the analyzed studies. Finally, the paper concludes with a summary of the managerial and policy implications of these studies and outlines future research avenues.

## **BACKGROUND**

Due to the large amount of different cues that may influence consumer choice, purchase decision for wine is more complex than the choice for many other products (Mueller *et al.*, 2010). In addition, as powerfully stated by Laroche *et al.* (2001), efforts to understand environmentally friendly consumers date back at least 30 years. In general, while consumers are highly concerned of the effects of food production practices on the health of the environment, they are less concerned about the effects of wine production practices (Forbes *et al.*, 2011). Academic and professional studies on the consumer perspective of sustainability in the wine sector are quite recent and have mainly focused on two different streams of research: consumers' behaviors towards organic wines and consumer attitudes/purchasing intentions towards wines that have some sustainable characteristics (as environmental friendly or carbon neutral). The first avenue of research has mainly investigated the core reasons that induced consumers to purchase organic wines instead of conventional ones, as these wines are perceived to be less harmful to the environment mainly due to the non use (or rules of use) of chemical inputs. Whereas the latter researches have more deeply observed the propensity of individuals to participate in the "sustainable" market. In both cases, the bottom line is that sustainable practices are valuable for businesses only if consumers are willing to pay a price premium for these wines. Thus most of the studies available have investigated willingness to pay (WTP) through diverse methodologies – ranging from open-ended WTP studies to choice experiments and experimental auctions – and with very heterogeneous samples (mostly convenience samples). Finally it is important to remark that while a large amount of the articles concerning organic wines are developed in Europe, nearly all the

studies that have focused on other sustainable features of wines have been performed in the new world.

## LITERATURE REVIEW

### *Organic wines*

In general, it is assumed that organic wines constitutes a relatively small share compared to other organic farming products like fruits, vegetables and eggs (consider that the European organic market is the biggest in the world, valued around 14 billion Euros, see among others Willer et al., 2008). This due to the fact that many consumers perceive wine to be a natural product and do not necessarily see a need for wine to be organic (Sirieix and Remaud, 2010). In addition, the wine industry has in recent years been untroubled by scandals and food scares that have strongly hit other food industries (as meat). Indeed the latest important sanitary outbreaks concerning wine occurred in Italy (methanol added to wine) and in Austria (frost protection used to sweeten wines) in the early and mid eighties. Furthermore, while organic food products constitute an independent premium category, organic wines find themselves in the middle of the wine assortment, being present in different categories (e.g. red or white wines), within different grape varieties as well as within different price segments. Finally, some authors have suggested (Olsen *et al.*, 2006) that consumers' resistance to purchasing organic wine is related with bad taste and therefore less pleasure. As a consequence market response to organic wines is not uniformly positive and there are several contradictions in consumer attitudes to organic wines. Nevertheless organic wines are a good example of how the environmental concerns addressed by eco-labeling meet with other normative demands in consumption. In their socio-demographic profile of the organic wine buyer in Greece Fotopoulos et al. (2003) showed that these people more often purchase food at specialty shops, are more concerned about their healthy dietary patterns and use more media compared to non-organic buyers. Brugarolas et al. (2005), investigating Spanish consumers' willingness to pay (WTP) for organic wines, found that the average price premium was around 17%. Barreiro-Hurlé et al. (2008), investigating consumers' interest for functional wines, indicated that the additional WTP for an organic wine on average was 15% of the maximum price that respondents declared they usually pay for a bottle of wine. Remaud and colleagues (2008) showed that, overall, a minority of Australian wine consumers (14%) valued organic wines. However, this group of consumers are willing to pay a 22% premium for a special occasion. Nevertheless, the average Australian wine consumer would only pay a 1% premium for an organic wine. In a replication of this study the same authors

(Mueller and Remaud, 2010) found that the environmental claim had the same importance (5%) for choice over all consumers, while its influence strongly increased for one environmental sensitive segment. Additionally, they revealed also that a segment of consumers seemed to be 'eco-allergic', deriving a considerable negative utility from environmental claims. Another Spanish study (Brugarolas *et al.*, 2010) revealed that consumers from regions where wine production shares a larger proportion of the regional economy are willing to pay more for organic wine. Delmas and Grant (2010), exploring over 13.000 wines of California, have estimated and revealed that the organic production method has a positive impact on the price of the bottle but this effect lasts only as long as it remains undisclosed, in fact bottles with organic labels dragged down prices. Specifically, Delmas and Grant (2010) found that an environmental certification increases the price by a 13%, but the inclusion of an eco-label reduces it by 20%. Mann *et al.* (2012) exposed that for Swiss consumers the organic attribute was more important than the color of the wine, but less important than the price and the country of origin. In addition, urban and female consumers were relatively likely to consume organic wine, as consumers who perceived organic wine as being healthy. At last the research by Olsen and colleagues (2012), in the U.S.A., demonstrated that hedonistic and environmental protection values and beliefs can partially explain the propensity to purchase organic wines.

#### *Environmental friendly wines*

Prominent scholars have settled on the assumption that ethical-political consumers are not insensible to price or quality, and what counts as 'ethical' or 'political' is neither simple nor uncontested with multiple motivations establishing an extremely complex space (Herman, 2012). Wine, obviously, makes no exception.

Loureiro (2003) found that American consumers in some cases were not willing to pay more for the environmentally friendly wine when quality was a perceived difference, while D'Souza *et al.* (2006) found in their study of Australian consumers, that nearly 70% of the sample indicated they would purchase these products even if they were more expensive than the alternatives.

Furthermore, Bazoche *et al.* (2008) found, in their study in France, that the environmental signal (on the wine label) is valued differently depending on who conveyed the information and that dissemination of information about the environmental repercussions of farming methods does not significantly affect willingness-to-pay. Similarly, In Australia, Remaud and colleagues (2008) forcing consumers to trade-off different attributes, through a discrete wine

choice experiment, found sustainable attributes to be overall irrelevant. Barber et al. (2009) conducted a study on the influence that knowledge and attitudes about environmentally friendly practices have on US consumers when choosing a wine, revealing that the choice of these products is made because consumers are more interested in helping producers. Similar findings can be retrieved in Forbes et al. (2009), who found that nearly 73 percent of respondents (in New Zealand) stated that, although sustainable wines may cost more than traditional alternatives, they will be willing to pay that extra. In sound with previous mentioned research Zucca and colleagues (2009), in their study on Californian consumers, revealed that respondents liked the concept of sustainable winemaking (around 90% of positive responses) but they really did not have a clear idea of what sustainability meant in practice or what processes the wineries did to achieve it. Barber (2010), exploring green wine packaging, revealed that consumers' environmentally friendly behavior can be motivated by emphasizing the importance of environmental issues. Nowak and colleagues (2010), exploring Californian Millennials, find evidences that consumers who believe that the winery's pro-environmental business practices make a difference have increased purchase intentions. Loveless et al. (2010) research, on an international consumer panel, shows that sustainability is less important to consumers than other credence characteristics like quality control. Berghoef and Dodds study in Ontario (2011) revealed that consumers are interested in purchasing eco-labeled wines but their other expectations must also be met, in addition the majority of respondents was willing to pay a premium for eco-labeled wine. The empirical results of Schmit and colleagues (2012), in New York state (USA), revealed that sensory effects dominate extrinsic environmental attributes; indeed once consumer willingness-to-pay was conditioned on a wine's sensory attributes, the addition of environmentally friendly information did not affect their WTP. Finally the forthcoming paper by Mueller and Remaud (2013) shows that corporate social responsibility (CSR) claims relating to social and environmental issues have similar awareness and penetration in UK, France, Germany, USA and Canada. However their impact on consumer choice is different, as environmental corporate responsibility claims have higher marginal WTP. In addition, consumer valuation of CSR claims significantly differs across different markets.

## **DISCUSSION**

A major outcome revealed by the current literature review is the existence of a hierarchy of consumer concerns: as clear signs of concern can be retrieved inherent to the negative environmental effects of food production while individuals appear unconcerned of wine

production environmental externalities. Our review points out that consumer knowledge of the concepts of sustainable viticulture and wine-making is rather limited and the expression sustainable wine is still perceived as extremely confusing. In addition, strong differences remain on academic and professional outlooks of the amount of wine drinkers willing to purchase these types of wines in the next future and consumers' willingness to pay a premium price for wines with sustainable features. Most authors believe that consumers will not be willing to trade-off the quality of a wine for environmental/social features (Lockshin and Corsi, in press), thus sustainable wines should be sold at the same price as regular wines. Whereas many scholars remark that sustainability will most likely become a relevant competitive advantage in the international arena (Pullman *et al.*, 2010; Forbes *et al.*, 2009; Bison *et al.*, 2002). These findings are not particularly surprising if we look at sustainable wine consumption in the wider perspective of current debates on the relations between consumption and sustainable development. Indeed, activists and several academics are arguing that much of Northern consumer behavior is unethical and immoral because it frequently impacts negatively on the next generation, those living elsewhere, those not yet born, and the environment (e.g. Sanne, 2002). Since ultimately, all the environmental impacts caused by man can be related to human consumption patterns (Carlsson-Kanyama *et al.*, 2003) and waste production (Urry, 2010). Thus individuals, through their more conscious purchases, are called to act as citizens working towards a more sustainable future (Hinton and Goodman, 2010). Even if the exact scope and definition of sustainable consumption remains quite ambiguous, the current institutional consensus has tended to settle for a position which implies consuming differently rather than consuming less, and in which this is to be achieved primarily by the production and sale of more sustainable products (Jackson and Michaelis, 2003). As a consequence, in the last twenty years or so developed countries markets have witnessed the growing popularity of goods that seek to embody sustainable consumption practices that do not jeopardize the needs of future generations. Tough consumers' understanding of sustainability has, so far, received little research attention (Hanss and Böhm, 2012) and studies on how relatively important the different dimensions of sustainability are and which purchase decisions consumers consider sustainable would provide valuable input for the promotion of sustainable consumption. Nevertheless, general consensus has been reached on the fact that socio-demographic variables alone are not sufficient for explaining sustainable food consumers behavior (Verain *et al.*, 2012). Personality characteristics, lifestyle variables and behavioral variables should all be considered in future studies on sustainable consumption. Not surprising, as this review has highlighted, studies

on consumer's attitude and WTP for sustainable wines are very recent, dating not more than 12-15 years. Scholars' interest is clearly growing in the wake of the overwhelming popularity of sustainability in society and public policies.

## CONCLUSION

Although the general public has become increasingly interested in sustainable development this interest has failed to engender an effective political response, or to bring about significant changes in the everyday behaviors of consumers (Soron, 2010). Therefore, today new types of policy approaches are needed to create opportunities for making consumption more sustainable and to change unsustainable activities. Alongside, it appears that there is currently a positive momentum to develop new sustainable consumption policies, but such policies should overcome existing skepticism and uncertainties. The current literature review of consumer attitudes and behaviors towards sustainable wines reveals the complex and sometimes contradictory feelings and interests that shape consumers' practices. In summary, available studies seem to show that the adoption of organizational models for sustainable production do not allow directly to obtain higher prices or to compensate for poor quality. However, this should not lead to the conclusion that sustainability is not an important factor for marketing, or for the development of strong relationships between firms and markets. Several elements need to be considered in the light of the principles of market orientation and relationship marketing (Arnould and Thompson, 2005; Gummesson, 2002; Narver and Slater, 1990; Kohli and Jaworski, 1990). These principles taken together indicate that the development of competitiveness is based on the ability of the company to focus not only and not so much on the individual transaction (as in the perspective of transactional marketing) and the trading price, but in the development of a wide network of relationships certainly with customers but also with numerous other individuals who directly or indirectly may affect the performance of the company and company's human resources. In this perspective, and given the institutional importance of the issue, sustainable production enriches and strengthens the relations with political institutions, with consumer associations and social groups sensitive to ethical problems. Inside the firm, then consistency with the principles of sustainable development determines enhancing the capacity of individuals, in terms of specific skills, but also, the attention and sensitivity towards the context in which the company operates which is reflected in greater enterprise's ability to understand and possibly anticipate market needs. In sound with other scholars we could sum up our review stating that the motives which trigger sustainable wine buying behavior have not yet been deeply

analyzed by academics and professionals. Indeed, consumer awareness of sustainable winegrowing and winemaking is currently quite low and sustainable wine is a rather confusing and vague term (Zucca *et al.*, 2009). Furthermore these studies have to be well weighted since the linkages between attitudes and behavior are complex and that the precise nature of the relationship is contingent on many contextual factors (Selfa *et al.*, 2008). However, as consumer awareness grows, the market should see growing acceptance and demand for certified sustainable wines, therefore the industry should develop appropriate marketing programs that guide consumers in identifying and distinguishing these products on the market shelves. The simple solution of launching labels (e.g. eco or carbon neutral labels) can facilitate the identification of sustainable products and may guide purchase decisions (Gallastegui, 2002). With the caveat that the proliferation of various types of labeling may confound consumer understanding of sustainable wine, both if it's a private (made by firms that make unverified claims about their products) or public certification. Indeed, it is important to keep into mind that competing certification schemes can create potentially negative effects and that lately Northern consumer demand has required sustainability to encompass both social and environmental sustainability (Browne *et al.*, 2000). Notwithstanding that different certification schemes within the wine industry face significant pressure from interests located in state agencies, dominant market players, and social and environmental interest groups (Mutersbaugh *et al.*, 2005). In addition, wineries can be frustrated by the fact that the world of sustainable agriculture is one where the horizon is always receding (Ohmart, 2008). Available studies have focused on the price premium that consumers are willing to pay for organic or broadly environment-friendly wines, further research should analyze WTP for wine that carry more comprehensive and specific sustainability features. Additional studies should directly compare consumers' attitude and behavior towards these wines across different countries to confirm (or disprove) the previously described results. Furthermore a major drawback of most of the articles here review is the use of contingent valuation techniques that do not capture actual behavior due to strong hypothetical bias. New studies should try to simulate real shopping environments, that reduce or eliminate hypothetical bias, to provide more reliable and precise information. Some limitations of the current work are related to the non exhaustiveness of the review and the rapidly changing scenario that complicates the goal of framing exactly the current market situation. In addition, the lower environmental impact of organic food is contested and undercut by uncertainty and paradoxes (Mondelaers *et al.*, 2009; Foster *et al.*, 2006). In

conclusion, we also recognize that the meanings of sustainable wine are very complex and still heavily debated.

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## CRAFT BEER: A CONSUMER PREFERENCE AND SWITCHING PERSPECTIVE

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### ABSTRACT:

**Purpose** – The aim of the paper is to analyze the growing trend of craft beer consumption from a customer point of view. The paper benchmarks the profile of traditional beer consumers with those of craft beer drinkers, thanks to an exploratory study, and seeks to identify which traditional beer consumer characteristics could be important in pushing them towards craft beer consumption.

**Design/methodology/approach** – A sample survey enabled us to empirically assess research questions by identifying differences between traditional and craft beer consumers. A probit model was specified to capture factors enhancing switching attitudes towards craft beer.

**Findings** – Craft beer drinkers can be distinguished from traditional beer consumers by their different habits and frequency of consumption, which are also crucial elements favouring switching.

**Research limitations/implications** – The main limitation can be found in the non-probabilistic sample design.

**Practical implications** – Craft beer consumption is increasing despite a higher price compared with traditional beer prices, highlighting the importance of quality in determining consumer beverage choices, opening new opportunities for business in this sector, in Italy, but also in Europe.

**Originality/value** – To the best of our knowledge no studies have as yet been conducted in Europe in this particular beverage segment, above all from this

perspective, so this is a first exploratory study which considers consumer preferences and their possible switch from traditional beer to craft beer consumption.

**Keywords:** traditional beer, craft beer, consumer preferences, consumer characteristics, consumer switching features.

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## **1. INTRODUCTION**

Craft beer is one of the growing beverage segments, despite the important economic crisis in Europe and above all in Italy, where business struggles to find new opportunities and profitable activities mainly due to the decrease of disposable income.

The beer sector is particularly interesting because today only the top of the range beers have increased consumption (i.e. special and premium beers), despite the decreasing consumption trend of other types of traditional beers with lower prices (AssoBirra, 2011).

This growing trend also affects craft beer consumption which is becoming more and more popular among customers, making its weight felt in the entire sector, also worrying firms which traditionally operate in this industry and whose incomes and profits could be negatively affected by the growing consumption rate of craft beer. However, this same trend could also represent an important opportunity for business, especially for small start-ups, if craft beer is perceived as quality beer, as the USA market shows. Therefore, the first research question which supports this paper concerns factors affecting consumer choices for beer purchase and consumption, also studying whether there are links between some important choice characteristics such as price and quality.

The second one concerns the profile of beer consumers, benchmarking the most important characteristics of traditional beer consumers with those of craft beer drinkers.

The third concerns factors which could eventually enhance a switching attitude between traditional and craft beer consumption, enhancing, on the one hand, new businesses in understanding which characteristics consumers desire and expect from a craft beer and, on the other, managers of established firms in better supporting their products, possibly partially changing their characteristics or communication and distribution strategy in order to meet changing consumer desires, expectations and preferences.

In order to answer the above research questions the paper includes the relevant data on European and Italian beer manufacturing and consumption, where the exploratory study has been carried out, and a benchmark with the USA market where some studies concerning craft beer consumption have already been conducted. It also presents a section devoted to factors affecting beer choice and consumption in the past and present, taking into account new emerging attitudes and preferences in this particular segment of the beer industry.

In the next section the paper explains the methodology used to conduct the exploratory study, their results and elaboration. The paper concludes with some insights, including managerial implications, limitations of this study and possible steps for future research.

## **2. THE BEER MARKET IN NUMBERS**

### *2.1 A benchmark between Europe and Italy*

Since 2007 the European beer market has grown continually, both in production levels which peaked over the last 10 years, 409 million hectoliters produced, and in the 80.3 liter per capita consumption (AssoBirra, 2011; Brink et al., 2011; Datamonitor, 2010a). The effects of the economic crisis have been felt since 2008 and have determined a 1.47% drop in production compared with the previous year, but the greatest drop was registered in 2010 when the differential with 2007 showed a loss of 6.21%. A slight sign of economic recovery was observed in 2011 with a positive variation of 0.33%, even though the 2011 production and per capita consumption are quite different from the values observed in the pre-crisis years.

For European governments, the beer industry is an important source of revenue from the application of VAT, workers' income tax and from tax paid by the production companies. In 2010 this income was approximately 50.6 billion euro, which was decidedly inferior to 2008, when the public income amounted to 54 billion euro.

Since 2008, a series of economic maneuvers have been introduced by various countries in the euro zone to modify increasing or decreasing of VAT rates. The average UE27 tax rate went from 19.4% in 2008 to 20.7% in 2011, even though tax levels are destined to rise because of additional maneuvers Member States must introduce to comply with constraints between balance and GDP deficit, as is the case with Italy where in all probability the rate will go from 21 to 22% by the end of September/December 2013 (AssoBirra, 2011; Brink et al., 2011; European Commission, 2013).

**Table 1.** U.S.A., Europe with 27 memberstates and Italy: production and consumption

Production (000 hl)	U.S.A.*	Variation	EU 27**	Variation	ITALY**	Variation
2007	230,618.00	-0.52%	409,353.00	0.11%	13,462	5.02%
2008	231,772.00	0.50%	403,327.00	-1.47%	13,343	-0.88%
2009	230,937.00	-0.36%	385,535.00	-4.41%	12,776	-4.25%
2010	228,982.00	-0.85%	383,914.00	-0.42%	12,814	0.30%
2011	225,337.00	-1.59%	385,179.00	0.33%	13,410	4.65%

Per capita consumption (litres)	U.S.A.*	Variation	EU 27**	Variation	ITALY**	Variation
2007	21.79	0.09%	80.30	1.52%	31.10	2.64%
2008	21.72	-0.35%	78.30	-2.49%	29.60	-4.82%
2009	21.08	-2.94%	74.80	-4.47%	28.00	-5.41%
2010	20.70	-1.78%	72.20	-3.48%	28.60	2.14%
2011	20.31	-1.92%	74.70	3.46%	29.00	1.40%

Source : our elaboration of AssoBirra\*\* and Beer Institute\* data (2012).

Production and consumption levels are countered by the increase in the number of beer factories, whose number grew by 18% in Europe between 2008 and 2010, encouraged by the opening of microbreweries and the changing tastes and preferences of consumers whose purchasing preferences are increasingly directed at quality beers and not only on-trade acquisitions (outside the home, in restaurants, in brewery, pubs, etc.) but above all in off-trade (through modern and/or traditional distribution) (AssoBirra, 2011). There have been no specific studies on market trends and purchasing motivation for craft beers in Europe, although Brink et al. (2011) estimate that over 70% of breweries within Europe are microbreweries producing high quality beers with special characteristics.

From the economic-income point of view the beer market makes an important contribution to the European Union through production and sales services. The sector provided work to over 2 million people in 2010, representing 1% of the Union workforce, even though there was a negative trend in 2009 with the loss of approximately 264,000 jobs compared with the previous year.

Per capita consumption of beer in Europe shows a decreasing trend; from 2007 to 2011 per capita consumption dropped by 7%, even though in 2011 consumption began to increase again (+3.46% compared to 2010). The country with the highest per capita consumption rate is the Czech Republic with 154 liters of beer, followed by Belgium with 145 liters, Ireland with 108.3 liters and Germany with 107.2 liters. Italy holds the last position in the per capita consumption classification (l. 29.0). Part of the drop in beer consumption in the entire European Union can certainly be due to the general increase in taxes, but without doubt is also due to increased VAT which impinges directly on the price paid by the consumer (AssoBirra, 2011). Given beer demand is elastic compared with its price and in the presence of low switching costs to alternative products like wine and spirits, the price increase has had direct consequences on the profitability of the entire chain, causing a loss of jobs, above all in the hospitality and retail sectors (European Commission, 2013; Rojas and Shi, 2011; Global Insight and The Parthenon Group, 2005).

Looking at some European countries in detail Germany, the country which traditionally has been the major producer, 24.43% of European production, even though there has been a drop of -0.1% since the previous year. In the United Kingdom there has been a 1.56% increase in production, compared with the European production level of 11.69%.

Italy has shown a production increase of 4.65%, placing it in ninth position in terms of market quota; however, the consumer approach in Italy is changing, paying more attention to quality and on-trade and off-trade consumption. In fact consumption increased in 2011 compared to 2010 in two top beer ranges, respectively by 4.4% for the specialty segment and 2.6% for the premium (AssoBirra, 2011). Today these two segments represent overall a market quota of 44%, quota within which it is possible to include the typicality and quality of craft beer which is becoming increasingly important in Italy. If one looks at the number of beer producing companies, the number increases from 266 in 2008 to 347 in 2011, the number of microbreweries is estimated to be 339 (Brink et al, 2011).

## *2.2 Comparative data: Europe vs U.S.A.*

European production has a position of leadership in the world market, second only to Chinese production (489 million hectoliters in 2011), while in the United States beer production reached a quota of approximately 225 million hectoliters in 2011, but the economic development is totally different from the European one (Beer Institute, 2013; AssoBirra, 2011).

Production and diffusion of this drink in the United States underwent a drastic interruption during the period of prohibition in 1919. Only in 1933 with the introduction of the XXI Amendment did beer production resume; while in 1976 with the legalization of home/domestic production introduced by President Jimmy Carter, small breweries and brew pubs were able to enter the market. Interest in craft beer and the perception of high quality was initially a strong point for the food and beverage markets, which subsequently became the only brewing segment to enjoy an increase in consumption that has since been consolidated.

Since 1999 the growth in the number of small beer producers has increased and consolidated compared with big commercial beer producers (Carroll and Swaminathan, 2000; Tremblay and Tremblay, 2005) until such a point that the widespread distribution of small breweries has overcome the advantages connected to the economies of scale of the big producers.

In the United States production is highly concentrated and connected to 23 big breweries and above all to custom distribution which has reached 2,751 breweries among brewpubs, microbreweries and regional craft breweries (Beer Institute, 2013).

Anyway the small market share of craft breweries is causing concern in big multinational companies because of the increased interest in specialty brews. This particular segment has high profitability since it is associated with the so-called “millennium generation”, that is to the high income consumer group between the ages of 21 and 30 (approximately 70 million consumers in the USA), interested in exploring new tastes in beer and willing to pay higher prices (Ascher, 2012).

Having outlined the economic situation of the beer sector and above all the development dynamics both at a production and consumption level, it would appear interesting to carefully examine consumer purchasing motivation to better understand the reason for their interest in craft beers.

### 3. FACTORS AFFECTING BEER CHOICE AND CONSUMPTION: A LITERATURE REVIEW

The study of the literature has enabled the underlining of critical success factors which directly affect beer consumption (see Table 2).

**Table 2.** Critical success factor for beer

Characteristics	Author
Quality	Ascher, 2012; AssoBirra, 2011; Brink et al., 2011; Donoghue et al., 2012; Jackson, 1988; Kim and Chintagunta, 2012; Kleban and Nickerson, 2012.
Differentiation	Ascher 2012; AssoBirra, 2011; Clemons et al., 2006; Datamonitor, 2010a, b; Dawes, J. (2008); Eckert, A. E. and Douglas, W., 2013; Douglas and O'Neill, 2012; Nelson, 2005; Tremblay and Tremblay, 2005; Wilcox, G.B., 2001; Woodside, A. G., 1972; Woodside, A. G. and Bearden, W.O., 1977.
Price / Taxation	AssoBirra, 2011; Brink et al., 2011; Datamonitor, 2011; European Commission, 2013; Global Insight and The Parthenon Group, 2005; Kleban and Nickerson, 2012;

Characteristics	Author
	Rojas and Shi, 2011.
Craft	Carroll and Swaminathan, 2000; Clemons et al., 2006; Datamonitor, 2010a, b; Datamonitor, 2011; Douglas and O'Neill, 2012; Kleban and Nickerson, 2012; Woolverton and Parcell, 2001.
Taste	Allison and Uhl, 1964; AssoBirra, 2011; Choi and Stack, 2005; Datamonitor, 2010a; Datamonitor, 2011; Kleban and Nickerson, 2012; Tremblay et al, 2005.
Sustainability	Benson-Armer R. et al., 1999; Choi and Stack, 2005; Datamonitor, 2011; Donoghue et al., 2012; Koroneos et al., 2005; Moyaux and Baboli, 2010.
Packaging	Donoghue et al., 2012; Koroneos et al., 2005.
Buying behavior	AssoBirra, 2011; Brink et al., 2011.
Naturalness, Agreeableness Lightness	AssoBirra, 2011.

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Source: our processing.

The aspects which occur most frequently and are present in most studies are quality, differentiation and price.

Quality has been studied in literature under different aspects; Ascher (2012), Brink et al. (2011), Donoghue et al. (2012), Kim and Chintagunta (2012), Kleban and Nickerson (2012) study quality in function of the characteristics of the primary materials used, malted barley, hops, yeast and water and of the special ingredients added to the product to create different

styles and flavors, Jackson (1988) uses a different approach and studies quality in relation to the control of the production process and of the high standard of production used in the sector, while others focus their attention on quality perceived by the consumer who chooses the product based on brand preference and consumption habits (AssoBirra, 2011; Kim and Chintagunta, 2012).

The second factor, differentiation, refers to the diverse varieties of beer, like ales, stouts, low/no alcohol, standard, premium, specialty beer and the brands to which they can be traced. Clemons et al. (2006) and Ascher (2012) analyze differentiation regarding the concentration and consolidation of the main brand properties over time. Other authors instead analyze the effects that differentiation has on brand preference, in relation to all the choice mechanisms which come into play in different consumption situations and which so determine consumer behavior and brand switching (Eckert, A. E. and Douglas, W., 2013; Douglas and O'Neill, 2012; Nelson, 2005;).

Price is one of the main elements of many analyses because it can seriously affect the choice of the beer consumer, not only because it is influenced by a wide flexibility of demand but also because it reflects the value the consumer gives to the product (Datamonitor, 2011; Ascher, 2012). Research into the changes in consumer preferences following price variation due to increased taxation, as well as the effect such price modifications have on the quality of the product carried out by Rojas and Shi (2011) is relevant here.

The above concepts have undergone a radical revision in recent years whilst still remaining the key factors which influence and condition consumer choice.

The consumption of craft beer and attention to taste which were previously insignificant have become new important characteristics in determining consumer behavior.

Craft beers use traditional styles combined with their own unique formulas by adding non-traditional ingredients.

There are a series of contributions which analyze different aspects of this new segment of the beer market. Kleban and Nickerson (2012) for example, have studied the competitive forces of craft beer connected to increased characteristics of the product, product consistency, freshness, social responsibility, for customer satisfaction.

Clemons et al., (2006) on the other hand analyze the force of hyperdifferentiation in the craft beer industry and the value of resonance marketing for the positioning strategy.

The other factor present in literature is taste perception and its influence on consumer preference (Allison and Uhl, 1964; AssoBirra, 2011; Choi and Stack, 2005) and how the product differs from the high economic perception connected to craft products, which generates a “taste revolution” (Kleban and Nickerson, 2012). To date the elements which seem to motivate consumer choice in beer seem to be firmly connected to the discovery of taste, the search for quality and the product craftsmanship. Growing attention towards this form of consumption is modifying the habits and purchasing behavior, favoring off-trade consumption compared to places traditionally connected to consumption habits like brewpubs, restaurants, etc.

An exploratory study to empirically verify the changes in consumer preferences and identify the relevant factors which encourage traditional beer consumers to change to craft beers has thus been conducted using the following methodology.

## **4. METHODOLOGY**

### *4.1 Research design and data collection*

With the aim of evaluating the popularity and level of consumption of craft beer, as well as understand the differences (if any) in consumer perceptions and habits of this type of beer compared to traditional beer consumers, a sample survey was drawn up and carried out. Data were collected in July 2012 by means of standardized personal interviews. On the basis of a judgmental sampling design, a total of 444 individuals of a minimum age of 18 were selected at random among people participating in a cultural literary festival in the city of Viterbo (Italy). The respondents were asked to complete a questionnaire regarding their habits, attitudes and behaviour towards drinking traditional and craft beers.

### *4.2 The questionnaire*

The questionnaire was composed of 24 questions divided into two sections. The first section focused on traditional beer consumption.

The first set of questions in this section referred to consumer preferences concerning *i)* favourite beer colour beer and packaging *ii)* frequency with which beer is consumed *iii)* where they drink it and *iv)* with whom.

The second set of questions referred to the moment of purchase of the beer, requiring a judgement of importance (on a numeric scale from 1 to 6 where 1 was the lowest level of importance and 6 the maximum) concerning various characteristics of the beers (aroma, froth, fizziness, quality, etc...) as well as the factors that influence the purchase (brand, price, availability in stores, etc...).

The second section of the questionnaire focused on craft beer. Participants were asked about the same aspects (presented in Section 1) referring to craft beer, in order to carry out a comparison between the two types of beer consumers.

Lastly, the questionnaire included questions concerning personal socio-demographic information such as gender, age, residence and professional status.

#### *4.3 Identifying craft beer consumers: a comparative analysis and a segmentation approach*

The information gathered enabled us to perform two different types of analyses, whose results will be discussed in the following section. Firstly, through the identification of the profile of both traditional and craft beer consumers we carried out a comparative analysis both from a socio-demographic standpoint and according to consumer attitudes and habits. Secondly, by focusing on the sample of consumers, we were able to identify factors that can enhance a switching attitude of traditional consumers towards craft beer. On the basis of a segmentation approach, we considered the binary variable indicating whether the respondents consume craft beer or not as the dependent variable of a probit regression model which can be described as:

$$y_i = \mathbf{x}_i' \boldsymbol{\beta} + \varepsilon_i \quad (1)$$

where  $y_i$  is the dependent variable indicating whether the craft beer was consumed ( $y_i=1$ ) or not ( $y_i=0$ ) by the  $i$ -th respondent.  $x_i$  is a  $k$ -dimensional vector of exogenous variables representing the respondents' personal characteristics and factors related to habits and consumption towards traditional beer.  $\beta$  is the vector of parameters to be estimated and  $\varepsilon_i$  is the error term.

The estimation results, obtained by using STATA software, are presented referring to marginal effects (MEs) showing how a one unit change in one of the explicative variables affects the predicted probabilities, leaving the other variables constant at their mean value (Greene, 2012). It is worth noting that for dummy independent variables the ME was calculated as a discrete change (from 0 to 1) holding other variables constant (Long and Freese, 2006).

## 5. FINDINGS

### 5.1 *Who are the consumers of traditional beer and what are their habits and preferences?*

About 76% of participants declared they generally drink beer (337 respondents out of 444 participants). As shown in Table 3, about 6 out of 10 beer consumers were male. Moreover, over 60% were aged between 18 and 33.

**Table 3.** Socio-demographic characteristics of beer consumers

Variable	%
<i>Gender</i>	
Female	41.05
Male	58.95
<i>Age</i>	
18-25	38.27
26-33	26.54
34-41	15.74
42-49	12.04
50+	7.41
<i>Professional status</i>	
Employee	36.80
Self-employed	18.69
Searching for a job	7.12

Variable	%
Housewives	5.04
Retired (Pensioners)	2.67
Students	25.52
Professional status not declared	4.15

Concerning the moment of purchase, the participants were asked to indicate how much importance was given to the aspects reported in Table 4.

**Table 4.** Factors influencing the purchase of traditional beer

Factor	Mean	Standard Deviation (SD)
Brand	4.10	1.62
Price	3.61	1.73
Availability in bars, restaurants, etc...	3.55	1.70
Availability in stores	3.50	1.62
Packaging	2.66	1.60

Brand is the most important factor influencing purchase (average value 4.10), followed by price (average value 3.61).

**Table 5.** Importance of the various characteristics of traditional beer

Characteristics of the beer	Mean	SD
Quality	4.61	1.54
Aroma	4.52	1.53
Fizziness	3.85	1.58
Alcoholic grade	3.72	1.62
Colour	3.54	1.58
Froth	3.46	1.62
Organic raw materials	3.32	1.79
Calories	2.77	1.71

Quality plays the most important role when choosing a beer, followed by aroma and grade of fizziness (Table 5). Given the importance of price and quality when choosing a beer, we distinguished consumers according to the degree of importance they attributed to quality, and whether the different levels of importance given to quality also corresponded to those of price. We found that the higher the importance given to quality, the lower the importance given to price. For example, consumers who gave little importance (equal to 2) to quality expressed average importance to price equal to 4.71 while consumers who gave a lot of importance to quality (equal to 6) expressed average importance to price equal to 3.84. An ANOVA (Analysis of Variance) test was applied to evaluate the significance of the differences among the groups. The obtained F statistics enabled us to strongly reject the null hypothesis of equal means between the different groups ( $F$ -statistic=6.26 ( $p$ value: 0.000)).

Concerning the type of beer preferred, about 57 consumers out of 100 declared that they prefer light (lager) beer. Amber-coloured beer was preferred by about 18% of consumers while few participants preferred dark and red beer.

A high percentage of consumers prefer to drink draft beer (49%) and bottled beer (43.4%) while only a small percentage of consumers declared they preferred canned beer.

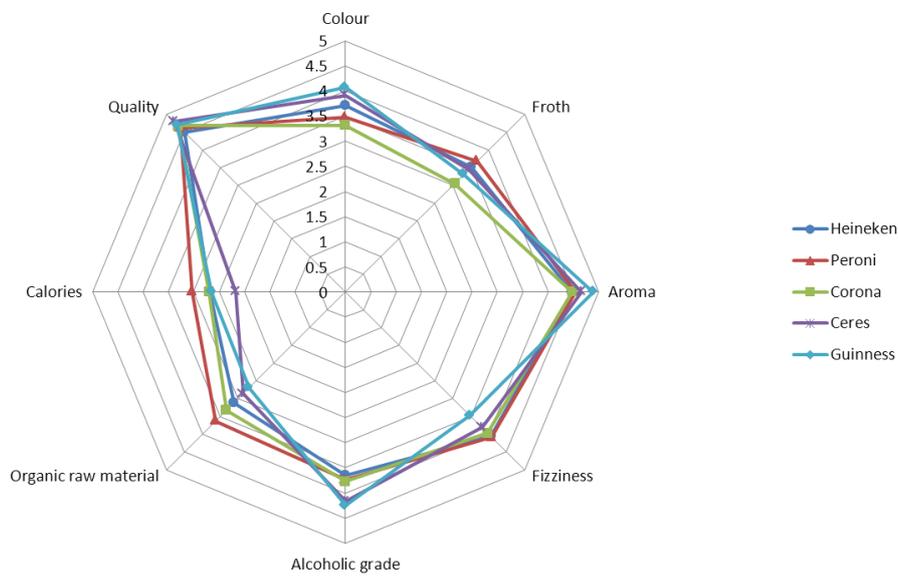
Participants were also asked which brands they purchased regularly and about a third mainly consumed Heineken beer. One participant out of five preferred Peroni beer followed by Corona, Ceres and Guinness. The consumers who consider themselves beer experts are those whose declared consumption was Tennent's and Tuborg, as shown in Table 6, whilst, the less knowledgeable consumers are Corona drinkers.

**Table 6.** Preferred brand of traditional beer and consumers' self-evaluation as beer experts

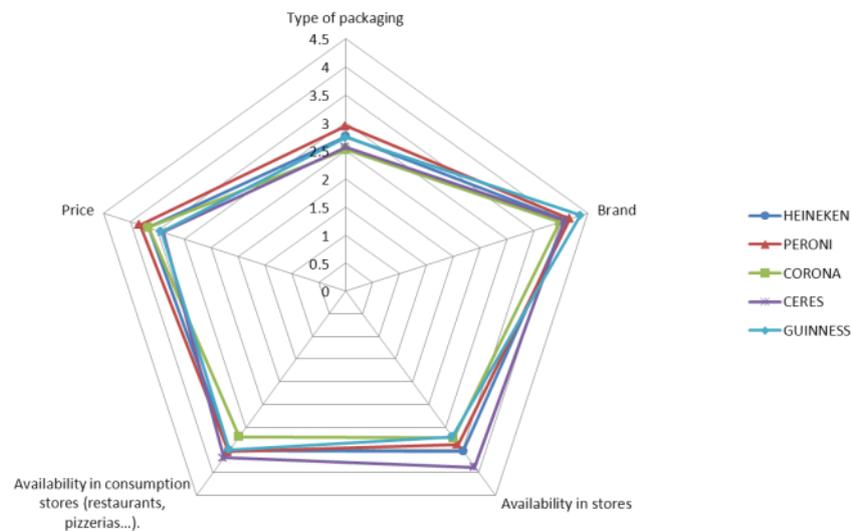
Brand of beer	%	Self-evaluation of the consumers as beer experts (scale 1-6)
Heineken	32.64	3.26
Peroni	19.88	3.27
Corona	18.10	2.72
Ceres	13.95	3.23
Guinness	13.06	2.80
Nastro azzurro	12.76	2.91
Beck's	12.46	3.21
Moretti	12.46	3.10
Budweiser	9.50	3.22
Tuborg	7.42	3.60
Tennent's	7.12	3.75
Foster's	4.15	3.36
Carlsberg	3.86	3.23

*Notes: Percentages do not sum to 100 because respondents can choose more than one beer brand.*

Figure 1 shows the distribution of the average values of importance relative to the characteristics of the favourite five beer brands.

**Figure 1.** Importance of the various characteristics for the favourite five brands

Heineken drinkers give more importance to the amount of fizziness compared to the other four brands. Peroni drinkers also give a lot of importance to the fizziness and presence of froth. The most exigent consumers in terms of alcoholic level, taste, colour and quality are Guinness drinkers.

**Figure 2.** Factors influencing the purchase of the five most favourite brands

Consumers who choose Peroni beer give more importance to price, brand popularity and packaging when purchasing beer and therefore it seems that they seek product which lies within their shopping budget and whose brand and packaging are well-known (Figure 2).

Those who purchase Ceres are less influenced by price, but are very influenced by brand availability in traditional stores as well as restaurants, pizzerias and pubs.

In terms of distribution channels, an aspect already found in literature (Assobirra, 2011) and confirmed by our sample survey is the remarkable proportion of beer consumption that takes place off-trade. In fact, about 25% of respondents declared they generally drink beer at home while pubs, pizzerias and bars are respectively the favourite places of consumption outside the home (on-trade).

Regarding the occasions of beer consumption, respondents declared that beer is mainly drunk at parties (45.99%) and at home with meals (33.53%). Over 70% of respondents stated they usually drink beer at least once a week, 12% once a month and 18% only on special occasions. The existence of a relationship between the frequency of consumption and

importance given to price was investigated by the ANOVA test (Table 7) indicating there are no significant differences among the mean values of the different groups.

**Table 7.** Frequency with which traditional beer is consumed and importance given to price

Frequency of beer consumption	%	Average Importance given to price
Everyday	11.41	3.50
Five/six times a week	9.91	3.69
Three/four times a week	19.22	3.48
Once/twice a week	30.03	3.54
Once a month	11.71	3.89
Only on special occasions	17.72	3.69
Total	100.00	3.70

Notes: ANOVA test: F-statistic=0.37 (pvalue: 0.87) Bartlett's test for equal variances:  $\chi^2 (5) = 3.9398$  Prob> $\chi^2 = 0.558$

Regarding the social aspect of beer consumption, beer is considered a beverage which is mainly consumed in a social context: “drinking beer with friends” seems to be the slogan for about 70% of the respondents followed by the partner (equal to 20% of the respondents) and lastly drinking beer in the family and alone.

### 5.2 Who are the consumers of craft beer and what are their habits and preferences?

About 79% of traditional beer drinkers stated they have drunk craft beer at least once. Moreover, those who declared themselves craft beer drinkers are those who on average considered themselves expert beer drinkers (average value equal to 3.2 versus 2.6 for those who have never drunk craft beer).

As shown in Table 8, no significant differences were found from a socio-demographic point of view between craft and traditional beer drinkers

**Table 8.** Socio-demographic characteristics of craft beer consumers

	%
<i>Gender</i>	
Female	39.68
Male	60.32
<i>Age</i>	
18-25	37.15
26-33	28.06
34-41	15.81
42-49	13.44
50+	5.53
<i>Professional status</i>	
Employee	38.40
Self-employed	19.39
Searching for a job	7.98
Housewives	3.04
Retired (pensioners)	2.28
Students	24.71
Professional status not declared	4.18

The most important factor influencing the choice of craft beer is the availability of this product in bars, restaurants and pizzerias (average value 3.78).

**Table 9.** Factors influencing the purchase of craft beer

Factors	Mean	SD
Availability in bars, restaurants and pizzerias	3.78	1.59
Price	3.47	1.69
Availability in stores	3.43	1.56
Brand	3.34	1.65
Packaging	2.59	1.61

As Table 10 shows, the characteristic of the craft beers deemed to be most important is quality followed by aroma.

**Table 10.** Importance given to the various characteristics of craft beer

Characteristics	Mean	SD
Quality	4.72	1.58
Aroma	4.52	1.53
Colour	3.92	1.79
Fizziness	3.91	1.65
Organic raw material	3.87	1.82
Alcoholic grade	3.86	1.53
Froth	3.77	1.60
Calories	2.87	1.70

Lager is also the favourite type of craft beer (46% of the respondents), followed by amber-coloured beer (27.38%), dark and lastly red beer.

Craft beer is mainly consumed in pubs (60% of the respondents) while home consumption is less frequent (15.21%) than traditional beer consumption. The profile of the people with which craft beer consumption is preferable is similar to that for traditional beer drinkers, a large percentage prefer to drink it with friends (69.58%) followed by in company of the partner (18.63%) and the family (11.41%).

The main difference between craft beer drinkers and traditional beer drinkers is the frequency of consumption. In fact, about 45% of craft beer drinkers declared they only drink this type of beer on special occasions (Table 11). This percentage is about three times higher than that of traditional beer drinkers.

**Table 11.** Frequency with which craft beer is consumed and importance given to price

Frequency of craft beer consumption	%	Average importance given to price
Everyday	10.12	3.28
Five/six times a week	4.67	3.42
Three/four times a week	7.78	3.10
Once/twice a week	16.73	2.93
Once a month	14.79	3.61
Only on special occasions	45.91	3.74
<i>Total</i>	<i>100.00</i>	<i>3.47</i>

Notes: ANOVA test: F-statistics=1.73 (p-value 0.1288); Bartlett's test for equal variances:  $\chi^2(5)=5.4161 - \text{Prob}>\chi^2=0.367$

Regarding craft beer, we found that the average level of importance given to price is not significantly different according to the frequency of consumption. This result strongly confirms that price does not represent a limit concerning the frequency of consumption of

craft beer which is believed to be a quality product for which consumers are willing to pay a higher price.

### 5.3 A segmentation analysis: probit estimation results

Bearing in mind the third research question of our paper, Table 12 shows the estimation results of the probit model specified by [1].

**Table 12.** Probit model for the probability of becoming a craft beer consumer

Variable	M.E.	Std. Err.	Sign.
<i>Characteristics of (traditional) beer</i>			
Aroma	0.032	0.017	*
Quality	0.042	0.018	**
Organic Product	0.007	0.015	
Alcoholic grade	-0.014	0.015	
<i>Type of packaging (ref: draft beer)</i>			
Bottled	-0.162	0.052	***
Canned	-0.174	0.133	
<i>Habits towards (traditional) beer consumption</i>			
<i>Frequency of consumption (ref: at least once a week)</i>			
Once a month	-0.157	0.077	*
Only on special occasions	-0.262	0.127	**
<i>People with which beer is consumed:</i>			
Family-partner	0.009	0.061	
Alone	0.173	0.039	**
Friend-colleagues	0.077	0.087	
<i>Occasions:</i>			
Free time	-0.025	0.071	

Variable	M.E.	Std. Err.	Sign.
Meals	-0.065	0.077	
<i>Socio-economic characteristics</i>			
Gender	0.022	0.051	
<i>Age (ref. 18-25)</i>			
26-33	0.09	0.057	
34-41	0.065	0.066	
42-49	0.129	0.053	*
50+	-0.23	0.163	*
<i>Professional status (ref. salaried employed)</i>			
Self-employed	0.002	0.070	
Searching for a job	0.123	0.053	
Housewives	-0.304	0.160	**
Retired (pensioners)	0.111	0.071	
Students	0.02	0.070	
Professional status not specified	0.092	0.101	

NOTES: \* Significant at the 10% level. \*\*Significant at the 5% level \*\*\* Significant at the 1% level.

[LR Test:  $\chi^2(24) = 67.52$  \*\*\*; Pseudo Adjus.R<sup>2</sup>: 0.2632; Hosmer-Lemeshow *Goodness-of-Fit Test*: HL  $\chi^2(8) = 7.53$  Prob>  $\chi^2 = 0.4807$ ]

People aged between 42 and 49 are more likely to drink craft beer while people aged 50 or over are less likely to drink it, compared to young people aged between 18-25. Housewives are also less likely to drink craft beer.

Giving more importance to the quality and aroma when purchasing traditional beer means having a higher probability of switching to craft beer. This result also shows that people are more inclined to switch to craft beer when they pay attention to the whole production process.

People who prefer drinking traditional bottled-beer have a lower probability of switching to craft beer, compared to people who prefer traditional draft beer.

In a different specification of the probit model we also introduced the various brands of beer as explicative variables: however none of the brands considered has a significant effect on the likelihood of becoming craft beer consumers.

The frequency of consumption plays a fundamental role in determining the probability of consuming craft beer: in fact it is interesting to note that those who consume traditional beer less frequently have a lower probability of consuming craft beer. This probably means that those who drink craft beer are not occasional beer drinkers but habitual drinkers and thus experts of taste.

Finally, people who drink traditional beer alone are more likely to switch to craft beer: this stresses the fact that craft beer is deemed to be a quality product which one drinks for enjoyment and not just for social drinking.

## 6. CONCLUSION

Two main contributions distinguish this paper.

Firstly, a benchmark between profiles, habits and preferences of traditional and craft beer consumers, highlighting that craft beer drinkers are distinguishable from traditional beer consumers not for socio-demographic characteristics but rather for their different views concerning beer production and their consumption habits and frequency.

Secondly, factors which could perhaps enhance a switching attitude between traditional and craft beer consumption. We found that craft beer consumers pay great attention to quality, production process and aroma, but also frequency of consumption becomes a crucial element favouring the switch from traditional to craft beer.

From a managerial point of view this paper helps, on one hand, new firms in the craft beer segment to clearly identify which factors are considered the most important in beer choice and purchase and highlights which distribution channels could eventually be preferred by consumers who consider themselves experts and so more easily choose a craft beer. On the other hand, this paper explains in some way, why beer drinkers who consider quality important and not price so crucial prefer top of the range traditional beers or switch to

craft beers if they have this choice, helping managers of established firms in better supporting their products, eventually partially changing their characteristics or communication and distribution features and choices, in order to meet consumers changing desires, expectations and preferences.

Some limitation of this study can be found in the non-probabilistic sample used, but also in the number of interviews conducted, and in the restricted area in which they were carried out.

Further research could be represented by a national study in Italy, or a benchmarking study in different European countries to identify consumer profiles and differences and eventually map this growing trend in craft beer production and consumption in Europe to better understand its characteristics and future developments.

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# ROLE OF TAXATION IN INVESTMENTS ALLOCATION DECISIONS: USING A GRAVITY APPROACH FOR EXPLORING BILATERAL FDI INTO THE EU

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## ABSTRACT

The article analyses the impact of taxation on the FDI flow to European Union countries using a gravity approach. The aim of the research is to examine the applicability of the gravity model to FDI between EU countries and their main investor partners and measure the importance of tax variables to bilateral flows. We found a negative relationship between the tax burden and the amount of FDI for EU countries over the period from 1998 to 2011. The variable of double taxation treaty is nonsignificant; therefore, the treaty does not affect EU FDI. The results provide strong evidence of the importance of corporate taxation and total tax burden for inward FDI in EU countries.

**Keywords:** gravity model, foreign direct investments, corporate tax, European Union countries

## 1. INTRODUCTION

The study contributes to the discussion about the fundamental role of gravitation force in the financial flows into EU countries and the importance of taxation in these flows. Inward foreign direct investments (FDI) to EU economies have included considerable flows from the EU countries, mainly from the United Kingdom, the Netherlands, Germany and Luxembourg, and from third countries, mainly from the United States. The European Union has become one of the most important economic regions due to its favourable location, high economic development and high level of economic freedom, including free

movement of capital, goods and labour. The relation between foreign investment flows and economic, social, political and other factors has been an object of interest of economists for many years. The literature on FDI emphasizes the impact of tax treaties, investment and free trade agreements. The general purpose of these treaties and agreements is to ensure that the investments will be promoted and protected and that the profit earned will be exempted from double taxation. However, the actual effect of tax treaties on FDI flows is questionable. As the effect of low tax rate policy, which may enhance, stimulate or damage investments, is examined in numerous studies, we investigate the relationship between inward FDI and EU taxation because these announcements may influence FDI flows into the EU countries both from other EU economies and from third countries.

However, the investment decisions mainly depend on the perspectives of the host country's economy, its openness, degree of growth, institutional quality and many other political, economic and social factors. The differences in economic conditions, political climate and legislation of countries have a significant impact on the decision-making process concerning the allocation of investments. For example, let us have a look at the neighbouring EU countries the Republic of Lithuania and the Republic of Poland, which have almost the same geographical advantages, but different economic conditions. From the point of view of economic geography, their position is very good: the Russian Federation is on one side and old Europe on the other. This has enhanced economic growth in both countries. At the same time, Poland has more natural resources and a cheaper labour force. Lithuania has more qualified specialists and from the perspective of tax policy, allocation of capital into Lithuanian companies is more beneficial because the income tax rate is lower. Hence, the Lithuanian government competes with Poland by offering lower tax rates instead of natural resources. The dilemma is how much the flows are influenced by the level and mechanism of taxation. The single European market offers companies located in any EU country the opportunity to relocate production to countries with lower tax rates. Moreover, the regulations concerning corporate taxation, which are different in EU countries, may be observed as a potential advantage because the regulations concerning indirect taxation are harmonized in the EU countries. Third countries' investors may be interested in investing in a EU country and relocating the production from third countries because this provides the opportunity to avoid customs duties on goods imported to the EU. Moreover, the possibility of deducting expenses, especially payable taxes as part of corporate income, may be viewed as a potential

preference of a particular host country because the customs union<sup>29</sup> provides identical rules for all EU countries in matters concerning tariffs and customs duties. Therefore, besides various types of taxation policy that may affect investors the particular object of our interest is corporate taxation because of its variations in EU countries.

The concept of the gravitation force has been used by economists to explain the volume of trade, capital flows and migration issues. The gravity model was introduced in 1962 by Tinbergen (1962), who showed the importance of the gravitation force in trade theory. The first authors who applied the gravity equation to FDI flows were Brainard (1997) and Frenkel et al. (2004).

During the last decade the gravity model has been widely used in empirical researches concerning changes in foreign investments flows in order to find the main factors influencing bilateral FDI (Stone and Jeon, 1999; Buch et al., 2003; Kumar and Zajc, 2003; Bevan and Estring, 2004; Roberto, 2004; Portes and Rey, 2005). In addition to the standard variables used in the gravity model, such as the GDPs of the host and investor countries and geographical distance between the two countries, economists are interested in the independent variables that affect the FDI. Substantial changes in legal systems and tax competition between countries are also objects of remarkable studies and have been widely discussed and developed (Egger and Pfaffermayr, 2004; Milner et al., 2004).

The aim of the paper is to check the applicability of the gravity model to foreign direct investments between EU countries and their main investor partners and to evaluate the importance of corporate taxation and tax treaty for the investment allocation decisions in EU countries.

In section two we review the existing theoretical and empirical literature and draw some conclusions about how to use the gravity approach. In section three we describe the data set, explain the empirical examination and present the main results of the estimations. Section four is dedicated to the robustness test. The last section presents conclusions.

## 2. THEORETICAL CONSIDERATIONS

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<sup>29</sup> EU countries form a customs union, whose regulations are harmonized according to the Customs Code.

According to the classical gravity model, which will be the base for our theoretical approach, the gravity force ( $GF_{ij}$ ) between two objects  $i$  and  $j$  is expressed as the proportion of their respective masses  $M_i$  and  $M_j$  to the distance  $D_{ij}$  between these objects. In terms of natural logarithms the gravity model is expressed as:

$$\ln GF_{ij} = \ln M_i + \ln M_j - \ln D_{ij} + \varepsilon_{ij} \quad (1)$$

Gravity theory has been used for describing social phenomena in population migration, tourist travel, trade and information flows and traffic movements. The gravity model has been broadly used for the estimation of FDI. During the last decade economists<sup>30</sup> have paid great attention to the flows from Japan and China, to the flows between NAFTA countries, between China and Europe and between Central and Eastern European countries as well as to China and Asian countries and to the countries in transition.

According to the model, the investment flows from one country to another are explained by the economic development of the countries, their market size, direct geographical distances between the investor and host countries and other variables determining common economic development. In case of the capital flow from country  $i$  to country  $j$ , Equation 1 of the gravity model changes into:

$$\ln FDI_{ij} = \alpha + \beta_1 \ln GDP_i + \beta_2 \ln GDP_j + \beta_3 \ln D_{ij} + \varepsilon_{ij} \quad (2)$$

The gross domestic product ( $GDP$ ) of the countries is expressed as the mass and the geographical distance ( $D$ ), which is a factor that indicates transportation costs, cultural differences and historical relationships between the countries, is expressed as the distance between the two objects in accordance to the classical gravity model.

Similarly to the formulation applied by Frenkel (1997), the flow of capital is estimated as a function of countries' population, income per capital and distance. This approach was used by Choi (2003) in the estimation of FDI flows specified as:

$$\ln FDI_{ij} = \alpha + \beta_1 \ln POP_i + \beta_2 \ln POP_j + \beta_3 \ln GDP_i + \beta_4 \ln GDP_j + \beta_5 \ln D_{ij} + \varepsilon_{ij} \quad (3)$$

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<sup>30</sup> Cieřlik and Ryan (2004), Roger and Noel (2004), Keiko and Kyoji (2005), Demekas et al. (2007), Raymend (2007), Hidemi and Yasuyuki (2010), Resmini and Siedschlag (2013), Tatsui (2013)

In recent years special attention was paid to effective corporate tax rates (Mutti and Grubert, 2004) and corporate taxation policy (Folfas, 2011). Using the gravity approach Folfas (2011) focused on tax differences between host and investor countries. One problem that such approach does not take into consideration is the taxation differences between host countries that describe tax competition. Still Mutti and Grubert (2004) concentrated on differences in taxation in host countries. However earlier research generally indicates that host country taxes play a greater role (Hines, 1997).

As for taxation, we look at the tax burden in host countries. According to Root and Ahmed (1979), taxes do not have a significant effect on FDI. Contrary to them Swenson (1994) reports a positive effect of taxation on foreign investments. Considering the suggestion that higher taxes reduce investment a negative effect of a high tax burden on FDI is expected. The expectation will be investigated by the empirical evidence for EU countries. Similarly to the previous research (Raudonen and Freytag, 2013), this analysis cannot be used to distinguish pull effects from push effects, i.e. we are not able to give evidence of whether EU countries attract foreign capital because they have so attractive tax regimes or because the investor countries deter investment and drive capital out of their countries because their location is rather unattractive. In the course of our analysis we assume that pull effects dominate the decisions on average and do not consider this distinction further; our assumption is connected with the manifold motives of FDI and the rather small size of the EU countries.

Based on the theoretical considerations and the existing empirical research, we test the hypothesis that the bilateral FDI flows of EU countries are influenced by preferences conditioned by tax policy. Bearing in mind the formulated aim and the gravity approach, the following hypotheses will be tested:

1) Incentives and low tax rates influence the level of FDI flows positively. The European Union has harmonized tax policy in the field of indirect taxation and the member states have independent tax policy in the field of corporate taxation. According to the results of the European Commission's study (Ruding Committee, 1992) and Paying Taxes Report (World Bank, 2011) concerning the convergence of corporate taxes in the European community and tax burdens, the taxation aspects are important in the allocation and profit repatriation decisions.

2) Increasing the FDI inflow into the EU depends on the investor country. The signing of the Convention for Avoidance of Double Taxation between the investor country and the host country affects positively the FDI inflows into the EU countries.

3) The size and level of growth of an investor country's economy affect the FDI flow to the country. A country with a high GDP is preferable as a partner country in the investment into the EU economy to a country with a small economy. Long distances between the investor and host countries impact FDI negatively due to high transportation costs, differences in culture, lack of information concerning local market and other factors.

Several studies show that investors are sensitive to tax rates. The study conducted by Bénassy-Quéré et al. (2000), which also applied the gravity approach, shows that the size of the country has a major impact on the share of investments because larger states have a greater economic potential. The influence of taxation on FDI with the focus on the impact of corporate tax variables was examined by Bénassy-Quéré et al. (2005), who found a negative relationship between the taxation burden and FDI flows to OECD countries. Similarly, Boskin and Gale (1987), Grubert and Mutti (1991), Hartman (1994) and Hines and Rice (1994) found that a high corporate income tax rate has a significant negative effect on attracting FDI flows.

As a consequence of the theoretical thoughts and in relation to the set hypotheses the suggested gravity equation is as follows:

$$\ln FDI_{ijt} = \alpha + \beta_1 \ln GDP_{it} + \beta_2 \ln GDP_{jt} + \beta_3 \ln D_{ij} + \beta_4 TAX_{jt} + \mu_{ij} + \lambda_t + u_{ijt} \quad (4)$$

Tax variables in our equation include those variables linked with taxation aspects in the host country, in particular corporate income tax rate, tax burden and tax treaty.

In our model the distance that is one fundamental variable for the gravity model does not change over time. We used the Hausmann-Taylor (1981) estimation method for solving the problem for the data concerning time-invariant variables. According to this method, a few of the variables can be endogenous in the sense of correlation with individual effects but still be exogenous with respect to the error term as it was done in the study of Czarny et al. (2010). This approach allows us for the use of both time-varying and time-invariant variables.

### 3. MODELLING BILATERAL FDI FLOWS OF EU COUNTRIES

#### 3.1. Data set

FDI flows of EU countries are coming mainly from developed economies, mostly from the United States and the European Union countries (UNCTAD, 2011). According to the World Investment Report 2012, the index measuring FDI potential includes market attractiveness, availability of low-cost labour, presence of natural resources and infrastructure. Therefore, the prospective spending power and the growth potential of the market are expected to be important factors for attracting FDI. Policy measures such as corporate taxation changes, concluded double-taxation treaty and cultural proximity between the investor countries and the host region may be important determinants of FDI.

The empirical part testing the taxation variables of FDI is based on a panel of bilateral inward FDI flows of EU countries. We use data on FDI flows from 40 economies to 27 recipient economies from 1998 to 2011. Each observation point determines a FDI flow in euros between an investor country  $i$ , i.e., EU-27 and other selected countries, and host country  $j$ . In our sample the host countries are EU countries. The selected investor countries are the major suppliers of the FDI flows (see Table 1 of Annex). This group accounted for more than 90 per cent of the FDI inflows to the EU during the time span covered. Figure 1 of Annex provides a regional breakdown of EU FDI, by the reporting countries for which data are available. The data show that in 2011 the United States, Germany, the United Kingdom, the Netherlands and Luxembourg made almost 60 per cent of the EU FDI. In contrast, Ukraine with its share of less than 0.01 per cent in the EU FDI has been relatively unimportant for the European Union.

Literature supports the use of the following variables to explore bilateral FDI: country size, economic potential of the country, distance factor and tax determinants. The choice of the method measuring country size usually raises many questions and economists are widely discussing this (Paas, 2002; Folfas, 2011). Many economists use GDP as the variable of economic size of host and investor countries (Buch et al., 2003; MacDermott, 2007; Hidemi, 2010). Some prefer to measure country size by population (Portes and Rey, 1999; Choi, 2002).

Initially we use GDP to represent market size because we assume that a larger host country has a greater potential for attracting FDI. The coefficient of the market size variable is expected to be positive. The positive sign is also expected for the estimated investor market size. Similarly to Egger et al. (2008) we use real GDP in euros. The distance between the host and the investor country is expected to be important in bilateral FDI flows. Longer distance reduces FDI due to high transportation costs, discrepancy in culture, lack of information

concerning local legislation and investor climate and other factors. This variable is thus expected to have a negative relationship with FDI.

In accordance with Choi (2003), we expect a negative coefficient of tax rate variable. However, in contrast to Porcano and Price (1996) but in line with our reasoning in Introduction and Paying Taxes study (World Bank, 2012), the total tax rate was additionally included to the model. Central government corporate income tax rate as the basic central government statutory corporate income tax rate is expected to have a negative relationship with the FDI. Tax burden measured as percentage of all taxes to the commercial profit of a company is also expected to have a negative relationship with foreign investments. Comparison of the total tax rates in EU economies shows that the average is 28.3 per cent of the commercial profit, the lowest total tax rate, 20.8 per cent, is in Luxembourg and the highest rate, 68.5 per cent, is in Italy. The larger burden causes damage to the companies and affects negatively investor location decisions.

Using the data set, we estimate the impact of the Double Taxation Treaty on bilateral inward FDI. Moreover we investigate whether signing the Double Taxation Treaty affect FDI. We use a dummy variable to explore the significance of the treaty (see Table 1 of Annex). In accordance with Barthel et al. (2009), Double Taxation Treaties are expected to affect bilateral foreign investments positively. Politicians' main goal in concluding a Double Taxation Treaty with a partner country is to ensure investors that double taxation shall be avoided. Table 1 gives an overview of the expected signs of variables.

Table 1. Expected signs of variables

Variable	Expected sign
Corporate income tax rate	-
Total tax rate	-
Double taxation treaty	+
Gross Domestic Product	+
GDP growth	+
Distance	-

Data on bilateral flows of FDI were obtained from the database of the Eurostat. Data concerning taxation were extracted from the World Bank database. Data on GDP came from the Eurostat and UNCTAD statistical databases, corporate income tax rates mainly from the

OECD database and other variables from the database of the World Bank. Table 1 of Annex provides the descriptive statistics of all variables used in the empirical analysis.

Among the FDI data extracted from the Eurostat numerous values are missing. According to the sample the number of observations reduced to 11 881 in comparison with the preliminary sample of 15 498 observations. Despite the missing values, the sample is large enough because it contains many observation points.

### 3.2. Empirical analysis

We focused on the impact of tax burden on investment inflows. The empirical analysis proceeded in two steps. First we evaluated the significance of tax variables on inward FDI flows. The influence of three tax variables, corporate tax rate, total tax rate and tax treaty, on FDI was estimated separately. Secondly we explored how sensitive particular investor countries were to the taxation in the EU, For this purpose we estimate the model for various samples of countries.

In the basic version of the model, we used a gravity specification of the bilateral FDI inflow, where we included tax variables (CORPTAX, TOTALTAX and DTA). We analysed different models including the basic model (4) described previously. Models estimated within fixed country-pair and fixed time effects. The variable of geographical distance is time-invariant and this variable is affected only by fixed country-pair effect. We applied a test on a sample with a fixed effects panel data estimator (Wooldridge, 1995). We ran fixed-effect regression with GDP, GDP growth and tax variables. Similarly to the study of Bevan and Estrin (2004), the results were very poor, indeed  $R^2 = 0.36$ . After the inspection of the data we added population variable. A similar approach was used by Portes and Rey (1999), who estimated a gravity model of equity flow including population variables that represent the openness of the country. The coefficients they received for population in their regression are very close to ours. The goodness of this equation rises: from initial  $R^2 = 0.36$  to  $R^2 = 0.49$ . We therefore used model (3) as our baseline for further examination.

Table 2. Model. Different tax variables. Regression results for the foreign direct investments (log FDI)

	Model 1 (corporate income tax)	Model 2 (total tax)	Model 3 (double taxation treaty)
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Corporate income tax rate (CORPTAX)	-0.0208*** (-5.1310)	-	-
Total tax rate (% of commercial profits) (TOTALTAX)	-	-0.0196*** (-6.6157)	-
Double Taxation Treaty (DTA)	-	-	0.0531 (0.6769)
Host country GDP (LGGDP)	0.9449*** (29.8392)	0.8872*** (21.0872)	0.8764*** (30.3461)
Investor country GDP (LGGDPI)	1.5285*** (62.2451)	1.6066*** (43.0832)	1.5233*** (61.9353)
Population of host country (LGPOP)	-0.5020*** (-15.1917)	-0.3803*** (-7.5836)	-0.4678*** (-14.4332)
Population of investor country (LGPOPI)	-0.9426*** (-39.8088)	-1.0703*** (-30.0014)	-0.9416*** (-39.2437)
Distance between countries (LGDIST)	-0.8343*** (-33.2956)	-0.7123*** (-20.3332)	-0.8274*** (-31.6909)
GDP per capita growth (GDPGROWTH)	0.02790*** (2.9920)	0.03110*** (2.8008)	0.03461*** (3.7411)
Constant	3.9313*** (10.8546)	3.2921*** (6.3581)	3.6121*** (10.0739)
R-squared	0.4935	0.4527	0.4916
Number of observations	7010	3830	7010

Note: t-statistic in brackets. \*\*\*- significant at the 1% level, \*\*- significant at the 5% level, \*- significant at the 10% level.

The estimated parameters of the variables derived from the basic version of the gravity equation are statistically significant and have the expected signs (see Table 2). The positive sign before the variable of investor country GDP shows that the FDI flows from larger countries are bigger. It also indicates that a larger investor country has more potential to invest to the host country and its FDI flows will become larger. Similarly to the previous research by Folfas (2011), the sign before the host country GDP is also positive, which shows that countries with greater spending power are more attractive for investors. The positive sign of the host country GDP is most likely connected also with greater interest of the investor in the countries with high economic growth. The above-mentioned allowed us to conclude that FDI flows are bigger between countries with larger GDPs. The distance as a factor expressing cultural differences and transportation costs has a significant effect on bilateral FDI inflows. As we expected, a long distance between the investor and the host countries influences negatively the attractiveness of a country for investors. This is proved by the sign of the coefficient before the distance variable.

Next the impact of GDP growth was examined. As a country with a great potential is more attractive for investors, the sign was expected to be positive. Higher expected growth should attract more FDI inflows. The results presented in Table 2 show that GDP growth affects the amount of the FDI flow. The positive sign before the variable of GDP growth shows that FDI flows from countries with higher level of economic growth are bigger.

Finally, tax rate appears to be an important factor in the investment decisions. Low tax rates of host countries attract more investments, particularly into EU countries.

To sum up: the basic model describes the relationship between the inflow of foreign direct investments into the EU member states, the host and investor countries' GDP, geographical distance between the countries, level of economic growth and tax rate in the host country. The inflow of FDI from the investor country to the host country depends on the tax rate in the host country. A high tax rate has a negative impact on the FDI flow. Also a long distance and a high level of the total tax burden have negative impacts on bilateral FDI.

As the estimation results in Table 2 indicate, we cannot reject the first hypothesis: the taxation policy in the host country, incl. the corporate income tax rate and the total tax burden, is statistically significant. A large total tax burden and high corporate income tax rate have negative impacts. Similarly to Choi (2003), who added to the basic gravity equation the corporate tax rate variable of the host country, we found the coefficient for corporate tax rate to be negative and its size is 0.02. In general, the study suggests that an increase of the tax rate in host countries by one per cent will decrease FDI flows by 0.02 per cent, which is broadly in line with previous research. The size of the coefficient of the total tax burden variable comes next after income tax rate, and its impact on FDI is similar. However, as concerns our second hypothesis, empirical calculations show that the Double Taxation Treaty signed between the investor and the host country governments does not impact on the inflow of FDI into the EU. One explanation of the result may be that double taxation is regulated by the saving directive and other legislation acts in the EU additionally to the Tax Treaty. Besides, almost all countries under examination belong to the OECD and have the same regulations concerning double taxation according to the OECD model agreement. As hypothesised, the host country's GDP, the investor country's GDP and geographical distance between the countries are statistically significant at the 1 per cent level.

The above-mentioned results suggest that FDI flows into EU countries respond to the changes in taxation differently or that differences in the details that our measure did not cover cause

the differing effects. One could imagine that a tax break on reinvested profits would contribute to FDI inflows. Further research is necessary to identify the drivers of these differences.

### 3.3. Results and discussion

Empirical examination was done on the basis of panel data of bilateral FDI of the EU countries. The impact of the tax rate variables on bilateral EU FDI is high and the coefficients of the tax rates are indeed negative. There is a strong correlation between the corporate income tax rate and investment flow from the countries in the sample. To explore how sensitive particular investor countries are to the corporate taxation in the EU we performed additional tests with various samples. We formed the samples by the regions to which the investor countries belong and excluded other investor countries for the purpose of testing the sensitivity of investors from the various regions to the tax variables in the EU host countries. Table 3 shows that there is a significant correlation between investor country groups FDI and corporate tax in the host country. Generally speaking, in the EU the FDI flows from North America, the former Soviet Union and Balkan countries are sensitive to the corporate tax rate. However, it appears that investors from Norway, Iceland and Asian countries are not sensitive to corporate taxes in the EU countries.

Table 3. Impact of taxation for investor countries. Estimation results of tax variables

Region of Investor country	Model 1 (corporate income tax)	Model 2 (total tax)	Model 3 (double taxation treaty)
North America	-0.0325**	-0.0401***	-0.7951**
Asian countries	insignificant	-0.0262**	2.0978***
former Soviet Union	-0.0566***	insignificant	0.8114**
Switzerland/Lichtenstein	-0.0299**	-0.0325***	Insignificant
Norway/Iceland	Insignificant	-0.0243**	Insignificant
Balkans countries	-0.0443*	insignificant	Insignificant
EU-15	-0.0221***	-0.0153***	Insignificant
EU-12	-0.0188**	insignificant	Insignificant

Notes: The Table presents the sensitivity analysis of FDI on changes in taxation. The EU-15 includes old EU member countries. The EU-12 includes new EU member countries. North

America includes Canada and United States. Balkans countries include Bosnia-Herzegovina and Croatia. Asia includes China, Hong Kong. Former Soviet Union includes Ukraine, Russia and Belarus.

Source: Authors' calculations.

In addition to investors from North America, Balkan countries and the former Soviet Union the influence of corporate taxation on the investments flow is greater also for investors from Switzerland and Lichtenstein than from the other countries under examination. The FDI inflows to the EU from Norway, Iceland and Asian countries are not responsive to changes in corporate taxation.

The following hypotheses were proved in the course of the estimation of the gravity equation:

- 1) Being countries with taxation incentives the EU countries have great potential for the attraction of investors from partner countries; a low tax burden has a positive impact on FDI. The Double Taxation Treaty is nonsignificant for FDI flows.
- 2) The EU countries have preferred to achieve good relations with investors from large countries with a high level of economic growth. The economic potential of the investor country, measured by GDP, has a positive influence on the bilateral FDI flows to the EU.
- 3) The distance between investor and host countries impacts on bilateral FDI flows. The shorter distance increases FDI flows and a longer distance decreases FDI flows into EU countries. Cultural differences, transportation costs and historical relationships between countries measured as the geographic distance between the countries influence the foreign investments flows.

The above-presented modelling showed that the use of the gravity approach in the examination of FDI flows explains changes in FDI flows considerably well.

#### **4. ROBUSTNESS AND STABILITY ANALYSIS**

In this section we perform several robustness tests. The goal of this section is to check the stability of the results received in the gravity estimation, in particular the impact of tax rate on FDI flows. Differently from Folfas (2011), who checked the importance of the usage of offshore financial centres in investment location decision, we exclude tax haven regions from the sample in checking the stability of results, especially the impact of taxation variables. For

testing the sensitivity of the results, firstly we perform a robustness experiment for Model 1, which excludes the offshore financial centres such as Cyprus, Luxembourg and Malta from the estimation, and Model 2, which excludes all non-European economies from the sample as investor country. As a result of these changes not all the countries are included in the sample tested. Due to the above-mentioned changes the number of observations in corporate income tax rate estimations falls from 7010 to 6316 according to Model 1 and from 7010 to 4747 for Model 2. The results of the experiment are presented in Table 4.

Next we check the robustness of the estimations and the impact of control variables. Firstly, the level of inflation in the host country is checked via annual change of the consumer price inflation (*INF*).

Table 4. Robustness experiment

	Corporate income tax rate		Total tax rate		Double taxation treaty	
	Model 1 (without offshore centres)	Model 2 (European economies)	Model 1 (without offshore centres)	Model 2 (European economies)	Model 1 (without offshore centres)	Model 2 (European economies)
Corporate income tax rate (CORPTAX)	-0.0183*** (-4.0002)	-0.0281*** (-5.8438)	-	-	-	-
Total tax rate (% of commercial profits) (TOTALTAX)	-	-	-0.0107*** (-3.3753)	-0.0145*** (-4.1076)	-	-
Double Taxation Treaty (DTA)	-	-	-	-	-0.0005 (-0.0062)	-0.3481*** (-3.0154)
Host country GDP (LGGDP)	0.7545*** (21.6087)	0.9194*** (23.1209)	0.6209*** (13.6309)	0.7923*** (11.3102)	0.6665*** (21.8713)	0.8087*** (22.6814)
Investor country GDP (LGGDPI)	1.6460*** (63.4725)	1.9595*** (52.6418)	1.6653*** (43.7480)	2.0563*** (38.0228)	1.5995*** (63.5538)	1.9163*** (52.6649)
Population of host country (LGPOP)	-0.1334*** (-3.3295)	-0.4455*** (-10.8672)	0.0529 (0.9196)	-0.2989*** (-4.8663)	-0.0765** (-1.9761)	-0.3736*** (-9.4404)
Population of investor country (LGPOPI)	-1.0532*** (-42.5277)	-1.5522*** (-37.4047)	-1.1280*** (-31.1900)	-1.6781*** (-28.4842)	-1.0078*** (-41.2245)	-1.5044*** (-36.9397)
Distance between countries (LGDIST)	-0.8167*** (-32.0678)	-1.0421*** (-28.0476)	-0.7155*** (-20.3856)	-0.9078*** (-17.4072)	-0.8256*** (-31.1183)	-1.0603*** (-28.2418)
GDP per capita growth (GDPGROWTH)	0.0315*** (3.3430)	0.0125 (1.1111)	0.0281*** (2.5923)	0.0167 (1.2501)	0.0359*** (3.8542)	0.0196* (1.7597)
Constant	0.2397 (0.5489)	9.5573*** (17.2519)	-0.8812 (-1.4914)	8.5865*** (11.3102)	-0.1243 (-0.2879)	9.2883*** (16.8145)

R-squared	0.5169	0.5307	0.4756	0.4919	0.5147	0.4909
Number of observations	6316	4747	3588	2628	6339	4774

Note: t-statistic in brackets. \*\*\*- significant at the 1% level, \*\*- significant at the 5% level, \*- significant at the 10% level.

Low inflation as a determinant of macroeconomic stability matters positively affects FDI. However, most empirical studies ignore this variable. The study performed by Akinkugbe (2003) shows that inflation rate is a nonsignificant variable for the estimation of FDI inflows in developing countries. Udoh and Egwaikhide (2008) report that the effect of inflation rate uncertainty on FDI is negative. According to the gravity model of Lada and Tchorek (2008), inflation has a significant impact on FDI. Our results are presented in Model 1 of Table 5. The positive sign before the inflation coefficient is an unexpected result. One explanation of the result may be that the inflation in investor countries has the same tendency as in host countries. Inflation is probably related to the consumer spending power and therefore the variable has a positive effect on FDI.

Secondly, the impact of the unemployment level as a control variable is assessed via the percentage of unemployed persons in the host country (UNEMP). According to Roberto (2004), investors avoid in their location decisions distressed regions with high unemployment rates, according to his study the unemployment rate has a negative sign and it affects negatively foreign acquisitions. Therefore unemployment is expected to have a significant impact on FDI flows. The results presented in Model 2 of Table 5 show that the impact of unemployment on the FDI flow did not show persistence and is mainly not significant. This may suggest that other variables are more important for bilateral FDI into EU countries as well as that the governmental expenditures on labour development are not sufficient for the attraction of foreign investments and that this variable does not reflect the real situation of the labour market, because the quality of employment is more important than quantity. The impact of the tax variables remains unchanged.

Table 5. Robustness: adding control variables

	Corporate income tax rate		Total tax rate		Double taxation treaty	
	Model 1 (inflation)	Model 2 (unemployment)	Model 1 (inflation)	Model 2 (unemployment)	Model 1 (inflation)	Model 2 (unemployment)
Corporate income tax rate (CORPTAX)	-0.0203*** (-4.8582)	-0.0213*** (-5.2194)	-	-	-	-

	Corporate income tax rate		Total tax rate		Double taxation treaty	
Total tax rate (% of commercial profits) (TOTALTAX)	-	-	-0.0192*** (-6.4096)	-0.0209*** (-6.2554)	-	-
Double Taxation Treaty (DTA)	-	-	-	-	0.0513 (0.6546)	0.0638 (0.8103)
Host country GDP (LGGDP)	1.0244*** (29.1054)	0.9910*** (26.9074)	0.9909*** (19.6997)	0.8325*** (18.0052)	0.9608*** (28.1491)	0.8836*** (26.7335)
Investor country GDP (LGGDPI)	1.5712*** (61.7068)	1.5772*** (62.2618)	1.6341*** (42.4221)	1.6602*** (40.0978)	1.5253*** (62.0986)	1.5278*** (61.9408)
Population of host country (LGPOP)	-0.5709*** (-15.8221)	-0.5491*** (-14.0184)	-0.4669*** (-8.3550)	-0.3127*** (-28.4798)	-0.5435*** (-14.9833)	-0.4767*** (-12.6554)
Population of investor country (LGPOPI)	-0.9841*** (-40.2673)	-0.9897*** (-40.6703)	-1.0951*** (-29.8075)	-1.1166*** (28.4798)	-0.9439*** (-39.3854)	-0.9462*** (-39.3189)
Distance between countries (LGDIST)	-0.8299*** (-32.9769)	-0.8296*** (-33.0894)	-0.7154*** (-20.2115)	-0.7070*** (-18.4411)	-0.8251*** (-31.3854)	-0.8268*** (-31.6228)
GDP per capita growth (GDPGROWTH)	0.0323*** (3.4429)	0.0302*** (3.2215)	0.0326*** (2.8937)	0.0288** (2.3615)	0.0368*** (3.9835)	0.0348*** (3.7532)
Inflation, consumer prices (INF)	0.0348*** (0.3459)	-	0.0503*** (2.9559)	-	0.0505*** (4.6211)	-
Unemployment (UNEMPL)	-	0.0088 (1.3049)	-	0.0065 (0.5991)	-	0.0029 (0.4435)
Constant	3.9936*** (10.9823)	4.1240*** (11.1843)	3.2558*** (6.2036)	2.9296*** (5.0976)	3.6523*** (10.1977)	3.6491*** (10.0294)
R-squared	0.4945	0.4938	0.4517	0.4501	0.4932	0.4916
Number of observations	7010	6989	3830	3822	7010	6989

Note: t-statistic in brackets. \*\*\*- significant at the 1% level, \*\*- significant at the 5% level, \*- significant at the 10% level.

The stability of the coefficients of tax rate is checked by combining the independent variables with additional control variables. The checks show that the tax rate is not significantly different from the basic model and in comparison with the basic model the gravity model is also appropriate.

## 5. CONCLUSIONS

The results of the study show that the gravity approach could be used for the estimation of FDI flows in EU countries. The gravity approach for analysing the flows of foreign direct investments between EU countries and their main investor partners reveals that the indicator of distance between two countries, based on the transportation costs and cultural differences, has considerable influence on the bilateral flows. The results of the study support the

principle that the gravitation force plays the main role in the attraction of foreign investments, accordingly, the FDI of EU countries are influenced by the spending power, the size of the economy and its growth potential, which are expressed by the GDP of the investor country. FDI flows are bigger between larger economies. Further testing showed that additionally to the size of the economy and distance between the countries the level of the tax rate in the host country, especially in the field of corporate taxation, has an important role in the FDI between the investor and host countries. Nonetheless, the FDI gravity model faces a number of additional obstacles. Firstly the data of bilateral FDI flows are available only for selected countries and a limited period. Certain countries under examination have also limited availability of other data, but missing data do not damage the final result because the sample consists of many observation points. No data concerning the total tax rate variable are available for 1998-2004. Over time, however, the sample will become longer, which may resolve the problem concerning the sample.

In this paper we have investigated the effect of taxation policy on bilateral FDI of EU countries using a gravity model. Foreign investors tend to be attracted by host countries that have tax incentives and liberal legislation. The results suggest that EU countries are effective in attracting FDI due to low tax rates in host countries. The study shows that increasing the corporate income tax rate by 1 per cent will decrease the FDI inflow into a country by 0.02 per cent. Inward FDI reflect the changes in tax policy, in particular in the corporate income tax rate, but we did not examine the principles of taxation and exemption rules. With almost 7000 observations on bilateral inward FDI, we consider that these results are robust. Combining the various control variables confirms the stability of results. These findings are similar to the results of Demekas et al. (2007), according to whose estimation the coefficient of statutory corporate income tax rate is equal to -0.02. In line with the results of Blonigen and Davies (2002) we found that a tax treaty does not influence foreign investments flows. Our empirical work is strong evidence that international investment location decisions are affected by corporate taxation in force in the potential investment region. The result agrees with most previous empirical studies. However, our specific focus on EU tax rates and on tax treaties leads to additional conclusions. The study suggests that politicians should look for new regulations of common corporate tax policy in the European Union and to improve the incentives of tax treaties. Apart from other advantages of tax competition such as that it forces governments to search for efficiency and welfare, tax policy can be instrumental to attract investment from abroad. This paper does not pay attention on the specific deduction schemes

and does not simulate a model in order to decrease the tax base. Such analysis has to be left for further research.

## APPENDIX

**Table 1. Data source and definition**

Variables	Sources
Foreign Direct Investment flow (MEUR) Direct investment flows in the host economy from investor country Host country coverage: The sample includes Austria, Bulgaria, Belgium, Czech Republic, Cyprus, Germany, Denmark, Estonia, Spain, Finland, France, Ireland, Italy, Luxemburg, Netherlands, Portugal, Sweden, Malta, Poland, Estonia, Lithuania, Latvia, United Kingdom, Slovakia, Slovenia, Romania, Hungary. Investor country coverage: We have Austria, Bulgaria, Belgium, Czech Republic, Cyprus, Germany, Denmark, Estonia, Spain, Finland, France, Ireland, Italy, Luxemburg, Netherlands, Portugal, Sweden, Malta, Poland, Estonia, Lithuania, Latvia, United Kingdom, Slovakia, Slovenia, Romania, Hungary, United States, Canada, China, Japan, Ukraine, Russia, Bosnia, Belorussia, Switzerland, Turkey, Croatia, Lichtenstein, Iceland and Norway countries in the sample.	Eurostat
Gross domestic product (at current prices, MEUR). Real Gross Domestic Product	Eurostat, UNCTAD stat
Population Total number of inhabitants on 1 January	Eurostat, World Bank databank
Gross domestic product per capita growth (annual %)	World Bank databank
Distance Distance (in kilometres) is theoretical air distance between capitals of host and investor countries.	Own calculation based on web application <a href="http://www.timeanddate.com/worldclock/distance.html">http://www.timeanddate.com/worldclock/distance.html</a>
Corporate income tax rate (%) Central government corporate income tax rate as basic central government statutory corporate income tax rate expected to have negative effect. Where surtax applies, the statutory corporate rate exclusive of surtax is used.	European Commission's Directorate-General for Taxation and Customs Union, OECD stat
Tax burden Total tax cost (% of commercial profits)	World Bank databank
Double Taxation Treaty signed (dummy variable) Equal to 1 after Double Taxation Treaty has been signed, 0 otherwise	UNCTAD
Unemployment (% of total labour force) Annual average	Eurostat, World Bank databank
Inflation, consumer prices (annual %)	World Bank databank

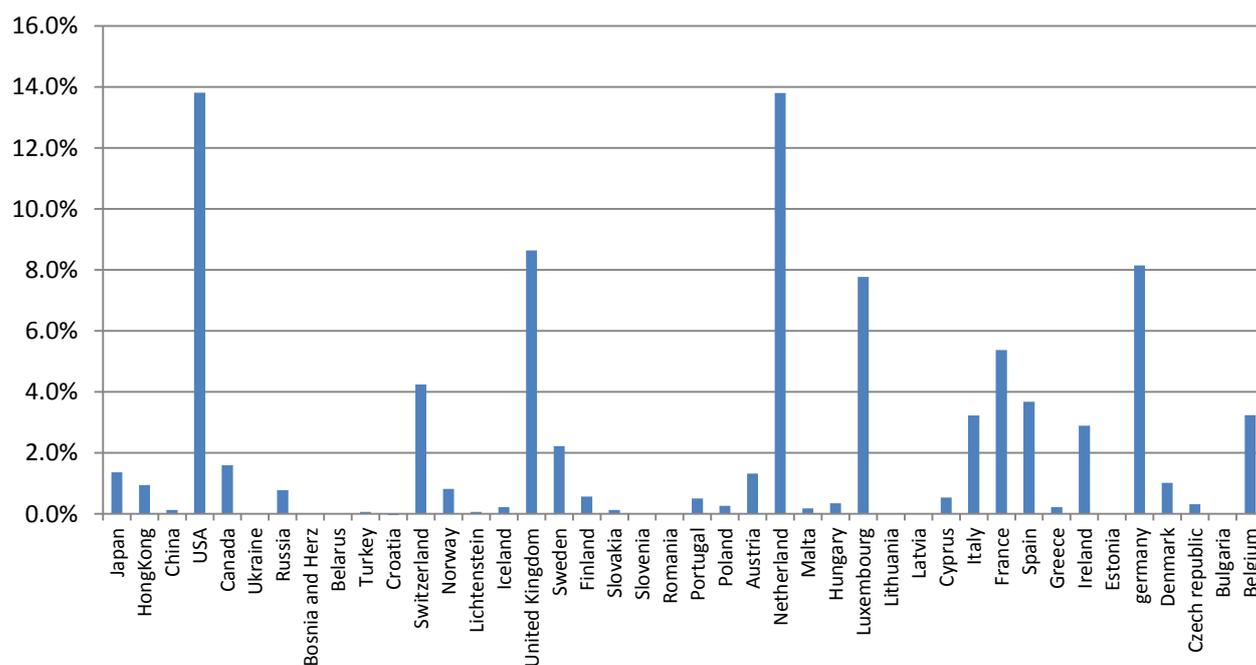
**Table 2. Descriptive statistics for the period 1998-2011**

	N	Mean	Median	Max	Min	Std.dev.	Kurtosis
Foreign direct investment flows	11881	450.13	3.00	94507.00	-40687.00	3065.95	249.92
GDP in host country	15498	389821.30	145057.40	2534311.00	3426.27	600359.70	5.42
GDP in investor country	15444(*)	709760.70	164699.10	11169589.00	2215.68	1680819.00	4.36

Population in host country	15489	18011722.00	8993531.00	82534176.00	377516.00	22348313.00	4.01
Population in investor country	15498	61517589.00	9473000.00	1.34E+09	31320.00	2.03E+08	33.95
Gross domestic product per capita growth in host country	15498	2.42	2.56	12.85	-17.54	3.80	6.69
Distance between host and investor countries	15498	2252.69	1486.00	11168.00	56.00	2317.93	6.38
Corporate income tax rate in host country	15498	25.74	26.00	45.00	10.00	7.61	2.29
Tax burden in host country	7284(**)	46.05	47.20	77.50	20.00	12.01	3.02
Double Taxation Treaty	15498	0.83	1.00	1.00	0.00	0.37	3.97
Unemployment in host country	15361(***)	8.33	7.50	21.70	1.80	3.95	3.76
Inflation in host country	15498	3.75	2.54	59.10	-4.48	5.33	55.14

Notes: (\*) there was no data of GDP for Lichtenstein for the period: 2010-2011; (\*\*) there was no data of total tax rate and number of tax payments available for the period: 1998-2004; (\*\*\*) there are missing values in unemployment data for Cyprus for 1998 and Malta for 1998-1999;

Figure 1. Regional structure of inward FDI into EU by investor countries in 2004-2011, average %.



Notes: The Figure presents the regional structure of EU FDI in percentage of total FDI.

Source: Eurostat. Authors' calculations.

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## THE IMPACT OF CHINESE FOREIGN DIRECT INVESTMENT IN SWITZERLAND

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### ABSTRACT

China has surged as an important contributor of outward foreign direct investment. Recent trends reveal that investment from China to Switzerland is growing faster than that from other markets; a number of Chinese firms have invested in long-established Swiss sectors such as the energy technology and the watch-making industry. The latter is a new economic phenomenon worthy of reflective assessment from both the theoretical and international business perspective. These new trends have been driven by a combination of intense competitive pressure, favourable policies for foreign investment and the need to secure long-term economic development. This paper focuses on Chinese investment into Switzerland given particular consideration to the assessment of these new entrants, aspects related to drivers and motivators, elements of difference, and considerations of resources and capabilities. Likewise, the challenges and opportunities facing incumbents in responding to the increasing presence of Chinese firms are offered.

**Keywords:** Foreign Direct Investment, Chinese Outward Foreign Direct Investment, Chinese Foreign Affairs, Switzerland.

### 1. INTRODUCTION

During the last decades, there has been an extraordinary transformation in the economy of China. The economic reforms of the late 1970s and the incorporation of China as a member of the World Trade Organisation in 2001 have led to the emergence of an economy based on greater openness and competition. A notable aspect of China's international openness has been its attractiveness for foreign direct investment (FDI); in 2012, China became the largest recipient of foreign direct investment (FDI) (UNCTAD, 2013). Another important aspect of the Chinese economy is its economic competitiveness expressed in the outsized surplus of its

balance of payments due to its export sector. The contribution of FDI and the remarkable performance of its exports are reflected in the impressive growth of the Chinese GDP in the last decades (World Bank, 2013). This extraordinary economic growth has led China to emerge as an important source of outward foreign direct investment (OFDI).

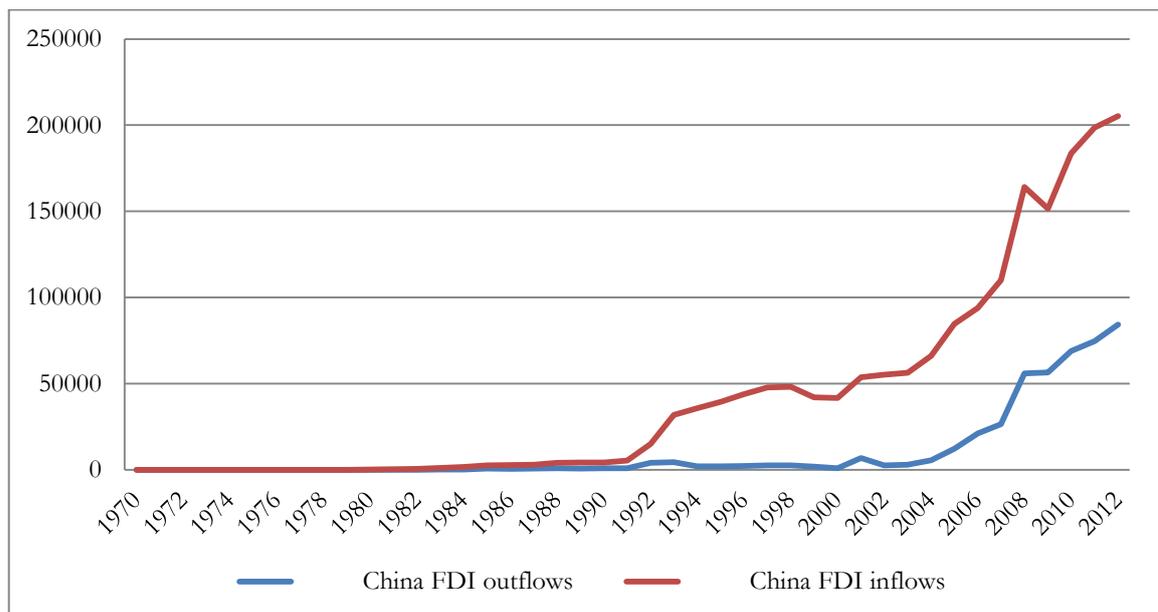
Although China is a newcomer as a source of outward investment, China ranks ninth among the top investor countries in the world (UNCTAD, 2012). Chinese investment has been directed to the four corners of the world, where developed and developing countries have been recipients of Chinese FDI. While in the developing countries Chinese investors are directed towards resource-seeking investments to secure access to raw materials, in the developed world Chinese investors are oriented toward market-seeking and strategic-asset-seeking investment to expand their markets and to have access to new technologies, brand names, distribution channels and managerial know-how. Europe endows Chinese investors with opportunities to expand their markets, but most importantly, Europe provides access to new technologies, brands, sophisticated distribution channels and managerial know-how; consequently, Europe has been the most attractive location for Chinese investment in the last past years (A Capital, 2013). This new trend also relates to Switzerland as Chinese investment in this small European country is growing faster than that from other investors partners (L'Hebdo, 2012).

Despite the major cultural, historical and political differences that exist between China and Switzerland, strong economic cooperation is emerging between these two countries. The growth of Chinese outward FDI in Switzerland emphasizes the need to further comprehend China as a major global investor. In the last few years, we have witnessed the reconfiguration of China's strategies as a global investor, moving from the resource-seeking investment to more sophisticated and competitive market-sites for FDI such as Switzerland. Although Chinese FDI in Switzerland is still relatively small in magnitude, its rapid growth is worthy of reflective examination from both the theoretical and international business points of view. The remainder of this paper is organised as follows: The next section assesses the prominent emergence of Chinese outward foreign direct investment. Section 3 considers Chinese investment in Europe. Section 4 focuses on Switzerland as a market place for foreign investment. Section 5 elaborates on Chinese foreign direct investment in Switzerland. Section 6 presents an analysis of the Chinese outward FDI in Switzerland. Section 7 draws conclusions and recommendations.

## 2. CHINESE OUTWARD FOREIGN DIRECT INVESTMENT

The participation of China in the global economic sphere has increased considerably during the past decades. Although there are many reasons behind this development, a major factor relates to the economic dynamism of China in the global economy (Greenaway et al., 2010). During the past decades, China has particularly focused on attracting foreign investment; FDI has been a central component of its economic policies. As a result, in 2012, China became the largest recipient of FDI inflows surpassing the long-standing position of the United States (UNCTAD, 2013). Although FDI inflows continue to be a most significant source of its economic growth, Chinese outward foreign direct investment has been increasing significantly during the last past decade. In Figure 1 we observe that while Chinese FDI outflows were practically nonexistent during the 1970s, during the 1980s and 1990s FDI outflows started to grow at a modest rate, and while the developed world was experiencing financial difficulties during the past half decade, Chinese OFDI started to rise notably (see Figure 1).

**Figure 1: China FDI Inflows and Outflows, 1970-2012**

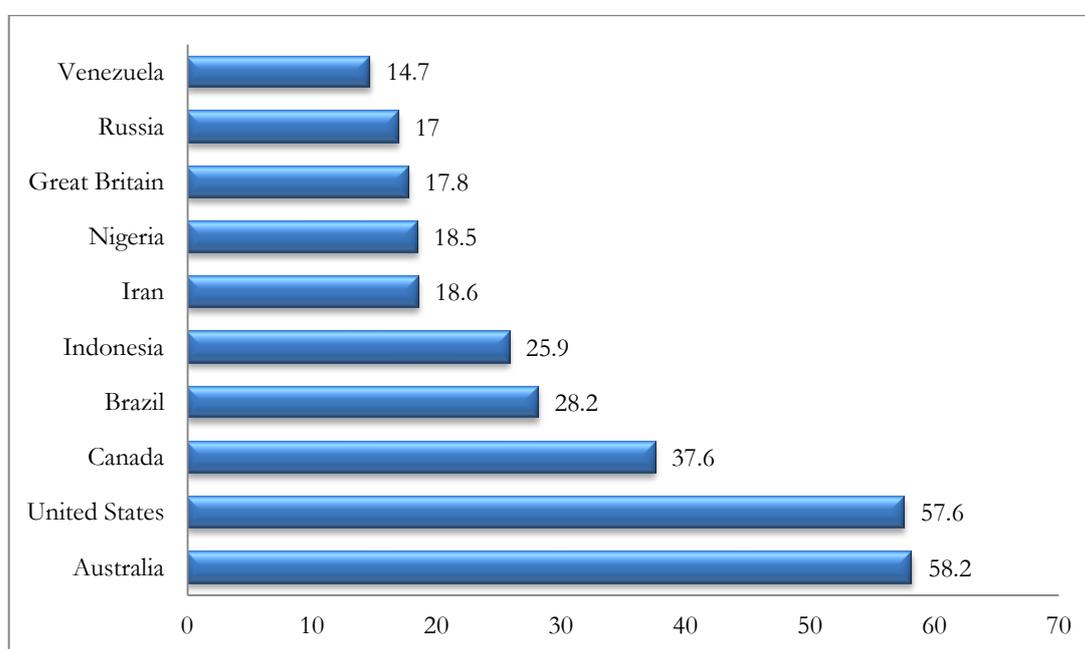


Source: UNCTAD (2013), FDI/TNC database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics))

A variety of reasons have been offered for the emergence of Chinese OFDI. Although the emergence of China as a global investor has been attributed to its economic dynamism; however, the role of the Chinese government must be acknowledged in shaping the path of OFDI (Dunning and Lundan, 2008; Rios-Morales and Brennan, 2010; Ren et al., 2012). In 1999, the Ministry of Foreign Trade and Economic Cooperation together with other Chinese

departments launched the 'Going Global' scheme to support the internationalisation of Chinese firms. Policies were designed to encourage Chinese firms to invest and set up factories overseas (Ren et al., 2012). The Ministry of Commerce, formerly named Ministry of Foreign Trade and Economic Cooperation has been responsible for the policies and measures implemented to support and encourage the Internationalisation of firms. This institution together with the Department of Outward Investment and Economic Cooperation have been providing relevant support and practical information about investment opportunities, market research and other types of necessary information in the assessment of foreign investment (Rios-Morales and Brennan, 2010).

**Figure 2: The Ten Top Chinese OFDI Destinations, 2005-2012 (in US\$ bn)**

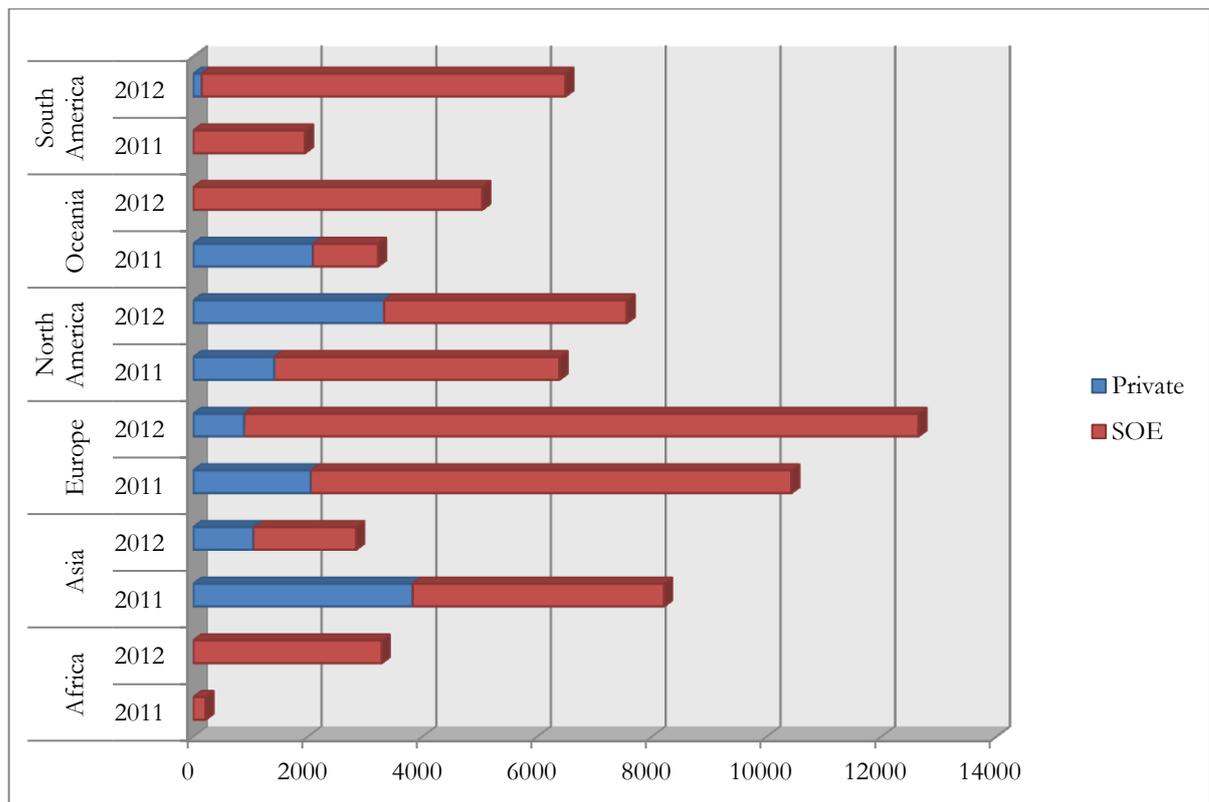


Sources: The Heritage Foundation (2013), China Global Investment Tracker.

China has been seeking investment opportunities in the developed and developing countries. According to the Heritage Foundation, the ten top destinations for Chinese OFDI during 2005-2012 were: Australia, the United States, Canada, Brazil, Indonesia, Iran, Nigeria, Great Britain, Russia and Venezuela (see Figure 2). Chinese OFDI has been oriented to maintain its added value industries, especially targeting suppliers of natural resources such as petroleum and minerals. Australia, Brazil and Indonesia have mainly received FDI from China in the agricultural and steel industries; whilst, the United States, Iran, Nigeria, Russia and Venezuela have essentially obtained investment in the petroleum industry. Unlike the other destinations, the United Kingdom received Chinese investment across a broad spectrum of

economic activities; Chinese firms have invested in the manufacturing sector, financial and business services, as well as in sales and marketing operations (Burghart and Rossi, 2009). China has also invested a considerable proportion of FDI in the Virgin Islands, Cayman Islands and the Bahamas (MOFCOM, 2008); given the status of these islands as financial havens and their prominence as destinations for China's OFDI, some critics have questioned Chinese FDI figures (Nicolas, 2007).

**Figure 3: Chinese OFDI 2011-2012.**



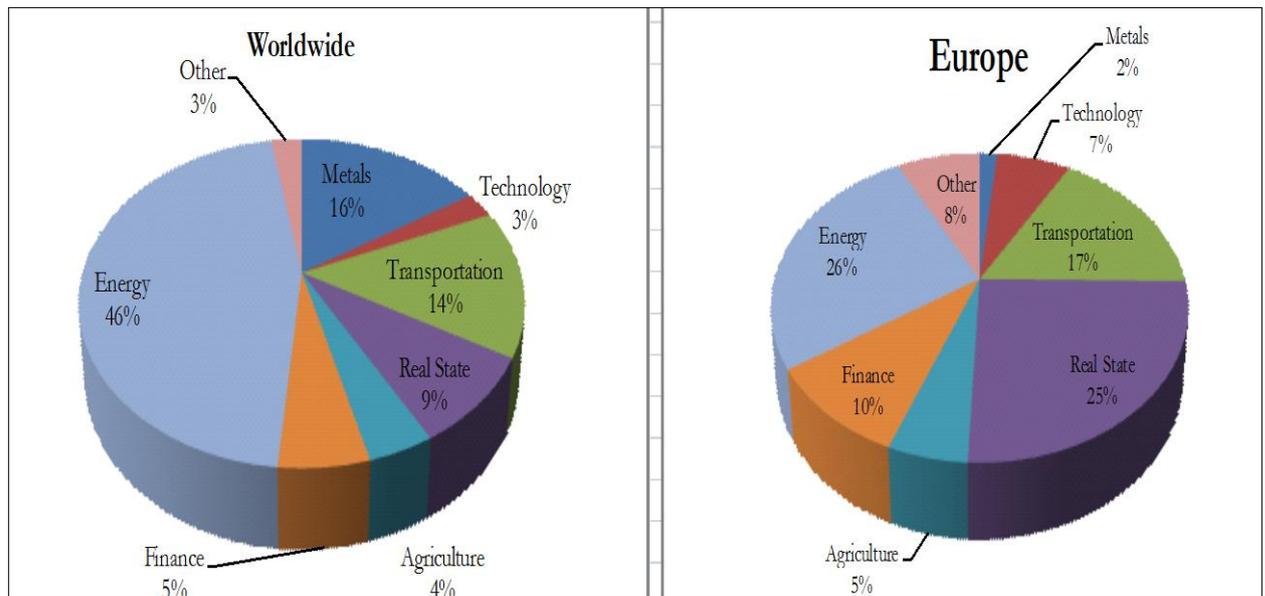
Source: A Capital (2013), The A Capital Dragon Index for the Full Year 2012.

During the period 2011-2012, the growing trend in China's OFDI can be observed across all regions of the world with the exception of Asia (Figure 3). In addition over the period 2004 to 2012 the geographical distribution of Chinese OFDI has undergone a major shift. While Asia was the largest recipient of cumulative FDI from China at the end of 2004, receiving 75 percent of total Chinese investment, Latin America followed as the second most important market site for FDI from China reaching 18 percent; North America, Africa and Europe each obtained 2 percent and the Ocean Continent received 1 percent of cumulative FDI from China by the end of 2004 (MOFCOM, 2005); by 2012, Asia was the smallest recipient of Chinese FDI.

In 2012, Europe was the most important location for Chinese investment, obtaining 33 percent of total Chinese OFDI; followed by North America with 20 percent, South America with 17 percent, Oceania with 13 percent, Africa with 9 percent and Asia obtained 8 percent (A Capital, 2013). This shift also applies to the industrial sector distribution of Chinese OFDI. By investing in Europe, Chinese firms are moving away from resource-seeking investment that has greatly influenced the early internationalisation stage of Chinese OFDI. We can also observe from Figure 3 that investment from state-owned enterprises (SOE) continues to dominate Chinese OFDI worldwide, nonetheless, a sizable proportion of privately own investment has been located in Asia, Oceania, North America and Europe.

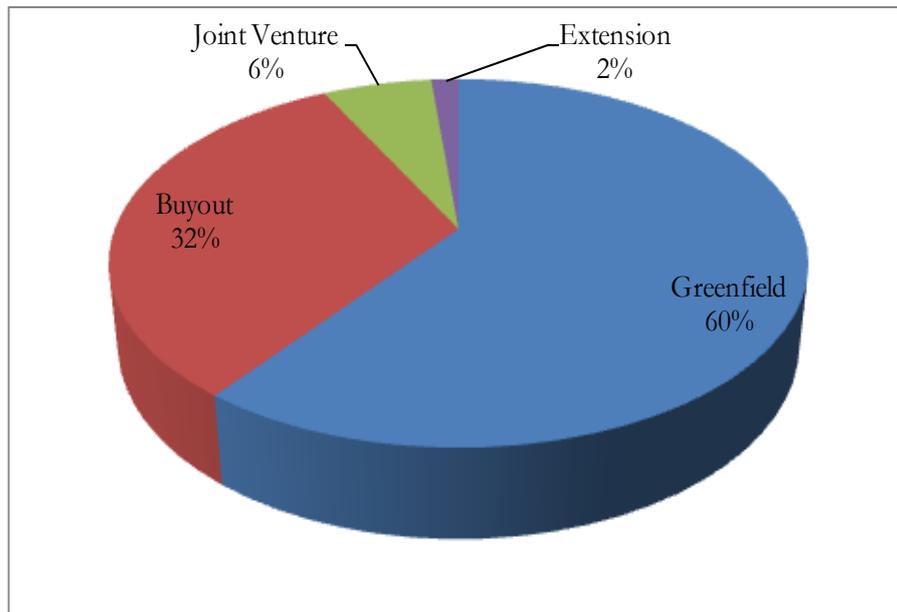
### **3. CHINESE OUTWARD FOREIGN DIRECT INVESTMENT IN EUROPE**

Chinese investment directed to Europe has grown rapidly in the last couple of years; this trend promises to continue growing. In 2011 and 2012, Europe has been the largest recipient of Chinese investment, receiving 34 percent and 33 percent respectively of total Chinese foreign investment (A Capital, 2013). This represents a major increase in the proportion of Chinese FDI going to Europe. Unlike other regions that mostly receive from China investment in natural resources, Europe obtains Chinese investment in a wide range of industries. Chinese firms are locating their capital in the business and financial services, real state, telecommunication, energy, high technology and in other sectors such as healthcare and education (see Figure 4). Chinese OFDI in Europe demonstrates an expansion of its investment programme, moving from resource-seeking investment to a market-seeking and strategic-asset-seeking investment approach. This change of strategy has been confirmed by different surveys conducted on the motives of Chinese investment, including the survey conducted by the World Bank. These surveys have revealed that the primary motive of Chinese investment in Europe is the expansion of their market share in host countries, followed by the strategic-asset-seeking motives that provide access to new technologies, well-known brands, distributions channels and managerial know-how (Nicolas, 2007).

**Figure 4: Chinese OFDI by Sectors: Worldwide and Europe**

Sources: The Heritage Foundation (2013), China Global Investment Tracker.

Another characteristic of Chinese investment in Europe is framed by the business environment's opportunities. During a period in which the Western economies have been facing severe financial distress in which the business environment has been characterised by liquidity pressure, asset write-downs and risk aversion, Chinese investors have been taking the opportunity to buy struggling European firms (Berger, 2008; Nicolas, 2009; the Economist, 2011). Although Figure 5 displays the entry modes of Chinese OFDI in Europe from 1980-2007 period in which 60 percent of Chinese investment in Europe is *greenfield* investment, while *buyout* constitutes 32 percent, *joint ventures* 6 percent and *extension* 2 percent, we expect that these figures might have been modified in the last few years as it has been observed that a number of European companies have been bought out with Chinese capital.

**Figure 5: Entry Modes of Chinese Firms in Europe: 1980-2007**

Source: Hay and Milelli (2010), adapted from Table 9.1.

Although Chinese investment in Europe has been increasing rapidly in recent years, Table 1 shows that the share of Chinese OFDI in Europe is still rather small. In 2009, Chinese investment in Europe (27 members of the EU) amounted to €5.9 billion, increasing to €6.4 billion in 2010 and rising to €15 billion in 2011. Table 1 lists the ten top European partners in terms of FDI. While China is represented among the ten top partners in terms of European investment in China, conversely China is not among the ten top investors in Europe during this period despite Europe having been the most attractive location for Chinese FDI. In 2011, Chinese investment amounted for 0.4 percent of total FDI inflows in Europe (European Commission-Eurostat, 2013). However, as displayed in Table 1 we observe that Chinese investment in Europe is growing faster (155.4 percent) than is the case for the other European partners, signalling this trend will continue to grow. It is expected that this expansion will be also fostered by the investment agreement negotiations agreed at the 14<sup>th</sup> European Union-China Summit held in Beijing in February 2012; the European Commission publically expressed its commitment to bringing this initiative forward in May 2013. The main aims of these investment negotiations have at its core the improvement of the protection of investment, to reduce investment barriers and encourage investment flows (European Commission, 2013).

**Table 1: Top Ten European FDI Partners, 2009-2011 (in €billion)**

	Outward				Inward			
	2009	2010	2011	Growth rate 2009-2011 (%)	2009	2010	2011	Growth rate 2009-2011 (%)
Extra EU-27	3'751.0	4'247.0	4'983.5	32.9	2'783.3	3'142.8	3'806.8	36.8
United States	1'204.7	1'275.2	1'421.3	18.0	1'089.7	1'240.0	1'344.3	23.4
Switzerland	518.5	561.5	616.4	18.9	340.0	395.9	467.3	37.4
Brazil	139.7	200.2	238.9	71.0	63.9	85.2	77.8	21.9
Canada	166.2	196.9	221.6	33.4	125.0	144.0	137.6	10.0
Russia	99.1	130.6	166.8	68.4	46.9	50.6	53.1	13.4
Australia	81.2	118.9	124.9	53.8	30.2	29.5	34.3	13.5
Hong Kong	90.2	110.9	124.0	37.4	27.5	41.5	63.9	132.0
Singapore	95.6	110.1	122.8	28.4	50.1	60.3	67.3	34.4
China	63.9	79.9	101.5	58.9	5.9	6.4	15.0	155.4
Japan	81.8	88.3	85.8	4.9	126.8	132.2	144.2	13.7

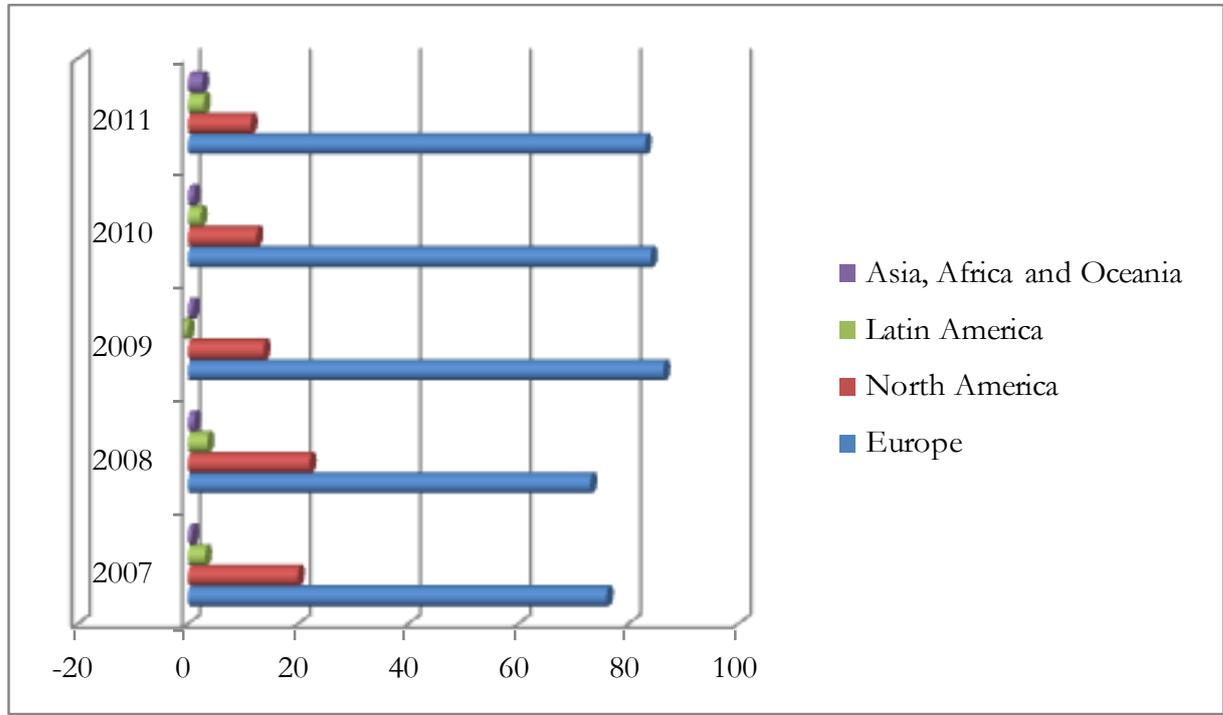
Source: European Commission-Eurostat (2013), Online Data: Statistiques sur les Investissements Directs Etrangers.

#### 4. SWITZERLAND AS A MARKET LOCATION FOR FDI

Switzerland is one of the most attractive locations for FDI in the world, in the Global Opportunity Index 2012 Switzerland had scored number eight among the countries in the world. This index measures the attractiveness of a market site for FDI that ranks countries according to the criteria that mirrors the countries' degree of economic openness and opportunity for foreign investment (Global Opportunity Index, 2013). The positioning of this small country amongst the world's most attractive locations for FDI is explained by a variety of factors. Among the most important determinants of attractiveness for FDI are the quality of the business environment and the stability of the legal, political and social system (Gugler and Tinguely, 2010). The highly qualified labor force that Switzerland possesses is also acknowledged as an important determinant; the Swiss education system has been influential in developing a qualified labour force (Swiss-American Chamber of Commerce & Boston Consulting Group, 2008). At present, Switzerland is a world's leader in innovation, scientific research and technology output; features that have been also instrumental in attracting high quality FDI into the country (Rios-Morales et al., 2013). Switzerland's capacity for innovation

has placed this country as one the most competitive countries in the world (World Economic Forum, 2011).

**Figure 6: Proportion Swiss Inward FDI by Regions**



Source: Swiss National Bank (2013), Investissements directs étrangers en Suisse.

Foreign direct investment has been an important component of the Swiss economy; foreign investment contributes about 23 percent of the Swiss gross domestic product (ACC and BCG, 2007). Foreign firms also contribute to the export sector and job creation employing around 10 percent of the Swiss labour-force (Gugler and Tinguely, 2010). A large proportion of inward FDI comes from Europe, contributing around 80.54 percent of total Swiss inward FDI during period 2007-2011; followed by North America which has invested around 15.96 percent, Latin America has invested around 2.17 percent and Asia, Africa and Oceania having contributed with only 1.32 percent (see Figure 6). A large percentage of FDI is located in the services sector, representing 87 percent of total FDI inflows from which the financial services obtains 56.2 percent, commerce 17 percent, the banking sector 5.5 percent, insurances 3.9 percent, transportation 2.5 percent and other services 1.6 percent. The industrial sector attains around 13 percent of total FDI inflows from which 6.4 percent is located in the chemical industry, 3.7 percent in the electrical and electronics sector, 1.7 in the machinery sector and 1.2 percent in other industries (Swiss National Bank, 2013).

## 5. CHINESE OUTWARD FOREIGN DIRECT INVESTMENT IN SWITZERLAND

Chinese investment directed to Switzerland has grown rapidly in the last few years. Since the establishment of large Chinese MNEs such as Lenovo, GMT Management and M.E. Times in 2006, we observe that Switzerland has received around 60 more Chinese firms (see Table 2). Although the availability of official data on Chinese OFDI to Switzerland is still scarce, it has been estimated that Chinese investment in Switzerland could have reached the sum of US\$180 million in 2012. Whilst it is difficult to estimate with precision the number of state own enterprises and private firms, Switzerland is hosting both types of firms. We can also recognize that the great majority (71 percent) of these firms have chosen the *greenfield* entry mode which is known for their participation in job creation, while 26 percent of firms have chosen the *acquisition* mode and only 3 percent have chosen the *joint-venture* mode which characterised the early stage of the internationalisation of Chinese investment.

**Table 2: List of Chinese Firms Operating in Switzerland**

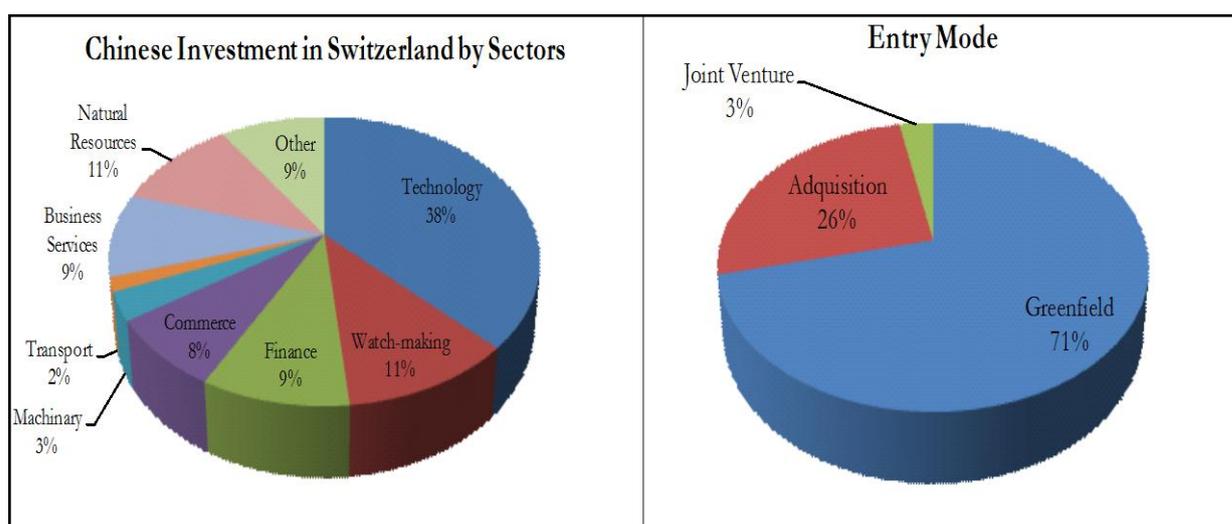
Year of Inv.	Company	Mode of Entry	Activity
2007	Absolut Invest	Acquisition	Software
2009	Addax Petroleum	Acquisition	Natural Resources
2009	Alfex	Joint venture	Watch making
2007	Alibaba	Greenfield	e-commerce
2008	Bank of China	Greenfield	Bank
2009	Balin Precision Technology	Greenfield	Electronic components
2009	Brightoil Petr. Geneva Ltd	Greenfield	Natural Resources
2008	CBC Switzerland	Greenfield	Market research
2002	Cetronic	Acquisition	Electric équipement
2012	China Business House	Greenfield	Business service
2009	CCTV	Greenfield	Television
2009	China Equity Exchange	Greenfield	Finance
2011	CF Asset Management	Greenfield	Finance
2009	China Unionpay	Greenfield	Bank
2009	Chaarat Gold Holdings Ltd	Acquisition	Mine
2004	COSCO	Greenfield	Transport
2013	Duferco	Acquisition	Steel
2008	eBaoTech,	Greenfield	Software
2012	Eberli Holding AG	Acquisition	Construction
2010	Eoply New Energy Technology	Greenfield	Solar energie
2012	Eterna	Acquisition	Watch making
2009	Eurosina	Greenfield	Watch making
2011	E&F Transped Trading	Greenfield	Natural Resources
2012	Fair Wind Europe	Greenfield	Infrastructure

Year of Inv.	Company	Mode of Entry	Activity
1991	Gimelli Produktions AG	Acquisition	Electric équipement
2006	GMT Management	Greenfield	Infrastructure
2009	Great View Aseptic Packaging Europe	Greenfield	Commerce
2005	Hantec Europe	Greenfield	Finance
2008	Heritage Fund management	Acquisition	Bank
2013	Hôtel Europe Europaischer Hof	Acquisition	Hotel
2008	Huawei	Greenfield	Technology
2011	Hubei Chuyuan International	Greenfield	Commerce
2010	Jiangsu Akcome Solar Science and Technology	Greenfield	Solar energie
2010	Jeanstar	Greenfield	Watch making
2010	Jing Mei Europe	Greenfield	Industry
2011	JinkoSolar	Greenfield	Solar energie
2008	Journey of Harmony	Greenfield	Business service
2007	Lavaro	Greenfield	Electric équipement
2010	LDK Solar Hi-Tech Co,	Greenfield	Solar energie
2006	Lenovo	Greenfield	Electric équipement
2010	Maipu Europe	Greenfield	Technology
2006	M.E. Times	Greenfield	Watch making
2010	Montres Chouriet	Acquisition	Watch making
2008	Neusoft Europe	Greenfield	Software technology
2013	Noble Resources	Joint venture	Natural Resources
2009	OC Oerlikon	Acquisition	Textil
2011	Otian International	Greenfield	Business service
2013	Philip Morris China Holdings	Greenfield	Commerce tabacco
2005	Ruida Electronics	Greenfield	Technology
2011	Saia-Burgess	Acquisition	Electronic components
1980	Shanghai Overseas	Greenfield	Business service
2011	Solartech Intl - LDK solar	Greenfield	Solar energie
2009	Sources Orient Holding	Greenfield	Business service
2010	Steiger Participations	Acquisition	Machinery
2008	Suntech	Greenfield	Solar energie
2009	Swiss Chronometric	Greenfield	Watch making
2012	Swissmetal Holding AG-Factory	Acquisition	Metal products
2012	Switzerland Nylonkong International	Greenfield	Solar energie
2010	Touchroad International Europe	Greenfield	Divers
2011	Trenaco	Acquisition	Coal
2010	Trina Solar	Greenfield	Solar energie
1988	U-star Trading	Greenfield	Commerce

Year of Inv.	Company	Mode of Entry	Activity
2010	VENTEC Europe	Greenfield	Electronic components
2013	Xorela	Acquisition	Machinery
2008	Yuanda Europe	Greenfield	Manufacturing
2011	ZTE	Greenfield	Telecom

Sources: L'Hebdo (2012) and data provided by Hay and Milelli.

**Figure 7: Chinese Investment in Switzerland by Sectors and Entry Mode**



Source: Estimated from figures of Table 2

Chinese investment in Switzerland has been allocated to different sectors of the economy ranging across a wide variety of activities. However, the sector that has attracted the highest proportion of Chinese firms is the technology sector, receiving around 38 percent of the total proportion of Chinese firms established in Switzerland. The natural resources sector and the watch-making industry are the second most attractive sectors for Chinese investment. Each sector accounts for around 11 percent of total firms. Investment in the Swiss natural resources sector differs from those undertaken in Latin America and Africa. Although Switzerland lacks natural resources, it does however have large MNEs operating in this sector. Chinese firms have acquired Swiss MNEs operating in natural resources, for instance, in 2009; Sinopec bought Addax Petroleum a large Swiss petroleum company. Other firms such as Brightoil Petroleum, and E&F Transpeed Trading that have been established as greenfield investments have based their headquarters in Geneva. The watch-making industry which is a traditional industry in Switzerland seems to have attracted a significant proportion of Chinese capital, followed by the sectors of finance and business services which each account for 9 percent,

while commerce accounts for 8 percent, machinery 3 percent, transportation 2 percent and other activities account for 9 percent (see Figure 7).

Although Chinese investment in Switzerland is still relatively insignificant, it has shown a clear upward trend over the past two years. Despite the major cultural, historical and political differences that exist between China and Switzerland, strong economic cooperation is emerging between these two countries. This dynamic cooperation started in 2009 with the signing of a bilateral investment agreement (BIT). This BIT entered into force in April 2010 (SECO, 2010). To broaden economic cooperation, China and Switzerland signed a free trade agreement (FTA) in July 2013. This accord addresses the protection of intellectual property, investment promotion, fair competition, transparency, trade-related environmental and labor issues. However, the main objective of this FTA is promoting the increase of international trade of both signing parties (SECO, 2013). While in 2012, Swiss exports to China accounted for around US\$8.1 billion, representing 3.7 percent of total Swiss exports, China's exports to Switzerland accounted for around US\$10.95 billion (SECO, 2013). Whilst a steady increase of Switzerland's imports from China is observed, accounting for 3.86 percent of total imports in 2010, 3.99 percent in 2011 and 5.08 percent in 2012, Swiss exports to China remain relatively constant, accounting for 3.66 percent of total exports in 2010, 4.27 percent in 2011 and 3.70 percent in 2012 (Swiss National Bank, 2013). Switzerland mainly supplies China with specialised industry machinery, luxury watches and electrical machines, China supplies Switzerland with manufactured products such as textiles, toys, apparel and electronic components (L'Hebdo, 2013).

## **6. ASSESSING OUTWARD FDI FROM CHINA TO SWITZERLAND**

Outward FDI from China to Switzerland is perceived as a new phenomenon. In the last few years, China has deepened its relationship with Switzerland through the bilateral investment agreement signed in 2009 and the free trade agreement completed in 2013. Although Chinese investment in Switzerland is still relatively small, a reflective examination from both the theoretical and international business perspective is necessary. Outward FDI from China to Switzerland conforms to the stages of the internationalisation theory. The evolution of internationalisation of Chinese firms to Switzerland has a trajectory background based on the evolution of trade. However, two features of outward FDI from China to Switzerland challenge the conventional understanding of internationalisation. These features are 'psychic distance' and the political aspect of the internationalisation of Chinese firms.

According to the Uppsala-model of internationalisation of FDI, firms invest in countries or regions with similar idiosyncratic features. Mainstream theories of internationalisation assume that dissimilarity in cultural, linguistic, institutional and developmental levels between the investor and the host country increases the cost of doing business which finally results in a competitive disadvantage for the firm (Child and Rodriguez, 2005). In the case of China and Switzerland, the 'psychic distance' between these countries is enormous. Although China is not the first country that has challenged conventional theory in this respect, the question is whether Chinese investment in Switzerland will successfully integrate. Different studies have revealed that Chinese firms have been unsuccessful with their investments abroad due to their ineffectiveness in integrating their companies' operations in foreign markets, especially in the developed world (Nicolas, 2007; Brown and Wood, 2009). The challenge of "liability of foreignness" is however present and since local firms are more mature than those from the developing world (Hitt et al., 2005; Nicolas, 2007); Chinese investment in Switzerland carries an element of risk.

The other aspect of this case that challenges conventional theory is the political aspects of outward FDI from China. Mainstream theories remain largely focused on the economic factors of FDI that influence the decisions of foreign investors and fail to consider the influence of governments on FDI. In the internationalisation process of Chinese firms, government policies have played an important role. Since the implementation of the market economic model in the late 1970s and the launch of 'Going Global' scheme in 1999, Chinese firms have been encouraged to invest abroad and improve their global competitiveness (Ren et al., 2012). The traditional Chinese firm oriented to the domestic market has evolved into a modern Chinese firm oriented to expand internationally (Erdener and Shapiro, 2005). While most governments nowadays are playing an active role in creating incentives by adjusting economic policies to encourage FDI (Blomström, 2001), the degree of the involvement of the Chinese government in the internationalisation of firms is very high (Ren et al., 2012). In contrast to its counterparts, China provides support in every aspect needed toward the internationalisation of its firms. The Chinese government supports the internationalisation of firms by providing quality information about investment opportunities, preparing market research and given training to nationals on topics concerning international business and providing financial support (Keller and Vanoli, 2012). The Government has also fostered intergovernmental cooperation through bilateral investment treaties, free trade agreements and regional trade agreements; these have been acknowledged as important facilitators of FDI in the global economy (Rios-Morales and Brennan, 2010).

A number of studies have posed the question as to whether Chinese firms would have been successful in their internationalisation process without the support received by the Chinese government, considering that Chinese firms have relatively weak competences in technological know-how, management skills and ability in integrating acquired firms, often with a very dissimilar corporate culture from the Chinese firms (Deng, 2004; Nicolas, 2007). Ren et al., (2012) suggest that the rapid increase of Chinese OFDI is the result of the state involvement in the process of firms' internationalization, shaping not only the trajectory of firms but also of China. Since China becoming a member of the WTO in 2003, an opportunistic approach has characterised the internationalisation of Chinese firms. In the early years of Chinese OFDI, capital was oriented towards rich natural resource countries. The pull factors of Chinese investment were based on stable supplies of natural resources to support China's added value industries (Gottschalk and Prates, 2005). Subsequently, Chinese firms have moved to market-seeking strategies, targeting the developed world and more recently, moving to strategic-asset-seeking investment.

The main motives for Chinese firms locating in Switzerland relates to strategic-asset-seeking. Switzerland offers access to sophisticated skilled labour force, managerial know-how, established brand names and international distribution networks. However, Switzerland has been historically associated with a well-developed manufacturing sector, the production of top-quality custom-built equipment and products of precision engineering. Switzerland is also renowned for its exquisitely engineered luxury timepieces, the watch-making industry have earned world renown for their expertise, workmanship, and creativity. Switzerland also possesses a favourable business environment.

### **6.1. Drivers and Motivators of Chinese OFDI to Switzerland**

The above distinctiveness of Switzerland are some the most important drivers and motivators of Chinese OFDI. In our appraisal of the Chinese OFDI to Switzerland, we have identified that a large proportion of companies investing in the technology sector have placed their investment in the solar energy. The energy sector in Switzerland has been traditionally well-known for its innovation, for centuries the physical energy of falling water has been the main source of the manufacturing sector; contributing to the development of pioneering engineering and advanced know-how in this industry. Nowadays, Switzerland is the world's leader in renewable energy (Rios-Morales et al., 2013). The second most attractive sector for Chinese OFDI in Switzerland is the watch-making industry. As mentioned above;

Switzerland is the traditional world leader in this sector due to its expertise, workmanship and inventiveness. Chinese firms have also placed their capital in the natural sources sector. Although raw materials are scarce in Switzerland, the country has a number of well-established MNEs in this sector. Although there have been a number of acquisitions in this field, a large proportion of Chinese OFDI is greenfield. These Chinese companies have based their headquarters in Geneva, taking advantage not only of the fiscal system but also of the networking system provided by this metropolitan city. The sector of finance is another Swiss targeted sector by Chinese OFDI; again, this is another traditionally well-developed sector in Switzerland. While there has been only one acquisition in this field, greenfield investment in the banking and investment sub-sectors are observed with the Bank of China a leading investor (see Table 2).

Chinese firms in the business services sector have also been established in recent years. However, we have identified that most of these firms are of a small size; their social capital accounts for only about CHF50,000 (approximately €40,575). These firms seem to have identified the need to provide support to Swiss exporting business to China and Asia, as well as providing information about investing in China and in the Asian region. It is noteworthy that the first firm *Shanghai Overseas* was already established in 1980 in Geneva, while its counterparts have launched their business in very recent years (see Table 2). Chinese firms located in the commerce sector are small-medium sized enterprises with similar social capital to those working in the business services sector. The machinery sector in Switzerland is also a well-established and renowned sector; although we have identified only two firms in this sector, one was a Chinese acquisition and the other is a greenfield investment. Similar to other Chinese firms, these firms have their headquarters in Switzerland but their manufacturing plants are established in China; one of these firms have the following logo "*Swiss engineering Chinese manufacturing*". In the transportation industry, COSCO the Chinese State-own MNE has a presence in the Swiss market. Chinese investors have also placed their capital in other sectors such as the hotel industry, television and other activities.

## 6.2. Opportunities and Challenges for Switzerland

Foreign direct investment has been acknowledged for its contribution to the host economy through job creation, increase in exports and long-term economic development. While a large proportion of Chinese OFDI in Switzerland is greenfield investment (see Figure 7), currently

it is difficult to estimate the number of created jobs by Chinese OFDI. Considering that a large proportion of Chinese companies established in Switzerland are relatively small enterprises and those that have large capital have placed their production plants in China, coupled with the fact that Chinese OFDI is still small, it is estimated that the contribution of Chinese OFDI toward job creation in Switzerland is currently insignificant. With respect to the increase in exports, it is also considered that the contribution toward the export sector is minor; if products are not produced in Switzerland but rather in China, there would not be a contribution towards the export sector. However, Chinese OFDI in Switzerland could contribute with the on-going improvement of efficiency and competitiveness of the economy. It could also provide greater access to Swiss firms in China and the Asian region.

Although Switzerland has attracted Chinese OFDI in various sectors, there is a tendency for Chinese firms to invest in sectors that have particular strength and advantage in the global market; sectors such as advanced-technology, watch-making, finance and machinery. These sectors are distinguished around the world for their top-quality, custom-built, efficacy and innovation. Investing in these sectors indicates the ambition of Chinese investors to attain strategic-assets that have been traditionally known in the international market for their high-value. Although this may well create a genuine competitiveness in the Swiss business sector, challenges with respect to price of products and their quality and unfair competition could develop. While Swiss products produced in Switzerland carry higher costs, "Swiss products" produced in China would be cost-effective. The strategy of "*Swiss engineering Chinese manufacturing*" raises some apprehension concern with the possible leakage of critical Swiss technologies to China, this concern that has also raised apprehension in Europe. The other concern arising from this strategy adapted by some Chinese investors is related to the possible undermining of the long established "*Swiss made*" reputation. Given that Chinese products are known for their generally low-quality levels, there is the possibility that this strategy could harm the reputation of Swiss products and mislead customers in the international market.

## 7. CONCLUSIONS AND RECOMMENDATION

The impact of OFDI from China to Switzerland is still relatively insignificant; the main reasons are due to the still small share of total FDI in Switzerland, the establishment of a large proportion of small enterprises and that many of the large Chinese companies have established their headquarters in Switzerland but their plants are based in China. Although

developed countries continue to be the most significant source of FDI in Switzerland, Figure 6 shows that the share of FDI inflows from the Asia, Africa and Oceania region, which China is part of, has increased more than threefold in the last few years. Chinese investment in Switzerland is expected to continue growing. Investing in Switzerland indicates that Chinese investors are willing to compete at the global level and to take on the challenge of the 'liability of foreignness', which carries an element of risk. Nonetheless, it is worth noting that outward FDI from China to Switzerland has been influenced by political considerations including home government mandate and host country government' receptivity to Chinese investment.

While the Swiss government has shown enthusiasm in engaging commercially with China, it needs to be mindful that China is determined to have access to strategic-assets to ensure the long-term security of its economic advance. Swiss authorities need to be aware of the challenges that Swiss firms might face in terms of price competitiveness when Swiss technology is transferred to China. Swiss authorities should also protect the long-well-renowned "Swiss Made" label. Swiss authorities should also ensure that the investment and trade agreement treaties work both ways as it is observed that while exports from China to Switzerland have grown in recent years, Swiss exports to China have remained relatively constant.

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## BIOTECHNOLOGICAL MERGERS AND ACQUISITIONS: AN OVERVIEW

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### ABSTRACT

*Purpose* – The aim of the paper is to analyze the phenomenon of Mergers and Acquisition in high-tech sectors with a special focus on biotechnological firms. In recent years there was an impressive wave of mergers and acquisitions (M&As), but this operations have produced mixed results for their stakeholders. In fact despite their popularity, M&As produce mixed results for stakeholders Fowler and Schmidt, 1988; Lubatkin and O'Neil, 1987; King et al., 2004), and there has been no systemic vision.

*Design/methodology/approach* – The paper can be classified like a descriptive paper. After a literature review on M&AS processes on high-tech sectors, the paper analyzes the dynamics, the results and the specificities of red biotechnological Mergers and Acquisitions.

*Findings* – In the biotech sector, over the last few years - during difficult economic times - it was difficult to attract investor capital. In this context, it's possible to identify a specific trend: traditional pharma companies with sufficient cash from their existing sales, but facing a dried-out product and patent pipeline have acquired innovative, but cash-poor biotech firms.

*Research limitations/implications* – The limitations of the paper consequent to its very nature: a secondary data-based research and a largely conceptual one, requiring further empirical testing and development.

**Keywords :** M&A, Biotech and Pharma Industries, Strategies

## INTRODUCTION

In recent years there was an impressive wave of mergers and acquisitions (M&As). What was traditionally considered to be extraordinary operations have become common business development options. During the first half of 2011, global M&A continued the resurgence that began in the second half of 2010, but markets cooled in the second half of 2011, resulting in aggregate volume of US\$2.38 trillion in 2011.

Stock market volatility, fear of a “double dip”, concerns over European sovereign debt and the future of the Euro zone, and regulatory uncertainty in the United States and Europe have created uncertainty in the market and put a number of deals on hold. However, would-be acquirers’ considerable cash stockpiles, strengthened balance sheets, access to attractive financing (for many investment grade borrowers), and need to expand into new markets are continuing to drive acquisitions. Megadeals returned in 2011, particularly in the energy and pharmaceutical industries; nine deals exceeded US\$15 billion in value, compared to just four during all of 2010 (XBMA, 2011).

Despite being a highly popular form of corporate development (Cartwright and Schoenberg, 2006), M&As produce mixed results for stakeholders (Fowler and Schmidt, 1988; Lubatkin and O’Neil, 1987; King et al., 2004). In spite of the extensive economics debate surrounding M&As, there has been no systemic vision or consolidated models that integrate the different schools of thought (Stahl and Voight, 2008; Weber and Drori, 2008). The complexity of the variables involved in the external growth process has favored analysis based on partial vision rather than a comprehensive and integrated analysis.

In this context, the research analyzes the phenomenon of Mergers and Acquisition in a specific sector: biotechnology. “The nature of high-growth technology-based industries distinguishes them from other types of industries. In addition to their high-growth potential, however, another distinctive feature of high-tech industries is the inherent uncertainty associated with companies whose values rely on future outcomes or developments in unproven, uncharted fields” (Kohers and Kohers, 2000: 40). Moreover, high-tech sectors’ strategies are viewed in the context of the overall business and consumer environment changes of recent years (Vrontis and Thrassou, 2007; Thrassou and Vrontis, 2009); their consequent business transformations, often through innovation and new product development (Thrassou et al 2012a,b; Chebbi et al, 2013); as well as national and locality contexts (Bresciani et al, 2013).

In the following section we present the methodology. Subsequently a literature review is conducted on M&As in high-tech sectors, with a specific focus on biotech firms. In the third section we define principal deals and strategies used by principal acquirers. Finally we present conclusions and managerial implications.

## **METHODOLOGY**

### *Aims and objectives*

The research is based on secondary data (XBMA, 2011; HBM, 2012) and aims to describe the phenomenon of Mergers and Acquisitions in high-tech sectors with a specific focus on biotech firms.

It is an overview of the state of the art of M&A in the biotech industry and has the research objectives of:

1. executing a literature review of M&A in high-tech sectors, with a specific attention on biotech sector,
2. analyzing the dynamics, results and specificities of biotech M&A,
3. describing principal deals and M&A strategies in biotech industry.

### *Research value and limitations*

The paper can be classified as a descriptive paper. On the basis of previous researches (Rossi et al., 2011; Tarba et al. 2013) after a literature review on M&A processes on high-tech sectors, the paper analyze the dynamics, the results and specificities of biotechnological M&A.

The value of the paper stems from the fact that it defines and helps comprehension of the link between the biotech industry and M&A activities. The research offers a valuable theoretical basis for empirical development and practical application. At the same time, this research provides the context of prescribed actions and processes.

The limitations of the paper are a consequence of its very nature, the fact that it is a secondary data-based research and a largely conceptual one. Consequently further research should firstly empirically test this research's findings.

### **M&As in high-tech sectors: Literature review**

M&As have been studied using different approaches that have generated a considerable amount of empirical and theoretical studies, resulting in high fragmentation of points of view (Capasso and Meglio, 2005). This consideration is particularly true for high-tech sectors that were characterized – in last decades – for a significant expansion of Mergers and Acquisition activity. In these sectors “many operations involved the acquisition of small and young start-ups. The principal driving force behind these acquisitions was the need of the acquiring firms to obtain new skills and new technical and technological knowledge” (Tarba et al, 2013: 6). The most important characteristic are the strong link to core business of firms. Kohers and Kohers (2000) sustain that “The nature of high-growth technology-based industries... and the inherent uncertainty associated with companies whose values rely on future outcomes or developments in unproven...” have a strong impact on M&A process in these sectors.

There are difficulties to define what does hi-tech M&As mean. In fact M&As in high technology sectors concern two different typologies of acquisitions: the acquisition of high-tech companies and acquisitions in which technology is only one component of the acquired firm’s assets (Ahuja and Katila 2001).

These factors determine an high heterogeneity in the literature, both in methodology and in the results achieved. For these reasons it’s important to define the subject of the investigation. A common topic is acquisition performances but other important topics are the complex process of integration and/or the complex strategic decisions process. Despite the extreme fragmentation of the literature, in a specific study, Meglio (2009) divided the literature on M&As in technology-driven sectors into these three main areas: strategic decision-making, integration process, and acquisition performance.

Only three of these paper – Schweizer, 2005/2005a; Laamanen e Keil, 2008 – have focused their attention on biotechnology firms.

Schweizer (2005a, 2005b) focuses its attention on Integration process and on knowledge transfer particularly. The first article focuses the post-acquisition integration of biotech firms by pharmaceutical companies. It is based on a short analysis of recent issues in the pharmaceutical and biotechnology industries and on five in-depth case studies. In view of the complexity and the multifaceted nature of M&As, Schweizer (2005a) concluded that pharmaceutical companies should apply a hybrid post-acquisition integration approach with simultaneous short- and long-term motives/orientations, and segmentation at a different pace

across different value chain components. In his second paper Schweizer (2005b) analyzed the consequences of the acquisition of biotech companies for knowledge transfer and the organization of R&D at acquiring pharmaceutical companies. The author concluded that there is no systematic biotechnological know-how transfer from the biotech to the pharmaceutical company after the acquisition. Instead, the biotech companies remain independent and assume the role of centers of excellence for R&D within the pharmaceutical companies, which is the only way of preserving the innovative capabilities of the acquired biotech company.

In their study Laamanen e Keil (2008) focus their attention on acquisition performance. Biotech is only one of seven sector considerate form authors. In fact they examined acquisitive performance among several of the most active acquirers in seven industry sectors (pharmaceuticals and biotechnology, computers and office equipment, packaged software, communications equipment, measuring and medical equipment, telecommunications, and health services) in the US in the 1990s. They found that a high rate of acquisitions is negatively related to performance: "An acquirer's size, the scope of its acquisition program, and acquisition experience moderate the relationship by weakening the negative effects" (p. 663).

## **BIOTECHNOLOGY M&AS: DEALS AND STRATEGIES**

"Biotechnology Mergers and Acquisition (Biotech M&A) can help the industry's fully integrated players to increase in size and market value, boost the emerging players' efforts to reach full integration or allow horizontal players to survive cyclical financial crises" (Pavlou, 2003: 85).

In his research Pavlou (2003) defines principal reasons for M&A in the biotechnology sector: increase pipeline productivity, support market expansion, aid the transition towards full integration.

"Pharmaceutical companies are facing the challenges of a declining pipelines of products, a continuing increase in the costs to develop and commercialize new products and a more demanding market that is reducing the prospects to achieve premium pricing for new drugs. These market dynamics are likely to effect pharmaceutical M&A activities in the following ways" (Kohl, 2005: 105)

Traditionally it's possible to define two different typologies of M&A:

1. acquisition of biotechs by pharmaceutical firms (intersector activity);
2. biotech-biotech mergers (intrasector activity).

The intersector M&A concern a phenomenon of acquisition by Pharma companies of biotech firms. Biotech companies offer one obvious source of new products. Large pharmaceutical companies have partnered with biotech to develop and commercialize particular products for many years. A more recent, less cautious, trend is for pharmaceutical companies to make outright acquisitions of biotech. There are many examples in recent years: the acquisition of Antisoma by Roche the acquisition of Esperion Therapeutics by Pfizer and the Johnson & Johnson acquisition of Scios. Through the acquisition of a biotech, a pharmaceutical firm can add new technologies, new product platforms in a way that is more cost effective than developing these items from scratch. Additionally, biotech products are more difficult to reproduce by competing generics companies and therefore may be less vulnerable to patent expiration. A biotech company, in turn, can benefit from a pharmaceutical company's improved financial and marketing strength and greater experience in developing drugs through trials. Also, in the absence of a robust IPO market for biotechs, a sale may be the best way for the biotech founders and venture capital backers to realize a return from their investment. There may, however, be greater difficulties in achieving a successful integration of a pharma-biotech merger. The R&D expertise of a biotech may not be compatible with that of a pharmaceutical company, although this issue may become less of a factor as the therapeutic platforms of biotechs and pharmaceutical companies move toward convergence. Perhaps more important are the differences in culture that may be faced between pharmaceutical firms and biotechs. Biotech scientists and managers, who have generally grown up in an entrepreneurial culture, may have difficulty in adjusting to a big-business culture of a large pharmaceutical company (Kohl, 2005).

The intrasector M&A concerns a process between two biotech firms. This is a relatively recent trend. Examples are the Biogen-Idex merger and the acquisitions by Amgen of Immunex and, most recently, Tularik. As biotechs have grown into significant players large biotechs, like the big pharmaceutical companies, have increasingly looked to mergers with other biotechs to achieve needed critical mass and economies of scale. Merged biotech companies hope to achieve enough sales revenue to support their own manufacturing, marketing and sales operations. These types of deals demonstrate an increasing maturation of the biotech

industry. Also, a biotechbiotech merger may face less problematic integration issues than pharma-biotech acquisitions (Kohl, 2006).

In sum, the pharmaceutical industry faces numerous uncertainties driven by market, technological and regulatory factors. In light of these factors, pharmaceutical and biotech companies certainly will continue to employ M&A activities as a short-cut in product development and a means to maintain and enhance their competitive edge.

The number of M&A transactions in 2011 (71 deals) was a bit lower than in 2010 when a record number of 79 transactions were completed. 24 public companies were sold in 2011 (compared to 20 in 2010). 2011 showed strong M&A activity in the North American and European pharma/biotech sectors with upfront transaction volumes reaching \$64.1 billion. When comparing 2011 with 2010, one should consider that the deal volume in 2010 includes the purchase of Novartis' remaining stake in Alcon for \$41 billion which accounted for over half of that year's transaction volume (HBM, 2012).

In 2011, US target companies accounted for almost two thirds of deal volume (\$42.8 billion, 39 deals). The 28 European biopharma companies sold generated \$21.2 billion of transaction volume. Even if one excludes the Nycomed/Takeda deal, transaction volume in Europe was at a similar level (\$7.5 billion) as in 2010 (\$7.6 billion). Finally, 4 Canadian companies were sold in 2011 for a total of \$133 million. The largest deal in 2011 was the purchase of Genzyme by Sanofi for \$20.1 billion plus contingent payments of approximately \$2.8 billion. The sale of private-equity-backed specialty pharma Nycomed to Takeda for \$13.7 billion marks the largest-ever trade sale of a private pharma company. Other notable transactions were the sale of Cephalon to Teva (\$6.8 billion), the sale of King Pharmaceuticals to Pfizer (\$3.6 billion), the sale of Talecris to Grifols (\$3.4 billion) and the sale of Crucell to J&J (HBM, 2012).

The number of trade sales of VC/PE-backed companies also held up well (31 trade sales vs. 32 trade sales in 2010), whereas the number of "other" private companies sold dropped from 27 in 2010 to 16 in 2011.

In 2011, as in previous years (with the exception of 2009), European buyers again significantly outspent their US peers on biopharma acquisitions. European buyers not only have been more active buyers in their home region, i.e. in Europe, they also put up more money for US acquisitions than US buyers (HBM, 2012): Since 2005, European pharma firms have purchased US companies for a total of \$192 billion whereas US pharma buyers "only" spent \$170 billion (of which \$109 billion was accounted for by the two megadeals Pfizer/Wyeth and

Merck Inc./Schering Plough). Even if one excludes the two largest US acquisitions by European firms (Roche/Genentech \$46.8 billion and Novartis/Alcon \$52.1 billion<sup>1</sup>), European buyers still disbursed close to \$100 billion on other US acquisitions.

In every year covered by this report, large pharma companies have been clearly the most important buyers of US and European biopharma companies contributing 58% (2005) up to 96% (2009) of yearly transaction volume (see chart on next page). This percentage is of course strongly influenced by “mega deals” with big pharma firms on the buy side. But large pharma companies also dominate the smaller end of the M&A market. Their share of acquisition dollars spent to buy of VC-backed private companies has since 2005 averaged roughly 50%. After an increase to 67% in 2007, the share dropped to below 50% in 2009 and then picked up again reaching 56% in 2011 (HBM, 2012). Big pharma’s continued interest in innovative companies – as demonstrated by the increase of their share of VC-backed companies bought in 2010 and 2011 - is encouraging. However, most industry observers would agree that large pharma companies have become very selective and – if they are interested in buying a company – try to offload some of the risk to the sellers of.

The most acquisitive company in the period – for US and Europe – was Sanofi, which did 9 deals from 2009 to 2011(after having only bought one company in the period 2005-2008). Pfizer, having done most acquisitions during 2005-2008, is still actively acquiring companies (5 acquisitions during 2009-2011, 3 in 2011). Another very active acquirer during the last three years was specialty pharma company Valeant (5 acquisitions 2009- 2011, 3 in 2011) (HBM, 2012).

After a very strong first half of the year which included the landmark sale of PE-backed Nycomed to Takeda, fewer venture- and private-equity-backed companies were sold during the second half of 2011. The 12 transactions in H2 2011 generated an upfront transaction volume of \$1.3 billion (\$1.9 billion including biodollars). These numbers are somewhat disappointing as industry participants and especially investors in private biopharma companies hoped that the great momentum seen during H1 2011 would continue into H2 2011.

Private M&A activity dropped strongly especially in Europe where in H2 2011 only 4 VC-backed companies (Astex, Cellartis, DuoCort and Lectus) were sold, with only Astex and DuoCort yielding a significant upfront consideration, but on the private-equity side, the action was mostly in Europe (HBM, 2012).

The sale of Nycomed (Switzerland), backed by Nordic Capital and some other investors, to Takeda was, the principal operation. The multiple of this deal is unknown, but investors' gains are in the billions of dollars. This hugely successful transaction could whet the appetite of larger buyout firms to enter the pharmaceutical space.

Another notable deal was the sale of specialty pharma company PharmaSwiss to Valeant for about \$475 million. The sale of PharmaSwiss, backed by HBM BioVentures and Enterprise Investors, was the second largest European exit of a VC- or PE-backed private pharma company during the last 5 years (HBM; 2012).

Average transaction values from trade sales of VC-backed biopharma companies (PE deals excluded) were high in 2011 when compared to 2010 values. Average upfront proceeds notched above \$200 million, and average total deal value jumped to \$333 million, the highest number for the period covered by the survey. It is interesting to note that the average total VC investment into companies that were sold remained pretty stable over the years, averaging \$50 million to \$70 million. In Europe, average transaction values and average investment amounts were significantly lower, confirming that US biopharma companies are significantly better capitalized, but can also command higher exit values (HBM, 2012).

## CONCLUSIONS

In the biotech sector, the last few years faced significant difficulty in attracting investor capital. "Small- and mid-cap biotech companies have heavy investments in R&D, and it's not uncommon for them to raise capital through the capital markets every two or three years. Whenever the economy and the financial markets are in a down cycle, it's increasingly difficult for biotechs, especially ones under \$1 billion in market cap, to successfully access the capital markets, or at least access them on favorable terms. Small- and mid-cap biotech is considered a speculative investment space, and thus investors are less willing to invest there in times of economic turbulence, and especially in companies that are smaller in market cap" (Simeonidis, 2010:1).

In this context it's possible to explain the specific trend of recent years: traditional pharma companies with sufficient cash from their existing sales but facing a dried-out product and patent pipeline have acquired innovative, but cash-poor biotech firms. In fact the pharmaceutical and biotechnological industry had to face severe structural challenges in the previous years. Factors like changing patent or regulatory laws have tightened the cost

pressure. The growing complexity of R&D has made it more difficult to refill the product pipeline, which is responsible for future revenue streams. M&A have been a frequent strategic response to these challenges. In fact 2011 was a very strong year for biopharma M&A: the number of both larger and smaller transactions was high. This phenomenon will increase because “The overall slowdown in prescription drug sales in Western Europe and the US will accelerate the need for further consolidation” (HBM, 2012: 14). Moreover there are other important trends “that favor growth via acquisitions, including US health care reform, evolving FDA standards, and increasing pressure for pharmaceutical companies to diversify into generic products, consumer health, devices, and emerging markets” (Accenture, 2011: 15).

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## ON THE CONSISTENCY AND LINEARITY OF ASSOCIATIONS BETWEEN NATIONAL CULTURAL DIMENSIONS AND ENTREPRENEURIAL INTENTIONS RATES

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### ABSTRACT

There is growing interest in the cultural contextualization of the entrepreneurial mind-set. The purpose of the current study is to analyse associations between aggregate national scores along cultural dimensions and national levels of entrepreneurial intentions. Results show that when using Hofstede's dimensions, individualism and power distance have a non-linear association, time orientation has a linear association, while masculinity and uncertainty avoidance have no association with entrepreneurial intentions. However, when using the GLOBE dimensions, results show that institutional collectivism, humane orientation and uncertainty avoidance have a linear association with entrepreneurial intentions, while all other dimensions have no such association. The similarities and differences between these results are discussed, and some explanations for gaps are suggested.

**Keywords:** Entrepreneurial Intentions, Culture, Hofstede, GLOBE, Linearity, Individualism, Power Distance, Masculinity, Uncertainty Avoidance, Time Orientation

### INTRODUCTION

Entrepreneurship literature has often focused on the entrepreneurial individual in terms of demographic and psychological dimensions that influence his or her intentions, attitudes, motivations and actual engagement in entrepreneurship. However, there is growing interest in the socio-cultural contextualization of the entrepreneurial mind-set (Hindle et al., 2009), while aiming to identify favourable conditions for entrepreneurship (Davidsson, 1995, Hofstede et al., 2004, Mueller and Thomas, 2001, Shane, 1993). The current study seeks to contribute to this line of inquiry by analysing associations between aggregate national scores along key cultural dimensions and national levels of entrepreneurial intentions.

## **LITERATURE REVIEW**

As culture strengthens certain characteristics while discourages others, it is plausible that some cultures will be more entrepreneurially oriented than others (Mueller and Thomas, 2001). This logic attracted researchers to explore associations between cultural dimensions and various expressions of entrepreneurial orientations and activities across countries.

In a review of research at the intersection of culture and entrepreneurship at the national level, Hofstede et al. (2004) identified two main approaches, each with its own supporting studies. The first, referred to as the 'aggregate psychological traits perspective', assumes that cultures characterized by low power distance, low uncertainty avoidance, high masculinity, and high individualism represent social settings in which more individuals have entrepreneurial values, and hence a larger supply of potential entrepreneurs (Davidsson and Wiklund, 1997).

A second approach, referred to as the 'dissatisfaction perspective', assumes that cultures characterized by high power distance, high uncertainty avoidance, high masculinity, and low individualism represent social settings in which entrepreneurial individuals cannot follow initiatives within existing organizations, and, therefore, are forced to engage in self-

employment. This approach draws on social legitimation perspectives (i.e. Etzioni, 1987), and the theory of the displaced entrepreneur (Shapero, 1975, Shapero and Sokol, 1982).

At this stage, it is worth noting that the previous studies assumed linear relationships between cultural dimensions and various indicators of entrepreneurship at the national level. However, such assumption should be challenged. Indeed, earlier studies have identified non-linear relations between entrepreneurship and a number of cultural variables (Minniti, 2005, Zahra et al., 2004, Morris et al., 1993, Wennekers et al., 2005).

Hence, the current study will aim to clarify and pacify some of these controversies through evaluation of associations between cultural dimensions and entrepreneurial intentions, while using both Hofstede and GLOBE in both linear and non-linear models.

## **METHODOLOGY**

Culture is captured by using scores from both Hofstede (2001) and the Globe project (House et al., 2004). National levels of entrepreneurial intentions are captured by average of multiple annual scores adopted from the GEM Reports (Global Entrepreneurship Research Association, 2012). The relationships between them are analysed through regressions of both linear and non-linear (e.g. curvilinear and cubic) models.

Since various cultural dimensions have shown to exhibit significant intercorrelations within and across cultural frameworks (Hofstede, 2001, House et al., 2004), in order to avoid problems of multicollinearity, the analyses are run for each cultural dimension separately, while comparing linear and non-linear models.

The number of observations in each analysis is set by the availability of data in every source used. Hence, the number of observations is 40 when using the GLOBE dimensions' scores (House et al., 2004), 51 when using Hofstede's scores for the original four dimensions (Hofstede, 2001), and 53 when using the new scores suggested for the long term orientation dimension in Hofstede, Hofstede and Minkov (2010).

## FINDINGS AND DISCUSSION

Specifically, the current study shows that when using Hofstede's dimensions, individualism and power distance have a non-linear association, time orientation has a linear association, while masculinity and uncertainty avoidance have no association with entrepreneurial intentions. However, when using the GLOBE dimensions, results show that institutional collectivism, humane orientation and uncertainty avoidance have a linear association with entrepreneurial intentions, while all other dimensions have no such association.

Explanations for differences in findings across frameworks are traced to differences in operationalization and measurement of related aspects of similar dimensions in the two cultural frameworks that were used.

Non-linearity of associations in the case of power distance and individualism-collectivism are explained by identification of "turning points". Such points reflect a momentum, where culture facilitates change in environmental conditions sufficiently so as to give priority to different considerations towards entrepreneurial engagements. More specifically, these reflect changes between the dissatisfaction approach to entrepreneurship (Hofstede et al., 2004, Baum et al., 1993, Shapero, 1975, Shapero and Sokol, 1982), and the aggregate psychological trait approach (Davidsson, 1995, Davidsson and Wiklund, 1997, Shane, 1993).

Finally, it is suggested that since more observations are available for analysis when using the Hofstede dimensions, and since these are bi-polar in nature, an identification of significant non-linear associations becomes possible, in comparison to when using the more limited number of observations of the GLOBE's unipolar dimensions.

### Conclusion

While earlier cross-country studies did identify significant differences between countries (Giacomin et al., 2011, Lee et al., 2006, Pruett et al., 2009), these have rarely been traced back to cultural explanations. And those that did so came up with conflicting hypotheses

(Hofstede et al., 2004). Hence, conducting the analysis presented in this paper contributes to existing knowledge in three ways. First, it enhances our understanding of the relationships between culture and entrepreneurship at the national level, while pacifying conflicting findings in earlier studies. Second, it highlights the non-linear nature of some of these associations, which was largely unaddressed in earlier studies. Third, it does so by employing concepts from the two main competing cultural frameworks, while contributing to a more pluralistic and complimentary discussion of culture in the context of entrepreneurship.

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## MANAGING TEAM PERFORMANCE: DISINGENUOUS OR JUST PLAIN STUPID!

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### ABSTRACT

**Purpose** In a turbulent economic climate, characterised by pressures to improve productivity and reduce costs, performance management has a more central role in helping to ensure competitive advantage. A focus on teamwork has become an almost universal feature of performance management in modern organizations. It is essential that messages concerning teamwork and rewards are clear and seen to be fair if they are to bring about commitment to discretionary effort, which is increasingly a key feature in gaining competitive advantage.

**Methodology.** This paper uses the concepts of equity and motivation to explore the outcomes, procedures and implementation of teamwork in contemporary organizations. It draws on a range of theoretical frameworks from both philosophy and social science, examines current practices and experiences and considers future trends. Empirical research includes a ten year study of practising managers and also ethnography, questionnaires and interviews in two large manufacturing and service organizations

**Findings.** Investigations show that the espoused theory of organizations concerning the need for teamwork is often at odds with their theory in use. This frequently creates both actual and perceived injustice in organizations and a tension between managing performance and encouraging engagement, which is dependent on perceptions of fairness.

**Implications** Organizations are sending out mixed messages that are causing tensions which may affect productivity.

**Value** This research opens a debate that seeks to assess the contribution of teamwork to the achievement of an organization's goals and how this may be applied in the practice of performance management.

**Keywords:** Performance Management, Teams, Performance-related pay, Fairness, Competitive advantage, Motivation

### INTRODUCTION

In a challenging economic climate, characterised by pressures to improve productivity and reduce costs, performance management has a more central role in helping to ensure competitive advantage (CIPD, 2009). A focus on teamwork has become an almost universal feature of performance management in modern organizations. Leaders are saying that teamwork is an essential component in the achievement of organizational objectives. However, the emphasis of appraisal, development and pay continues to be on the individual (Armstrong and Baron, 2005). The challenge for managers is to bring about commitment to discretionary effort, which is increasingly a key feature in gaining competitive advantage.

As organizations have developed more structured approaches to strategic management, there has been some movement towards the integration of these processes with the management of human resources. This has involved many organizations in the introduction of formal performance systems, frequently characterised by appraisals or performance reviews (Prowse and Prowse, 2009).

As the prevalence of performance appraisal has grown so has its influence in shaping employee perceptions of justice. Outcomes and processes which are perceived as unfair in an organization will result in a workforce whose contribution through enthusiasm and "going the extra mile" is not fully achieved (Suliman, 2007).

Equity theory and Organizational Justice are concerned with the fairness by which the benefits and burdens of an organization are allocated and the fairness of the process by which decisions are made (Adams, 1963, Greenberg, 1987; Folger and Bies, 1989; Beugre, 1998; Greenberg, 2006). Equity is a useful concept through which to examine the outcomes and processes of performance review and management. It is core to the psychological contract and to employee engagement and discretionary effort.

## **THEORETICAL BACKGROUND**

### *Equity and Justice*

Social scientists have explored concepts of fairness and justice since the beginning of the 20<sup>th</sup> Century, but it was not until the 1980s that the workplace became a focus for what has become known as Organizational Justice (Greenberg, 1987). Theorists have made a distinction between distributive justice – the fairness of outcomes- and procedural justice – the fairness of process to achieve these outcomes. More recently there has been a theoretical separation within procedural justice between how decisions are made and how they are implemented and communicated (Bies, 2001). Notions of distributive justice are present in political theory

(Marx, 1969). However, the early focus of Organizational Justice was grounded in the contributions of Homans (1961) and Adams (1963), whose equity theory suggested that workers compare their own input/output ratios with that of others. A corollary of this was that both behaviours and attitudes changed where there were disparities as workers attempted to achieve equilibrium.

Models of fairness and justice in outcomes go back considerably further. Aristotle considered justice to be people receiving that which they deserved. Bentham (1789) considered the outcomes of utilitarianism/fairness to be happiness. Later commentators suggest linkages of happiness to both work and personal performance (Blanchflower and Oswald, 2011). Stakeholder theory considers the 'sustaining corporation' making a positive contribution to human performance (Clifton and Amran, 2011). Utilitarianism cites the importance of healthy, respectful and supportive organizational culture and fair treatment, security and recognition (Ashkanasy, 2011).

#### *Teamwork, Motivation and Reward*

Much has been written about the importance of teams since the early 1980s. In many areas this research has focused on motivation and contributions to organizational success.

In the 1990s there was a shift away from behaviourism and expectancy theory coalescing around the three main areas of goal setting, social cognitive theories and organizational justice (Latham and Pinder, 2005).

The importance of management culture and explicit and implicit management values have been partially explored (Hofstede, 2001, 2010; Solatari, 2006) but little has been discussed regarding teams.

The appraisal, performance and reward of individuals has been well reported but those of teams has received less attention. Meyer, (1994) indicated possible systems of appropriate rewards for teams; but there is a paucity concerning the linkages between team reward motivating performance despite the almost universal belief that teams are a crucial component in organizational effectiveness (Prowse, 2009; Mullen, 2010; Clopton, 2011).

The importance of teams is reflected in the belief that they can achieve more than individuals and that this synergy is a pivotal part of gaining competitive edge (Clark, 2005).

#### *Appraisal and Performance Management*

Appraisal is usually part of a performance management system and can result in increased pay and other rewards such as promotion, career opportunities or actions to remedy disciplinary or capability issues, perhaps resulting in dismissal. Appraisal systems can result in unfair or inequitable distributions of organizational rewards and punishments. If the

outcomes of appraisal are considered unfair then it might explain the attitudinal and behavioural outcomes predicted by Adams (1963), including reduction of effort and a lack of engagement.

Since the late 1950s research into appraisal systems has shown repeatedly that schemes which link interviews with remuneration are at best unhelpful and at worst counterproductive (Maier, 1958; O'Neill, 1995; Oliver, 1996 and Prowse and Prowse, 2009). The same is true for schemes linked to teamwork (Geary, 1992; Mullen, 2010). No evidence currently exists from any controlled study in the UK or USA to show that long-term improvements in the quality of performance result from appraisal-based extrinsic rewards. Nonetheless, providing information for remuneration purposes continued to be one of the major objectives of appraisal, along with objective setting and training needs analysis for employee development purposes (CIPD, 2009).

However, there are few reported instances of group or team appraisal. There is some evidence of the evolution of e-appraisal carried out in a small number of organizations and in some instances there is an element of self-appraisal (Payne et al, 2009).

There is clearly a link between the methods in use, the reasons why appraisal is employed and the underlying philosophies of performance management (Neeley, 1998; Bennett, 2006; Rowland and Hall, 2010). Recent shifts in both the articulated purposes of appraisal and the methods employed may signal a fundamental change in the underlying philosophies of human resource management. At face value the trend seems to support this interpretation. The values of utilitarian instrumentalism, exemplified by the Michigan school (Fombrun et al, 1984) appear to have given way to the Harvard approach of developmental humanism (Beer and Spector, 1985). Concepts of ideology, politics and power have been replaced by ideas of empowerment, commitment, culture and consensus. Yet there seems to be little congruence between the espoused theory of "people are our greatest asset" and theory in use.

It is clear that many organizations have taken a more strategic approach to human resource management and see performance management as fulfilling a key integrative role. However, the extent to which this strategic emphasis reflects a change in values remains largely unanswered and perceptions of fairness are not fully considered in a climate where discretionary effort is critical to success.

## **RESEARCH FOCUS**

The recent downturn in economic activity has placed a premium on effective performance and the harnessing of discretionary effort for competitive advantage. At the same time the connection between performance management, equity, teamwork and fairness has not been adequately explored. The focus of this research was on whether employee perceptions of the fairness of performance management systems have an impact on the effectiveness of team performance and discretionary effort.

Do mixed messages regarding team and individual contribute to disparities in organizational rewards and burdens?

Do employees perceive outcomes and procedures as fair?

Do the espoused standpoints of organizations regarding teams fit with the theories in use as perceived by employees?

Is there a tension between control and commitment influencing the effectiveness of performance management?

## **METHODOLOGY**

A mixed methods approach was used with documentary analysis, formal and informal interviews, questionnaires and observation as primary tools. Literature reviews were carried out to establish comparable current research findings and theoretical frameworks. The research commenced with an exploratory phase using informal interviews followed by content analysis to identify emerging trends and patterns.

The information came from three main samples:

Sample one was a longitudinal study and comprised of over 100 managers engaged on management development programmes at two higher educational institutions over a period of ten years. The sample was also a convenience sample representing both the public and private sectors. There was a 100% response rates from these participants due to personal and prolonged contact with each participant. All participants in this sample were interviewed informally and also completed a questionnaire.

Samples two and three were taken simultaneously from two large service and manufacturing organizations and comprised of a purposive diagonal ethnographic survey of 40 employees followed by a postal questionnaire sent to all employees and completed by 495. Response rates were 30% from Organization A and 16% from Organization B. All participants were based in the United Kingdom and were in full time employment.

All participants in sample one (100 persons), and all those from samples two and three who had taken part in the ethnographic survey (40 persons) completed a semi-structured account of how appraisals, performance management and reward systems operated in their organizations. They were also asked to give their own perceptions of the effectiveness and appropriateness of any of the systems and outcomes they had experienced. Content analysis then took place and identified themes. These were used to design questionnaires with categories that could be interrogated by a mixture of quantitative and qualitative means. The emphasis of the questionnaires was to test the tools, systems, procedures and outcomes of appraisal and the participant's perception of linkages to individual performance, team performance, motivation and organizational effectiveness.

Significance testing was undertaken by means of Chi-Squared (Bhattachary and Johnson, 1977). The purpose of this was to examine whether there were any significant differences between responses from different organizations, sectors, occupations, length of service and gender.

## FINDINGS

### *Ethnographic survey findings*

Several themes emerged from the ethnographic survey that were common to both organizations. The common themes were a distrust of appraisal and performance related pay and a belief that there was an inequity of treatment between high and low producers centring on arbitrary standards of discipline. A large proportion of those interviewed were cynical about appraisal and although they believed that in an ideal world it could be a useful and positive experience, in reality it was often *"just going through the motions"* and was not carried out in a fair and systematic way. Most participants were strongly against being rated for performance related pay even some that received it. In one case, a manager responsible for administering the performance related pay systems said, *"it is unrealistic and complicated ... we must spend many hundreds of man hours performing paper exercises which have very little impact on the performance of people, thus the business"*.

During the ethnographic survey many participants spoke about the importance of team work. These values were observed to be strongest amongst managers and workers directly involved on the shop floor. Nevertheless, these beliefs were also expressed by senior managers and administrators.

*"In my area we are highly reliant on teamwork. I have little or no control over spares from Stansted or Copenhagen. This is a common hold up, on a typical day this happens at least twice. I am not over fond of P.R.P., I don't think it would work."* (Participant 6, Organization B, Ethnographic Survey)

Management values and systems at both organizations encouraged teamwork by speaking positively about the need to work together and the organization of work. However, both workers and managers were often dismissed this as being disingenuous.

*"If you speak the truth you are perceived as being a non-team player - it seems to be mainly a production thing. People are frightened to speak the truth. Real teamwork is not just talking about teams."* (Participant 1, Organization A, Ethnographic Survey)

#### *Union views*

Both organizations in the survey had strong union memberships representing over 75% of the workforce. Union officers from both organizations were interviewed using the same semi-structured format experienced by other participants.

Interviews with the unions at both organizations revealed very strong inculcated beliefs in equity, collectivism and teamwork. All union representatives believed that performance management should be team centred rather than focused on the individual. However, payment for team results was also seen as divisive and would result in isolation of winners and losers leading to de-motivation. These findings reinforce the views of Porter and Lawler (1968) and Deery et al. (1999). They speak of deeply entrenched beliefs in the importance of equity and pluralism that would make changes based on individual reward very difficult to implement. Typical employee comments at the host companies concerning individual and team based payments were *"PRP ... it didn't work, too divisive"* and *"team PRP - it would be a nightmare, too many elements out of your control"*.

This divisive aspect of performance management seems to confirm Grint (1993) who sees a major problem of appraisal schemes often being their aim to limit the collective aspects of work and individualise the employment relationship.

Interviews with union officers at both organizations found there was a belief that there were hidden agendas for performance systems other than rewarding contribution. Evidence and anecdotes were given of the use of yearly reviews and being used for redundancy choices or as tools for disciplinary action. Performance related pay was seen as wide open to systematic abuse with constant references to favouritism, subjectivity and politics. It was seen as counter to the central values of trade unionism represented as pluralism and equity. Quotes were

made such as *"We are against PRP," "We refute the principle and we would not co-operate," "We tried it once; it didn't work - too divisive."*

#### *Management Views*

Interviews with senior managers showed a variety of beliefs. Some were in favour of individual measurement and rewards, some were for team measurements and rewards and some were for all in the organization sharing the same reward in the form of gain sharing. As a rough guide those who tended to favour individual and team rewards tended to be managers from a human resource background and those who favoured the gain share approach were from an operations background. This reflects similar findings from Armstrong and Baron (1998) who observe that human resource practitioners may often have different perceptions than operations managers. These findings do indicate an interesting divide worthy of further investigation.

Interviews with Managing Directors at both organizations found a similar prevailing theme. This was a desire for rewarding contribution. Both recognised the need for a general framework and the need for equity. There was recognition that the large number of variables would prove difficult in the design and implementation of such a system. Both Managing Directors favour a less complicated bonus or gain system. Individual performance pay was discussed but was not pushed as being highly beneficial. Change and good performance management systems were seen by both Managing Directors as being crucial and were high priorities.

Again, an interesting contrast to the approach taken by the Managing Director was apparent in the interviews with the Human Resource Directors at both organizations. Both took a positive view towards performance related pay, in particular it was seen as a motivator and reward for contribution. Both HR Directors believed that a large balance of the workers' wages should be based on individual contribution.

*"A significant portion of salary that is at risk based on individual performance."*(Organization A, HR Director)

*"I believe that all should have a significant proportion of their pay linked to their contribution to the Organization."*(Organization B, HR Director)

All managers in the study recognised the complexity and difficulties inherent in such systems but were convinced of their potential to increase productivity. This difference of emphasis on the benefits of PRP is consistent with the findings of Geary (1992), Armstrong and Baron (1998), and (Kessler, 2000). They draw conclusions concerning different perceptions between

Human Resource practitioners and Operations Managers and also workers and middle managers concerning performance related pay.

#### *Employee Views*

Observations, surveys and interviews confirmed that the majority of people felt that equity and change could only be ensured if teams were empowered and trusted the management. Meyer (1994) argues much the same, he sees the overriding purpose of performance management as being devised and used by teams to help the team to help improve performance rather than for the use of top managers to gauge progress.

Many of those interviewed at both organizations spoke of the difficulties of controlling external variables that teams depended on to achieve targets. These were things such as parts or services from within the organization, or from different bases and also parts from suppliers based in the UK or abroad.

An interesting belief prevalent in past surveys carried out by the author at other organizations and also occurring in both the Organization A and B ethnographic surveys and questionnaires concerns individual perceptions. This is the belief by individuals that performance related pay would work for them if fairly supervised but not for others. This belief was underpinned by the conviction that the individual's own performance was well above average and therefore he or she would benefit from PRP. However, for most other people it would not be of benefit because many of them were below average and some even needed disciplining. *"If we had PRP I would be a very wealthy person indeed."* (Organization A, respondent 483)

Share schemes were discussed and views were positive. These schemes had proved popular and workers had made money from them. Gain share was also discussed and again opinions were positive although somewhat lukewarm. There seemed to be a certain amount of cynicism reported back from union members concerning the small amounts set aside in the scheme resulting in very small pay outs.

#### *Questionnaire findings*

Data was interrogated to see if there were any groups that were unrepresented by the survey. No groups were unrepresented. The information was based on up-to-date personnel print outs from both organizations.

There was no statistical significance in expected frequency between organizations. These participants were found to be a representative sample consistent with the profiles supplied by both organizations in the form of personnel and departmental records. The findings of the questionnaire showed a marked consistency between organizations and also consistency

between gender, occupation and length of service in the majority of cases. This allowed for generalisability in many areas.

Respondents were asked to comment on anything not included in the questionnaire concerning teamwork, performance related pay or company culture that they felt was important.

#### *Results*

Almost 75% of those who responded had experienced some form of performance management including formal appraisal at their present organization and many had also experienced appraisal in their previous organization.

The results from the questionnaires showed that there was no majority in either organization in favour of individual performance pay. Over 25% in each organisation were *strongly* against it, and a further 20% at Organization B and 26% at A were against it. These results point to a strong culture of collectivism. This argument is further strengthened by identical questionnaire results showing the belief that performance related pay would be counter-productive. It would *cause disagreements within teams* (64% of respondents from each organization) and *it would cause disagreements between teams* (58% of respondents from each organization).

The results from questionnaires showed a majority in each organization being against performance related pay. Over 25% of respondents from each organization were strongly against it. 41% of respondents from A and 59% of respondents from B would like all workers to receive the same yearly performance pay based on the performance of the organization. This seems to be in line with the CIPD (2009) who concludes that profit sharing is a popular choice with workforces at it is perceived as giving all in the organization a chance to share in its success.

#### *Longitudinal Study Sample*

There was a constant and almost universal concern about "fairness" from all participants in both the study of two organizations and the longitudinal study. There was no shift in emphasis over a ten year period up to and including 2009.

*"It's a joke, PRP does not work it prevents sharing". "It is about your face fitting". "We call ourselves teams but managers don't walk the talk". "What's the point, we are making people redundant and it is not the poor performers who are going."*

Content analysis showed a marked emphasis on the tension between the espoused theory of fairness and teamwork and perceptions of inequality, subjectivity and inconsistency.

## SUMMARY OF FINDINGS AND DISCUSSION

All participants volunteered information freely. Employees at all levels spoke openly at both informal and formal exchanges. There were no significant differences between responses from males and females, different age groups, length of service and area of work.

The issues that arose from the author's research at both organizations, the longitudinal study and the body of research and literature prior to this gave rise to some interesting discussion concerning performance-related pay, team working and theory in use.

Three interesting things from the researcher's viewpoint were:

The similarity in beliefs from a diagonal slice of the workforce taken from Organizations A and B and participants in the longitudinal study who were all managers.

The preference of HR professionals for individual performance rewards as opposed to the preference of operations managers and workers for team based reward schemes.

The practice at both organizations of rewarding individual contribution yet their consistent and emphatic official message that "it is all about teamwork".

There was a convincing raft of evidence from all sample groups based on anecdotes, chats, ethnographic surveys, formal interviews and questionnaires to make the following observations: Findings reflect a cultural web where values of steady state strategy, teamwork and pride of membership are highly regarded. Teams and the belief in their importance play a major part in the cultural assumptions, values and heroes making up the cultural web at every organization (Hofstede, 2001, 2010; Johnson and Scholes, 2005).

Anecdotes and statements from both questionnaires and interviews constantly refer to entrenched beliefs on the shop floor concerning hard work, a job well done, knowledge, quality and discipline. Pluralism and teamwork were also highly esteemed.

The belief that everyone *should* work hard was well represented and as such represents the normative nature of the established culture. Managers and workers at both organizations spoke freely about different standards of performance management and many expressed anger and frustration concerning discipline.

*"At this time I do not believe there is a proper and accurate way to measure staff individual or team performance."*

Union officials stressed the difficulties of measuring activities and placing similar value on different activities. Statistics were often seen as open to manipulation and distrusted. Rewards for individuals were seen as counter to the union's belief in equity and objectivity.

Equity was a central issue in all research findings. It was mentioned by almost every participant and was of equal concern for managers and employees alike. Perceptions of

inequalities arose in many areas but most concerns occurred in the areas of discipline, payment and trust. Anecdotes, observations, interviews and questionnaires constantly referred to the need for team work, fairness, unfair treatment, inequity; and most involved strong emotions concerned with self-worth. Anecdotes of workers taking action to balance the perceived inequity were also related (Adams, 1963; Porter and Lawler, 1968.) There was widespread evidence of pervasive cultural beliefs holding equity as a lynchpin of working life. *"I would like openness and honesty."* The belief that everyone should work hard represented the normative culture of participants. Both managers and workers spoke at length about different standards of performance management and many expressed anger and frustration concerning the procedural and distributive justice of discipline in their workplace. *"Nothing happens here if people aren't pulling their weight."* Trust was a concern for many participants and there were many complaints about managers and their different agendas. Some managers also spoke about the need to build and establish trust.

Equity and trust were found to be highly valued but it was debatable if they existed other than as espoused theory at organizational level. It had been expected that the notion of equity would be an important aspect of this research but the overwhelming pre-occupation of the majority of participants provided a rich source for future research and discussion.

Observations, surveys and interviews confirmed that the majority of people felt that equity and change could only be ensured if teams were empowered and trusted the management (Meyer, 1994; Brown, 1995). There was a widespread distrust of both appraisal and performance related pay.

Performance management systems were viewed as bureaucratic, costly and often a waste of time. Performance related pay (PRP) was seen as being too dependent on variables outside the individual's control. This was seen as unfair by many who were unclear as to how it could consciously increase organizational performance.

The concept of PRP remained popular with Human Resource Directors and personnel practitioners despite the reservations of managing directors, the deep misgivings of many operations/line managers, the resistance by the majority of workers and the total opposition of the unions. Experiments with performance related pay at both organizations and further enlargements of such systems still remain a distinct possibility, despite the negative experiences in the past. There was an interesting and widespread belief by most individuals that PRP would work for high producers like themselves but not for the vast majority of others who were either not competent or not motivated. The possible move to person based pay rather than job based pay did not reflect the espoused belief systems of both

organizations, or those of participants in the longitudinal study. These belief systems value team working, quality and achieving value for stakeholders and it is the enactment of these beliefs that motivate workers (Brown, 1995; Latham and Pinder, 2005). There was common belief of workers that more money did not result in their doing a better job. This was opposed by the belief of some managers and both senior Human Resource executives that money would motivate workers to perform better once they realised they had been rewarded for their contribution.

Managing Directors at both organizations struggled with the conundrum of which comes first, paying for performance or performing for pay. There seemed to be no preferred strategy. This situation was also reflected in the research with managers at other organizations participating in the longitudinal study. Human Resource Directors were working towards the future adoption of HRM mechanisms of performance related pay for both teams and individuals. However, this strategy may not solve management problems but could in many ways generate new ones (Kerr, 1975; Geary, 1992).

Hofstede's (2010) research into culture concludes that institutions may often write down their missions or values but other value systems may also exist in the organization. These assumptions underlying the explicit 'official' values of the institution are evident in the day-to-day conversations of people. They may also be so taken for granted that they can only be observed in what people actually do. The author's free access to both host organizations and the relationship of mutual trust enabled these findings to be further tested. Over a period of several years the author observed interesting differences between the explicit management/institution values and the implicit but equally influencing values of the workforce and unions.

## CONCLUSIONS

Performance management systems based on individual rewards are not congruent with established cultures of teamwork and the move to autonomous self-managed teams.

They are commonly perceived as being divisive and contrary to team productivity.

Although literature confirms the place of equity theory in motivational studies it does not emphasise the crucial role it seems to play in the arena of performance management and measurement (Latham and Pinder, 2005). It is postulated that this importance may well be seen in organizations and cultures other than those in this study.

The move by many organizations to management systems, which espouse teamwork and a shared mission, lies uneasily with an approach to performance management which is reliant on individual appraisals and performance related pay. Many of these same organizations believe that performance related pay is congruent with a unitarist value system. However, it is ironic that the application of performance-related pay undermines unitarism by introducing a culture of individualism and plurality of interest.

A fundamental issue that has yet to be resolved lies at the heart of the performance management debate. This is team versus individual contribution. One side believes that emphasis on the individual stretches targets and increases personal productivity for those who have significant discretion over their own output. The other side believes that individual targets are counter-productive because they create individual competition at the expense of the collaboration so crucial to team success.

To achieve positive outcomes organizations need to be clear about why teamwork is espoused, is in place and how it fits with strategy, culture and philosophy.

This research builds on previous research in the following respects:

- It places teamwork and performance within a framework of organizational justice; perceptions of fairness are important in harnessing goodwill (Greenberg, 2006).
- It confirms findings that performance management reinforces power relationships and is often perceived as being open to abuse (Geary, 1992; Greenberg, 2006).
- Dissatisfaction with processes and the resulting distributive justice had a negative impact on employee perceptions of fairness and could act as a barrier to organizational effectiveness (Holbeche, 2001; Cook and Crossman, 2004).
- Performance management often ignores systems factors (Deming, 1986; Soltani et al, 2006; Clopton, 2011), particularly relationships in teams *and* between teams; and can work against the establishment of a quality culture. It often seeks to act as an agent to bolster managerial power rather than to enhance quality.
- This research supports the case put forward by others that effective performance will not be obtained unless all dimensions of organizational justice are satisfied within the performance management system and that there is a strong argument for all stakeholders views to be incorporated in the system (Cook and Crossman, 2004; Suliman, 2007; Simmons, 2008; Brebels et al. 2011.)

- There is a significant disparity between espoused theories and theories in use (Townley, 1993; Suliman, 2007). Unitarist assumptions of a commonality of interests are a much repeated management message in selling teamwork. However, the theory in use, which may be inferred from the actions of many managers, is that performance management acts to reinforce management hegemony through political processes. In denying a plurality of interests it serves primarily as a covert compliance system. This has generated much cynicism in workforces.

These conclusions add some weight to the research findings that confirm that most appraisal and performance systems do not work well and can be divisive (Armstrong and Baron, 1998; Kaplan and Norton, 2007; and Holloway, 2009).

The move by many organizations to management systems, which espouse teamwork and a shared mission, lies uneasily with an approach to performance management, which is reliant on individual appraisals. It is also ironic that many of these same organizations believe that performance related pay is congruent with a unitarist value system.

For many decades adherents of the human relations movement have argued that organizations, with their emphasis on control systems, discourage the full participation of their members. This may well be detrimental to performance and could affect competitive advantage (Deming, 1986; Wiese and Buckley, 1998; Simmons, 2008). Organizational experience is often demotivating rather than empowering. A growing emphasis on knowledge management has encouraged organizations to believe in the rhetoric "People are our greatest asset." Only by creating a culture in which people can fulfil their potential can organizations survive, compete and grow in today's global environment. Yet, few organizations have thought this through to the extent that the development of teams and individuals is a key component of corporate strategy, embedded in all aspects of the organization. The idea that individuals need to be controlled persists. If a control philosophy permeates notions of empowerment, development and continuous improvement, paradoxically it will dilute both control and motivation.

## **CONTRIBUTION**

This research clearly indicates that both managers and employees see a potential for teamwork, which is rarely achieved in practice. This is almost universally seen as desirable and perceived as an effective method in gaining commitment. If, at the same time,

management say they value teamwork *but* appear to be rewarding individuals then commitment degenerates into resigned compliance with widespread resentment and perceptions of inequity. This research also confirms the findings of others most significantly in terms of reinforcing perceptions of mistrust, inequity and managerialism. Happiness and stakeholder interests are not addressed and stakeholders are often left feeling aggrieved.

Organizations are purposive entities. They have goals and need to measure the achievement of those goals. But, by sending out mixed messages the cynicism engendered by the performance management system and process may hamper development. Creating an environment where individuals can grow and develop as part of a team may be an appropriate competitive strategy. If, at the same time, performance review is focused on individual contribution then commitment to teamwork may be prevented. This research also confirms the findings of others most significantly in terms of reinforcing perceptions of dishonesty, mistrust, inequity and managerialism; both employees and managers are often left feeling dissatisfied.

Measurement and performance related pay of individuals is of dubious relevance in team working environments. Judgements, about how individuals contribute to teams, are perhaps best made by teams themselves. If teamwork is to contribute to the achievement of an organization's goals, then the organization needs to be clear how this fits with strategy, culture and philosophy. Performance systems and procedures say much about organizational value systems and how these relate to societal values. This research shows that it is helpful to examine teamwork and reward through the lens of concepts of fairness and wider frameworks of employee perception and motivation, which have not previously been considered. To achieve competitive advantage through teamwork and discretionary effort organizations need to not only *say* they value teams but have to be seen as practising what they preach.

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# LESSONS FROM THE PAST: LIGHTS AND SHADOWS OF PUBLIC-PRIVATE PARTNERSHIP IN THE ITALIAN HEALTHCARE SECTOR

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## ABSTRACT

This paper outlines characteristics of the diffusion of public-private partnership (PPP) and focuses attention on its use in Italy, especially in the healthcare sector. After more than a decade since its introduction, inspired by foreign experiences, the academic literature contribution to the debate and the empirical experiences have highlighted several gaps of the instrument with financial and managerial implications for the public sector. In particular, in Italy, with reference to the value for money, risks and accounting treatment, the initial uncertainty about appropriate measures for evaluating the projects, now, should lead to a more accurate reflection. Through a comparative analysis of two case studies - public hospitals -, the paper shows the most relevant areas in which it is a time for an urgent rethink of PPP utilization, as a lesson for the future.

**Keywords:** public-private partnership, healthcare management, hospital infrastructure finance, value for money

## INTRODUCTION

Throughout the evolution of the Italian NHS, particular attention has been paid to investments for the renovation of hospital infrastructures and the creation of new healthcare facilities.

According to recent national health plans, hospital redevelopment – expansion, modernization, reconversion of small size hospitals – as well as the construction of other types of healthcare facilities require substantial consideration. In order to implement this renovation process, the government has been encouraging the regional authorities, who are

responsible for the local healthcare services, to practice the special plan for investments, which is historically hard to manage and does not always have the capacity to respond to real financial needs. Further, taking into account the global financial crisis, a matter of considerable concern relates to the search for new solutions to access financial resources without negatively affecting public debt. For that reason, *Public-Private Partnerships* (PPPs) have once again come to the forefront, following the recommendations contained in the Communication of the European Union (COM 615, 2009) *Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships*, claiming (p.2): “Public Private Partnerships (PPPs) can provide effective ways to deliver infrastructure projects, to provide public services and to innovate more widely in the context of these recovery efforts”.

After its debut in the early 2000s in Italy, Project Financing (PF) has been the best-known formula identifying the public-private partnership (PPP), as in many other countries (Broadbent and Laughlin, 1999; Froud and Shaoul, 2001; Akintoye *et al.*, 2002; Grimsey and Lewis, 2002, 2004; Broadbent *et al.*, 2003). In the light of the literature debate, the most frequent issue concerns whether the support given to PF is still acceptable, according to an optimism bias (MacDonald, 2002), “as a measure of the over optimism in project estimates” (Broadbent *et.al.*, 2008), or whether any additional precautions should be taken so that the PPP model can be virtuous enough to create effective advantages and social benefits. The achievement of *value for money* (VFM), the testing of a long-term *affordability* and the *risk transfer* continue to be the cause of the serious concerns that have so far accompanied PPP contracts (Broadbent *et.al.*, 2008; Demirag and Khadaroo, 2008; English *et al.*, 2010). As observed in the experiences carried out in other countries (mainly Australia and the UK), the frequently-asked question is whether such investment strategies are the result of an opportunistic approach rather than of a rational choice. This has unavoidably pushed academics and scholars to explore “the underlying nature and rationale for PPPs; processes and procedures aiding decisions to undertake PPPs; processes and procedures for ex-post evaluations of PPPs; the merit and worth of PPPs; PPPs regulation and guidance” (Andon, 2012: 878). In the last decade, several articles have offered research findings and reflections on these topics (see, for example, Broadbent and Laughlin, 1999, 2002, 2003; Froud, 2003; Edwards and Shaoul, 2003; English and Guthrie, 2003; English and Skellern, 2005).

In particular, the paper aims to investigate two issues : 1) whether hospital investments made by PF in Italy have a positive impact on the whole system in terms of social and economic

benefits; 2) how the PPP experiences of the “first wave” could be an effective guide for the future according to an accounting logic. As a matter of fact, it is a common conviction that PF is proving a financial drain for the healthcare sector, especially because some of these experiences are now in the operational phase. Inevitably, that should entail reconsideration of the key variables and their accounting relevance to make the choice of PPP more reliable.

Section 2 examines PPPs in greater detail, inspired by theoretical approaches, at national and international level. Section 3 focuses on the PF features in the healthcare sector, its actual ability to represent a strategic alternative for the future and the critical variables to which the government must pay more attention. Section 4 illustrates a comparison of PF in two Italian hospitals, highlighting and discussing the most controversial issues of the contracts. Finally, some concluding reflections.

## **THEORETICAL ASPECTS OF PPPS**

The *New Public Management* (NPM) reforms, through a redefinition of the boundaries between State and market, have encouraged the acceptance of a contractual approach to public service delivery (Hood, 1991, 1995; Lane, 2000; Osborne, 2000; Hebson *et al.*, 2003). “A major implication of all of these reforms [has been] an increased emphasis on management rather than administration of services, with a concomitant shift in emphasis from the traditional stewardship role of accounting to cost management” (Jackson and Lapsley, 2003). PPPs have been coherently considered an “extension” of the NPM agenda for change (Broadbent and Laughlin, 2003) and their introduction “has largely been evaluated through conceptual lenses that emphasise either the administrative, managerial, financial or technical dimensions of this reform strategy” (Flinders, 2005:215). The expression PPP is intensely “malleable as a form of privatization” and “despite its ambiguity, is sometimes a useful phrase because it avoids the inflammatory effect of “privatization” on those ideologically opposed” (Savas, 2005:1). As has been claimed, the PPP stresses “the use of contracts for the management of the risk”, thus representing the highest expression of the reforms due to NPM (Froud, 2003). In addition, the very concepts of accountability and transparency, as main elements of NPM, seem to have a direct effect on PPPs (Demirag and Khadaroo, 2008).

In this context, the concept of cooperation between public and private sectors flourished to form an inter-organisational partnership, especially in those countries where the privatization

process has been actively undertaken (Pongsiri, 2002). PPPs were immediately perceived as a broad umbrella, which can safeguard the public interest while creating potential investment and adding value from the private sector (Carr, 1998; Pongsiri, 2002). That would corroborate a conceptual model based on the “mixed economy” with a sort of liberalisation policy in the way public services are produced and delivered. The idea that PPPs open up possibilities for public service delivery, deriving not only from organisations owned and controlled by the public sector, but also from both public and private sectors in partnership, is convincing (Broadbent and Laughlin, 2003; Flinders; 2005). In a certain sense, PPPs could be described as the result of a troubled search for new formulas to soothe the impact of public expenditure on national accounts but also to avoid the consequential complexity in the operational process of the public administration.

#### *A brief history*

In Europe, the origins of PPP (acting as PF) date back to 1979, when the UK Conservative government began the still-continuing shift of activities away from the public sector. Early financing proposals were mainly designed to evade the controls on public expenditure (Grahame, 2001). The actual Private Finance Initiative (PFI) program was announced in 1992, with the aim of achieving closer partnerships between the public and private sectors. This policy was introduced to increase the involvement of the private sector in the provision of public services (Grahame, 2001; Spackman, 2002; Pollock *et al.*, 2002; Broadbent and Laughlin, 2003). Some years later, with the Labour Government (1997), the program was proposed with a different label, but with its contents essentially unchanged. The objective was “to accelerate the process by which PPP contracts are agreed, in part by taking equity stakes in projects and in part by providing loans to public bodies” (Parker and Hartley, 2003).

Even if the primacy remains in the UK, PPPs have spread to many other countries; and after a first phase of experimentation, in 2004, the European Commission issued the *Green Paper on Public-Private Partnerships and Community Law on Public Contracts and Concessions* to launch “a debate on the application of Community law on public contracts and concessions to the PPP phenomenon” (Green Paper). The recent financial crisis led to a dramatic reduction in the capital value from almost EUR 30 Billion in 2007 to EUR 16 Billion in 2009 (EPEC, 2010). This poses a series of questions about the factors that are negatively influencing the use of PPPs and, once again, what obstacles have to be overcome in order to make the practice more reliable and viable (Connolly and Wall, 2013).

A PPP is usually a long-term contract between a public party and a consortium of private companies - referred to as a *Special Purpose Vehicle* (SPV) - under which the private company is required to *Design, Build, Finance and Operate* (DBFO) an infrastructure in return for payment for both the cost of construction and operation of the related services (Grimsey and Lewis 2004; Yescombe, 2007). The facility remains under public-sector ownership, or reverts from private partner to public-sector ownership at the end of the PPP contract. Its economic relevance depends on the fact that:

- cash flows generated by the operating process are the main guarantee and the source for covering the debt service;
- implementation of the private initiative should be accompanied by an adequate level of project certainty and reliability deriving from a rigorous analysis and an indispensable risk adjustment;
- sustainability of the initiative does not depend on the reliability of a company but concerns the quality of the single project (including the capacity to generate the cash flows with reference to a given level of risk);
- the initiative takes advantage of a project autonomy – due to the constitution of an ad hoc company to safeguard the stakeholders' interests;
- the operational phase represents the critical success factor as only a management based on a high level of performance can contribute to generate the cash flows that are indispensable to satisfy shareholder expectations;
- the most significant guarantees connected with the initiative have a contractual nature rather than a real one (this is the so-called “without recourse operation”);
- all the phases of the operation converge in a negotiation process, which has a variable duration and is considered to be a decisive factor in the risk allocation between public and private partners.

This partnership procedure cannot be explained just by the concession of both the construction and the management of an infrastructure to a private partner because of the lack of financial resources but it must be based on an effective assessment of VFM, through the appraisal of the public sector comparator (PSC) (Gaffney and Pollock, 1999; Edwards and Shaoul, 2002). “A public sector comparator is a costing of a conventionally financed project delivering the same outputs as those of the PFI [PPP] deal under examination. It is just one of a number of ways of evaluating a proposed PFI deal. It is directly relevant only when the option publicly financed on which it is based is a genuine alternative to the PFI deal” (House of Commons, Committee of Public Accounts, 2002, 9 June 2003). In that way, the possibility of

a traditional financing procedure must not be ruled out. In the UK, the VFM methodology proposed by the government is based on an economic appraisal that compares costs and benefits of alternative investment decisions. It provides for two critical variables such as the method used to discount the future annual cash cost (in order to get the net present value) and risk transfer (Pollock *et. al.*, 2002:1206).

From the financial point of view, the PPP rationale turns round the conventional financing “from subject to object”, mainly by taking into account the intrinsic value of the project rather than the eligibility of a subject. Through the PF formula, the Public Administration entrusts a third party with the realization of public infrastructures and the management of its operational process. This approach can enable public organizations to undertake projects which they would be unable to finance conventionally, because of the lack of financial resources for the capital asset during its construction. It implies also a concrete change in the way the public sector intervenes in the economic field for public service delivery but, although responsibility for many elements of service delivery may be transferred to the private sector, the public sector remains responsible for (Torres and Pina 2001):

- deciding on the level of services and resources to pay for them;
- setting and monitoring safety, quality and performance standards for services;
- enforcing those standards, taking appropriate action if they are not delivered.

The public sector should benefit from the presence of the private party, above all in terms of reduction of the total financial commitment, investment promptness and, consequently, the timeline of service use. This implies that the convenience of the operation must be analysed under two different profiles. On the one hand, it would be advisable to verify the advantage for the Public Administration by taking into account VFM and, on the other hand, risk transfer. VFM is the key rationalising motive for partnership. As Edward and Shaoul (2002) assert, “its meaning in the context of PFI is no more precise and is similarly based upon the economy as reflected in the use of discounted cash flows over the lifetime of the project”. VFM depends on the “estimate of future costs and operates only at the point of procurement”. Many studies and reports have been carried out in the UK on this topic given that accountability depends on the detailed recognition of VFM, by discharging accountability to the stakeholders, the lack of which in PPP has been persistently criticized (Demirag *et al.*, 2005; Demirag and Khadaroo, 2008).

Risk transfer and uncertainty seem to be the crucial elements under discussion since under PFI private sector borrowing, transaction costs and the requirements for profits necessarily generate higher costs than conventional public procurement (Broadbent, *et al.*, 2008). Further,

many authors sustain that the PFI contract reduces the ability of the public sector to deal with uncertainty, given the long-term duration of the contract in which the public sector is locked (Froud, 2003; Lonsdale, 2005). It is, therefore, necessary to analyze what the principal vulnerabilities are that derive from risks (Broadbent *et. al.* 2008; EPEC, 2011). Traditional risks are identified as follows: demand and economic context; residual value; design; performance/availability; changes in relevant costs; obsolescence (ASB, 1998). Actual risks seem to be (Burger *et al.*, 2009): the risk of an increase in the interest rate, leading to rising costs; liquidity problems and project feasibility considerations for private partners; the risk of credit being unavailable, leading to the termination of existing projects failing to reach the financial close.

Most of the considerations on the costliness and convenience that the public sector can have in undertaking a PPP depend on the solution of problems related to risk. Several studies show that private cash can be more expensive than public finance since PF causes an increase in the annual cost. It is claimed that costliness could be acceptable since it should usually be balanced by the private sector taking on the risks of a project failure or default (EPEC, 2011).

#### *Accounting treatment and risks*

One of the acclaimed advantages of PFI/PPP is not only that infrastructure can be built without recourse to direct public-sector borrowing but that the assets (and associated liabilities) are deemed to be off-balance sheet for the public administration which commissions the PFI/PPP (Private Finance Panel, 1996; Froud, 2003). The accounting treatment of PPP falls under FRS 5, revised in 1998 by the Accounting Standards Board (ASB) (ASB, 1998; Broadbent and Laughlin, 1999). In deciding whether the owner of the asset is the public or the private sector, risk is central to any evaluation. This orientation has visibly influenced statements at the European level.

In this regard, Eurostat established that the deficit and debt treatment should follow the requirements of the European System of Accounts (“ESA95”). For the purposes of recording PPPs, ESA95 requires national statisticians to look at the risk/reward balance in the underlying PPP arrangement. This balance is evaluated by analysing the allocation of two key risk categories between the public sector and the SPV, construction risk and market risk (i.e. *availability* and *demand*). The decision specifies the impact on government deficit/surplus and debt and it is in line with the European System of Accounts (ESA95), according to the opinion

of the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB). Eurostat recommends that the assets involved in a PPP should be classified as non-government assets, and, therefore, recorded off-balance sheet for government, if both of the following conditions are met:

- the private partner bears the construction risk;
- the private partner bears either the availability or the demand risk.

If the government bears the construction risk, the PPP will always be on the government's balance sheet, irrespective of the allocation of the demand and availability risks. If the private partner bears the construction risk, the PPP will be classified off the government's balance sheet unless the government bears both demand and availability risks.

The *construction risk* covers events related to the construction and completion of assets. In practice, it makes reference to events such as late delivery, non-compliance with specified standards, significant additional costs, technical deficiency and external negative effects (including environmental risk) which trigger compensation payments to third parties. The *availability risk* covers situations where, during the PPP operational phase, an underperformance linked to the state of the PPP assets results in services being partially or wholly unavailable, or services fail to meet the quality standards specified in the PPP contract. Finally, the *demand risk* refers to the variability of demand (higher or lower than expected when the PPP contract was signed), irrespective of the performance of the PPP company. A change in demand could be the consequence of factors such as the business cycle, new market trends, a change in final user preferences or technological obsolescence. The demand risk is part of the usual economic risk borne by private businesses in a market economy.

At this critical time the view of the aforementioned risks is obviously an element of additional concern. In order to comply with the *Stability and Growth Pact*, EU Member states have considerable interest in promoting PPPs, but at the same time they have to ensure that the costs arising from investment in infrastructure be considered off-balance sheet. Given the importance of the national debt and deficit treatment of a PPP, this represents a decisive issue for the Public Sector (Connolly and Wall, 2011).

## **THE IMPLEMENTATION OF PPPS IN ITALY**

In Italy, even though there have been no PFI programs, in the last decade some actions have been undertaken with the purpose of making rules more flexible in the context of public procurement and facilitating private participation in the realization of public infrastructures (most frequently by the DBFO formula). As is clear from a study by the Bank of Italy, the projects funded are relatively small. In the period 2002-2008, the average amount of bids amounted to around EUR 14.1 million and concerned the field of local public services with not very complex interventions. In the same period, the total value of the tenders increased from EUR 1.3 billion to EUR 5.8 billion, their number from 184 to 411 (representing 1,7 % of the total number of tenders for public works and 17.6 % in value terms) (Giorgiantonio e Giovanniello, 2009). According to data collected by Finlombarda (2012), in 2011 there was a decline in PF, although the government has repeatedly encouraged the use of the procedure. However, several obstacles seem to stand between the launch of initiatives and financial close, mainly due to the shortage of liquidity together with lengthy procedures and unpredictable times. The awards amounted to approximately EUR 6.6 billion a year, but in the last four years, the financial close has stopped at EUR 1.8 billion.

#### *A regulamentary approach*

In the Italian system, the PPP has its normative point of reference in the model of the “concession”, with or without private initiative. The PPP is, in fact, regulated by law, as in other countries (Belgium, Poland, Spain, Portugal) even if it is widely known that a specific PPP law is not a necessary condition for PPP development. The legal framework can also be provided by changing existing legal provisions which may have an impact on the PPP project (EPEC, 2011). Through a concession, the public sector, interested in the realization of an infrastructure, allows a private subject a concession whose provisions include:

- the duty, for the concessionaire, to construct the infrastructure through his own resources with a risk transfer to the private party;
- the right to manage it for an extensive duration, in order to allow a satisfying return on investment;
- the consequent ownership transfer to the public institution by the end of the concession.

The PPP arrangements are based on a long-term contract and must have appropriate mechanisms in place to ensure that VFM is maintained for the duration of the partnership.

Since 1998, these rules have cleared up ambiguities regarding the utilization of *projet financing* as a financial instrument, by widening the range of application of the discipline and increasing the transparency of some norms relating to contracts, controls, guarantees and risks. Moreover, a few European countries have provided further regulation in this sector by setting up a specific taskforce at governmental level. Even if an explicit program has not been launched, such as the PFI/PPP in the UK, in 1999 the Italian Government created a centralised office, the *Technical Unit for Project Financing* (It. *Unità Tecnica Finanza di Progetto, UTEP*) to facilitate privately-financed infrastructures. This organization as a taskforce of the Ministry of Economy and Finance, has the aim of promoting the use of PPPs, also supporting the public administration at the regional and local level, for its implementation. After the uncertain debut of the implementation procedures and an unclear meaning attributed to the PPP, the UTEP outlined a stable framework tending to identify PPPs in three main subcategories:

1. the granting of construction and operation;
2. the granting of services;
3. other residual formulas.

Such a framework derives from the empirical analysis of the views of the PPP carried out by the National Observatory of PPP, sponsored by Union of Chambers of Commerce and the Chamber of Commerce of Rome with the Ministry of Economy and Finance and the UTEP. The construction of an infrastructure is the key element distinguishing the first model from the remaining categories. The first group includes bids involving the preliminary design, the definitive design, the executive design, the execution of a work and its management. The second group includes the tenders carried out with the procedures concerning the granting of public service management through existing structures. For this second procedure, the private concessionaire normally pays a license fee, although government grants are not ruled out. The third group includes various formulas, such as joint ventures for the operation of public services, district contracts, and sponsorships.

#### *PPP in the Italian NHS*

As seen above, the typical PF features imply some observations about its beneficial application in the Italian NHS, by considering an increasing need for buildings and modernization, above all with regard to hospitals (Amatucci and Vecchi, 2009). In the last decade, the hospital sector has appeared particularly interested in the use of PF, because of

the continuous evolution of technology and strategies implemented for a rationalization of health expenditure. The main factors behind the need for modernization are attributable to the following:

- the gradual increase in the average age of the population (involving an increase in per capita expenditure);
- innovation and advanced technologies;
- the scientific and cultural progress of the population catalysing the demand for services in healthcare in terms of quality and quantity.

In addition, there has been a gradual reduction in the number of ordinary admissions (acute patients) and a greater development of day hospital and day surgery care. More importance is given to the long-stay structures, where healthcare needs are to be considered with the request for comfort of the accommodation and the quality of the service. In general, according to the experience observed in the *first wave* (2000-2006) of PPPs, the method focused on a cost-benefit evaluation for both the *Local Healthcare Units* (LHUs) and users/patients, although this appraisal has led to large uncertainties. The PSC technique was never used in this first phase. Suffice it to say that it was only in 2008 that new, corrective legislation introduced the rule that in assessing the feasibility projects public authorities must draw up a real *business plan* to verify the economic and financial feasibility, the value creation and the sustainability of the initiative. VFM and PSC received a real impulse from the UTFP in a special document, in 2009 (Martiniello e Zaino, 2009).

In the Italian PPPs, the private partner usually takes on the responsibility for the management of the services mix regarding the functioning and maintenance of the structure and part of the core and non-core services. In particular, the system of services includes the following categories:

- the facility management for buildings and supporting systems such as the thermic heating system, refrigerator system, air conditioning, electrical equipment and plumbing, medical gas supply systems;
- hotel services (catering for in-patients and staff, cleaning, disposal of waste material, reception, reservation centre, parking);
- other services (stock management, hospital information systems, supply management, chemist, set-up of operating theatres, etc.).

Initially, the Italian model of PPP in the healthcare sector was not supposed to modify the hospital management, which normally has recourse to outsourcing for building maintenance. It should have achieved through the management of the concession an administrative

simplification and an improvement in management, with consequent economies of scale. In the case of the PPP proposed in Italy, the only private aspect is the operation of the healthcare facility itself, not the provision of clinical care. Between 2002 and 2005 there was a 30.6% rise in the number of projects (27) and a 56.7% increase in spending (EUR 1,298 million). In value terms, 93% of the initiatives promoted involve the building or refurbishment of healthcare facilities, with non-medical support services (non-core) entrusted to the concessionaire. This proportion has remained unvaried over time. (Finlombarda, 2005; 2008; 2012). It is to be expected that LHUs will continue to control and monitor the impact of quality on users/patients.

The composition of the price for the economic exploitation of the concession consists of an annual fee and a tariff. The annual fee is paid by the LHUs when a new structure starts to run (from the service availability date). This consists of two components, fixed and/or variable, and has to cover the services management, the facility management and the assistance to the medical structure. The private partner is thus allowed to have a return on investment. The fee is determined and paid according to different criteria.

The tariff relates to the operating costs of both commercial spaces and services. The payment consists of revenues deriving from the lease or direct management of the adjacent commercial areas. Such a payment concerns the volume and typology of activities regarding the structure itself and is a function of the management system defined and/or contracted, from time to time, between the SPV and the LHU. For this revenue, the commercial risk is borne by the SPV. It is, however, clear that the main risk concerns demand. This means that any compensation arising from the operations of additional services partially affects the risk simulations contained in the business plan.

These two heterogeneous components justify the potential application of the PF in the Italian healthcare sector and in the specific case of the hospitals make it possible even in the presence of a public payment (*subsidies*). Hospitals appeared initially as belonging to a not self-financing category because of the lack of correspondence between utilization and payment of tariffs by users – reimbursed by the LHU on behalf of the patients (Amatucci, 2002).

Through hospital activity development and a clear identification of its components, it has been possible to postulate the application of PF for hospital construction. On one hand, the fee is like a shadow toll, paid by the LHU for supporting services; on the other hand there are the prices paid by users for commercial services. This mechanism does not rule out placing the instrument of the public contribution side by side with the two mentioned above

(Amatucci and Biondi, 2002). In fact, the application of shadow tolls is commonly considered inappropriate because it implies such a low risk transfer as to put the project back on the public sector balance sheet (Yescombe, 2007:235).

Another issue regards the structure of the fee. It consists of a fixed part corresponding to the equivalent amount in order to cover building availability; and a variable part, representing the equivalent sum in order to reimburse the services delivered by the SPV, according to volume and quality parameters (payment for usage, volume or demand).

As a sector analysis by UTFP (2002) explained, greater attention is to be paid to the fixed component, which has a structure essentially correlated to the risk allocation according to the models of 'availability payment' and 'capacity charge'. In the first case, the amount is a function of the *bed occupancy rate*. The availability services include everything from cleaning services, to the reception and clinical data information systems. This method contributes to the allocation of the commercial and operating risks between contractors and the LHU, using the bed occupancy rate as a reference parameter. As an alternative, the 'capacity charge' model consists of a fixed amount that the LHU has to pay independently of the utilization level of the infrastructure. Usually, this amount is not comprehensive of the relative amount for the special maintenance of buildings, systems and equipment. The criterion, therefore, does not transfer the risk to the private contractor. Consequently, in the case of the 'availability payment' method, the LHU makes a unitary payment, limited to the availability of areas and/or wards and to a given level of quality and efficiency of the services. According to this formulation, the contracts usually provide a proportional reduction in the case of an interruption of services or a lower level of quality or efficiency, with a series of contractual penalties. On the contrary, postulating the "capacity charge" application, LHUs make a separate payment of the two fee components. The fixed one must always be paid, and its reduction occurs only in a few cases; while the variable component concerns the quality and efficiency parameters in a more generic way than the availability payment.

## **TWO CASE STUDIES: A COMPARISON**

The research team has carried out the study starting from a definition of a legal framework and variants of the contractual formula, followed by an analysis of the conditions of applicability. Finally, it proceeded by the case study methodology, with reference to two

LHUs of the Veneto Region (Stake 1995; Yin, 2008). The study benefited from the collaboration of the *Managers of the Technical Departments*, responsible for the procedure. Several interviews were conducted with them during the construction of the case studies, also with the support of documentation regarding the different phases of the PPP implementation (business plan, agreement, make or buy simulations). In both cases, the managers gave their utmost in terms of commitment and effort for the implementation of the procedure; and their ability in planning the preliminary project, following the procedure, and steering the internal and external coordination must be duly acknowledged.

In the course of the case studies, some different models of partnership emerged, which take into account various critical aspects and offer different solutions to legal, economic, social and environmental issues. In both cases, we reconstructed the PPP logic to explain the choice of the private financing in comparison with other financing formulas, by running the methodological framework again and analyzing the economic motivation, the influence of the critical aspects and their impact on management. Effectively we have traced a comparison between the empirical evidence drawn from two different experiences: the first for the renovation and extension of two hospitals (Case X); the second for the construction of a new hospital (Case Y). In both cases, the hospitals are not autonomous entities but are dependent on LHUs in different local contexts of the same region. We gathered information during 2005-6-7-8 with successive monitoring of the operation phase. To facilitate the comparison in this occasion, we used the criteria selected by the *Resource Book on PPP Case Study of European Commission Directorate-General Regional Policy* (June, 2004) with some additional information as follows (Schemes 1 and 2):

- *Value of Investment and financial structure*– the capital investment of the project as a stand-alone investment exclusive of the income stream or operational costs;
- *Contract Duration* – the duration of the PPP contractual relationship with respect to the initial investment;
- *Transfer of Responsibility* – the degree to which the private party is involved in the project defined by the contractual model and obligations, ownership of assets or operating rights and the project operational structure;
- *Demand Risk and Availability Risk* as explained above;
- *Contract Type* – the type of PPP contractual arrangement, using the typology of the Guidelines.

## Scheme 1 – Case X

<b>Case Study X</b>	Two Hospitals: completion of a hospital and construction of another one (in two different locations of the same territorial area under control of the LHU)
Total Amount	EUR 147.328.168 ( including VAT)
Private Finance	EUR 91.340.754
Rationale/Objectives of the PPP (from the documents analysed)	To increase efficiency; introduce new financial resources to complete the existing hospital, seize the opportunity to build a new hospital to meet an increasing demand
PPP Actors	LHU-Firm, Private Consortium (SPV)
Financial Structure	The investment is financed by public money (1/3) (LHU-Firm) and private (2/3)
Contract Agreement between Parties	DBFO and concession
Risk Allocation	The risk is principally borne by the private party, which is covering maintenance and operating costs.
Institutional/Managerial Structure	Healthcare services are managed by LHU and non-core services (12), such as parking, catering, facility management are managed by a private <i>Special purpose vehicle</i> with LHU oversight on quality service. A particular tariff mechanism is in place to ensure equipment replacement.
Tariff settings	Availability payment with some reference to qualitative standards aimed to boost the quality in service  Monthly fee  51.94% for service management, 27.72% as payment for works carried out, 20.33% for plant and technological renewal
Causes of tariff variations	Execution of additional works Additional changes in services Service fees fixed in proportion to the actual management activities: Variations for the reduction in services (e.g. meals provided etc.) A decrease in service fees of more than 70% of the value outlined in the business plan Meals for in-patients: number of days patients stay in hospital Meals for fee-paying* patients: number of days spent in hospital (* fee paid for single-room occupancy) Change in the tax system relating to activities and materials New laws and regulations setting out new tariff mechanisms or new conditions for the activity Extraordinary and unexpected events, other than those mentioned above, if the pure cost of service management increases or decreases by more than 5%
Strong Points	Transformation of the existing outsourcing of facility management (Global service) into PF with a low impact on the operational phase
Weak Points	Lack of a management culture in order to effectively assess the

	<p>investment convenience</p> <p>Rigidities dictated by excessive duration of the contract</p> <p>Increase of the investment for the presence of VAT, which represents a cost for the LHU</p> <p>There is no surrender clause</p> <p>There are only <i>clauses of withdrawal</i> for the SPV</p> <p>There are no provisions for reduction of the fee if the company proceeds to renegotiate the conditions of the loan at an interest rate lower than the original</p> <p>Excessive burden on the budget of the fee paid by the LHU</p>
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**Scheme 2 – Case Y**

<b>Case Study Y</b>	A hospital in an area with high population density
Total amount	EUR 254.902.050
Private finance	EUR 120.163.197
Rationale/Objectives of the PPP	To find funds to build a new hospital according to the standards of national planning in healthcare, with respect to an old project that was never realized
PPP Actors	LHU-Firm, Private Consortium (SPV)
Financial Structure	The investment is financed by public money (1/2) (LHU-Firm) and private (1/2)
Contract Agreement between Parties	DBFO and concession
Risk Allocation	The risk is principally borne by the private operator which covers maintenance and operating costs but the security package is less detailed than in Case X
Institutional/Managerial Structure	Healthcare services are managed by LHU, non -healthcare services (22), such as parking, catering, facility management are managed by a private <i>Special purpose vehicle</i> with LHU oversight on quality service. There is a particular element with reference to the Radiology Ward and Analysis Laboratory whose administration, and not only maintenance, are attributed to the private contractor
Tariff settings	Availability payment with some reference to qualitative standards aimed to boost the quality in service
Causes of tariff variations	<p>Meals for in-patients: number of days patients stay in hospital</p> <p>Meals for fee-paying* patients: number of days spent in hospital (* fee paid for single-room occupancy)</p> <p>Change of the tax system about activities and materials</p> <p>Execution of additional works</p> <p>Laboratory service: number of tests</p> <p>Diagnostic service: number of tests</p> <p>Mandatory adjustment every four years</p>
Strong Points	Realization of infrastructure without making healthcare

	expenditure for investment worse. Outsourcing of facility management
Weak Points	Lack of a management culture in order to effectively assess the investment convenience Rigidities dictated by excessive duration of the contract Increase of the investment because of VAT, which represents a cost for the LHU. There is no surrender clause There are only clauses of withdrawal for the SPV There are no provisions for reduction of the fee if the company proceeds to renegotiate the conditions of the loan at an interest rate inferior than the original Excessive burden on the budget of the fee paid by the LHU Progressive emptying of internal capabilities and unsuccessful involvement of the medical personnel in the major decisions regarding the project (e.g. the lay-out)

The comparison between the two procedures examined has made it possible to highlight the following characteristics:

- in Case Y, the PF initiative represents a true point of reference at the national level because it constitutes one of the first experiences conducted in the healthcare sector; furthermore there has been continuity in the implementation, for the legal provisions of “urgency and necessity” and given that it is deeply rooted in a project dating back to the 1990s. The concession started in 2002 and the PPP model is inspired by the first regulatory approach of the Italian law. Therefore, it may be considered as a pioneer experience in the Italian context;
- in Case X, the solution of some critical aspects of the procedure has indirectly benefited from an evolving practice of PPP in healthcare, even though it has suffered from a series of events holding up the course of the procedure. The first factor to consider (an instability factor at the decision-making level) was the uncertainty about the general manager’s permanency in the same LHU. The choice to undertake a PPP coincided, in fact, with the end of his appointment, so it was necessary to wait for a new general manager. At the same time the change in legislation caused further interruptions due to differences in interpretation and practice. The concession started in 2004;
- the two procedures started in a different manner. In Case X, the LHU did not need a request for proposal because the private party took full advantage of the opportunity offered by the change in the law in order to submit a proposal in relation to the requirements listed by the LHU in its three-year plan. Instead, in Case Y the request for

proposal to activate PF played a focus role by attracting proposals from promoters and launching a new procedure;

- the object itself of the initiative may well be considered a focus element of distinction since it introduces some differences, influencing the procedure in terms of “time and costs”. In Case Y, the manager dealt with a project already discussed at the political level but with a strong socio-economic impact on the territory of reference, while in Case X it was the completion of an existing infrastructure and its impact was smaller than in Case Y.

Despite the above-mentioned differences, the procedures have many elements in common, above all from the evaluation point of view, because at an institutional level, they were examined by the same advisors, the Regional Audit Office and the UTFP. So, both cases present an in-depth preliminary study, well-matched with the economic and financial model of the project, as intended in the first wave of Italian utilization of PPPs, in order to assure the maintenance of an adequate economic-financial equilibrium to the private contractor. From a financial standpoint, the initiative presents a different amount of investment.

Although in mixed proportions, both initiatives have benefited from a public payment including the LHU's own funds in Case Y. It means that in relation to the new financing mechanisms in force for LHUs, PPP in the healthcare sector may be implemented with the participation of the regional administrations in the financing. This raises a series of doubts and criticisms of the PPP utilization for the sole purpose of obtaining some of the missing resources, rather than through recourse to traditional forms of finance. Under the profile of the financial sustainability the business plan highlighted a provisional detailed articulation and a consistent economic return for private investors without a very substantial assumption of risk. As the accounting treatment imposes, this may constitute a severe problem in order to demonstrate the debt as off-balance sheet, above all in the light of several critics that have been descending on the intrepidity of the regional government that allowed the procedures. In general the LHUs dealt with a grid of financial ratios aiming to demonstrate the financial sustainability of the investments, their convenience, and the profitability for the private counterpart. A discouraging note derives from the fact that neither case presents the same perspective of internal procedure analysis, since in Case X a series of estimates and comparisons with the traditional procedure were made and are available. In Case Y, there was no validation test about the real VFM of the initiative. The same thing seems to occur in many cases of the UK experience also outside the hospital context (Kakabadse *et al.*, 2007). With reference to financial sustainability, in both cases, the *debt service cover ratio*

(DSCR) is positive, so it should ensure coverage of the loan repayment and guarantee the conditions for financial stability of the SPV. Under the conditions examined and tariffs charged, the results show that the two PPPs are too expensive. The hospitals remain the property of the SPV for the length of the contract and the remuneration obtained is superior to any other investment. Thus the private sector seems to be the only one to have convenience.

From an accounting point of view, the assets do not appear in the budgets of the healthcare organizations, and the tariffs are treated as operating costs. Their incidence, therefore, has a double meaning. On the one hand, the costs weigh very heavily on the management of the LHUs and, consequently, of the regional group of reference, by eroding part of the funds allocated to healthcare; on the other hand, an evaluation according to the Eurostat statements would indicate that this kind of PPP has a negative effect on the public deficit.

## CONCLUSIONS

The real and tangible advantages of PPPs lie in the contribution of private capital for the realization of infrastructures that would not otherwise be possible, and a reduced incidence on public expenditure for investments. This should mean that initiatives may be considered somewhat off-balance sheet. Another key advantage is that a single approach gives multiple answers to the potential complexity of many outsourcing contracts whose risks are on the private partner. However, as highlighted in the two cases examined, the contractual formula should certainly be refined in order to mitigate those risks that in the PPP framework should be on the private sector.

In the case of hospitals, if the construction risk is on LHUs or Regions (on which they depend), or if the private partner bears only the construction risk and no other risks, the assets are classified as public assets. This implies significant consequences for public finances, both for deficit and debt. The initial capital expenditure relating to the assets will be recorded as public fixed capital formation, with a negative impact on public deficit/surplus. Above all, the most relevant effect lies in the integration of forces aimed at the functioning of a public service. It is advisable to envisage two counterparts (public and private) only in the programming phase, when rules and roles are fixed, but, once the work is implemented, the strategy for a successful partnership consists of a coordinated combination of actions in a unitary perspective. Therefore, in national accounts the assets involved in a PPP can be

considered as non-government assets only if there is strong evidence that the partner is bearing most of the risk. What is mentioned above may lead to some repercussions on the utilization of PPP since effectiveness and efficiency in the long term may be affected by the private partner with an overestimation of costs in order to ensure a surplus in the PPP. Last but not least, it is possible to claim an effective contractual risk transfer by observing the contract performance when in use. This delegation of the operating process does not mean a loss of control on hospital functioning and service quality, for which the LHUs (NHS) remain responsible. The message launched by these experiences emphasizes the concept of mutual exchange in the PPP regarding the lack of financial resources. It is crucial to know whether, in the long run, the results will meet expectations.

In general, the hospitals observed in the case studies seem to take advantage of potentialities offered by this financing and operational mechanism since it represents the ideal tool for a realistic example of public-private integrated management.

Several PPPs, already underway, present some elements of analysis from which to draw lessons for the future, given that the system is aiming to increase exemplary practices. As observed, what is problematic concerns the following factors: overcoming the merely opportunistic propensity to use the PPP, the use of ex ante test methodologies able to make realistic simulations on the future of the partnership, the flexibility to be given to contracts, so that risks shift to the private party but can also be adjusted when external variables require it. Of course, in the hospital case it is necessary for an ex ante evaluation to be able to count on reliable estimates concerning the use of hospitals and that the risk on the private party is not being excessively compensated by revenues that the private party itself would be prevented from reaching under normal market conditions. This is the paradox to be avoided.

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## CLUSTERS – A KEY ELEMENT OF REGIONAL DEVELOPMENT IN ROMANIA

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### ABSTRACT

In the recent years, due to the increasing development gaps between regions in Europe, the clusters have an increasingly important role. Although the literature has treated this subject a long time ago, experts like Porter, Marshall have recalled into question the importance of clusters for regional economies in recent years. Their role is important in the difficult process of reducing regional disparities and the local authorities are supporting the establishment of such conglomerates between companies and specialized institutions. As for Romania, only after joining the European Union in 2007, the concept of cluster began to be mentioned as important for the development of the national territory. The transition to a market economy meant for Romania the increased competition and competitiveness on foreign markets. Thus, the establishment of clusters in various fields and in as many areas of the country as possible has been an important factor for the growth of the Romanian economy in the mid-2000s. However, their coordination and follow-up should be performed with great responsibility, otherwise undesirable phenomena such as the deepening of intraregional economic and social disparities may occur. As investigative methods used in the preparation of this research we can remind the analysis and synthesis, the normative and explorative approach, the quantitative analysis and the qualitative assessments. Also, this paper also uses modern investigative methods, but also frequently used methods in the research activity like the statistical methods of interpreting the data (the tabular method and the graphical method)

**Keywords:** cluster, regions, economic growth, regional development, regional policy, agglomeration

## THE CONCEPT OF CLUSTER

Throughout the history the concept of "clusters" have been assigned different names: pole of competitiveness, industrial district, industrial agglomeration; through the terms that have won there were: pole of competitiveness (in France and Belgium) and cluster (the most used term). (Cismaş *et al.*2010)

The term is originated in English and in free translation has the meaning of "*bouquet*" or "*group*". The specialized literature has given several different definitions to this term.

For example, the definition given by Michael E. Porter, a staunch promoter of the concept, says: "Clusters are the interconnected companies and institutions' geographic concentrations in specific areas." (Părean *et al.*2010)

Continuing the analysis of the development of industrial structures, Porter demonstrates the influence of competitive relations between national industries and economic development, through the model of competitive advantages of national industries. He claims the need of substantiation of strong industrial links between competitive sectors, so as to result in a significant increase in the national prosperity. (Cismaş *et al.*2010)

In his studies, professor Porter, analyzed the business environment from 10 countries and also from over 100 industries with an important competitive position. Thus, he emphasized how the firms manage to become competitive and to contribute to raising the living standard of the countries in which they are located. (Cismaş *et al.*2010)

As professor Porter did, other scholars especially from the Economic Geography field, drew attention to the fact that both clustering and industrial and regional specialization were evident phenomena in all economies. Clusters could also be identified in many types of industries: the high-tech and traditional fields, manufacturing field, the services field, etc. (Solvell *et al.*)

The Official Journal of the European Union defines cluster as a "geographic concentration of specialized firms in a particular sector, related to certain suppliers and other companies from connected sectors that are competing, while working at the same time." (Părean *et al.* 2010)

In other words, we can say that these clusters are a kind of economic activities taking place within related sectors, forming in a certain period of time, their emergence being one of the greatest challenges of achieving economic development in a given region. From a historical point of view, it should not be forget that the development of the concept of *cluster* is closely linked to academic trends and schools of thought from the time of Alfred Marshall.

In his studied, Marshall talks about the industrial regions of England in the Nineteenth century, where these groups between firms acted in the same field were quite common. Later in the 80s, in Italy, the term was developed by ties that were formed between several small and profitable businesses in this country. In the mid 90s, the clusters played a special role especially in the Netherlands, specifically in the Eindhoven region. The region was passing through a sharply economic decline and the local authorities have decided to develop a program called STIMULUS, which was based on clusters, in which small and medium-sized groups received funding for development and implementation of new products. (Sabău, 2012)

Finally, Buro and Katz, two other authors concerned with this issue, believe that *the clusters are groups of related companies, actors and institutions located near each other that gain a productive advantage from this mutual approach*. Clusters are steadily growing because the companies within the group are making an important profit due to the competitive advantages resulting from the existence of a specialized workforce and exchange of information. (Muro and Katz, 2010)

Therefore we will consider the clusters as conglomerates (associations) of several specialized companies in a particular industry, which obtain various benefits from these approaches.

Actually, clusters help increase national regional and local competitiveness and represent an important lever which a country is better to use in dealing with tough competition that the market economy represents. Also, it should be noted that a growth of regional or local economy depends not only on the existence of clusters, but also by other factors such as: climate and natural conditions, fertility of the soil in the area, the existence of advanced technologies, the skills and structure of the labor force, and so on.

## **THE ADVANTAGES AND THE CLASSIFICATION OF CLUSTERS**

The emergence and development of clusters in a specific region or in a specific administrative area is achieved either naturally or planned. During this complex process a particularly important role have the local governments as they know quite well the companies belonging to a specific branch.

According to the specialized literature, clusters have more complex features such as: (Părean *et al.* 2010)

- they have a certain identity and are geographically located in a well determined

regional, national and international place;

- they are a great potential for the development of regional, national and international markets from a particular field of activity;
- encourages the competition and strengthens the internal and external cooperation relations between the branches of the national economy;
- provides a solid basis for increasing the competition and the standard of living within the regions.

The main elements that can justify the formation of these organizations are: (Părean *et al.*2010)

- access to specialized factors (in saying this, we understand well-trained workforce, the quality of professional services, etc.);
- access to information (inside a cluster there is a continuous accumulation of information that is later disseminated to stakeholders);
- complementary: positive results from a field of work affects the ones from the sectors where it has relationships with;
- the access to public institutions and goods; if we are dealing with a well-organized cluster, which plays an important role for the economy of the area, it is indicated to deal with public investment that will have a positive effect also on component companies.

Also, authors Mihai Părean, Maria Oțil and Monica Boldea believe that the crisis affecting the global economy in the recent years can be achieved through the existence of these clusters. (Părean *et al.*2010)

The competition generated by companies included in a cluster forces the companies to innovate and to develop, they stimulate research and introduce new forms of economic development. Clusters affect the competitive advantage on three major directions: (Cismaș *et al.*2010)

- growth of the productivity of the companies that are part of a cluster;
- stimulate innovative capacity;
- helping the attraction of new businesses within the cluster.

The key benefits identified after adopting the clusters organizational model are the productivity, regional specificity, the increased mobility of information.

In attempting to form clusters, the involved entities take into account several factors, such as productivity, the increase of wages and of employment. However, the authors *Laura*

Cismaş, Andra Miculescu, Maria Oţil believe that: "the creation and development of a specific regional, through the formation of clusters, help regions in creating a favorable and productive business environment, which leads to attract as many profile companies as possible to their territory". (Cismaş et al.2010)

Therefore, we can state that the development of a dynamic business environment in a certain region is also influenced by the existence of as many clusters specialized in various industries.

To all these it must be added the very important and increasingly growing role of the information, its mobility increasing greatly and is actually a benefit of clustering (Cismaş et al.2010). It is a known fact that technology and innovation does not develop in isolated organizations, but in open environments where there is interaction between competent individuals from different organizations.

Yet often the result of sustained increase of competitiveness of a region is not directly related to the existence of clusters, because if there is too much concentration of clusters within a certain area, that area may become vulnerable. (Cismaş et al.2010)

Nowadays more and more voices appeared stating innovation as one of the factors that may cause the economic growth. Starting from this idea it was concluded that clusters are an enabling environment to promote and support innovation, so indirectly they are a source of growth and development of the national economies.

The authors Jorg Meyer-Stamer, Ulrich Harmes-Liedtke question the existence of four types of clusters. Therefore, they state: (Meyer-Stamer and Harmes, 2005)

- o *The latent clusters* are identified through a critical mass of firms from connected industries sufficient to reap the benefits of clustering. However, under this type of organization, the interaction and information flow necessary to truly benefit from the collocation, is not very well developed;
- o *The potential clusters* have some of the elements necessary for successful cluster development, but these elements should be more carefully studied in order to benefit from the impact of agglomeration;
- o *The policy-based clusters* are chosen by governments for support, but which don't have in their componence the minimum number of firms to create favorable conditions for the regions' development;
- o The „dream” clusters are groups of policies based not only on the lack of a minimum number of fcompanies, but also of basic resources.

A very interesting and comprehensive classification is performed by George-Marian Isbășoiu, which, reminiscent of Porter, presents two types of clusters: (Isbășoiu, 2006)

- *The Vertical clusters*: composed of industries that are linked through buyer-seller relationships;
- *The Horizontal clusters*: include industries that might share a common market for goods, use a common technology, labor skills and similar resources.

Within these clusters a leading role is also played by the innovation. This topic has received in recent years, growing attention from regional analysts.

This division of the clusters actually starts from Porter's classification of clusters performed by Jacob and De Long in 1996. They analyze more deeply the definition of industrial cluster, taking into account the geographical and spatial economic activities, the horizontal and vertical relationships between sectors, the presence of a main actor, the cooperation between companies and the intensity of ties between people. (Isbășoiu, 2006)

Ian R. Gordon and Philip McCann, step a little further and link the issue of innovation to the agglomeration economies, bringing into question two known authors: Krugman and Porter. Gordon and McCann recall the link between innovation and regional development, but also draw attention to the fact that innovation differs from invention. (Gordon and McCann, 2010)

Therefore, the creation of clusters brings a direct economic benefit to a region and to local economies. Firstly, it is stimulated the entrepreneurship and the increase of innovation in as many sectors of the economy as possible. Secondly, they are supplemented by the development of local industries and the increase of employment in the area. (Muro and Katz, 2010)

## **CLUSTERS - A CHANCE FOR THE DEVELOPMENT OF REGIONS IN ROMANIA**

As the authors Michael Guth and Daniel Cosniță recall, in Romania, the existing planned economy until 1989 led to the existence of clusters as industrial centers.

What followed after 1990 signified an important decrease of the industrial activity which inevitably led to a relocation of resources and a repositioning of the economy as a whole. But regarding concentrations or industrial agglomerations it really began to speak only after 2001 when the Romanian economy began gently to register on a growth trend and after the EU accession in 2007. (Guth and Cosniță, 2010)

The first study that presented in detail these industrial agglomerations in the form of clusters was the one conducted by the International Center for Entrepreneurial Studies in 1998. The research was conducted at the indications of the World Bank Institute for Economic Development and aimed mostly the Romanian entrepreneurs competitiveness. This resulted in the appearance of three areas in which it is possible to speak about the existence of clusters: making software, engineering and wood industrz. (Guth and Cosniță, 2010)

The same authors, Guth and Cosniță recall another survey, this time conducted by Marco Riccardo Ferrari, research assistant at the Economic Department from the University of Milan. In this case, again, it were identified three "proto-districts" 19, for wood, textiles and ceramic industry. (Guth and Cosniță, 2010)

A third relevant study was conducted by Valentin Ionescu, whose research was based on the previous analyzes. During his study, as stated by Guth and Cosniță, Ionescu shows the differences between the methodological criteria applied by other studies and emphasizes the uncertainty of a cluster definition. The researcher states conclusion is that in Romania there are emerging clusters and applied questionnaire focused only two possible clusters, one in the ceramics industry – Alba Iulia county and the other one in the software industry in Bucharest. (Guth and Cosniță, 2010)

Another significant work which deals with the clusters in Romania is VICLI21, a project within the European program INTERREG II C - CADSES22. The project started in 1999 and ended in 2001. It was meant to identify and support the development of cluster groups through the transfer of regional know-how. On the completion of the project four potential clusters in Harghita county were mentioned: woodworking, pottery, printing and equipment. (Guth and Cosniță, 2010)

In addition to these studies and researches, over time there have been carefully examined all types of clusters across the country and also divided by regions.

The table and figure below show, on one hand, a situation with the clusters identified at a regional level, and on the other hand, it presents a situation with the clusters eventually recognized as functional.

As evident from these cases the number of identified potential clusters is quite large, and in the most diverse fields. Certainly an important factor in establishing these regional clusters is the specific of the area.

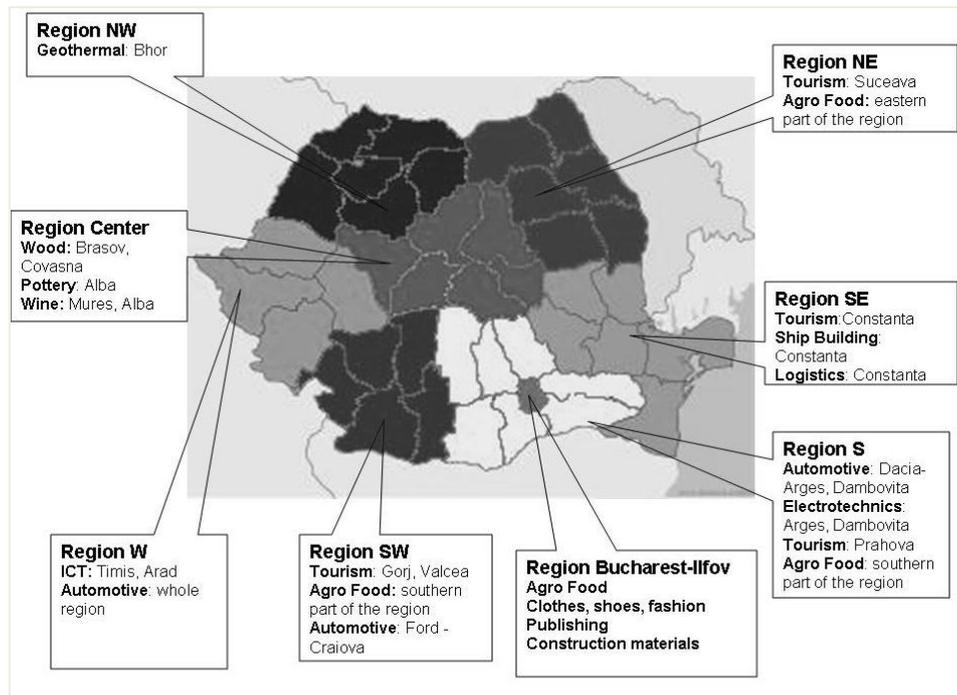


		<ul style="list-style-type: none"> <li>• Glass Industry</li> <li>• Electro Technical Industry</li> <li>• Metallurgy</li> </ul>
South East	Brăila	<ul style="list-style-type: none"> <li>• ICT</li> <li>• Agro Food</li> <li>• Tourism</li> <li>• Ship Building</li> <li>• Alternative Energy</li> </ul>

Source: Michael Guth, Daniel Cosnița – *Clusters and Potential Clusters in Romania, A Mapping Exercise*, February 2010

From the analysis of the table it results that the ICT field is present in most regions of the country, followed by tourism and bio industry. Clusters in certain areas are made depending on the geographical location and climate of certain areas. For example, agriculture is present mainly in the southern, south-west regions where there is lowland terrain very suitable for growing grain.

Figure no. 1 illustrates better the specialization of the areas mentioned before. Thus, the North-West region has reserves of geothermal water, the Center region has reserves of wood processing, wine production and ceramics, while the Western Region is specialized in ICT and automotive industry. On the other hand, the North-East region is known for tourism and agriculture and the Eastern region has a significant specialization in tourism, logistics and shipping industry. In the South region, the attractions include agriculture, automotive, electronics and tourism, while in Bucharest-Ilfov region there are activities concentrated mainly in agriculture, textiles, advertising, construction. Finally, the South-West region is specialized in automotive, tourism and agriculture.

**Figure no.1 Regional Romanian Clusters Recognised**

Source: Michael Guth, Daniel Cosnița – *Clusters and Potential Clusters in Romania, A Mapping Exercise*, February 2010

The new thinking on regional development raises the question "How does clusters integrate in the economic development?" For example, the cluster analysis can diagnose the opportunities and threats from an economic region and help identify the future actions.

At the EU level, clusters occupy an important place, which results from many documents and position papers adopted by the European Commission since 2005 and especially from the setting up of the European Cluster Policy Group. In 2008-2010 it studied clusters policy in countries outside the EU. (Dan, 2012)

As Mihaela Cornelia Dan mentions, the policy regarding clusters was including into other policies (competition, industry, entrepreneurship, education and science). At the European level there is not yet implemented a policy in its own right on this issue, as it is at the stage of searching and testing strategies, tools. (Dan, 2012)

Clusters are now the subject of a whole series of documents issued by national and international organizations (OECD, 2005, 2010, The European Commission, 2008) and based on the vast experience including in Romania, authorities supports the creation of clusters that have direct effects on local economies by increasing competitiveness, increasing employment, businesses and regional economies are growing. (Dan, 2012)

Yet somehow the natural question arises: why should clusters be supported? And the answer to this question can be obtained after completing the research conducted on this topic. Thus it was concluded that during a period of economic instability (as it is the one we are passing through now), these forms of organization bring a series of benefits which directly relate productivity, the private initiative, innovation, research, industry, businesses and last but not least the economy performance as a whole. (Dan, 2012)

However, some theorists (Muro, Katz) support the idea that clusters should act solely in areas where there some partnerships are already built and there are communication networks between companies. Also, due to underdeveloped economy in certain regions, the state should support through various means the private companies.

In Romania, the beginning was made by the Ministry of Economy, which has funded, some years ago, several studies in order to define the Romanian concept of cluster. Thus it was started from "triple helix" model which includes the three natural partners (the industry, especially SMEs, the universities and the state). In their case it was found that there was no effective cooperation and then there was brought into question a fourth element represented by the promoters. Their role is primarily to ensure a promotion among potential participants recognizing the benefits of clusters, and then to handle the technology and innovation transfer. (Dan, 2012)

To all those listed above the author Mihaela Dan recalls that regions must face some risks; these risks come mainly from the authorities because they assume major responsibilities and objectives regarding competitiveness, industrial policy and clusters, but eventually they never get to complete them or even worse, they give up on them over time. In Romania, the state's involvement regarding the clusters policy is different. As in other European countries, regional development policies, clusters, the role of SMEs in the economy are included the programs of several ministries and institutions. The main actors are the Ministry of Regional Development and Tourism. (Dan, 2012)

Through the ministries involved in the clusters issue, we include: the Ministry of Economy, the Ministry of Environment, the Ministry of Transport, the Ministry of Administration and Internal Affairs (responsible with industrial parks). In Romania, in the years to come (programming exercise 2014-2020) the most important role will be held by the development regions because the projects evaluation will be performed by the regional authorities. All these will make the local government's involvement more intense than ever before. (Dan, 2012)

As previously noted, in Romania in terms of clusters, it was passed to a four-leaf model, entitled "Four clover"; this model is mentioned by the authors Cosnița D. and Guth M. in their paper entitled, *Clusters and Potential Clusters in Romania*. They reinforce the idea that in this model we deal with different actors having different interests that will try to harmonize.

These can be summarized in the form of the following table:

**Table no. 2 The interests of various actors in "Four clover" Model**

Partner	Contribution	Effects/Benefits
R&D Sector	Up to date and applied research Informații, transfer de know-how	- adapting the curriculum - new industry-sponsored laboratories - continuous learning - research centers
Industry	cooperation availability of production capacity	- increase added value - other competitive advantages
Public authorities	mediator central, regional and local dissemination direct support	- central, regional and local economic development
Expert consultants	know-how transfer	- added value
General consultants	Coordination National and international dissemination Know-how transfer	-participation in an innovative network

Source: Michael Guth, Daniel Cosnița, *Clusters and Potential Clusters in Romania - A Mapping Exercise*, 2010

According to [www.clustero.eu](http://www.clustero.eu) accessed on the 11th of March, 2013, some of the most important clusters in Romania at the moment speaking, are the following:

**Table no. 3 The most recent clusters**

Crt. No.	Cluster Name
1	AGROFOOD Food Products Regional Cluster
2	Agrofood Crișana-Banat
3	Astrico North East Textile Cluster
4	AUTOMOTIVEST
5	Romanian Maritime Cluster
6	ETREC Electrotehnical Regional Cluster
7	GREEN ENERGY Biomass Innovation Cluster
8	"Tradiții Manufactura Viitor" Association
9	ITC Oltenia Cluster (ICT - Regional Competitiveness Pole Oltenia Cluster)

Crt. No.	Cluster Name
10	Regional Information and Communication Tehnology – West Region
11	IND-AGRO-POL Competitiveness pole
12	PRO WOOD
13	REGIOFA INNOVATIVE CLUSTER
14	ROMANIAN TEXTILE CONCEPT
15	Transylvania Aerospace Cluster,
16	Tourism Regional Cluster – Bucovina Tourism Association
17	Oltenia Tourism competitiveness pole – Innovation and Traditions in Tourism – Tur Olt InTT
18	South -West Oltenia Automotive competitiveness pole

Source: conducted by the author based from the data from <http://www.clustero.eu>

As from the above table, the clusters in Romania are among the most diverse areas. Starting from the clusters in the food industry, electronics, information technology and continuing with textile industry, the regional tourism and and the automotive industry, these forms of organization are seen as an important element for the future development of the national regions. The authorities have realized the benefic effect of the clusters and therefore have begun in recent years to support their establishment by different measures.

Based on Ketels's statement from 2003, quoted by George Marian Isbășoiu (Isbășoiu, 2006) "clusters develop in time: they are not a phenomenon that appears or disappears overnight," we can say that, in Romania's case, the concept developed gradually and, when joining the European Community, more associations of this type made their place into the national economy. Now the only thing that needs is to see their direct effects on local economies.

## CONCLUSIONS

Following the conducted research a few key ideas emerge, such as:

*Firstly*, it was found that at the European level but not only, clusters represent an effective element that can ensure the economic development of certain regions, the effects of such agglomerations being the most beneficial. Many regional economies within the European Union have increased greatly after the emergence of clusters and the involved actors (companies, the local public authorities, the national states) created the necessary means for it to grow even more in the future.

*Secondly*, Romania has a fairly new experience in the problem of clusters, although, before the Revolution from 1989, they existed in the form of industrial clusters in different parts of the country. The accession to the European Community in 2007 brought the

emergence of a large number of clusters in the eight Romanian regions, many of which are specific areas in which those territories are specialized.

*Thirdly*, after the fall of the communism, Romania has gone through some major social, economic and political changes, which led to significant opportunities for foreign companies to locate their activities in this part of Europe.

*Fourthly*, and perhaps the most important conclusion of this research is that for urban settlements, regions or even private investors, the industrial clusters represent a particularly important point in the development strategies for the future. However, there is a prerequisite: the state must implement at its highest parameters the market economy mechanisms, thus we will witness a much stronger economical growth.

Besides all these, it is necessary for the companies from the production area operating in the clusters to be able to cope with the new technological challenges and at the same time, to meet, through the provided products, the requirements of the national and international markets.

Most of the clusters mentioned throughout this research are beginning their activity, that is making them easily vulnerable through the challenges that will be faced them in the future especially in economic field.

In the future this paper can be extended by identifying a model for the development of these forms of organization, which can be put into practice by those who are involved in the clusters.

Pe viitor aceasta lucrare poate fi extinsa prin identificarea unui model de dezvoltare a acestor forme de organizare, care va putea fi pus in practica de cei ce sunt implicati in cadrul clusterlor.

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## **IMPACT CAPITAL FOR SUSTAINABLE DEVELOPMENT IN THE MEDITERRANEAN REGION**

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### **ABSTRACT**

Impact capital is representing a new asset class, it is the new venture capital industry ready to face the institutional, structural, and cultural problems characterizing the Mediterranean region, as well as legal imperfections that must be overcome.

This paper presents prominent elements shaping and fostering impact capital in the Mediterranean region such as environment, social and governance elements in the frame of sustainability, as well as a new way to connect philanthropy to investors and investors to philanthropy.

Venture philanthropy is a concept getting closer to venture capital. Several philanthropic entities are using their capital following the techniques of venture capitalists in order to optimise management and use of resources

It also provides a description of the congruency between Islamic finance and venture capital industry which stand for a positive factor to catalyze capital flow in the region and making value from cross-border investment deals, connecting successful business model all over the Mediterranean region and improving cultural interrelation.

Impact capital is a new industry characterized by passion and broad-mindedness. Investors and entrepreneurs shall know that lack of idealism and values is proportionate to failure, since success is traced and reckoned not only with profit but also with satisfaction and peoples real needs.

This paper is part of a larger project on venture capital in the Arab-Mediterranean countries and is based on information collected from various sources, including case studies, interviews, and archival data.

**Keywords:** Impact Capital, Venture Capital, Venture Philanthropy, Arab-Mediterranean Region, Sustainable Development, Sustainability, Islamic Finance, Values.

This paper aims at recalling the importance of the impact capital industry, representing a new asset class for investor worldwide and particularly for emerging markets.

Impact capital is the industry where impact investments are carried out. Impact investments are investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending upon the circumstances. Impact investors actively seek to place capital in businesses and funds that can harness the positive power of enterprise (JP Morgan 2010).

The paper come out from empirical analysis about impact capital industry carried out in the Mediterranean Region. It was important to operate and spend time locally to get a closer insight for a better understanding of the region stage of development and to identify ways to improve social solidarity.

The following countries were selected to collect information as representative of the different areas of the Mediterranean South East region: Tunisia, Egypt, Jordan, Palestine, Israel.

Tunisia was selected for the Maghreb (the term is generally applied to all of Morocco, Algeria, and Tunisia), Jordan for the Mashreq (the term refers to a large area in the Middle East, located between the Mediterranean Sea and Iran) and both Egypt and Palestine as significant countries in the region.

Israel was selected not only because it represents an active country in the region but because it is significant in terms of public participation and the governmental role in developing the venture capital industry. Nevertheless, Israel's circumstances are peculiar and not comparable to any of the neighbouring countries. Attention was paid particularly to the policy framework level.

Jordan, Egypt and Tunisia were chosen not simply for geographical reasons, but having regard for the strong commitment governments and both public and private national

institutions in these countries are showing to facilitate venture capital industry development in their respective countries. Palestine's selection takes into consideration the peculiar challenges this economy is facing today and the interrelation with the region.

## **VISION AND VALUES TO FOSTER SOLIDARITY**

Principles and values respecting people and environment are weakly taken into consideration by policy makers, investors, managers and entrepreneurs. This lack is particularly strong in the Mediterranean region where countries have weak governance from one side and from the other side investors are taking advantage from significant factors such as abundance of natural resources and cheap labour forces. The risk for corporations to exploit illegally precious resources and violate human right is very high.

Main economic theories developed and followed in the last century, Marxism and Capitalism, have always reckoned ethics as an independent entity relevant to the economy in a deterministic way (Cohen G.A. 1977), (Gouldner A. W., 1980), (Blackledge P., 2008) (Critchley P., 2001).

In Marxism, ethic is traced as an obstacle to correct knowledge and action, as an obstacle to progress, at which the natural laws of history aim. Capitalism, based on liberalism, it is also deterministic in its core. "It presupposes that the free play of market forces can operate in one direction only, given the constitution of man and the world, namely, toward the self-regulation of supply and demand, and toward economic efficiency and progress" (Ratzinger, 1985). Economy, it is said, should be guided by its own rules, which are in essence good, and not in accordance with imposed moral considerations. "Following the tradition inaugurated by Adam Smith, this position holds that the market is incompatible with ethics because voluntary moral actions contradict market rules and drive the moralizing entrepreneur out of the game" (Ratzinger, 1985).

After international financial crises break out during these last years and the numerous scandals and bankruptcies that have hit many corporations as well as violations made by foreign investors in emerging countries in the last years, it seems to be more clear that man and his moral freedom can not be excluded from the world of economics and businesses. It is becoming ever so clear that the development of the world economy has also to do with the development of the world community and with the universal family of man, and that the development of the spiritual powers of mankind is essential in the development of the world

community. These spiritual powers are themselves a factor in the economy: the market rules function only when a moral consensus exists and sustains them (Ratzinger, 1985).

In the last decades and more since the end of the cold war, the power of multinational corporations has risen sharply as a result of globalisation and the liberalisation of international trade. Private and public stakeholders have been engaged in a debate about nature of these responsibilities (Kincaid, 2012). It is today widely accepted that corporate activity and profit goal should be balance with responsibility and accountability for both its positive and negative impact on human rights and the natural environment (Friedman and Milton, 1970). Entrepreneurs, managers and investors have a moral obligation to society besides personal believe and own value obligation.

Corporate codes of conduct, guidelines and recommendations on model corporate behaviour proposed by international institution, provide a framework within which corporations should operate to generate profits in a manner that maximises the enjoyment of human rights and the environment. Many global codes of conduct and conventions have emerged in attempts to ensure a positive impact of corporate activity as well as many industry specific codes of conduct. OECD Guidelines, which are recommendations accepted as a model code of conduct with global application, recommend among other things the companies which carry out global trade and investment refrain from the use of child, bonded and slave labour, pay decent wages and provide acceptable terms and conditions of services. Financial transparency is also encouraged in order to avoid corruption and bribery (Getz, 1990).

Nevertheless all these codes and conventions, whether global or industry specific, violations in emerging market are still numerous. Guidelines are not binding and mechanism of control till weak. Although legal and non-legal efforts regarding human right and environment have been made and more in the future should be done, it must be said that without common values recognised at personal and society level, the human being and natural law will be always easily violated.

The respect for the dignity of the person express the proper aspirations of the human spirit, and constitute the ideals that should underpin any development and investment process. Centrality of person, as a method to look for and start working with entrepreneurs, is important for any investors and particularly for impact capital stakeholders. The single person with its own capacity, desire and project should be set at the centre of any valuation and investment process.

This is mostly relevant when investors are looking for seed and early stage investments. Investors and fund managers shall set together with entrepreneurs having value and passion for reality that should be transform in products and services in order to improve life quality and conditions.

Impact capital industry fits well with passionate person, moved by curiosity and willingness for new challenges. Both investors and entrepreneurs have to be characterized by this passion, broadmindedness and opening to the world. Keeping social and environmental impact dimension is mandatory to make a profit that is inclusive of values fully corresponding to human nature.

Lack of ideals and values, whether in investors or entrepreneurs, is proportionate to failure. Respect the natural law engraved in any human hurt and therefore having respect of human rights and standard rules of conduct is a guarantee for personal and companies success. So must be said, recalling history and empirical analysis that utilitarianism, the doctrine which defines morality not in terms of what is good but of what is advantageous, threatens the freedom of individuals and nations and obstructs the building of a true culture of freedom (Wojtyla, 1995).

The question about markets and ethics, businesses and ideals, it is correlated to the development of economic systems so to the development of the venture capital industry strongly anchored to single man creativity and idealism. Policy and strategy therefore, cannot be based only to the good of the single or group, but indeed to the common good of a determinate countries as well as to the common good of the family of man. The common good shall be pursue together by stakeholders in order to obtain profit but always being aware that single life and earth resources are part of a mysterious transcendent level.

Promoting venture capital operations pursuing this ideal dimension is a means to prevent improper exploitation and as well a good way to foster human creativity, industry potentiality and nations development. The real answer to human right violation and illegal business development is not only coercion nor repression, nor the imposition of one social "model" on the entire world but more a common effort to move first from human person inside desire of good for the earth and all humanity. Investors and entrepreneurs, must be aware that they have within them the capacities for wisdom and virtue which should be used in the attempt to create wealth and profit.

Ideal sphere and values in the economy are nowadays linked to some words and issues such as corporate sustainability, responsible investments, environment, social, governance, international cooperation for development, others. So the following paragraphs aim at presenting positive mutual relation between these issues, impact capital industry and economic development.

## **PATIENT CAPITAL FOR SOCIAL INVESTORS**

Doing business has to be understood, now more than ever before, in an articulated and broader way in order to construct an economy that will soon be in a position to serve the national and global common good. There is a shifting of competences from the “non-profit” world to the “profit” world and vice versa, from the public world to that of civil society, from advanced economies to developing countries (Ratzinger 2009).

Both the philanthropic sector and the pure profit oriented venture capital industry are rapidly changing. The lines between the private and social, profit and non-profit are beginning to blur. As has been set forth heretofore, over the last decade, several venture capital actors have increasingly kept in consideration environmental and social values. Many venture philanthropy organizations are benefiting from following venture capital principles and organizational methods (Kohn H., Karamchandani A., Katz R., 2012).

The concept of venture capital is linked to impact capital and impact investments. Venture capital industry and technique represents a way to improve impact investments. “Impact investments are investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return. They can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending upon upon the circumstances” (JP Morgan, 2013).

A new breed of venture capitalists is emerging, and have various labels but are mainly being dubbed social or impact investors. These investors seek to combine financial returns with social impact by using the tools of venture capital to make investments in promising private companies that have the potential to deliver some measurable social or environmental benefits. Investment valuation analyses are therefore carried out not only based on financial assumptions but on primary products distributed and on people reached with relevant services.

Traditional charity and aid alone will not solve the problems of poverty. This is also true of markets - the market alone will not solve the problems of fair and complete development. Traditional charity often meets immediate needs but too often fails to enable people to solve their own problems over the long term.

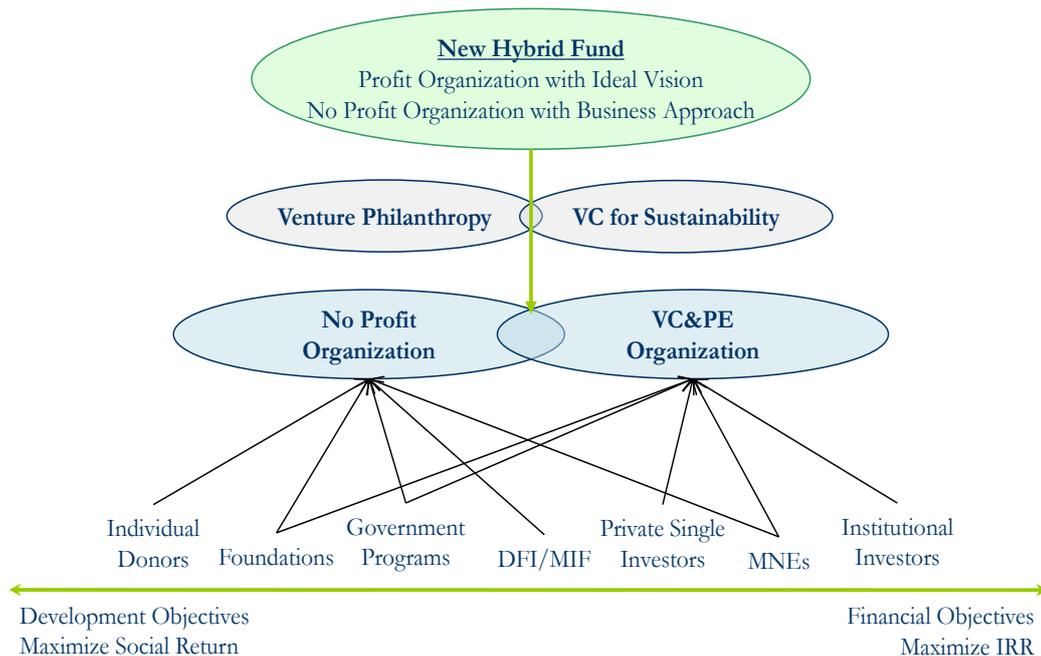
Development projects and initiatives must be run as a business, but fully respecting people's uniqueness, their ultimate good and the good of the society within which they live. Together with a deep idealism, it is surely necessary to find someone who can provide the philanthropic support such as training, strategic advisers, management and access to new contacts and new markets. There is a real need and role for a combination between investors and philanthropists.

More companies are integrating charitable initiative (or even a defined charitable mission) often correlated to their own business. Non-profit organizations are becoming more businesslike, and more individuals desire to pursue second careers in order to "give back" to local and international development by sharing their ideas, skills, time, and money.

New hybrid actors are taking form strongly focused on "patient capital" bringing sustainable jobs, goods, services and dignity to the world's poorest.

Patient capital means make available funds for long-term use, being focused more on business development than on stellar rate of return. The investment strategy is therefore to provide social and environmental returns in addition to financial returns with an emphasis on returns over the long-term.

The motivations of investors can vary widely along a spectrum of having development objectives at one end, and financial objectives at the other. Indeed, the boundary line among investors' categories can diverge. There are always pure donors focused only on philanthropy and pure investors focused on profit but there is also very often a dynamic crossing of interests. More and more institutional investors and large corporations operating globally such as in the industrial, insurance, and banking sectors tend to increase action of corporate responsibility in order to please governments of countries where they seek to expand their business.



Responsible investors must refuse conventional assumptions (IRR of 25 to 40 percent and short time horizon, usually 5 to 7 years) and ideological bias but also, in turn, look for enterprises run by social entrepreneurs who are unafraid to work in markets where individuals have minimal income, where infrastructure is often non-existent, and where the institutional system is very corrupt. Very often entrepreneurs must pay bribes to get a license and to start a business. This means not simply invest and expect quick results. An intense work alongside entrepreneurs is necessary, offering management advice and technical help and, most importantly, connections to a wider network (Kohn H., Karamchandani A., Katz R., 2012).

Investors must be realistic about how and when loans would be repaid and equity share would be sold, while always remembering that businesses at the bottom of the pyramid could take a long time to grow and that primary goal is not only money but to effect long-lasting change.

Patient capital has all the discipline of venture capital – demanding a return, and therefore rigour in how it is deployed – but expecting a financial return that is more in the 5 to 10 percent range, with the plus of a great social return that is measured by the incisiveness to bring primary products and services at a lower cost to millions of poor people.

This approach can be merely driven by funder and investor idealism (such as environmental and social impact) as well as institutionally driven thus sponsored by government and development financial institutions (DFI) or driven by regulatory framework and political programs.

Patient capital can include for-profit funds, non-profit organizations, government-sponsored funds, domestic funds, global funds, technology funds, and many others. Patient capital funds can raise money from a vast range of investors.

The organizations which are more inclined towards development objectives can raise a significant amount of money from individual donors and obtain grants from foundations. (EVPA 2012). While funds that tend to be more profit oriented usually raise money from financial institutions, pension funds as well single high-worth individuals. In between, there are governments and a range of institutional funds, which invest in both strategic business and social funds, as well as strong promoters of creative hybrid funds.

Venture capital organizations focused on sustainability and in delivering affordable, basic services to the poor, are considering partnership with governments in different ways. Creative new models and forms of partnerships emerge. New hybrid funds operating in between extreme profit and poor non-profit models are considering to define alternative constructive ways to be more effective in solving problems of lack of development using a mix of markets and smart subsidies.

## **VENTURE CAPITAL FOR SUSTAINABILITY**

Venture capital and sustainability are increasingly being linked together as investors see that financial returns can also coincide with societal benefits.

Venture capital for sustainability is deemed a specific area within venture capital where profit objectives are supplemented by a mission, which has direct impacts on sustainability. A mission can be grouped in term of: sustainable products, portfolio company economic impact, processes and internal operations utilised by the company with regards to sustainable management.

Venture capital companies sensitive to sustainability are usually more open to search for opportunities in developing countries as well.

Sustainability, in a general sense, is the capacity to maintain a certain process or state indefinitely. The concept of sustainability applies to all aspects of life on earth and is commonly defined within ecological, social and economic contexts. In an ecological context, sustainability is defined as the ability of an ecosystem to maintain ecological processes, functions, biodiversity and productivity into the future. In a social context, sustainability is expressed as meeting the needs of the present without compromising the ability of future generations to meet their own needs. When applied in an economic context, a business is sustainable if it has adapted its practices for the use of renewable resources and is accountable for the environmental impacts of its activities.

Corporate sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability is an evolution on more traditional phrases describing ethical corporate practice such as corporate social responsibility (CSR, also called corporate responsibility, corporate citizenship, responsible business and corporate social opportunity) is a concept whereby organizations consider the interests of society by taking responsibility for the impact of their activities on customers, suppliers, employees, shareholders, communities and other stakeholders, as well as the environment.

Sustainability is a notion that has been growing steadily in the financial services sector in the last decade and it is particularly bound to venture capital industry which have seen as a tool to foster economic growth, innovation and job creation. As well, it must be noticed that sustainability is often the fruit of innovation and innovation is often driven by the creativity and energy of young entrepreneurs and start-up companies. Venture capital can therefore be an important leverage for the development of innovative and sustainable technologies, products and processes.

At present there is not a large number of sensitive investors among institutional investors such as pension fund and foundation, which are not so careful to pay attention to sustainability comparing to smaller and family investors. On this regard, policy makers should encourage and incentive institutional investors to direct more of their portfolio allocations to venture capital funds that have sustainability as a part of their missions.

## VENTURE PHILANTHROPY

Venture philanthropy is an approach to charitable giving that applies venture capital principles, such as long-term investment and hands-on support, to the social economy. Venture philanthropists work in partnership with a wide range of organizations that have a clear social objective. These organizations may be charities, social enterprises or socially driven commercial businesses (Mario Morino 2012).

Venture philanthropy is a concept getting closer to venture capital. Several philanthropic entities are using their capital following the techniques of venture capitalists in order to optimise management and use of resources.

Venture philanthropists assess progress and track the outcomes of their investments in terms of the social value produced. They maintain a close and active relationship with grantees, providing ongoing strategic guidance in addition to financial capital.



The fundamental objective of venture philanthropy is to achieve higher social or financial return (or both) from non-profit organizations.

The term venture philanthropy was probably first coined in 1969 by the American philanthropist, John D Rockefeller III, but in connection to funding unpopular social causes. In the meaning it is used now the term, it was certainly first utilized among US dot.com companies and related venture capitalist. The concept took off during the time of the high-tech boom, when profitable companies and venture capital funds were looking for more innovative ways to put their donations to work.

Its focus on building organisational capacity in entrepreneurial social purpose organisations, matching appropriate finance with strategic advice, makes a venture philanthropy fund a distinctive provider of capital. Not like traditional charitable giving institutions, venture philanthropy invests in core capabilities and growth, with the aim of scaling the impact of social purpose organisations – charities and non-profits, but also social enterprises and ethical

firms. Funding is typically provided over a multi-year period, tied to mutually agreed benchmarks, with a clear “exit strategy” for ending the relationship. Unlike a grant making model that relies on proposal submissions, venture philanthropy organization actively seek out organizations that would benefit from funding and expertise, including innovative start-up charities perhaps more open to innovative charities funding models. Each charity institution selected is treated as an investment, subject to a due diligence process, evaluation analysis and board approval.

As venture philanthropy is spreading all over the world, also in emerging markets, specific practices should be adopted to local conditions, taking into consideration specific legal norms and cultural practices.

Venture philanthropy is nowadays more developed in Europe where it has strong links to the private equity and venture capital community. Venture philanthropy concept is also influencing the corporate social responsibility of a set of major players in Europe’s financial services industry. Several new venture philanthropy funds have been established by philanthropists with successful careers in private equity. A European tradition can be discerned which is more pluralistic than that of the early US pioneers with the use of a wider range of financial instruments and performance management strategies.

European venture philanthropy organizations tend to have worked more closely with traditional charitable foundations, co-investing, learning from one another and influencing each others’ practice. The evolution of European VP industry has been closely allied to the European venture capital sector. As a result, VP is well placed to provide a synergistic model for corporate social responsibility in VC and private equity firms – again, offering distinctive prospects for growth. The movement is still nascent, and total funds in VP are currently small.

Venture philanthropy entails the application of venture capital principles, including long-term investment and hands-on support. Principles which must be adopted, defining specific investment tools, processes and methodologies in a way they may work effectively in the social sector.

Venture Philanthropy commitments maintain a set of widely accepted characteristics (Balbo, Mortell, Ostlander, 2008) which can be so explained and summarized:

- A high level of engagement. Venture philanthropists have a close relationship with the social entrepreneurs and ventures they support, driving innovative and scalable models of social change. Some may take board places on these organisations, and all are involved at strategic and operational levels;
  - Tailored financing using a variety of financial instruments (including grants, loans, mezzanine/quasi-equity and equity). Depending on their own missions and the ventures they choose to support, venture philanthropists can operate across the spectrum of investment returns. Some offer non-returnable grants (and thus accept a purely social return), while others use loan, mezzanine or quasi-equity finance (thus blending risk-adjusted financial and social returns). As in venture capital, venture philanthropists take an investment approach to determine the most appropriate financing for each organisation.
  - Multi-year support, which support typically lasts at least three to-five years, with an objective of helping the organisation to become financially self-sustaining by the end of the funding period. Financial support, if offered, it is provided to a limited number of organisations.
  - Non financial support to help organisations build strategic and operational capacity. Venture philanthropists provide value-added services such as strategic planning, marketing and communications, executive coaching, human resource advice and access to other networks and potential founders.
  - An emphasis on performance measurement. Venture philanthropy investment is performance-based, placing emphasis on good business planning, measurable outcomes, achievement of milestones, and high levels of financial accountability.
- So value is added to non-profit organizations and social businesses beyond financial support, enhancing the organisation's capacity, market understanding, strategy and operations as well as governance and organisational structures.

## **CONGRUENCY BETWEEN ISLAMIC FINANCE AND VENTURE CAPITAL**

The aim of this paragraph is not to provide an in-depth background about Islamic finance nor to introduce all the essential elements of Islamic finance but to give evidence of the natural link between venture capital operations and Islamic finance, representing therefore a chance to improve cross border relations in a complex region.

Islamic finance refers to a system of banking or financial activity that is consistent with the principles of Islamic law (Sharia) and its practical application through the development of Islamic economies. Sharia prohibits the payment of fees for the borrowing of money (Riba) for specific terms, as well as investment in businesses that provide goods or services considered contrary to its principles (Haraam). It is also not permitted to insure against uncertainties (gharar) or carry out any speculative activity similar to gambling (maisir)

These restrictions preclude most traditional western banking practices, including taking interest-bearing deposits, granting interest-bearing credit facilities, providing trade credit insurance, providing guarantees or investing in speculative ventures.

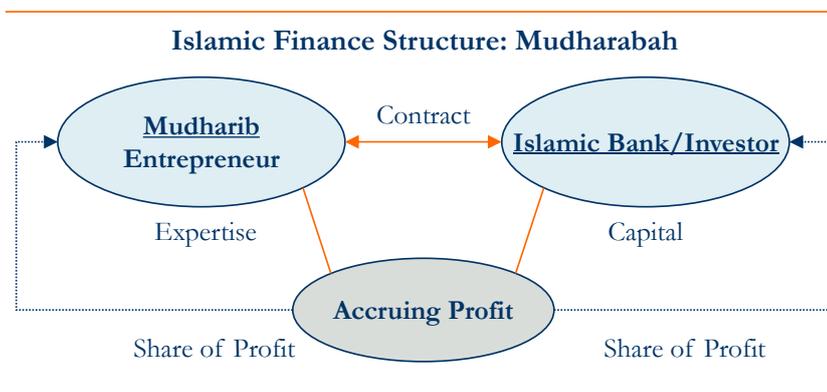
Islamic banks offer a range of alternative services and products. Islamic banks in effect enter into transactions or investments with the same rights and obligations as their customers and an equal share in their success or failure. Many Islamic economists have been calling for a re-orientation of this sector towards a greater role in profit-sharing and risk capital (Durrani, Boocock, 2006).

Islamic venture capital funds must adhere to the following fundamental requirements: underlying assets and an acceptable structure from a Shariah viewpoint.

Venture capital as an asset class is very close to equity-based Islamic finance structures, notably *mudharabah* and *musharakah*, although these have to be adapted to create the flexibility required by venture capitalists. Those financial structures are based on the principle of partnership, where no collaterals are required.

It is believed by Islamic economists that venture capital finance has its original roots in the Islamic world, especially in the concept of *mudharabah*. In *mudharabah*, the Islamic bank contributes funds, and the client/entrepreneurs contributes expertise and works to execute a potentially successful project. Profits are distributed in a percentage agreed beforehand, but the bank bears any

loss, though an exception may be made if the client is not negligent or in violation of the terms. Thus, *Mudharabah* is a

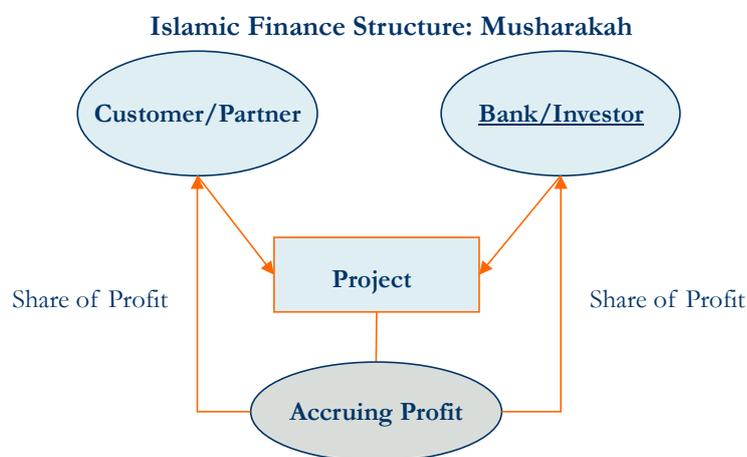


contract between those who have capital and those who have expertise, serving therefore the interest of the capital owner and the Mudarib (entrepreneur). The capital owner may not have the ability or the experience to run a profitable business. On the other hand, the entrepreneur may not have adequate capital to invest in a business or project. Therefore, by entering into a contract of *Mudharabah* each party complements one another, allowing a business venture to be financed.

*Mudharabah* can cover one deal, several deals, or a specified period of time up to a specified ceiling. This funding mechanism provides working capital finance to support entrepreneurs with skills (IT managers, engineers, traders, craftsmen) but lacking financial resources. It is the primary profit and loss sharing of asset and liability creation in Islamic banking. The bank's return is therefore determined by a share of the profits; but if a business venture fails, the capital provider (bank) loses its capital and the labor provider (entrepreneur) loses his/her time and efforts. However, the bank is not authorized to participate in the management of a *mudharabah* project, hence this form of financing carries a greater degree of risk. So profit from the venture will be shared at a pre-agreed profit sharing ratio. The key to a *mudharabah* structure is the fact that the manager cannot be placed at risk to bear losses, unless proven negligent. The capital provider will bear the risk but is limited to the amount of investment made.

Another form of Islamic finance is *musharakah*, which is similar to the former equity-based structure, but differs in the way that all the partners that join the business are committed with an amount of capital. *Musharakah* is a partnership concept where two or more investors come together to invest in a business venture, all partners are committed with an amount of money. Profits are shared at a pre agreed ratio and losses are split according to the proportion of capital injected. Each

single partners has a right to participate in the management of the business venture, however they can waive the right of participation in favour of any specific partner and/or person.



The word *musharakah* is derived from the Arabic word *sharikah* meaning partnership. Islamic jurists point out that the legality and permissibility of *musharakah* is based on the injunctions of the Koran, Sunnah, and Ijma (consensus) of the scholars.

The two structure are similar, there are differences in the way investors' involvement is regulated and in the way risk is shared in case of losses; in that case each partner in the *musharakah* bears part of the loss proportionate to its share in capital. The *mudharabah* partnership was moreover originally intended to continue up to the dissolution of the company. But it is possible and permissible that for one reason or another, one of the partners sells its share in the capital to withdraw from the project.

It can be affirmed that venture capital and private equity funds have a natural fit for Islamic investors, since at the core of Shari'ah principles money should be directed to the real economy through investing in businesses that offer ethically acceptable products and services. This means that returns should be earned through active involvement and participation in the business risk in Shari'ah compliant investments. An Islamic VC industry could apply almost all of the conventional valuation, structuring and monitoring techniques used for risk mitigation purposes. It might be argued that the valuation technique currently adopted by the global VC community involves the use of interest rates (*riba*) that are forbidden under Islam. Islamic objections do moreover arise in respect of the most popular techniques used by venture capitalists, the discounting of future cash flow. Although the use of interest in financial transaction is prohibited, it may be acceptable to use interest rates as a benchmark to gauge a project's relative value.

The widely practised risk management techniques in conventional VC very rarely contradict the Islamic principles. With minor adjustments and innovation, VC can thus be added to the list of high priority asset classes that Islamic financiers should target. Although certain types of financial instruments, notably preferred stock, are forbidden, Islamic variants can be utilized to give Islamic VC funds the capacity to offer flexible financial packages. The Islamic finance industry can therefore begin to make safe forays into VC investment and could even incorporate some of these practices into Islamic banking procedures.

In conclusion, it can be said venture capital industry focus on social and environmental impact represent an opportunities to foster cultural and business relation between northern and southern shores of Mediterraneo, as well as among Arabs countries and between Arabs countries and Israel.

## CONCLUSION

Empirical analyses show difficulty in obtaining financing in the region especially for small enterprises; particular problems are faced by start-ups and young entrepreneurs.

Domestic credit to the private sector is insufficient. Some regional governments such as Jordan, Egypt, and Tunisia have introduced public guarantee instruments in cooperation with banking sectors in order to meet borrowing requirements of young firms and for strategic sectors. These efforts, although worthy, are not sufficient to meet entrepreneurial financing needs in the region.

A cultural gap over impact capital finance is still present in the Mediterranean area. From the investment side, small business entrepreneurs are usually reluctant to relegate control and reduce ownership preferring to rely on self-generated funds, which include family and trusted close friends. From the investor and market side, financial institutions are not well equipped to evaluate and monitor the risks of equity investments in small firms focus to bring primary goods and services to the lower class of people.

Despite several problems, opportunity are present in the Mediterranean area. The growing population and the increase in the number of people that are exiting the poverty level, offer the opportunity to create economies of scale all over the region.

An opportunity for further development of the impact capital industry is underscored by the presence of ample liquidity in the region. Furthermore, the region possesses a number of high net worth individuals which are more and more amenable to impact capital finance. These high net worth individuals provide a base for new impact capital fund, thereby acting as a “substitute” for institutional investors or bank finance.

There is a growing need in this region for alternative methods of financing to support promising projects and enterprises. In this regard, impact capital is becoming increasingly attractive to investors and entrepreneurs, as it provides investors with more involvement in the entrepreneurial process and it gives entrepreneurs a comprehensive opportunity to facilitate success and support growth.

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## SUPPORTING PROGRAMS TO DEVELOP IMPACT CAPITAL IN THE MEDITERRANEAN REGION

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### ABSTRACT

The paper aims at underling the great opportunity that impact capital represents, as well the role institutional actors can play in improving policies, norms, and setting up supporting programmes to be carried out in order to attract new capital and to facilitate the creation of new impact capital funds.

Country empirical analyses have been carried out spending long periods in the field (Egypt, Jordan, Tunisia, Palestine, and Israel) researching in close cooperation with local and international stakeholders, which are made-up of both past and present actors in the venture capital industry of the region.

The paper highlights the role of the policy makers to ensure impact capital industry development. A complete set of policies must be set in place geared toward the local and regional conditions that continuously enable the following of changes in circumstances and market evolution.

As learned from the time spent in the region, a long-term economic development strategy should be adopted. Extremely challenging but relevant for the region is to implement programs focus upon supporting R&D activities to bring technology into traditional industries and products, the enhancement of innovation capabilities, and the stimulation of entrepreneurship culture. Therefore, governments should commit resources and all kind of efforts to enhance programs and projects leveraging capital and commitments of both public and private institutions.

Initiatives must be always undertaken aiming at fostering collective learning and increase awareness about the importance of fostering impact investments to create positive impact alongside financial return.

**Keywords:** Impact Capital, Venture Capital, Mediterranean Region, Emerging Market, Supporting program, Policy maker.

## INTRODUCTION, METHODOLOGY AND OBJECTIVES

This paper aims at understanding methodology and programs to develop and foster impact investing in emerging markets with a focus on the Mediterranean region.

Impact investments are investments made into companies, organizations, and funds with the intention to generate positive measurable social and environmental impact beyond financial return (O'Donohoe N., Leijonhufvud C., Saltuk Y. 2010; Saltuk 2011). Therefore, impact investors are investors setting a strategy that generates financial return while intentionally improving social and environmental conditions (Bugg-Levine and Emerson, 2011).

The specific objectives pursued during the entire analysis were: to draw policy-makers' attention to proposals and recommendations to set up and consolidate an impact capital industry in emerging markets; and to define some concrete and creative support programs to be carried out by both public and private actors in order to exploit synergies and reach common interests.

Considerations reported are based on information collected in the following countries: Egypt, Jordan, Tunisia, Palestine, and Israel. Five researchers spent time over three years (November 2006, February 2010) meeting key stakeholders, grouped in the three main categories: investors and fund managers; entrepreneurs and industry associations; and officers of public institutions and international organizations. The empirical research was supported and carried out in collaboration with United Nations Industrial Development Organization (UNIDO) field offices in Cairo, Tunis and Amman.

The following actors were interviewed and proposals drawn with their support: 14 regional investors active in the **MENA region**; 3 incubators, 4 entrepreneurs, 4 investors, 2 public institutions, 2 international organizations **in Jordan**; 1 incubator, 3 entrepreneurs, 9 public institutions, 3 investors, 2 international organizations **in Palestine**; 2 incubators, 10 investors, 4 public institutions, 3 industry associations, 3 international organizations **in Egypt**; 2 incubators, 4 public investors, 8 private investors, 7 public institutions, 3 international organizations **in Tunisia**. International regional conferences in Dubai, London, Bethlehem, Tel Aviv, Amman and Milan, in the period 2006-2010, were also attended and proved to be useful for collecting significant information, and data and feedback from stakeholders.

Country empirical analyses have also been carried out spending long periods in the field researching in close cooperation with local and international stakeholders, consisting of both

past and present actors in the venture capital industry of the region (Saltini 2006; 2009a; 2009b; 2010).

The theoretical framework and literature taken into consideration is that relating to the venture capital industry development (Black and Gilson, 1998; Gilson 2003; Gompers and Lerner 1998, 1999, 2001). However, this paper does not address the many theoretical papers that deal with the venture capital industry but it focuses on the interrelation that exists with the new impact capital industry. The study pays special attention to the investors that seek to combine financial returns with social impact by using the tools of venture capital to make investments in promising private companies that have the potential to deliver some measurable social or environmental benefits.

The analysis carried out is also based on potential lessons learned from other countries [Israel (Avnimelech 2008; Avnimelech and Teubal 2003a; 2003b; 2004a; 2004b);, Germany (Becker and Hellmann 2005), Italy (Finlombarda 2002, 2003)] drawing important conclusions for emerging countries.

Previous work has stressed the importance of proper policy framework and supporting programs to foster venture capital industry development (Avnimelech 2008; OECD 1997; 2000; 2002; 2003; 2004; 2006; Saltini 2006). This paper maintains its focus on particularities and specific actions needed in emerging markets of the Mediterranean region.

A model to foster venture capital industry development in emerging markets is therefore presented, focusing on pursuing social and environmental impact investing as an innovative solution for traditional businesses. The model proposes that policy makers follow five coherent consequential phases. Actors to be involved for each of the phases and activities to be implemented are also presented.

Keeping the focus on emerging countries of the Mediterranean region, as mentioned by the stakeholders interviewed, attention is paid to the emergence phase. Recommended actions for government policy makers are presented. The design of a comprehensive policy framework represents a key issue particularly for countries where social problems are spreading and where political turmoil is a threat. A significant part of the paper is devoted to explaining the role that supporting programs may have in catalyzing impact investors and leveraging public funds.

The research highlights the great opportunity that impact capital represents, as well as the role institutional actors can play in improving policies and programs to be carried out in order to attract new capital and to facilitate the creation of new venture capital funds (Black and Gilson, 1998; Gilson 2003). Gilson affirms that to create a venture capital industry significant efforts and coordination among different actors are required, and that three groups of actors are necessary: promising new enterprises, investors and venture capital companies.

This paper underlines how crucial can be the role of some public and private organizations and institutions (such as government bodies, development financial institutions, multilateral development organizations, universities, R&D centres) for catalyzing impact investors. These key players need to act simultaneously in setting up special programs and policies to encourage the emergence of these first level of actors, and hence of new industries able to improve development and ensure a positive impact on society.

Special attention is paid to understanding the positive role institutional investors can play in setting up institutional venture capital, also called formal venture capital (Landstrom 2007). Government institutions can finance venture capital organizations with a mission to invest in industries that are crucial for the country's development as well as fostering particular issues such as innovation for traditional industries (Nelson 1994), thus setting up new companies and supporting growth of micro-small enterprises operating in important sectors and in underdeveloped regions.

## **CONCERNS TO DEVELOP IMPACT CAPITAL**

The concept of venture capital is linked to impact capital and impact investments. Venture capital industry and techniques represent a way to improve impact investments.

The definition of venture capital is very controversial due to the mixed use of the terminology of venture capital and private equity, especially when it comes to investing in later stages of company operations. Venture capitalists act as financial intermediaries between investors and entrepreneurs, most commonly drawing funds from a wide variety of sources including private investors, pension funds, banks and insurance companies (Gompers and Lerner 1999, 2001).

Venture capital can be presented as a financial activity by which professional investors support high-growth small to medium size entrepreneurial talent with medium to long-term

equity finance and business skills in order to exploit market opportunities and thus obtain long-term capital gains (Bygrave and Timmons 1992).

There are many factors to be taken into consideration in setting up initiatives and encouraging proper processes in order to foster venture capital operations for impact.

A calibrated and well-defined institutional action plan can play an active role in spurring impact capital industry emergence and developments. Three main issues are identified as priorities in order to create the preliminary conditions necessary for impact capital emergence and consolidation:

- Supporting education and R&D programs through a number of special incentive schemes, using grants and awards.
- Financing early stage high-tech investments and innovative start-ups; in many countries governments are engaged directly or indirectly in supplying capital to new technology based firms (OECD 1997).
- Supplying capital for social impact venture capital funds.

Empirical analyses carried out seem to confirm the importance of government intervention and its playing an active role at a policy level. This is also supported by the Israeli experience, where the government implemented, both successfully and unsuccessfully, several special programs (Avnimelech and Teubal 2004b). The Israeli experience was then worked out again by other European governments (Finlombarda 2002).

Nevertheless, it is controversial and difficult to establish a permanent and viable set of policies. It is important to promote partnership among public and private institutions to foster R&D programs and launch special initiatives to enable conditions ensuring a sound impact capital industry. Governments must also sustain education by supporting universities and executive training centres, projects, and proposals. Increasing ways to improve technical know-how and educate a young generation of researchers, entrepreneurs, financial experts and specialized professionals significantly contributes to the development of new impact funds.

## **PROCESSES TO SET UP A VENTURE CAPITAL INDUSTRY FOR IMPACT IN EMERGING MARKETS.**

Most of the literature related to venture capital development and policy for venture capital emphasizes the need for effective financial regulation and capital market structure, as well as

legal and tax frameworks for LP and GP operations (Black and Gilson 1998; Gompers and Lerner 1998; OECD working papers and country studies).

A lack of venture capital investors and operations is due not only to a lack of money but also to a lack of a comprehensive system representing a new industry. During the last few decades, governments and national policy-makers in different countries and states have tried to establish a venture capital industry working exclusively at the regulation level by reducing capital gain taxes, providing tax benefits programs, offering guarantee systems, among other initiatives. All these initiatives, although important, are not sufficient.

Venture capital industry is correlated to a more evolutionary perspective and to a broader context; an approach that is confirmed by the relevant literature (Becker and Hellmann 2005; Bottazzi 2004; Florida and Kenney 1998). In other words, attention must be paid not only to the money supply side but an emphasis must be placed on the investment opportunities side as well. It is essential to establish the conditions for the existence of an adequate number of high quality deals and to have a good number of entrepreneurs that understand the venture capital investment process as an opportunity for their business growth and success.

In this regard, R&D support and innovation is required (Kim and Nelson 2000). Capable policy makers, academic consultants, and specialized professionals are called upon to define proper policies and programs, and to undertake research about policies implemented in other countries, their effectiveness and impact in the given context. It is important to learn from relevant experiences, successful actions, and from failures and deficiencies as well.

Empirical analyses carried out and the failure of venture capital policies in many other countries confirm the assumption that an appropriate policy framework to properly develop venture capital operations should be based on sequencing phases rather than on a simultaneity of actions. It is not true that once there are investors and venture capital firms, the right investment opportunities (start-ups and SMEs) will automatically emerge (Avnimelech and Teubal 2004).

For this reason, a model to develop an impact capital industry, aimed at fostering emerging markets development and pursuing social and environmental impact, is hereafter presented together with recommended actions for policy makers that should be set in place to facilitate the emergence of this strategic industry.

## **A MODEL FOR VENTURE CAPITAL INDUSTRY DEVELOPMENT IN EMERGING MARKETS**

The lack of good investment opportunities and well-prepared entrepreneurs is as important as a lack of investor capital. From past experience and the failure of European and American policy makers during the 80s and 90s, it is more clear how important it is to create a positive environment for venture capital development supporting innovation and technology growth as well (Becker and Hellmann 2005; Nelson 1993).

Government programs and public policy failures were related to initiatives committed to establishing venture capital industries independent of any related efforts to establish high-tech centres and clusters focused on innovative enterprises (Florida and Smith, 1993).

It follows that for public action to be successful in fostering the venture capital industry these must be part of a broader and more comprehensive set of policies, which support financial issues on the one hand and industrial clusters on the other. A comprehensive support which embraces the whole high-tech issue such as R&D, innovation, business application, start ups, together with industry, marketing, management issues and necessary coordination is required. It is also crucial for an emerging market to define its strategy on how to attract and/or train high quality professionals for the venture capital industry, with venture capital capabilities and full venture capital industry comprehension (Avnimelech and Teubal 2005).

Therefore, considering the complexity of this matter and based on industry research and empirical analyses carried out, a model is proposed to foster venture capital industry development, particularly in emerging markets. The model introduces correlated processes to be faced in order to develop an impact capital industry and each of these processes has been carefully linked to its environment and geographical context.

The model has been developed taking input from the analysis and evolution of the Israeli experience of the last four decades (Avnimelech 2008; Avnimelech and Teubal 2004a; 2005a; 2006). The case of Israel adheres to a different logic and context, but it provides important hints to policy makers and key industry actors operating both in Europe and the Mediterranean region. The development of the venture capital industry in Israel has been particularly rapid and successful given the particular circumstances in which its development has transpired. However, the development of the venture capital industry in Israel was possible also because an unprecedented range of supporting programs was launched putting together private and public money to foster the small business sector.

This experience is here reposed, reviewed and remodelled, referring to the Mediterranean region, taking into consideration regional weaknesses and threats as identified in the empirical analyses carried out in Jordan, Palestine, Egypt and Tunisia (Saltini 2006; 2009a; 2009b; 2010).

**Table 1 – Model for Impact Capital Industry Development in Emerging Markets**

<b>Phases &amp; Processes</b>	<b>Issues</b>	<b>Actors</b>	<b>Activities &amp; Instruments</b>
<i>Preliminary</i>	Economic Conditions Entrepreneurship and R&D Culture	Government – Ministries Universities and Research DFIs, MODs and NGOs	Reduce Bureaucracy and Regulation Increase Business and Financial Awareness Training, Scholarship
<i>Emergence</i>	Technology Transfer Innovation and R&D Policy Framework Human Capital and VC Awareness	<i>previous +</i> Government - Policy makers DFIs, MODs and NGOs Multinational Enterprises Start-ups	<b>Design Policy Framework</b> <b>Design Supporting Programs</b> Sustaining Research Grants and Programs for Technology Transfer Mentoring Impact Entrepreneurs
<i>Beginning</i>	Tax & Legal Catalyse Know How VC Industry Awareness	<i>previous +</i> Local Investors & VC firms from Scientists to Entrepreneurs Companies and Local Managers DFIs, MODs and NGOs	Industry Networking Set up Impact Fund Set up Innovative Companies Capacity Building for investment team and specialized professionals
<i>Development</i>	Catalyse Capital Operations/Deals Local Networking M&A Markets	<i>previous +</i> Regional Investors and Global VC International Managers and Entrepreneurs Specialized Professionals MNEs, DFIs	VC Firms Strengthening SMEs Growing Transparency & Governance Value Added Services Events/Conferences
<i>Consolidation</i>	Coordination Standardization International Networking Globalisation Capital Markets	<i>previous +</i> VC Associations Enterprises Associations Institutional Investors Stock Exchange	Events/Conferences Sharing Data & Experiences M&A/Industrial Deals IPO/Listing Companies

Source: Avnimelech G., 2008 and own elaboration  
DFIs – Development Financial Institutions

MODs – Multilateral Organizations for Development

MNEs – Multinational Enterprises

MoF – Ministry of Finance

MOFTI – Ministry of Foreign Trade and Industry

A process is here identified as a set of structured activities and related relationships among categories of actors that are typically part of a venture capital industry. These actors and the actions they can set in place to foster venture capital operations have to confront different issues along five main sequential phases: preliminary, emergence, beginning, development and consolidation phase. Special attention was paid to catalyzing investors willing to foster social and environmental impact, making money but also making a difference improving country development and comprehensive access to primary goods and services (Bugg-Levine and Emerson 2011). In this regard, R&D and innovation is deemed crucial to transfer technology into traditional businesses.

The preliminary process sees mainly interaction between supporting institutions and the young generation of innovators. Preliminary and basic initiatives must be set in place to create R&D centres and to foster a university approach to research and business culture. Development Financial Institutions in coordination with governments can set up creative and dynamic programs to help in creating preliminary conditions. Governments must also attempt to reduce bureaucracy and cumbersome regulations.

In the emergence phase policy makers, governments, MNEs and DFI must all be part of a common attempt of supporting innovation together with high-tech centres and engineering universities, thereby fostering advanced education development. Many of the greatest venture capital successes have had a relationship with research centres and universities.

R&D capabilities have to be directed toward creating new products and services and consequently new start-up companies; this is a major condition to move from the first phase to the second one (Avnimelech 2008). In the region, a special focus should be given to applying innovation and technology to traditional business, innovating industrial processes, products and services. Programs based on technology transfer should be implemented.

The government, in particular, plays a multi-faceted role. There is a political level that relates to maintaining currency and economic stability as well as developing a favourable tax and legal system. Attention must be paid to protecting intellectual property and properly regulating the capital market.

This is a time to create a critical mass of start-ups in order to have an effective demand for venture capital, and therefore a good number of suitable and promising investments.

In the beginning phase the processes which take place are on programs and activities between the public and private spheres. Institutional and private stakeholders are moved to pay attention on ways to finance innovation and business technology projects.

In this phase the main target is the venture capital industry. Technical supporting institutions are established and programs launched to leverage positive conditions, accelerate venture capital demand and company growth, and foster local capabilities. Local investors make the first move to establish venture capital firms and local managers and entrepreneurs have a key role in allowing start-ups to survive and grow.

Venture capitalists look for growing industries and high returns that are always linked to high technology industries or to innovation applied to traditional sectors.

During the development phase processes involve development of relationships between venture capital firms and entrepreneurs at a broader level: local, regional and international. Venture capital teams of managers have to be put together leveraging local networks and knowledge in order to be able to catalyse capital resources available in the region and to allocate them intelligently.

In these first phases the size of funds should not be so large as to lose the focus on small investment size. If these initial investors and firms build up a good reputation, the funds size and investment target will increase spontaneously.

Focus has to be placed on attracting not only capital but also consistent entrepreneurial and technical know-how. Moreover, during and after venture capital growth (in order to provide a broader perspective to the process) an extensive category of specialized professionals has to take part in supporting operations such as attorneys, accountants, tax experts, advisers and consultants.

The consolidation phase sees interaction among all previous actors, in addition to institutional investors, global professionals, and industry associations. Coordination among local and international actors must be ensured and standardization of contracts, procedures and guidelines pursued. The strength of the local IPO market and country stock exchange dynamism is mainly related to late stage venture capital investments and venture capital industry development rather than earlier stages (Matheson 2005).

Success in consolidation depends on the industry's capacity to design a new structure and a new institutional framework promoting broader policies able to enhance the contribution of high-tech to other non high-tech and traditional sectors, thus sustaining demand and capital

raised which become more difficult in time of maturity (OECD 1997; OECD 2001; Nelson 1993).

Venture capital firms become more specialized investing in identified industries and targeting deals strictly for investment size. It could be advantageous to have a vertical expansion by raising a large fund, and thereby developing global venture capital players with specialized divisions that will invest throughout the different stages of development, from start-ups until expansion and large growth of the companies. Another possibility is for a single venture capital firm to expand horizontally to new geographic markets, and thereby help to consolidate country venture capital industry at a regional level.

During the consolidation phase crises can arise. In this case, priority should be given to assuring a minimum level of activity in start-ups, targeting innovation. During critical times government involvement and forms of direct financial support could be a determining factor in the industry's survival and therefore help to overcome the crisis and reach a stronger consolidation status. Interesting forms of support have been set in place in the last thirty years by some European governments such as Sweden and Norway (Karaomerlioglu and Jacobsson, 2000).

Throughout this period, it is essential to encourage a process of consolidation and strengthening (or renewing) of supporting institutions and programs.

Difficulties encountered in implementing policies for encouraging venture capital operations are due very often to a misunderstanding of the evolutionary nature of the venture capital industry (Avnimelech and Teubal 2003). The Israeli success story, as is also well shown by the US case, demonstrates very well how venture capital industry development and start-up formation and growth can be strongly correlated (Avnimelech and Teubal 2004b). The enhanced venture capital activity spurred additional start-ups, and additional start-ups spurred further venture capital activity. In the US successful start-up founders became venture capital partners while venture capital partners and managers took active roles in founding and developing portfolio companies. This virtuous circle of enhanced capabilities and networking contributed to the further success of venture capitalists and enhanced value adding services to start-ups (Avnimelech, Kenney and Teubal 2007).

What appears to be evident (and better supported with useful elements by the following paragraph) is that government policies must play a key role during each phase of venture capital industry development starting from the background conditions until the consolidation period. Venture capital policies require adoption of an evolutionary perspective to venture

capital as an industry and a perspective of the venture capital policy framework as a system in constant evolution (Avnimelech and Teubal 2003a; 2005a).

## **AN EXTENSIVE EVOLUTIONARY POLICY FRAMEWORK IS CRUCIAL**

A nascent venture capital industry can be market driven, supported by policy or triggered by policy. This is more the case in emerging countries where both market preliminary conditions and external supportive programs are weak or absent.

Improving the investment climate by reducing government failures is a necessary but not a sufficient condition for fostering rapid growth through investment. Market failures also need to be addressed. The lack of equity capital can be partially attributed to an excessive perception of high risk and information asymmetry.

Emerging market governments call for contributions recognizing the important role risk capital can play in broadening the private sector, and should therefore willingly institute the necessary reforms. On the part of financial institutions the expectation is that they fulfil their role by sharing risk with private sector counterparts and assisting governments to strengthen regulatory environments. They should also provide support for creative new approaches to venture capital investing.

Choosing the appropriate form of assistance is in general related to individual country weaknesses and opportunities. In order for a government to be successful it must be able to assess, and even to influence, the context under which venture capital policies and programs will be implemented. However, a good measure is expected to encourage good investors to provide risk capital to target enterprises and to support entrepreneurs in exploiting in a proper manner the incentives offered.

Considering global trends on venture capital development in the region, and having carried out empirical country analyses at the regulatory level, some recommendations to policy makers are listed herein.

**Table 1–Recommended Actions for Government Policy Makers to Develop Impact Capital**

<b>Area</b>	<b>Actions</b>	<b>Recommendations</b>
<i>Investment Regulations</i>	Equity guarantee schemes Incentives' programs to new investors categories.	Reduce perceived risk and increase motivation toward excluded areas and industry. Reduce restriction for domestic insurance, pension funds, universities.
<i>Legal &amp; Tax</i>	Tax reductions and exemptions	Reduce capital gain taxes on VC investments and consider tax incentives to local and

	Intellectual property system Company legislation Labour regulation Stock Markets and M&A	international investors. Ensure legal property rights as well a simple and transparent commercial legislation. Facilitate and ensure ways of exiting.
<i>Innovation</i>	Business incubators Start-ups grant programs Finance R&D institutions	Set up incubators to launch new innovative products and services. Sustain start-ups with institutional programs and R&D centres with substantial resources.
<i>Capital Market</i>	Set up proper laws Simplified Stock Exchange procedure	Enforce M&A and securities law. Ensure transparency and efficiency. Allow dual listing on local and foreign Stock Exchanges.

Source: own elaboration

According to the experience developed in transition economies about venture capital matters, governments are expected more and more to take actions on several priority matters, hereafter some recommendations to policy makers:

- Area Investment Regulations – Since the economic landscape in the region is largely dominated by SMEs and small family enterprises, the country regulatory framework should consider encouraging venture capital investment focused on this specific company target. Equity guarantee schemes and programs based on incentives should be designed to increase investor confidence.

Local and regional pension funds and insurance companies can be good prospective investors having long term liabilities, which gives them both the necessary liquidity and the ability to absorb risk. Special and suitable measures must be undertaken to induce them to target and pay more attention to venture capital firms. Alternatively, individual wealth in the region as well as foundations, universities, and charitable endowments, may be a substitute for bank or institutional investments. Governments should develop measures to encourage these individuals and actors. Collective schemes to facilitate retail investment in venture capital must be developed. Ministries such as the Ministry of Finance, Industry, Trade can offer government equity guarantees to institutional investors who participate in (or initiate) impact capital funds.

- Area Legal and Tax – It is crucial for the development of a local venture capital industry to mobilize local investors, as well as to attract foreign equity (OECD 2006). The most relevant issues (as has already been stated) include a taxation system, reducing barriers to entrepreneurship, setting up appropriate regulations, intellectual property, and

commercial legislation, as well as improving access to public stock markets and fostering M&A so as to improve exit ways for investors.

#### *Tax system*

Assessing existing tax and regulatory systems to eliminate unnecessary complexity in tax treatment of capital is a priority. Some countries have responded to this demand by providing tax relief for various forms of investment in unlisted companies or companies listed on second tier of growth exchanges. In this regard, several European countries (OECD 2006) have recently reduced tax pressure.

It is extremely important to define policy to encourage not only financial investors but also to target new people to become impact entrepreneurs investing their savings. In this regard here are listed some significant measures:

- o Since venture capitalists depend upon capital gains for their income, the industry tends to press for low rates of capital gains taxation; reduction or exemption of capital gains taxes for local and foreign investors (in order to encourage impact capital investments and entrepreneurs) is therefore a high priority since taxation of capital gains has long been pointed to as a driver for both entrepreneurship and venture capital operations.
- o Optimizing all the tax regulations affecting R&D, innovation, and start-ups.
- o Providing tax reduction and exemptions to encourage students and employees to become entrepreneurs.
- o Providing tax incentives to key institutional investors, such as pension funds and insurance companies, when open to invest patiently, fostering a social and environmental impact business model.

#### *Legal framework*

- o Improving labour regulations and the intellectual property protection system as well as providing sufficient incentives for innovative activities to exist.
- o Providing a simplified legislation for establishing enterprises and venture capital funds, as well as a transparent regulation for exit of unsuccessful enterprises, specifying clear insolvency procedures and standards.
- o Promoting sound corporate governance standards in line with the international consensus, aimed at establishing standardized public disclosure and management accountability (including accepted accounting practices, independent audits, and defined responsibilities of boards of directors).

*Stock Markets and M&A*

A significant number of legal and regulatory changes will need to be implemented to strengthen local stock exchanges in the region. Significant measures should be focused on:

- o Liberalizing investment restrictions for local institutional investors such as pension funds, insurance companies, mutual funds and other financial intermediaries.
  - o Striving for closer co-operation with sister organizations and other development financial institutions, with the objective of creating a well-functioning network that promotes effective risk-spreading and helps to secure financing.
- Area Innovation – It is impossible to talk about venture capital emergence and development without providing a suitable environment for innovation. In this regard, empirical analyses give evidence of all the attempts made by authorities to institutionalise programs (such as business incubators) to raise the level of patentable innovation and innovative start-ups. Experience has demonstrated that venture capital activity tends to be geographically clustered in areas rich in skilled human capital, universities and research centres, as well as legal and technical services.

Governments should foster innovation and entrepreneurship through business incubators and facilitate linkages among incubators, R&D institutions, universities and sources of finance. It is important to create a social and economic climate conducive to the emergence of clusters, where innovative enterprises can find an environment in which to grow and be exposed to target investors.

Achieving sufficient results on R&D and innovation capabilities to also support traditional sectors requires a long-term policy program and financial resource long-term commitment.

- Area Capital Market – Since capital markets and company listings on stock exchanges is always one of the main and most consistent ways of exit for venture capital firms, and given that domestic markets may not be able to accommodate listings, governments should foster local stock exchange development as well as facilitate listing of domestic companies in overseas markets.

## **SUPPORTING PROGRAMS TO FOSTER IMPACT CAPITAL, BETWEEN PUBLIC AND PRIVATE**

The paper notes the crucial role that public actors and policy makers can have in developing an efficient policy framework, in fostering capacity building and education, and in supporting R&D programs and innovative start-ups and small enterprises focused on impact solutions. The government and public institutions can play an active and fruitful role in fostering innovation, entrepreneurship, and business orientation. Appropriate and effective investment regulations facilitate the emergence of preliminary conditions and their positive exploitation.

Governments supported by developed financial institutions, multilateral development agencies and ordinary banks, planning together with other institutional investors such as pension funds and social responsibility investments organizations, along with the support of specialized professionals and private direct investors can develop specific creative investment funds and programs that directly foster emerging countries' efforts to improve investment climates as well as strategic sectors, industries and geographically critical areas. It is important to act as a catalyst for first-time risk capital operations, creating the conditions and confidence for subsequent operations through demonstration effects.

Governments are requested to design and launch concrete programs that could be developed at the national and regional level to make the most of public and private capital.

A creative public and private approach is recommended to foster impact capital industry emergence. Partnerships between public and private entities can be an optimum way to set up funds well focused in scope and committed on a long term basis. Public money can be crucial to catalyse both local and international capital as well as to bring in technical and financial expertise. Developing funds and programs with public and private capital and know how, strategic industry and underdeveloped regions can be supported. Government sponsored initiatives can also easily help micro and small enterprises to access innovative financial instruments, encouraging investors to become involved even where environments lack the regulatory requisites and preliminary conditions.

Public involvement to foster the development of a new impact capital industry is welcome but it is important to recall that the government as facilitator and investor should have the ultimate goal of creating self-sustainable markets rather than creating conditions for dependency. After target goal achievement, public actors are expected to timely remove their presence.

In order to set up an efficient impact capital industry in an emerging market, it is important to create conditions and launch a process to facilitate the establishment of more than one impact

fund contemporaneously which can operate as an intermediary between the country's resources and private corporate counterparts in the industrialized world. Different funds can be set up according to geography, industry, size, export or local country priority strategies.

Hereafter are listed some specific and concrete forms of governmental intervention which could be launched to increase motivation and facilitate activities of venture capital investors and venture capital firms aiming at supporting impact businesses:

- Establishment of investment funds (venture capital) in which the state (through a public institution) is a partner, investor or participant, even if on less advantageous terms than other investors;
- Grants to impact VC funds to cover part of their administrative and management costs;
- Providing guarantees to impact funds against a portion of investment losses, or with respect to loans to investors/funds for investment risk capital;
- Public launch programs and setting up of alternative institutions to finance seed capital at a very early stage.

It is not only important to set up far-sighted policies and supportive programs, but to adapt them carefully to the context and to the right timing concerning phase of development. Unfavourable background conditions may prevail and, if not taken into account, they might hamper positive effects.

Finally, it must be said that pressuring governments to take action on all these matters entails steady risk as this involvement could become too intrusive, thereby stifling real development. Again, government roles should last for a limited period and any programs and initiatives launched should always be geared toward increasing the numbers and the role of private stakeholders.

## **SUMMING UP ACTIONS FOR THE REGION, RESULTS AND CONCLUSIONS**

This paper endorses the great and crucial role policy makers have in developing impact capital industry in the Mediterranean region. The entrepreneurial spirit of the young generation in the region must be supported by effective programs able to leverage virtuously public and private capital. This paper has adapted to the local regional context inputs and conclusions taken from previous work focused on Israeli and European experiences

(Avnimelech 2008; Avnimelech and Teubal 2003a; 2003b; 2004a; 2004b; Becker and Hellmann 2005; Finlombarda 2002, 2003)

The paper's conclusions are in accordance with the relevant literature on venture capital policies for industry development that affirms the importance of a simultaneous effort by all main industry actors including investors, entrepreneurs and institutions (Avnimelech 2008; Gilson 2003).

The model presented in order to foster impact capital development and the concept elaborated of supporting programs give a prominent role to academics and particularly to policy makers. A major contribution is offered having adapted policy and model to develop venture capital industry to impact capital for impact entrepreneurs in emerging countries of the Mediterranean region.

The role that governments and public institutions can play in fostering and facilitating the initiatives taken by impact entrepreneurs and impact investors is crucial, particularly in emerging markets. The presence of active impact capital investors can be encouraged and strengthened by programs undertaken both by public and private institutional players including governments, research institutes, universities, financial institutions and international organizations. Identifying and encouraging programs – such as financial and technical support schemes, tax incentives, higher education, and risk-sharing plans – may be useful for optimizing resources, by attracting new capital and so supporting universities, technological parks, industry associations and industrial clusters to allow new businesses to emerge, start-up and grow.

Policy makers must play an important role to ensure successful venture capital industry development focus on social and environmental impact. A complete set of policies must be set in place geared toward the local and regional conditions that continuously enable the following of changes in circumstances and market evolution.

A critical factor in the region is the policy makers' lack of capabilities to set priorities and translate them into programs and policies. Accordingly, assembling highly skilled teams of policy makers, academic consultants, and specialized professionals is essential in order to undertake analyses about policies implemented in other countries, their effectiveness and impact.

As learned from empirical analyses, a long-term economic development strategy should be adopted. Extremely challenging but relevant in emerging markets is to focus upon the enhancement of innovation capabilities, and the stimulation of entrepreneurship culture. Therefore, governments should commit resources and maximum efforts to enhance R&D programs and projects, as well as creating other favourable conditions.

As a further step, actions must be undertaken to move technology and innovative solutions toward traditional sectors, facilitating the creation of new products and services. A critical mass of promising start-ups with a strong focus on social and environmental sustainability is required prior to setting policies directly focused on impact capital.

Supporting programs should be designed and pinpointed confronting past and present policy programs failures and weaknesses. It is also crucial to design programs aimed at leveraging the positive conditions of the local context and confronting the fragile state of the local economic situation of the Mediterranean region. Supporting programs should also be designed to utilize and leverage public resources in order to catalyse private capital, locally and internationally.

At this point policies targeted at directly developing impact capital funds are required. Policy makers and policies that they design and implement should be aware of the preliminary market and industry needs and should be able – in a proactive way – to identify, bring out, and direct all these crucial factors to develop impact capital funds in tune with the local context.

New hybrid actors are taking form strongly focused on patient capital bringing sustainable jobs, goods, services and dignity to the world's poorest. Patient capital will accordingly make available funds for long term use, being focused more on business development than on stellar rates of return. The investment strategy is therefore to provide social and environmental returns in addition to financial returns with an emphasis on returns over the long-term (Trelstad 2009).

Entrepreneurs and visionary leaders using a business approach to solving big social problems must be sought and supported by both private and public institutions. Investors must be realistic about how and when loans will be repaid and equity shares be sold, while always remembering that businesses at the bottom of the pyramid may take a long time to grow and that the primary goal is not only money but to effect long-lasting change.

In emerging countries, more than in an advanced context, this approach can be driven by funder and investor idealism (such as environmental and social impact) but it must be institutionally driven, thus sponsored by government, international organizations and development financial institutions as well as driven by regulatory framework and institutional supporting programs.

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## INSIGHTS ON ITALIAN AND INDIAN HEALTH CARE SYSTEMS FROM VSA PERSPECTIVE

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### ABSTRACT

**Purpose** – Health is considered to be an integral part of the socio-economic development of a country. The purpose of the paper is to analyze potential contribution, criticalities and conditions of success of *Public-Private Partnership* (PPP) as a strategy to face the complexity of nationally relevant Italian-Indian service systems.

**Design/methodology/approach** – The methodology is built upon the basis of the *Viable Systems Approach* (VSA) as integrated with the fundamental interpretative elements of Service Science (SS) and Service-Dominant Logic (SDL) to contextualize interpretation to the management of service systems.

**Findings** – PPPs appear to be an interesting solution when resources are scarce leading to a positive conclusion.

**Practical implications** – From theoretical perspective, the study contributes to the scholarly understanding of complex health care system in Italy and India. It also suggests a generic framework for VSA as applicable. Also from practical perspective, the study stimulates managers to a critical reflection about current health care management approaches.

**Originality/value** – The paper proposes a new approach to the study of health care, capable of highlighting relevant aspects of the system's dynamics, shifting focus from its structural, objective description to its systems, subjective interpretation. The paper also discusses decision making challenges, such as the equality in the populations' access to health service, suggesting managers to leverage on creating

conditions of consonance among the diverse stakeholder for a successful health care PPPs.

**Keywords:** Health Care System, Viable Systems Approach (VSA), Public-Private Partnerships (PPP), Stakeholders, Public-Private reports, Service Science (SS), Service Dominant Logic (SDL).

## INTRODUCTION

One of the largest and fastest growing industries in the service sector is health care industry (Andaleeb, 2001). The ability of the healthcare system of a country is to meet the emerging challenges and carter health needs of the population effectively and adequately (Guruswamy *et al.*, 2007).

Health care is a worldwide great concern. However, despite the relevant economic, technological and social progress, access to health care service still significantly varies across the countries and populations that is not only being affected by the countries' social and economic conditions, but also by the health policies adopted by governments. Yet, health is the main need of individuals and populations in front of which no differences should be justified. In a context of significant inequality, some observed phenomena may appear paradoxical in a context in which the main concern should be to alleviate the consequences of conditions of poverty or resource scarcity for populations. Think about *medical tourism* (Pollock and Williams, 2000) –an emerging phenomenon in health care industry as it occurs in countries where the largest part of population has no (or minimum) access to very basic primary health care services. It is the case of India, where we observe the coexistence of an increasing trend of “luxury health care” service and of a totally underserved large part of population. It has been predicted, by the Confederation of Indian Industry (CII), that India would have seen revenues of US\$2 billion from medical tourism by 2012. Nevertheless, despite the industry's predicted growth of 30%, the country has not produced any guidelines on this issue. Moreover, “Indian doctors are worried about how to gear the health care system so that rich foreign patients will affect the care of India's millions of impoverished people” (Shetty, 2010).

In developed countries, the medical community “has started to recognize medical tourism

as a real phenomenon that involves the professionals, practitioners, and patients [and] peer-reviewed medical and health journals began publishing papers on this topic in 2006" (Horowitz *et al.*, 2007: 33). This phenomenon, which is mainly characterized by a direction from developed to emerging economies, may be seen, indeed, as an aspect of a wider phenomenon of a health care technological progress, that is reaching great results pushing up the level of service, but still coexists with the reality of almost no access to even very basic services for large part of world population.

In such a context, private organizations appear to play a relevant role and are ever more involved into the health systems. In fact, collaboration between public and private organizations, especially at international level, is considered as an effective strategy to reduce disparity in health between rich and poor (Widdus, 2001). The questions raised are: *Does the involvement of private organizations help to improve the overall health conditions of population? Given that governments are generally considered as responsible actors in the management of national health care systems, how does the involvement of private sector affect the health care services?*

These questions lead to the well known phenomenon of *Public-Private Partnership* (PPP) that represents a solution that is frequently adopted in many industries and countries, particularly when public funding is not adequate to the society needs. In this respect, we observe that the adoption of such partnership solution occurs both in developed and in developing countries where the social and economic scenario is dramatically different. Then, such solution is expected to be useful in different situations whose common feature is just a resource scarcity, although to a very different extent.

Therefore, with the aim of analysing potential contribution, criticalities and conditions of success of PPP as a strategy to face the complexity of nationally relevant service systems, in this paper a joint Italian-Indian research group has started a shared reflection on the subject, by leveraging on a common methodological interpretative framework built upon the basis of the *Viable Systems Approach* (VSA). The VSA is then integrated with the fundamental interpretative elements of Service Science (SS) (Maglio *et al.*, 2010) and Service-Dominant Logic (SDL) (Vargo and Lusch, 2006) to contextualize interpretation to the management of service systems benefitting from recent advances in these research fields (Vargo, 2011; Mc Coll-Kennedy *et al.*, 2012; Wieland *et al.*, 2012).

The methodological choice has a particular relevance. Our aim is to investigate two different realities in which the phenomenon of PPPs is showing a growing relevance: one in

the Mediterranean area that refers to a relatively successful and effective healthcare system – that of Italy–, and one outside the Mediterranean area that refers to a far more problematic healthcare system –that of India–, increasingly engaged in a positioning strategy as a key player in global health care sector. The two countries appear to be linked also by the growing phenomenon of medical tourism. Considering the significant differences and commonalities characterizing the two realities, we recognized the necessity to adopt the same perspective in order to avoid the results of observation being affected by our dominant interpretation schemes. Accordingly, in order to minimize the methodological implications in the analysis of the two cases, we decided to identify a methodological approach that could result as a meta-level lens with respect to the specific observed phenomena. In this respect, the *VSA* represents a good reference in that it provides *general* interpretation schemes, which, being based on systems thinking, are useful to highlight key elements of analysis common to any system's functioning in a social as well as economic context.

## **PUBLIC-PRIVATE PARTNERSHIP (PPP) IN HEALTH CARE SYSTEMS**

In order to function effectively, any health care system generally needs to combine and organize resources (competences) and capabilities that are owned by different actors making them to converge toward a shared health care finality. These actors may represent public as well as private organizations, so inevitably expressing different logics and expectations.

In this context, PPP, by integrating public and private resources (Barile and Saviano, 2013) represents an ever more common solution, adopted particularly in the situations where public and private organizations recognize the opportunity of creating synergies in pursuing a given finality. In this respect, it should be considered that “the term ‘partnership’ has recently been used to cover collaboration in general and the emerging forms of collaboration. However, it poorly represents the diversity of new relationships, a wide variety of which have been placed under the umbrella term of ‘public–private partnerships’” (Widdus, 2001: 716-717). The subject of collaboration between health care organizations and professionals has been discussed by many scholars and from different perspectives (Field and Peck, 2003; English, 2005; Nikolic and Maikisch, 2006; Akintoye *et al.*, 2008; Basu *et al.*, 2012; Luijten *et al.*, 2012). It has been interestingly argued that the “public-private partnerships should generally be viewed as social experiments that are attempting to learn how to tackle intractable health problems in better ways. There is no formula for constructing them and it is unlikely that a universally applicable one will be found” (Widdus, 2001: 718). Agreeing with this opinion, we

believe that there is no “one best way” (especially in health care) but only general principles (and values) of reference that need to be shared by decision makers if an agreement is to be reached when pursuing general level goals. However, any kind of PPP configuration is the result of the partners’ mutual agreement on finalities and interests. To deepen this aspect, systems thinking can represent a fundamental support providing general principles of reference on which decision making can be based directing toward sharable choices.

Moreover, the wearing of the systems thinking lens makes apparent the main implications of the subjectivity and diversity of perspectives and interests in multi-stakeholder contexts offering useful guidelines for decision making. In fact, PPPs typically define multi-actor and multi-subjective contexts in which the obviously different interests need to be harmonized to make the partnership effective. In this harmonization process, the partnership ultimate goals should be clearly set in the partnership agreement and agreed on by the partners (especially when the partnership scope and finalities go beyond the direct interests of the partners). In other words, when the object of the partnership is an activity oriented to the benefit of third parties, there is a risk of speculation or opportunism. The case of health care, in particular, qualifies a context in which, while the public party should act in the interest of the community and is responsible to it on the basis of an “agency” relationship (Jensen and Meckling, 1976), the private party essentially acts in its own interest.

In order to reflect upon such issues, deepening the criticalities of PPPs and the conditions for their effectiveness in the context of healthcare, we propose the adoption of a *vSA*-based interpretative framework capable of evidencing key elements of analysis. Accordingly, in next section we will introduce the basic assumptions and fundamental concepts of the *Viable Systems Approach* with the aim of developing a general scheme of reference for reading the healthcare scenarios in Italy and India evaluating the criticalities and the potential role of PPPs in the improvement of national health care systems.

## **THE VSA: BASIC ASSUMPTIONS AND CONCEPTS**

The *vSA* has been developed within the Italian research community (Golinelli, 2000, 2008, 2010; Barile, 2000, 2008, 2009a, 2013; Barile and Saviano, 2011) on the basis of an updated version of the Viable System Model of Stafford Beer (1972). It has been developed within the disciplinary field of business management starting from the early works of Barile and Golinelli, following a rich research stream of systems theories, such as the theories of open

and closed systems (von Bertalanffy, 1968), socio-technical systems (Emery and Trist, 1960), law of requisite variety (Ashby, 1958), and systems dynamics (Forrester, 1994). The main aim of the *vSA* research community is the study of business as well as social organizations as *viable systems* that aim to survive in a dynamic context by establishing *consonant* relationships with other viable entities so gaining access to the resources necessary to the system's functioning, with the ultimate aim of achieving viability through a sustainable governance approach to business phenomena (Barile *et al.*, 2012).

The interpretative paradigm of *vSA* summarizes its fundamental premises and key concepts in five postulates (Barile, 2008: 24), in accordance with the key concepts of *vSA*, viz. the *survival* as ultimate purpose of the system; the dual *structure-system* perspective; the *isotropy* of the viable system consisting by a governing body and an operative structure; the system's *context* as composed by sub- and supra-systems; the *consonance* and *resonance* as criteria of governance of intra- and inter-systemic relations; the *recursion* of systemic levels as characterizing the system's structure (Saviano and Caputo, 2013: 229).

According to *vSA*, three fundamental systemic conditions characterize the functioning of business and social organizations (Barile and Saviano, 2011) which are as follows: (a) *openness*, which is the ability to exchange resources with the other systems of the context in a selective manner; (b) *contextualization*, which is the search for viability through interaction with certain privileged entities, such as supra-systems that influence its survival, and (c) *dynamism*, which is the development of structure in accordance with emerging changes.

When defining the system's viability strategies, decision makers should take into account these three systemic conditions that essentially imply that any phenomenon (or system) cannot be observed in isolation but needs to be interpreted with reference to the specific context in which it occurs (or is organized), in particular considering the various interests that it needs to effectively involve and harmonize so as to achieve its goals.

#### ***A vSA-based interpretation framework***

Integrated with the main assumptions and key concepts of SS and SDL, the *vSA* highlights key elements to analyse in order to define the most appropriate governance approach of health care organizations. By following the general framework of Figure 1, as has been developed on the basis of the integrated *vSA*-SDL-SS view (Saviano *et al.*, 2010; Saviano, 2012), our conceptual pathway starts by selecting the system under observation, focusing on health

care systems with a Service-Dominant logic mind set that is with a logic of *service* as “the applications of competences (knowledge and skills) for the benefit of a party” (<http://sdlogic.net/>). This logic helps in particular to identify resources and relational operative mechanisms to integrate competencies and co-create value. The *vSA*, instead, reveals the different perspectives in play, the priorities, and the mechanisms of influence of suprasystems to take into account in the service system governance. The application of *vSA* in the context of health care management is essentially aimed to identify conditions for improving the overall level of a community health (the ultimate goal of the whole system) and the responsiveness of the system to people’s needs and expectations, at the same time ensuring financial fairness in the way funds are collected.

The pathway follows with a focus on the parts and relations that define the system’s structure configurations. However, to understand the system’s functioning, a change in perspective is required, shifting from a static to a dynamic view, according to the *structure-system* paradigm (Barile and Saviano, 2011), and interpreting the system’s potential dynamics through the reading of the intra- and inter-systems interaction, keeping in mind that *from the same observed structure several systems can emerge depending on the actors’ pursued finality*. It is fundamental, then, to recognize the roles played by the various actors involved in the system’s value-creation process by focusing both on the internal and the external context going beyond the structure ‘boundaries’. This wider view is necessary to identify all relevant suprasystems, which own resources critical for the system’s functioning and may consequently exert a power of influence on its survival dynamics. These aspects suggest the decision makers to carefully evaluate the conditions of *consonance* (relational harmony) and *resonance* (value outcome) within the whole system and accordingly define appropriate strategies to improve efficiency, effectiveness and sustainability of the system as a fundamental requirement for the system’s viability (Saviano *et al.*, 2010). On this basis, the health care value propositions should be defined directing all involved actors toward the sharing of the ultimate health care finality by harmonizing their specific goals through their progressive alignment. The key elements upon which decision makers can act, are those qualifying a service system according to SS as follows: *people* that represent the human side of health care service and set the effective requirements not only from a technical perspective but also considering personal emotions, feelings and values; *organization* that directs focus on efficiency; *technology* that is relevant for innovation and competitiveness; and finally the *shared information* that represent a key factor in developing an efficient, effective and

sustainable service system, overcoming the typical problem of information asymmetry and building upon the actors' variety alignment (Barile, 2009; Saviano, 2012).

Thus, decision makers should govern and manage the system by accomplishing an on going learning process that allows it to constantly adapt itself to the changing requirements of a growing context complexity so that the system could contribute to the improvement of the physical and psychological conditions not only of the patients directly involved in the service process, but of the whole social context, at the same time increasing public awareness of the healthcare leading to welfare community. As suggested by SS, the reaching of these goals require the seeking of positive interactions between providers and clients considering that they are dynamic and changing; this in turn requires a dynamically changing configuration of resources (physical or non-physical with rights or no-rights) on the basis of an actors' mutual agreement on reciprocal value propositions.

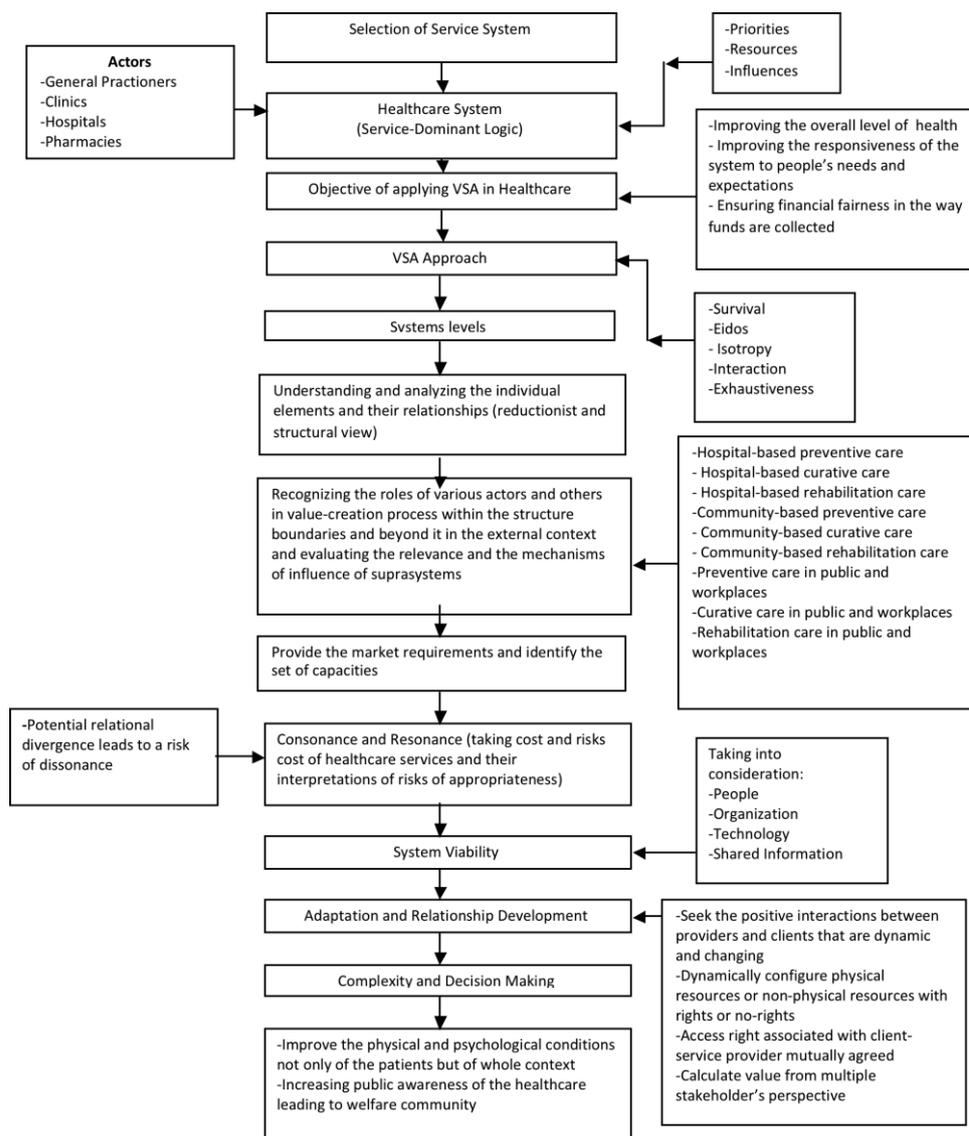
On the basis of this general framework, in next section we will shortly describe the Italian and Indian scenarios as different contexts for PPPs that offer lessons to learn highlighting interesting peculiarities of the PPPs phenomenon that appear common to the two countries.

## **HEALTH CARE SYSTEMS AND PPPS EXPERIENCES IN ITALY AND INDIA FROM A VSA PERSPECTIVE**

### *The Italian scenario*

The Italian National Health Service, founded in 1978, is a universal system with comprehensive insurance and uniform healthcare for the entire population. It is financed mainly by general taxation. Primary care is provided by GPs (General Practitioners), who have the status of independent, self-employed physicians, working for an LHA (Local Health Authorities) under a public contract. They are paid according to a capitation fee, determined by the number of people registered with each doctor. They also act as gatekeepers for access to secondary services whose provision is refunded by the NHS, such as diagnostic checks, hospital admissions, and specialist visits (Fabbri and Monfardini, 2009: 291).

Figure 1: A Generic Research Framework of VSA as applied to Healthcare Systems



Source: Our elaboration

It would certainly appear clear, reading the results of Economist Intelligence Unit survey on Italian Healthcare (Economist Intelligence Unit, 2012: 2), that there is a strong focus on performance indicators and, in particular, on the measurement of economic resources absorption due to health service as it is a main concern of the Italian system.

The strong focus on performance indicators and the intense pressures from political institutions with a need to lower the cost of services provided, in the last decade, affected the livelihoods of the NHS. It should be noted that in 2010, there was an average of 6.3 nurses per 1.000 people (about 159 patients per nurse) compared to an average in OCSE Countries of 8.7

nurses per 1.000 people (about 115 patients per nurse) in Italy (Economist Intelligence Unit, 2012: 2).

As a consequence, a lowering of the level of service is observed together with an increase in demand for private healthcare services. The Italian NHS plays a major role in the market for specialist consultations, where public, closely regulated and mainly salaried specialists compete with private, less strictly regulated ones. Specialized NHS outpatient services, including visits, diagnostics and treatment, are provided either by the LHA's salaried specialists or by accredited public and private facilities with which the LHA has agreements and contracts. People can access NHS specialist care only with their GP's authorization and referral. Because of waiting lists, co-payments and unsatisfactory quality, many patients seek care outside the NHS, resorting to the private market for specialist care (Fabbri and Monfardini, 2009: 292).

In this context, we observe a growing mobility of population seeking for a better/cheaper service in other Nation's regions. This phenomenon is often related to that of medical tourism, especially when directed toward emerging economies countries essentially because of their economical accessibility (Connell, 2011) given a certain quality level of service.

The internationalization of health, in this perspective, acquires a new meaning especially considering the transition from *health tourism* to *medical tourism* where the health tourism is based on "travel where the primary purpose is treatment in pursuit of better health" while medical tourism "incorporates health screening, hospitalization, and surgical operations" (Henderson, 2004: 113).

To seek for health service outside, the NHS contribute to the increasing of the private organizations involvement in the health care systems also increasing opportunities for potential PPPs for leveraging on resource integration and value co-creation consistently with a SDL mindset (Barile and Saviano, 2013). PPPs, in particular, could have a positive impact on economic efficiency of health care system (Iandolo *et al.*, 2013).

Health care PPPs experiences in Italy are still under discussion with regard to their potential contribution to face uncertainty related to a growing health demand in a general context of economic crisis that urges the identification of more sustainable solutions. Several organizational solutions are possible for implementing PPPs requiring a deep analysis of alternatives considering their criticalities (Martinez *et al.*, 2011). This variety suggests

identifying key elements of analysis supporting decision makers in defining the most appropriate strategy.

### *The Indian scenario*

Healthcare system in India being the responsibility of the state, local and central government has emerged as one of the largest service sectors. In 2004, national healthcare spending equalled about 5.2 per cent of nominal GDP, or about US\$ 34.9 billion. Healthcare spending in India was risen by 12 per cent per annum through 2005-09 (in rupee terms) and scaled up to about 5.5 per cent of GDP, or US\$ 60.9 billion, in 2009 (WHO, 2013). The delivery of healthcare services may be segmented into three stages, viz. primary, secondary and tertiary care. Primary care constitutes treatment on an outpatient basis. Secondary care refers to hospitalization for 'non-critical' ailments. Tertiary care relates to treatment of critical ailments and requires high-tech and expensive facilities and equipment. As of now the corporate sector is focused on tertiary care. The opportunity exists because of the lack of adequate facilities, high investment requirement (which becomes an entry barrier for smaller players), higher revenue realization per patient, less competition from doctor-entrepreneur led facilities as well as an ability to differentiate product offerings.

The drivers for the growth of healthcare sector in India are due to the following reasons: (a) increase in population, (b) shift in demographics, (c) rise in disposable income, (d) increase in incidence of lifestyle-related diseases, and (e) rising literacy. Apart from these factors, several other economic factors, such as tax benefits, medical tourism, insurance tourism, etc. also affects the growth of healthcare sector. However, Indian health financing faces a number of challenges, such as increase in healthcare costs, high financial burden on poor effecting their incomes, need for long term and nursing care for senior citizens because of increasing nuclear family system, increasing burden of new diseases and health risks, limited government funding leading to negligence of preventive as well as primary care and public health functions. Both the public and private sector need to work in tandem to make healthcare available, accessible and affordable. In order to tackle the above-mentioned challenges, government has taken various initiatives to improve the public healthcare system in India. The Indian government is focused on developing the PPP model to cover the demand-supply gap prevalent in the healthcare sector. Private sector expertise coupled with efficiencies in operation and maintenance would lead to improved healthcare services to the

clients (patients). The healthcare sector in India is still required to be addressed both in terms of accessibility of healthcare services and quality of patient care.

Although India's healthcare system has gradually improved in the last few decades, it continues to lag behind those of its neighbouring countries. The poor state of healthcare in India may be attributed to the lack of government funding on healthcare initiatives, as estimates reveal that the per capita spending on healthcare by the Indian Government is far below international recommendations (National Coordination Committee, 2006). However, India's healthcare infrastructure has seen steady improvement in the recent past. There still exists a severe shortage of sub-centres, primary health centres, and community health centres. PPPs have emerged as one viable method of growing the healthcare sector while keeping public goals into consideration. The main objectives of PPPs are to improve quality, accessibility, availability, acceptability, and efficiency of healthcare services. While different states in India have had different levels of success with implementation of such initiatives, it is expected that the private sector will continue to take on an increasing role in India's healthcare system (Boston Analytics, 2009). The provider (public or private) plays a major role in providing the core services of designing, building, and operation of healthcare units. However, they are constrained by several areas of growth leading towards various advantages.

Table-1: Public and Private Providers in Healthcare (CII, 2011)

Provider	Areas of Growth	Advantages
Public	<ul style="list-style-type: none"> <li>• Efficiency issues in management and operations hamper the system from realizing complete potential</li> <li>• Inflexibility and issues in responsiveness</li> <li>• Customer satisfaction and quality perception low</li> </ul>	<ul style="list-style-type: none"> <li>• Motive of improvement in overall health of population drives growth and expansion strategy</li> <li>• Potential for economies of scale can be realized both within a unit as generally facilities are large and across units due to extensive network</li> <li>• More equitable in outlook</li> </ul>
Private	<ul style="list-style-type: none"> <li>• Financial sustainability without Government support restricts expansion into all regions</li> <li>• Quality of service can suffer in areas of low competition and lack of regulation</li> <li>• Higher costs exclude large sections of the poor population</li> </ul>	<ul style="list-style-type: none"> <li>• Efficiency in management and operations with a thrust towards employing technology and latest best practices</li> <li>• Increased access in areas of operation and availability of round the clock services</li> <li>• Increased flexibility and responsiveness</li> </ul>

While private players are keenly entering this "social" infrastructure sector, innovative measures are needed to improve financial performance using *vSA*. The last decade has seen a significant increase in private sector participation in healthcare delivery. Existing players, such as AIIMS, CMC, Apollo, Wockhardt, Manipal, Care Hospitals and Narayan Hrudalaya

have expanded aggressively. New players, such as Fortis, Max, Sterling, Global Hospitals, AMRI, Ruby Hall and Reliance and ADAG have entered the sector with plans to establish national and regional presence. International players, such as Elbit, Columbia Asia and Parkway have also entered India with plans of establishing a network of hospitals.

These corporate players together operate around 25,000 beds across the country. Healthcare providers have also attracted investments from private equity players such as IDFC, Apax Partners, Actis, Indivision, ICICI Ventures, Trinity Capital, etc.

In such a context, the medical tourism industry is worth about \$108 billion (Press Trust of India (PTI), 2005) and, according to recent estimates, the number of foreign patients that visit the country for medical services is expected to exceed 3.200.000 units by 2015 (Assocham, 2011) as effect of National policy that “promote medical tourism took off in late 2002, when the Confederation of Indian Industry (CII) produced a study on the country’s medical tourism sector, in collaboration with international management consultants, McKinsey & Company, which outlined immense potential for the sector” (Chinai and Goswami, 2007: 164).

The above drivers are likely to result in an annual increase of 10-12 per cent in the size of the healthcare delivery market over the next five years.

The challenges the sector faces are quite substantial, from the need to improve the physical infrastructure for improving the healthcare assess and quality of healthcare. However, the opportunities equally compel better use of technology, such as telemedicine that may efficiently provide diagnostic services to remote areas so that they can take proper advantage of it (Mehr, 2008).

Therefore, public and the private sector must work together to not only take-up the massive job of improving health care services in India but also strive to exploit the massive potential to make India a destination for health care for the rest of the world (Lath, 2008).

## **DISCUSSION AND INTERPRETATIVE HYPOTHESIS**

As it may appear to the reader, our choice to discuss two cases characterized by very different historical, economic, social and cultural scenarios, can be better understood if we make more explicit our aims and assumptions.

Consistently with a systems thinking approach, we move from a wide view of business as well as social phenomena in which several aspects and perspectives are required to be considered and integrated within a unitary and general framework. Accordingly, we consider it as interesting to analyse the Italian health care system widening the perspective outside its “borders”. This wider perspective and view have lead us to search for stimuli to reflection outside the “box” (both conceptually and geographically).

In addition, awareness of a globalized world where complexity typically emerges from unexpected interconnections, our look at health care phenomena and trends was also directed toward the identification of uncommon reasoning pathways. Thus, it appeared to us interesting to explore a comparison between countries clearly “distant” with respect to the specific health care system as well as the general conditions, but potentially related for particular phenomena, such as those of health tourism and medical tourism that typically imply the involvement of private organizations.

The adoption of our approach is not much directed to empirical research but to a conceptual reasoning that is based on very general (if not universal) principles and properties of systems theory (von Bertalanfy, 1968) that is expected to deductively give evidence to possible characterizations of the investigated phenomenon. Accordingly, our ‘findings’ are derived not only from the more or less objectively described scenarios but from a conceptual reasoning based on systems thinking.

## CONCLUSIONS

Shifting focus from the descriptive (structural) representation of the phenomenon to its systems interpretation, considering, in particular, the implications of subjectivity and contextualization, other aspects emerge to consider. In the Italian case, the public role in health care system is prevalent. Conversely, in the Indian case they are the privates to play a more relevant role.

Then, when considering PP partnership in the two cases, we should expect that this different relevance has an effect when considering the radically different logics, expectations and interests of a public compared to a private player. Accordingly, we may expect that health organization managers will direct their decision making and choices looking for consonance with the suprasystems perceived as more relevant suprasystems, i.e. owning

more critical resources and capable of exerting a greater power of influence on the managed organization survival dynamics.

In this respect, it appears that while in the Italian case, public health care organizations' managers (who are politically appointed) perceive the political-institutional suprasystem as the most relevant one, often ending up for disregarding the service expectations of the client suprasystem (Saviano *et al.*, 2010), in the Indian case, private health care organizations' managers are expected to give more attention to the interests of shareholders.

In a nutshell, while Italian health managers are mainly focused on cost (cutting), Indian health managers are expected to put greater attention on profits. This may lead Indian managers to 'celebrate' the richest segment of population, risking to disregard even the basic service expectations of the largest part of poorer population.

As a result, both the Italian and the Indian health managers may appear to direct little or any attention to the populations' needs. Clearly, PPPs are expected to be affected by these conditions and dynamics. This possible result, indeed, reveals how health care managers may vary away from the original finality that legitimates their appointments. Any health care system is legitimated to exist to the extent which the ultimate goal is achieved (or at least concretely pursued): populations' health.

Costs on the one hand, profits on the other hand catch the greater attention of managers. *What about keeping healthy populations? What about the declared finalities of resource integration, creating synergies, etc. if these hypotheses be confirmed?*

## **LIMITATIONS, CHALLENGES AND FUTURE RESEARCH**

In the light of the above discussed hypothesis, countries' governments should deepen the reflection on their current and future health care strategies. It would be at least paradoxical if the effort for progress and economic development in the name of the health care mission might result in maintaining (or even increasing) a so apparent disparity.

In this respect, we point out that we are absolutely not critic with PPPs. It is not the phenomenon or the strategy in itself under criticism; it is the way decision makers take these collaboration opportunities. The way they direct the country's effort toward sharable and valuable (or not) goals. Thus, our vSA-based interpretation stimulates such reflections and sets the main challenge for health care managers: to keep in mind the ultimate finality that

legitimizes their appointment being aware of the risks of becoming excessively focused on costs or profits targets.

Obviously, our reflections may appear an abstract reasoning if not supported by empirical evidences. This is an objective research limitation that, however, does not imply a weakness of the overall methodology whose contribution remains valuable, if assumptions and finalities of observations are shared. Conversely, there are significant opportunities for future empirical research in which a multi-stakeholder systems approach should be adopted investigating the phenomenon by appropriately adopting the different perspectives involved in the observed dynamics, subsequently trying to harmonize them in order to effectively integrate knowledge resources and co-create value to the benefit of everyone.

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## ARE PUBLIC PRIVATE PARTNERSHIPS WORTHWHILE?

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### **ABSTRACT:**

This paper examines whether public private partnerships (PPPs) are a good value for governments. The paper begins with a brief historical review of PPPs and discusses the arguments that have been proposed to support PPPs. Afterwards, the paper assesses recent instances of PPPs and examines other studies of PPPs. This appraisal leads to the conclusion that PPPs are more expensive than the traditional procurement approach. However, there are some circumstances where the benefits from the PPP can justify the additional costs of a PPP. One case is where the PPP shortens the building of the project. A second case is where due to budgetary limitations, the government is unable to build the project at all. A third case is that the PPP frees up money for other purposes whose benefits are deemed as being greater than the additional costs of the PPP. Furthermore, it is argued that there is a higher probability that the benefits of a PPP project are greater than its costs by "hard" infrastructure projects, while by "soft" infrastructure projects, it much less likely that the benefits will be greater than the costs. The paper ends by noting that if a government does go ahead with a PPP project it needs to take into account several factors with regard to the contract and the bidding process to insure that the benefits of the project truly end up being greater than its costs.

**Keywords:** PPP, government spending, government decision making, infrastructure

### **INTRODUCTION**

Throughout history the public and private sectors have worked together. Wettenhall (2010) notes that such partnerships existed in ancient Egypt, China and Rome. Wettenhall lists eight different ways that private organizations and individuals worked with the government throughout the centuries: privateer shipping, mercenary armies, trade, commerce and colonial expansion, treasury and public finance, collaboration in agriculture, health and

education, infrastructure provision, organizing hallmark events and public and mixed enterprises.

One example was turnpikes in Great Britain (Grimsey and Lewis, 2004). In 1706-7, turnpike trusts began to be established in which private individuals were responsible for building and maintaining a road and in return they received the tolls from the people who travelled on the roads. By the 1840s there were almost 1,000 turnpike trusts for various sections of roads in Great Britain, but then the government began to take control of the roads and the last private toll road was closed in 1895. A similar story occurred by the London Underground, which was built by private companies between 1894-1907 and then the lines were nationalized in 1933.

In France, in 1638 and 1666, concession were granted to private companies to build canals, bridges and tunnels. In 1782, the Perrier brothers were granted a concession to provide water to the city of Paris, and still in 1995, it was estimated that 75% of the French population receives their water from private companies (Wettenhall, p.26). Barjot (2011) notes that in France the concession system developed in two dominant sectors, public works and public utilities.

In 1992, there was a new impetus for public private partnerships (PPP). The British government had limited budgetary freedom, but the government wanted to update the country's infrastructure. To solve this problem, it proposed a scheme called private finance initiative, PFI, under which a private company would design, finance, build and operate such facilities as roads, bridges, tunnels, schools, hospitals and prisons subject to government specifications, and eventually the facility would revert to state ownership and control. According to one estimate, in the UK from 1992-2009 there were approximately 800 deals between the government and private companies with a combined value of £64 billion (Private finance projects and off-balance sheet debts, March 2010, p.10, point 19).

In the mid-1990s, the term PPP began to replace the term PFI, though PFI still remains in use. Other names are also used. The World Bank uses the term PPI, private participation in infrastructure. In North America the term P3 is used, while in Australia and in the UK, the term PFP, privately financed projects, is also used. In this paper, we will use the term PPP, which appears to be the most popular.

This concept has been embraced by government throughout the world. Some cases of PPP are "hard infrastructure" projects where a good is moved, produced or processed, such as transportation, energy, waste management, while others are considered "soft infrastructure" projects where the goal is to provide services such as hospitals, school and prisons. One

interesting example of a PPP by "soft infrastructure" is that it is estimated that 70% of the US intelligence budget is spent on contractors, (Hamburger and O'Harrow, 2013).

With the growing use of PPPs it is important to determine whether PPPs are an efficient use of government funds or a waste of taxpayer money. This paper will review the arguments for and against PPPs and examine the success and failures of recent PPP projects. Based on this review, we will offer criteria as to when there is greater likelihood of success with the PPP approach as opposed to the traditional procurement system. We will start with a definition of PPP and a brief review of some of the variations that have developed in the past few years.

## **DEFINITION OF PPP**

Forrer, *et. al.* (2010, p.476) write, "Public-private partnerships are ongoing agreements between government and private sector organizations in which the private organization participates in the decision-making and production of a public good or service that has traditionally been provided by the public sector and in which the private sector shares the risk of that production." They note that there are three key aspects to this definition which distinguish PPPs from concessions and franchises that governments traditionally granted. They explain that these aspects are:

1. The relationship between the public and the private sector organization is long term, rather than a one-time relationship, such as might occur in a conventional contract for a good or service (such as office products or secretarial assistance).
2. The private sector cooperates in both the decision making as to how best to provide a public good or service and the production and delivery of that good or service, which normally have been the domain of the public sector.
3. The relationship involves a negotiated allocation of risk between the public and private sectors, instead of the government bearing most of the risk.

This definition highlights some of the differences between a PPP and traditional public procurement. In traditional procurement with private contractors, once the work, for instance constructing a facility, is done, then the relationship between the contractor and the government is over. However, with a PPP, the relationship between the private company and the government is long term, for example thirty years, which means that the firm not only builds or refurbishes the facility but also runs the facility for many years. Due to this double role of the firm, it also plays a much larger role in the design of the facility than by

traditional contractors. Furthermore, in a PPP, the private firm takes on debt to build the facility, and then the profits from running the facility will allow it to pay back the debt. On the other hand, in traditional procurement projects, the government funds the project, usually by borrowing, while the contractor has no loans or just limited and short term debt.

In a PPP due to this long term relationship, the crucial idea is that there is a partnership between the private firm and the government and this partnership can take on many different formats. Urio (2010, p.7) divides these partnerships into three categories. One, "the private sector designs, builds, owns, develops, operates, and manages an asset with no obligation to transfer ownership to the government. These are variants of design-build-finance-operate (DBFO) schemes." Within this category are partnerships which are termed: Build-own-operate (BOO), Build-develop-operate (BDO) and Design-construct-manage-finance (DCMF). The second category is where "the private sector buys or leases an existing asset from the government, renovates, modernizes, and/or expands it, and then operates the asset, again with no obligation to transfer ownership back to the government." Within this category, the partnerships are labeled: Buy-build-operate (BBO), Lease-develop-operate (LDO) and Wrap around addition (WAA). In the third category of partnerships the "private sector designs and builds an asset, operates it and then transfers it to the government when the operating contract ends, or at some other pre-specified time. The private partner may subsequently rent or lease the asset from the government." Within this category, the partnerships are branded: Build-operate-transfer (BOT), Build-own-operate-transfer (BOOT), Build-rent-own-transfer (BROT), Build-lease-operate-transfer (BLOT) and Build-transfer-operate (BTO).

## **PROS AND CONS OF PPPS**

Does the PPP lower the costs of providing the goods and services? Yescombe (2007, p.18), a proponent of PPPs, notes that "private sector finance for a PPP clearly costs more than if the project were procured in the public sector and financed with public-sector borrowing." The reason for this is that is costlier for the private sector to borrow than for the government, and the government pays for these extra borrowing costs of the private company in its payments to the company. Why then should the government have the private sector build the asset?

One possibility is that the government is limited in its borrowing capacity due to budgetary problems, and hence is unable to produce the project at all. Podkul (2011) reports that in 2008, the city Chesapeake, Virginia had a crumbling, 80-year-old bridge, and had no money to fix the bridge. Instead, the city sold the bridge for \$10 to private investors, who tore

it down, are building a new one, and will receive a \$2 toll for each car that uses the bridge. One of the investors noted that the choice for the city was either the private bridge or no bridge at all. In addition, if there are budgetary restrictions, by using the private firm, the government has postponed its payment to after the project is built and if the government gives the private firm the right to collect services fees from users of the project instead of the government paying the private firm, then the government never "pays" for the project.

If there are no budgetary limitations on the government, admittedly a rare situation, then can a PPP save taxpayer money even though the private company's borrowing costs are higher than the governments? Yescombe lists several advantages to having a PPP.

One, projects by the public sector tend to have delays and cost over-runs, while with the private sector, the payments are fixed by the contract between the government and the firm, which means that the construction risk is transferred from the government to the private sector. The idea being that if the facility is not finished on time and running, then the private contractor will have a problem repaying his loans, which forces him to finish on schedule.

Two, there can exist economies of scale that enable the private company which has experience in building large projects to build the project cheaper than the government.

Three, if the private sector is going to build and operate the facility, then they have an incentive to design and build the facility in such a way to produce the greatest cost saving from running the facility. This idea, called "value for money" (VFM), is that even if it costs more for the private firm to build the facility, in the long run the combined costs of building and running the facility will be lower with the private company.

Silversides (2008) reports one example of this argument with regard to a hospital that was built in Canada as a PPP. The private company, Infrastructure Ontario, that was arranging the deal admitted that "the basic cost of the new Sault Ste. Marie hospital would be lower if the public sector financed and negotiated the procurement." However, David Livingston, president of Infrastructure Ontario, argued that the "higher costs are offset by the value of the "risk transfer" to the private sector, in which the consortium agrees to assume the risk of delivering projects on budget and on time." He claimed that "these value-for-money calculations are a mathematical puzzle and in the end the math has to prove that there is value for doing it." The company claims that in "the long run "taxpayers will save \$101.7 million on the cost of the hospital's development, which is now pegged at \$988 million over the 30-year deal." However, Silversides notes, "the public documents don't provide details on exactly how that risk transfer calculation was made," and one wonders how accurate these calculations can be based on thirty years in the future.

Four, the private sector has skills which government workers do not always have. These skills range from specific expertise in certain fields, a greater willingness to innovate, and a better judgment as to worthiness of a project when the payments to the private firm is based on future service fees. A single manager of the entire project can also save the government from having to monitor all the steps in building and operating the facility. It is also claimed that by having a "single address" there is greater transparency to the building and operating of the facility than if it run by the government.

Five, since the private company has to borrow to pay its costs to build the facility, the banks providing the finance add another layer of due diligence in determining whether the project is worthwhile. This differs when the government borrows to pay for the PPP since government borrowing is not related to specific projects.

Ferror *et al.* (p.477) note that these benefits are based on an assumption and a presumption. "The assumption is that governments often do not have the in-house knowledge of the most cost-effective ways to deliver many types of public goods and services—either directly or through contracts." And the presumption is "that governments can partner with private firms in a relationship in which government gains access to the technical expertise it requires and can assess the cost-effectiveness of private delivery, and firms are willing to share their expertise in exchange for long-term service contracts." Thus, they argue that "public managers need to sort out, assess, and address various dimensions of public accountability when considering a PPP" to ensure that this assumption and presumption are applicable.

Nevertheless, even if one accepts this assumption and presumption, this is not enough to justify the use of PPPs. The problem is that the private firm's emphasis is on generating income, while the government's goal is to provide service to its citizens. Accordingly, even if the private firm can build and operate the facility cheaper than the government, the government still has to insure that the firm provides the services at the level that the government desires. The government has to specify the services it wants provided at the time when it signs the contract with the private firm but here is the problem.

There are several difficulties with relying on the contract to provide the level of services desired by the government. One problem is that in some cases, such as by "soft infrastructure" it is difficult to quantify the level of services. For example, it is desired that health care workers treat their patients respectfully, but this cannot be measured by a contract, though this same problem exists by government workers.

A second problem is the length of the contract, that the private firm generally wants it to be longer to enable it to recoup its initial investment, but this protects the firm from competition, and reduces its incentive to innovate. For example, the private firm may not be required by the contract to use new technology which is developed after the contract is signed, and hence throughout the years of the contract, the private company might have higher costs or provide lower quality of services than what is available. Thus, many long term contracts have included a requirement for the private firm to abide by all government legislation, but this cannot help in all cases where there are small and specialized developments that are not subject to government legislation. Brenninkmeijer (2010, p. 122) notes that "in order to ensure that services remain of high quality, procurement contracts have become longer, more complex, and include increasingly detailed descriptions of what is expected from the private sector partner... There is, in other words, a greater focus on regulatory principles in PPPS where previously more traditional government procurement relied on inter-personal trust and cooperation." In addition, the longer contracts contradict the need for simple contracts to measure performance. One possible solution is to have periodic re-evaluations of the term of the contract. Highway concessions in France are re-evaluated every five years, and their contracts are much shorter than UK, US and Dutch concession contracts (Brenninkmeijer, p. 109).

A third problem is that inevitably a percentage of contracts generates disputes arise as to interpretation of the contracts, and this means that court proceedings concerning the contract can slow down the infrastructure project. Thus, there needs to be some method of binding arbitration included in the contracts to insure that disagreements are resolved speedily.

A fourth problem is that that one cannot use "boiler plate" contracts for a PPP since each situation is unique, and hence government workers and agencies are usually not as well trained in preparing these contracts as are the private firms, which enables the private firms to acquire better terms than need be. This is even a problem in the UK, which has the longest and most extensive experience with PPPs. In an inquiry by the House of Lords in 2010, a Mr. Sutherland, from the firm Interserve Investments and the Confederation of British Industry, stated (Private finance projects and off-balance sheet debts, 2010, p.25, point 111) "I find it amazing that we are still finding people on the public sector side who are doing it for the first time. When I look across the deals that we get involved in I think that there are some really excellent teams and there are some really poor teams."

A fifth problem is that the government will only be able to make an effective deal if there are various private companies that are competing for the contract. If there is only one private company that is bidding for the contract, then the private company has the ability to demand high payments. This problem arises even when there are several bidders in the beginning stage of the process, but towards the final stages of the negotiations, the government enters into exclusive negotiations with the preferred company and the benefits of competition melt away. Furthermore, after the contract is signed, the government loses all of its bargaining power and if there are new conditions in the industry, then the private company can demand high payments to meet these new conditions. Finally, due to the long term nature of a PPP contract, the government has limited its budgetary freedom in the future.

Accordingly, due to all the problems with the contracts, it is not clear that PPPs provide the best service and it is not intuitively obvious that they reduce costs. Thus, it is not apparent that PPPs are beneficial to society. We will now review some of the evidence as to their effectiveness.

## EVALUATING PPPS

It is not simple to evaluate the success and failures of PPPs for several reasons. One, it is difficult to make comparisons as to what would have been without the PPP since most of the alternatives are theoretical. Would the government really have been able to build the facility and at a cheaper price? Two, private companies do not divulge all the information necessary to make precise calculations. Three, there appears to be a great deal of subjective bias in discussions of PPPs. Contractors, consultants and lawyers who profit from these deals have a personal interest in PPPs and people who are "pro-capitalist" will have a proclivity to view them favorably since they reduce government involvement in the economy. On the other hand, unions and their workers who feel threatened by the private firms and people with an "anti-capitalist" bent tend to view PPPs negatively. Nevertheless, in some cases the failures of PPP were quite evident.

One clear failure of a PPP type arrangement was Railtrack, a private company that won the right to run the trains in Britain, after the railways was privatized in 1993. Due to poor maintenance by the company, there were three crashes with multiple fatalities, and the government re-nationalized the railway in 2001 (Flynn, 2007, pp. 259-263). Furthermore, in 2002, the British government bailed out the shareholders of Railtrack, and *The Economist*

(March 2002) noted that "the message from Railtrack's bail-out is that there is no genuine risk transfer when the government deals with the private sector." The article points out that "PFI deals are supposed to transfer risk from the public to the private sector. But with so much at stake politically, the government cannot afford to let them fail. One way or another, the railways have to work and the underground has to run. This makes it genuinely impossible to transfer risk from the public to the private sector, which undermines the purpose of PFI."

Another disappointing example of PPP is the London Underground, which was set up as a PPP in 2002, with two private companies Tube Lines and Metronet, who were responsible for maintenance and upgrade of the infrastructure. Initially, there was some improvement service, but in 2007, Metronet went into public administration due to "poor corporate governance and leadership" and Metronet's failure caused the British government a "loss of between £170m and £410m," (BBC News, 2009). In 2010, a report by the Commons Transport Select Committee reported that the contract with the second infrastructure company Tube Lines was "flawed, failed to prove value for money... and the company's "failure to deliver the upgrade of the Jubilee line on time was unacceptable," (Transport for London, 26 March 2010).

Not with standings the failures mentioned above, on the positive side, PPPs have a much better record of completing projects on schedule compared to traditionally procured projects, and have led to an increase in innovation. Hodge and Greve (2007) is a review of PPPs, write "traditional public infrastructure provision arrangements are on time and on budget 30 percent and 27 percent of the time, respectively, while PFI-type partnerships are on time and on budget 76 percent and 78 percent of the time, respectively." Similarly, they quote a study from Pollitt (2005) who argued that projects under PFI "are [now] delivered on time and to budget a significantly higher percentage of the time ... with construction risks generally transferred successfully and with considerable design innovation." An inquiry by the House of Lords in 2010 states (Private finance projects and off-balance sheet debts, March 2010, p.19, point 69, p. 26 point 123 and p. 24 point 108), "There is strong evidence that PFPs have a better record of on time and on budget delivery than traditionally procured projects, although it appears that the gap is narrowing." They also list various innovations such as "prison where long wide corridors enabled better use of CCTV and improved safety for inmates and staff; hospitals where better designed corridors enabled smoother transport of patients; and better road surfacing treatment which reduced disruptions to motorists." Furthermore, they stated that "private finance has led to a much needed focus on maintenance of public infrastructure."

These improvements in infrastructure have not been cheap. Acerete, *et. al.* (2010), studied PPPs with regard to roads in Spain and the UK. They conclude "the use of private finance has proved expensive for both the taxpayers and road users, but it has been beneficial for the construction industry, road operators and their financial backers."

Sarmiento (2010) studied the experience in Portugal with a PPP called SCUT, where a private company was contracted to construct and maintain 930 kilometers of highways and in return to receive shadow toll payments from the government. Sarmiento compared the costs of this deal with a publicly owned company BRISA which was largest highway operator in Portugal and whose "territory" was a more difficult terrain than SCUT. He writes (p.116)

The results confirm that using private-public partnerships in the conditions set up in the contracts did not add value for money to the public sector. If traditional procurement had been used, it would have been far less expensive, even given the public sector's tendency to be less efficient. We find that, carrying the same costs in mind, it would have been 2 billion or 3 billion euro less, when considered 4.5% or 6% as the discount rate. Even with a 50% extra cost of capital expenditure and operating costs, it still would have been a better solution to use public procurement rather than the public-private partnership. The level of risk transfer to the private sector in the SCUT was very low and that undermined the performance of the public-private partnership. We question whether a shadow toll system is the most appropriate one. We conclude that the negotiation of the SCUT public-private partnership was not correctly managed, mainly because no studies were undertaken prior to the negotiation. Having carried out a public sector comparator would have shown that the bidders' offer was unrealistic and that taxpayer's money could have been saved.

On the other hand, Pereira and Andraz (2012, p.337) argue that "overall the investments in SCUTS make sense from an economic perspective" since it led to positive economic effects in all regions of the country. Yet, the question is whether the same benefits would have occurred if the government had built the roads, and would the government have been able to build the road cheaper, as argued by Sarmiento?

We turn now to the "soft" infrastructure projects such as hospitals. Again in terms of speed and actual construction, PPPs appear to be an improvement on the traditional procurement system. In the UK, from 1997-2005, nearly all new hospitals and extensions in the UK were done through PFIs. Flynn (2007, p.264) notes that this building program modernized the hospitals in the UK. "In 1997, the average of buildings in the National Health Service (NHS) was older than the NHS, which was founded in 1948. By 2005, fewer than a

quarter of NHS buildings were built before 1948." Without the PPPs, it is very unlikely that there would have been so much improvement in the hospital infrastructure in the UK. Yet, what were the costs of this building boom?

Shaoul, *et. al.* (2008) argue that in the hospitals in England that are PPPs, the "annual payments to their private sector partners are higher than expected" and "the additional cost of private over public finance for the first 12 hospitals is about £60M a year." In addition, they argue that "PFI charges create budget inflexibilities and are increasing the pressure on the National Health Service to cut their largest cost: the jobs, working conditions and pay of their staff." In another study of the PPP's in Britain's National Health Service, Hellowell and Pollack (2010, p. S23) argue that that "there is no evidence that the excess cost to the public sector is offset by greater efficiency through the contracting process," and "that the effect of PFI has been to reduce the NHS capacity."

Similarly Gilbert (2009) reports that in an audit of Canadian hospital, the Brampton Civic Hospital that was built and operated as a PPP, the Ontario Auditor General, Jim McCarter, concluded that "The government could have saved almost \$100 million on the cost of design, construction and provision of nonclinical services if it had followed traditional procurement methods. Because the government can obtain lower interest rates, another \$200 million in savings could have accrued had the government, rather than industry, borrowed money for the project. Furthermore, McCarter' claimed, that "the value for money assessment was overestimated by \$634 million, while the cost of construction using the P3 model nearly doubled. The value of "risk transfer," the estimate of what it will cost the consortium to deliver the project on time, was also overestimated by a wide margin."

There also have been cases of increased costs with a PPP due to poor contracts. One example is desalinated water in Israel (Bar-Eli, 2011). Israel's main water company, Mekorot, is a government company but when Israel wanted to construct desalination plants it issued a tender for private companies to build the plants. By 2011, eighty percent of Israel's desalinated water is treated by a single private company, IDE, and the government realized that it needed to buy more water than originally stipulated in the contract. When the Israeli government asked IDE to produce more water, the company agreed provided the government would pay more than what was agreed in the initial tender. The government had no choice but to agree.

Another example is day care facilities in UK hospitals, as explained by Sir Peter Dixon, of University College London Hospitals. "These facilities had not been provided for in the

original design due to a planning error.... Rectifying this was very expensive because under the private finance contract the hospital was stuck with the one provider and could not get quotes from alternative contractors. We had no ability to challenge the capital costs of our provider and of course they did it to suit them and we just had to cough up," (Private finance projects and off-balance sheet debts, March 2010, p.28, point 133.)

This review indicates that PPPs are costlier than traditional government procurement projects, they add significant budgetary limitations due to their long term contract, and at times they cause the government to relinquish control of the facilities. On the other hand, they have enabled facilities to be built, which might not have been built without a PPP, and the facilities are built quicker with PPPs than by the traditional government procurement process. Thus, PPPs, like most things in life, have benefits and costs, and we now will list criteria to help one determine ex ante whether the benefits of a particular PPP project are likely to be greater than its costs.

## **CRITERIA FOR USING PPPS**

In what circumstances is it better for the government to use a PPP and when is it better for the government to use traditional procurement approach, where the private contractors just build a facility without also running the facility? When a government contemplates doing a PPP it needs to do a meticulous examination of the costs and benefits from the project and the various alternative options. The government must find that the benefits from having the facility are greater than the cost of using the private company to build the facility and all the future payments to the contractor. These are not simple calculations since the benefits are not easily quantifiable and it is difficult to identify all the future costs.

There are three situations where the PPP could be worthwhile. One, the PPP could be worthwhile if the due to budgetary limitations the government is not able to build or refurbish the facility. In this case, the question is whether the benefits from the facility are worth the higher costs. Two, since a PPP has a higher probability of being completed on time than the traditional procurement process, it could be that the time benefit of finishing the project sooner is worth the extra costs of the PPP. Three, a PPP could also be worthwhile, if the PPP frees up money for other projects, and the benefits from these projects are believed to be greater than the additional long run costs of using a PPP.

All three of these scenarios might be tempting for a person with a limited time horizon (i.e. politician), but they are all dangerous to the long term financial soundness of the

government since it will be burdened with costs that contractually cannot be changed for many years. In all three cases, the problem of budgeting the building of the facility is pushed off to the future but is not removed by using a PPP. The PPP is functioning as a loan from the private company to the government, and these future liabilities can create a large drain on future expenses.

For all three scenarios, the calculation is simpler when the PPP is a "hard" infrastructure where the "output" can be measured and the users of the facility pay for the facility since then the government is not limiting its future budget. The user of the facility might be paying a higher price than if the government built the project, but one could argue that the high costs of the private company are closer to the "true" costs as opposed to the theoretical cost. On the other hand, by "soft" infrastructure projects, where the cost is all borne by the government and it hard to define the level of services, the government should be very wary about doing a PPP.

If the benefits of the PPP are thought to be greater than the costs, then there still needs to be competitive bidding for the project, a method for quickly arbitrating disputes in the contract, flexible contracts which allow periodic review, an awareness of the future liabilities if applicable, and a very thorough understanding of the contract by the government workers involved in approving the PPP contract.

It is hoped that the review here of PPPs will help government officials make better decisions in choosing whether to use PPPs and if they decide to do a PPP, to make it more effective. Of course, more studies on measuring the costs and benefits of PPPs are to be encouraged to further our knowledge of whether PPPs are worthwhile.

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## THE MAIN EFFECTS OF GREEN HARVESTING ON THE SICILIAN WINE COOPERATIVES

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### ABSTRACT

In Sicily in the 2010-2012 period green harvesting is the most successful of the 9 measures provided by the Italian National Support Programme (NSP) for wine. Its main goal is to contribute to restoring the balance between supply and demand by destructing or removing grape bunches in their immature stage in order to prevent market crises.

The paper firstly presents the main results of a “three-year” application of Green Harvesting measure to the Sicilian wine sector. Firstly the implementation of Green Harvesting Measure was examined at EU, national and regional level through the analysis of the available statistical data; at a later stage its effects on the Sicilian wine sector were investigated. The trend of vineyard area and wine production was studied by comparing them before and throughout the application of Green Harvesting. Another stage of the research consisted of a survey carried out through direct interviews to 30 Sicilian wine cooperatives, the aim of which was to collect and analyse the trend of grape quantities delivered to the cooperatives, as well as the correspondent prices concerning the last 6 grape harvests (2007-2012). Another aim of the research was to collect the most common viewpoints and impressions of people working in the wine sector cooperatives with regards to the above-mentioned measure.

The study has pointed out that “Green Harvesting” has been contributing – together with other elements - to reduce the supply of wine grape in Sicily and partially to

raise the prices of the wines involved in this region. This measure has been however object of criticisms in relation to its impact in economic, social and ethical terms.

**Keywords:** Wine-CMO, Green harvesting, Sicily, wine cooperatives.

## INTRODUCTION

The Common Market Organisation (CMO) of wine has always been distinct from those of the other agricultural products as, in addition to common problems, it has had to deal with questions specifically covering the sector such as regulations governing the control of and reduction in production potential, the movement and introduction to consumption of viticulture products, the oenological practices and treatments as well as the regulation of the quality of the wines.

Despite a wealth of complex regulations, the European Union (EU) wine market has suffered from structural imbalances stemming from the surplus wine production, the concurrent steady reduction in wine consumption, the slower growth in EU exports and the growing competition from “New World” wines (European Commission, 2006a, 2007c; Čačić et al., 2012; Meloni and Swinnen, 2012). The latest reform of the wine CMO which became effective in 2008, among other innovations, introduced the National Support Programme (NSP) or envelope measure, an array of eleven different regulatory measures. Together with the progressive elimination of traditional market measures (including potable alcohol distillation, crisis distillation and the use of concentrated musts, known as *phasing out* measures), the new CMO has resulted in the consolidation of two measures previously adopted with Agenda 2000 (restructuring and conversion of vineyards and distillation of by-products of winemaking), and also the introduction of other six measures aimed at improving the competitiveness of the production chain during its various phases (promotion on third-country markets and investments), reducing risks and crises (green harvesting, mutual funds, harvest insurance) and cutting the link between subsidies and production with the decoupling of direct aid to producers (single farm payment) (European Commission, 2006a, 2006b, 2007a, 2007b, 2007c; Cagliari and Sardone, 2009, Meloni and Swinnen, 2012). The aims of the reform featured the reduction of wine surpluses via *ex-ante* measures (e.g. green harvesting) rather than *ex-post* measures (aid with private storage or distillation) (Iannettoni, 2009; Meloni and Swinnen, 2012).

More particularly, the green harvesting measure was one of the recommendations made in the 2004 Ex-Post Report (European Commission, 2004) to control occasional surpluses of wine

on the EU market via the *“total destruction or elimination of grape bunches while still in their immature stage”* in order to restore a sustainable balance between supply and demand, and to contain the collapse in the product price at source.

By playing a significant role in the production and commercial levels of EU viticulture (OIV, 2013), Italy is the only country, together with Slovenia and Cyprus - both marginal due to the size of their viticulture – that since 2010 introduced the green harvesting measure into its NSP. The most active and receptive Italian region is Sicily. In fact, among the 9 measures introduced by the Italian NSP, the most successful in Sicily has been the one relating to green harvesting, with the highest expenditure equivalent to just over 40 million Euros (RRN, 2013) during the financial years 2010-2012. The strident criticism from one sector of operators in the production chain, and in particular those in the cooperative section, urged the Sicilian Region to issue a provision supporting wine cooperatives, whose members had embraced the measure substantially, thus protecting them from the ensuing downturn in rewards and the increase in unit processing costs.

This paper aims to investigate the effects of the implementation of the green harvesting measure in Sicily in economic, social and ethical terms, by analysing the official statistics as well as carrying out a direct survey on the wine cooperatives operating on the western side of the island (in the provinces of Trapani, Agrigento and Palermo) where the measure registered its quasi-entirety of adhesions on a regional level (99.9% in the 3 years 2010-2012).

The paper is structured as follows. After examining various studies relating to the wine CMO, it will show the methodical approach used. Then, the production figures in Sicily will be delineated also by drawing on the data concerning the implementation of green harvesting during the financial years 2010-2012 and its relative effects sourced from various structural and production indicators. In the following section the results of the research into wine cooperatives will be analysed. The paper will then illustrate a number of conclusions.

## **LITERATURE REVIEW**

Thanks to the ceaseless reforms affecting the wine CMO, as well as the importance attached by the viniculture sector to the economic range of the agricultural and food industry in the EU, there is a rich source of literature existing on the subject, and particularly official documents covering programming and/or evaluation of the CMO (European Commission 2002, 2004, 2006a, 2006b, 2012a).

Over the years, various economic studies on the EU's wine market assert that policies have caused some major distortions in the wine sector instead of contributing to a solution (European Commission, 2004, 2006b, 2007c). The overproduction problems that have plagued and continue to plague the EU wine sector were not caused by bumper harvests, but were rather a result of regulatory measures and market intervention on the part of the CMO for wine (European Commission, 2002). Measures related to planting rights limitation and premium for definitive abandonment were effective in reducing the area of low quality vineyards though not fully effective in controlling production levels nor preventing surpluses (European Commission, 2004). In contrast to planting rights, distillation measures and market intervention were largely inefficient in their attempts to decrease structural surpluses (European Commission, 2002), stimulating overproduction of low quality wine and causing fairly high EU expenditure (Grant, 1997; European Commission, 2004).

Looking at the previous wine CMO, Pomarici and Sardone (2001) provide some critical remarks on the 1999 reform through a detailed reading of its contents, especially with regard to its application in Italy. Conforti and Sardone (2003) assess the ability of wine potential constraints and of the oenological practices in attaining the reform goals and assert that potential control system contribute to create distortion in production localisation. Some studies analyse the effect of the 1999 CMO on the Hungarian wine economy before EU accessions (Sidlovits and Kator, 2007), whereas others focus specifically on territories endowed with a strong viticulture tradition, such as those in Tuscany in Italy (Bongini et al., 2007) or in France, thus appraising the effects of specific measures such as distillation (Salies and Steiner, 2011).

More recent studies focus on the latest reform of the wine CMO. Meloni and Swinnen (2012) analyse the political economy mechanism that created the existing set of quality and quantity/price regulations by documenting their historical origins, and relate them to political pressures resulting from international integration, technological innovations and economic developments. Iannettoni (2009), after a brief overview of the various reforms of the wine CMO, evaluate the latest one demonstrating that the majority of the current regulatory reforms codified by the Council Regulation (EC) No. 479/2008 are based upon prior reforms employed during the 1987-1996 period. Others studies refer to how the new CMO will affect producers in California and the rest of the United States (Brunke et al., 2008) and in Croatia (Čačić et al., 2012), many others analyse specific measures: in particular, Brunke (2010) assesses the early impacts of the grubbing-up scheme and conduct country-by-country comparisons on participation in this scheme to evaluate which EU members are most

successful in addressing their problem of overproduction. Tudisca et al. (2012) calculate that in the western area of Sicily the grubbing-up premium does not compensate the loss of income due to cessation of production. However, according to the 2012 Evaluation Report (European Commission, 2012a) the resulting income loss is more than compensated in most analysed regions in those cases where vineyards are replaced by other permanent crops. Although grubbing-up represents both a surplus management measure and a quality measure by reducing in primarily low-quality wine (European Commission, 2004; Iannettoni, 2009), the European Court of Auditors (2012), in its analysis, find that the scheme is not sufficient to correct the existing market imbalance; on the contrary, the restructuring and varietal conversion measure improves the competitiveness of vineyards, but in a number of cases also lead to an increase in wine production. In addition, there are studies directed at simulating potential future scenarios in the sector or evaluating the effects of politics on the liberalisation of the wine planting rights due to be abolished by 2015 (Bogonos et al., 2012; European Parliament, 2012; Corsinovi et al., 2013, Deconinck and Swinnen, 2013, Gaeta and Corsinovi, 2013).

There are, to date, no bibliographic references on green harvesting implementation and its effects other than small references to the analysis boundaries referring to the broadest characteristics relative to the CMO in its entirety (Iannettoni, 2009; Pomarici and Sardone, 2009; RRN, 2012 and 2013; Piras and Gutierrez, 2012) due to the limited take-up of the measure among Member States. This study has been conducted in an attempt to bridge these gaps.

## **MATERIALS AND METHODS**

The methodology applied within this study combines the statistical analysis of data relating to the vitiviculture sector and to the implementation of green harvesting in Sicily from various sources, with data directly stemming from the information retrieved from various Sicilian wine cooperatives.

Specifically, regional productivity was firstly analysed data from the 5<sup>th</sup> and 6<sup>th</sup> General Agricultural Census made by Italian National Institute of Statistics (ISTAT) that take into account the structural data of farms every 10 years (in this study, 2000 and 2010). At the same time we took into consideration the economic data provided by the Vitiviculture Observatory of the Regional Vine and Oil Institute (RVOI) which covers the area under vine and the weight of wine grapes produced in each province, as well as the hectolitres of wine

per wine designations of origins (PDO, PGI and table wine). This latter analysis covers the 2007-2012 period, both during the three previous years (2007-2009) and throughout the application of green harvesting (2010-2012). Furthermore, the analysis of the implementation in Sicily takes into account the current regulatory framework as well as various other sources of information and statistics (DG AGRI, EU Regulations, ISTAT, MiPAAF, AGEA, RRN, official regional statistics). In particular, we have looked at the number of applications approved, the amount of aid granted, the relative surface area also based on wine appellations (PDO, PGI and table wine).

The direct survey, carried out in 2013, looked at all the 30 wine cooperatives receiving regional financial support in 2010 in order to cover increased operating costs resulting from their members which implemented the green harvesting measure. These wine cooperatives are situated in the western area of the Island, in particular in the provinces of Agrigento, Palermo and Trapani which, as well as being responsible for more than 4/5 of the Sicilian area under vine have also recorded almost all of the adhesion out of all regional vintners who benefited from the measure. The managers of the wine cooperatives took part in a survey so as to obtain information on the quantity, volume of grapes by wine designation of origin (PDO, PGI and table wine) and the correspondent prices paid to members during the last 6 grape harvests (2007-2012), and in terms of quality, in relation to their opinion concerning the effects produced by the “three-year” application of green harvesting measure to the Sicilian wine sector (2010-2012) at the economic, social and ethical levels.

## THE SICILIAN VITIVINICULTURAL SECTOR

According to the data in the 6<sup>th</sup> General Agricultural Census, Sicily which has 114,291 hectares of wine growing surface area (with an average farm size of 2.81 hectares), is the largest wine-producing region in Italy.

When compared with the data from the previous census, there is a decrease of 6.2% in the regional area under vine, which is slightly lower than Italy. Sicilian viticulture is characterised on one hand by the concentration in the western part of the island (85% of the overall wine growing surface area) and on the other by a traditional structural conflict between several small family businesses and a few large production businesses which could be capable of closing down the whole supply chain also through the commercialization of wine in foreign markets.

Because of the smaller production businesses, the cooperative phenomenon in the wine sector becomes very important in Sicily where more than 80% of total production is condensed in wine cooperatives (Sarnari, 2011). According to data from the Institute of Services for the Agro-Food Markets (ISMEA) in 2011 there were 85 wine cooperatives (with 72 in the three provinces we have looked at).

The recent dynamics of the Sicilian wine industry have been analysed using data supplied by the Vitivinicultural Observatory of RVOI, which in turn has used information from the Office of General Vitivinicultural Statistics 2000/SRRFV, from the Agency for Agricultural Payments (AGEA) and from ISTAT for the period 2007-2012.

Table 1 shows an overall recessive trend from 2008 as regards both the area under vine (except for the last year) and the volume of grapes produced, which is not only attributable to climatic, phytosanitary and surface trends, but also to the application of green harvesting. In particular, according to the census data, the largest territorial concentration of regional vitivinicultural production is in the west of the island, and over the period covered, it is this area which has the highest level of reduction in vineyard surface area. By contrast, however, there is a positive trend in productive cultivation in the provinces of Catania and Ragusa, due in part to the emergence of business ventures concentrating on production of quality wines to compete on the national and international markets (D'Amico, 2011). The latest available figures from RVOI for 2012 show an area under vine of 108,595 hectares producing 657.5 thousand tonnes of wine grapes.

Provinces	2007		2008		2009		2010		2011	
	Ha	000 tonnes								
Trapani	68,121	380.0	68,780	462.0	68,075	415.0	66,558	374.0	65,031	324.4
Agrigento	21,026	83.0	20,973	100.4	20,606	148.2	19,943	101.8	19,050	91.9
Palermo	16,455	123.0	16,625	155.0	16,450	103.1	15,822	127.0	15,432	67.5
Caltanissetta	5,786	56.4	5,764	56.4	5,646	56.4	5,540	82.2	5,448	45.2
Catania	2,958	19.0	3,074	22.5	3,150	19.0	3,177	15.0	3,181	7.4
Syracuse	1,918	15.7	1,944	16.1	1,919	16.1	1,877	15.4	1,841	9.3
Ragusa	1,400	18.3	1,467	14.5	1,493	12.1	1,514	10.4	1,537	10.6
Messina	877	14.0	891	21.0	872	17.5	880	14.0	885	10.2
Enna	365	6.6	376	6.3	370	6.6	376	6.6	329	2.6
Sicily*	118,906	716.0	119,894	854.2	118,581	794.0	115,687	746.4	112,734	569.1

Table 1: Regional area under vine and wine grape production.

\* The regional total data is the only available for 2012 (108,595 hectares of surface area and 657.5 thousand tonnes of wine grape production).

Source: RVOI.

Wine production in 2012, according to the same source, is 4.7 million hectolitres, which during the six-year period follows more or less the same trend as the production of wine grapes (Table 2). In particular, the entire regional production, made up in 2012 of mainly PGI wines (44.2%) followed by table wines (39.8%) and PDO (16.0%), has greatly changed in the period under review, showing that the Sicilian vitivincultural sector has moved towards production of vineyard-designated wines.

Vineyard designation	2007	2008	2009	2010	2011	2012
PDO	153,015	229,508	213,256	170,188	166,568	756,527
PGI	1,147,173	1,561,600	1,710,177	2,365,823	2,183,170	2,092,998
Table wine	2,641,120	3,233,913	3,010,838	2,364,152	1,144,343	1,888,912
Total	3,941,308	5,025,021	4,934,271	4,900,163	3,494,081	4,738,437

Table 2: Regional wine production by vineyard designation (hl).

Source: RVOI.

Analysis of the production data shows the effects of the introduction of green harvesting as from 2010, in synergy with other factors, with an inversion of the trend in 2012 in relation to the reduction in financial budget and, consequently, its implementation, compared to prior years.

## GREEN HARVESTING IMPLEMENTATION IN SICILY

An examination of the data covering the financial execution of the NSP of the three recipient member countries, shows that the measure absorbed around 1.2% of the total cost envisaged by the wine CMO for the period 2009-2012 (European Commission, 2012b). In particular, Italy received 97.6% of the budget available, while the rest was split between Cyprus (1.7%) and Slovenia (0.7%). Within Italian boundaries, Sicily received the largest share, absorbing 84.5% of the national budgetary envelope (81.5% of the total EU expenditure for this measure) distributed over the 2010-2012 three-year period. Nevertheless, the implementation of green harvesting has instilled contrasting views among the people operating on different levels in the regional vitivincultural sector. If on one hand it has been a great success in terms of adhesion among regional vintners, on the other hand it has also produced several negative opinions, as it is viewed as damaging for the supply and operating procedures implemented by the wine cooperatives (Pomarici and Sardone, 2010) and as an additional form of excessive state aid to the revenue of agricultural producers.

The conditions for accessing the measure in Sicily forecasted that the harvest would only be conducted via a manual method and that it could not be carried out over two successive seasons on the same vineyard. The latter, at the time of the tender, had to be planted since at least 4 campaigns and also to have made up the object of the harvesting declaration of the previous season. During the first two seasons of implementation, the minimum farm surface area was established as 1 hectare and the maximum at 6 hectares; the maximum surface area however could be extended to 20% of the area above 6 hectares, up to a maximum of 15 hectares. The third participation session reduced the maximum area to 3 hectares which could be extended to 20% of the excess area up to a maximum of 6 hectares.

Since the first tender, the Regional Department of Agricultural and Food Resources (RDAFR) of the Sicilian Region has regulated the aid per hectare according to the vineyard designation concerned: €1,500/ha, €1,700/ha and €2,000/ha respectively for grapes destined for production of table wine, PGI wine and PDO wine.

Compared to the first two tenders, the third, whereby fewer financial resources were available, linked the funding to a regional classification taking into account a specific score attained by adding points gained on the basis of precise evaluation parameters (qualification of the applicant; participation in the first tender; age of the vineyard).

During the three years of participation, the total financial execution was around 40 million Euros (Figure 1); in particular the three western provinces of Sicily absorbed around 98.8% of the total, with Trapani receiving 76.9%.

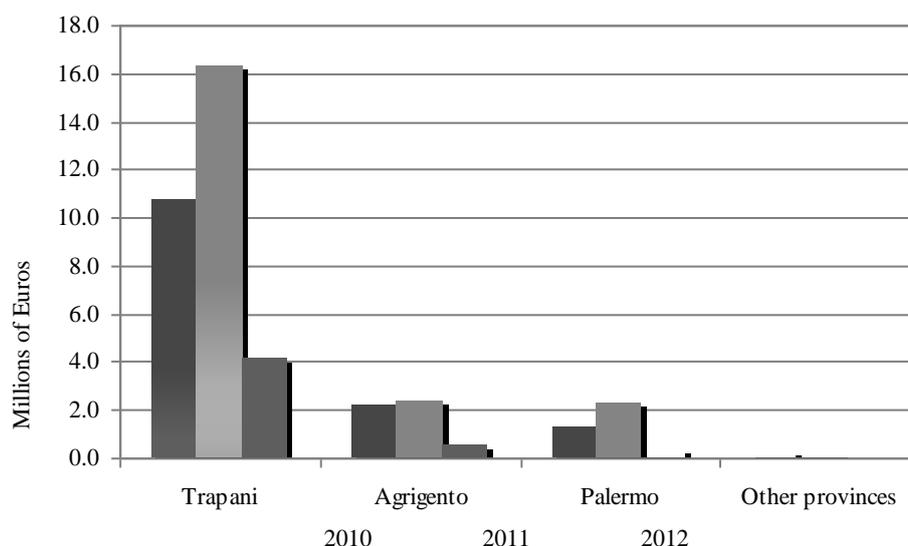


Figure 1: Financial execution of green harvesting implementation in the period 2010-2012.

Source: Our elaboration on RDAFR data.

In the three 2010-2012 grape harvests Sicily had 8,823 applications financed and registered with the highest degree of adherence equivalent to 88.5% of the national total (9,853 applications): the other regions involved were Marche, Umbria and Piedmont. In Sicily adherence to green harvesting was concentrated in the province of Trapani (73.9% of the total), Agrigento (15.4%) and Palermo (9.7%). A close examination of the trends relating to the applications financed in the three provinces analysed shows a boom in requests during the second tender, namely more than 50.0% compared to the first one (Figure 2). In the last tender, however, there was a large reduction in the number of requests mostly due to the lesser financial eligibility from MiPAAF.

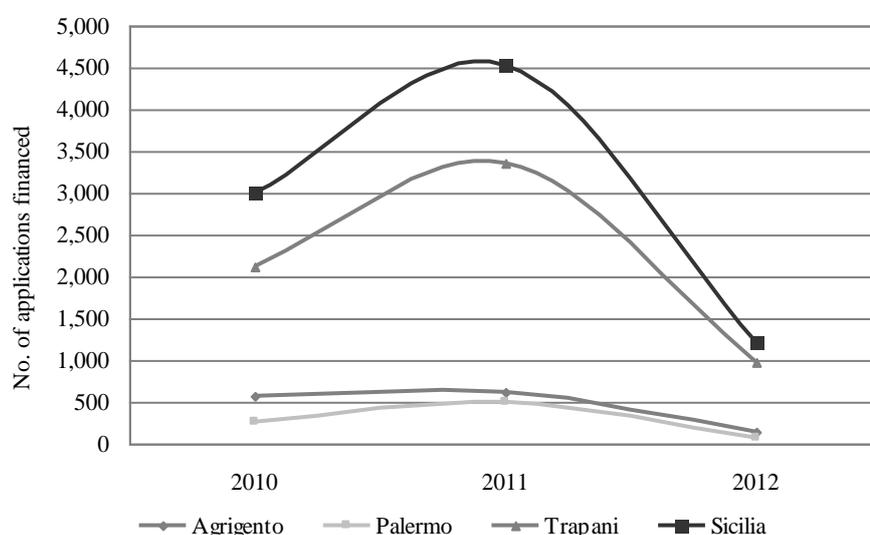


Figure 2: Applications financed in the 2010-2012 period.

Source: Our elaboration on RDAFR data.

The surface area benefiting from financing in the same period was equivalent to 24,453 hectares, concentrated in the province of Trapani (76.9%), Agrigento (12.3%) and Palermo (9.6%). As pertains to vineyard designation, it emerges that PGI wine benefited most from green harvesting (equivalent to 67.8% of the total subsidies) followed by table wine (28.0%) and PDO wine (4.0%) (Figure 3).

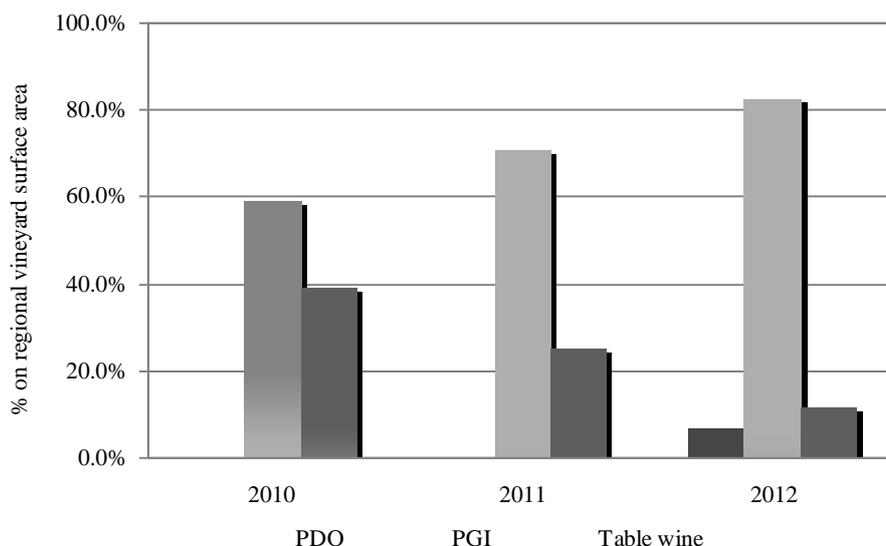


Figure. 3: Benefiting area under vine divided per types in the 2010-2012 period (% on regional area under vine).

Source: Our elaboration on RDAFR data.

As regards the impact on wine cooperatives, the smaller quantity of grapes produced by the vine growers and delivered to the cooperatives, caused an increase in operating costs, urging the RDAFR in Sicily, in association with the professional Organisations and categories, to undertake a supporting measure in 2010 restricted to the wine cooperatives whose members adhered to the first green harvesting tender. In particular, the funding was differentiated according to the surface areas resulting from the cadastral plan relating to the partners in the same year, amounting to €250/ha, €220/ha and €200/ha for the wine cooperatives with surface areas respectively between 200 and 1000 ha, between 1000 and 2000 ha and greater than 2000 ha. According to the figures provided by RDAFR, 30 wine cooperatives benefited from a total funding of approximately 1.5 million Euros.

## RESULTS

The 30 wine cooperatives in this study are mainly located in the province of Trapani (17) with the others located in the provinces of Palermo (7) and Agrigento (6).

With reference to the quantity of grapes delivered to these cooperatives, the figures registered during the last 6 harvests, apart from the production which was lower in 2007 due to a bad attack of downy mildew, show a significant decrease in volume compared to 2010 (-27.7% compared to 2009) coinciding with the first year of green harvesting implementation,

followed by an almost identical result the following year (-26.0% compared to 2010). In 2012, and in accordance with the figures supplied by RVOI, there was an increase in production delivered to the wine cooperatives which reached 287,257 tonnes of wine grapes (+47,3% compared to 2011) (Figure 4).

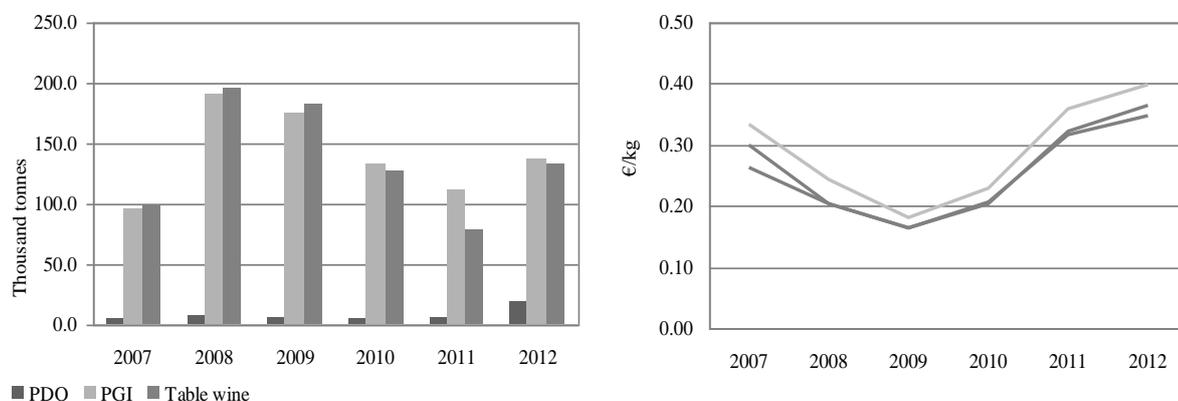


Figure 4: Evolution of the wine grape production delivered to wine cooperatives and the price paid during the 2007-2012 period.

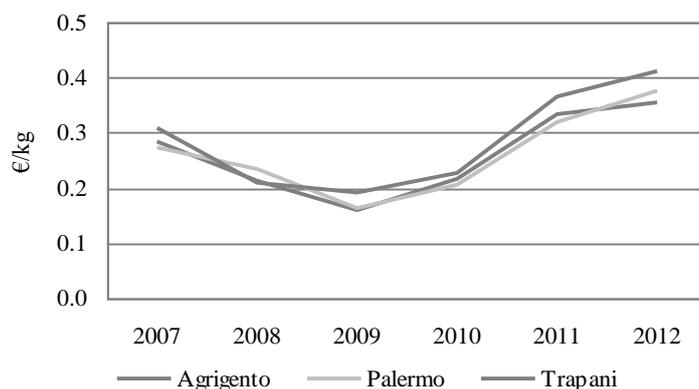
\* Data relating to 2012 price is an estimated projection..

Source: Own calculation based on survey data.

In particular, with regard to the types of grapes (PDO, PGI and table wine), the drop in volume was mainly in the grapes destined for production of table wine and PGI, as opposed to those destined for PDO which were hardly affected by the implementation of green harvesting, after a decrease in 2010 showed a rapid increase stemming from the adhesion of several enterprises to the investment measure by the NSP.

An analysis conducted on the prices granted to members, which decreased until 2009, shows an increase to which green harvesting also contributed. In particular, the grapes with the best performance are those used in the production of table wine and PGI as opposed to the PDO grapes. Furthermore, these PDO grapes strangely appear to be endowed with a lower commercial value that is due, according to several growers interviewed by us, to the low quality value of the cultivar with this designation delivered by the members to the cooperatives.

An analysis by province shows that the grapes delivered to the Trapanese cooperatives are better paid (Figure 5). This could be due, on the one hand to the ability of the enterprise to make financial savings thanks to the high volumes produced, and on the other hand to the competition between the many wine cooperatives operating in one of the most substantial areas of vitivinicultural industry in the EU.



Graph 5: Evolution of the price of wine grapes by province (€/Kg).

Source: Own calculation based on survey data.

Moreover, the survey shows an increase in average fixed operating costs, due to the smaller volumes delivered, which went from €70-80/tonne to €140-160/tonne of grapes, and was only partly compensated for by financial support granted on a regional level equivalent to €20/tonne for the 2010 grape harvest. According to the people interviewed in the survey, it is felt that there is a loss on not only in economic and social terms connected to the entire vitivinicultural industry which employs thousands of people, as well as a loss relating to the value of the farms and the exclusion from some markets due to product shortage, but also on an ethical level related to production destruction.

## CONCLUSION

This study has striven to appraise the salient aspects regarding the implementation of green harvesting in Sicily, with particular reference to the western area of the island which, during the 3 years of implementation (2010-2012) obtained, on a national level, almost all subsidies and relative surfaces as well as the EU expenditure for this measure.

Within the three-year period, these indicators (applications, surfaces and expenditures) recorded a growing trend between the first and second year of implementation, whereas a significant decrease during the last year. In this regard, it is to note that even though in the 2013 financial year 30 million Euros were made available on a national level (with Ministerial Decree No. 3525 of 21/05/2013, other 10 million Euros were earmarked for the measure for 2014) the measure was not activated in Sicily (on the contrary, it was activated in Lombardy, Sardinia, Campania, Calabria and Apulia).

By aiming to reduce vitivinicultural production charges, an analysis of the regional scenario shows a reduction in wine grape production during the first biennium, due in part to

green harvesting, in conjunction with an increase in the production of wines with a designation of origin and to favourable market trends, and to a small increase in the prices of grapes after the 2010 harvest.

If on the one hand the measure has proven extremely successful among vintners, albeit in some cases with amply justified reservations of an ethical nature, on the other hand it has damaged the island's wine cooperative system which, in addition to involve almost all of the regional vintners, is responsible for a large portion of the vitivincultural production. The smaller volume of grapes delivered to the cooperatives, according to the people interviewed in the survey, brought about an increase in operating costs as well as difficulties in the programming of the cooperatives activities, affecting all members across wine cooperatives (regardless of whether they participated in green harvesting); the whole, however, was partly offset by the rising of the sales price of the wine and consequently the liquidation paid to members. At the same time the green harvesting measure definitely entailed strong repercussions on all satellite activities of wine industry, particularly in the territories concerned.

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## THE CONTRIBUTION OF WEB COMMUNICATION TO AGRI-FOOD SMES' COMPETITIVENESS. A COMPARISON BETWEEN ITALIAN- AND ENGLISH-LANGUAGE WEBSITES.

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### ABSTRACT

The development of Web 2.0 lead to an evolution in the Enterprise – Customer relationship, allowing the latter to access a wide range of information with a growing importance in the purchase process. Enterprises – particularly the small ones – have been required to use the web with greater awareness and a sense of observation to deal with consumers' empowerment and to generate sustainable benefits to both the territorial and business systems.

In the light of these considerations, this study aims at highlighting the contribution of web communication to agri-food Small and Medium Enterprises' (SMEs') competitiveness and at analysing agri-food SMEs' web communication patterns.

In line with these goals, a field research on Italian- and English-language websites has been conducted to identify the essential determinants in the "brand-land-product" web communication as well as the most common verbal contents adopted by agri-food SMEs and their transmission through the Internet.

Managerial implications are indicated in the possibility for Mediterranean agri-food business SMEs to acquire deeper semantic and lexical expertises in communicating their products on the web, in support of their competitiveness, by filling the gap between their opportunities and capabilities to compete on the global scene.

This study is part of a project named *ISCI – Innovative Services to Strengthen Cooperation and Internationalization between SMEs in the field of Agri-food Industry*, financed by the European Territorial Cooperation Programme (Interreg) Greece - Italy 2007-2013.

**Keywords:** agri-food, SME, consumer empowerment, competitiveness, web communication, Internet, local development, territory, brand, place of origin.

## 1. INTRODUCTION

In defining the concept of a “typical product”, its origin from a specific geographical area is highlighted because it conveys a high degree of differentiation (in terms of organoleptic characteristics as well as of production techniques, which guarantee specific qualitative standards) thanks to the strong relationship developed with the territory where the product comes from (Maizza, 2010).

However, such uniqueness features are not perceptible exclusively in reference to the *geographic component* (intended as a localisation of the production area) but also in its coexistence with a specific *cultural* (converted in values, beliefs, knowledge, and traditions), *social* (rules of behaviour, relationships, sense of community), *landscape*, *climatic* and *historical* heritage that, permeating the entire chain, conveys a unique value to the product.

For such a heritage to be transformed into an economic value, *brand name capital* is necessary (Williamson, 1985), which, acting through *image* and *reputation*, confers typical product *awareness* (as a result from the collective action of tangible and intangible resources of a specific territory), *appeal* and *fame* (Keller, 1993; Aaker, 1997).

For this purpose, communication has a fundamental importance (Sriramesh and Verchic, 2009) in, on the one hand, making people aware of those territorial features that have a decisive impact on the agricultural production and, on the other hand, conveying a series of symbolic and experiential elements, geared at creating positive perceptions and unique associations in the consumer’s mind. In fact, beyond the cognitive or tecno-functional content of the message transmitted, the “story” of the relationship between a product and its territory (which cannot exclude, for example, the eno-gastronomic culture or the connection among raw materials, cultivation techniques and organoleptic features of the product) causes local Enterprises to join their forces and to be constantly, enduringly and coherently committed to the protection and conservation of territorial resources by applying a model of sustainable development based on the Triple Bottom Line (Elkington, 1997).

The growth of such a complementary relationship between the territory and the product boosts, in the perspective of systemic consonance (Golinelli, 2000), the competitive potential

of both. In fact, by giving value to the territorial vocation and by promoting the identity of the product, *reputational capital* is developed (Dowling, 2001), which is not reproducible by competitors and which represents a great source of differentiation able to do the following:

- Increase a product's awareness and a producer's reliability;
- Involve a consumer into highly committed experiences that strengthen his/her *brand loyalty* by allowing him/her, on the one hand, to taste a product's authenticity and, on the other hand, to dive into the atmosphere and mood of its territory;
- Reduce perceived risks and transactional costs connected to the purchase because the territory guarantees certain qualitative attributes incorporated by the product;
- Reinforce local *attractiveness*, allowing those benefits deriving from marketing efforts to be spread from the product itself to the whole farming area;
- Strengthen both the product's and the territory's *brand images*, demonstrating that they are not the results of a fictitious or short-term process but the proper realisation, in a long-term perspective, of the promises conveyed through communication.

As such, the typical product becomes the facilitator of attention for the territory, and the territory becomes the facilitator of attention for the typical product. Therefore, when this synergic and mutual relationship is established, an even more complete strategy of Customer involvement could take place by promoting engaging experiences, encouraging word of mouth to positively affect the branding processes, and exploiting all possibilities included within the Web 2.0 instruments.

Thus, the aim of this current research is twofold. The first aim is to highlight the contribution of web communication to agri-food Small and Medium Enterprises' (SMEs) competitiveness, particularly in terms of shifting away from traditional marketing techniques to consumer empowerment. The second aim is to analyse agri-food SMEs' web communication patterns, by identifying the essential determinants in the "brand-land-product" communication.

The paper is structured as follows: after a literature review on the role of the Internet in defining new patterns in the Enterprise-Customer relationship, how marketing has boosted consumer empowerment is discussed. Then, the main results of the field research are analysed, also to support agri-food SMEs in developing their semantic and lexical skills and communicating more efficiently on the web.

## 2. HOW THE WEB HAS DEFINED NEW PATTERNS IN THE ENTERPRISE – CUSTOMER RELATIONSHIP

According to the definition by Tim O'Reilly (2007), Web 2.0 is not a technology in itself but rather a social attitude, centred on the rediscovery of the value of relationships.

The opportunity of sharing experiences and exchanging opinions has, actually, imposed a meaningful overturn in both traditional marketing approaches and business communication paradigms (Hennig-Thurau *et al.*, 2004) by stimulating horizontal cooperative processes and thus transforming consumers from “targets” to “sources” and “channels” of the communication stream.

Thanks to the development of the web, the hierarchal and mono-directional (from the Enterprise to the Consumer) communication between two subjects has been replaced by a network model, where the Enterprise, through its very own brand, is just one of the different subjects involved in an equal relationship: the Enterprise communicates in real time with other figures of the web (the Consumers) in the same way in which Consumers entertain relationships with other users (Esch *et al.*, 2006).

This development has triggered off innumerable processes of co-created content (Vargo and Lush, 2008), meanings (Galimberti, 2011) and values (Godes and Mayzlin, 2004), thus maximising the collective intelligence of the individuals participating in these relationships. The Enterprise, therefore, delves into such a stream of intersubjective and multidirectional conversations, not so much as to define Customer needs but rather to build and nourish in the course of time a set of connections allowing to a) acquire more *knowledge* by gathering feedback and functional suggestions for a complete improvement of the product/service and towards the development of innovative processes (Cova and Dall'Aglio, 2009); b) generate *trust* by raising Consumers' choice options and product loyalty (Riegner, 2007); c) create *brand awareness* and increase corporate reputation by developing different forms of *brand interaction* (Kaplan and Haenlein, 2010) and *brand engagement* (Wenyu and Krishnamurthy, 2007); d) fasten cognitive and affective *ties* by offering consumers the possibility to enhance their own identity and express their creativity through storytelling and socialisation (Brown *et al.* 2005) and to live unique, deeply engaging and memorable experiences (Csikszentmihalyi, 1997).

The main potential that, in return, Consumers recognise when these different forms of Web 2.0 sociality take place can be summed up into three main levels (Graffigna *et al.*, 2012): a) the *brand relationship* level, linked to the possibility of feeling as an “expert interlocutor”, able to

contribute, thanks to one's own feedback, to an Enterprise's marketing strategies; b) the *relationship-with-equals* level, through the possibility of coming into contact with other consumers recognised as akin and giving life to an "elective community"; and c) the *inspirational-project-for-oneself* level, guaranteed by the access to branded "possible worlds" (Semprini, 2006).

The new forms of interaction allowed by the development of Web 2.0 have, in general, made the consumer more informed, networked, empowered, and active. That is, Web 2.0 has given him/her a more active role within the complex value chain, making the market a forum of conversations and interactions among Consumers, Consumer communities, and Firms (Prahalad and Ramaswamy, 2004). In particular, *consumer empowerment* is recognisable in a) the reduction of the Enterprise's control of communicational content and fluxes (Gorry and Westbrook, 2009) through the development of a never-ending dialogue where access and transparency are the pivot for value co-creation; b) the generation of more informed and aware paths of consumption, thanks to the possibility to easily monitor and promptly report inconsistencies or non-fulfilment in companies' behaviour, thus triggering word of mouth on a global scale (Fombrun *et al.* 2000); c) the resulting increase of the User's power of weighing on *brand reputation*, influencing the success or failure of a brand, product or service (Brown and Reingen, 1987).

### **3. IMPACTS OF CONSUMER EMPOWERMENT ON SMES' MARKETING STRATEGIES**

The possibility of sharing information, experiences and meanings in *flow* situations (Csikszentmihalyi, 1997), which are much more emotionally involving and intensely experiential than when they occur in traditional contexts as, for example, in retail stores or through mass media advertising, has given Web 2.0 users the power of orientating other users' attitudes and purchasing behaviours, as well as the possibility to reduce costs, in terms of both money and time, in all phases of the purchase process (Berthon *et al.*, 2007).

In particular, the spread of Web 2.0 has provided a large number of information sources and virtual spaces, as well as growing sophistication in terms of efficiency and effectiveness of the virtual communities and software instruments, for the simplification and the automation of the assessment of alternatives, thus reducing the cognitive costs of elaborating the large quantity of information potentially available online (Simon, 1955). In this way, informative

asymmetries between the Enterprise and the Consumer have been weakened, while individuals' learning circuits have been widened, thus enabling the production of new knowledge through interactions and shared experiences and simultaneously leading to the reinforcement of the consumer empowerment process (Pires *et al.*, 2006).

Cost reductions and effectiveness increases are also definable in terms of major conveniences due to the almost unlimited availability of (virtual) sites where purchases can take place at any time of day, in a simple and highly personalised way, without having to physically reach a retail store, as well as in terms of an easier *use of voice*, related to the possibility to share personal consumption experiences (whether negative or positive) in the virtual communities associated with the specific product or category of products, thus triggering word of mouth on a global scale.

Therefore, the Enterprise needs to seriously evaluate its Customer orientation that, far from the mere adoption of a specific technology, is connected to its culture and reputation. Customer orientation takes shape in the growing capacity of listening and quickly answering to Consumer requests and analysing an even more pronounced multi-channel purchase process; otherwise, the risk is the breaking down of *trust* relationships and *loyal* behaviours (the latter made even more ephemeral by the reduction of the *lock-in* effect, which, on the contrary, grows in presence of informative asymmetries).

To stabilise the relational and trust aspects in transactions connected to the development of Web 2.0, increase the amount of clear information conveyed to the market and strengthen their own competitive advantage, Enterprises are also called to share objectives and values on the basis of collaboration by restructuring B2B relationships in terms of greater interaction and cooperative value-creation (Grieger, 2003). Initiating cooperation with other players along the entire production chain is effective in allowing the development of creative learning processes, while the improvement of trading functionalities and the expansion of value-added services are the primary lines for the development of platforms projecting the emergence of a more networked agri-food industry with an embedded Web 2.0 infrastructure.

#### **4. GOALS AND RESEARCH METHODOLOGY**

The current research aims at highlighting the contribution of web communication to SMEs' competitiveness and analysing SMEs' web communication patterns, particularly in terms of

verbal content conveyed and with regard to how communication is transmitted through the Internet. Due to the specific characteristics of the sector and its role in the development of the whole Mediterranean area, as well as for its capability to put into practice the EU Horizon 2020 perspective, in terms of local preservation, sustainable development and Consumer empowerment, the analysis has been focused on the agri-food sector.

Previous studies (Fritz e Schiefer, 2008; Duffy *et al.*, 2005; Sparkes and Thomas, 2001) have suggested that effective communication is one of the most important determinants for sustainable competitive advantage in this sector, both in terms of adequate frequency and information quality. Important research has been conducted on Greek (Manthou *et al.*, 2005; Matopoulos *et al.*, 2007; Baourakis *et al.*, 2002) and UK (Leat and Revoredo-Giha, 2008; Sparkes and Thomas, 2001) SMEs; thus, there is high demand for research on how the Internet's potential as a new communication tool is exploited in other countries to observe potential differences in how the Internet allows the engagement of all participants in the production and distribution of agri-food products.

With the aim to contribute to filling these gaps, field research on Italian- and English-language websites has been conducted to identify the local determinants in the "brand-land-product" communication as well as the most common verbal content adopted by agri-food SMEs and their transmission through the Internet.

A content analysis of the first 30 Italian-language and the first 30 English-language web channels on typical agri-food products was done. For each language analysed, both basic and in-depth research has been conducted. The first step consisted in the selection of web sources dedicated to typical agri-food products through the identification of keywords to be inserted in the most common search engines (Google and Yahoo). For this purpose, the annual report *Zeitgeist* and Google Trends have been used. Then, a comparison of the data obtained was conducted through the analysis of their visibility on the result page.

The second step consisted in the identification of top search tools in Google and Yahoo, validated through Alexa's service rank analysis.

Third, the keywords identified in the first step of the analysis were inserted into each of the top search tools selected in the second phase, leading to the identification of 1200 websites. To reduce this number to 30 for each language analysed, a further validation was conducted by eliminating websites (such as e-commerce websites) that were not relevant to the purpose of the survey. Finally, through Alexa, each of the identified links has been evaluated in terms of

its a) *traffic rank*, as an indicator of the global popularity of the site; b) *rank in*, as an indicator of the national popularity of the site; and c) *sites linking in*, as an indicator of the reputation of the site among web users.

In reference to the texts (23,466 Italian words, 67,405 English words) of the identified websites, an exclude list and an algorithm for the normalisation of words with the same semantic root have been enforced. Then, a quali-quantitative content analysis took place through Catpac. The use of this software is justified by the possibility of identifying not only the most-used words but also connections activated by specific words, with the help of neural network models (Woefel, 1993).

The elements on which the research mostly concentrated on were the analysis of frequencies, to set the *porosity* of the words, and the identification of specific topics, by grouping words in semantic clusters. For the creation of the latter, among the different hierarchical methods used in the literature, the Ward method was adopted (Johnson, 1967; Everitt, 1979) to create groups of words that, at every phase of the process, have a minor increase in the inter-group deviation ( $DEV_{IN}$ ) and a major increase in the intra-group deviation ( $DEV_{OUT}$ ). The analysis of non-hierarchical clusterisation started from the identification of the most-frequently used words (that were found to be “product” in Italian and “food” in English) and the measurement (within a 0, +1 range) of the intensity of co-relationships between these words and all the others within each text. The analysis took place in mobile windows of 7 terms each. Words included in clusters reveal an important co-relationship (persistently superior to 0,41) with the word that brings to life the same cluster.

## 5. RESULTS

From the analysis of the first 160 (maximum number Catpac is able to elaborate) unique and most-frequently used words on the analysed websites, it is possible to identify differences connected to the lexical choices of web users that communicate in Italian with respect to the English-speaking ones (see Tab. 1).

Websites in Italian			Websites in English		
<i>Word</i>	<i>Frequency</i>	<i>Percentage</i>	<i>Word</i>	<i>Frequency</i>	<i>Percentage</i>

Product	1.037	4.4	Food	2.744	4.1
Italy	876	3.7	Agriculture	2.070	3.1
Agri-food	754	3.2	EU	1.669	2.5
Agriculture	738	3.1	Market	1.298	1.9
Production	699	3.0	Research	1.115	1.7
Time	595	2.5	Development	1.097	1.6
Cooperation	483	2	Information	1.021	1.5
New	463	1.9	Production	998	1.5
Region	455	1.9	Project	957	1.4
Firm	418	1.8	Price	925	1.4

Note: due to display requirements, only the first 10 words in terms of frequency are reported. However, it is interesting to observe that 53,4% of the whole textual content of Italian-language websites, as well as 56,6% of the English-language websites, is concentrated within the first 50 words in each group. Differences in percentages between Italian- and English-language websites may be explained in light of the fact that English websites are more complex, both in terms of number and length of contents, than the Italian ones.

*Tab. 1: The 10 unique words used more frequently by Italian and English spoken web-user referring to agri-food products*

The basic informational requirements of Italian-speaking web users are concentrated on specific product types such as “wine” (482 times), “milk” (252), “meat” (131) and “oil” (154), on the individuals involved in realising them (“enterprises”, “farmer”, “consortium”, “operator”, “agriculturur”, “producer” and “production line”, with 837 occurrences in total, are the most-frequently used words), and on the territory of production. With regard to the latter the use of the words “Italy” (876), “region” (467), “territory” (199), “town” (226), and specific geographical areas such as “Calabria” (314) and “Tuscany” (115) are considered, all of

which are evidence of the value, in terms of competitiveness, of the *uniqueness* originating from the relationship between a typical product and its territory of origin.

Differently, web conversations of native English-speaking users are influenced by the political and economic environments, considered as supra-systems that are external to the Enterprise, and capable of influencing the competitive scenario by exerting pressures and expectations. With this regard, the occurrences of words such as “policies” (770 times), “projects” (957), “EU” (1.669), “opportunity” (238) “development” (1.097), “growth” (825), for the “local” (530) “community” (652), thanks to “research” (1.115), “organic” (889) “production” (998), “traceability” (233), and the dissemination of “information” (1.021) through “reports” (673) could be considered.

It is worth noticing that Italian-speaking users pay greater attention to the “quality” of agri-food products (330 times) with respect to “price” (273), in contrast to the English-speaking users (398 and 925 times, respectively). Quality is considered, particularly by Italian speakers, as one of the essential conditions for “development” (140), together with the relationship of the product with the “territory” (199) and the capacity of the local operators to co-operate as a proper “system” (132).

Regarding marketing mix tools, essential elements are “product” (quoted 922 times on English-language websites and 1,037 times on the Italian-language ones) and “price” (quoted 925 times on English-language websites and 273 times on Italian-language websites); however, there are also clear references to “communication” (mentioned 586 times by English-speaking users) or “marketing” (mentioned 122 times by Italian-speaking users) and “distribution”, the latter referred to, on English-language sites, by words such as “sales” (203 occurrences) , “commerce” (171 occurrences), “supply” (350 occurrences), and “trade” (825 occurrences).

If clusters activated by the most-used word on Italian- and English-language websites are compared, it appears that Italian consumers have a more *production-orientated* approach, as shown by the higher co-relationship of the word “product” with words such as “production” and “wine” and the lower co-relationship with aspects connected to “sales”, “time” and “results”. On the contrary, English speakers are more *communication orientated*, as demonstrated by the fact that the first two words correlated to “food” are “information” and “social media”, followed by “production”, “system”, “crop”, and “people”.



- c) *Experimental and emotional elements*: words that link the product within a perceptive system (Tregear and Ness, 2005), which is able to bring to life intense experiences and unique emotions. Within this area of meanings, there is also the interaction with “consumers” and the respect for their needs as well as the needs of the Enterprises of production and the environment, showing how the requests of the Triple Bottom Line increasingly enter web users’ conversations.

Finally, the presence of a high number of terms with low frequency but an elevated co-relationship with the words “territory”, “typical”, “quality”, “price”, “wine” and “oil” has been considered. Particular reference has been made to “service”, “information”, “business” and “results”. This fact shows the need, particularly for Italian agri-food SMEs, to establish a more effective communication relationship with their consumers and to build services based on a constant exchange of information.

## 6. MANAGERIAL IMPLICATIONS

This paper has tried to demonstrate that the use of Web 2.0 as a communication and marketing platform provides agri-food SMEs with considerable competitive advantages, particularly in terms of information quality, efficiency and economic feasibility. This paper a) supports the development of integrated digital environments that could provide platforms for the reorganisation of sector activities, by giving birth to virtual networks; b) fills the gap between the agri-food industry and consumers, by easing the problem of limited communication budgets of individual organisations and, above all, by engaging all participants in the production and distribution of products with respect to the wider establishment of collaborative supply chains.

A dynamic strategic approach in the adoption and utilisation of Web 2.0 communication is needed. In particular, the words connected to the above-mentioned areas of meanings can be considered as a dataset of keywords around which a more efficient online communication of agri-food products can be arranged.

Particularly, this dataset provides support for web marketing activities, both in terms of visibility and product commercialisation. For Enterprises that have already adopted a web communication strategy, the dataset contributes to satisfying the need to control and manage these processes. For Enterprises that have not yet adopted these processes, the current

analysis appears useful because it stimulates interest in and consideration of web marketing themes and the need to be adequately aware of them.

This study has also tried to understand whether web communication may be based on single words or if there are groups of words able to communicate more persuasively the typicality of the agri-food product. The study of co-relationships among words, in particular, intends to move from a purely *lexical* program to a *semantic* one, so as to have a more realistic picture of the neural itinerary users follow when they communicate on the web.

Moreover, the research has demonstrated how the characters of *web communication* (absence of space-temporal restrictions and full involvement of web users) ease the perception of the complex “brand-land-product” relation. In particular, this study offers a considerable contribution to the appreciation of local production, favouring the protection of specific rural geographic areas; as such, in line with the European program Horizon 2020, the “local” product can be preserved, intended as the harmonious combination of a territory’s tangible and intangible assets. Enterprises are called to plan a strategy and a device of contact that appear to be important in the temporal-space combinations in which the User is found, with the aim of satisfying at best his/her informative needs and establishing long-term relationships. Should such an action be successful, Enterprises will consolidate their competitive advantage and simultaneously contribute to the sustainable development of the territory in which they operate. In fact, when efficient typical production communication strategies are developed on the web, the benefits are reaped not only by the individual Enterprise but also by the entire geographic area referred to, allowing the pursuit of forms of socio-economic developments compatible with the tradition and culture of places.

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## THE IMPACT OF CONSUMER LOYALTY ON THE COMPETITIVENESS AND SUSTAINABILITY OF PRIVATE LABELS.

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### ABSTRACT

According to Ailawadi and Keller (2004), those who manage private labels currently make use of the principles of Brand Management in order to define their strategies vis à vis the expectations of their consumers. Nevertheless, retailer brand management effectively differs from national brand management inasmuch as the private label will take into account the diversity of their supply and consider how it embodies their corporate policy.

After reviewing the existing literature about private label, this research tries to estimate the impact of customer orientation, brand affect and brand choice (as antecedent variables) on brand trust and brand commitment (as mediating variables). The interaction results must show us the conditions for getting loyalty behaviours. The future intention of this project is generate an on-line survey by using a convenience sample for applying a structural equation modeling in order to test hypotheses about the model's variables.

**Keywords:** Private label; brand retailer; customer value; customer orientation; brand trust; brand loyalty.

### INTRODUCTION

This working paper is part of a larger study that will – upon completion of a review of the literature – enable an empirical study to be undertaken in northern Portugal and Galicia. In this research we'll use private labels from both regions to analyze different consumer's behavior.

In accordance with the above, our model is most strongly justified when its framework is based on interpreting the constructs that can explain the generation of loyalty to a retailer brand; in this sense, trust, affect and risk perception are critical information units with regard to the degree of acceptance of private label supply.

Consequently, users' degree of commitment to a private label will increase according to the value that the brand offers them. A private label's customer orientation may therefore play a fundamental role.

This research tries to estimate the impact of customer orientation, brand affect and brand choice (as antecedent variables) on brand trust and brand commitment (as mediating variables). The interaction results must show us the conditions for getting loyalty behaviours. According to Ailawadi and Keller (2004), those who manage private labels currently make use of the principles of Brand Management in order to define their strategies vis à vis the expectations of their consumers. Nevertheless, retailer brand management effectively differs from national brand management inasmuch as the private label will take into account the diversity of their supply and consider how it embodies their corporate policy. There are also other variables, such as the perception of the point of sale, which are equally relevant to the choice of retailer.

Private labels account for a major market share in retail sales both in Europa and in the USA, according to Ailawadi et al. (2008) and Kumar and Steenkamp, (2007), and their study is therefore of considerable importance.

This work intends to be a contribution to private label's knowledge and also understand the different strategies they could adopt to generate loyalty behaviours in their customers, increasing its market share and creating more attractive offers.

Portugal and Spain offer a clear example of this inasmuch as they exhibit a high growth rate, while private labels in both countries have committed themselves strongly to the whole supply range available to the consumer. In particular will also examine whether the cultural differences between the two regions (Northern Portugal and Galicia) are reflected in purchasing behaviour. Hofstede (2001) proposes five cultural parameters – individualism, the ability to distance oneself, aversion to uncertainty, masculinity and a desire for long-term relationships; it is indeed the case that there are cultures in which consumers privilege these relationships, resulting in the existence of bonds of loyalty together with a low level of openness to risk and new suggestions. This fact is not advantageous to private labels, however, insofar as purchasing risk may be interpreted as higher – since if the customer is

happy with the product they have purchased, their expectations will readily create a relationship with the brand in question.

Portugal and Spain are countries in whose cultures perception tends to be extremely feminine and collectivist, fostering and developing long-lasting relationships with brands – which means that maintaining these relationships is of the highest importance. On the basis of this cultural element, hinging on long-term relationships, we therefore propose to examine whether there is any difference between the two countries in terms of brand loyalty relationships (repeat purchasing).

## **THEORETICAL BACKGROUND**

### *Customer orientation*

Since Narver and Slater (1990) conceptualised the construct of market orientation, various authors have shown a particular interest in their study. Our focus in the present paper is on the customer orientation construct, whose role in the proposed Model is as an antecedent variable of brand loyalty; we will seek to estimate to what extent customer orientation is a determining factor in customers' choice of a private label.

This fact justifies the inclusion of this variable in the model inasmuch as it encourages repeat purchasing of the product; the customer will perceive that the main purpose of this technical investment and the added value created by the brand is to satisfy their expectations.

Customer orientation is based principally on the brand's concern for the customer's well-being; that is to say, the retailer's goal as an organisation is to deliver solutions based on satisfying their best interests (Deshpande and Webster, 1989 and Slater and Narver, 1994).

In this context, Brand Management policies will only be effective when they target the interests and benefits perceived by customers as added value in a policy of innovation, production and the level of performance delivered.

According to Martin and Bush (2006), the performance of staff at the point of sale can increase customer satisfaction depending on the quality of service provision.

The retailer's concern with customer orientation goes beyond delivering service; it requires them to adopt a more comprehensive policy – that of CRM (customer relationship management), Payne and Frow (2005).

According to this point of view, value to the customer is an outcome of their co-production of the private label's value.

For most authors, however, as for Nasution and Mavondo (2008), value to the consumer is a trade-off between the cost and the recognised benefit. These are the main points that have to be present in a private label, to the extent that having a lower price than that of the national brand is one of the principal features of these brands; nevertheless, the customer has to perceive a positive trade-off and if they do not perceive this they do not recognise the brand as having value, and their relationship with the brand ceases.

#### *Brand trust*

Trust is perceived as an influential variable in the purchasing decision process.

According to Morgan and Hunt (1994), brand trust only exists if the consumer believes in its good intentions as well as in all the characteristics that describe the nature of the brand and the supply.

It should also be emphasized that for Moorman et al. (1992) trust is defined as the intention to establish an exchange relationship based on confidence. There are two distinct principles here:

1. Trust in a brand is perceived as a belief, a feeling, an expectation with regard to this exchange – reliability (Pruitt 1981).
2. Brand trust is understood as a behavior of intention, or a behavior that reflects how much the consumer is able to expect that those promises will be kept, resulting in their reliance on a brand/consumer partnership. Nevertheless, trust arises out of the uncertainty and vulnerability of the truster. That is to say, trust arises as the result of an evaluation of the brand (Moorman et al. 1992). These are the principles and definitions used as the basis for the present text.

Hence brand trust has the function of reducing uncertainty in a consumption situation where the consumer feels particularly vulnerable, inasmuch as they may perceive that the quality of [their] purchasing decision can depend on their trust in and knowledge of the brand. Accordingly, they do not consider other purchasing options. In the case of the private label, this trust is associated not only with retailer brand products but also with the services provided by the point of sale (store).

It is noteworthy that in the case of the private label, trust includes the consumer's perception of the product and of the service provided. The private label employee recognizes and identifies the consumer's need or desire and advises them appropriately. As the retail sector is positioned extremely close to the consumer, this facilitates their ability to be customer-oriented.

According to Hong-Youl Há (2004), however, building trust involves [no fewer than] 6 elements: security, privacy, brand name, word-of-mouth, experience and information. All these variables define private label policies and its strategic orientation.

### *Brand loyalty*

The present text focuses on identifying to what extent the private label generates loyalty to the point of sale.

According to Agustin and Singh (2005), the customer's intentions of loyalty are associated with a tendency towards a [particular] set of behaviours as a sign of motivation with the aim of encouraging long-term relationships with the person in charge of service, including repeat purchasing. Satisfaction with the service or product may mediate the relationship between trust and the intention to be loyal, as a relational mechanism that can encourage exchanges between customer and brand.

Trust in the service provider is thus essential as a way of increasing loyalty when it comes to relationships that fulfil their promises.

According to Brexendorf et al. (2010), the level of customer satisfaction [observed] through brand loyalty is important in relationships inasmuch as when [one takes on] loyalty to a point of sale that makes it easier to consider loyalty to the private label.

Ailawadi et al. (2008) point out that, as is generally known, the use of private labels is associated with high [levels of] loyalty to the point of sale. Moreover, Richardson et al. (1996) argue that private labels help retail companies increase the frequency of customer visits to the point of sale by increasing their loyalty to it as long as they offer own-label products that cannot be found in other competing outlets. Furthermore, according to the *Private Label Manufacturers Association* (2007), retailers use their brands to increase business as well as to gain customer loyalty. According to our review of the literature, however, this topic can be controversial. Firstly, a positive relationship has been observed between the use of the own-brand and loyalty to the point of sale (Kumar and Steenkamp, 2007). On the other hand, it can also be observed that customers may not perceive any difference between different private labels; in other words, as Richardson (1997) points out, private label customers may be loyal to private label products without being loyal to a point of sale. If this proves correct, it could be a knotty issue to see how a private label could increase loyalty to its point of sale. Singh et al. (2006) show how private label customers are more likely to change after entering the point of sale, and it thus remains pertinent to check what link there is between private label customer and loyalty to the point of sale.

Ailawadi et al. (2008) also identify two important issues:

1. If there is a positive relationship between private label users and loyalty to the point of sale, could the causality of this relationship be reversed? Customers who are loyal to a point of sale are more likely to buy products of this private label brand and not another. The fact that the customer makes a great deal of their time and money available at a given point of sale increases the customer's familiarity with the retailer, and this familiarity is fundamental to their perception of the promises that the brand impresses upon them. Moreover, the behaviour of customers who constantly shop at a particular point of sale, to the detriment of others, may be explained in terms of the quality of the retailer, whether with regard to their brand or with regard to the surroundings at the point of sale. Such customers are more likely to purchase private label products from that point of sale.

2. Relationships need not be linear. Ailawadi and Harlam (2004) find that an average own-brand user contributes more to the brand than a "weak" or non-user and accordingly less than a high user. The ability of private labels to increase loyalty to the point of sale, according to a study by Corstjens and Lal (2000), is a quality that "tips the scale" between customers who prefer private label brands and those who prefer manufacturers' brands. This issue is critical to understanding the non-linear relationship between the effect of using private labels at the point of sale and loyalty to that same point of sale, and vice versa, [and to understanding the effect] if retailers were to increase their strategic decisions about the form and duration of strategies adopted to push their brand. Nevertheless, according to the authors Ailawadi et al. (2008), empirical evidence is still scarce.

This authors constructed a model for the relationship between household "expenditure" (the household share) on private label [products] at a given point of sale and loyalty to this retailer.

The model allows the causality of nonlinear relationships between own-brand share and SWO (shared-of-wallet) to be reversed, including determining factors for both constructs, as there are econometrically identifiable determining factors that can influence either one construct or the other.

The primary concern of Ailawadi et al. (2008) is to evaluate whether this relationship takes a specific and potentially non-linear form between the customer *share* in the private label and the SWO given to a particular retail chain.

It can be accepted that consumer behaviour is a function whose characteristics are stimulated [both] by the point of sale and by the subject (the consumer) Assael (1998). Previous research

has identified four important roles in customer purchasing behaviour at retail outlets (Ailawadi and Keller, 2004; Steenkamp and Wedel, 1991):

1. quality and diversity of supply;
2. price;
3. service at the point of sale and the atmosphere of the surroundings;
4. location

Ailawadi et al. (2008) developed an econometric model to evaluate the relationship between the market share of household products and loyalty behaviours with regard to the point of sale.

The results obtained show that private labels have a significant impact on two measures of loyalty: the volume of items purchased and the number of times the customer visits the point of sale. Similarly, they suggest that loyalty has a significant effect on the market share of the private label.

The results of our model's structural equations could indicate that the private label's market share plotted against money spent gives an inverted-U graph. In other words, an increase in the private label's market share increases the money spent on this brand's private label products, but only up to a certain point; when the market share exceeds 40% the effect is inverted, i.e. the more the market share is increased the less investment there will be in private label products. The inverse effect is also strongly marked. Moreover, this inverted-U relationship is observed in all three behavioural clusters: low, medium and high levels of private brand purchasing.

According to Ngobo (2011), private labels have shown rapid market development and are particularly well-known for high annual growth. It transpires that almost all of a retailer's points of sale carry its own-brand products, and that the number of product categories in which these brands are present has grown.

The payback for the points of sale is high, though it should be noted that retailers have to ensure that they have a good mix of supply at their points of sale and that the manufacturers' brands they sell cover all product categories and meet [all] their customers' needs.

Although the low prices of private labels attract a considerable number of consumers, other consumers are more receptive to and inclined to trust the quality of manufacturers' brands and are sometimes a little reluctant with regard to the private label.

## **FINAL REMARKS**

Understanding Private Label Management is a [highly] topical issue, in that this [is what] enables the private label to closely match its supply to customer demand. The present paper examines customer orientation as a novel variable in the study of the private label, on the grounds that understanding what customers want in terms of features and benefits should increase levels of loyalty to the supply offered by the private label. In this paper, the loyalty is associated not with mere repeat purchasing but also trying to evaluate the impact of customer orientation and brand trust generating long-lasting relationships of loyalty which will be able to provide economic returns and strengthen the capital of the private label.



Figure 1: An integrative model of private label's loyalty

The future intention of this project is generate an on-line survey by using a convenience sample for applying a structural equation modeling in order to test hypotheses about the model's variables.

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## COMPETITIVE ENVIRONMENT AND THE ADOPTION OF CUSTOMER-ORIENTATION BEHAVIOUR: AN EMPIRICAL STUDY.

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### ABSTRACT

Fletcher & Nusbaum (2010) suggest that, in organisations, the existence of a competitive climate among peers can influence the adoption of customer- or sales-oriented behaviours depending on the perception of threats or challenges. In this way, an organisation's guidelines, through its organisational culture, are able to reduce salesperson "role ambiguity and role conflict" and therefore impact on their performance through the adoption of customer-oriented behaviours. The transmission of customer-focused values will lead the salesperson to adopt customer-oriented sales behaviours (Schwepker, 2003).

This research show the impact that the adoption of customer orientated or sales orientated behaviours might exert not only on performance in meeting fixed sales targets, but also on the performance achieved when the force of sales are perceived to have high average levels of competitive climate. The results show that a customer orientated sales force achieves increasingly better levels of performance when compared to the adoption of short term strategies geared towards applying sales pressure on potential clients.

**Keywords:** *Sales Management; Competitive Climate; Adaptative Selling; Customer Orientation; Sales Orientation; Hard-selling; SOCO Scale;*

### THEORETICAL DEVELOPMENT

Recent research (Zhan, 2010) points to how analysis of the competitive environment can be decisive in more efficiently managing the factors that can induce higher levels of sales team

motivation and performance. The working environment is not immune to fast-moving external changes. Because of this, an organisation's working environment must be able to sustain rapid changes and the implementation of changes in organisational dynamics will have to be carried out in a way that meets and fulfils employee needs while also maintaining the company's productivity.

Arnold et al. (2009) report that a competitive environment is present within an organisation in which employees perceive that their productivity rewards will always be dependent on the results of performance compared to their peers. There is no consensus in the literature (Brown, Cron and Slocum 1998) as to which motivational and performance benefits a competitive internal environment can generate (Reeve & Deci 1996; Stanne, Johnson, & Johnson, 1999).

A study, together with a survey of half a million salespeople, concluded that competitiveness is a personality trait of successful salespeople (Brewer, 1994; Schwepcker & Ingram, 1994). Moreover, organisational climate has been defined as the "perception" of what the organisation is like with regard to "practices, policies, procedures and routines" (Bowen & Ostroff, 2004). Rogg, Schmidt, Shull & Schmitt (2001) suggested that if organisational climate affects the attitudes and behaviour of employees, then consequently it impacts on performance.

Bigné, Boluda & Torres (2001) consider the sales force: (1) acts as the frontier between the company and the market; (2) constitutes a two-way platform for communication with unique potential between the company and the clients; (3) assumes control over the value of the offer with the customer; (4) acts as the function that contributes most to the overall success of the organization.

More particularly, the interpretation of the qualities associated with the sales force of the organization assumes a positive correlation between the degree of the company's market orientation, competitive climate and the sales team performance. It is, indeed, the responsibility of the organisation to instil and mould its members' behaviours in accordance with its guidelines and policies. In other words, an organisational culture that defends and takes on board customer interests, i.e. one which is customer oriented, will confirm the behaviour of its salespeople, focusing it on the customer. A customer oriented culture can be defined as "a set of beliefs that puts the customer's interests first, while not excluding those of other stakeholders, in order to develop a long-term profitable enterprise" (Deshpandé, Farley, and Webster 1993, p. 27). A customer-oriented organisational culture could be translated into

the development and dissemination of shared values and behavioural guidelines aimed at putting customer interests above all others. In this way, an organisation's guidelines, through its organisational culture, are able to reduce salesperson "role ambiguity and role conflict" and therefore impact on their performance through the adoption of customer-oriented behaviours (Flaherty, Dahlstrom and Skinner, 1999). The transmission of customer-focused values will lead the salesperson to adopt customer-oriented sales behaviours (Schwepker, 2003).

As a result of profound changes in the perception and role of marketing in organizations, the 1990s mark the emergence of the concept of marketing relationships. The impact of this on sales management extends the concept of sales relations which finds its praxis in adaptive sales. The adoption by organizations of more market orientated behaviour has facilitated the move from a transactional focus to one that emphasizes the importance of sustainable management that supports sales through relations. With regard to this, Homburg & Becker (1998) and Jairo & Küster (2003) reported that traditional definitions of personal sales show an orientation towards short-term transactions. The information that the sales person shares with the client is more contingent on the interests of securing the first sale than on the satisfaction obtained by the client through the purchase.

However, the literature on relationship marketing (Rapacz & Reilly, 2008) draws attention to the particularity of the sales process that it makes sense to apply. Some customers might not be classified as profitable customers, necessitating a more transactional approach for this group than one based on relationships. It is crucial that the sales director selects those clients with whom they should establish or maintain a relationship (R.A.C., read as Return on Assets per Customer). The concept of "relationship selling" refers to a broader interpretation than a mere seller-client relationship. Thus it contributes towards strengthening the concept of relationship marketing: long-term projected sales, sustained by trust, services of superior value offered to the client and collecting the information about them and the competition.

As such, it can be said that customer orientation will not only stimulate market-oriented organisational behaviours but will also individually impact on its Performance. Indeed, a customer-oriented organisation will value customer orientation traits when recruiting staff, as well as in its incentives and / or rewards programme. In this sense, sales force training will focus on developing customer-focused skills. Based on social learning theory, Guenzi, De Luca & Troilo (2011) state that customer-oriented organisations recruit team leaders with a strong sense of customer orientation who act as an example, inspiring others to assimilate similar types of behaviours.

## 1. DATA AND METHODOLOGY

A medium-scale data collection (n= 120) was conducted in Portugal. In this study the sales people were from telecommunications (n= 65) and LPG Bottles (n=55) companies. The sample is composed of 78% male and 22% of female respondents. Also, our sample corresponds to that with the following age representation (18-29: 15%; 30-39: 22%; 40-49: 35%; 50-59: 16%; 60 or more: 12%). Their educational qualifications lie between (55% finished the 9<sup>th</sup> year of school; 25% completed the 2<sup>nd</sup> cycle; 20% have a degree) and are members of a company.

To measure the degree of customer orientation or the degree of the orientation of the sales force for the sales in question, we used the most common approach (SOCO Scale de Saxe & Weitz, 1982). The scale reflects how important it is for organisations that apply the concept of marketing to configure the relationships between their sales teams and their clients. It should be emphasised that this scale was tested and validated in a b2b context in which the level of repeated purchasing is a critical factor for business. More specifically, in the creation of this measure lay the assumption that the results obtained by its application would lead to the implementation of the concept of marketing (ever concerned with the degree of market orientation adopted by organizations clearly reflecting the effort of client orientation) to the level of individual relationships established between each element of a sales team and their clients (Singh & Koshy, 2008).

Therefore, as far as the initial description of the SOCO scale is concerned, literature classifies it as a multidimensional scale comprising 24 items (12 items expressed positively and the remaining 12 negatively). Each of these items corresponds to a concrete action that can and should be implemented at the time that the seller/business interacts with its customers. In particular this scale is intended to measure six dimensions in terms of the behaviour adopted by the sales force when: (1) customers are helped to make better purchasing decisions; (2) it helps to ensure that clients are aware of their consumer needs and are able to communicate them; (3) it is able to identify offers (products and/or services) capable of meeting those needs; (4) it objectively discriminates the tangible and intangible attributes of the products and services wishing to be sold; (5) it avoids using manipulative actions that might influence the client's decision making process concerning the purchase (6) it avoids using excessive pressure to force the purchase of what is being offered.

Hence we assume that (H1a) the orientation of the Sales force towards the client should have a positive effect in accomplishing the sales objectives and that the sales orientation should have a negative effect in meeting the sales objectives of the sales force (H1b). On the other

hand, to measure the concept of competitive climate and its impact on the performance of the sales force we used the scale developed by Brown, Cron & Slocum (1998).

In this sense, we assume that (H2a) the sales force orientation towards the customer should have a positive effect on the perception of the extent to competitive climate impacts on performance, while the (H2b) sales orientation should have a negative effect on the sales force's perception of how much competitive climate impacts on performance. These 24 items (SOCO Scale) were subjected to a principle component analysis with varimax rotation, using SPSS 18. As previously described, the literature usually recognises two components in Soco Scale: Client orientation and sales orientation. The global scale Cronbach's Alpha is .85 is equivalent to that obtained (.86) by Saxe & Weitz (1982).

The hypothesized model was tested with Oneway ANOVA and "Cluster Analysis", by the method K-means Cluster.

## 2. RESULTS

The dependent variable "achieving the sales objectives" assumes three (3) performance levels in this study: 1 = not achieved; 2 = achieved the sales objectives; 3 = exceeded the sales objectives. In this sense, it represents the performance of the sales force in an analysis based on the previous classification of the companies studied based on the contrast between the sales objectives and the results achieved. To test the "H1a: The orientation of the sales force towards the client should have a positive effect in accomplishing the sales objectives", the data was subjected to a "Oneway ANOVA" analysis to observe significant variations in the intensity of customer orientation over the three (3) distinct levels of objective achievement. The results obtained (see Table I) confirm the first hypothesis, in that the two levels of objective achievement being tested : "hit" ( $\bar{x} = 4,40$  sd = ,383 ) and, "exceeded" ( $\bar{x} = 4,24$  sd = ,381 -) express a high customer orientation from the responding sales people. If a negative evaluation of the sales people who fail to meet the sales targets is not registered ( $\bar{x} = 4,30$ , sd = ,634), the culture of the sales forces from the companies studied is transversely orientated to the market. The value F ( $F=, 303$ ,  $p=, 740$ ) shows this general orientation of the organizations in test.

**Table I**  
**Oneway ANOVA - Customer Orientation Factor by Sales Objectives**

	Std.	Std.	95% Confidence		
N	Mean	Deviation	Error	Interval for Mean	Minimum Maximum

					Lower Bound	Upper Bound		
Fail to meet the sales targets	48	4,30	,634	,135	4,02	4,58	3	5
Hit	15	4,40	,383	,145	4,05	4,76	4	5
Exceeded	57	4,24	,381	,075	4,09	4,40	4	5
Total	120	4,29	,493	,066	4,15	4,42	3	5

To observe significant variations in the intensity of sales orientation over the three different levels of objective achievement (H1b), we used the same methodology (Oneway Anova). The results confirm that H1b, in the extent to which the third (3) level of objective achievement - "exceeded" ( $\bar{x} = 3,16$   $sd = ,922$  -) is significantly less than the other levels (2) "hit" ( $\bar{x} = 4,08$   $sd = ,629$  -) and (1) "did not reach the sales objectives" ( $\bar{x} = 3,44$   $sd = ,700$ ). Table II shows the significant impact that the sales orientation had on reducing the performance of the salespeople studied ( $F=3,702$ ,  $p = ,031$ ).

**Table II**  
**Oneway ANOVA - Sales Orientation Factor by Sales Objectives**

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	4,832	2	2,416	3,702	,031
Within Groups	33,934	116	,653		
Total	38,766	118			

In order to have an ordinal variable that collects the intensity of the sellers' perception towards competitive climate which impacts on performance, the scale developed by Brown, Cron and Slocum (1998) serves as a base for a "Cluster Analysis", using the method K-means Cluster, for the group of respondents in relation to this behaviour. The results obtained enable the classification of the 120 sales people analysed in three clusters with a perceived distinct and increasing competitive climate: 1 = Below Average -  $\bar{x} = 2,89$ ; 2= Average -  $\bar{x} = 3,28$ ; 3= Above Average -  $\bar{x} = 3,40$ . As can be seen in Tables III a and b, the differences between clusters are statistically significant ( $F= 17,086$ ,  $p = ,000$ ) which allows the unquestionable use of this variable as a dependent variable, in the testing of hypothesis in relation to the impact of the client orientation and to the sales performance of the sales force being tested.

**TABLE III a)**  
**ANOVA - Sets of Competitive Climate**

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	2,996	2	1,498	17,086	,000
Within Groups	3,857	109	,088		
Total	6,853	111			

**TABLE III b)**  
**Multiple Comparisons - Scheffe**

(I) Cluster Number of Case	(J) Cluster Number of Case	Mean Difference (I-J)	Std. Error	Sig.	95% Confidence Interval	
					Lower Bound	Upper Bound
1	2	-,38804	,21828	,217	-,9410	,1650
	3	-,51304*	,08830	,000	-,7367	-,2893
2	1	,38804	,21828	,217	-,1650	,9410
	3	-,12500	,21867	,850	-,6790	,4290
3	1	,51304*	,08830	,000	,2893	,7367
	2	,12500	,21867	,850	-,4290	,6790

\*. The mean difference is significant at the 0.05 level.

The results obtained partially confirm the H2a (a sales force orientated towards the client must have a perceived positive effect on how much competitive climate impacts on performance): "average competitive climate" ( $\bar{x} = 4,67$   $sd = ,333$ ) and "above average competitive climate" ( $\bar{x} = 4,27$   $sd = ,366$ ), show an elevated degree of customer orientation (CO) from the sellers above the global average for customer orientation (CO) ( $\bar{x} = 4,25$   $sd = ,494$ ) that will lead to higher performance. In turn, hypothesis 2b ("the sellers' sales force orientation must have a perceived negative effect on how much competitive climate impacts on performance") was confirmed to the extent that the intensity of sales orientation in the perceived third level of competitive climate "perceived above average competitive climate" ( $\bar{x} = 2,31$   $sd = ,875$ ) is significantly less than the other levels: "perceived average competitive climate" ( $\bar{x} = 3,41$   $sd = ,696$ ) and "perceived below average competitive climate" ( $\bar{x} = 3,79$   $sd = ,665$ ). The Table IV shows the negative impact of the sales orientation of the sellers surveyed concerning their perceived competitive climate and therefore their performance ( $F=12,007$ ,  $p = ,000$ ).

**TABLE IV**  
**Oneway ANOVA de Sales Orientation Factor by competitive climate**

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	12,214	2	6,107	12,007	,000
Within Groups	25,939	116	,509		
Total	38,152	118			

### 3. GENERAL DISCUSSION

The growing constraints that the markets have been exposed to gives the impression that the sales force is reconstituted in the strategic element of an organisations proximity to its clients. Now supported by the development and sophistication of new information technologies (CRM and Database Marketing), marketing departments have the operational and analytical strategic means to organize and rationalize the quantity and quality of the information necessary to make more accurate decisions, without incurring unnecessary costs, but above all, providing higher levels of profitability and customer satisfaction. This combination undoubtedly forms a desirable platform for the hoped for enhancement of competitiveness that the commercial area can bring to the role of marketing for organizations. In this way, the paradigm of relationship marketing finds in the sales force management a fair contribution to the interfunctional coordination that the market orientation models of Narver & Salter (1990) and Kohli & Jaworski (1990; 1993) propose, emphasizing the importance of strict collaboration between organizations, their human capital and their actual/or potential clients. The client orientation versus the sales orientation remains a central research theme in the analysis of best practices for the direction and management of sales forces in the way that they impact on individual and collective performance. This justifies that organisations seek to systematically measure and understand the nature of the behaviour of their sales force and marketing professionals.

This research indicates that organisational environment significantly affects the organisation's salespeople's attitudes to work and the resulting "outcomes".

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## MUTUALLY BENEFICIAL RELATIONAL VALUE: AN ANTECEDENT OF BUSINESS-TO-BUSINESS INNOVATION

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### ABSTRACT

#### **Purpose**

The intensified competition of business-to-business value innovation creates a commotion, where incorporating the 4Ps marketing mix, Relationship Marketing (RM) endeavours to establish a long-term commitment and relational bond among the key stakeholders to nurture the mutually beneficial stakeholder relationship value, with the aim of innovating further value for customers. From this perspective, this study aims to recognise the implications of RM in stakeholder relationships, interactions and subsequent mutually beneficial stakeholder relationship value to nurture business-to-business product/service innovation for customers.

#### **Design/Methodology/Approach**

A case study is conducted on England and Wales Cricket Board (ECB) to familiarise how ECB fosters their stakeholder relationships to innovate value in association with their business partners.

#### **Findings**

Eleven RM indicators are recognised that the ECB utilises to construct/nurture their mutually beneficial stakeholder relationship value in order to innovate further product/service value for their customers and share that innovated/enhanced value with the key stakeholders in a venture.

#### **Originality/Value**

The identified RM indicators are recognised as value innovating constructs in a business-to-business setting, where the indicators nurture (identify, establish, maintain, enhance, regulate and sustain) the mutually beneficial stakeholder relationship value as an antecedent of further value innovation for the target markets of all associated stakeholders. Moreover, such a relational approach of value innovation appears as feasible across industries and markets.

**Keywords:** relationship marketing; value; innovation; business-to-business; relationship marketing indicators; England and Wales Cricket Board.

## INTRODUCTION

Relationship Marketing (RM) as a stakeholder relationship value centred approach of the contemporary marketing practices ensures the mutually beneficial stakeholder relationship and interaction, while stakeholders work interdependently towards reciprocally advantageous multifarious goals. Incorporating the traditional 4Ps in the total marketing management, RM extends a long-term commitment and relationship bond among the associated stakeholders/business partners to nurture the mutually beneficial stakeholder relationship value, with the aim of innovating further value for customers and share that innovated/enhanced value among the stakeholders. Eleven RM perspectives emerge as value innovating RM indicators in the England and Wales Cricket Board's (ECB) business partnership management, where the ECB has been utilising these RM indicators to innovate enhanced product/service value for customers through the underlying mutually beneficial relationship value of their partners. Such a value innovation approach of ECB appears as feasible across markets and industries.

## EVALUATIVE VIEWPOINT

Relationship Marketing (RM) focuses on rational perspectives of business management, while centralising the cause and consequence of stakeholder relationships and interactions. RM engages the key stakeholders to work interdependently to design and realign processes in order to pursue mutually beneficial multifarious goals and subsequent relational value. Primarily, there is a continual and mutually beneficial attempt in order to pursue the multifarious goals of the business partners towards a cooperative and prolific relationship/partnership, and an understanding of long-term commitment (Tomer, 1998). This long-term commitment originates a bond among the business partners, which gradually becomes more valuable and forms a chain of relationships (Gordon, 1998) among stakeholders, where underlying this valuable chain of relationships, the associated stakeholders establish their mutually beneficial relational value through their joint power in order to collectively sustain their competitive advantage in the market. In fact, RM helps the

associated stakeholders to create value for customers and share that value with the key stakeholders in a venture (Gordon, 1998). More specifically, RM systemises the

Mutually beneficial relationship values and multifarious goals of associated stakeholders, while the stakeholders working interdependently in order to (identify) establish, maintain and enhance (regulate and sustain) value for customers by meeting and exceeding customers' anticipation in a way that customers expect and accept, and share that value with the involved stakeholders towards a win-win outcome (Shams, 2012a, p. 244).

On the other hand, creating mutually beneficial superior value for all associated stakeholders including customers is a crucial factor of the contemporary business practices in order to sustainably attain, retain and enhance relational bond (Shams, 2012b). However, it requires a logical flow of long-term outlook in marketing management to let the associated stakeholders know what they can expect from an organisation and be sure that the organisation will deliver the promised/contracted value to the stakeholders. When such a mutual understanding will be established among the associated stakeholders, it would be convenient to sustain that relational bond. RM works from this viewpoint incorporating traditional 4Ps marketing management philosophy and including logical flow of long-term outlook from stakeholder relationship management perspective (Gummesson, 2002), while associated stakeholders work interdependently towards mutually beneficial multifarious goals in order to innovate value for customers and share that value among the key stakeholders as a mutually beneficial relational value. As a result, "relationships and (value) networks form the backbone of business and industrial marketing" (Håkansson, 1982; Håkansson and Lundgren 1995; Håkansson *et al.*, 2009, as cited in Zolkiewski, Story and Burton, 2012), particularly when innovating (identify, establish, maintain, enhance, regulate and sustain) mutually beneficial relational value. Value is defined as, "what customers (and other stakeholders) receive in comparison to what they give" (Ioannou, 2012, p. 170). More expressively,

Value is perceived as an anticipated outcome of any sort of planned and organized activity. The activity could be derived from monetary, psychic, or physical resources. The more the outcome meets initial anticipation, the more the possibility of win-win outcomes or value optimization for all involved stakeholders (Shams, 2012a, p. 244; 2012b, p. 263).

From this perspective, focusing on an anticipated outcome (for example, the result of a prospective value innovation for customers) of any sort of planned and organised product or service innovation activity of the business partners/associated stakeholders; RM integrates

the inter-reliant relational bond and subsequent innovative effort of the stakeholders to attain and enhance the anticipated mutually beneficial relational value for the associated stakeholders. Examples are illustrated in the Mutually Beneficial Relational Value and Business-to-Business Innovation section of this paper. Eleven RM perspectives are recognised as value innovating RM indicators to innovate value for customers and share that value with the key stakeholders as a mutually beneficial relational value from the RM practices of the England and Wales Cricket Board (ECB) as a organisation that has been experiencing steady growth in the recent years (Shams, 2011). The value innovating RM indicators are:

- adaptation;
- relationship and service values instead of bureaucratic legal values;
- quality is the concern of all;
- high stakeholder service, stakeholder commitment and stakeholder contact;
- further segmentation of a segmented market or niche marketing;
- innovative offerings;
- joint power;
- share of dependency, risk and uncertainty;
- orientation on benefits or knowledgeable customers and/or other stakeholders;
- value-breeding bond (VBB) network;
- customisation.

RM centred value innovation keeps an inquisitive eye on changes that helps to timely adapt the innovation process with any transforming circumstance (Gummesson, 2002) by flourishing further opportunity and/or minimising weakness and threat. Gummesson (2002) further added that RM promotes relationships and service values in a value network rather than bureaucratic legal values. Such a relationships and service values smoothens the progress of joint value innovation process by promptly responding to the anticipation of the involved stakeholders/business partners and avoiding any bureaucratic complication. Furthermore, RM entrusts and ensures all staff members of an organisation (and other external stakeholders, such as business partners) to deliver superior service quality to the customers (Kurtz, 2009). Likewise, Stavros (2005) summarises that “In RM, it is the responsibility of all employees to promote the quality because RM is not just concerned with relationships administered by a marketing department within an organisation, but with all departments of an organisation” (as cited in Shams, 2012a, p. 224), as well as the associated business partners. Therefore, quality is the concern of all, as a RM indicator signifies its prominence in value innovation

process for customers, while the dedication and innovative value contribution scopes of all involved stakeholders are encouraged during the service innovation, delivery and evaluation process.

Another RM indicator is acknowledged as high stakeholder service, stakeholder commitment and stakeholder contact. Since, these are one of the crucial factors of RM (Stavros, 2005) in order to nurture mutually beneficial relational value through superior stakeholder commitment, service (Kurtz, 2009) and contacts. Moreover, RM bases on customers' and other stakeholders/business partners' preferences in terms of innovating alternative products and service value for customers. RM helps to realise customer and other stakeholders' contemporary and latent needs, wants, demands, anticipation and preferences through high stakeholder contact, commitment and interaction. "RM service providers gain a better knowledge of the client's requirements and needs. This knowledge can then be combined with social rapport built over a number of service encounters to tailor and customize the service to client's specifications" (Little and Marandi, 2003, as cited in Shams, 2012a, p. 223). Similarly, Kurtz (2009) illustrated that the level of customisation is advanced in RM, compared to the transactional marketing. As a result, customisation appears as another value innovating RM indicator, which keeps a keen eye on customers' and other stakeholders' requirements, while attempts to create value.

The next analysed RM indicator of this study is further segmentation of a segmented market or niche marketing. "The division of the total market into smaller, relatively homogeneous group is called segmentation" (Kurtz, 2009, p. 28).

RM helps marketers to identify, meet, satisfy and delight the latent needs of the market by further segmenting of a segmented market. The further segmentation of a segmented market helps to closely realize and serve (design/innovate offering) every single and even smaller needs, wants and demands of the market through niche marketing (Shams, 2012a, p. 221).

According to Kotler *et al.* (2009, p. 228) a "niche is a more narrowly defined segment of a market or customer group seeking a distinctive mix of benefits. Marketers usually identify niches by dividing a segment into sub-segments". As a consequence, the sub-segments of a segmented market of the total target market(s) make convenient to closely scrutinise the alternative needs, wants and demands of the total target market, where the mutually beneficial stakeholder/business partners' relationship value collaboratively engages the stakeholders to advantageously design/innovate product or service offering to meet and

delight that needs, wants and demands. On the other hand, Donaldson and O'Toole (2007) exemplified that a relational approach of marketing has an influence upon innovative product/service development process through the interaction of customers in a network. RM helps to proffer new and existing ways to innovate products and services, including from the prospective value identification phase to the design phase, product testing phase, product marketing phase and even product life-cycle management phase; ultimately that identifies alternative routes for mutually beneficial relational value based marketing. Consequently, centred on the mutually beneficial effort of the involved stakeholders for innovating/offering value to the customers, innovative offering evolves as another value innovating RM indicator. Joint power of the associated stakeholders recognised as a relevant RM indicator that also significantly contributes to the value innovation process. Based on the mutually related trust, commitment and relational bond, RM develops a joint power among the stakeholders (Kurtz, 2009), which helps an organisation to utilise the stakeholder/business partners' relationship value that originates from their relational bond to innovate further value for customers. RM also shares the dependency, risk and uncertainty among the key stakeholders (Gummesson, 2002). RM inspires business-to-business interaction based on stakeholder cooperation and trust (Kurtz, 2009). In return, stakeholders are able to share the mutually beneficial relational value at a profit, as well as share any unforeseen risk and uncertainty during the value innovation and delivery process. Simultaneously, an encouraging approach is likely as part of the relational interaction. The relational interaction should be consequential through customers' and/or other stakeholders' adequate knowledge about the organisation or about the offering (Gummesson, 2002). Since, *client knowledge* is positively allied to the quality of relational interaction (*Rajaobelina and Bergeron, 2009*). Consequently, RM emphasises on stakeholder's orientation on benefits about the business with an organisation that helps stakeholders to properly allocate resources in the value creation process. On the other hand, Value-Breeding Bond (VBB) network is acknowledged as:

A significant value proliferating network of RM, centred on a steady and continuously re-processable approach 'to identify, establish, maintain and enhance value' (Grönroos, 2004, p. 101) within and some time beyond the value network or group of stakeholders, so that value can be generated repeatedly through the re-productiveness of existing value, while each stakeholder plays some value added role, by way of stakeholders working interdependently towards mutually beneficial, multifarious goals (Shams, 2012a, p. 228; 2011, p. 43; Gide & Shams, 2011c, p. 1086).

Similar to the other value innovating RM indicators, VBB also shares the mutually beneficial relational value among key stakeholders/business partners to innovate further value for customers. An example is illustrated in the Mutually Beneficial Relational Value and Business-to-Business Innovation section of this paper. These value innovating RM indicators are favourably utilised to innovate value for customers through the underlying mutually beneficial stakeholder relational value from business-to-business, as well as business-to-customer contexts in order to innovate value through:

- competitive advantage (Shams, 2013);
- nurturing stakeholders' value contribution scope through the cause and consequence of stakeholder relationships and interactions and subsequent organisational growth (Shams, 2012a; Gide and Shams, 2011a);
- brand positioning, rebranding, corporate identity and reputation (Shams, 2012b; 2012c; Gide and Shams, 2011b);
- VBB network (Gide and Shams, 2011c).

As a result, this study aims to recognise the implications of these value innovating RM indicators in the mutually beneficial stakeholder relationship value in order to innovate further value through product and/or service innovation for customers, while the associated stakeholders/business partners work interdependently, with the intention to share that innovated/enhanced value among themselves in a business-to-business context.

## **METHODOLOGY**

Pertinent to the aim of the study, a case analysis is conducted on England and Wales Cricket Board (ECB), highlighting ECB's mutually beneficial stakeholder relational value in business-to-business setting. The ECB is selected to analyse because recently in 2009, they have restructured the policy of their business-to-business stakeholder relationships, interactions and partnerships (Building Partnership, 2009), as well as following this restructured policy, they have been experiencing steady growth in recent years, where the commercial

partnerships of ECB with various stakeholders, and their mutually beneficial stakeholder relationship value have been contributing prolifically to their growth (Shams, 2011). Content analysis of the websites and other relevant publications (e.g. annual report, promotional material, commercial partnership templates and so forth) of the ECB are utilised to collect data. The case analysis and synthesis approach has been adapted from the guidelines of Hartley (1994, 2004), Dey (1995), Stake (1995, 2000, 2003), Creswell (1998), Gomm, Hammersley and Foster (2001), Gomm (2006), Stavros (2005) and Yin (2003, 2009), which helps to analyse the relevant issues, concepts and variables (value innovating RM indicator centred mutually beneficial stakeholder relationship value) identified from the ECB's business-to-business value innovation have been analysed through insight, intuition and impression for comprehending whether the identified issues, concepts and variables are pertinent to the major areas of inquiry (the significance of the RM indicators for mutually beneficial stakeholder relationship value in order to flourish further value for customers through product/service innovation) by direct interpretation and or naturalistic generalisation. Such a case analysis approach helps to synthesis the ECB and its business partners' mutually beneficial stakeholder relationship value on further value proliferation through product/service innovation for customers, while they work interdependently, with the intention to share that proliferated value among themselves in a business-to business context.

## **MUTUALLY BENEFICIAL RELATIONAL VALUE AND BUSINESS-TO-BUSINESS INNOVATION**

Centred on the evaluative viewpoint, the chosen case analysis approach identifies the following perspectives to analyse in this section in order to demonstrate the findings, relevant to the aim of the study:

- analyse any prospective mutually beneficial stakeholder (ECB and its business partners) relationship value;
- impact of that mutually beneficial stakeholder relationship value on further value proliferation through product/service innovation for customers;
- Significance of the value innovating RM indicators in the prospective mutually beneficial relationship value and the product/service innovation.

## Building Partnership as a Stakeholder Relationship Value driven Initiative

The Chief Executive Officer of ECB clarified the goals of the Building Partnership (2009), which is a five year strategic plan framework as: ECB needs to acclimatise as a customer/stakeholder-focused organisation by promoting relationship and service values, while reducing bureaucracy (Collier, 2009). The Building Partnership gives a clear, focused and assessable target for ECB and its business partners to meet that goal. ECB had set out the following area, where they need improvements in order to adapt with the transforming business requirements (Building Partnership, 2009):

- improve Accountability;
- streamline management;
- slash paperwork and bureaucracy;
- performance management;
- efficiency;
- commercial awareness.

ECB wanted to promote trust with stakeholders by efficient communication, service and reduced bureaucracy in order to establish long-term stakeholder commitment and subsequent relationship bond. Therefore, ECB endeavours to let their stakeholders to know what they can expect from ECB and be sure that ECB will deliver. At the beginning of 2008, ECB established a communication system by which 80% of their communication can be done online to reduce paperwork and bureaucracy (Building Partnership, 2009). To achieve the Building Partnership goals, ECB has adapted a more customer and other stakeholder value driven culture by implementing relationship and service values instead of bureaucratic legal values.

ECB's initiative towards professional change through the Building Partnership (2009) including the stakeholder management helps ECB to adapt with the contemporary business challenges, focusing on promoting mutually beneficial stakeholder relationship value with their key stakeholders. Since, ECB prioritises the type of stakeholders and the relevance of individual stakeholder's significance towards their financial and other operational goals, with the aim of a value innovating win-win outcome for all associated stakeholders (Building Partnership, 2009). Such an adaptation and relationship and service value centred RM initiative offers ECB to put into practice the competitive product or service innovation opportunities for their target markets in association with their key stakeholders. ECB's

initiative to create a customer/stakeholder-driven organisation, reducing bureaucracy, and defining roles and responsibilities clearly across their business as a whole (Building Partnership, 2009), offers the opportunity to innovate new and more dynamic services for ECB's stakeholders. Moreover, ECB's initiatives (Building Partnership, 2009) of improving the way the game is led, through effectual leadership and governance, building a vibrant domestic game, enthusing participation and following, especially among young people, developing successful England teams, ECB's continuous innovative effort on developing partnerships across various industries as per the needs of the ECB and the potential partners and ECB's Focus Club and Clubmark approach of partnership with the cricket clubs across England and Wales are nothing but the modification of ECB's existing services with new and different characteristics that innovates additional benefits/value for the target markets of ECB and their commercial and operational partners. As a result, such an initiative to modify the existing service with more value innovating stakeholder relationship and interaction helps these key stakeholders to realise the latent mutually beneficial relational value that may be originated and utilised through the cause and consequence of business relationships and interactions with ECB focusing to create value for their target market and share that value among themselves (Shams, 2011; 2012a).

To serving and delighting sponsors and business partners, ECB categorises their sponsors and partners into seven different business requirements and opportunities, which helps them analyse to serve the partners most, as well as, to bring out the most value from the partners aiming to foster the certain business requirement and subsequent relational value (Commercial Partners, 2010). Moreover, such a further segmentation of a segmented market or niche marketing (the different categories and sub-categories of sponsorship and partnership requirements and opportunities) helps ECB to realise the different needs of their businesses and creatively niche those needs by identifying and offering innovative mutually beneficial relational value to the sponsors and business partners towards a further value innovation process for their (ECB and its partners) markets.

### **Broadcasting Partners**

Sky Sports (2010) have exclusive live broadcast rights to all international cricket played under the auspices of the ECB. They also have exclusive live broadcast rights to all domestic competitions. Sky Sports sponsors ECB's Coach Education Programme too. Channel Five (2010), BBC Radio (2010) and talkSPORT (2010) radio are ECB's other co-broadcast partners. Therefore, ECB is able to innovate further services to develop their coaches as another key

stakeholder through the joint power and effort of their broadcasting partner. Moreover, ECB sub-segments their broadcasting partnership segment of the total partnership market into television and radio broadcasting sub-segments, where the partners realise the significance of mutually beneficial relational value by associating with ECB's business (Shams, 2011).

### **Team Sponsors**

Brit Insurance (2010) is the official team sponsor of ECB. Brit Insurance's logo appears on England teams' shirts. Brit Insurance (2010) demonstrates the significance of mutually beneficial relational value with the ECB as, "our association with cricket is an excellent way to increase the profile of Brit Insurance with those that purchase and advise on business insurance" (np). More discussion on ECB's insurance partnership has been presented in the Other Partners sub-section of this section. Since, ECB sub-segments their team sponsorships with other partnership opportunities as well.

### **Competition Sponsors**

Leading energy supplier Npower (2010) has been sponsoring all domestic international test cricket since 2001 and their existing agreement is up to 2013. Npower will continue to enjoy significant commercial access to the England team, as well as an extensive package of rights including ticketing at test matches and image rights. The deal will also provide Npower with the opportunity to build a greater brand presence at test match venues through advertising, branding and sampling. Npower will also continue its successful grassroots initiative to spread up cricket around the UK, Npower Urban Cricket, which it runs in partnership with the ECB. These initiatives provide a permanent and safe space for children to learn the basics of cricket, aim to increase participation and leave a long-term, sustainable legacy for the sport. Kevin Miles, Chief Executive of Npower retail described:

We're delighted to announce our continued sponsorship: to be at the heart of the game for eleven years is something we can be extremely proud of. Our Urban Cricket initiative continues to go from strength to strength. Renewing our contract ensures future investment in this scheme, which is vital for the development of cricket from playground to test arena. From a brand perspective, not only has our cricket sponsorship provided us with great visibility, it has also provided a strong marketing platform for our other products and services like our gas boiler installation service, Npower home team. We're already looking forward to the next two seasons (Shams, 2012b, p. 253; Npower 2010, np).

ECB chief executive David Collier added “its (Npower) Urban Cricket initiative has helped give thousands of children across the country a chance to play cricket for the first time” (Npower 2010, np). ‘LV=’ (2010), the insurance and investment group has been sponsoring English county cricket since 2002; they renewed the contract with ECB and announced that they will continue their sponsorship. ECB Chief Executive, David Collier described about the renewal of the sponsorship contract:

This renewal underlines the benefits that sponsorship can bring to commercial partners. This announcement is fantastic news for domestic cricket, and LV’s continued support will play a key role in the future success of our national summer sport (‘LV=’, 2010, np).

‘LV=’ chief executive Mike Rogers added:

Our sponsorship of the LV County Championship has proved very successful in getting our message across to cricket fans far and wide. We look forward to strengthening our partnership with the ECB (LV=, 2010, np).

Friends Provident (2010), the life and pensions company, is proud to be a long term domestic competition sponsor of ECB. Following three successful years as the title sponsor of the domestic fifty-over competition, the sponsorship of the ECB’s new enhanced Twenty20 competition provides a natural evolution for Friends Provident and its involvement in domestic cricket. Friends Provident also supports ‘Chance to Shine’ (a cricket development programme of ECB), the Cricket Foundation’s campaign to regenerate competitive cricket in state schools, and the Professional Cricketer’s Association (PCA).

NatWest (2010) part of the Royal Bank of Scotland Group, has been a major sponsor of English cricket for more than twenty five years. Over the last two decades more than £35 million has been invested into the game both at international and grassroots levels. This includes the highly successful NatWest Interactive Road show and NatWest Speed Stars competition, the Interactive Cricket programme taking cricket into secondary schools, the Volunteers in Cricket initiative, as well as, the innovative ‘Sun Safety-Don’t get caught out’ campaign to raise awareness of skin cancer in the UK.

Clydesdale Bank and Yorkshire Bank’s (2010) sponsor the Twenty20 Cup, which is hosted by ECB. The partnership continues to support cricket at all levels of the game. Gareth Johnson, promotions executive for Clydesdale Bank and Yorkshire Bank, explains:

Our support for Twenty20 continues to generate great feedback from our customers and our employees—the pace and energy of this form of the game is something that we can all identify with. (Clydesdale Bank and Yorkshire Bank 2010, np).

### **Other Partners**

Buxton (2010) Natural Mineral Water is the Official Water Supplier to the England Cricket Team. As part of the agreement Buxton provides the England Cricket Team with bottled mineral water to be used during all home international matches and training sessions. ECB commercial director John Perera described:

We feel there is an excellent brand fit between Buxton and the England Cricket Team and are confident this partnership will further demonstrate that cricket can have a positive impact in a business environment (Buxton 2010, np).

Paolo Sangiorgi, Nestlé Waters UK Managing Director, commented:

Buxton and the ECB share several important mutual characteristics, a rich heritage and a strong sense of Britishness – and this is why we believe our new sponsorship deal will work so well. Buxton has always used strong sports associations to increase its awareness and promote healthy and active lifestyles, and we are confident that the new partnership will benefit everyone (Buxton 2010, np).

Hewitt Associates (2010), a global human resources services company with offices in thirty five countries, is proud to be an Official Human Resource Management Partner of the ECB. Maximising human resources is what Hewitt is all about. Cricket, while a team sport thrives on the importance of specialist skills and individual strengths as key elements of success—just as ECB does at Hewitt. Through this partnership, Hewitt can reach out to employees, clients, associates and a wide range of ECB's stakeholders and audiences. As one of the commercial partners of the ECB, the Hewitt name will be a fixture at some of the world's most famous grounds.

Marshall Wooldridge Ltd, a general and financial services insurance company is the insurance partner of ECB (ECB Extra Cover Insurance, nd). In the partnership with Marshall Wooldridge Ltd, ECB provides discounted Extra Cover (2010) to its affiliated Focus Clubs and Clubmark clubs as official insurance scheme. The ECB recommends strongly to all affiliated

clubs to consider the Extra Cover scheme to protect their assets and overcome liabilities. Extra Cover is the ideal way for cricket clubs to insure against a wide range of risks-all in one simple policy. It provides a flexible and customised range of cover designed solely for cricket clubs around the UK, who are one of the target markets of the Marshall Wooldridge, as well as the key stakeholders of the ECB in order to spread up cricket.

### **Suppliers**

Maximuscle, the UK leader in sports nutrition was the official partner of ECB for sports nutritional products up to the end of 2010 (Cricket World, 2010). Maximuscle and the ECB worked at new methods to improve performance with Maximuscle providing proven products like Viper and Recovermax, offering expert advice from their team of nutritionists and creating new sports nutrition solutions to the rigorous demands of international cricket. James O'Shea, Marketing Director for Maximuscle described (Cricket World, 2010, np) as: "this is an exciting opportunity for Maximuscle to showcase the virtues of sports nutrition to anyone looking to improve their performance".

### **Grassroots and Recreational Partners**

ASDA (2010), the leading European conglomerate corporate house is ECB grassroots level's development partner. More discussion has been made on this in the ECB Focus Club, ECB Clubmark and Partnership with Schools sub-section. On the other hand, Npower (2010) and NatWest (2010) extended their partnership with the ECB into ECB's grassroots levels development and recreational activities along with their competition sponsorship. Again, as being a broadcast partner of ECB, Sky Sports (2010) extended their support to ECB into ECB's recreational activities.

### **ECB Focus Club, ECB Clubmark and Partnership with Schools**

ECB develops school and junior cricket and other local cricket through ECB affiliated Focus Clubs around the UK.

Affiliation to the ECB allows clubs and, where appropriate, leagues to access a range of tangible benefits. Affiliation is via the County Board within whose area the club or League is based. We provide those benefits centrally by the ECB—individual County Boards will provide additional benefits and may charge

additional affiliation fees for these benefits (Play Cricket Making A Difference, 2006, p. 10).

Centrally and regionally through the regional County Boards, ECB provides enormous supports, guidance, resources, development planning and initiatives, technical and expertise supports for business and game development to these affiliated Focus Clubs in association with their sponsors and commercial partners (Shams, 2011; Play Cricket Making A Difference 2006). Furthermore, in return of these huge endorsements, ECB's regional County Boards charge a nominal affiliation fee to the clubs. ECB provides these supports to the clubs through their prolific relationship with their sponsors and partners, which helps to develop cricket country-wide, as well as helps sponsors and commercial partners to meet their business targets. Simultaneously, ECB and its regional bodies earn additional revenue from the club affiliation fees. It shows that only through the cause and consequence of stakeholder relationships development and maintenance initiatives and subsequent interactions, ECB has been increasing their revenue and innovating the routes for their growth.

There are in excess of 1,400 Focus Clubs which have been strategically identified across England and Wales. On average each Focus Club will work in partnership with four schools and one community group. This equates to over 5,600 schools and 1,400 community groups. On the other hand, the ECB Clubmark is a motivational program for the Focus Clubs, which boosts the competition among the Focus Clubs to achieve and compliance as many supports as possible from ECB and set an example for other Focus Clubs. These Focus Clubs are currently registered and actively working towards ECB Clubmark. More than 850 Focus Clubs have achieved the prestigious ECB Clubmark accreditation putting in place and maintaining the required minimum operating standards for community club cricket (Play Cricket Making A Difference, 2006). Under the Clubmark (2010) scheme, in the partnership of UK's government department 'Sport England', ECB and Cricket clubs can play a key role in the successful delivery of building partnerships with the key stakeholders by supporting the delivery and implementation of various business, promotional and operational activities. A Focus Club has to meet the criteria of seven steps to obtain and maintain the prestigious ECB Clubmark status (ECB Clubmark Process, 2010).

ECB always encourages the Affiliated Focus Clubs and Clubmark clubs to have their own sponsors and commercial partners from local and national businesses to get sufficient funds to run the clubs. For this, ECB helps the clubs through their expertise sponsorship marketing

guidelines, as well as the clubs to get grant and aid through their Sources of Grant Aid and Funding for Cricket Clubs (2009) publication.

ECB is concerned to develop and nurture cricket talents from grass root level for which, they established and maintain partnerships with country-wide schools through country-wide local ECB Focus Clubs and Clubmark Clubs. ECB introduced cricket activities for primary and secondary schools' boys and girls (Cricket in Partnership with Education, 2010) in the partnership with their grass root partner ASDA (2009; 2010), and the local ECB affiliated clubs. ASDA works in partnership with the ECB to develop and implement two major campaigns designed to use ASDA Kwik Cricket as a vehicle to educate children about the benefits of healthy living and also raise the profile of the sport within communities. A core element of these campaigns will involve the ECB, in conjunction with the eighteen first-class counties, and ASDA establishing a series of recreational junior cricket festivals across the country. This will also include new girl's tournaments aimed at increasing levels of participation. These festivals will be attended by high-profile professional cricketers who, in addition to passing on coaching tips, will also talk to kids about the benefits of healthy eating (ASDA, 2010). ASDA Kwik Cricket is played in 8,000 primary schools and over 4,500 of the 6,000 ECB affiliated clubs. It is designed to provide children, between the ages of 7 and 11, with an introduction to cricket and can be played through various flexible and adaptable ways (ASDA, 2010).

Deborah Whitehead, Local Marketing & ASDA in the Community general manager, said: ASDA Kwik Cricket is proving to be very popular with the number of primary schools participating increasing each year. It's perfectly aligned to our strategy to focus on Kids within local communities. In 2008 we added to the program by educating children around the benefits of healthy eating and doing more to support cricket within the local communities (ASDA, 2010, np).

### **Significance of Value Innovating RM Indicators on Mutually Beneficial Relational Value and Business-to Business Value Innovation**

The delighting remarks of the ECB's partners and sponsors clearly demonstrates the significance of the mutually beneficial relational value of these stakeholders' and ECB through their joint value innovating initiatives for their different target markets. Since, the partners are able to meaningfully innovate/promote their offerings to their own target markets, as well as

ECB is able to nurture and innovate further value for their own target markets through such initial mutually beneficial relational value of their partners.

In order to achieve the Building Partnership goals by prolifically utilising the mutually beneficial stakeholder relationship value with the aim of innovating further value for all of the involved stakeholders' target markets, ECB has adapted a more stakeholder focused culture by implementing relationship and service values instead of bureaucratic legal values. ECB started funding its regional bodies, Focus Club and Clubmarks Clubs based on their annual performance (Shams, 2011), which indicates that ECB promotes the quality is the concern of all in their intra-organisation practice. Moreover, the overall stance towards an organisational change from a traditional practice to more customer/stakeholder driven practice of ECB indicates that high stakeholder service, stakeholder commitment and stakeholder contact would be a key of ECB's success through their reformed customer/stakeholder driven organisational practice.

As per their business requirements, ECB categories and sub-categories their sponsors and partners into seven different segments and underlying sub-segments of the sponsorship and partnership opportunities. Such a further segmentation of a segmented market or niche marketing (the different categories and sub-categories of sponsorship and partnership requirements) helps ECB to realise the different needs of their businesses and creatively niche those needs by identifying and proffering innovative offerings to the sponsors and commercial partners towards a win-win outcome. Moreover, ECB has been developing them and cricket throughout the UK through the resources and opportunities gained by the joint power of their sponsors and business partners. Simultaneously, in general, share of dependency, risk and uncertainty is always involved among the business partners, based on the partnership contract. Another RM indicator, orientation on benefits or knowledgeable customers and/or other stakeholders is involved in ECB's RM practice too. Since, ECB tries to enlighten potential sponsors or business partners about the potential benefits for sponsoring or partnering ECB, as ECB ensures to let their stakeholders know what ECB can offer them and be sure ECB will deliver that (Building Partnership, 2009).

In the partnership with the sponsors and business partners, ECB provides grassroots cricketing facilities to the ECB affiliated clubs. By which, the affiliated clubs continue the cricketing activities among the country-wide schools' kids. Through such ventures, all involved stakeholders are benefiting and breeding further value towards their future interest. Commercial partners and sponsors are gaining their promotional advantage by partnering

and/or sponsoring ECB, which exhilarates their potential sales. Again, affiliated clubs are gaining cricketing facilities from ECB and County Boards because of ECB's partnership with their business partners and sponsors, which exhilarate affiliated club's growth too. Simultaneously, country-wide schools are gaining the opportunity to involve their students in the sports activities, which helps young students to gain sustainable physical structure since their childhood, as well as helps the school to socialise their extra-curricular activities. On the other hand, ECB and its regional bodies are gaining club affiliation fees from such ventures too. As a result, the Value-Breeding Bond (VBB) is found in ECB's venture. Since, all of the involved stakeholders are gaining their individual interests through the venture, which breeds further value among the VBB network.

ECB introduces the Clubmark status for the Focus Clubs, where the 'Focus Clubs' only can gain the 'Clubmark' status after fulfilling ECB's standard. That means quality is the concern of all is involved from this perspective too. Again, ECB and their insurance partner customise various insurance services for ECB's Focus Clubs.

## **IMPLICATION AND CONCLUSION**

Existing literature shows that the implications of the RM indicators have a favourable impact on nurturing mutually beneficial stakeholder relationship value, and innovating further value for customers through product/service innovation in order to share that innovated/enhanced value among the associated stakeholders. Accordingly, ECB has been proving that what value they can deliver to their business/operational partners in order to foster mutually relational value and subsequent innovated/enhanced value for customers through a strategic stakeholder relationship and interaction. Moreover, underlying such value innovating RM indicators in a business-to-business setting, ECB ensures an interdependency among the business/operational partners that helps them to transform their value network into a Value-Breeding Bond network, where value is innovating/generating through the re-productiveness of the existing value, while each stakeholder plays some value added role, by way of stakeholders working interdependently towards mutually beneficial, multifarious goals. Correspondingly, the Building Partnership approach of ECB keeps a keen eye on flourishing latent market (all associated stakeholders, including customers) needs in a way that the target market expect and accept, where the value innovating RM indicators help ECB to enrich their relational influence in order to meet and exceed that expectation, which is tailored based on

their stakeholders' needs. As a result, the mutually beneficial stakeholder relationship value derived from the value innovating RM indicators is utilised as an antecedent of business-to-business innovation in ECB's value network. The key implication of such a RM indicator centred value innovation initiative in a business-to-business context is it can be utilised to innovate value in any setting (market, culture, industry and so forth); however the relationship portfolio should pursue only the given situation of the targeted setting (Gummesson, 2002).

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## CAN A SOCIAL NETWORK MARKETING STRATEGY BENEFIT SMALL AND MEDIUM ENTERPRISES?

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### ABSTRACT

The study explored what benefits to small or medium sized firms could be derived from the development of a social media marketing strategy. Results indicated that Facebook can facilitate communications between (SME) companies and customers, and can also be an important tool in creating brand recognition and broadening awareness. The importance of developing a thoughtfully designed strategy was cited as SME's often lack sophisticated marketing or business plans. The positive study results suggest that SMEs can derive benefits from a SN strategy and, in particular, Facebook was shown to be an important channel that enabled small and medium sized companies to advertise their brands without large budgets. Facebook presents itself as a unique environment that can enable businesses to increase prospective clients and also offer current consumers a closer relationship to the company. As such, the study indicated that presence on social networks can have an important role in both relationship development and increased sales/membership.

**Keywords:** Social networks, SME, Facebook, strategy, small medium companies

## INTRODUCTION

While the need for a social network (SN) marketing strategy has been explored with large firms little exploration has been undertaken to determine their usefulness to small (< 50 employees and ten million in sales) or medium (< 250 employees and fifty million in sales) enterprises (SMEs). The intent of this study was to examine the potential benefits to an SME that could be derived from a social network strategy.

The importance of a social network strategy for a small or medium sized firm emanates from the explosion of online social networks that allow information to be disseminated in different ways and sociability to take new directions. An additional significant benefit to the SME is the relatively inexpensive cost of a relatively sophisticated SN strategy that connects the firm directly to current and potential consumers. Social networks sites provide a way to be closer to consumers with the added benefit of not needing to go through "gate keepers" to transmit information having the ability to communicate in an easy and accessible way (Hennig-Thurau, et al., 2010).

There are several important online social networks where millions of users interact daily. Facebook, Twitter and Kurkut are among the most widely used. The study focused on Facebook, with 90 million members, due to its heavy European influence as well as its importance in Portugal where the study was conducted. Currently, there are 4,644,220 Facebook users in the Portugal, which makes it #39 in the ranking of all Facebook statistics by Country. Facebook penetration in Portugal is 43% in relation to population and 85% in relation to Internet users. The largest age group is currently 25-34 with total of 1,214,920 users, followed by the users in the age of 18-24. Meanwhile, 51% of the Facebook users are male and 49% are female (Socialbakers, 2013). Perhaps one reason for Facebook's popularity is that Facebook, compared to LinkedIn and ASmallWorld, offers the most comprehensive tools for personalization and a larger management of the profile on the network (Papacharissi, 2009).

Companies recognize that social networks represent a new way to communicate with consumers allowing a company to extend its communications, develop a reputation and promote firm image (Becker, Nobre and Vijay, 2012). It would seem natural then that firms would look to this channel to promote their brands, communicate with customers and increase sales (Burson-Marsteller, 2010).

The important of SN is well stated by Facebook promotional materials which point the benefits to firms who use their platform. Stressing the importance of WOM marketing the Facebook site notes the following benefits of using Facebook in social network strategy (Facebook, 2013).

- 1. Customized news feed based on users' personal information and interactions, which indicates what they may like.*
- 2. Brand recognition means that you stand on a huge public platform, where every eye can be focused on you resulting in image building of your brand or service.*
- 3. Facebook fan box is persuasive tool through which email recipients or website visitors can easily become your fan, and follow your business page.*
- 4. Effective brand monitoring allows the firm to counter misconceptions or negative comments or opinions about your company by directly addressing them.*
- 5. Increase search engine rankings because all data public can be public so using major brand key words a company page can come up on top on Google or Yahoo search engines.*

Social Networks appear to be an exceptional tool for companies to communicate with consumers due to the speed which information circulates and the low costs associated compared to the traditional marketing. Of particular importance to a firm is the ease of consumer feedback. Focus groups are becoming a tool of the past as firms with solid consumer recognition can solicit information directly from hundreds of interested Facebook fans. The power of social media lays in its viral nature so it is a consumer relating to another that quickly spreads the marketing message throughout the internet. While WOM can work against the brand in a negative way a carefully monitored SN strategy is amply justified (Becker, Nobre and Vijay, 2012).

While the nature of SNs is dramatic the preponderance of research still focuses on the more traditional marketing concepts. Gil-Or (2010) points that in the area of online social networks and particularly in Facebook, there is little academic research related to marketing and business. In this sense, to study how companies work their image, communication and relationship management, specifically in the context of Facebook, provides an important contribution. This is even truer in the case of small and medium sized firms. It is also important to recognize how social network strategy can be used in small nations as most research tends to focus on North America or the more industrialized nations of Europe such

as the UK and Germany. The purpose of the study was to explore how SMEs are using social networks in a small lesser developed nation (Portugal) to determine what lessons could be ascertained for other similar nations and sized firms. To this end the study addressed three questions of:

1. Do social networks have an impact in management strategy for Small Medium Portuguese Enterprises?

2. Does a company's presence on a social network help improve communication with the firms current and/or potential consumers?

3. Will a presence have a positive impact on the relationship that the consumer establishes with the firm/brand?

In the process of online communication WOM plays a central role in the dissemination of new products and services where their intangibility makes sharing the experience is even more important to consumers (Gil-Or, 2010). Brown and Reingen (1987) further reinforce the crucial role WOM plays in consumer attitudes and behaviors.

WOM is a very prominent communication tool on the Internet, this presents itself as a privileged way means for consumers to share their opinions, as well as preferences and experiences (Trusov, et al., 2009). Havlena and Graham (2007) contend that the interest in the power of WOM can be traced to the advent of the Internet, which facilitated the sharing of information from consumer to consumer regardless of time or location. They argue, the online opinions of consumers can be long lasting and far-reaching demonstrating effects on purchase choice. Hyllegard, et al. (2011) also emphasize that consumers seem to rely more on the opinions expressed in social media than in the information generated and shared by companies themselves. Based on these ideas the following hypothesis was formulated.

*H1: Small Medium Enterprises will benefit from the impact of WOM on social networks*

It is clear that Facebook provides a company with a unique opportunity to communicate with a collection of consumers who have a personal interest in the company's products and brand. With this knowledge Facebook can contribute to better understanding of the product and the sharing of experiences related to satisfaction or dissatisfaction to the product (Hyllegard, et al., 2011). Facebook also allows for a greater social activity between users and, simultaneously, helps businesses, through direct dialogue, to interact, with the existing and/or potential customers (Deloitte, 2012). Through social networking WOM consumers can

share their experiences with the products in a unique way (Soares, et al., 2012). The importance of SN in discussing products and services led to the following hypothesis:

*H2: Social networks are an important means of enabling consumers to share information about a product/service*

Soares, et al. (2012) state that for consumers to decide communicate with companies feel comfortable to share personal information and free to provide direct company/product comments. Kaplan and Haenlein (2010) also corroborate this idea arguing that companies must deliver their message in a coherent and consistent way. Reinartz, Krafft and Hoyer (2004) conceptualize CRM at the client level and believe there are three stages of relationship developed with the customer (initiation, maintenance and end). It is important that a firm recognize, in their communication, which stage the customer represents.

Gil-Or (2010, p. 22) states that "in order to build the level of trust and transparency that is needed for the consumers to feel comfortable with companies participating in what is considered a not commercial environment (such as Facebook), companies should invest in doing Relationship marketing right". When this is accomplished McKeefery (2008) states that social networks such as Facebook can provide a powerful presence for the firm which can, according to Zang (2010) can serve to build strong relationship between potential and current consumers. Based on this assumption a third hypothesis was formulated:

*H3: The level of communication in social networks reflects the quality of the relationship that companies have with consumers.*

In a study conducted by Deloitte (2012) Facebook was found to enable companies to focus advertising toward a specific group of user once the site visitors had become fans of the firm. Through monitoring the communication between consumers and engaging visitors companies are able to promote the brand where it is most effective and meaningful in order to generate awareness and new sales. According to Urde (1999) a brand is inseparable from the company so the effective use of brand sites can create an environment where personal interactions, about a product/service, can result in increased brand value. Social network sites can be effective in developing a personal relationships with the firm/brand which can serve to assist consumers to identify with the brand making it different from others and, at the same time, help the company to differentiate itself from the competition (Grönroos, 2001).

Familiarity with the brand happens when the consumer formulates favorable, strong and unique brand associations (Keller, 1993, p.2). These build brand image and, simultaneously, the construction of value. Social networks are an important channel in the management of the company's reputation which for this discussion could be equated to brand value (Becker, et al., 2012). This leads to the following hypothesis:

*H4: The presence of Small Medium Enterprises in social networks will have a direct impact on the brand familiarity of these firms to the consumer*

If the consumer is satisfied there are more chances to be loyal, or engage with the brand and buy it whenever you need (Bloemer and Kasper, 1994).

A study by Deloitte (2012) determined that a company's Facebook page can increase knowledge about the brand and about their activities enabling companies to interact through direct dialogue with existing or potential consumers and can promote the firm's links to their websites. By increasing traffic on the company website Facebook has been responsible for helping increase sales. Facebook offers a firm the ability to advertise to a particular consumer group focusing messages that meet their specific needs and tastes (Deloitte, 2012). In addition, the less formal communication format allows the company to connecting with consumers and "tell a story" about the identity of the brand or product helping to convert customers into loyal advocates of the company (Burson-Marsteller, 2010). This led to the final hypothesis:

*H5: The direct contact with consumers through social networks generate greater involvement resulting in a direct impact on brand loyalty intentions*

Virtual brand communities in social network sites have received increasing attention from both academia and industry. A study of 333 virtual brand community members in Korean social network sites suggests that members of brand communities have six primary social and psychological motives for engaging in virtual community activities: interpersonal utility, brand loyalty, entertainment seeking, information seeking, incentive seeking, and convenience seeking. Among them, brand loyalty acts like the facilitator who set up an essential connection between real world and the intangible cyber network. It was noted that members of consumer versus marketer-generated brand communities had both similarities as well as differences in terms of the extent of community participation and the levels of community commitment, satisfaction, and future intention (Sunga, et al., 2010).

## METHODOLOGY

A qualitative approach was chosen as the best method since this methodology appears when there is a "need to get meaning and in depth" (Carson, et al., 2001, p. 69). According to Neale, Thapa and Boyce (2006) one of the main advantages of studying the case is that this method enables access to more detailed information compared to other methods providing thus "a more complete picture" of what happened in that particular "context and why".

The use of social networks as a management tool, particularly for Small Medium Enterprises, is a recent development and scientific literature remains scarce (Gil-Or, 2010). Yin (1994) states that the exploratory multiple-case study is an appropriate, and perhaps the best method, when under taking this type of investigation. The multi-case analysis has several advantages as multiple firms can indicate trends and offers insights that a single case study is not capable of. Herriott and Firestone add that "evidence from multiple cases are considered more compelling and comprehensive...being more robust" (Herriott and Firestone, 1983 cited in Yin, 2001, p. 68).the study offered greater support for generalization as he four companies represented different business sectors.

Yin (1994) notes that the case study fits in the investigation when a "'how' or 'why' question is being asked about a contemporary set of events over which the investigator has little or no control" (Yin, 1994, p. 9). Building on this the researchers believe that the multi-case method, is well suited for and can be applied to, investigations that have an initial exploratory hypotheses that can be studied and developed to provide future insights into broader research activities. The research was designed to investigate how social networks impact the strategy of Small Medium Portuguese Enterprises. The format was to analyze four cases using semi-structured interviews, and later on elaborating a "cross company case" where each company was analyzed and compared to ascertain the expectation of patterns relating to either social network strategic designs or outcomes.

Four Small Medium Portuguese Enterprises were selected based on four specific criteria:

- Companies had to be present on Facebook
- Companies had more than 250 "likes" on their pages
- Were selected companies that operated in different areas, two of which offer products and the rest falls in the services area

- The geographical location of firms, which are all located in the northern region of the country, in order to give facility and access to company managers to be interviewed.

Consistent with the exploratory nature of the study the collection of data was made by semi-structured management interviews.

A detailed script was divided in three parts: 1) The reasons that led the company to be present on Facebook; 2) The way management is implemented in Facebook and 3) The advantages that the company derived from its presence on Facebook. In addition, secondary data was obtained from the company managers / directors.

## THE EMPIRICAL STUDY

Four SME Portuguese Enterprises were selected for the multi-case study: ACIAB, Braga Pop Hostel; Brb. Artesanato Urbano (Brb. Urban Craft) and MARKA – Vinhos do Douro (Table 1).

The ACIAB is a business association, founded in 1911, and its goal is to promote business development in the region providing assistance to firms to adapt in the current market as well as providing tools to compete and innovate. ACIAB has more than 1000 associates (companies) in different branches of business, from trade, industry and services.

Braga POP Hostel is the first hostel in the city of Braga, in an early differentiating aspect of the brand, and desires to position itself as a local informal housing alternative that is close to the customer and youth culture.

Brb. Urban Craft produces an urban crafts adapted to constantly changing consumer habits and their search for something unique. Creativity and innovation are the hallmarks of the company as well as environmental concerns, having a clear careful selection of materials used in the various manufactured parts.

Durham Agrellos Wines S.A. was founded in 1991 but the name “MARKA” appeared only in 2004. This was at the time of the introduction of the wine “Doc Reserva 2002”. MARKA markets an extensive range of wines, red, white, classic blends and has received several medals in European competitions.

All the selected cases are from the north of Portugal, for the data collection facility. Companies have a philosophy of proactive, that is, despite being very small and not having extensive resources, they adapted themselves to the circumstances and got into the market with a clear vision of what they represent and how they intend to place towards the competition. These companies are concerned about their brands

All firms are active Facebook sites which allows them to communicate to a large number of individuals in a where it simple to be a membership, requiring only user registration and an Internet connection.

The cases of the research are summarized in Table 1.

Table 1. Description of companies studied

	ACIAB	Braga Pop Hostel	Brb. Artesanato Urbano	MARKA – Vinhos do Douro
Location	Arcos de Valdevez/ Ponte da Barca	Braga	Viana do Castelo	Porto
Business Activity	Economic Organization	Local hosting of short duration	Manufacture and sale of jewelry (craft)	Production of wines
Product Type	Intangible, durable	Intangible, not durable	Tangible, durable	Tangible, perishable
Beginning of Activity	1911	2011	2006	1991
Initial Presence on Facebook	May 2010	July 2011	May 2010	April 2010
Number of fans on Facebook page : March 2012	256	714	1.308	5.721
Number of friends on Facebook profile page: March 2012	4.899	1.259	610	It has not profile page

## RESULTS

Managers had different aspirations for their Facebook page (Table 2). Only one desired to have the site expand the number of interested viewers (ACIAB). This is an understandable goal for them being an association membership based company. Two firms of the four expressed a desire to mitigate the effects of negative WOM comments on the site. While the international aspects of the internet and Facebook are widely discussed it is interesting that all firms desired viewers to share information about their company and to obtain a greater fan base from the local area.

The first aspect is reflected in how WOM appears in Facebook, once that in the four cases, the site seems to present itself as a means of fostering the sharing of information about the company and a wider range of consumers territorial level as well, because the companies have visitors from various parts of the world.

The purpose of the company Facebook page varied among the firms. The firm ACIAB had a different outcome objective than the others being a not for profit organization whose goal was not revenue based but was to assist firms in the region through seminars and consulting. As such, it was the only firm with the objective of creating a viral environment to spread information among members about organization operations. All firms shared the objectives of sharing information about the company and gaining local customers. Only Urban Craft and Douro Wines felt that the Facebook page should management the effects of negative WOM responses (Table 2).

Table 2. Purpose of company Facebook page

	ACIAB	Braga Pop Hostel	Brb. Urban Craft	Douro Wines
Expand awareness by WOM	X			
Share information about the company	X	X	X	X
Greater coverage of consumers at territorial level	X	X	X	X
Manage negative WOM impacts			X	X

The objectives of the Facebook site also varied among the different firms but each firm appeared to have a developed strategy based on the type of firm and desired outcome of Facebook interaction (Table 3).

Table 3. Objectives of company Facebook page

	ACIAB	Braga Pop Hostel	Brb. Urban Craft	Douro Wines
The importance to formulate questions and exchange dialogue with consumers	X	X	X	X
Act as a channel framed in the communication strategy of the company	X	X	X	X
Importance in organization and promotion of company events	X			
To assist in understanding the consumer profile	X		X	X
Importance in consumer relationship management		X		

The outcomes of site ownership varied among the firms and three of the four met either increased sales or membership results. Table 4 depicts the reported benefits to the different firms coming from their Facebook page.

Table 4. Benefits the company reported as a result of their Facebook page

	ACIAB	Braga Pop Hostel	Brb. Urban Craft	Douro Wines
Increased knowledge about this company	X		X	X
Increased traffic on the company website	X			
Increased traffic	X	X	X	X

on the company's  
Facebook page

Increased the  
number of clients

X

X

Act as a channel  
for brand loyalty

X

Increased the  
sales volume

X

X

## CONCLUSIONS

When the objectives of the different company Facebook pages were analyzed it was determined that only ACIAB had the objective of organizing member events which is consistent with its mission. All firms reported that the site should engage consumers in dialog and be part of the company communication strategy. Braga Hostel, Urban Craft and Douro Wines stated that the site should act to find ways to understand the consumer profile and only Braga Hostel desired the site to further the consumer relationship. It is worthwhile to note that while two firms wanted to use the Facebook site to better understand the profile and desires of the consumer. When Urban Craft asked consumers about a product preference consumers responded they liked the color of a product that had the least sales. While only a single case this highlights drawbacks of taking consumer responses at face value. Such contradictions are frequent and recalls the famous Coke survey where thousands of consumers reported a preference for "new Coke" but when the firm introduced the product found that consumers rebelled demanding the reinstatement of their Coke Classic (Table 3).

The Facebook strategy of the different firms, as well as their different objectives, was reflected in the varied reported benefits of the company Facebook page. Three firms (excluding Braga Hostel) noted increased knowledge about the company which indicates the "Facebook effect" of Braga Pop Hostel may not be as effective as the others but Braga Hostel found the site increased traffic. The only common benefit of four companies in the case research is the increased traffic on the company's Facebook page. Only in one case (Braga Pop Hostel) Facebook was selected as a channel of choice for establishing relationships with customers because this media allowed the company to interact with the client in a unique way of immediacy and interactivity that no another channel provided. This was consistent with ACIAB's object to increase membership and awareness of their offerings and the site did increase the number of clients. As a membership organization they would not be involved in sales, however, the significant traffic on ACIAB's website seemed to successfully lead to the

wider customer basis, as well as the better company acknowledgement. Determined by ACIAB's business model, which targets directly at customers, the number of clients is much more essential than sales volume.

Braga Hostel did increase brand loyalty and traffic but this did not translate into increased sales. Both Urban Craft and Douro Wines increased knowledge, traffic and sales. What appears to be the case with these two firms was that the increased sales came from different customer sources. In the case of Urban Craft, who saw increased client number, sales came from existing and new consumers. Actually, injecting energy in either reaching out for new or keeping existing clients can be extremely acceptable and help a small or middle-size company to expand. In the case of Douro Wines, however, there was not an increase in new clients pointing to the increase in sales to come from existing consumers buying more products (Table 4).

For the first formulated hypothesis - *H1: Small Medium Enterprises will benefit from the impact of WOM on social networks*- the results suggest these firms can benefit with the impact of WOM on social networks. WOM presents itself as a prominent factor for the Facebook users to learn about companies and their products through the sharing of information and the interaction that the site enables. It must also be taken into consideration that the sites may generate negative communications about a firm that has to be taken into account making it necessary for firms to monitor the sites carefully. It was suggested that when WOM is negative it can be minimized if the content was taken from pages quickly and/or responded to effectively.

In consideration of *H2: Social networks are an important means of enabling consumers to share information about a product/service* the results suggest that Facebook is a privilege channel for consumers to talk about brands and their products and services. Companies can accentuate this trend by promoting interaction between consumers and the firm through such activities as contests and sweepstakes on its pages. Such actions would have as their objective to increase the number of visitors interacting with the site.

Results concerning the third hypothesis, "*networks reflects the quality of the relationship that companies have with consumers*" indicate that each of the selected companies communicated on Facebook in a structured way in order to convey the brand values clearly.

In regard to *H4: The presence of Small Medium Enterprises in social networks will have a direct impact on the brand familiarity of these firms to the consumer* the results indicated

that Facebook plays a crucial role to promote the brand in online environments and were responsible for the increased knowledge about the firm and its products/offerings.

An analysis of the final hypothesis - *H5: The direct contact with consumers through social networks generate greater involvement resulting in a direct impact on brand loyalty intentions* suggests that Facebook leads to greater involvement with the brand and increases loyalty as evidenced through increased sales and increased customers.

Thus, and given the above, on the main research question "**How do social networks have impact in the management of Small Medium Enterprises?**", the results indicate that, in particular Facebook, is an important channel that enables small and medium sized companies to advertise their brands easily and accessible without having to have large budgets. Similarly, this tool allows companies to communicate with consumers and establish a relationship with them that will prove crucial for a greater involvement with the brand and increased loyalty.

The study demonstrated that Facebook is a medium that facilitates and expands communication with the consumer of small or medium sized firms. Working in an interactive environment and having tools that allow rapid conversation between all parties, Facebook presents itself as a unique environment that can enable businesses to increase prospective clients and also offer current consumers with a closer relationship to the company. As such, the study seemed to indicate that presence on social networks can have an important role in both relationship development and increased sales/membership. It is noted that when companies promoted the firm in a creative way that enabled consumers to interact with content (e.g. photographs, texts, contests, sweepstakes or promotions) consumers were more likely to engage with the company and promote their products through WOM. The diverse range of firms and objectives of the study demonstrated that Facebook can be a useful, inexpensive and dynamic part of a small/medium size firm's business strategy. To do so, however, requires insight, focus, a well-developed Facebook plan, an understanding of analytics and the courage to engage the consumer in a meaningful open manner.

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**PERCEPTUAL ANTECEDENTS OF VOICE TO VOICE SERVICE  
ENCOUNTERS AND ITS IMPACT ON CUSTOMER LOYALTY:  
EVIDENCE FROM A SOUTH ASIAN COUNTRY**

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**ABSTRACT**

Listening to the customer is very important to develop a marketing oriented firm. At the same time, it is a difficult, time consuming and costly exercise. As a result many of the firms have disengaged themselves from listening to their customers in larger scales. However recent technological advances in information and communication technology has allowed marketers to fundamentally alter the nature of conducting business by providing much easier and cheaper avenues to listen to their customers. This paper will discuss one such mechanism i.e. call centers. Main objective of the research will be to find out the impact of customer perceptions of voice to voice service encounters on behavioral intentions. Research was conducted as a survey where data was collected using self-administered questionnaires. The survey was conducted in Western and Southern provinces of Sri Lanka across a sample of 750 respondents. Four independent variables namely attentiveness, responsiveness, empathy and adaptiveness were used to predict behavioral intentions which was the dependent variable. Regression analysis was used to analyze data. As far as the impact is concerned, the study found out that perceived attentiveness, perceived responsiveness and perceived empathy have positive impacts on behavioral intentions while empathy has been the strongest predictor.

**Keywords:** Call Center, Attentiveness, Responsiveness, Empathy, Adaptiveness

**INTRODUCTION:**

Listening to the customer is very important to develop a marketing oriented firm. But at the same time, it is a difficult, time consuming and costly exercise. As a result many firms have disengaged themselves from listening to their customers in larger scales; firms who do engage in similar activities are more focused on balancing costs and benefits. However recent technological advances in information and communication technology has allowed marketers

to fundamentally alter the nature of conducting business by providing much easier and cheaper avenues to listen to their customers. This paper will discuss one such mechanism i.e. call centers, available to marketers to listen to their customers and will evaluate the larger consequences of performance of the call center on customer intentions.

“A call center has been defined as a physical environment dedicated for servicing and interacting with customers or potential customers, which comprise of agents whose primary dedicated function is to handle inbound and outbound traffic via the telephone and other available channels” (Contact Center Industry Benchmarking Study-2003). According to Moon et al., (2004, p. 227) call centers, are where human agents and/or automatic voice response machines handle computer assisted telephonic communications with customers. As a whole call centers are dealing with integrating technology with human component to provide unique service to the customers.

Service-based competition and the potential for significant cost reduction have resulted in a significant worldwide growth of call centers in recent years (Callaghan and Thompson, 2002). Many firms have introduced call centers to improve the responsiveness of their service and to minimize the costs (Tax and Brown, 2000). For an example number of call centers have almost doubled and expenditure on developing call centers have almost tripled during last five years (Richard et al., 2000). Moreover the total number of call center seats across the south Asian region is estimated to be over 200,000 by mid 2000.

Despite the importance and given that the use of call centers has grown over the years (Crome, 1998), the contexts have rarely been studied from the customer point of view, even though most consumers at some point in their life has contacted a call center (Keiningham et al., 2006). Further Monger et al., (2004) highlights the importance of managing the first call properly, as the first call has importance influences on customer satisfaction. Most of the available literature in the field focuses on staffing aspect of the call center. Even the available studies have focused on “evaluating call center performance, based on performance of employees in call centers using “hard data” like the number of calls handled, agent sales, productivity, and amount of errors.” (Brown and Maxwell, 2002, p. 311). There is a clear gap when it comes to studies measuring customer satisfaction elements (Jaiswal, 2008; Keiningham et al., 2006; Unzicker, 1999). Few studies which have focused on customer perceptions (e.g.: Ruyter and Martin, 2000) have failed or haven’t tried to link perceptions to any behavioral outcomes. Thus there is a clear knowledge as well as a contextual gap. Therefore the objective of this study is to find out the impact of customer perceptions of voice to voice service encounters on behavioral intentions.

## LITERATURE REVIEW:

### *Predicting human behavior:*

Explaining human behavior in all its complexity is a difficult task, since behavior is interplay between lots of different actors. Ajzen, (1988) and Sherman & Fazio, (1983) have used social attitude and personality traits, to predict and explain human behavior. Theory of Reasoned Action (TRA) which was developed by Ajzen & Fishbein, (1980) with the assumption that individuals are rational and make systematic use of information, predicts that people consider the implications of their actions before they decide to engage or not to engage in a given behavior. Ajzen and Fishbein, (1980) define attitude toward the behavior as “a person’s general feeling of favorableness or unfavorableness for that behavior” and subjective norm as “a person’s perception that most people who are important to him think he should or should not perform the behavior in question”. However TRA lacks practicality and even the original authors realized it, which made them introduce an extension to the theory (Godin & Kok, 1996). The extension which is also known as Ajzen’s (1985) Theory of Planned Behavior (TPB) is one of the most influential and well-supported social psychological theories for predicting human behavior. The central argument for the theory is that behavioral decisions are not made spontaneously but made as a result of a rational process in which behavior is influenced, both directly and indirectly, by attitudes, norms, and perceptions of control over the behavior (Ajzen, 1985). As far as the study is concerned the attribution of three components to attitudes is widely accepted: cognitive, affective, and behavioral elements (Sánchez and Iniesta, 2004).

### *Customer expectations and satisfaction:*

According to Garbarino & Edell (1997, p. 147) “It is increasingly clear that a brand’s attributes are not the only elements, and perhaps not the most important elements, in determining consumers’ attitudes”. Pre decisional evaluation of services, due to its specific characteristics may depend on other factors as well, such as the prestige of the company, recalled attributes of the product, or prior overall judgments (Lynch et al., 1988). Customer satisfaction is interpreted as a function of the blend between customer’s expectations and actual experience of the service (Zeithaml et al., 1993). Expectations are viewed as “predictions made by customers about what is likely to happen during an impending transaction or exchange”

(Zeithaml et al., 1993, p. 2). Many researchers (Gronroos 1990; Parasuraman et al., 1988) break service into two dimensions: the outcome (what the customer receives) and the process (the manner in which the service is delivered to the customer). The services literature further suggests that the quality of the interaction is also a critical component of the service **recovery** process (Bitner et al., 1990).

#### *Call center service encounters:*

Voice-to-voice encounters are critical encounters because the telephone can be the first interaction with a company (Unzicker, 1999). Therefore one of the most important aspects of call centers is that their agents are listening to customers as well as responding to their requests. Voice-to-voice encounters provide a way to build, maintain, and manage customer relationships (Anton, 2000) and increase satisfaction (Feinberg et al., 2002). Listening as perceived by customers has been defined as “a set of interrelated activities, including apparent attentiveness, non-verbal behavior, verbal behavior, perceived attitudes, memory and behavioral responses” (Lewis and Reinsch 1988, p. 18). Moreover Rust and Oliver (1994) on the other hand discussed the service encounter with respect to two dimensions, namely, the service performance and the service environments. Moreover Boshoff (1999) in his scale instrument (RECOVSAT) identified eight elements which can be used to measure customer perception towards call centers. They are, time, communication style, empathy, reliability, perceptions of commitment to service quality and customer satisfaction, empowerment, staff attitude, and explanation.

## **METHODOLOGY:**

Research was conducted as a survey where data was collected using self-administered questionnaires. The population for the study is all telephone subscribers in Sri Lanka. Sri Lanka was selected due to its booming economy and conducive environment to call center establishments. Sample comprised of 750 subscribers and was selected across different telephone users. Sample was selected using convenience sampling. The survey was conducted in Western and Southern provinces of Sri Lanka these two provinces were selected in this regard since those are the two provinces with highest number of telephone subscribers (These two represents 54% of all fixed access users in Sri Lanka) ([www.trc.lk](http://www.trc.lk)).

Questionnaire was divided into three main sections namely, general information about the respondent, general information about the service, and information relevant to customer

perception. In order to measure the customer perception of call center experience researcher used the scale developed by Burgers et al., (2000), which has four variables to measure the service encounter namely adaptiveness, assurance, empathy, and authority and De-Ruyter, & Wetzels (2000), which has used four items attentiveness, perceptiveness, responsiveness, and trust. This part of the questionnaire included closed ended symmetrical scale questions.

Researcher created a questionnaire carrying twenty eight questions covering these eight variables and was tested through a pilot study which comprised with 100 university students. Researcher then did an exploratory factor analysis and found out four main factors. Oblique rotation was used due to high correlation among the initial factors. Loadings above 0.4 were selected and the new factors were named and their similarity with initial factor structures was considered during the process. Here four factors were identified, namely attentiveness, responsiveness, empathy and adaptiveness. Each factor had four variables except responsiveness which had five variables.

Attitudinal statements were constructed on above dimensions and were measured on a seven point scale; which ranged from strongly agree (7) to strongly disagree (1). The midpoint of the scale will be anchored by 4 (neither agrees nor disagrees). Researcher decided to use seven point likert type scales in order to minimize the possibility of moderate answers instead of a five point scale. Questionnaire was developed in English and then was translated to Sinhala by a language expert. Moreover questionnaire was given to an industry expert for his review in order to increase the face validity.

*Measures used in the study:*

Attentiveness is defined as "the extent to which customers receive verbal and nonverbal cues from call center agents during the telephone service interaction" (De Ruyter and Wetzels, 2000, p. 277). Adaptability, can be identified as the level of flexibility (Zeithaml and Bitner, 2000), and observed by the customer through effectiveness exhibited by the call center agent in managing different circumstances (Bearden et al., 1998). Responsiveness can be defined as "the level of understanding or agreement between the call center agent and the customer" (De Ruyter and Wetzels, 2000, p. 277). Ramsey and Sohi (1997) identifies at least 3 components of being responsive, namely answering to the customer at the right time, using complete sentences to answer the question and doing these things in a manner that customer feels the agent is enthusiastic about solving the problem. "A caring, individualized attention" can be defined as empathy (Parasuraman et al., 1988, p. 23). With relevance to call centers it is

the ability of the call center agent to make the customer feel like he was given individualized as well as prompt service (Burgers et al., 2000).

Following hypotheses were developed by the study in order to test the potential relationships as well as to achieve the objectives.

H1: Perceived attentiveness has a positive impact on behavioral intentions.

H2: Perceived responsiveness has a positive impact on behavioral intentions.

H3: Perceived empathy has a positive impact on behavioral intentions.

H4: Perceived adaptiveness has a positive impact on behavioral intention.

Researcher conducted a reliability test to determine the reliability of the items. All the items had greater than 0.8 Cronbach's Alpha values signaling very good strength of association among the instruments according to Hair *et al.*, (2006). Table 1 provides the reliability statistics.

Table 1: Reliability statistics

Measure	Cronbach's Alpha	Cronbach's Alpha	
		standardized items	No.of items
Attentiveness	.870	.873	4
Responsiveness	.835	.839	5
Empathy	.881	.881	4
Adaptiveness	.874	.874	4
Retention	.894	.894	4

### Analysis:

Sample consists of 56% females and 44% males. Majority of the respondents (47%) were belonging to the age group of 18-25 while the second largest group (32%) was belonging to age group of 26-35. Majority of the customers (33%) had contacted the call centers during 7 p.m. and 11 p.m. and the second most preferred time slot was 3 p.m. to 7 p.m. (23%) which was closely followed by 7 a.m. to 11 a.m. time slot (22%). 29% of the customers were picked up by an active agent before 5 minutes while a significantly higher (12%) set of respondents had to wait more than 10 minutes before they actually got an active agent. Researcher would

like to note that actual waiting time on hold and perceived waiting time on hold by respondents might vary quite a bit and latter generally be higher than former. But the study also wants to note that for respondents, perception is reality, thus whether it is correct or not doesn't have any impact.

Before examining the regression model a correlation matrix was conducted. All the correlations were significant at 99% confidence level. Empathy had the highest correlation with retention (0.730). The next highest correlated variable with retention was attentiveness which had a correlation of 0.711. Responsiveness and adaptiveness had correlations of 0.702 and 0.676 respectively. Both responsiveness and empathy were highly correlated with each other (0.780 and 0.781 respectively). All the independent variables exhibits significant correlations with other independent variables, this was a warning sign for the researcher. Thus the researcher decided to include multicollinearity diagnostics into the analysis.

As depicted in table 2, all three variables in the equation have VIF values less than 10 and tolerance values higher than 0.2 which signals a model with low multicollinearity.

Table 2: Coefficients and colinearity statistics

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Colinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant)	.998	.148		6.748	.000		
Empathy	.793	.027	.730	29.237	.000	1.000	1.000
2 (Constant)	.366	.154		2.381	.018		
Empathy	.506	.039	.466	13.037	.000	.433	2.311
Responsiveness	.426	.043	.351	9.802	.000	.433	2.311
3 (Constant)	.146	.155		.940	.347		
Empathy	.389	.043	.358	9.025	.000	.337	2.968
Responsiveness	.296	.048	.243	6.148	.000	.338	2.956
Attentiveness	.276	.048	.242	5.794	.000	.305	3.283

a. Dependent Variable: Retention

Table 3: Regression Model Summary

Model	R	R square	Adjusted R square	Std. error of the estimate
1	.730 <sup>a</sup>	.533	.533	1.022
2	.766 <sup>b</sup>	.586	.585	.963
3	.777 <sup>c</sup>	.604	.603	.943

a. Predictors: (Constant), Empathy    b. Predictors: (Constant), Empathy, Responsiveness    c. Predictors: (Constant), Empathy, Responsiveness, Attentiveness

The final model which was selected by the study to interpret, included three predictors namely attentiveness, responsiveness and empathy, and could explain 60% of the variation of the dependent variable which is behavioral intentions. Table 3 provides more details on the three models developed by the step wise regression process. Regression equation was determined as follows.

$$\text{Retention} = 0.146 + 0.276 (\text{Attentiveness}) + 0.296 (\text{Responsiveness}) + 0.389 (\text{empathy})$$

Attentiveness ( $b = 0.276$ ) value indicates that when attentiveness of the call center agent increases by one unit in the scale, retention increases by 0.276 units in the scale. Responsiveness ( $b = 0.296$ ) value indicates that when the responsiveness of the call center agent increases by one point in the scale, retention increases by 0.296 units in the scale. Empathy ( $b = 0.389$ ) value indicates that when a respondent rated one unit higher on the empathy scale, respondent retention tendency will increase by 0.389 units on the scale. Moreover t-test values can be used to see whether the predictor is making a significant contribution to the model (Field, 2006). Therefore highest contribution comes from the empathy (t-test value = 9,025) while attentiveness and responsiveness contributes respectively (t-test values 6.148 and 5.794 respectively).

First hypothesis of the study stated that perceived attentiveness has a positive impact on behavioral intentions. Attentiveness had an unstandardized Beta value of 0.271, a t- test value of 5.66 and was significant at 0.01 level. Thus research decided to accept the 1<sup>st</sup> hypothesis which stated that perceived attentiveness has a positive impact on behavioral intentions. Attentiveness signals how successful the call center agent is in creating a successful interaction (De-Ruyter & Wetzels, 2000). Therefore the study highlights the importance of creating a positive interaction with the caller.

2<sup>nd</sup> Hypothesis of the study stated that perceived responsiveness has a positive impact on behavioral intentions. Responsiveness had an unstandardized Beta value of 0.280, a t-test

value of 5.56 and was significant at 0.01 level. Thus research decided to accept the 2<sup>nd</sup> hypothesis which stated that perceived responsiveness has a positive impact on behavioral intentions. Responsiveness creates trust in the eyes of the consumer (De-Ruyter & Wetzels, 2000), thus the above findings are logically related.

3<sup>rd</sup> Hypothesis of the study stated that perceived empathy has a positive impact on behavioral intentions. Empathy had an unstandardized Beta value of 0.361, a t-test value of 7.05 and was significant at 0.01 level. Furthermore empathy had the highest ability of prediction out of all other variables in the equation. Therefore research decided to accept the 3<sup>rd</sup> hypothesis which stated that perceived responsiveness has a positive impact on behavioral intentions. The individual attention given to the customer determines how much empathy was created during the transaction (Burgers et al., 2000). The importance of empathy in employee satisfaction is well documented in the literature (Kettinger & Lee, 1994).

Final hypothesis of the study stated that perceived adaptiveness has a positive impact on behavioral intention. Adaptiveness had an unstandardized Beta value of 0.052, a t-test value of 1.01 and was not significant at 0.05 level (sig = 0.309). Thus the hypothesis which stated that perceived responsiveness has a positive impact on behavioral intentions was rejected by the study. Adaptiveness deals with the flexibility shown by the call center agent. These findings are in contradiction with the existing literature; which suggests positive impact between these two dimensions (Burgers et al., 2000). Table 4 provided summary of the hypotheses testing.

*Table 4: Summary of the hypotheses tested*

Hypothesis	Results
1: Impact of Attentiveness on Behavioral Intentions	Accepted
2: Impact of Responsiveness on Behavioral Intentions	Accepted
3: Impact of Empathy on Behavioral Intentions	Accepted
4: Impact of Adaptiveness on Behavioral Intentions	Rejected

## **FINDINGS AND CONCLUSIONS:**

Study found out that demographic variables have some kind of influence in respondent's voice to voice perceptions. However at the same time it is important to note that these differences are minimal and do not impact the firm's ability to influence consumer perceptions.

However as far as call center related factors are concerned there is significant room for firms to improve. Especially when it comes to customers on hold time, even though researcher assumes that waiting times may be inflated due to the nature of the interaction, still customers are kept on hold for significant period of times. The situation becomes even worse because of the fact that some of these customers wait on paid lines. However study also wants to note the positive perceptions by customers across all areas and across all companies. This as far as the study has identified is due to proper and effective training of the call center agents. Therefore study would recommend these firms to maintain these higher standards. Study found out significant relationships as well as the impact on three perceptual antecedents on behavioral intentions. Namely attentiveness, responsiveness and empathy have significant impact on customers' willingness to be with the firm in the long run. As pointed out earlier, attentiveness, empathy and perceptiveness has also been found earlier as significant predictors of behavioral intentions (Mount and Mattila, 2002), and which supports the findings of this study. Thus a firm needs to identify and manage call center voice to voice encounters properly.

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## ANTECEDENTS AND CONSEQUENCES OF SURROGATE ADVERTISING – AN EMPIRICAL STUDY IN INDIA

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### **ABSTRACT**

The ban on advertising for liquor and cigarette is now likely to be extended to surrogate advertising that defeats the purpose. Another problem came into focus when brand extension strategy used in response to the ban on advertisements of one product category. Although many of the consumers know the negative effects of surrogate advertising for alcohol and tobacco products but this particular study aims to quantify the ill effects caused by it, will definitely increase their responsibility

towards health. Major portion of respondents believe that surrogate advertising leaves a wrong impression on corporate reputation and corporate are losing their potential on ethical ground. The statutory warning could be more effective to increase consumer awareness if it quantifies how much it is responsible for health hazards. An amount of respondents thinks that it is a normal promotion of products and does not affect on their purchase and usage decision. The antecedents and consequences proposed by the study model designed based on the literature, appeared reasonably valid.

**Keywords:** Surrogate advertising, brand extension, corporate reputation, India

## INTRODUCTION

Corporate communication carries the essence of a corporate identity (Balmer, 1998; Scott and Lane, 2000). As ethical concerns are an inseparable factor of business, advertising cannot ignore them. It is a communication process directed from the marketers towards the consumers. The basic objective of advertisement is to provide information and create awareness about the product and the market. According to Wells and Burnet (1998, p.13) advertising is a paid non-personal communication from an identified sponsor using mass media to persuade or influence an audience. However, many times some advertisements are accused of misleading the mass. Such accusations came in the lime light when the flashes are on the advertisements that are openly endorsing liquor and tobacco products. Consumer awareness was carried out on topics ranging from MRP to Gold Hallmarking, ISI marked products, expiry dates etc. Numbers – it really matters. This particular study aims to quantify the direct and indirect ill effects caused by this kind of advertisements and aims to increase consumers' degree of personal responsibility towards their health.

## REVIEW OF LITERATURE

Surrogate advertisement: A Surrogate advertisement is one in which a different product is promoted using an already established brand name such ads helping in contribution to brand recall (ASCI – Laws Governing Ads). 'Surrogate advertising' is one of the emerging ethical issues in advertising in India (Chander & Sharma , 2007). Advertising leads to awareness. Keller (2003, p.76) defines awareness as “ the customers' ability to recall and recognize the

brand as reflected by their ability to identify the brand under different conditions and to link the brand name, logo, symbol, and so forth to certain associations in memory". Surrogate advertising is performing the same in a substitute way. Despite significant contributions in the past, there is still a growing need for answers in the area of business ethics and social responsibility of the firm (Donaldson, 2003; Harrison and Freeman, 1999; Walsh et al., 2003). Chander and Sharma (2007) found that, the attitude of the respondents towards surrogate advertisements are much on the negative side. Through surrogate advertising Tobacco and alcohol companies' left unethical impact on their corporate reputation, challenge consumes ethical consciousness, government policies, corporate strategic practices etc.

Corporate reputation and communication: Fombrun and van Riel (1997) sought to subsume corporate image and identity within reputation. Bromley (2001) defined a firm's image as 'the internal collective\state of mind that underlies its corporate communications efforts (successful or not) to present itself to others'. A corporate identity is their reputations through corporate communication (Balmer and Gray, 1998; 2000). To obtain a reputational status, a company should consider different ethical dimensions of advertising (Cunningham and Cunningham, 1977; Zanoletti and Pincus, 1983; Hunt and Vitell, 1986; Zinkhan et al., 1989; Treise et al., 1994; Miniard, 1999; Cohan, 2001; Perry and Berky, 2002). The behavior of firms and the values guided the means of achieving the goals, can be broadly extended to corporate communication. A failure to communicate ethical values and socially responsible behavior impacts on corporate identity as it depends on organizational values and behaviors (Fombrun, 1996; van Riel and Balmer, 1997). Benetton positions its corporate identity successfully with strong ethical values in its marketing communication campaigns and social initiatives (Borgerson, J.L., Schroeder, J. E., Escudero Magnusson, M. and Magnusson, F., 2009). It is desired, a responsible corporate should be participating actively in ethical social dilemmas (Löhman & Steinholz, 2003; Philipson, 2004) and proper Communication, as it is an important part in ensuring future business (Charter & Polonsky, 1999). Corporate reputation implies individual's knowledge or emotions since these indicate an awareness of the firm. Empirical evidence has supported the argument that consumers gave a positive appraisal if news media focus on ethical issues (Christians & Nordenstreng, 2004; Berkman & Shumway, 2003) and it will definitely hurt firm's reputational indicator. Once there is negative impact in a company's reputation because of ethical issues like surrogate advertising, it is nearly impossible to influence the consumers' attitude and their enduring beliefs towards the positive way.

Questionable use of Best corporate practices: Brand extensions can be defined as the stretch of the established franchise to a different product class (Aaker and Keller, 1990). The advantage of extensions compared to new brand names is it requires lower marketing and brand development costs (Smith and Park, 1992), borrow awareness and positive associations from the parent brand (Aaker & Keller 1990; Volckner & Sattler 2006; Ahluwalia 2008) and appeals to the prospects. The argument is on using brand extension strategy by the tobacco and alcohol companies to capitalize equity, based on their core business. Mehta (2003) and Sirisha and Mukund (2003) give lights on the deceptiveness of surrogate advertising and how they entering into new businesses like cassettes and CDs, mineral water, soda, giving sponsorship on holiday packages, entertainments with the same brand name, logo or symbols. Parent brand category dominance (Keller, 2003) may help the surrogate advertisers to keep hold of their actual business. There is nothing to counter as so far no universal model has been widely recognized which could offer guidelines for brand extension practices (D'Astous, Colbert, and Fournier 2007; Sood and Dreze 2006; Echambadi, Arroniz Reinartz & Lee 2006) or anything declared that brand extension is not allowed for banned products. Thus surrogate advertising leads questionable implementation of the brand extension strategy using restricted brand names.

Surrogate advertising increase consumers' advertisement involvement: The key purpose of surrogate advertising, is to motivate consumer characteristic like influencing their positive mood for their core brand (Nijssen et al., (1995), Broniarczyk and Alba (1994), Gurhan-canli and Maheshwaran (1998), Barono et al. (2000), Flaherty and Pappas (2000), and Klink and Smith (2001). Involvement is a motivational condition in which people have an impact on their decisions and actions. In the current study, involvement can be simply defined in the context of motivational properties evoked by a particular stimulus such as advertisement. This study seeks to know whether Surrogate advertising may advance the degree of involvement towards the tobacco and alcohol products. According to J. Craig Andrews, Srinivas Durvasula, Syed H. Akhter) as it carries intensity, direction and persistency towards usage, purchase decision etc. Moreover advertising involvement (e.g., Andrews 1988) facilitates message-oriented thoughts, message-argument recall. Using tobacco and alcohol brand names in ads helping in contribution to brand recall (ASCI) only. Active involvement, identification is an important motivation for, and outcome of, media exposure (e.g., Ang, 1982/1985).

Defying Government policies and socially irresponsible behavior: Keller and Aaker (1997) defines Corporate Social Responsibility as a “firm’s philosophy to improve the quality of life in local communities through various activities and programmes”. In contrary, Chander and Sharma (2006) opine that surrogate advertising promotes wrong impressions and leads to social degradation. “Business is not divorced from the rest of society. How companies behave affects many people, not just shareholders. A company should be a responsible member of the society in which it operates” (Internet, World Business Council for Sustainable Development, 1, 2006). Through surrogate advertising companies are showing their socially irresponsible behavior.

Issues of concern: This kind of indirect advertising also may increase involvement, which has an impact on consumers’ decisions and actions, original brand original product category recall, identification. All of these may lead to addictive disorder like alcoholism and tobacco addiction. A market survey in 2001 revealed that advertising has a direct influence on the consumption habits of 431 million people in India and an indirect impact on 275 million ‘aspirants’ from the lower income group (Mehta 2003).

Another problem came into focus when Companies started offering new product sharing the same brand name as it was used for tobacco and alcohol products. (Ex: Companies such as Kingfisher have several businesses with the same brand name - such as mineral water, airline and soda). The vision behind selling drinking water and apple juice packaged by alcohol companies is getting young people to start early and be life-long consumers (Raekha Prasad, 2009).

Tobacco and alcohol takes enormous lives daily. Alcohol is the leading risk factor related to the major burden of disease in low mortality developing countries and the third most prevalent risk factor for leading diseases and injuries in developed countries (WHO, 2002). To maintain the customer base the companies started attracting children, youth and women and producing a range of feminized brands associating smoking with slimness, modernity; sophistication. Some examples are Virginia slims, glamour, camel pink etc. (TAPS).

Companies are not only violating ethical issues but also abusing corporate social responsibility. “Godfrey Philips Bravery Awards” is an example of media- hyped CSR activity. The company would justify the advertisement by claiming that it is an example of

social responsibility. By using the tobacco brand, they are only, contradicting with their aim and responsibility towards society.

Research gap: Although the previous studies examined the ethicality of advertisements on controversial products like cigarettes, alcoholic beverages (pomeroy, castellano, Becker, Johnson, and Brown 1992; Zinkhan et al. 1989), but in India, there are still a number of unresolved issues in the area of surrogate advertising. The study has not been confined on the controversial use of surrogate advertising but further extended on the consequences like corporate irresponsible nature towards its surrounding by targeting segments like youth, feminism; challenge consumers' ethical concern, defying government policies, questionable use of brand extension strategy which are largely neglected issues yet.

The objective of the paper: Consumer awareness and protection has been recognized, as a major thrust area of this study. This particular study aims to quantify the direct and indirect ill effects caused by surrogate advertising.

This study has been undertaken to address the deficiency of research in the field of surrogate advertising by exploring people's perceptions towards such controversial advertising practices and related ethical issues.

The paper is offered as an information service to consumers, companies, and academicians and could play a pivotal role in creating mass awareness.

Proposed study: The research accounted in this paper is a preliminary assessment of some antecedents or previous circumstances and consequences of surrogate advertising, proposed by the study model designed based on the literature framework.

Antecedents

Consequences

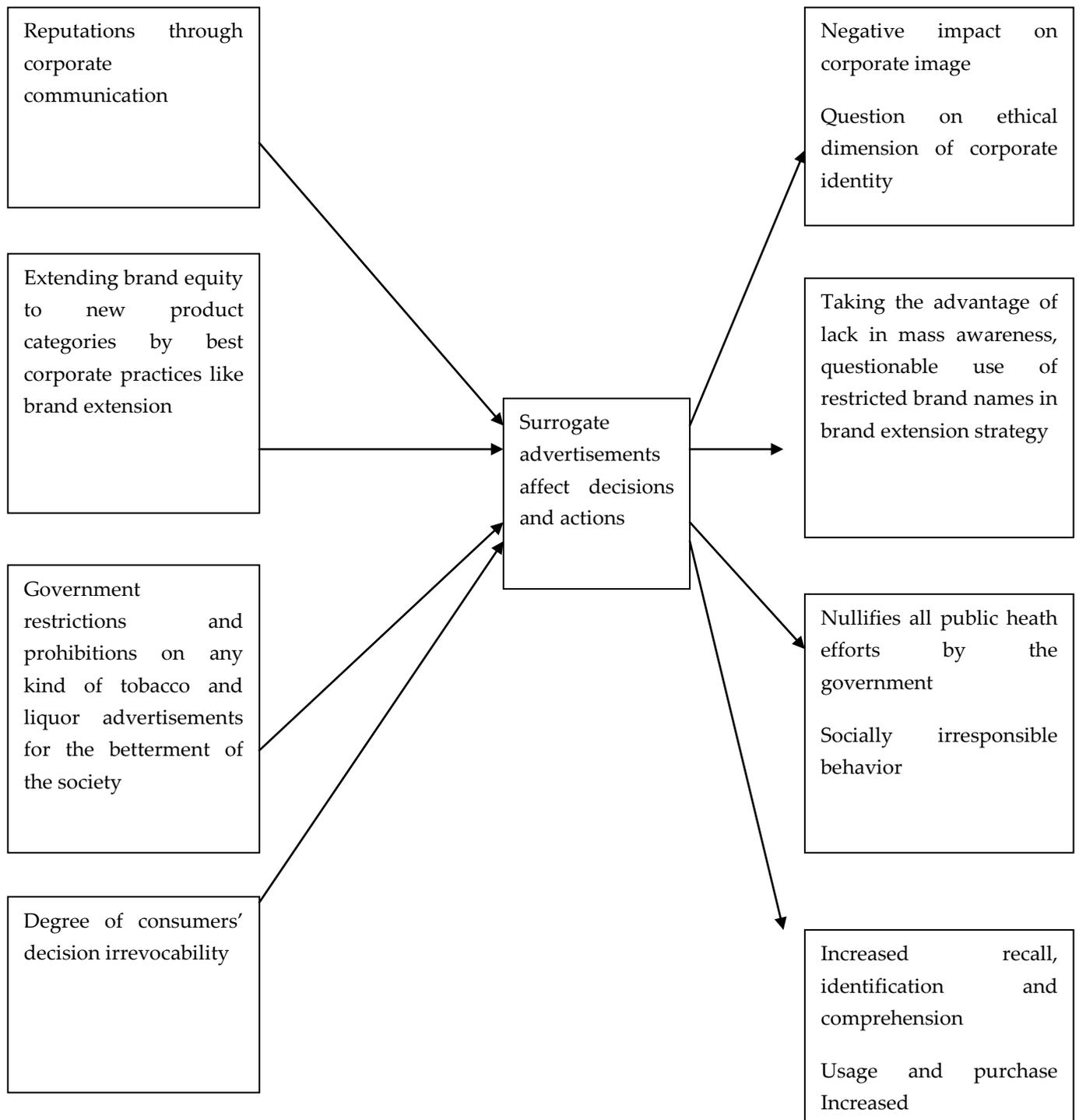


Fig. 1 Solid arrows signify direct influences

## METHODOLOGY

Table 1

Descriptive research: Quantitative analysis was done based on a survey using convenience sampling in Kolkata, India. The sample comprising of two forty two respondents.

In an attempt to answer following questions of the research, which were;

1. According to you for this type of surrogate advertising,

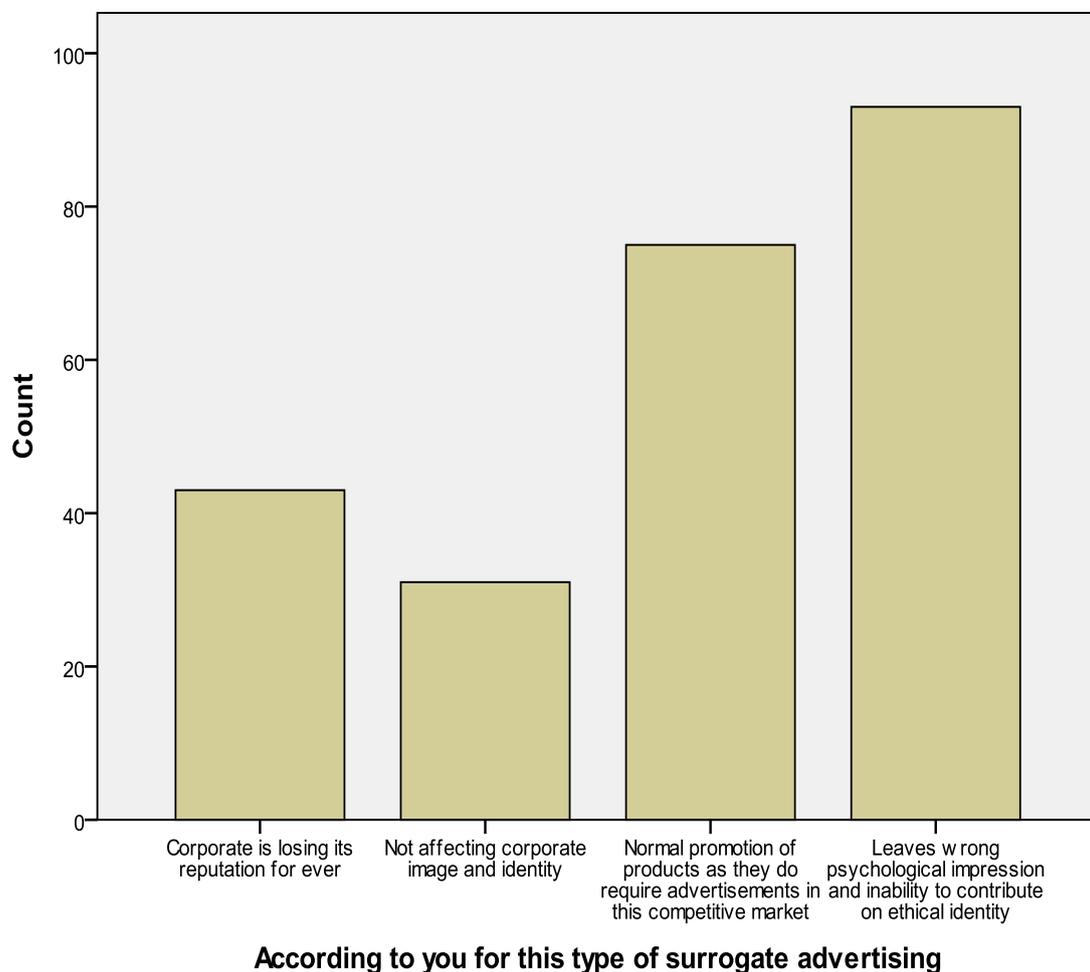
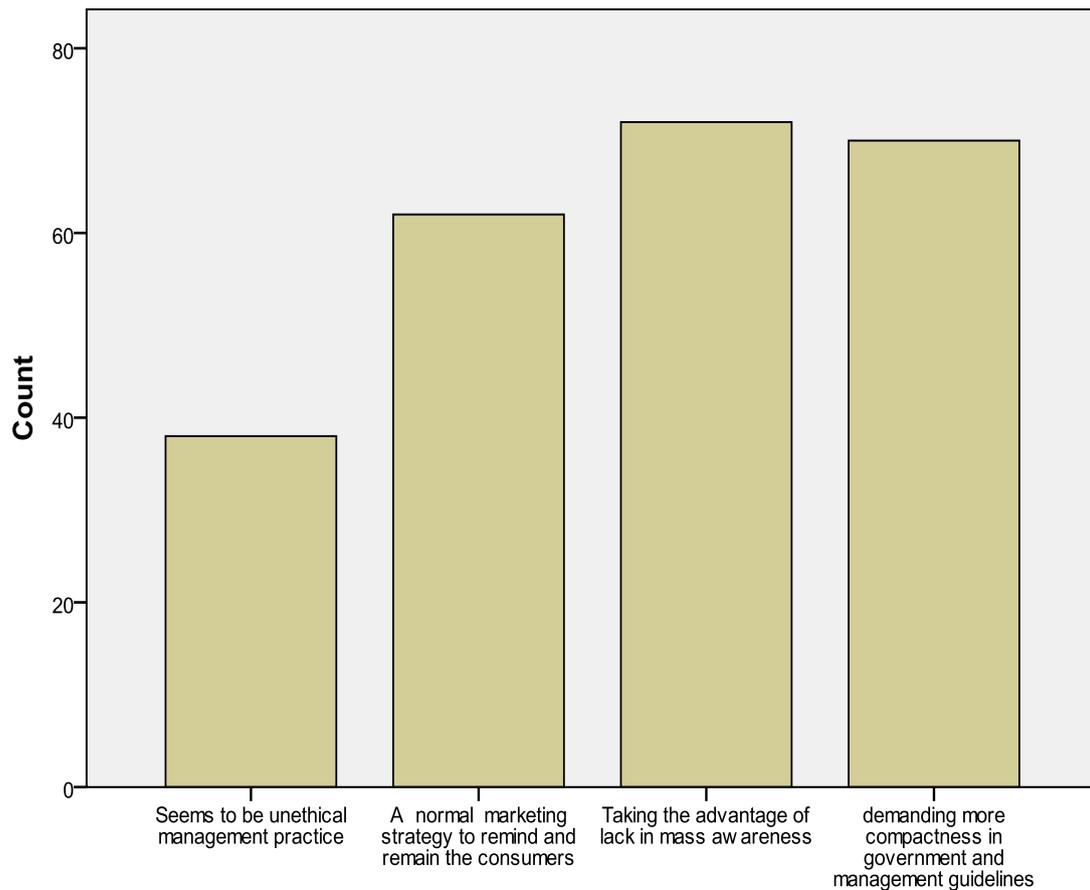


Fig. 2

The greatest amount of respondents believed it increase involvement towards tobacco and alcohol. The second highest finding it as normal promotion of products. The logic behind this

is if there is no restriction on sell then why on advertising? It is necessary to advertise in the competitive market. Few respondents found it responsible for loosing corporate reputation and few found it not effecting corporate image and identity.

2. According to you, introducing mineral water, CDs under the tobacco and alcohol brand name is



**According to you, introducing mineral water ,CDs under the tobacco and alcohol brand name is**

Fig.3

Common mass is unaware of the fact that brand extension is a qualified branding strategy but it is used in brand stretching of restricted products via introducing mineral water, CDS etc.

3. Can you identify the Brand of the ad campaign in which Saif Ali Khan, Yuvraj Singh and Harbhajan Singh played music on the streets?

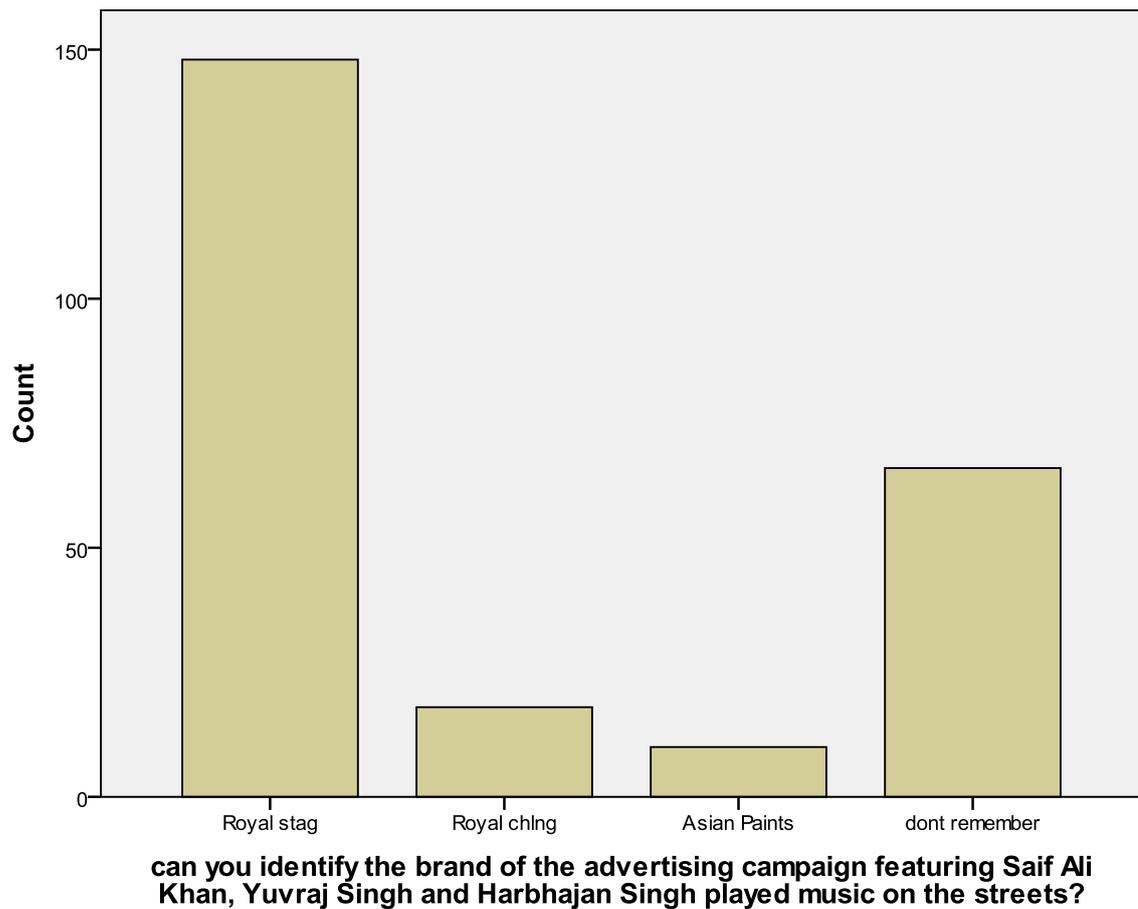


Fig. 4

The greatest amounts of respondents easily spot the brand name. It emphasizes the strong identifiable level of the original brand through surrogate Ads.

4. According to you what would be the probable approach to normalize the current problem?

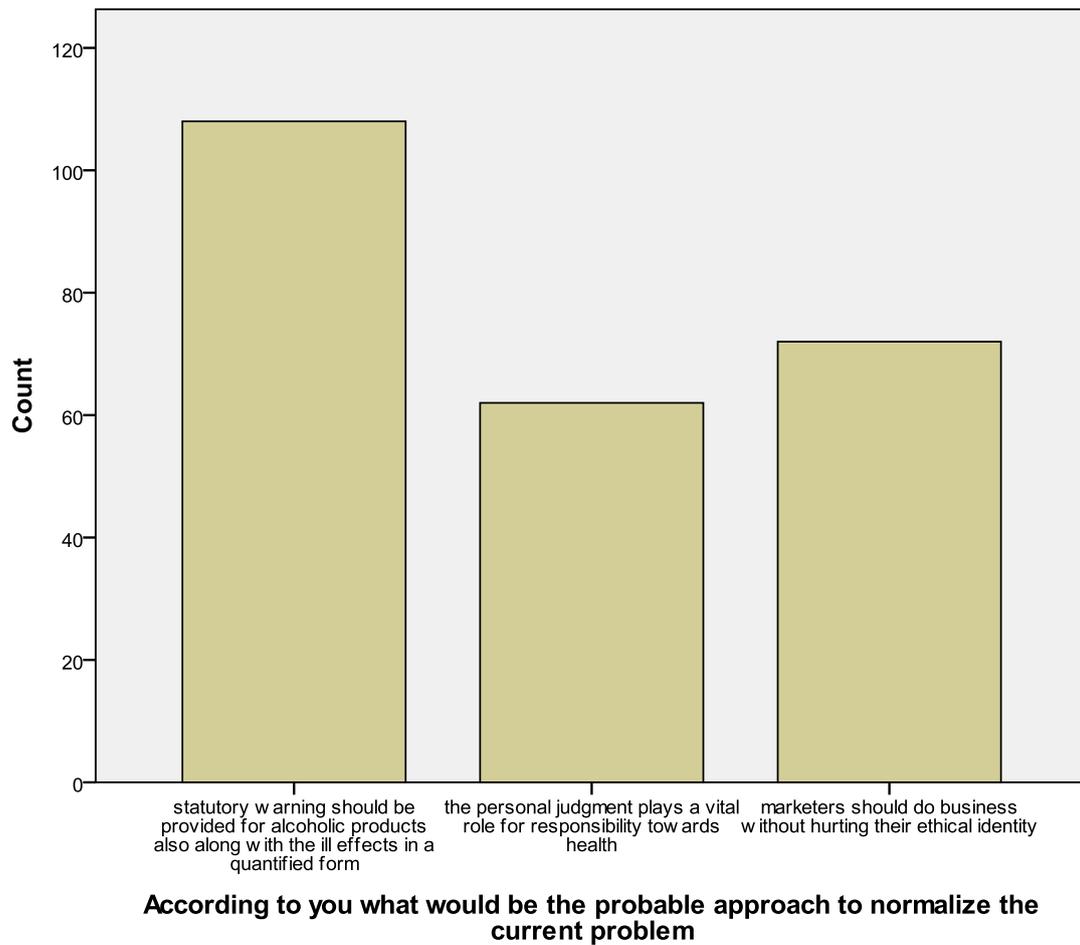


Figure - 5

4. Is there any significant relationship between number of tobacco and alcohol brand advertisement viewership and increase in usage and purchase decision?

## Seen advertisements on various media \* Increase usage and purchase decision Crosstabulation

			Increase usage and purchase decision		Total
			yes	no	
Seen advertisements on various media	Count		120	98	218
	% within Seen advertisements on various media		55.0%	45.0%	100.0%
	% within Increase usage and purchase decision		85.7%	96.1%	90.1%
	% of Total		49.6%	40.5%	90.1%
no	Count		20	4	24
	% within Seen advertisements on various media		83.3%	16.7%	100.0%
	% within Increase usage and purchase decision		14.3%	3.9%	9.9%
	% of Total		8.3%	1.7%	9.9%
Total	Count		140	102	242
	% within Seen advertisements on various media		57.9%	42.1%	100.0%
	% within Increase usage and purchase decision		100.0%	100.0%	100.0%
	% of Total		57.9%	42.1%	100.0%

Table – 2

The above cross tabulation result reveals that the higher the number of viewers higher the increase of usage and purchase decision.

## Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	7.095a	1	.008		
Continuity Correction <sup>b</sup>	5.982	1	.014		
Likelihood Ratio	7.876	1	.005		
Fisher's Exact Test				.008	.006
Linear-by-Linear Association	7.066	1	.008		
N of Valid Cases	242				

a. 0 cells (.0%) have expected count less than 5. The minimum expected count is 10.12.

b. Computed only for a 2x2 table

Table – 3

Chi square analysis revealed that there is strong association (significance  $p = .008 < .05$ ) between number of advertisement viewers and increasing usage and purchase decision of tobacco and alcohol products.

5. Is there any significant relationship between brand original product category recall at the time of purchase any of their extended product and knowledge about tobacco and alcohol brands through surrogate Ads?

original brand original product category recall at the time of purchase any of their extended product \* knowledge about tobacco and alcohol brands through surrogate ads Cross tabulation

		knowledge about tobacco and alcohol brands through surrogate ads		Total
		yes	no	
original brand original product category recall at the time of purchase any of their extended product	Count	82	48	130
	% within original brand original product category recall at the time of purchase any of their extended product	63.1%	36.9%	100.0%
	% within knowledge about tobacco and alcohol brands through surrogate ads	58.6%	47.1%	53.7%
	% of Total	33.9%	19.8%	53.7%
no	Count	58	54	112
	% within original brand original product category recall at the time of purchase any of their extended product	51.8%	48.2%	100.0%
	% within knowledge about tobacco and alcohol brands through surrogate ads	41.4%	52.9%	46.3%
	% of Total	24.0%	22.3%	46.3%
Total	Count	140	102	242
	% within original brand original product category recall at the time of purchase any of their extended product	57.9%	42.1%	100.0%
	% within knowledge about tobacco and alcohol brands through surrogate ads	100.0%	100.0%	100.0%

original brand original product category recall at the time of purchase any of their extended product \*  
 knowledge about tobacco and alcohol brands through surrogate ads Cross tabulation

		knowledge about tobacco and alcohol brands through surrogate ads		Total	
		yes	no		
original brand original product category recall at the time of purchase any of their extended product	yes	Count	82	48	130
		% within original brand original product category recall at the time of purchase any of their extended product	63.1%	36.9%	100.0%
		% within knowledge about tobacco and alcohol brands through surrogate ads	58.6%	47.1%	53.7%
		% of Total	33.9%	19.8%	53.7%
no	no	Count	58	54	112
		% within original brand original product category recall at the time of purchase any of their extended product	51.8%	48.2%	100.0%
		% within knowledge about tobacco and alcohol brands through surrogate ads	41.4%	52.9%	46.3%
		% of Total	24.0%	22.3%	46.3%
Total		Count	140	102	242
		% within original brand original product category recall at the time of purchase any of their extended product	57.9%	42.1%	100.0%
		% within knowledge about tobacco and alcohol brands through surrogate ads	100.0%	100.0%	100.0%
		% of Total	57.9%	42.1%	100.0%

Table – 4

The above cross tabulation shows that the surrogate Ads helps the organization to advertise their product in a different way and make a brand original product category recall at the time of purchase.

#### Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	3.146a	1	.076		
Continuity Correction <sup>b</sup>	2.700	1	.100		
Likelihood Ratio	3.148	1	.076		
Fisher's Exact Test				.090	.050
Linear-by-Linear Association	3.133	1	.077		
N of Valid Cases	242				

a. 0 cells (.0%) have expected count less than 5. The minimum expected count is 47.21.

b. Computed only for a 2x2 table

Table – 5

According to chi-square test of association, there is no association ( $p = .076 > .05$ ) found between original brand original product category recall at the time of purchase any of their extended product and surrogate ads.

Findings: As per descriptive analysis, major part of the group saw the Ad as an offensive corporate activity leaves wrong psychological impression and shows inability to contribute on ethical identity. Moreover it Challenges consumers ethical concern, since these behaviors are related to moral feelings about right and wrong (Clow&Baack, 2007).

In contrary, an amount of respondents supports the fact that it as a normal promotion and marketers do require advertisements of their products in this competitive market. As the sales of these, products are not banned. However, there is also a major group of respondents who are confused about questionable practice of brand extension strategy used in response to the ban on advertisements of one product category. The result reveals that the higher the number of viewers higher the identification level of brand and original products through surrogate ADs. Media effects on identification increase the association between exposure and impact (e.g., Basil, 1996). The cross tabulation result reveals that the higher the number of tobacco

and alcohol brand advertisement viewers, higher the increase of usage and purchase decision. Chi-square test there is strong association between higher the number of tobacco and alcohol brand advertisement viewers and increase of usage and purchase decision. Here we emphasize degree of personal responsibility associated with decision regarding usage and purchase of tobacco and alcohol products.

The major portion of respondents believe statutory warning should be provided for alcoholic products also and instead of general statutory warning provided for tobacco products, it should be quantified how much it is responsible for health hazards. The introduction of more graphic and bigger warnings for cigarettes has impacted on behavior (Hammond et al. 2003) and is a source of information for consumers (Hammond et al. 2006) .It can be said that it will be definitely decrease the consumption rate.

Chi square test reveals there is no association between original brand original product category recall at the time of purchase any of their extended product and knowledge about tobacco and alcohol brands through surrogate ads. Emphasizing there are respondents who are unaffected by the Ad in terms of ABC (awareness, branding, and communication) and it does not affect any more on their purchase decision.

## **DISCUSSIONS AND RECOMMENDATIONS**

Services or products sometimes go wrong. Therefore, to maintain a brand's reputation it is important to Deal with this effectively. In India, the top management, in their speeches has been resorting to social reporting but it should be more serious in nature (Bhatia, 2005 & Raman, 2006). Social responsibility of a brand broadly affects consumers' overall evaluation of the company, which in turn creates a preference of the consumers for the products inherited from the same brand. Empirical evidence has supported that argument that consumers gave a positive appraisal if news media focus on ethical issues (Christians & Nordenstreng, 2004; Berkman& Shumway, 2003). While there is a continuous tug of war between government guidelines and corporate strategies, the personal judgment plays a vital role.

Counter-advertising also can be beneficial. It involves circulating information about a product (in this context tobacco and alcoholic products), its effects, or the industry that promotes it, in

order to reduce its appeal and use. It is distinct from other types of informational campaigns in that it directly addresses the fact that the particular commodity is promoted through advertising (Stewart 1997).

Need to develop clear and comprehensive laws and Mechanisms for tobacco and alcohol control policies. Special education and awareness should be communicated to save children, youth, females to not take it up and middle aged for quitting.

The alcohol problem must be addressed in a more concerted manner by international organizations such as the World Health Organization and the United Nations Drug Control Programme, prohibition instead of restricting on advertising and sponsorships of public events, which can create an erroneous impression on consumers.

NGOs such as HRIDAY (Health Related Information Dissemination Amongst Youth)-SHAN (Student Health Action Network), created a supportive environment to enforce tobacco control measures. More and more NGOs should involve on CSR aspects because it needed external expertise.

Companies' are as responsible part of the society should respect and co-operate Government policies and laws as ethical values and social commitments can strengthen corporate identity (e.g., Bhattacharya et al. 2004).

These are the findings and recommendations that serve as guidelines for both individuals and organizations; they help make boundaries regarding what is acceptable and what is not. According to Leo Burnett "Let's gear our advertising to sell goods, but let's recognize also that advertising has a broad social responsibility."

## **RESEARCH LIMITATION AND INSPIRATION**

The literature on surrogate advertising is very scanty as the problem is of recent origin and is confined to the countries where advertising such harmful products is banned.

In Asian context, many of our countries in Asia have not given alcohol the serious attention but Indian Government has been taking several steps to restrict and prohibit the same. Sirisha and Mukund (2003) opined that liquor surrogate advertising in India has faced a series of challenges.

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## INNOVATION AND SME GROWTH: THE CASE OF PALESTINE

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### ABSTRACT

The development of small and medium-sized enterprises (SMEs) has long been regarded as a seedbed for economic growth. In the case of the future State of Palestine, the importance of these enterprises as an engine of growth is even more crucial within the economy's weak and distorted supply capacity, and the limited size of local markets. This research paper presents the drivers, dimensions, and achievements of innovations carried out by SMEs in the agribusiness, furniture and stone and marble sector in Palestine. Further, it discusses the growth rates of innovative SMEs vis-à-vis non-innovative SMEs. Thereafter, it has explored and analyzed the relationship between innovation and growth with respect to innovative SMEs of the three sectors.

Results of the survey show that a substantial proportion of SMEs in all the three sectors are innovative, mostly informally. Most of the innovative SMEs attributed the origin of their innovations to a combination of internal factors such as self-motivation, technical qualification, knowledge, experience, and innovative ideas of entrepreneurs, and external factors like customer requirements and demand, information provided by suppliers of equipments and materials, market opportunities, and competition.

Innovative SMEs have primarily focused on both product and process innovations in the three sectors and a substantial majority of these innovative SMEs registered higher growth relative to non-innovative SMEs in terms of sales turnover, and employment.

**Keywords:** Innovation, SME, Growth, and Palestine.

### INTRODUCTION

The contribution and significance of small and medium-sized enterprises (SMEs) as an important engine of growth are receiving increased attention in both developed and developing countries. These enterprises are often regarded as the "backbone" of the economy, serving as major sources of development, new jobs and a seedbed for entrepreneurship. Such a prominent role is mainly attributed to their flexibility in responding to emerging opportunities and their flexibility in the face of adverse conditions.

In the case of Palestine, the development of SMEs ranks high on the Palestinian Authority's (PA) policy agenda. However, relatively little is known about the dynamics determining their birth, expansion and closure. A solid understanding of these dynamics is extremely important at this critical stage of the development process. Enterprises are facing increasing pressures as the criteria that define best practice in production are continually evolving to reflect the constant pace of upgrading in both product and process technologies. They are also continually seeking to adhere to international standards on quality assurance, environmental standards, labor norms and social ethics, all of which are becoming critical determinants of global competitiveness.

Given the above, this research paper attempts to understand issues such as what factors drive SMEs to innovate, what is the nature of SME innovations, what are the achievements of SME innovations. As well, it discusses the growth rates of innovative SMEs vis-à-vis non-innovative SMEs. Thereafter, it has explored and analyzed the relationship between innovation and growth with respect to innovative SMEs in the agribusiness, furniture and stone and marble industries.

## **LITERATURE REVIEW**

For over a decade of economic volatility and political instability, the Palestinian private sector has demonstrated dynamism and the ability to adapt to changes. However, the global economic landscape is very different today from what it was in the past, and with these new global realities, the Palestinian private sector will have to be very creative and efficient to catch up with the competition. SMEs are generally more flexible, adapt themselves better, and are better placed to develop and implement new ideas. The flexibility of SMEs, their simple organizational structure, their low risk and receptivity are the essential features facilitating them to be innovative (Harrison and Watson 1998). Therefore, SMEs across industries have

the unrealized innovation potential (Chaminade and Vang 2006) and these innovations are likely to be an important determinant of their success (Hoffman et al. 1998).

.However, the ability and innovative capacity of SMEs varies significantly, depending on their sector, size, focus, resources, and the business environment in which they operate (Burrone and Jaiya 2005). Particularly innovation in the manufacturing sector is a very complex process which is propelled by numerous factors (Becheikh et al. 2006). There are internal and external factors that lead firms to innovate (Porter and Stern 2001). Firms should have in-house competence in the form of technically qualified and motivated entrepreneurs or managers with innovative ideas and technically skilled employees. Similarly, there must be a market demand for the innovated products in the form of an explicit customer demand or implicit market opportunities. Of course, the relative importance of these internal as well as external factors might vary from firm to firm or from industry to industry or even from economy to economy and from time to time.

SMEs might undertake only process innovations in the form of material substitution, change in technical process of manufacturing, etc. to achieve cost reduction or quality improvement or product innovations in the form of changing product shapes/dimensions/sizes or introducing improved or new products, or both (Freeman and Soete 1997). According to Hoffman et al. (1998) SME innovations are more likely to involve product innovation than process innovation (which is important nonetheless). Reid's (1993) study ascertained that 60 percent of the surveyed firms had undertaken both product and process innovations. Martinez-Ros (1999) found that product and process innovations are interdependent and closely linked.

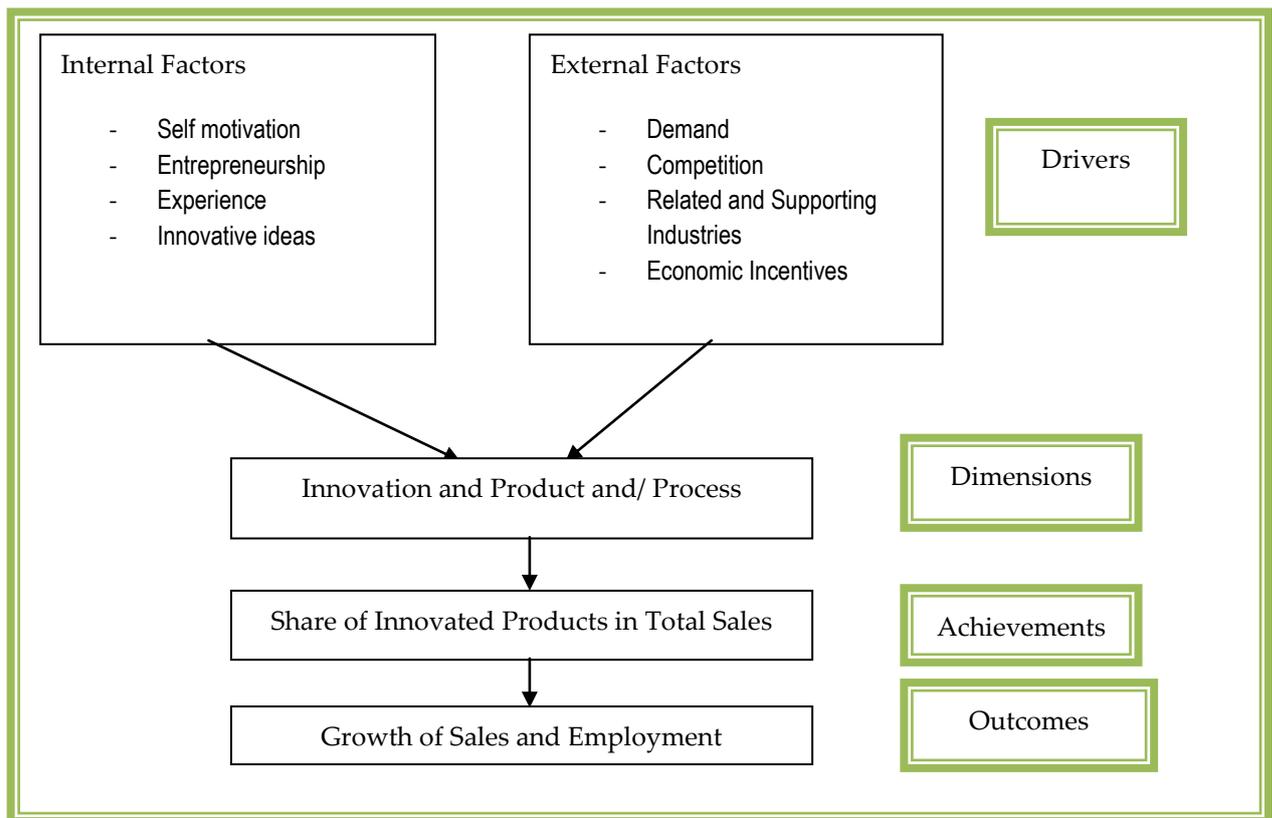
SMEs need innovative products in order to gain and maintain competitive advantages (Lee 1998). If they succeed, they will be able to realize a greater share of such innovated products in their total sales. Lehtimaki (1991) observed in the context of Finnish SMEs that on the average, the contribution of innovated new products was more to total sales than to profits. Roper (1997) whose study focused exclusively on product innovations in German, UK, and Irish SMEs, ascertained that the output of innovative SMEs grew significantly faster than that of non-innovators implying that innovated products contributed to the faster growth of the former. Engel et al. (2004) found that sales turnover of innovative firms grew faster than that of non-innovative firms. They detected a significant relationship between the share of innovative sales and sales turnover change of firms. Lumiste et al. (2004) found that innovation effects were felt in terms of both product-oriented results such as (i) improvement

in quality of goods and services, and (ii) increased range on goods and services, and process-oriented results like increased production capacity and improved production flexibility.

Roper (1997) comparing the innovation strategies of German, UK, and Irish SMEs, observed that there is a strong association between innovation and turnover growth. But Edwards et al. (2001) argued that growth is not necessarily dependent on those factors attributed to 'innovative potential'. Of course, they further stated that this does not mean that innovation does not lead to growth, rather there is a need to develop methods to assess the relationship.

Bala Subrahmanya (2001) observed that SMEs of North East England pursued radical innovations as a strategy of firm growth though he did not explicitly probe the relationship between innovation and growth. Danneels and Kleinschmidt (2001) claimed that innovative products present great opportunities for SMEs in terms of growth and expansion into new areas though they did not study the relationship between innovation and growth. Lumiste et al. (2004) found that innovation helped Estonian SMEs to improve their performance in terms of market share and diversified range of goods and services. However, they did not study whether the size of those SMEs changed over time.

However, all of these studies are related to industrialized countries and therefore their relevance to a developing country like Palestine might be questioned. USAID (2006) conducted a survey four eight industrial clusters in Palestine with a special focus on agribusiness, furniture and stone and marble sectors. These sectors managed to stand in front of the instable political and economic environment in the region. Figure (1) presents the conceptual framework of the study.

**Figure 1: Innovation and SME growth**

There are four primary issues concerning innovation and growth of SMEs: (i) driving forces, (ii) dimensions, (iii) achievements, and (iv) outcomes. What factors drive SMEs to innovate? Are they internal factors or external factors, or both? What kind of innovations do SMEs undertake? Are they exclusively product focused or process focused or do they necessarily have to undertake both together? What are the achievements of innovation by SMEs? If innovation is successful, whether new products or improved products emerge due to product or process innovations, the share of such innovated products is likely to increase in the total sales of the firm. If this happens, such firms would be able to achieve growth in their sales turnover and employment resulting in the growth of firm size.

## RESEARCH OBJECTIVE

The research paper has the following objectives:

- Assess the drivers, dimensions and achievements of innovations carried out by SMEs
- Assess the growth rates of innovative SMEs vis-à-vis non-innovative SMEs
- Discuss the relationship between innovation and SMEs growth

## RESEARCH METHODOLOGY

An academic and business literature search was conducted to capture the domain of each potential construct adequately. As part of the literature review, books, journal articles, tertiary literature such as indexes and catalogues, company minutes, internet sites, chambers of commerce surveys and professional association surveys have been used.

A combination of the quantitative and qualitative methods is used employing both quantitative and qualitative data and offering an opportunity in order not to test the hypotheses but also to explore deeply into the issues raised by the research questions (Saunders et al. 2000). The multi-method design enables triangulation to take place.

The area random sampling is used. The population is the sum of all SMEs working in the three industrial sectors (agribusiness, furniture, and stone and marble cutting firms). The population has been divided into three strata based on the type of industry. Dividing the population into a series of relevant strata means that the sample is more likely to be representative, and each of the strata is presented proportionally within the sample.

The number of SMEs working in West Bank in each industrial sector is ranging between 380 and 420. The researcher selected a random sample that represents 10% of each industrial sector (i.e. 40 SMEs). The researcher used the survey as a quantitative method and the questionnaire as a tool to collect the primary data from 120 SMEs working in the three sectors. The questionnaire consists of three parts: part one covers the characteristics of SMEs, entrepreneurial background, location and year of establishment. Part two covers the driving forces, dimensions, objectives, sources, dimensions, achievements of innovation, and part three covers the economic variables such as employment, and sales turnover. The questionnaire was discussed with university academics, industry experts and representatives of SME associations. Cronbach alpha was calculated as 0.75.

The first objective was descriptively analyzed making use of frequency tables for innovative SMEs. Innovation was measured by asking the SMEs to prove any innovative product or process it developed during the last five years. The second objective was analyzed in terms of percentage growth of economic variables for both innovative and non-innovative SMEs. The third objective was analyzed for innovative SMEs using correlation analysis, analysis of variance (ANOVA), and regression analysis. As well, the researcher conducted semi-structured interviews with representatives of chamber of commerce, industrial associations and Ministry of National Economy to discuss the results of the survey.

## RESULTS AND ANALYSIS

The main results of the research study are the following:

### Drivers, Dimensions and Achievements of Innovations

All of SMEs in the three sectors were started as new ventures (i.e. entrepreneurs have set-up their firms to gain self-employment by implementing their innovative ideas and/or to exploit market opportunities) in 1980s and after. Majority of the entrepreneurs are in the age group of 40 to 50 years and hold associate degree or BA degree (mainly in accounting and languages). Their size characteristics revealed that size structure of the SMEs is more towards small to medium sized enterprises (i.e. less than 50 employees).

Table (1) shows that the majority of SMEs are innovative, during the last five years, in all the three sectors. A greater proportion of SMEs in the stone and marble sector is innovative relative to agribusiness and furniture sectors. SMEs are generally known for informal innovations, without any exclusive innovation department or documentation. They carry out their innovations along with their day-to-day manufacturing operations within the same premises.

**Table 1: Innovative and Non-innovative SMEs**

Classification	Number of SMEs		
	Agribusiness	Furniture	Stone and Marble
Innovative	32	25	35
Non-innovative	8	15	5
Total	40	40	40

Table (2) presents that a majority of the SMEs identified both internal and external factors as the driving forces of their innovations as discussed by Porter and Stern (2001). However, a considerable number of SMEs in the stone and marble sector has identified external factors as the driving force of their innovations. Those who have attributed their innovations exclusively to internal factors are not many. It is clear that both internal factors such as self-motivation, technical education background, work experience, and innovative ideas of entrepreneurs on the one hand, and external factors such as customer requirements,

information given by suppliers of equipments and materials, and competition are responsible for a majority of SMEs to innovate.

**Table 2: Internal and External Drivers of Innovation**

Drivers of Innovation	Number of SMEs		
	Agribusiness	Furniture	Stone and Marble
Internal Factors	2	4	5
External Factors	5	6	10
Internal and External	25	15	20
Total	32	25	35

Innovation could be at the product level and/ or process level. Product focused innovations comprised the introduction of new products and/or the improvement of existing products through changing product designs and dimensions or quality improvement to suit customer requirements. Process-based innovations involved the introduction of new process technology for existing products, adoption of cost reduction techniques, etc. Table (3) shows that a higher proportion of SMEs in the three sectors have undertaken both product and process focused innovations.

**Table 3: Dimensions of SME Innovation**

Classification	Number of SMEs		
	Agribusiness	Furniture	Stone and Marble
Product Innovation	3	5	6
Process Innovation	10	5	8
Product and Process	19	15	21
Total	32	25	35

Table (4) presents the share of innovative products in total sales in innovative SMEs. A higher percentage of innovative SMEs have succeeded in converting their innovations into sales in the stone and marble sector relative to furniture and agribusiness sectors. Among those SMEs working in the stone and marble sector which have succeeded in converting their innovations into sales, the majority accounted for a share of innovated products in total sales in the range of 10 percent to 25 percent. Thus, as shown in the table, more successful innovative firms might realize a higher share of innovated products in total sales compared to less successful innovative firms.

**Table 4: Percentage of Innovated Products and/ or Processes in Total Sales**

Percentage Share	Number of SMEs		
	Agribusiness	Furniture	Stone and Marble
Zero	4	6	3
Up to 10%	16	11	7
10% - 15%	8	5	10
15% - 25%	4	3	15
Total	32	25	35

### **Innovative and Non-innovative SMEs**

The growth performance of SMEs has been analyzed in terms of sales and employment. The growth performance has been analyzed for all the SMEs of each sector—for innovative and non-innovative SMEs. For measuring growth, all the SMEs have collected together in each sector and did not separately identify growing ones from the rest. The SMEs were asked to present the growth of employment and sales during the last five years.

Table (5) presents the growth of sales and employment for innovative and non-innovative SMEs. It is clear that innovative SMEs have enjoyed a higher rate of growth compared to non-innovative SMEs in terms of sales, and employment in all the three sectors. However, the growth rates of the two variables differ within as well as between sectors. In the three sectors innovative SMEs registered a higher growth of sales than by employment. In fact, employment of non-innovative SMEs was declined absolutely in the furniture sector.

**Table 5: Growth (Percentage) of Innovative and Non-innovative SMEs**

Variable	Agribusiness		Furniture		Stone and Marble	
	Innovative SMEs	Non-Innovative	Innovative SMEs	Non-Innovative	Innovative SMEs	Non-Innovative
Sales	18.3	12	15.5	12.1	24.5	10
Employment	6.2	1.2	4.3	-10	6.8	2

### Innovation and Growth of SMEs

This section discusses the relationship between innovation and SME growth. To find out the answer, the researcher testify whether there is any statistically significant positive correlation between the average rate of growth of sales and percentage of innovated products in total sales. The results (see table 6) indicate that there is a statistically significant positive correlation (at 0.05 level) between sales growth and percentage of innovation sales in total sales.

**Table 6: Correlation between Sales Growth and Innovation Sales**

	Number of SMEs		
	Agribusiness	Furniture	Stone and Marble
Correlation Coefficient	0.38*	0.34*	0.40*

\*Significant at 0.05

To know whether higher growth SMEs should have higher shares of innovated products in total sales compared to lower growth SMEs. The innovative SMEs of each sector were divided into two groups: high growth SMEs, and low growth SMEs. The results clearly indicate that higher growth innovative SMEs, on average, have a higher share of innovated products in total sales compared to low growth innovative SMEs in all the three sectors (see table 7).

**Table 7: Share of Innovated Products in Total Sales**

	Agribusiness		Furniture		Stone and Marble	
	No. of SMEs	% of IPs in Sales	No. of SMEs	% of IPs in Sales	No. of SMEs	% of IPs in Sales
High Growth	12	22.5	19	19.5	22	31
Low Growth	20	15.4	6	11.2	13	22

- 
- IPs = Innovated Products

In order to testify whether there is a significant relationship between the share of innovated products in total sales and sales growth, a regression analysis was used both for innovative and non-innovative SMEs. The regression model is statistically significant as indicated by the F-value. The results clearly indicate that the percentage share of innovated products in total sales has a significant influence on the average rate of growth in innovative SMEs in all the three sectors. Thus if an innovative SME could expand the scale of production and achieve an increase in innovation sales, it will be able to experience a significant improvement in its performance. This enables us to conclude that innovation sales do contribute to firm growth.

## CONCLUSION

This research paper has discussed the driving factors, dimensions, and achievements of innovations carried out by SMEs in the agribusiness, furniture and stone and marble sector in Palestine. It also discussed how far the growth rates of innovative SMEs are different from that of non-innovative SMEs. Finally, it has explored and analyzed the relationship between innovation and growth with respect to innovative SMEs of the three sectors.

The majority of SMEs in all the three sectors are innovative, mostly informally. Most of the innovative SMEs attributed the origin of their innovations to a combination of internal factors such as self-motivation, technical qualification, knowledge, experience, and innovative ideas of entrepreneurs, and external factors like customer requirements and demand, information provided by suppliers of equipments and materials, market opportunities, and competition.

Majority of innovative SMEs in the three sectors focused on both product and process innovations and managed to convert their innovative efforts into sales as they realized

varying proportions of innovated products in their total sales. This has enabled the majority of them to achieve sales growth more. Innovative SMEs registered higher growth relative to non-innovative SMEs in terms of sales turnover and employment. There was a statistically significant positive correlation between innovation sales and sales growth. Innovative SMEs, which experienced higher growth accounted for a higher share of innovated products in their total sales and employment relative to those which experienced lower sales growth.

To conclude, the overall analysis lends substantial confidence to the argument that innovation contributes to the growth of firms.

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## **CLOUD COMPUTING AND THE WEB: THEIR POTENTIAL DISRUPTION OF THE DIGITAL AND EDUCATION DIVIDE**

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### **ABSTRACT**

Disruptive innovations such as cloud computing and the Web are impacting many aspects of organisations' and people's lives in many parts of the world. The economic attraction of cloud computing's cost model (e.g., pay as you go) has made it particularly attractive to many organizations in the current global and gloomy economic environment and many organisations in the developed world have adopted it in one way or the other. However, it is yet to make any comparable impact in the developing world. But this situation can change and cloud computing, as will be demonstrated in this article, could potentially have a disruptive impact on people's and organizations' ability to access IT services in those countries, thanks to increasing levels of internet penetration and the proliferation of smart mobile devices. Furthermore, the development of MOOCs (Massive Open Online Courses), thanks to improvements in Web technology, could potentially have a great impact on the way we learn, both in the developed and the developing worlds. This article examines the impact of such disruptive innovations on organizations and people and their potential to bridge the digital and education divides.

**Keywords:** Cloud Computing, MOOCs, Online Learning, Mobile, Smart Phones, Disruptive Innovation.

### **THE ADVENT OF IT AS A UTILITY**

Since cloud computing emerged in 2007 it attracted a great deal of attention from many quarters (e.g. authors, consultants, technology analysts, companies). The more interest it attracted the more attempts were made to define it. At one point, a study by McKinsey & Company (the global management consulting firm) found that there were 22 possible

separate definitions of cloud computing (Grossman, 2009; Voas and Zhang, 2009). However, a comprehensive and jargon-free definition of cloud computing was attempted by Sultan and Sultan (2012). They defined it as an IT (Information Technology) service delivery model that uses advances in ICT (Information and Communication Technology) such as virtualization and grid computing for delivering a range of ICT services through software, and virtual hardware (as opposed to physical) provisioned (by data centres owned and operated by cloud providers and/or end users) according to user demands and requirements and delivered remotely through public (e.g., Internet), private networks or a mix (i.e., hybrid) of the two delivery modes. The provided ICT services include:

- business-related computer programs (software as a service –SaaS);
- fast and almost unlimited processing capabilities and large and almost unlimited storage facilities (infrastructure as a service –IaaS);
- development tools and hosting options for clients preferring to create and manage their own Web applications (platform as a service –PaaS).

Cloud computing services can be provided by cloud vendors through their data centres (public clouds) and end users (i.e., client organizations) using cloud software installed on their own data centres (private clouds) or installed on their own and other cloud vendors' data centres (hybrid clouds). The authors also draw attention to “community” clouds (often touted as another possible addition to the other three models). These types of clouds can be provided (often by one organization) and consumed by groups of organizations in businesses or professions similar to that of the providing organization. However, according to these authors, there are little examples to demonstrate the viability of this approach (Sultan and Sultan, 2012).

#### *Advantages*

When it first emerged in 2007, cloud computing received a mixed reaction. While some analysts saw merits in its application, others (including highly respected IT individuals) such as Richard Stallman, creator of the GNU operating system and founder of the Free Software Foundation and Larry Ellison, founder of Oracle, regarded it as a useless business model (Hasson, 2008; Johnson, 2008). In spite of this, cloud computing continued to attract many followers and increasing numbers of IT companies embraced it and began to offer many of their services in the cloud.

Having passed the fad stage, few people now doubt the economic attractions of this new computing service paradigm. Cloud computing delivers a variety of essential software and hardware services (e.g., applications, storage, processing power, virtual servers) over the medium of the Web (i.e., the cloud) on a pay-as-you-go price structure, thus offering scalability and obviating the need to make large investments in expensive hardware and software licenses and offering organizations significant cost advantages (Leavitt, 2009; Lin *et al.*, 2009). Continuous upgrades of software and hardware are common (and expensive) practices in many organizations. Tighter cost control in organizations is increasingly prevalent following the near collapse of the world's financial systems and is a condition which is likely to worsen over time. Cloud computing can provide many of those organizations with the opportunity to continue to take advantage of new developments in IT technologies at affordable costs.

While cloud computing seems to make economic sense, some people think this can only be achieved in the long run. Reflecting on his company's successful implementation of a SaaS solution, Doug Menafee, CTO of the Schumacher Group, a leading US emergency and hospital medicine management company, admitted that a cloud solution could be more expensive to run in the short term due to the heavy connectivity demands that require the installation of expensive high speed cables such as fibre optics. He explained that it takes a three year ROI (Return On Investment) period to break even and over five years to realize the economic benefits (Brooks, 2010).

### Concerns

Despite, the economic and flexibility attractions of cloud computing there are still many issues that it needs to overcome: security, vendor-lock and outages are the most problematic (Sultan and Sultan, 2012). Security is no doubt one of the main concerns for organizations contemplating the adoption of this IT service modality. A survey of 244 chief information officers and IT executives conducted in 2008 by IDC (International Data Corporation), the market research firm, revealed that 75 percent of the respondents rated security as their main cloud computing concern while performance and availability were the next two concerns for 63 percent of the respondents (Cisco, 2009). Moreover, various governments, such as those in the European Union (EU), have privacy regulations that prohibit the transmission of some types of personal data outside the EU. This issue, however, is no longer a problem as many cloud vendors now (such as Amazon, Microsoft and others) were able to establish some of

their cloud data centres in various locations across the EU region and elsewhere in the world and can offer their cloud clients the option of where they want their data to be stored.

Organizations are likely to adopt a careful approach to cloud computing. Another survey by EDUCAUSE, US-based non-profit organization that promotes the intelligent use of information technology in higher education (HE), involving 372 of its member institutions revealed that a great proportion of the respondents with use cases that involved cloud-based services reported that data privacy and data security risks were among their top barriers to overcome (Goldstein, 2009).

Another concern is vendor-lock and outages. Currently, many cloud providers offer their services through proprietary Application Programming Interfaces (APIs). This means that organizations that sign up for the services of cloud providers will find it difficult to change cloud providers in the same as way as, for example, changing an electricity supplier.

Furthermore, failure of a cloud provider that hosts client data in its data centres can have serious repercussions for those clients who trusted their data with that provider. This issue could force potential cloud users to go for well-established and large companies that are more likely to be around for many years to come (e.g., Microsoft, Amazon, Google, IBM, Salesforce.com).

Lastly, reliability can also be a serious problem for cloud users. Many of the big cloud providers such as Salesforce.com, Amazon, Google and Microsoft saw their systems afflicted with outages which affected large scores of their customers (Leavitt, 2009; Naughton, 2009; Clarke, 2011). One of the latest such events occurred in April 2011 when Amazon's EC2 (Elastic Compute) cloud service experienced an outage when its northern Virginia data centre site was affected. Amazon attributed the incidents to a networking glitch that caused many of its storage volumes (used to store data when an EC2 instance is created) to create new backups of themselves, thus filling up Amazon's available storage capacity and kicking off a series of connectivity problems that affected many of the cloud provider's customers (Pepitone, 2011). For more stories of similar outages see (Raphael, 2011). Outages are not limited to cloud computing platforms. Some of the online social networking sites (especially Facebook) had their fair share of this problem (Johnson, 2010). The latest outage to afflict Facebook was in February 2012, one day after its filing for IPO (initial public offering) (Brown, 2012).

### *Solutions*

The aforementioned concerns are genuine and real. However, there are efforts to address some of those problems emanating from different quarters. Portability is likely to be increasingly important as the number of cloud providers increase. One of the solutions to this problem would be to base the APIs of cloud solutions on open source message communication standards such as SOAP (Simple Object Access Protocol) or REST (Representational State Transfer). In some situations this is already happening. For example, cloud solutions such as Amazon Web Services and Microsoft's Azure can now be accessed through the SOAP and REST protocols. The need for inter-cloud interoperability was highlighted by Vint Cerf, a co-designer of the Internet's TCP/IP, who likened the current lack of cloud communication standards to that of computer networks in the early 1970s (Krill, 2010). Moreover, there are also efforts by some organizations such as the Cloud Computing Interoperability Forum intended to address this issue (Grossman, 2009). IEEE, the Open Data Center Alliance (ODCA) and the Distributed Management Task Force (DMTF), the latter two working in partnership. The issue of security is, nevertheless, a controversial one. Many analysts believe that security is likely to be more robust in a cloud environment, given the massive resources of cloud providers, than one maintained in-house (Ashford, 2009; Linthicum, 2009; Financial Times, 2009). Nevertheless, many cloud providers are now offering hybrid solutions where clients are given some level of control over the security of their data (Taneja Group, 2011).

## **THE DISRUPTIVE FORCE OF CLOUD COMPUTING**

New technologies, especially those of a radical nature, are often looked upon, initially, with cynicism or dismissed as useless inventions. William Orton, the President of Western Union (once a major US communications company specializing in telegraphy), described Alexander Graham Bell's telephone invention as "an electric toy" when his company declined to buy the inventor's patent for US\$ 100,000. The telephone eventually killed telegraphy and led to the demise of Western Union.

The concept of disruptive innovations was first raised by Christensen and his colleagues and developed into a theory known as the "theory of disruptive innovation". According to this theory, there are mainly two types of disruptive innovations: new market and low-end disruptions. New market disruption occurs when an innovative product attracts customers

who were prevented from acquiring similar products due to cost and/or complexity issues. Examples of such innovative products include Sony's first battery-powered transistor pocket radio, Canon's desk photocopier, etc. Low end disruption affects the low end of the original business or mainstream value network by attracting customers who are served by this level of the business. One example of this type of disruption was the Korean automakers' entry into the US market. The Korean automakers did not create a new market; they simply attracted the "least attractive" customers of the targeted businesses.

A hybrid of the two types of disruption can also be found. The American low cost Southwest Airlines is one example of a hybrid disruption. It initially targeted people who were not flying (those who used cars or buses) but later pulled customers out of the low end of the major airlines' value network as well. In addition to the simplicity and the affordability they bring, disruptive innovations, according to this theory, occur less frequently and tend, initially, to have performance problems (Christensen *et al.*, 2004).

From this brief description, it is evident that cloud computing has many of the attributes of a disruptive innovation (Sultan and Sultan, 2012). For example, it has the potential to destabilize existing IT markets (e.g., those that rely on providing traditional on-premises IT solutions) and create other business opportunities that did not exist before (e.g., consuming IT, both as software and hardware) when needed, according to demand and with less requirements for infrastructural expenses (e.g., hardware, staff). Disruptive innovations that create new markets, according to this theory, can occur when characteristics of existing products and services (e.g., size, price, complexity) limit the number of potential consumers or force consumption to take place in inconvenient or centralized settings. Bell's telephone, Sony's transistor radios, Apple's personal computers and eBay (among others) are examples of new-market disruptive innovations. They were able to create growth by making it easier for people to do something that historically required a great deal of expertise or great wealth.

The theory also suggests that disruptive innovations often tend to initially have performance problems. The aforementioned concerns of cloud computing and the infrequent loss of service experienced by cloud customers are clear examples of the initial performance issues that often characterize disruptive innovations.

## THE CLOUD IN DEVELOPING COUNTRIES

Given the compelling economic attractions of this computing service delivery model, many organizations are likely to embrace it despite its current problems. Gartner (the global IT research and advisory company) anticipates a massive cloud computing explosion, fuelled largely by the economic turmoil of the last few years. In a recently published report, Gartner expects the global cloud services revenue to reach nearly US\$150 billion by 2014. This level of spending, according to Gartner's Vice President, Ben Pring, is directly related to increased economic pressures which made organizations scrutinize every expenditure (Hickey, 2010).

Small to medium enterprises (SMEs) are likely to be among the main beneficiaries of this computing service due to their limited resources which constrain their ability to make large IT investments (Sultan, 2010a, 2010b, Sultan, 2011). However, an increasing number of major companies are also embracing the cloud (Sultan, 2010a).

What is interesting is that cloud computing is making an impact in many developing countries. For example, a number of African educational establishments have adopted cloud computing, largely due to the inadequate IT infrastructures that exist in their countries and their inability to cope with the endless cycle of hardware and software upgrades. Google, in particular, has been very successful in targeting the East African educational market. For example, the giant cloud provider has partnered with a number of East African educational establishments (e.g., the National University of Rwanda, the Kigali Institute for Education, the Kigali Institute for Science and Technology, the University of Nairobi, the United States International University, the Kenyan Methodist University and the University of Mauritius) in order to provide their students with some of its cloud services ( e.g., Gmail, Google Calendar, Google Talk and Google Docs and Spreadsheets). These universities were also helped by an a World Bank grant that supports bandwidth subsidy in universities (Wanjiku, 2009).

In Ethiopia, Microsoft has rolled out 250,000 laptops to the country's teachers, all running on Microsoft's Azure cloud platform. The laptops were intended to enable teachers to download curriculum, keep track of academic records and securely transfer student data throughout the education system, without the extra cost of having to build a support system of hardware and software to connect them (Chan, 2009).

The ability of cloud computing to help African education, not only by reducing IT costs but also by making education more efficient than before, is likely to be a very powerful (and

empowering) tool for the advancement of education in this under-developed continent. Indeed, many of the large cloud providers see lucrative opportunities in some of the developing and emerging economies. For example, IBM has established a number of computing centres in China, India, Vietnam and Brazil. Other cloud players such as Microsoft, VMware, Salesforce.com and Parallels are also active in the developing world (Kshetri, 2010).

There are increasing speculations from some industry observers that cloud computing will be a great help to developing countries which generally suffer from poor IT infrastructures. Given that cloud computing reduces reliance on physical infrastructure this, on the surface, seems to make sense. However, the reality is different in some developing countries that suffer from continuing power cuts and poor broadband infrastructures (essential necessities for a proper use of the internet). Such environments are unlikely to be conducive to any meaningful use of cloud computing. However, during the last few years the penetration of the internet in many of these countries has been dramatic.

Egypt, for example, has been one of those countries that have experienced high Internet penetration rates during the last few years. A report by its Ministry of Communications and Information Technology (MCIT) indicated that there were 23.51 million Internet users in January 2011 growing at an annual rate of 39.61 percent while the proportion of households using the Internet was 32.76 percent and growing at an annual rate of 7.25 percent (MCIT, 2011). Tunisia also has one of the highest Internet penetration rates in the African continent with 3.6 million users, half of the population (Ryan, 2011). Such high rates of Internet usage (which enabled access to online social media) in these two countries have played an important role in topping the dictatorial regimes in these two countries during what came to be known as the Arab Spring. This issue is echoed by Janardhan (2011) who argues that the growing use of new media (in reference to online social networking and Internet-enabled mobile devices) to advance political reforms is a natural consequence of the fast-rising number of Internet users in the Arab World, estimated at 46 millions in 2008 which represents an impressive Internet-usage growth rate of about 13 folds between 2000 and 2008.

Broadband speeds in emerging markets may not be great (e.g., 1,691 kbps) with average upload speed of 795 kbps. They are however adequate for basic cloud services. Some countries such as Egypt, South Africa, and the UAE have developed their networks sufficiently to support intermediate cloud applications such as CRM, ERP, and basic video conferencing. Large enterprises in emerging markets are likely to find the model of cloud

computing appealing as it addresses three of the most important challenges: 1) limited availability of IT skills, 2) capital constraints, and 3) security risks (Ford and Belmans, 2012). A Cisco survey suggests that small businesses in developed countries will rely extensively on cloud applications to manage their communications and business processes over the next five years with nearly 50 percent of them spending more than one third of their IT budgets on cloud services in 2013. The cloud impact, according to Ford and Belmans (2012) will be much greater in emerging markets where small businesses do not have capital or the skills to use IT and will put such companies onto the first step of the technology ladder.

### **A MOBILE-BASED CLOUD INFRASTRUCTURE**

Indeed, if there is any real future for a massive uptake of cloud computing in the developing world it is likely to be through mobile devices. And there is rationale for this suggestion. In 2011 worldwide shipments of smart phones were estimated at 487.7 million gadgets, overtaking client PCs (e.g., pads, netbooks, notebooks, desktops). This was a 63 percent increase on the 299.7 million smart phones shipped throughout 2010. The increase of the demand for smart phones was driven partly by their availability at low prices and partly by a driving trend of increasing consumer appetite for Internet browsing, content consumption and engaging with apps and services on mobile devices (Canalys, 2012). According to Dikaiakos et al., (2009) one of the visions of the 21st century computing is that users will need to access Internet services over lightweight portable devices rather than through some descendant of the traditional desktop PC. And since users who have access to such devices are unlikely to have (or be interested in having) powerful machines, it is likely that cloud computing will be the source of that computing power.

The comfort level of mobile phone usage in these countries – combined with the lack of power and broadband infrastructure – offers a unique opening that cloud computing can fill. Providing SaaS through mobile devices can give businesses in the developing world a free or low cost alternative to traditional desktop-based productivity applications. These businesses now have the option to use business software (e.g., CRM applications) that is prohibitively expensive in the traditional software world. By moving their data to the clouds, these businesses are not held hostage to frequent power failures and broadband disruptions that are common in many third world countries (Goundar, 2010).

With the advent of low cost smart phones and netbooks with mobile data capabilities, they can now have IT infrastructures that can parallel even those of developed countries (Subramanian, 2008; Greengard, 2010; Harris and Nunn, 2010, cited in Goundar, 2010). Cloud computing provides an opportunity for individuals and businesses in developing countries to compete with those in advanced nations on an equal footing. Such an opportunity has the potential to create tremendous growth in these countries and help in their fight against global poverty (Subramanian, 2008, cited in Goundar, 2010). Such a scenario will no doubt have a disruptive impact on the world's ability to access IT resources and will potentially bridge the digital divide that currently exists between the developed and the developing worlds. It will also make the world more globalized than ever before.

## **THE DISRUPTIVE FORCE OF THE WEB**

The Web has had a profound (and disruptive) impact on our lives (both as individuals and organizations). It created a new market opportunity, epitomised in online trading or e-commerce, and disrupted many traditional businesses such as those involved in music, books, stocks, etc. Increasingly, the Web is having a disruptive impact on learning and teaching. Since the early 2000s, online learning was often being provided by institutes (e.g., colleges, universities) as an additional learning tool (to other existing traditional learning tools, e.g., class room lectures) or provided by institutes (mostly commercial) as a tool for programmes fully accessed using this mode of delivery. In either case, users of this service had to pay for it through fees. Increasingly, online learning has become a Knowledge Management (KM) tool and organizations are using this technology to provide their workers with free access to online resources as part of their KM efforts (Sultan, 2013). It is evident here that online learning (enabled by the Web) is an example of a new market created in education by the disruptive Web. Degree courses delivered fully through online learning are relatively inexpensive when compared with traditional college or university degrees (Clark, 2009). This is especially true in many Western countries. In the UK, for example, a university home student can pay a total of up to £ 27,000 in fees for a three year undergraduate degree. Online learning is enabling people to gain access to education at far less cost. It also removes many of the inconveniences associated with a traditional education, e.g., registering at certain times of the year, commuting, attending classes, finding a seat in a class (especially if the class is crowded).

In a new book, Christensen and his colleagues (well before the advent of MOOCs) have predicted the disruptive impact that “computer-based” learning will do to education (particularly secondary US education). They estimate that by 2019 about 50 percent of high school courses in the USA will be delivered online as the world begins “flipping rapidly to student-centric online technology” (Christensen *et al.*, 2008). The authors see online learning as a classic example of a new market disrupting or substituting an existing business model (i.e., class-based education). They argue:

“This substitution is happening because of the technological and economic advantages of computer-based learning, compared to the monolithic school model. Online technology provides accessibility for those who previously would not have been able to take the course. It provides convenience for a student to fit the course into his or her schedule at the time and place that is most desirable. To varying degrees, it is simpler because it offers comparatively greater flexibility in the pace and learning path. And when it is software-based, it can scale with ease” (Christensen *et al.*, 2008).

The Web has also ushered in a new era of communication and interaction. The emergence of new media, define as the use of Web-enabled digital mobile technology (e.g., smart phones, iPads) is adding a new dimension to online learning: mobility. No longer is online learning constrained to a desk in your bedroom or office. Thanks to Web-enabled digital mobile devices you can now learn while on the move.

### **The emergence of MOOCs**

During the last few years a new online learning trend has emerged known as Massive Open Online Course (MOOC). There is no common definition of a MOOC. However, it would probably be safe to describe it as a life-long learning initiative aimed at delivering free courses through online platforms to an unlimited number of students without any entry requirements for registration.

The history of MOOCs is traced back to early efforts by two Canadians: George Siemens (an educator Professor at the Center for Distance Education) and Stephen Downes (an online learning designer and researcher). In 2008, Siemens and Downes offered a free online learning course entitled “Connectivism and Connective Knowledge 2008 (CCK08)”. The course was offered formally through the University of Manitoba and informally through open enrolment (at no cost) to anybody in the world (Fini, 2009). Some initiatives aimed at

providing free university education have emerged since. One such is the University of the People (UoPeople). UoPeople was founded in 2009 by educational entrepreneur Shai Reshef and is affiliated with the United Nations GAID, the Clinton Global Initiative, and Yale Law School ISP. Courses provided by UoPeople are free but students are required to pay a one-time application processing fee of US\$50 and subsequent examination processing fee of US\$100 levied per course. The free university has signed collaborative partnership agreements with New York University (NYU) to accept students; and with Hewlett-Packard (HP) - through the Catalyst Initiative - to provide student internship opportunities. It offers undergraduate programs in business administration and computer science and has more than 1,500 students from 135 countries. However, what is very interesting about new developments in free online learning is a surge of interest in MOOCs by leading US universities which seemed keen to deliver their own “free” online courses. Since 2011, MOOCs began to attract a great deal of interest, especially from highly prestigious US universities. Examples include Harvard, Stanford, Michigan, Pennsylvania, Princeton and MIT (to name but a few). Several start-up companies since then have developed partnerships with universities and professors to offer MOOC's. These include companies such as Coursera, Udacity, edX, Udemy and Khan Academy.

In an interesting and extended blog article hailing the potential merits of MOOCs, Shirky (a keen advocate of MOOCs) argues that MOOCs are unlikely to replace traditional education. He comments:

“...anything that could replace the traditional college experience would have to work like one, and the institutions best at working like a college are already colleges. The possibility MOOCs hold out is that the educational parts of education can be unbundled. MOOCs expand the audience for education to people ill-served or completely shut out from the current system, in the same way phonographs expanded the audience for symphonies to people who couldn't get to a concert hall, and PCs expanded the users of computing power to people who didn't work in big companies” (Shirky, 2012).

Aware of the new online educational developments across the Atlantic and their potential threat to the UK's educational market, a new company by the name of “FutureLearn” has been set up by the Open University to offer similar services (starting in 2013) to those offered by MOOC companies in the USA and their university partners. FutureLearn is majority owned by the Open University (which has decades of experience in distant learning) and

includes a number of leading UK universities such as King's College London, Bristol, Exeter, Warwick, East Anglia, Leeds, Lancaster, Southampton, Cardiff, Birmingham and St Andrews. More universities are expected to join this alliance in the near future. The enthusiasm for this venture by UK universities is matched by their fear of being left behind.

The UK government, represented by David Willetts, Minister of State for Universities and Science, is supportive of this initiative. He was quoted as saying "MOOCs present an opportunity for us to widen access to, and meet the global demand for, higher education" (Bateman, 2012). In 2012, the UK government (under the current coalition of the Conservative and Liberal Democrats parties) almost trebled university tuition fees for its national students. UK national students entering HE in 2012 were required to pay a tuition fee of up to £ 9,000 (as opposed to £3,375 for the previous year). Making UK HE expensive could prevent many people from gaining academic qualification, thus potentially creating an education divide between those who can afford it and those who cannot. The decision to increase fees at such levels was widely criticised by large numbers of the UK population and huge student demonstrations were organised to protest against it. In that year the total number of applicants to all British universities fell 7.7 percent, with applications to some subjects (e.g., English) witnessing a much higher drop (Vasagar, 2012). It is logical therefore for government officials to be seen supportive of initiatives (such as that of FutureLearn) that aim at widening access to education.

## **EDUCATION AS A SERVICE (EAAS)**

It is not clear at this stage of their development how MOOC providers will make their money. They can afford, for now, to provide their registered students with free access to courses. For example, MIT and Harvard have together committed US\$ 60 million to edX, Coursera has raised US\$16 million in venture funding, and Udacity is sitting on an undisclosed infusion from Charles River Ventures. The MOOC providers are in strange territory, according to Kolowich (2012), in that they have staked their future on a vision that makes HE more accessible than ever before. However, eventually they will have to figure out how to pay for the costs of these services and also how to make money. It should be noted that a number of these MOOC providers (e.g., Coursera, Udacity) are businesses and making money will be one way to stay in business.

Some analysts such as Moody (the international financial research company) suggest that advertising (copying the Google model) could be one option to make money out of MOOCs. Another possibility is to pay a fee to license MOOC material from other institutions, similar to paying for a textbook (Marklein, 2012). So far, the only revenue stream that the major new MOOC providers (e.g., Coursera) have indicated they will pursue is charging a small fee (e.g., US\$ 30 or US\$ 80) for issuing certificates of completion to those who register and successfully complete their exams. However, the extent to which revenue from issuing such certificate can support a MOOC business is still unclear, given that only a small fraction (between 10 and 20 percent) of the students who have registered (so far) for MOOCs actually made it to the final exam. Other MOOC providers (such as Udacity) are contemplating the prospect of making money from recruitment by headhunting for companies that might like to hire some of its more impressive students. By doing so, Udacity will be able to charge a commission for each successful match. There are also suggestions that MOOC providers might try to make money by matching the large number of students who do not complete their courses with traditional online programs where they might have a better chance of gaining acceptance (Kolowich, 2012). While credit-bearing MOOCs are not yet available, this might change in the future. There are suggestions that MOOC providers could use some of the global testing networks to enable their MOOC students to sit fee-based invigilated exams to recognise their achievement in some way. MOOC providers such as edX and Udacity have signed deals with the education company "Pearson" so that their learners can take exams via the company's network of test centres (Parr, 2012).

Whatever business model or models that might eventually emerge from this endeavour it will no doubt involve an element of cost that will have to be borne by somebody (whether registrants, advertisers or employers). Indeed, MOOCs have the potential to commoditise education in a manner that has not been experienced before by providing education as service (EaaS) similar to the way cloud providers provide their IT services (e.g., SaaS, IaaS and PaaS). Registered students could end up paying for their education on a pay-as-you-go basis, similar to what many companies now pay for their cloud services. MOOC providers could end becoming the new cloud providers of education.

MOOCs are likely to be attractive to those people who cannot gain access to HE (due to cost or lack of sufficient secondary education entry requirements) and who might see MOOCs as a potential avenue towards achieving that objective. It could also be potentially attractive to people who are already in employment and cannot afford the time and/or completion

commitment required by campus-based (or even other traditional online-based) education but who aspire to achieve career progression, at their own pace, by having MOOC certificates from some of the most respectable universities in the world. Most interestingly, MOOCs could be hugely popular with learners from poor third world countries who aspire to acquire certification from respected Western universities but cannot afford the cost implications associated with a Western education (e.g., travel, fees, subsistence) or do not have the required academic or pre academic certification that is often required by most Western HE establishments. Indeed, if online learning, as Christensen and his colleagues have suggested, is a new market disruption to the established class room-based education, MOOCs are an example of a “sustaining innovation”, one that is geared towards making improvements to the online learning product. Sustaining innovations, according to Christensen, are often innovations that occur frequently and are implemented by established large companies in order to improve the performance of some of their products that have strong market shares. Some sustaining innovations, according to this theory, can also be breakthroughs that can leapfrog beyond the competition products (Christensen and Raynor, 2003). MOOCs have the potential to belong to this category of sustaining innovations. But can MOOCs disrupt campus-based HE by replacing it or by becoming a good alternative to it? One respondent to Shirky’s interesting blog article wrote:

The push for MOOCs is not coming primarily from students who want to take classes in their pajamas. Instead it is coming from administrators and investors who see a big opportunity to make a big pile of money... What you don’t cite is the number of students who learned enough to have passed the course. My recollection is that it was something like 2% of the students enrolled. And the percentage is probably smaller given that many of them may have cheated their way to that result. Is that what the future narrative of education looks like? If so, I will be checking, very carefully, the credentials of my doctors and nurses before I count backwards from 100 inhaling the anaesthetic (See Shirky, 2012).

MOOCs are unlikely, in the view of this author, to replace or be a good alternative to campus-based HE, as we know it. But they could end up becoming an acceptable element of HE. However, if the cost of campus-based HE continues to rise and restrict access (except to those students who can afford it) then the future situation for MOOCs could be different. Competing for students will require innovative solutions to reduce costs and MOOCs could be one of those solutions.

There are massive IT infrastructural problems in many developing countries; many of which are the consequences of decades of neglect and corrupt regimes. And if there is any real future of taking advantage of the knowledge and learning that is being made available by Web and new online learning developments such as MOOCs, it is likely to be through Web-enabled mobile devices. In 2011 worldwide shipments of smart phones were estimated at 487.7 million gadgets, overtaking client PCs (e.g., tablets, netbooks, notebooks, desktops). This was a 63 percent increase on the 299.7 million smart phones shipped throughout 2010. The increase in demand for smart phones was driven partly by their availability at low prices and also by a growing consumer appetite for Internet browsing, content consumption and engaging with apps and services on mobile devices (Canalys, 2012). According to Dikaiakos *et al* (2009) one of the visions of the 21st century computing is that users will need to access Internet services over lightweight portable devices rather than through some descendant of the traditional desktop PC. And since users who have access to such devices are unlikely to have (or be interested in having) powerful machines, it is likely that cloud computing will be the source of that computing power. This scenario will bode well for the development of MOOCs. Free learning offerings made through this new learning model could have a huge transformational impact on education in many parts of the world and could potentially improve the lives of many millions of people by reducing poverty which is often caused by lack of access to proper education according UNESCO (Van der Berg, 2008).

## CONCLUSION

Cloud computing has made a great impact on the world's IT landscape since its emergence in 2007. Many analysts doubted its viability as a sound IT service model. But cloud computing proved to be more enduring and seems to have the potential to be a more disruptive force than initially envisaged. This IT service model has already made a great impact on organizations in the developed countries. Many small and large organizations in those countries saw merit in what it had to offer and chose to use it. Well established and adequate IT infrastructures in those countries (especially broadband connections and reliable power supply) have been useful in facilitating this process. Lack of similar infrastructures in developing countries might have hindered a more widespread uptake of this service in that part of the world. However, this position, as argued in this article, could change thanks to high levels of new media penetration. Furthermore, the disruptive force of the Web is having a great impact on education. Online learning has made education affordable to many people.

With the emergence of MOOCs, as contended in this article, access to education, especially HE, could become far more widespread and affordable, both in developed and developing countries. Indeed, cloud computing and Web-based education have the potential to disrupt (by bridging) the digital and education divides that currently exist in countries and between countries.

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## EXPLORING ORGANIZATION'S CHANGE CAPABILITY

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### ABSTRACT

In the speed of how business are operating currently, key terms like transformation and change are not a new phenomena. The elements of change and change management are widespread and multifaceted. Change management is a well established concept in academic literature but in order to implement it, suitable measuring instruments have to be in placed.

An organization's capability to change is very closely linked to the capability to change of its employees. The behaviour of people is in turn closely dependent amongst others on their motivation, leading to issues like how does motivation influence change?. Here aspect like a) communication, b) leadership: emotional intelligence and factual intelligence, c) change management as an on-going and lasting challenge and d) Focus on processes play a remarkable role.

This is a work on process paper, where the researchers explore several measuring models in order to answer those questions, being the EFQM model one of them. The objective of this paper is to explore the organizational change capability and identified strengths and weakness of current existing models. This paper will be used as a stepping stone for the final research which aim is to create an extension of the EFQM model by adding a new component which is suitable to measure the change capability.

The research will apply a qualitative methodology using a combination of methods for an optimal possibility to answer the research question. The action research gives the framework with the intention of helping to develop practice, and in this case specifically to create an extension of the EFQM Model. The case study will provide a detail understanding of what is happening at the work place by conducting in-depth interviews in the real situation.

**Keywords:** Change management, change capability, EFQM model and measurement

## INTRODUCTION

Change management has a long tradition in literature; it was already in 1951 when Lewin exploring this phenomenon divided the change process into three phases: “unfreezing”, “moving” and “re-freezing”. This journey through time will be undertaken against this background to find out to what extent these basic assumptions can be found in the newer models. In particular because this view is based on fundamental assumptions about the world: stability, certainty, homogeneity and centralized sources of power and authority. From this it can be deduced that change can be made in steps. This assumes that change it is a planned and controlled process. In addition this perception has a strong inwards focus. (Wimmer, 2011).

Modern change management is however marked by the increasing dynamics of the change processes and their concurrency. As Appelbaum et.al., (2012, p.764) stress “changes are an inevitable part of the current market. These changes can be seen and triggered by the pressure from the national and international markets, customers, competitors and the overall internationalization process, demanding “ a higher degree of willingness to change along with an increasing pace in the implementation of the change management” (Weismann, 2010, p. 19).

The problem could be that the capability to deal with change is not built into organizations. Kotter (2001) states that it is not built into either the skills, nor in the brains of the people who run the organizations. The big question for the future is: how can organizations be helped to build those capabilities?. Kotter (2001) can be quoted here as a well-known author representing authors who have developed the so-called phase models of emerge change.

Another important aspect in change management is the involvement of the employees. If it is assumed that the necessary inclusion of the employees involvement is one of the major challenges, then the factors affected by emotions have a particular influence on a company’s capability to change, (Roth, 2010). As explained by Scherer (2005) because, emotions are the key element for employees’ adaptiveness to new behavior. As employees cannot be adjusted as machines can, models are necessary which make measurable the so-called emotional intelligence of a company (Weismann, 2010). The emotional intelligence’s perception of those involved in the change process plays an important part here. Therefore, Burch and Ghoshal,

(2003) suggest to explore if all the members involved in the change process really have the same perception of the issues. Additionally, not only the perception should be explored, also the willingness to change is crucial. Hofstede and Hofstede, (2005), explained that members coming from societies characterized by high levels of risk's acceptance are more willing to accept change than member of a society with high levels on uncertainty.

When exploring change management in projects, it is almost impossible to implement in organizations without a suitable measuring instrument (Krüger 2002, Capgemini, 2010). According to Raisch (2007) only where change can be measured is it possible to attribute clear areas of responsibility and to monitor whether the aspired goals are reached or not. Based on these statements, the paper aims to examine suitable measuring instruments for change management. In order to conduct this examination a selection of measuring instruments are introduced, for example the EFQM model (later explained) investigating if it can be extended with a change component which is suitable to measure the change capability.

The paper is structured in four parts, the first one review topics on measurability of change capability, introduces some measurability models and examines to what extent potential measuring tools are at all suitable for measuring this complexity, and finally the EFQM model is introduced. The second part, explain the planned methodology to be applied to answer the research questions. The third part, presents some initial findings based on the literature review. Finally, some conclusions and an anticipation of potential limitation in the research are addressed.

## **MEASURABILITY OF CHANGE CAPABILITY**

According to Capgemini (2010, p.33ff) the capability to change consists of the dimensions of the willingness to change, capacity to change and possibility to change. With these three dimensions it is expressed that the organization wants to (willingness to change), that it is able to (capacity to change) and that it is possible to (possibility to change) change. Based on this definition, the strating point to measure change capability is provided.

Nevertheless, the measuring tools must be able to cover a wide spectrum in order to be used flexibly and universally. In addition, it must be possible to decide on courses of actions in the light of the measured results. Under the presumption that the success of change processes depends on whether the chosen approach suits the company's starting situation, the effective monitoring of change processes requires independent and differentiated instruments

(Charbonnier-Voirin 2011). Those various independent and differentiated instruments or capabilities which emerge in the literature refer to: organizational agility (Charbonnier-Voirin 2011), organizational energy (Bruch and Ghoshal 2003), organizational fitness (Voepel and Leibold 2004), organizational change capacity (Soparnot 2011).

It can be observed that the company often prioritizes the improvement of product characteristics, the production processes or also the structure and process flow triggered through the change process. During this prioritization process, companies often overlook the point that they are not only affected by their structure, but also, in particular by the attitudes, interaction and behavior of their employees. The change in ways of thinking and behavior, however, is often at the bottom of the list, although this is where the source of sustainable competitive advantages lies, as the Expert Circle "Zukunftsstrategien" has found out (Expertenkreis 2009). In the same line of thought, Ansari and Bell, (2009, p.139) highlight the more holistic approach towards the implementation of change. They suggest that "implementing change requires thinking as a designer and employing the logic of conjecture rather than scientific deductive or inductive reasoning. Successful implementation requires conjuring an image of a future reality that does not currently exist and making that image persuasive by connecting it with the values of the organizational participants"

Reflecting on those statements, questions arise as to does such a „wonder tool“ exist? Or are there still similarities in the various approaches which also help simplify the measuring and the evaluation?. In mainstream literature key factors regarding these issues are discussed. The factors relate to a) Communication, b) Leadership: emotional intelligence and factual intelligence, c) Change management as an on-going and lasting challenge and d) Focus on processes, (Vermeulen, Puranam and Gulati 2010; Doppler and Lauterburg, 2005; Kostka and Mönch 2009; Weismann, 2010; Krüger 2002)

**Communication** is a process which runs parallel to the change process. Through focused corporate communication cultural and structural conditions along with states of mind must be created so that employees, despite or possibly due to the changing structures in the organization, are taken along with the flow and can subsequently develop their optimal performance ability (Kostka and Mönch 2009). At the same time, the employees involved with their questions, worries and emotions must be gathered up and won over for the changes. This is where leadership is required, because the success of a change process depends considerably on the communication capabilities of the managers (Weismann 2010).

Very often projects are schemes with a defined beginning and a defined end, which are marked by the characteristics of time restrictions, uniqueness, complexity and novelty (Krüger 2002). With these specific characteristics and requirements **change management** can be spelt out. If an organization does not only want to keep up with competitors, but also, to achieve sustainable competitive advantages, then changes in organizations must be considered as an on-going and lasting task in the future. Accordingly Appelbaum et.al., (2012, p.765) stress that “successfully implementing changes can be a major determinant of its short- and long-term company success”

A core competency of successful organizations lies in the capability to change. Most organizations are built around one single aspect, be it function, product, customer or the market. The focus is on this single aspect, and this is seen, as being the most important one. To optimize this aspect all existing resources are deployed on it. However the organization unit in its entirety is disregarded. There is a danger that the optimization of the individual aspects can lead to the separation of the individual areas, and due to this, it is impossible to achieve the optimal results for the organization as a whole (Weismann, 2010). As a consequence of this the problem arises that communication and cooperation are limited to one of these separated areas. So it can be concluded, that a modern and versatile organization ought to be geared up to functional **processes** and a meaningful process chain (Doppler and Lauterburg 2005). Keeping this in mind, the challenge faced by many companies remains the creation of an organization capable of changing, and not only the specific structuring of change in one particular situation. If the issue concerning how the organizational capability to change is considered as essential, it is a logical reflex, from a scientific point of view along with from a practical point of view, to examine the measurability or scalability aspects.

Conclusively, the explanation derived from the literature review reveals the complexity of change management. Focusing on this complexity, is where the researchers identify the main challenge and reach the conclusion that this complex system cannot be described with a simple and practical model.

## **MEASURING TOOLS**

Measuring tools must be able to cover a wide spectrum in order to be used flexibly and universally. In addition, it must be possible to decide on courses of actions in the light of the

measured results. Under the presumption that the success of change processes depends on whether the chosen approach suits the company's starting situation, the effective monitoring of change processes requires independent and differentiated instruments (Charbonnier-Voirin 2011).

There are already various approaches and models which examine the measurability of the capability to change of an organization. A selection of models based on the studies of Judge and Douglas (2009) and Charbonnier-Voirin (2011) are examined, and the strengths and weaknesses of the models are introduced.

**Table 1:** Summary of models "Measurability of the capability to change"

Authors	Model	Advantages	Disadvantages
Palanisamy and Sushil (2003)	Organizational flexibility: "The capacity to respond to environmental change."	Simple model with only 4 factors	Too broad and general to be meaningful Not rooted in a theoretical framework
Hatum and Pettigrew (2004)	Organizational flexibility: "A combination of a repertoire of organizational and managerial capabilities that allow organizations to adapt quickly under environmental shift."	Two-dimensional model - degree of internationalization - degree of product-market Diversification	Tried and tested in only two organizations and these organizations belong to the same industrial sector
Butler (2003)	Organizational receptivity: "An emerging, but undeveloped notation which attempts to reveal the factors which contribute to organizations being either low-change, non-receptive contexts, or high-change, receptive contexts."	Good results were achieved in the study	Tried and tested in only two organizations in the public sector
Moilanen (2005)	Organizational learning: "A consciously managed organization with learning as a vital component in its values, visions and goals, as well as in its everyday operations and assessment."	Five-interrelated dimensions	"There is no agreement on the concept itself or its measurement."
Holt et al. (2007)	Employee readiness for change: "The extent to which an individual or individuals are cognitively and emotionally inclined to accept, embrace, and adopt a particular plan to purposefully alter the status quo."	Well-regarded scale development approach, reliable and valid 25-item, four dimensional measures.	This model was only examined in two organizations
Judge and Douglas (2009)	Organizational Capacity of Change (OCC): "A combination of managerial and organizational capabilities that allows an enterprise to adapt more quickly and effectively than its competition to changing situations."	Examines the success factors of change management.	The use of complicated mathematical formulas implies accuracy to the last decimal point. The measure does not consider the specific nature of the organizational change.

Source: based on Judge and Douglas (2009) and Charbonnier-Voirin (2011).

It can be summed up that all the models do indeed have advantages individually in their own rights. However, it cannot be overlooked that the disadvantages or drawbacks are in some cases serious (Voepel and Leibold 2004).

In particular, many of these tools involve a very mathematical or statistical approach. It is often overlooked that these tools are to be used mainly in the human resources departments, and in most human resources and organization departments the employees do not have a mathematical background. In addition to this, the literature review has also shown that it appears that the change process very much depends on the motivation of those involved. It also indicates that the emotional factors and the company culture also play a significant role. The process and the emotions are connected inseparably. Each new phase within a change process reveals its own emotional issue and with this, the phase's specific function for the handling of the change process tasks (Roth 2000). Therefore, dealing with these emotional climate curve is a particular challenge in the change process, because such emotions can support the process as bringing joy and excitement, but they can also hamper it with negative emotions of fear and grief (Liu and Perrewe, 2005)

If those responsible are aware of the importance of these fluctuations they will find it easier to recognize the signs of issues threatening the process early on and so be able to intervene early enough (Weismann 2010). Change produces extreme emotional pressure which must be released. The emotional handling of the situation follows in these cases in the same and natural sequence, regardless of the reason for change (Schmidt-Tanger,1998). In view of this, it can therefore be stated that the existing models for measuring the capability to change more or less ignore these emotional factors (Bruch and Ghoshal 2003). Finally, measuring instruments are flawed with weaknesses on account of which their practical use can be questioned.

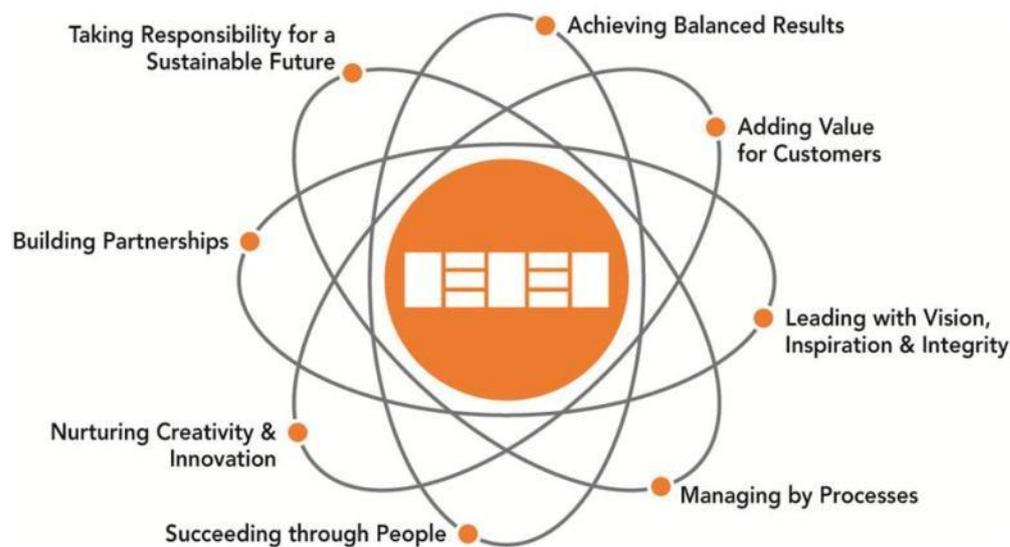
## **EFQM AT A GLANCE**

The „European Foundation for Quality Management“ EFQM is a global non-profit membership foundation. The EFQM model provides organizations with assistance in the setting up of and the continual further development of extensive management systems. The organizations use it as a tool to determine its strengths and the potential for improvement based on self-assessment, to encourage and increase business success.

Excellent organizations distinguish themselves through similar characteristics and ways of thinking, regardless of the environment in which they operate. These characteristics which make successful organizations excel in comparison to other competitors are identified in the EFQM model as basic concepts. These basic concepts have been identified through global

benchmarks, observation of emerging trends and interviews with senior managers throughout Europe. Each basic concept is important in its own right, but the highest gain can be achieved if they can be interlinked with each other. There is no particular order or importance of these basic concepts. Each organization itself must recognize which basic concepts are the most important for them.

**Figure 1: EFQM – The basic concept**

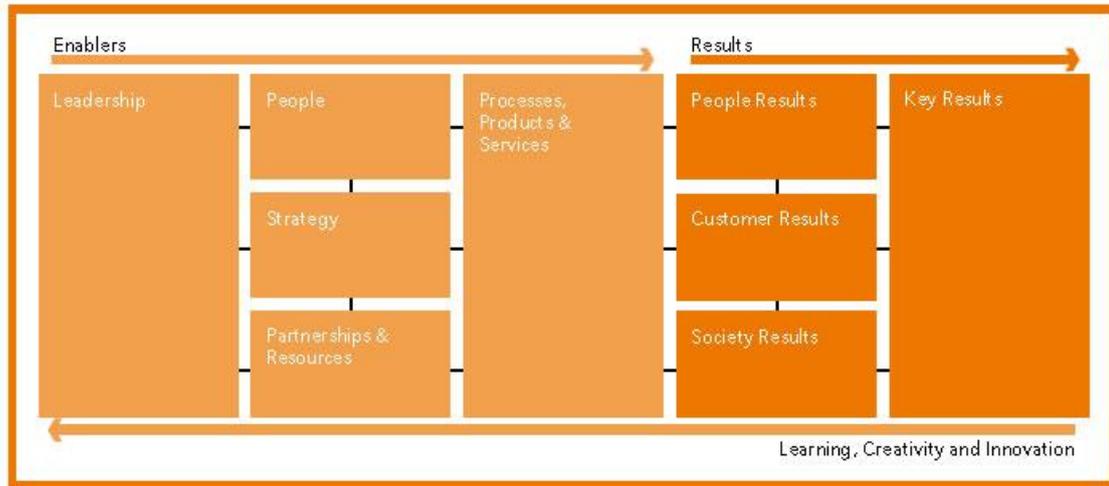


Source: (EFQ 2012)

This approach sets out that the employees are involved in the processes in such a way that the company can improve its results.

The EFQM Excellence model is based on eight basic concepts and nine essential criteria with a total of 32 sub-criteria, divided into “enablers” and “results.” (EFQM 2012). The wording was chosen so that the model can be used similarly for differing sectors, large/small companies, or simple/sophisticated organizations.

**Figure 2: EFQM – The main criteria**



Source: (EFQ 2012)

The three main pillars in the vertical boxes clearly form the fundamental components of the model. The corresponding horizontal boxes in between form a further sub-division and they indicate with which measures the implementation of the model can be achieved and which intermediate results are necessary for this. Basically, the model explains that customer and employee satisfaction and the influence on the society can be achieved through leadership with the support of policies and strategies, employee orientation and management of resources, which subsequently, with the help of appropriate business processes, leads to excellence in the organization's results.

The second issue to be seen is that the model is divided into two large parts, in **enablers** and **results**, both of which make up half of the whole model in the evaluation. This is one of the fundamental points of the TQM model, that it is not sufficient to manage the results but that it is essential to include the ways of approach (the enablers). This is the reason why half the weighting falls on the ways of approach although at the end it is the results which have to be achieved. With the results, *what* the organization has achieved it is defined and with the enablers *how* the organization wants to approach the issue it is defined along with which resources and methods they want to achieve the results.

So far the research questions as to whether it is possible to adapt the EFQM model with specific change requirements until here is still unanswered. This model was chosen because on first sight it analyses the above mentioned key factors, along with the internal and external view. Whether or not the model can fulfill the expectations is under examination and the

question cannot be answered directly at this stage, but model extensions do already exist as indicated by (Schat, 2011) as it can be seen with the following concepts (extensions).

**ROWE Concept:** the first additional module is the ROWE concept (Results Only Work Environment). The aim of this concept is a strict focus on employee results. The employees decide themselves when and where they work. The managers and the employees agree on specific goals and outline the framework of conditions which support them in reaching these goals (working materials and equipment, resources, courses and seminars etc.).

**OED Concept:** the second additional module is the OED concept (Overall Employment Deals). In the light of demographic developments the importance of employability is growing. For this reason, in addition to salary payment, fringe benefits and perks, the following aspects are also gaining in importance: workplace health promotion, workplace design, flexible working hours, work-life balance, lifelong learning, career planning until 67, and the transfer of knowledge. OED offers an integrative approach which combines these components into a convincing and logical company-specific strategy.

There are already the first studies in which companies, which have used the EFQM model, have shown certain factors of success, for example by obtaining higher profits and an improvement in employee's retention. Although, two extensions to the current model have already been developed (ROWE and OED) concepts as explained above the emotional part involved in change management is still missing. Therefore, the researchers are convinced that the EFQM model can further be extended by focusing on the emotional part involved in change management. Being the aim of this research the extension of the EFQM-model by a change component which does not exist at present.

## **CHANGE MANAGEMENT**

In literature, there is no one unambiguous, clear and conform definition of change management (Weismann 2010). The following three definitions are the most wide-spread (Capgemini 2010):

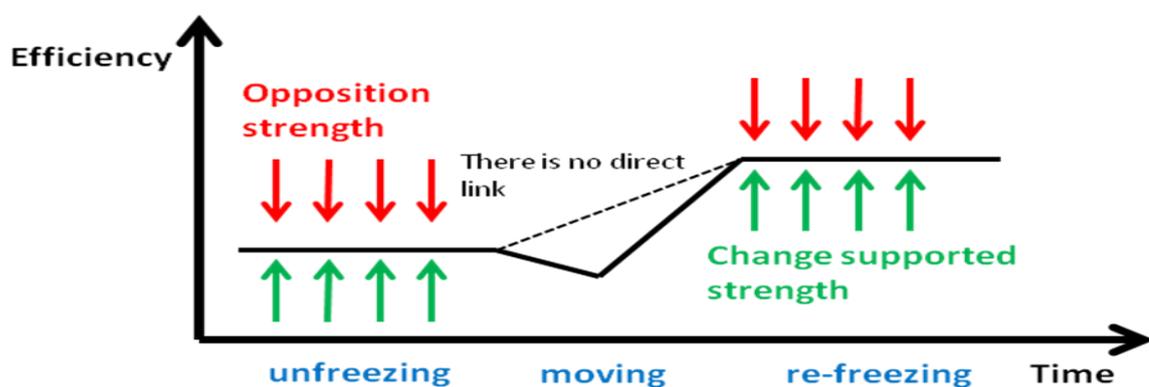
Planning-oriented definition: the aim of change management puts the increase in efficiency above a focussed change in culture, systems and behaviour within an organisation.

Stakeholder definition: here change management is understood as the organized and systematic approach dealing with changes from the point of view of company managers and employees.

Result-oriented definition: the aim of change management is the improvement of business objectives and results via the change process.

Deeping further into change management, Lewin's (1952) three basic approaches are described with the intention to work out which starting points from the various approaches offer in the way of making an organization's capability to change measurable. Lewin is regarded as one of the main protagonists of Organizational Learning. Lewin's model is based on three phases in the change process (Burnes, 2009, p.364).

Figure 3: Lewin's model



**Unfreezing:** "The starting situation is marked by a balance of the competing powers of stability and change. In this phase the employees involved are to be prepared for the changes. They should be sensitized to the demands of a transformation. Through this forming of awareness the necessary willingness for change in the employees involved is established and built up and the powers for change strengthened. At the same time the powers of resistance are reduced due to which the balance of the organization is out of equilibrium for a while.

**Movement:** As soon as the necessary willingness to change and the main aim of the first phase has been achieved the actual change takes place. Solutions are compiled and new patterns of behavior are tried out, in order to be able to cope with the challenges of the change process. This phase runs for as long as it takes to achieve the change strived for and until the new balance is reached.

**Re-Freezing:** The new behavior patterns are lived out consistently in order to stabilize the new balance. The problem solving strategies applied in the second phase are integrated into the company's workflows. By doing this the organization can prevent itself falling back into its old ways".

Changes at all levels, individual or company level always means to abandon one's comfort zone for something perhaps unsure or unknown. At the stage, is when leadership needs to

combine the skill identified previously of communication, emotional and factual intelligence, change abilities and attention to processes have to come to the fore.

## **METHODOLOGY**

The research applies a qualitative approach on the basis of interpretivism. Creswell (2009) describes the research design as an overall plan for connecting the conceptual research problems to the pertinent and achievable empirical research. It remains important that the design frame is suitable to answer the research question (Salkind 2003). Therefore, to achieve effective improvements, a combination of action research and case study will be chosen. The researchers regard this combination of the two approaches the optimal possibility to answer the research question. This is confirmed by Mumford (2006) stressing that often a mix of methods produces the best results.

The action research gives the framework with the intention of helping to develop practice (Coghlan and Brannick, 2010). Through the case study the understanding of the details of what is happening can be established. Yin (2009) describes this circumstance that the researcher would use the case study method because he wanted to understand a real-life phenomenon in depth.

The researchers have planned 6 steps for data collection (in-depth interviews, focus groups and company's reports) which will be conducted in one of the researcher's company. The sample will be employees and members of middle management and top management. The selection of the participants will be made on the ground that middle and top management play a particularly important role in the change process. With this type of data collection the personal interaction between the researchers and the participants would be very important. Once the data is gathered, content analysis will be used to conduct the analysis.

## **LITERATURE FINDINGS' DISCUSSION**

At this early stage, as the research is part of doctoral work only findings based on literature review can be presented.

Kotter, (2001) has been researching change management for a few decades and he says, that the fundamentals on how organizations change are quite clear. He has found out how

organizations change and what people need to do to make them change. Changes and changing processes are part and parcel of today's business environment. Which challenges are waiting on the road towards change? Do we really know how a company has to be structured and which capabilities are necessary for it to be able to cope with continuous change? In general business literature is often pointed out that many companies fail during the change process. But what exactly does it mean, to fail? Or, what makes some change processes successful and others not? The problem could be that the capability to deal with change is not built into organizations. Kotter states that it is not built into both the skills and the brains of the people who run them. The big question for the future is: How can organizations be helped to build those capabilities? How can managers and staff be helped to incorporate usefully a way of thinking that enables corporate change? How can it be ensured that everyone has the capability to play their appropriate role in any change process? In other words the capability of change is a question of company culture within which managers see the process of change as one of the most important management tasks.

Capability of change is made up of change readiness, change competence and the scope of possible change. In this case the main challenges, especially for managers, are to support the willingness to change of those involved, to encourage change competence and to outline the scope of change possibilities.

If a company doesn't only want to keep up with competition but also gain a cutting edge it must be in a position to tackle these challenges of change. That means the establishment of an organization which is capable of changing, but not only for one specific forming of change in one specific situation, is the main challenge for companies. In other words the main job of corporate change will be to build the specific capabilities into the organizations allowing them to deal with extreme turbulence. This requires getting enough people and all kinds of people in the organization involved in the right way to handle change. When a topic such as organizational capability of change is considered as being essential the next logical step is to ask about measurability and scalability.

Related to the three steps of change management, the basic approach of this model is to bring about the willingness to change in the employees involved. All in all, this model is very general and conclusions based on only three phases are hardly possible for the real world. Furthermore this approach is based on the assumption that the organizations can always work under consistent conditions. It is also assumed that the organizations can develop from

a stable starting point to the next stable state. A further important point of criticism is also that this approach does not take into account possible crisis situations at all. Finally, it is also assumed that all the people involved work together, all pulling in the same direction and that they fully support the change process. With this assumption organizational and political conflicts are equally ignored. Or in other words, it is assumed that conflicts can be easily identified and solved (Todnem, 2005, p.374).

It was indicated before that without a suitable system for measuring it is almost impossible to implement the changes within an organization. Raisch 's statement that only where change can be measured is it possible to attribute clear areas of responsibility and to monitor whether the aspired goals are reached or not, found several supporters in literature.

The overriding opinion emerging from the literature review related to the models of measurement is that the model has not been able to be operationalized. This leads to the dilemma that on the one hand the measurability of the capability to change is considered as being important as stressed by Todnem (2005), and that on the other hand, suitable measuring instruments do not exist. Could the reason for this possibly be found in that the authors of the existing measuring instruments wanted to develop basic new models? Did they fail due to the complexity of change processes? Might it be possible to add on a so-called change component to existing models which have already been proved useful in practice? .

## CONCLUSION

As an interim conclusion of the literature review, these models of measurement have not been able to implement neither in practice nor in sciences or teaching. This is, at least, the overriding opinion emerging from the corresponding literature. This leads to the dilemma that, on the one hand, the measurability of the capability to change is considered important and on the other hand, suitable measuring instruments do not exist.

The question as to why this is the case inevitably crops up. Is it possible that the assumptions made for the models for measuring a company's capability to change are wrong? Wrong, in the sense of the methods used?

It looks as though change is a function of external dynamics and internal capabilities and significantly success or failure is often determined by the interaction between the two as stressed by (Jarret, 2008).

The extension of the EFQM should be able to support management to find out the level of the current capability to change and also to identify the specific possibilities for action to improve capability to change. In this model the main focus of attention should be on the interaction between the external events and the internal capabilities. Therefore, the existing additions discussed above show that the EFQM model can be extended for specific needs. So what can be said against the idea that by using a so-called EFQM change component a pragmatic instrument for measuring the capability to change can be developed? To be able to examine this in depth though, firstly, further intensive research and secondly a trial experiment are necessary to confirm the suitability.

## LIMITATIONS

What is important here is that the researchers examine the potential sources carefully and then bundles optimally for the specific case. So, even if the researchers consider various techniques for the analysis phase, according to Yin (2009), for example pattern matching, explanation building, time-series analysis, logic models and cross case synthesis and the researchers embed the case studies in an action research, not all the weak points can be compensated for. This is particularly the case, because the collection of data and information is restricted to the researchers' company and so, a generalization of the knowledge gained is not really possible.

This preliminary decision is also influenced by the central topic concerning company culture. From the researchers' point of view today it can hardly be expected that other companies in the industry will be willing to give away such sensitive and company-internal information, as all the companies in the lacquers market are in direct competition to one another.

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## FACTORS INFLUENCING FUND RAISING: AN EMPIRICAL STUDY ON ITALIAN STARTUPS

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### ABSTRACT

This paper aims at identifying the factors that influence fund raising in new ventures. We analyzed a sample of 108 Italian startups. The research is aimed at identifying the characteristics of the entrepreneurial team that have a bigger influence on equity acquisition. We focused the research on the lead person in the founders' team (we identified with the person who assumes the CEO position) and we carried out a Tobit regression to test hypotheses developed on a list of variables extracted from the literature analysis. The analysis shows a significant relationship between the ability of a startup in fund raising and the level of education of the CEO. This causal relation is even stronger if the CEO has a managerial education acquired through an MBA. Moreover, previous work experience seems not to have a key role in fund raising, while company's size and legal form may affect it. Future research lines conclude the paper.

**Keywords:** Entrepreneurship, Startups, CEO, Fund Raising, New Technology-based Firms.

### 1. INTRODUCTION

Entrepreneurial activity fosters the innovation and technological change of a nation (Schumpeter, 1943). Shane (1995) demonstrates how key is entrepreneurship for the economic growth of the country providing data about the contribution of entrepreneurial firms to the US real economic growth in the period 1947-1990. Moreover, new ventures are responsible for job creation (Vesper, 1996). Recent studies (see inter alia, Stangler and Kedrosky, 2010; Kane, 2010) show that startups are accountable for almost all the new jobs created in the United States (about 63%), net of jobs lost.

For all these reasons, entrepreneurship has attracted the interest of scholars since many decades. Entrepreneurship is a multifaceted phenomenon that can be defined in different

ways (Gartner, 1990; Bull and Willardt, 1993; Lumpkin and Dess, 1996). The interdisciplinary nature of entrepreneurship research reflects aspects related to individuals and groups (team), enterprise, culture, geographic distance/location, industry, country's policy.

In this paper we refer to entrepreneurship as a process whereby firms and individuals (entrepreneurs) explore and exploit opportunities (Stevenson and Jarillo, 1990; March 1991), leveraging their ability to manage uncertainty in a pro-active way. Moreover, this process impacts (and is impacted by) the company's strategy and business model (Onetti *et al.*, 2010b) as well as the fund raising process (Eckhardt and Shane, 2003).

This paper focuses on equity capital acquisition since it is one of the most critical factors in the growth/development for a startup/new venture (Hustedde and Pulver, 1992). Stated the importance of startups for the economic growth of countries and job creation, we decided to focus the research on the factors that favor fund raising. We decided to analyze factors that refer to the startup as a whole ("company specific factors") as well as the single individuals composing the entrepreneurial team ("human capital").

The way entrepreneurs mobilize resources (in terms of quantity and quality) to exploit opportunities is a crucial research issue in the field of studies related to entrepreneurship. Insofar studies have focused on network ties between entrepreneurs and investors (Shane and Cable, 2002; Zheng *et al.*, 2009) and entrepreneurs' characteristics (Watson *et al.*, 2003; Burton *et al.*, 2002) to explain financial capital mobilization/acquisition. Moreover, Cooper, Gimeno-Gascon and Woo (1994) linked initial human and equity capital to new venture performance. While the above-mentioned issues have been deeply investigated, access to equity capital for startups at an early stage and the existing linkages with human capital and firm characteristics still remain an open research problem.

Our analysis aims at filling this gap linking the founders' background (education, working and entrepreneurial experiences) to the ability in acquiring new equity capital. This study aims at contributing to the literature on entrepreneurship and provide important implications for researcher and practitioners who are more and more interested in startup companies and (qualitative and quantitative) criteria to be used during the investment process (Startup Genome, 2012).

The paper is structured in six main sections. The first is an introduction to the topic of entrepreneurship and capital raising. The second section contains a comprehensive literature review on human capital - new venture characteristics and relationship between them and the capital raising process. In this section we also provide a brief description of the conceptual framework we adopted to run the analysis. Then, the methodology is discussed and the main

features of the sample are presented. In last section, results are described and discussed. Some managerial and research implications complete the paper.

## 2. THEORY AND HYPOTHESES

### 2.1 *Human capital*

Several studies on entrepreneurship have focused on the person of the entrepreneur (human capital). According to this stream of research, several variables have been studied: education, past experience (both working and entrepreneurial), knowledge acquired by individuals (industry and market specific), family background and so on. According to Becker (1964), human capital relates also to the general knowledge (overall working knowledge or leadership experience) acquired by individuals through education and previous experience both as employee and employer.

The main variables related to human capital adopted in empirical studies referring to entrepreneurship focus mainly on basic demographic factors (such as age, gender, country of origin) (Roberts, 1991; Bates, 2002; Levesque and Minniti, 2006). A recent field of study is the so-called “young entrepreneurship” (Lewis and Massey, 2003; Schoof, 2006). In fact, as stated by Stevenson (1987), young entrepreneurs face major challenges by trying to raise financial assets capital to start up their business, first because they typically had no time to accumulate a lot of personal assets which that can be used as a collateral security for a bank loan and second because they lack of credibility from banks and financial actors. Other studies on cognitive aspects and social capital (Baron, 2004; Davidsson and Honig, 2003) and on motivational drivers, such as high need of achievement (Roberts, 1991) are helpful to understand entrepreneurship. Another relevant aspect of analysis that studies on entrepreneurship take into consideration is related to previous entrepreneurial and work experience. As regards previous entrepreneurial experience studies often refer to “serial entrepreneurship” (Delmar and Shane, 2006; Presutti *et al.*, 2008; Onetti *et al.*, 2010a). Empirical evidence supports that entrepreneurial startup experience increases the odds of venture success (Dyke *et al.*, 1992; Doutriaux and Simyar, 1987). Regarding previous entrepreneurs’ work experience (Brüderl *et al.*, 1992; Blanchflower and Oswald, 1998; Sorensen, 2007) previous researchers have found a positive association between previous experience in management and business success/performance (Gimeno *et al.*, 1997). Number and variety of prior work experiences (Lazear, 2004; Dahl and Reichstein, 2007) is also an important aspects.

Moreover, entrepreneurs' high educational levels/years of schooling (Bates, 1990; Roberts, 1991) is also related to superior startups' performance (Cooper and Gimeno-Gascon, 1992): in particular, Brinckmann, Salomo and Gemuenden (2009) show that startups, whose team members have strategic financial management competences, are often related to faster firms levels of growth. Another deeply analyzed field of study refers to indirect experience or passive experience of entrepreneurs, i.e. family and friends' entrepreneurial attitude (Roberts, 1991; Sorensen, 2007) that, in particular, can positively affect entrepreneurs' attitudes toward risks.

**Table 15. Human capital: variables studied**

Variable	Description	Authors
<b>Basic Demographic Factors</b>	Basic demographic factors (age, gender, country of origin)	Roberts, 1991; Bates, 2002; Levesque and Minniti, 2006
	Family and friends (entrepreneurial attitude)	Robert, 1991; Sorensen, 2007; Duchesneau and Gartner, 1990
	Personality traits	Glancey <i>et al.</i> , 1998; Steward Jr <i>et al.</i> , 1998
	High need of achievement	Roberts, 1991
	Cognitive aspects and social capital	Baron, 2004; Davidsson and Honig, 2003
<b>Education</b>	General knowledge acquired through education	Becker, 1975
	High education levels/years of schooling	Bates, 1990; Roberts, 1991
<b>Experience</b>	Work experience	Brüderl <i>et al.</i> , 1992; Blanchflower and Oswald, 1998; Sorensen, 2007
	Variety of jobs	Shane, 2001; Lazear, 2004; Dahl and Reichstein, 2007
	Specific capabilities (industry specific and entrepreneur specific, i.e. career and leadership experience)	Becker, 1964
	Entrepreneurial experience	Bates, 1990; Brüderl <i>et al.</i> , 1992; Delmar and Shane, 2006; Presutti <i>et al.</i> , 2008; Onetti <i>et al.</i> , 2010a

Some scholars have pointed out that individual characteristics may help the wanna-be entrepreneur in exploring and exploiting opportunities (Shane, 2000) or in accessing to the resources required to develop the business (Brush *et al.*, 2001). It is thus generally accepted in literature that human capital is a crucial resource to succeed in business (Bosma *et al.*, 1994; Brüderl *et al.*, 1992; Cooper *et al.*, 1994). Therefore we expect that entrepreneurs who have broader business experience, higher skills in business and management and are older should have more chance of succeeding in their business ventures. Actually, they could leverage

their prior experience and network and develop more sounding business plans and be more effective in raising capital (Hustedde and Pulver, 1992). In summary, we hypothesize that:

*H1a: Entrepreneurs with higher academic education are more successful in fund raising*

*H1b: Entrepreneurs with business education are more successful in fund raising*

*H2: The older and more experienced is the entrepreneur, the bigger is his/her ability to raise capital*

*H3: The previous working experience positively influence the entrepreneur's ability to raise capital*

## 2.2 Company specific factors

Company specific characteristics refer to the size of the company and group of promoters (entrepreneurial team), the country of origin and the legal status. McMahon (2001) found that the size of the company - measured in terms of headcount - positively impact its performance. Other studies show that the probability of success of a company depends also on the magnitude of the entrepreneurial team - measured in terms of number of founders - and the diversity of the competence base (Bates, 1990; Brüderl *et al.*, 1992) - startups benefit from the presence of founders with heterogeneous skills and competences (Cooper and Bruno, 1977; Eisehardt and Schoonhoven, 1990; Cooper *et al.*, 1994). Moreover, previous studies also support that firms founded by teams are more successful than those founded by individuals (Cooper and Bruno, 1977; Mayer *et al.*, 1989; Timmons, 1990; Kamm *et al.*, 1990).

Although many studies focus on the impact of country of origin on consumers' choices (Schooler, 1965; Lampert and Jaffe, 1996; Roth and Romeo, 1992), some authors have studied the relationship between the country of origin and the financial performance, although limited to companies targeting an IPO (Bell *et al.*, 2008). Startup companies begin their operations and sometimes the funding process also before being formally incorporated. This specific issue creates problem to scholars since they often need to include in their research samples companies that are not formally established as legal entities (Foo *et al.*, 2005). Reports show that venture capital funds prefer to invest in companies already established instead in companies not yet incorporated (Kauffman, 2008).

Assuming that the amount of capital raised is a good proxy of entrepreneurial performance (Lee and Zhang, 2011; Watson *et al.*, 2003), we thus formulate the following hypotheses:

*H4: The size of the company - in terms of number of employees - facilitate the fund raising*

*H5: The larger the founding team, the higher is the ability of the company to get funded*

*H6: Already incorporated companies are preferred target of investment than companies not yet incorporated*

Scholars argue that access to financial capital provides the necessary resources to foster exploration, to pursue new opportunities (March and Simon, 1958; Bourgeois, 1981; Zahra, 1991; Stevenson and Jarillo, 1990) and to sustain the new venture over the long term. The amount of capital raised is therefore an important resource (Cooper *et al.*, 1994) and can be considered a good proxy of entrepreneurial performance (Lee and Zhang, 2011; Watson *et al.*, 2003). The issue to address, then, is how to best capture the variables that support new ventures in accessing to financial resources. A first stream of research takes into consideration the influence of human capital on fund raising. Cressy (1996) suggests that human capital determines the ability of a company to access to financial resources, while others affirm that capital raised by a startup is positively related to the entrepreneurs' level of education (Bates, 1990). On the other side, some authors (Storey and Wyncarczyk, 1996) find that company specific factors have greater explanatory power than human capital as fund raising is involved.

As a consequence, in our research we decided to consider both company specific factors and individual specific factors (human capital) to understand their impact on the startup's ability to raise capital from investors.

### **3. DATA AND METHODOLOGY**

To shed light on the proposed issue we used a dataset composed of 108 Italian innovative new ventures that in 2011 voluntarily submitted their business plan to the Business Plan Competition organized by Mind the Bridge Foundation, a non-profit (501 c3) corporation based in San Francisco. As stated by Foo, Wong and Ong (2005), using data of participants of a business plan competition can be quite useful and relevant. In addition, drawing the sample from this source has several advantages, i.e.: identify teams engaged in the early stages of the entrepreneurial process; scout firms and founders characteristics and perform longitudinal studies, monitoring the phenomenon in a specific area or region; such competitions are a chance for students, those from industry, and potential investors to network with one another, and thus for teams to reshape ideas and strategies.

As regards sample representativeness of population, it is difficult to assess whether this sample would be representative or not of the Italian population of startup. Different studies report a magnitude of 800/1.000 new startup initiatives each year (see among the others, Onetti *et al.*, 2012). A recent law enacted by Monti Government (Law n. 221/2012, the so-called

“Decreto Legge Sviluppo bis”) establishes a register to survey innovative startup. This would help future research by “officially” identifying the Italian population.

Data gathered contains information about the new venture, such as the year of incorporation and place of establishment, sector, number of founders, business description and available market data, company investment profile (capital raised and investors typology), financials. Moreover, demographic information on the founders and management’s team are collected, such as date and place of birth, gender, education path, role played in the new venture, prior working experiences (detailed information on the prior positions in companies / universities / research centers) and prior entrepreneurial experience (detailed information for each previous startup the founders have been involved).

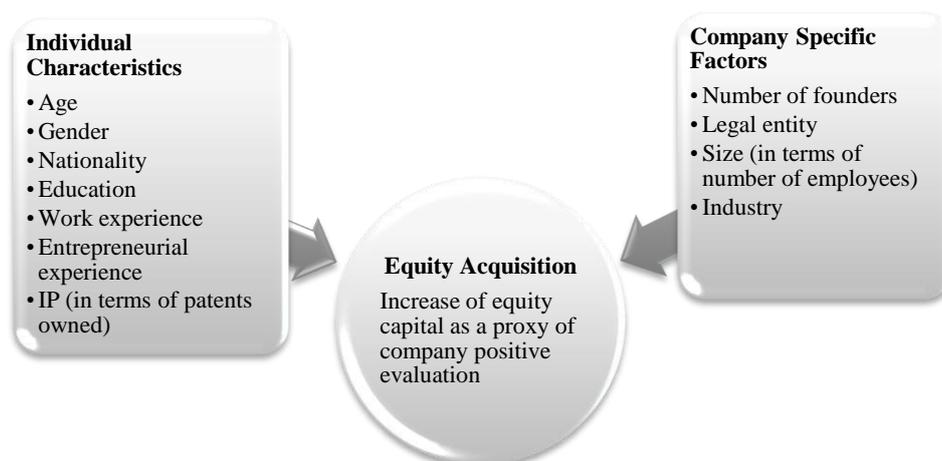
As a proxy of the individual specific factors we decided to concentrate the analysis on the Chief Executive Officer (CEO) of the new company who usually is a founder of the new venture and, in the early stages, the key figure for the company and for its strategic choices (Papadakis and Barwise, 2002). We thus take into deeply analyzed the 108 CEOs of the above-mentioned new ventures. The other people composing the founder team are considered among the company specific variables.

Below are described the main explanatory characteristics of the 108 companies we analyzed.

As regards the CEOs, they are on average 32 years old (ranging from a minimum of 21 to a maximum of 56); 87% are male and 13% female. As regards the field of activity of the companies, web and ICT represent the more prevalent business (85%). A minor role is played by companies operating in the Clean Technology industry (10%) and in Biotech/Life Sciences sector (5%). Companies are recently founded (on average 1 year); 39% are not yet formally incorporated. Bootstrapping is the most common source of funding (62%) for the 108 new ventures, 26% companies were able to raise seed capital, while 7% were funded by business angels and 5% by venture capital firms. Moreover, 14% of the companies had access to research grants.

### *3.1 Research design*

In our research, we decided to correlate the characteristics both of the CEOs and new ventures with the ability of a startup to fund raising (measured as the amount of the capital raised up-to-date), as shown in the following figure.

**Figure 26. Research Model and Variables.**

In doing so, we adopted a Tobit model. Tobit models are used when the dependent variable is non-negative and represents a corner solution. The variable is therefore zero for a part of the sample and is continuously distributed over positive values (Wooldridge, 2009). In fact, capital raised is zero for about 46% of our sample, while for the remaining 54% it assumes values ranging between 750 euros and 950k euros. This model has been used by different authors to accommodate censored dependent variables as sales/expected sales (Siegel and Wessner, 2012) or efficiency and technological progress (Foltz *et al.*, 2012). The explanatory variables we adopted are listed in the following table.

**Table 16. The explanatory variables of the model.**

Variable	Description	Type
CEO_ACADEMIC_EDU_Y_N	The CEO has an academic education (Bachelor or Master)	Dummy
CEO_AGE	CEO's age	Continuous
CEO_BORN_ABROAD_Y_N	The CEO is born abroad	Dummy
CEO_EXP_ABR_Y_N	The CEO has international experience	Dummy
CEO_GENDER_MOD	CEO's gender (male or female)	Qualitative
CEO_MBA_Y_N	The CEO has an MBA	Dummy
CEO_PATENTS_Y_N	The CEO has submitted at least one patent	Dummy
CEO_PHD_Y_N	The CEO has a Ph.D.	Dummy
CEO_PREV_EXP_COMPANY_Y_N	The CEO has previous experience in a company	Dummy
CEO_PREV_EXP_UNIV_Y_N	The CEO has previous academic experience	Dummy
CEO_SERIAL_Y_N	The CEO is a serial entrepreneur	Dummy
INCORPORATED_Y_N	The company has been incorporated	Dummy
NO_EMPLOYEES	Number of employees of the company	Continuous
NO_FOUNDERS	Number of founders of the company	Continuous
SECTOR_WEB_NM	The company operates in the web-based	Dummy

Variable	Description	Type
	industry	
SECTOR_CLEAN	The company operates in the clean-tech industry	Dummy
SECTOR_ICT	The company operates in the ICT industry	Dummy
TEAM_MULTINATIONAL_Y_N	The team is multinational	Dummy

We carried out a Tobit model using EViews, testing the relationship between the amount of capital raised and the variables of the above table.

Model 1 takes into consideration the variables summarized in Table 3. The Tobit model includes 99 valid observations.

**Table 17. The Tobit model No. 1.**

Dependent Variable: CAPITAL\_RAISED

Method: ML - Censored Normal (TOBIT) (Quadratic hill climbing)

Date: 11/20/12 Time: 12:28

Sample: 1 108

Included observations: 99

Left censoring (value) at zero

Convergence achieved after 7 iterations

Covariance matrix computed using second derivatives

Variable	Coefficient	Std. Error	z-Statistic	Prob.
CEO_ACADEMIC_EDU_Y_N	206017.3	114983.4	1.791714	0.0732
CEO_AGE	6057.587	3070.118	1.973080	0.0485
CEO_BORN_ABROAD_Y_N	-141453.8	136345.6	-1.037466	0.2995
CEO_EXP_ABR_Y_N	-236.7454	40508.89	-0.005844	0.9953
CEO_GENDER_MOD	-72757.80	54672.64	-1.330790	0.1833
CEO_MBA_Y_N	230859.3	58569.69	3.941617	0.0001
CEO_PATENTS_Y_N	-30623.38	49739.96	-0.615670	0.5381
CEO_PHD_Y_N	47991.13	54552.86	0.879718	0.3790
CEO_PREV_EXP_COMPANY_Y_N	-17863.50	52636.75	-0.339373	0.7343
CEO_PREV_EXP_UNIV_Y_N	66178.05	48810.97	1.355803	0.1752
CEO_SERIAL_Y_N	-15202.59	47393.07	-0.320777	0.7484
INCORPORATED_Y_N	171020.8	43559.34	3.926158	0.0001
NO_EMPLOYEES	23006.79	8580.023	2.681437	0.0073
NO_FOUNDERS	-23651.14	13715.90	-1.724359	0.0846
SECTOR_WEB_NM	-83851.34	90186.67	-0.929753	0.3525
SECTOR_ICT	-64225.30	93547.44	-0.686553	0.4924
SECTOR_CLEAN	-5676.785	97938.88	-0.057963	0.9538
TEAM_MULTINATIONAL_Y_N	51260.02	46933.92	1.092174	0.2748
C	-388408.8	202953.2	-1.913785	0.0556

Error Distribution

SCALE:C(20)	131595.1	13196.44	9.972014	0.0000
Mean dependent var	45779.29	S.D. dependent var	115771.5	
S.E. of regression	101090.4	Akaike info criterion	14.93218	
Sum squared resid	8.18E+11	Schwarz criterion	15.45645	
Log likelihood	-719.1430	Hannan-Quinn criter.	15.14430	
Avg. log likelihood	-7.264071			
Left censored obs	46	Right censored obs	0	
Uncensored obs	53	Total obs	99	

To build up a parsimonious models, we erased variables with a z-Statistics  $< |1|$ , obtaining No. 7 restrictions on the parameters of the Tobit model. The following variables have been eliminated because are not statistically significant for equity acquisition:

- CEO\_EXP\_ABR\_Y\_N, the CEO's international experience;
- CEO\_PATENTS\_Y\_N, the CEO patents submission;
- CEO\_PREV\_EXP\_COMPANY\_Y\_N, the CEO's previous experience in a company;
- CEO\_SERIAL\_Y\_N, the CEO's previous entrepreneurial experience;
- SECTOR\_WEB\_NM, SECTOR\_ICT, SECTOR\_CLEAN, industry affinity.

**Table 18. The Tobit model No. 2.**

Dependent Variable: CAPITAL\_RAISED

Method: ML - Censored Normal (TOBIT) (Quadratic hill climbing)

Date: 11/21/12 Time: 13:33

Sample: 1 108

Included observations: 99

Left censoring (value) at zero

Convergence achieved after 7 iterations

Covariance matrix computed using second derivatives

Variable	Coefficient	Std. Error	z-Statistic	Prob.
CEO_ACADEMIC_EDU_Y_N	229428.9	110842.6	2.069862	0.0385
CEO_AGE	5373.521	2988.869	1.797844	0.0722
CEO_BORN_ABROAD_Y_N	-120967.4	133551.8	-0.905772	0.3651
CEO_GENDER_MOD	-71060.86	52183.33	-1.361754	0.1733
CEO_MBA_Y_N	232507.8	56696.21	4.100940	0.0000
CEO_PHD_Y_N	64438.06	49097.70	1.312446	0.1894
CEO_PREV_EXP_UNIV_Y_N	57020.92	47412.56	1.202654	0.2291
INCORPORATED_Y_N	158658.2	42063.70	3.771856	0.0002
NO_EMPLOYEES	23089.56	8452.419	2.731710	0.0063
NO_FOUNDERS	-21556.52	13080.57	-1.647981	0.0994
TEAM_MULTINATIONAL_Y_N	32461.62	42310.03	0.767232	0.4429
C	-474673.9	196493.7	-2.415722	0.0157

Error Distribution				
SCALE:C(13)	133456.9	13373.94	9.978876	0.0000
Mean dependent var	45779.29	S.D. dependent var	115771.5	
S.E. of regression	98505.65	Akaike info criterion	14.82495	
Sum squared resid	8.44E+11	Schwarz criterion	15.16572	
Log likelihood	-720.8349	Hannan-Quinn criter.	14.96283	
Avg. log likelihood	-7.281161			
Left censored obs	46	Right censored obs	0	
Uncensored obs	53	Total obs	99	

### 3.2 Testing the explanatory magnitude of the model

Before discussing the results, it was important to test the explanatory magnitude of the model. In doing so, we compared the Log likelihood of the two models, comparing them to the Chi Square with a number of degrees of freedom equal to the restrictions applied to the model.

The Chi Square test is useful to test the similarity between model No. 2 and model No. 1: in this way we can test rigorously that the general model and the restricted one are identical.

We need to test the null hypothesis, that Model 1 is equivalent to Model 2:

$$H_0: \text{Mod 1} = \text{Mod 2}$$

$$L1 \text{ Log likelihood} = -719.1430$$

$$L2 \text{ Log likelihood} = -720.8349$$

To accept the  $H_0$  hypothesis the following relationship must be satisfied:

$$2 * (L1 - L2) < \text{Chi Square (7)}$$

$$\text{With Chi Square (7)}_{0,050} = 14.0671$$

$$[-719.1430 - (-720.8349)] = 1.6919$$

$$2 * 1.6919 = 3.3838$$

And

$$3.3838 < 14.0671$$

This confirms that the restricted model (Model 2) is definitely able to explain the influence of independent variables on the dependent one in a parsimonious way.

## 4. DISCUSSION OF THE RESULTS

We tested the hypotheses arisen from the literature review on the sample composed of 108 new ventures. Our results demonstrate that education positively affects the fund raising

process. In particular, our regression model strictly correlates with the attendance of an MBA program with the amount of capital raised.

The hypothesis H1a:

*Entrepreneurs with higher academic education are more successful in fund raising*

is then supported by our analysis. The above-mentioned result supports the idea that entrepreneurs with a higher education are better able to present and communicate a business plan and likely benefit of higher reputation vis-a vis potential investors.

Also our H1b hypothesis:

*Entrepreneurs with business education are more successful in fund raising*

is strongly verified, with a z-Statistic of 4.10 and a p-value<0.01.

Such results could be explained by the fact that the key competences necessary to convince third part investors are more related to managerial aspects rather than a generic level of education. Actually, the ability to effectively explain the value proposition, strategy and business model of the new venture as well as the target market and customers requires specific managerial competences and skills.

Another important factor that usually authors take into consideration to explain new companies' performance is the previous experience of the entrepreneurial team. In our study, as described, we limited our analysis to the CEO of the new ventures. As pointed out by Kisfalvi (2002), strategies in general - and strategic orientations in particular - are strictly linked to the mindset and individual-related characteristics of the CEO, that represent often the more important and charismatic person of the founders' team (Miller and Toulouse, 1986). The age of an entrepreneur can be considered a good proxy of the experience accrued along years. In fact, we expect that more experienced individuals are more successful in fund raising, doing the experience nurtured during their working life and the larger network of contacts they can leverage (Hustedde and Pulver, 1992; Eesley and Roberts, 2012).

Therefore we formulated the following hypotheses:

*The older and more experienced is the entrepreneur, the bigger is his/her ability to raise capital*

and

*The previous working experience positively influence the entrepreneur's ability to raise capital*

Both these hypotheses are not confirmed by our analysis inasmuch as the p-value is not significant. As a consequence from our data the amount of capital raised does not look significantly correlated with the age/experience of the CEO as well as his/her working

experience. This result could be biased by the specificities of the geography of our sample. As known, entrepreneurship in innovative fields is a more recent phenomena compared to other countries such as the US. As a consequence serial entrepreneurship plays a minor role in this stage of development of the startup.

Company factors are also important to explain the ability of new ventures to secure investments. Dimensional factors - measured in terms of number of employees - can be considered a proxy of the stage of development of the company and the associated risk (Lee and Zhang, 2011). Therefore, we formulated the hypothesis that

*The size of the company - in terms of number of employees - facilitate the fund raising.*

Our data confirm that the dimension of the company facilitates the acquisition of investments ( $p\text{-value} < 0.01$ ). Data support that investors prefer to invest in companies that are more structured since the risk perceived results lower than in very early stage projects. The same applies to H6:

*Already incorporated companies are preferred target of investment than companies not yet incorporated*

where data show that already established ventures are preferred investment targets than not yet established companies.

Moreover, our data do not confirm the benefits on fund raising from a larger founders' team and in a certain way deemphasize the role played by the network in fund raising. The hypothesis:

*The larger the founding team, the higher is the ability of the company to get funded*

is therefore not confirmed.

It is worth to single out that our analysis only focused on the size of team and not on the diversity of the skills and competences associated to the team. Further research should also better investigate this topic.

## 5. CONCLUSION AND LIMITATIONS

Our analysis focus on the correlation between performance of a new venture (measured in terms of amount of capital raised) and characteristics of the company and the founders' team (human capital). The majority of studies use sales/year - sales/growth as a measure of new ventures' performance (Lechler, 2001). The innovativeness of this study lies therefore in the choice of the dependent variable. According to Lee and Zhang (2001) and Watson, Stewart and BarNir (2003) capital raised can be considered a good proxy of entrepreneurial

performance. Nevertheless, from our literature review arises a lack of empirical studies dealing with factors affecting new ventures' fund raising ability.

In particular our findings, based on data analysis through the Tobit model, show a significant link between fund raising and academic education (z-Statistic = 2.07,  $p < 0.05$ ) and - more specifically - business/management education (z-Statistic = 4.10,  $p < 0.01$ ). Consistently with previous studies carried out on the topic (Colombo and Grilli, 2005; Hustedde and Pulver, 1992), we found that MBAs and - in general - post-graduate education on management/business topics enhance the ability of entrepreneurs to attract third parties investments that are key for the success and survival of new venture companies. Conversely data do not support the role played by prior CEO's entrepreneurial/work experience. As regards firm specific characteristics, the model revealed a significant relation between company size, legal form and the ability in fund raising.

Concluding, the results of our empirical study provide further insights about the characteristics of the entrepreneurial team and startup that impact the success of new ventures. Moreover, we provided insights on the aspects seed and venture capital firms as well as business angels consider while evaluating an investment in a startup company.

The focus on startups founded by Italian entrepreneurs (though some of them result to be incorporated abroad) represents the major limitation that may impact on the generalization of the results. Therefore, a cross-country study will represent the natural prosecution of our research.

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## **SOCIAL AND PHYSICAL ASPECTS OF THE SERVICE ENCOUNTER: EFFECTS ON TRUST AND CUSTOMER LOYALTY TO THE SERVICE PROVIDER**

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### **ABSTRACT**

The purpose of this research is to evaluate the influence of two strategic service encounter dimensions on consumer beliefs and service loyalty. A conceptual model was generated with the aim of seeking to reveal the contribution of the physical environment and social interactions with front line employees on customer's evaluation of the service provider. An empirical study is conducted based on a sample of 400 customers of fitness centers. Collected data was analyzed using a structural modeling that highlight the contribution of each predictors.

The results revealed that physical and social cues differently influence customer trust and loyalty to the service provider. Overall, the joint effect of servicescape and social interactions positively influence customer trust and lead to service loyalty. This paper provides empirical evidence on the contribution of two service encounter cues: servicescape and social interaction on customer trust and service loyalty. The survey is limited to just one context, fitness centers and Tunisian customers. However, it offers a conceptual framework that can be tested in a variety of services. Managerial recommendations focus on improving relational aptitudes of frontline employees, particularly in personal services such as fitness centers

**Keywords:** servicescape, social interactions, front line employees, trust, loyalty, structural modeling

## INTRODUCTION

There have been several attempts in service marketing literature to discuss the issue of service encounter dimensions and their effects on service outcomes. Shostack (1985, p. 243) defines a service encounter as *“a period of time during which a customer directly interacts with a service”*. This definition implies that in the service industry, customer interactions with physical and human elements may be necessary for service delivery. Some authors have suggested that service encounters have more impact on customer evaluation than the service outcome (Bitner, 1990; Grönroos, 1990). This statement has been illustrated by the Nordic approach of service quality which distinguishes between the technical (service outcome) and functional (service interactions) dimensions. It might seem that customer perception of tangible clues such as the establishment's decor, furniture and front line employees' behavior are greatly significant in service evaluation and future intentions (Nguyen and Leblanc, 2002; Mari and Poggesi, 2013).

Many of the researchers on this issue have underlined the relevance of the physical environment and customer-contact personnel in service performance. While Eiglier and Langeard (1987) have classified those elements as key factors in service delivery (« servuction theory »), Booms and Bitner (1981) emphasize their strategic relevance by integrating them in the service mix marketing.

A review of the existing literature on this subject reveals that prior research has employed different methods to understand the role of the physical environment and/or customer-contact personnel on customer evaluation. Although qualitative research has focused on service experience, quantitative studies have tried to examine these two elements (separately) as predictors of service quality, satisfaction and patronage intentions (Baker et al., 2002). Scant empirical studies have combined the role of physical environment and customer-contact employees' relationship (e.g. Baker et al., 2002; Eileen and Berry, 2007; Musriha, 2012) in customer's beliefs, in particular, trust in the service provider. This research attempts to address this gap by (1) jointly investigating the effect of physical environment and customer-contact personnel relationship on trust and loyalty and (2) comparing their influence on customer evaluation of the service provider.

After reviewing the literature, the paper describes the study designed to test the conceptual model. This is followed by a discussion of structural modeling results, managerial implications and finally a suggestion of future research.

## PHYSICAL ENVIRONMENT IN SERVICE ENCOUNTER

Previous physical environment research in marketing has attempted to define and illustrate the influence of the physical setting in retailing and service organizations. Kotler (1974) used the terminology of atmospherics to describe « *the effort to design buying environments to produce specific emotional effects in the buyer that enhance his purchase probability* ». This definition points out the managerially controllable dimension of environmental stimuli and explains the internal mechanisms leading to consumer's emotional and behavioral reactions.

The Kotler (1974) framework is anchored in the environmental psychology paradigm (Mehrabian and Russell, 1974). Models were developed in this area to examine the direct physical environment influence on affect and the mediating role of emotion in understanding consumer behavior.

Based in this research tradition, the seminal study of Bitner (1992), illustrated the cognitive, affective, physiological and behavioral reactions of both customers and employees to the physical environment. This conceptual framework has encouraged many scholars to investigate the influence of physical cues in the service context by taking into account the frontline employee's behavior and the social interaction between customers and employees (Turley and Milliman, 2000; Baker et al., 2002; Eileen and Berry, 2007; Skandrani et al., 2011).

Referring to Bitner (1992), we consider that the physical environment or what the author named servicescape is the "*manmade, physical surrounding as opposed to the natural or social environment*". This conceptualization only focuses on "objective", "measureable" and "managerially controllable" environmental cues (Rosenbaum and Massiah, 2011).

## SOCIAL INFLUENCE IN THE SERVICE ENCOUNTER

Interactions between the customer and contact personnel derive from the nature of services and the customer involvement in the service delivery process. In the majority of service encounters, customers interact with front-line employees as coworkers and share conversations that go beyond the core service. This social aspect of service encounters is viewed as a key concept in service literature because it reveals that several service encounters are closer to friendship than to economic transactions (Price and Arnould, 1999).

To support this idea, Rémy and Kopel (2002) proposed the concept of "linking services" to address the customer need of social interaction and communitarian links. They suggested that

the physical setting, the customer involvement in service delivery and interactions with contact-personnel are fundamental cues in creating social bonds.

Many authors draw on the exchange theory to illustrate the nature of service relationships (Goodwin and Gremler, 1996). In this research, there is consistent evidence that the boundaries between transactional and social relationships are unclear. This statement supports the idea that service relationships vary on a continuum from transactional to social. Somewhat similar inferences can be found in the framework of Goodwin and Gremler (1996). The authors identify two types of social behavior in service delivery, functional aspects (that refers to "provider personalization"; "friendliness"; "empathy" and "Appreciation") and communal aspects that reflect friendship behaviors.

In the same way, Butcher et al. (2001) emphasize interpersonal relationships in the service process and distinguishes relational outcomes from service partner's characteristics or behaviors. Relational outcomes refer to "*the feelings, thoughts, and perceived relationships arising from the social interaction with the service employee*".

In this issue, the research of Bove and Johnson (2000) offers a literature review on consumer-service provider relationships that end in a conceptual framework showing the influence of interpersonal relationships on loyalty to frontline employees and service firms.

## **A CONCEPTUAL FRAMEWORK OF THE INFLUENCE OF PHYSICAL AND SOCIAL ASPECTS OF SERVICE ENCOUNTER ON CONSUMER'S TRUST AND LOYALTY**

Empirical studies on this issue are relatively scant, particularly regarding the investigation of the joint impact of servicescape and social interactions with front-line employees. In the following sections, the influence of the two aforementioned constructs will be discussed in order to propose a model that explains how consumers form beliefs and behaviors in service encounters.

### *Physical and social aspects of the service encounter as predictors of loyalty*

In service marketing literature, the loyalty phenomenon is mainly conceptualized as a tri-component construct that encapsulates behavioral, attitudinal and cognitive dimensions

(Oliver, 1999). Thus, service loyalty is depicted as customer commitment to a particular service provider, which led to a repetitive purchasing behavior, an advocacy of the service to others and a strong belief that this service provider is a first choice among a set of competitors. In service, it is argued that loyalty is linked to interpersonal relationships and tangible cues of the service encounter. For this research, it is assumed that the physical setting and social interactions with the contact-personnel are salient in explaining service loyalty. Further support can be found in the works of some researchers. In her conceptual framework, Bitner (1992) suggests that behavioral outcomes such as spending money and returning to the service provider are influenced by the servicescape. However, this influence reflects an indirect causal relationship that can be mediated by "internal responses" (cognitive, emotional and physiological responses). Numerous studies have also been inspired by the SOR paradigm and have illustrated that the perceived servicescape can predict behavioral outcomes through the customer's beliefs and emotions. Investigating on this issue, research in retailing stores has demonstrated the direct impact of environmental stimuli on returning, advocacy behavior and spending money (Turley and Milliman, 2000; Skandrani et al., 2011). Hui et al. (1997) have found a positive influence between ambient conditions and advocacy behavior in service area. In the same way, Keillor et al. (2007) confirm the same results in an intercultural study in the hotel industry. In a recent study, Musriha (2012) supported the impact of servicescape on customer loyalty in bank industry. In order to thoroughly understand this influence it is useful to examine the following hypothesis:

H1: Perceived servicescape has a positive and direct influence on service loyalty.

Regarding the social aspect of the service encounter, researchers tend to support the vital role of front-line employees on loyalty to the service provider. It's often argued that loyalty is a relational construct (Bowen and Shoemaker, 1998; Pitchard et al., 1999) that could be predicted by social interactions. On the basis of this assumption, many researchers have found a positive and direct impact of customer-service employee relationships on repurchasing behavior, advocacy and positive word-of-mouth. In his study, Barnes (1997) found that a strong relationship between the customer and the contact-personnel lead to repurchasing intentions and advocacy of the service provider. Similarly, Butcher et al. (2002) illustrated the positive impact of relational outcomes on loyalty. The authors specifically demonstrated that friendship was a strong predictor of service loyalty. Using SEM method Musriha (2012) demonstrated the influence of personal, communication quality on customer

loyalty. Similar results were found by Goodwin and Gremler (1996) and Price and Arnould (1999). Therefore, the following hypothesis is advanced:

H2: The relationship with front line employees has a positive and direct influence on service loyalty

*Physical and social aspects of the service encounter as predictors of trust*

Physical and social aspects of service encounters are also linked to the customer's beliefs. In Bitner's (1992) framework, the physical setting may reduce cognitive reactions as beliefs, categorization or symbolic meanings. In service literature, the customer's beliefs toward the service organization are also considered as an outcome of interpersonal bonds with frontline employees.

In this research, trust in the service organization will be investigated as an outcome variable reflecting the customer's beliefs. Trust will be incorporated in the conceptual model as a central relationship-building construct.

Researchers have yielded a variety of terms such as confidence, reliability, integrity, expertise, to define trust. Relationship marketing theory has suggested that trust could be defined as the customer's confidence or willingness to rely on the exchange partner's competence, reliability and integrity (Moorman et al., 1993; Morgan and Hunt, 1994). It would seem that customer trust arises from the perceived intentionality of the service provider to fulfill their promises.

The service encounters present to the customers an opportunity to test the service provider's intentionality. Any interactions with the servicescape or the frontline employees act as an indicator of the trustworthiness of the service provider. Insufficient inferences exist on this issue, so this investigation attempts to fill this gap in the research.

The study of Julien and Dao (2006) has suggested an influence of frontline employees' behavior on customer trust. The findings indicate that perceptions of employees' expertise have a positive impact on customer trust. Similar inferences can be drawn from Berry (1999). However, the authors didn't find a link between benevolence behavior and customer trust. Regarding retail banking services, Shainesh (2012) highlights the role of consumers' beliefs of trustworthiness arising from the competence, benevolence and problem solving orientation of

front line employees in building trust in the service provider. In line with these theories and some empirical results we expect that:

H3: The customer-front line employees' relationship has a positive and direct influence on trust in the service provider.

While there are many studies supporting these results, little published work aims to investigate the link between the physical environment and trust in the service context. In their study, Guenzi *et al.* (2009) generated some interesting results about the influence of the store environment on customer trust in the supermarket retailer. Somewhat similar inferences can be drawn from the study of Bitner (1990), showing the influence of travel agency decor on customer attribution for the agent behavior. Bitner (1992) supports the idea that "*The perceived servicescape may elicit cognitive responses...influencing people's beliefs about a place and their beliefs about the people and products found in that place*". By logical extension, it can be argued that:

H4: The physical environment has a positive and direct influence on trust in the service provider.

#### *The physical environment's effect on customer-frontline employees' socialization*

The conceptual framework of Bitner (1992) has addressed the question of the influence of the physical environment on social interactions. This idea underlines the role of environment clues in shaping individual behaviors in the service encounter. Thus, in the words of Bennett and Bennett (1970) "*all social interaction is affected by the physical container in which it occurs*" (in Bitner, 1992). Equipment and furniture arrangement in the service could enhance or limit social interactions between customers and front line employees. This implies that the physical environment affects the nature and the quality of social interactions. This is consistent with Varlander and Yakhlef's (2006) results. The authors have performed interviews and observation in the travel, banking and book-selling industries in order to examine the effects of the implementation of the Internet on spatial designs. The results show that furniture and artifacts model social interactions in terms of spatial orientation (proximal or distant), temporal orientation (accelerated or decelerated), behavioural outcome (approach or avoidance) and service outcome (suboptimal or optimal). Further support can be found in the quantitative study of Temessek-Behi (2008), which highlights the positive impact of customer

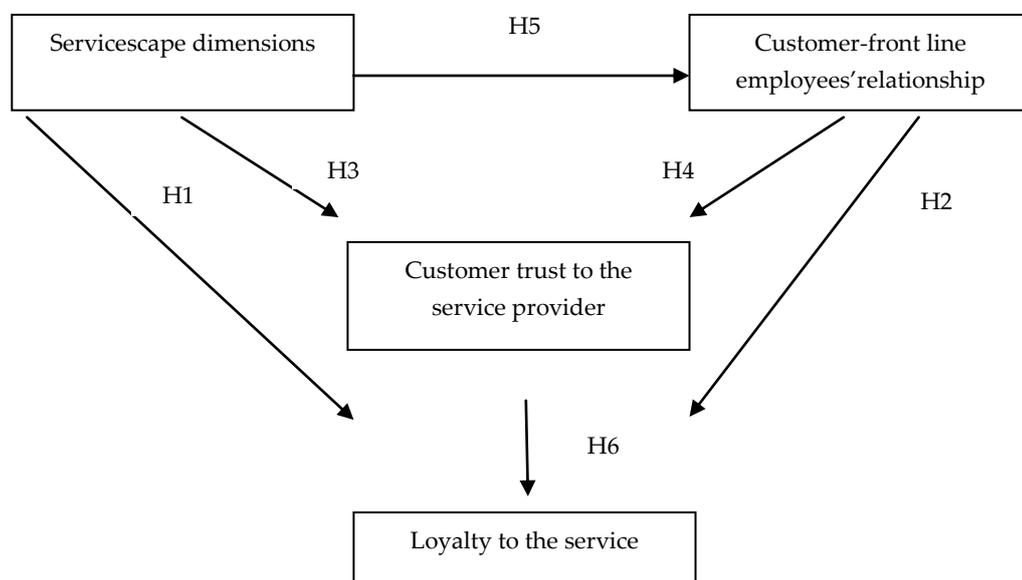
perception of a hotel's physical environment on the nature of the relationship between customers and front line employees.

*H5: The physical environment has a positive and direct influence on the customer-front line employees' relationship*

#### *Service loyalty and trust*

Extensive literature in social psychology and relationship marketing has emphasized the role of trust in creating long lasting relationships. Doney and Cannon (1997) suggest that customer trust refers to a psychological state, an expectation or a belief. Whereas Moorman et al. (1993) associate trust with the willingness to rely on the exchange partner and trustworthy behavior. Trust seems to be an implicit condition leading to loyalty and a key factor in long-term customer orientation toward the service firm (Gwinner et al., 1998; Julien and Dao, 2006). The link between trust and service loyalty has been supported by numerous empirical research (Gwinner et al., 1998; Julien and Dao, 2006).

*H6: Customer trust has a positive and direct influence on service loyalty.*



*Figure 1: The conceptual framework of service encounter*

## RESEARCH SETTING AND SAMPLE

To test the hypothesized relationships a survey was conducted in fitness centers. This choice is advantageous since it offers a setting where customers spend a lot of time observing, experimenting with the physical environment and developing interactions with frontline employees. Fitness centers also represent a hedonic service with a high linking value (Rémy and Kopel, 2002) yet it remains rarely investigated.

A total of 400 customers of fitness centers were interviewed face to face. The sample was proportionally distributed with regard to gender (52 percent women and 48 percent men). Interviewed customers were predominately young (45 percent aged between 20 and 30 years). The majority of the respondents had an occupation (53.8 percent).

## MEASURES

To measure customer loyalty, four items were selected from the behavioural consequences of service quality scale developed by Zeithaml et al. (1996). This scale has been used in several researches to determine customer loyalty (Price and Arnould, 1999). In order to measure the servicescape, scales proposed by recent research have been also considered (Capelli and Sabadie, 2007, Temessek-Behi (2008). The customer-contact personnel relationship was measured by Butcher et al. (2002)'s relational factors. Customer trust in the service provider was measured by a three-dimensional indicator (benevolence, integrity and competence) developed by Bartikowski and Chandon (2008). All the indicators were measured by a 5 points Likert scale ("strongly disagree" to "strongly agree").

## RESULTS

An exploratory factor analysis was carried out to examine the construct structure. Then, the two-step approach recommended by Anderson and Gerbing (1988) was used with LISREL 8.3. Firstly, a confirmatory factor analysis was performed to ensure the validity of the measurement model. Secondly, a path analysis revealed the hypothetical causal relations of the research model. The scale of the perceived physical environment showed a bi-dimensional structure with "space design" as a first dimension and "ambient conditions" as a second dimension. All the other scales had a one-dimensional structure. It was found that the Cronbach's alpha ranged from 0.72 and 0.82 and the Joreskog's Rho ranged from 0.68 and

0.87. Therefore, all measurement scales were considered reliable. However, there was a less satisfactory reliability and validity score for "ambient conditions" dimension (Table 1).

	<b>Scales structure</b>	<b>Cronbach's Alpha</b>	<b>Joreskog's Rhô</b>	<b>Rho of convergent validity</b>
<b>Perceived environment</b>	<b>physical</b> Bi-dimensional			
<b>Design</b>	7 items	0.82	0.82	0.56
<b>Ambient conditions</b>	3 items	0.72	0.68	0.48
<b>Social interactions</b>	one-dimensional 6 items	0.84	0.81	0.54
<b>Customer trust</b>	One-dimensional 7 items	0.75	0.87	0.52
<b>Loyalty</b>	One-dimensional 4 items	0.79	0.79	0.51

*Table 1: Scales' Reliability and validity*

The factor contributions are significant ( $p$  value =.05) and the Rho of convergent validity exceeds the recommended threshold by 0.50 except for the "ambient conditions" dimension.

After verifying measurement model fit we tested the structural model. The values of the indices show an acceptable fit between the empirical and theoretical model (RMSEA = 0.059, SRMR=0.054,  $\chi^2 / dl=2.39$ , GFI=0.88, CFI = 0.91). The predictors of the model satisfactorily explain the dependent variables. Thereby, the SMC relative to "customer trust" and "loyalty" is 0.40 and 0.52. The physical environment dimensions only explain a small part of the social interactions between the customer and the service employees (SMC=0.08). The results of the path analysis support the hypotheses (Table 2). The examination of the standardized

estimates and the significance of the relationships highlight the influence of social interactions and the physical environment on customer trust and loyalty towards the service provider.

As assumed, the interaction between the customer and the service employees acts positively on consumer's beliefs in the service provider's integrity (H4) and increases their loyalty intention (H2). The physical environment dimensions do not act directly and significantly on loyalty to the service provider (H1). The results (Table 2) similarly validate hypothesis H6. It thereby appears that consumers who trust the service provider are more likely to develop repatronage and advocacy behaviors. The results do not totally support the relation between the physical environment dimensions and the social interaction between the customer and the service employees. Only the ambient conditions seem to positively influence the customer-frontline employees' relationship (H1a).

Hypothesis	Structural path	Path Coefficients and t test	Hypothesis testing
H1a	Space design → Loyalty	0.09 (t=1.33)	Not supported
H1b	Ambient factors → Loyalty	0.10 (t=1.21)	Not supported
H2	Relationship factors → Loyalty	0.38 (t=4.60)	Supported
H3a	Space design → Trust	0.17 (t=2.34)	Supported
H3b	Ambient factors → Trust	0.28 (t=2.09)	Supported
H4	Relationship factors → Trust	0.44 (t=6.00)	Supported
H5a	Space design → Relationship factors	0.00 (t=0.03)	Not supported
H5b	Ambient factors → Relationship factors	0.25 (t=3.00)	Supported
H6	Trust → Loyalty	0.35 (t=4.27)	Supported

*Table 2: Results*

## DISCUSSION AND MANAGERIAL IMPLICATIONS

The purpose of this research was to examine the influence of physical environment dimensions and social interaction on trust and loyalty towards the service provider. The results provide some important insights that could enhance theoretical and managerial understanding of the role of servicescape and customer-frontline employees' relationship on behavioral outcomes. The social interaction between the customer and the contact personnel appears to be an effective factor that reveals the customer loyalty level to the service provider. This result confirms previous research, which insists on the strategic role of service employees in customer trust (Moorman *et al.*, 1993) and loyalty (Butcher *et al.*, 2002). From a managerial point of view, this result suggests developing the relationship between the customer and frontline employees by promoting interactions based on respect and even friendship. Coaching sessions should be considered to improve service employees' awareness of the importance of their role in the formation of consumers' beliefs.

Trust is also an outcome of physical environment dimensions. It seems in this framework that the ambient conditions have a more significant effect on customer trust than the design. Thus, the service providers should focus on ambient clues such as local cleanliness, temperature or even lighting which seems indispensable to the creation of an atmosphere inspiring confidence and denoting the service provider integrity and professionalism. Furthermore, the design relative to the aesthetic level, the architecture, and the furniture of the fitness centers act slightly positively on customer trust. These factors would be probably more associated with evaluative judgment variables like service quality, perceived value and satisfaction.

However, the two dimensions of the service encounter explain 40 percent of the scores for variation of customer trust. This result consolidates the choice of the explanatory variables and enables emphasis on their importance in the formation of the consumer's beliefs towards the service provider. The relationship between the dimensions of the servicescape and loyalty did not find any empirical support. No significant relationship has been found between loyalty and ambient conditions, on the one hand and between loyalty and design, on the other hand. This result points to the possibility of an indirect relationship between physical environment dimensions and loyalty. It is possible to consider a mediating effect of customer trust. This option confirms the theoretical Bitner's framework (1992) and Temessek-Behi's results (2008), which suggest an indirect effect induced by servicescape components on loyalty and behavioral outcomes. However, the results indicate that loyalty is positively influenced by social interactions between frontline employees and customers. This finding

converges with other research (Butcher et al., 2001, 2002; Price and Arnould, 1999). The relationship with contact personnel is an important dimension in the formation of the consumer's behavioral intentions.

Indeed, it seems that the influence of social interactions on the consumer's loyalty is stronger in the case of services with high spatial and psychological proximity like fitness centers (Butcher et al., 2002). Within this context, service providers would benefit from focusing their attention on the nature of the interactions between their customers and the service employees. This attention should begin with the implementation of hiring procedures in order to choose candidates with undeniable relational qualities. Training seminars are also necessary to anchor the customer orientation in the mind of the employees. The valorization of friendly and respectful interactions also passes through an effective reward system. The loyalty is also affected by the degree of customer trust which the consumer grants to the service provider. Thus, as it has been confirmed by a variety of research in different domains, the intention of consumer loyalty depends on the consumer's perception of the benevolence and the integrity of the partner exchange (Gwinner et al., 1998). Trust and social interaction seem to be effective predictors of service loyalty. However, the physical environment dimensions seem to indirectly contribute to service loyalty. This study validates the combined role of servicescape, customer-frontline employees' relationship and trust as drivers of service loyalty. They explain 52% of the variation in loyalty scores. Thus, loyalty is a process determined by consumer beliefs regarding their level of interaction with service employees and their perception of the physical environment dimensions. Service providers could develop sensory and relational stimuli that would engender positive beliefs and would denote their good intentions towards the customer. The ambient conditions and space design should first reassure customers in regards to the competence and integrity of the service provider. Social interactions would then play an essential role in the development of customer trust and the demonstration of loyalty intention. By verifying the relationship between the two dimensions of the service encounter, it has been possible to highlight a significant impact between environmental factors and social interaction. Thus, social interaction is directly affected by lighting, temperature and cleanliness in the servicescape. Pleasant ambient conditions will generate more positive social interactions between the consumer and service employees. However, the predictive power of the physical environment on the social interaction remains marginal ( $R^2 = 0.08$ ). This result suggests that an adapted physical environment is essential but not a sufficient element to direct the interaction between the customer and the service employees.

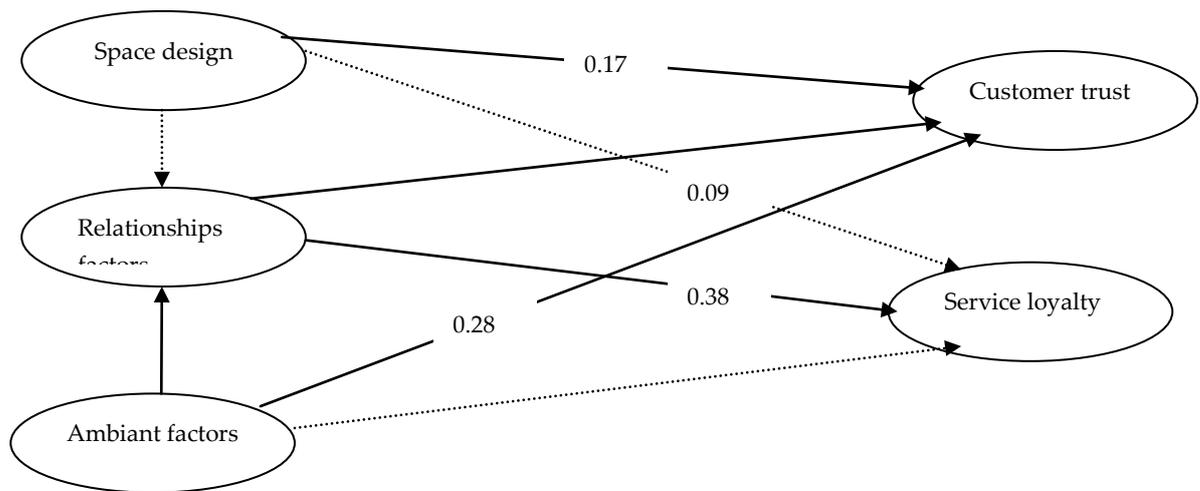


Figure2: path model

## LIMITATIONS AND FUTURE RESEARCH

The findings of the current study should be interpreted with caution due to several limitations.

This research raises new interrogations and several points which should be improved in future research. A test of the proposed conceptual model, with other measurement scales of the research variables, would improve the internal validity of the study. In spite of the significant size of the sample (400 people), generalization of results always remains raised up and other applications of the model with larger samples would be desirable. Another limitation is in the choice of studying a single survey context. An empirical test of the conceptual framework in a variety of services could provide a better understanding of the variation of variable's scores between service settings. Future researches should investigate this conceptual model in utilitarian (financial services) and hedonic services (hotels, restaurants, etc.).

Service encounter literature offers directions for other important dimensions such as customer to-customer interactions that could enhance the explained variance of behavioral outcomes in the service setting. Furthermore, the integration of mediating and moderating factors could improve this framework. The absence of direct relationships between loyalty and the two dimensions of the physical environment questions the trust mediating role. It

would then be promising to widen the potential track of the possible moderating effects of situational factors (temporal perspective, objectives of the visit) or individual (familiarity with the service, customer personality) between the dimensions of service encounter (physical environment and social interactions) and the consumer's reactions (trust and loyalty).

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## IS THE GLOBE MODEL USEFUL FOR CROSS-CULTURAL LEADERSHIP RESEARCH?

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### ABSTRACT

**Purpose:** The aim of this paper is to study the validity of the Global Leadership and Organizational Behavior Effectiveness (GLOBE) cultural dimensions “As is” and its “Bands” as defined by House et al. (2004) in the prediction of leadership practices, measured by the Leadership Practices Inventory created by Kouzes and Posner (2003).

**Design/methodology/approach:** In this paper we selected a quantitative approach. The data was collected from 1359 master students in management area in thirteen countries. We conducted correlation tests and comparison of means tests to analyze the data.

**Findings:** The results of our study support the scientific perspective that transformational leadership is both a universal and a culturally contingent phenomenon. We found empirical evidence that In-Group Collectivism, Assertiveness and Uncertainty Avoidance are important contextual moderator factors for Encourage the Heart, Model the Way and Challenge the Process leadership practices. Our study also indicates that GLOBE’s Bands are a valid tool to predict leadership practices.

**Practical Implications:** This study provides evidence for external validation of GLOBE model, supports the idea that GLOBE model is a valid framework to predict leadership practices and suggests a new line for cross-cultural leadership research based on GLOBE’s.

**Originality/Value:** This paper tries to fulfill a gap in the literature related to the validation of GLOBE’s Bands and provide information about countries that normally do not appear in the literature. It is also one of the biggest studies using GLOBE’s

cultural dimensions to predict leadership practices measured by the Leadership Practices Inventory.

**Keywords:** GLOBE; Leadership; Culture; Cross-cultural leadership; Leadership Practices Inventory.

## INTRODUCTION

In this paper we tried to explore a gap in the literature. There are a wide range of studies using GLOBE model to study leadership behaviors across cultures (Mittal and Dorfman, 2012; Kono *et al.*, 2012) however, few researchers have been used this model in the prediction of leadership practices measured by the LPI (e.g. Teodósio and Robalo, 2011; Raskovic and Krzisnik, 2010). Specifically we could not find, in our literature review based on databases PsycINFO, ISI Web of Knowledge and ProQuest, studies that focus on the validity of GLOBE's bands. Our study has also the purpose to answer to Hofstede (2010) that claims for external validity of GLOBE model and to contribute with new ways of research for the debate of universality versus culturally contingent leadership behaviors.

### *Cultural Models*

The Cross-cultural research is an ancient phenomenon (Gelfand *et al.*, 2007). In the modern sense, the first models of cultural dimensions were designed in the 50s and 60s (Parsons and Shils, 1951; Kluckhohn, 1951; Hall, 1959; Kluckhohn and Strodtbeck, 1961). Despite these first attempts, it is only within the past three decades that cross-cultural research and theories become prominent on the research agenda. Beyond others models that have been developed since then, Hofstede's model (Hofstede, 1980) was perhaps the major contribution to the development of modern comparative research (Leung *et al.*, 2005). In his seminal work, based on work-related values, he presented four cultural dimensions: Uncertainty Avoidance; Power Distance; Masculinity versus Femininity and Individualism versus Collectivism. Since then, Hofstede has upgraded his model with two more dimensions: Long-Term Orientation versus Short-Term Orientation (Hofstede, 2001) and Indulgence versus Restraint (Hofstede *et al.*, (2010).

One of the alternative models to Hofstede was presented by (House *et al.*, 2004). In this model the authors identified nine dimensions: Uncertainty Avoidance; Power Distance; Institutional Collectivism; In-Group Collectivism; Gender Egalitarianism; Assertiveness; Future Orientation; Performance Orientation and Humane Orientation. Related to each of the dimensions, GLOBE distinguishes between normative cultural values “Should be” and actual cultural practices “As is” at two levels: organizational culture and societal culture.

For this study we choose the GLOBE model because we found a gap in the literature related to external validation of Bands and it presents scores of cultural practices for cultural dimensions that is the focus of our research. The cultural dimensions that we used in this study were: Uncertainty Avoidance; Collectivism II and Assertiveness. House and Javidan (2004, pp. 11-12) presented the following definitions of these dimensions: “*Uncertainty Avoidance (UA)* – The extent to which members of an organization or society strive to avoid uncertainty by relying on established social norms, rituals, and bureaucratic practices; *Collectivism II (IGC)* – The degree to which individuals express pride, loyalty, and cohesiveness in their organizations or families; *Assertiveness (ASS)* – The degree to which individuals in societies and organizations are assertive, confrontational and aggressive in social relationships.”

The cultural scores for these dimensions and the aggregation of countries in bands are presented in Table 1. The cultural dimensions are divided in practices (“As is”) and values (“Should be”). According to House e Javidan (2004, p. 21) “Responses to *As is* questions reveal the perceptions of middle managers concerning current practices in their societies and their organizations”. Since this study concerns to leadership practices, we choose the “As is” scores. A Band means that all societies that fall within it are considered to be equivalent, that is, the societies that fall within the same band cannot be reliability differentiated (Hanges *et al.*, 2004).

Table 1. Cultural Scores “As is” and Bands per Cultural Dimension

Countries	IGC	Bands	ASS	Bands	UA	Bands
Argentina	5.51	A	4.22	A	3.65	C
Brazil	5.18	A	4.2	A	3.6	C
China	5.8	B	3.76	B	4.94	A
Germany	4.02	C	4.55	A	5.16	A
India	5.92	A	3.73	B	4.15	B

Countries	IGC	Bands	ASS	Bands	UA	Bands
Indonesia	5.68	A	3.86	B	4.17	B
Mexico	5.71	A	4.45	A	4.18	B
Portugal	5.51	A	3.65	B	3.91	C
Russian Federation	5.63	A	3.68	B	2.88	D
Thailand	5.7	A	3.64	B	3.93	C
Turkey	5.88	A	4.53	A	3.63	C
USA	4.25	C	4.55	A	4.15	B
Venezuela	5.53	A	4.33	A	3.44	D

Source: House *et al.*, (2004)

### *Transformational Leadership*

The study of leadership, especially during the last century, has generated a large number of theories. The focus of our study is in the Transformational Leadership Theory. The first model of transformational leadership was created by Bass (1985) which was based on Burns' (1978) concepts of "transformational leader" and "transactional leader". In 1987, an alternative model of transformational leadership was created by Kouzes and Posner.

As a result of case studies and in-depth interviews they identified five leadership practices: Model the Way; Inspire a Shared Vision; Challenge the Process; Enable Others to Act and Encourage the Heart. Based on their analysis they created a questionnaire (Leadership Practices Inventory) to measure the leadership practices. Kouzes and Posner (2007) presented the following definitions for the leadership practices (factors) that we used in our study: (1) *Model the Way (MTW)* - Leaders clarify values by finding their voice and affirming shared ideals and set the example by aligning actions with shared values; (2) *Encourage the Heart (ETH)* - Leaders recognize contributions by showing appreciation for individual excellence and celebrate the values and victories by creating a spirit of community; (3) *Challenge the Process (CTP)* - Leaders search for opportunities by seizing the initiative and by looking outward for innovative ways to improve. They experiment and take risks by constantly generating small wins and learning from experience.

## LITERATURE REVIEW AND HYPOTHESIS

An important line of research in cross-cultural leadership has been the search for universal and contingent leadership behaviors. The Transformational Leadership Theory and the Hofstede's model of cultural dimensions have been the main models used by researchers to find these answers. The research has presented mixed results. Some researchers support that transformational leadership is seen to have a universal tendency (Bass and Avolio, 1993) due to the increasing of globalization (Zagorsek, 2004) and it is universal and effective across cultures (Bass, 1997). Others support that at least some of the transformational leadership behaviors are culturally contingent (Teodósio and Robalo, 2011; Ergeneli *et al.*, 2007). Teodósio and Robalo (2011) using the GLOBE model of cultural dimensions and the Leadership Practices Inventory with a sample of eight countries found that the leadership practices Model the Way and Encourage the Heart were universal and the remaining leadership practices (Inspired a Shared Vision, Enable others to Act and Challenge the Process) were culturally contingent. Ergeneli *et al.*, (2007) using the same questionnaire and the Hofstede's model in three countries found different results. The leadership practices Challenge the Process and Enable others to Act were not related to any cultural dimension. The results of these two studies based on the same questionnaire but with different cultural models and national samples support the researchers that suggest that leadership is both a universal and a culturally contingent phenomenon (Dorfman, Hanges and Brodbeck, 2004). In this study we have analyzed this phenomenon in an innovative way. First, we studied cross-cultural leadership behaviors using a cultural model that very few researchers have used in this research topic (e.g. Teodósio and Robalo, 2011; Raskovic and Krzisnik, 2010; Tang, Yin and Nelson, 2010). Second, our focus was not only in general cultural dimensions scores, we expanded our analyses to the Bands that GLOBE presented for each cultural dimension.

### *In-Group Collectivism*

The collectivism of a society can be generally described as the degree to which people prefer to act as a member of a group rather than as individuals. According to Gelfand *et al.*, (2004) leadership behaviors associated with the guidance of teams (loyalty, cooperation and inclusion) and charisma (inspiring and visionary) are seen as promoters of effective leadership in societies with higher collectivism. Jung *et al.*, (1995) reported that members of collectivist societies tend to identify more easily with the objectives of the leader and with a shared vision of the group and organization. They are able to sacrifice their personal goals in favour of the

group (Gomez *et al.*, 2000) and they prefer an integrating style of leadership (Casimir and Waldan, 2007). Teodósio and Robalo (2011) comparing eight countries found a positive and significant correlation between In-Group Collectivism and the leadership practices Encourage the Heart ( $r = .643$ ). In a recent study Teodósio and Robalo (2013) comparing thirteen countries found similar results ( $r = .60$ ). The results also showed that this cultural dimension explains, by itself, 30% of this leadership practices variation in the sample. In the LPI, the Encourage the Heart factor describes practices such as: the leader supports his team members; values the collaborators that share the team values; expresses trust in his team members and praises his collaborators for the job well done.

Hypothesis 1 - There will be a positive correlation between In-Group Collectivism and Encourage de Heart.

Hypothesis 1a - There will be differences in Encourage de Heart practices between the master students from Band A, B and C.

Hypothesis 1b - The master students from Band A will have the highest score in Encourage the Heart practices and the master students from Band C will have the lowest.

#### *Assertiveness*

According to Den Hartog (2004, p.395) the “cultural assertiveness reflects beliefs as to whether people are or should be encourage to be assertive, aggressive, and tough, or non-assertive, nonaggressive, and tender in social relationships”. The same author refers that GLOBE was the first study that considered assertiveness as a cultural dimension. In his literature review he presents some characteristics for the societies with higher scores in Assertiveness that could be important to our study. He refers that the societies that score higher in Assertiveness tend to value competition and performance, tend to value taking initiative and tend to expect demanding and challenge targets. Assertiveness is accomplished by being explicit and direct in communications, by using unambiguous language (Holtgraves, 1997). Non-assertiveness (i.e., being non-dominant) can be linked to agreeableness. Agreeable people are cooperative (trusting, caring) and likable (good natured, gentle), they are softhearted and tolerant. Non-assertiveness is related to the use of high-context language, which is less direct, often more ambiguous, and more subtle (Schneider and Barsoux, 1997). Teodósio and Robalo (2011) found a positive and significant correlation between

Assertiveness and the leadership practices Model the Way ( $r = .643$ ). Teodósio and Robalo (2013) found similar results ( $r = .61$ ). The results also showed that this cultural dimension explains, by itself, 32% of this leadership practices variation in the sample. In the LPI, the Model the Way factor describes practices such as: the leader sets the example; his clear in his philosophy of leadership and makes sure that collaborators follow the principles and the standards agreed.

Hypothesis 2 - There will be a positive correlation between Assertiveness and Model the Way.

Hypothesis 2a - There will be differences in Model the Way practices between the master students from Band A and B.

Hypothesis 2b - The master students from Band A will score higher in Model the Way practices than the master students from Band B.

#### *Uncertainty Avoidance*

Uncertainty Avoidance is related with the variable needs that societies have to reduce the degree of unpredictability in the future. Luque and Javidan (2004) reported that members of cultures with higher uncertainty avoidance tend to prefer leadership styles that are oriented to teams (integrators and collaborative), to relations (modest and concern with others) and to self-protection (normative and procedural). The members of these cultures tend to formalize their interaction with others, show greater resistance to change and tend to accept moderated and calculated risks. Koopman *et al.* (1999) describe a greater emphasis on rules and procedures and a lower focus on innovation in managers from cultures that score higher in uncertainty avoidance. Raskovic and Krzisnik (2010) comparing Portuguese and Slovenian leadership practices found that Slovenian sample score higher in Challenge the Process than the Portuguese sample. According to GLOBE, Portugal score higher in Uncertainty Avoidance than Slovenia. However, the difference was not significant due the proximity of the scores in this GLOBE dimension. Tang, Yin and Nelson (2010) found similar results comparing USA and Taiwan. Teodósio and Robalo (2011) found a negative but not significant correlation between Uncertainty Avoidance and the leadership practices Challenge the Process ( $r = -.255$ ). Teodósio and Robalo (2013) found similar results but with a stronger correlation ( $r = -.50$ ). In the LPI, the Challenge the Process factor describes practices such as:

the leader takes risks even without guarantee of success; challenges the people to look for innovative ways to do their job and to test their skills and looks for benchmarking.

Hypothesis 3 - There will be a negative relationship between Uncertainty Avoidance and Challenge the Process.

Hypothesis 3a - There will be differences in Challenge the Process practices between the master students from Band A, B C and D.

Hypothesis 3b - The master students from Band A will have the lowest score in Challenge the Process practices and the master students from Band D will have the highest.

## METHODOLOGY

### *Sample*

As a sample we choose masters students in the field of management. Some authors have chosen similar samples for their studies (e.g. Zagorsek *et al.*, 2004; Aimar and Stough, 2007). Our sample (Table 2) consists of 1359 master students in thirteen countries: Argentina (n = 46); Brazil (n = 95); China (n = 241); Germany (n = 87); India (n = 96); Indonesia (n = 78); Mexico (n = 108); Portugal (n = 175); Russian Federation (n = 62); Thailand (n = 86); Turkey (n = 54); United States of America (n = 169) and Venezuela (n = 62).

### **Measures**

To measure the leadership practices we used the Leadership Practices Inventory (LPI), Self-Instrument, 3<sup>rd</sup> Edition (Kouzes and Posner, 2003). We choose LPI because it focuses on observable behaviors rather than personality traits, is not specific to American values (Tsend, 2000) and can be easily used outside the USA (McNeese-Smith, *et al.*, 2000). This instrument contains five leadership practices: Model the Way (MTW); Inspire a Shared Vision (ISV); Challenge the Process (CTP); Enable Others to Act (EOA) and Encourage the Heart (ETH). Each practice is composed of 6 statements on a 10-point Likert scale that range from 1 (almost never) to 10 (almost always). Posner (2010) reports a good internal reliability for the LPI, Self-Instrument, based in a sample of 282.867 responses. The Cronbach's alpha coefficients reported by Posner (2010) for the leadership practices were: MTW (0.84); ISV (0.91); CTP (0.86); EOA (0.86) and ETH (0.91). The construct validity of this instrument has been reported by different researchers (Kouzes and Posner, 1993; Fields and Herold, 1997; Zagorsek *et al.*,

2006). LPI was available in English and Spanish, thus the instrument was translated to the other official languages of the countries in the study, by a consulting firm with the help of local representatives before being disseminated.

### *Data Analysis*

For the statistical analysis we used SPSS (version 19). First we used the Cronbach's alpha test to analyze the internal reliability of the LPI factors. For the correlation analysis we used the R Pearson test. To compare means we used Kruskal-Wallis and Mann-Whitney tests (Marôco, 2011).

## **RESULTS**

In Table 2 we present the sample per country and the means and standard deviations for the leadership practices Model the Way, Challenge the Process and Encourage the Heart.

Table 2. Means and Standard Deviations for Leadership Practices

Countries	N	MTW		CTP		ETH	
		Mean	SD	Mean	SD	Mean	SD
Argentina	46	7.80	0.86	7.75	0.92	7.94	0.72
Brasil	95	8.08	0.87	7.82	0.94	8.24	1.05
China	241	7.40	1.21	7.05	1.36	7.72	1.21
Germany	87	7.61	0.99	7.08	1.24	7.51	1.10
India	96	7.67	1.06	7.25	1.33	8.27	1.11
Indonesia	78	7.60	0.89	7.54	0.99	8.29	0.74
Mexico	108	7.82	1.06	7.58	1.38	8.10	1.09
Portugal	175	7.48	1.08	7.30	1.20	7.61	1.07
Russian Federation	62	7.27	1.26	7.14	1.39	7.66	1.10
Thailand	86	7.00	1.08	6.97	1.26	7.60	1.05

Countries	N	MTW		CTP		ETH	
		Mean	SD	Mean	SD	Mean	SD
Turkey	54	7.74	0.75	7.62	1.00	8.20	1.00
USA	169	7.31	1.06	7.27	1.07	7.16	1.18
Venezuela	62	8.08	0.91	7.91	1.02	8.36	0.90
Total	1359						

The Cronbach's alpha coefficients for the total sample in the three leadership factors used were as follows:  $\alpha = 0.68$  for MTW (range between 0.41 and 0.78);  $\alpha = 0.75$  for CTP (range between 0.59 and 0.83) and  $\alpha = 0.77$  for ETH (range between 0.42 and 0.83). The Cronbach's alpha for the LPI factors in the study present considerable differences per country. Zagorsek *et al.*, (2004) reported similar results. The Pearson correlations (Table 3) show that Hypothesis H1 was confirmed and Hypotheses H2 and H3 were partially confirmed. The results show a positive and significant correlation between In-Group Collectivism and Encourage the Heart ( $r = 0.60$ ,  $p < 0.05$ ). The results show a positive correlation ( $r = 0.50$ ) between Assertiveness and Model the Way (H2) and a negative correlation ( $r = -0.45$ ) between Uncertainty Avoidance and Challenge the Process (H3) as we expected. However, the correlations were not statistically confirmed. The Pearson correlations also indicate that the leadership factors Model the Way, Encourage the Heart and Challenge the Process are positive correlated. Similar results were reported by Vito and Higgins (2010).

Table 3. Pearson Correlations

Variables	MTW	CTP	ETH	IGC	ASS	UA
MTW	1					
CTP	.87***	1				
ETH	.73**	.70**	1			
IGC	.05	.17	.60*	1		
ASS	.50	.46	.02	-.55	1	
UA	-.15	-.45	-.29	-.39	.15	1

\*\*\*Significant at  $p < 0.001$  (two-tailed) \*\*Significant at  $p < 0.01$  (two-tailed) \*Significant at  $p < 0.05$  (two-tailed)

To analyze Hypothesis H1a, H1b, H2a, H2b, H3a and H3b we conducted nonparametric tests because the assumptions of parametric tests (homogeneity of the variances and normality) were violated in some subsamples (Marôco, 2011).

Table 4. Comparison of Bands' means per Leadership Factor

Leadership Practices	Kruskal - Wallis Test			
	N	Mean Rank	$\chi^2$	Sig
<b>Encourage the Heart</b>				
Band A	1008	710.34 <sup>a</sup>		
Band B	95	827.11 <sup>b</sup>		
Band C	255	502.62		
	1358		71.72	.000
<b>Model the Way</b>				
Band A	621	735.10 <sup>c</sup>		
Band B	737	633.64		
	1358		22.59	.000
<b>Challenge the Process</b>				
Band A	327	594.80 <sup>d</sup>		
Band B	451	694.76		
Band C	456	706.18		
Band D	124	749.24		
	1358		22.01	.000

**Note:** The differences between Bands were calculated using Mann-Whitney tests. <sup>a</sup> Significantly different from Band B ( $p < 0.001$ ) and Band C ( $p < 0.001$ ); <sup>b</sup> Significantly different from Band C ( $p < 0.001$ ); <sup>c</sup> Significantly different from Band B ( $p < 0.001$ ); <sup>d</sup> Significantly different from Band B ( $p < 0.001$ ), Band C ( $p < 0.001$ ) and Band D ( $p < 0.001$ ).

First we conducted the Kruskal – Wallis tests to found differences between Bands in the three leadership practices in study: Encourage the Heart; Model the Way and Challenge the Process (Table 4). The results confirmed that at least two groups are statistically different in all the leadership practices: Encourage the Heart ( $\chi^2 = 71.72$ ,  $p < 0.001$ ); Model the Way ( $\chi^2 = 22.59$ ,  $p$

< 0.001) and Challenge the Process ( $\chi^2 = 22.01$ ,  $p < 0.001$ ). Then, we conducted pair comparisons for each Band in the different leadership practices using Mann-Whitney tests to analyze the Hypotheses. The significance of the differences between Bands are presented in Table 4. The differences found between all the Bands of the leadership practice Encourage the Heart confirmed the Hypothesis H1a: Band A versus band B ( $U = 39468$ ,  $p < 0.001$ ); Band A versus Band C ( $U = 89026$ ,  $p < 0.001$ ) and Band B versus Band C ( $U = 6501.5$ ,  $p < 0.001$ ). The differences found between Bands A and B in the leadership practice Model the Way confirmed the Hypothesis H2a: Band A versus Band B ( $U = 194349$ ,  $p < 0.001$ ). The results of Hypothesis H3a were only partially confirmed. The differences between Bands were only significant in comparison with Band A: Band A versus Band B ( $U = 62905$ ,  $p < 0.001$ ); Band A versus Band C ( $U = 62129.5$ ,  $p < 0.001$ ) and Band A versus Band D ( $U = 15835.5$ ,  $p < 0.001$ ). No significant differences were found in cross-comparisons between Bands B, C and D.

The results presented in Table 4 confirmed the Hypothesis H2b and partially confirmed the Hypotheses H1b and H3b. The Hypothesis H1b predicted that master students from Band A would score the highest in Encourage the Heart was not confirmed, master students from Band B score significantly higher than the master students from Band A (Mean Rank: Band A = 710.34; Band B = 827.11; Mean difference  $p < 0.001$ ). However, the prediction that the master students from Band C would score the lowest was statistically confirmed (Mean Rank: Band A = 710.34; Band B = 827.11; Band C = 502.62). The mean differences between the Bands were significant ( $p < 0.001$ ). As predicted in the Hypothesis H2b master students from Band A score higher in Model The Way than the master students from Band B (Mean Rank: Band A = 735.10; Band B = 633.64). The mean differences between the Bands were significant ( $p < 0.001$ ). The Hypothesis 3b was only partially confirmed, the results show that, as predicted, the master students from Band A score the lowest in Challenge the Process and the master students from Band the D score the highest (Mean Rank: Band A = 594.80; Band B = 694.76; Band C = 706.18 and Band D = 749.24). Despite of the Mean Rank of the Bands confirms the direction of our prediction, the mean differences were only statistically significant in comparison with Band A ( $p < 0.001$ ). As a result we can only statistically confirm that the master students from Band A score the lowest in Challenge the process (mean differences of cross-comparisons between Band B, C and D were not significant).

## DISCUSSION AND CONCLUSIONS

This study was designed to examine the validity of GLOBE model in the prediction of the leadership practices measured by the Leadership Practices Inventory (Kouzes and Posner, 2003). It had also the purpose to understand if the GLOBE's Bands are important for cross-cultural researchers, specifically when they are conducting multi-country studies. In Hypothesis H1 we predicted a positive correlation between In-Group Collectivism scores and leadership practices Encourage the Heart. The results of our statistical analysis confirmed this proposition ( $r = 0.60$ ,  $p < 0.05$ ). This result support our prediction that the master students of more In-Group Collectivistic societies would score higher in practices such as team support, trust in team members and value of shared values. This is in line with the results presented by Teodósio and Robalo (2011; 2013) and previous studies that found that the members of Collectivistic societies prefer an integrating style of leadership (Casimir and Waldan, 2007) and leadership behaviors associated with the guidance of teams (loyalty, cooperation and inclusion) (Gelfand *et al.*, 2004). In Hypothesis H2 we predicted a positive correlation between Assertiveness scores and leadership practices Model the Way. The results of our statistical analysis were only partially confirmed ( $r = .50$ ). Teodósio and Robalo (2011; 2013) found this correlation but with statistical significance. This difference justifies further investigation in order to understand why the significance was lost. Despite of that the presented correlation stills suggest that the master students of more Assertiveness societies score higher in practices such as set the example, clarity in speech about their philosophy of leadership and assertive in the respect of principles and standards agreed. These findings are consistent with Holtgraves (1997) and Schneider and Barsoux (1997) that found that members of societies with high Assertiveness are more explicit, direct and unambiguous. In Hypothesis H3 we predicted a negative correlation between Uncertainty Avoidance scores and leadership practices Model the Way. The results of our statistical analysis partially confirmed this proposition. They show that the correlation presents the expected signal ( $r = -.45$ ), however this correlation was not statistically supported. Similar results were found by Teodósio and Robalo (2013).

The remaining hypotheses (H1a, H1b, H2a, H2b, H3a and H3b) had the specific purpose to study how valid the GLOBE's bands were for research. The results of our predictions were confirmed for hypotheses (H1a, H2a, and H2b). That is, the answers of our respondents confirmed that there are significant differences in Encourage the Heart leadership practices between the members from Bands A, B and C in relation to In-Goup Collectivism (H1a). In

the same way, the results confirmed that there are significant differences in Model the Way leadership practices between the members from Bands A and B, in relation to Assertiveness (H2a). It was also confirmed that the master students from Band A score significantly higher in Model the Way than the master students from Band B (H2b). The results of our predictions were partially confirmed for hypothesis (H1b, H3a and H3b). In the Hypothesis H1b we predicted that master students from Band A would score higher in Encourage the Heart than the master students from Band B, and the master students from Band B would score higher than the master students from Band C. Results confirmed that master students from Band B score higher than master students from Band C, however, master students from Band B score higher than master students from Band A. The results of our predictions in Hypotheses H3a and H3b were partially confirmed. In Hypothesis H3a we predicted that master students from Bands A, B, C and D would score differently in Challenge the Process. The results show that only the master students from Band A score significantly different from the master students of the other Bands. In the Hypothesis H3b we predicted that master students from Band A would score lower in Challenge the Process than the master students from Bands B, C and D. This proposition was statistically confirmed, however the prediction that master students from Band D would score higher than master students from Bands A, B and C was only partially supported. The mean ranks present the expected direction, however only statistical significance was found between the master students from Band A.

As limitations of our study we would like to highlight that according to Kirkman *et al.*, (2006) we choose to present a study Type I, that means that we considered culture has the main factor to explain the variation of leadership practices. However some authors have reported the necessity to introduce other variables beyond culture in the explanation of the results and relations between individuals and cultures, once the variance explained by cultural scores is generally low (Kirkman *et al.*, 2006; Gelfand *et al.*, 2007; Gibson *et al.*, 2009). We intentionally do not considered any control variable in order to understand the strength of the GLOBE model by itself.

In this study we tried to contribute for the validation of cultural dimensions and bands from GLOBE model. The results presented go in the right direction, every hypotheses were confirmed or partially confirmed. They also confirmed the vast majority of the results that we have been presenting since 2011. In sum, for this sample and questionnaire the GLOBE model is an important source to explain the differences in leadership practices found. GLOBE's bands showed to be an important tool for cross-cultural researchers. The results of our study

based on this innovative approach to analyse the impact of culture in transformational behaviors also support the scientific perspective that transformational leadership is both a universal and a culturally contingent phenomenon. We hope that these findings contribute to open a new line of research related to GLOBE's bands using different instruments of data collection from different areas of knowledge.

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## EMERGING IMPLICATIONS OF THE DEREGULATION OF THE PHARMACY RETAIL SECTOR IN GREECE: THE PHARMACISTS' PERSPECTIVE

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### ABSTRACT

This paper seeks to provide an initial account of the changes that happen in the Greek pharmacy sector since the enforced by the government deregulation of the sector. It further looks at the response of the independent pharmacists to the changes that are in line to take place. Pharmacy retailing is defined by set of characteristics; scientific, vocational, and entrepreneurial; that makes it a very intriguing sector to research. The entrepreneurial shift of the pharmacists is identified as necessary and priorities for the transformation have been addressed. A qualitative research project was devised in order to collect data on the perceptions of the pharmacists on the deregulation of the sector and their response to the emerging landscape. The major finding of the project was the reported lack of entrepreneurial culture which stems from the absolute un-entrepreneurial business environment pharmacist developed and operated in the past and has a result the lack of confidence to make business decisions as they do not know how to analyse the environment and take advantage of the potential opportunities that emerge.

**Keywords:** Pharmacy retail, entrepreneurship, retail change, retail strategy

### INTRODUCTION

Pharmacy retailing in Greece will soon be deregulated by the state, among the massive structural changes that the Greek government will implement in order to satisfy the terms that are set by the foreign creditors in order to negotiate the bail-out of the Greek economy. The example of the last massive deregulation of the Greek retail sector in 1990, which involved among others the deregulation of the opening hours, and the removal of price

restrictions led to an overnight change of the whole image of the traditional retail to a more westernised version of it (Bennison and Boutsouki, 1995). The character of the competition then changed and price became the focal point since retailers could adjust their prices to the supply and demand of the products. The pharmacy retailing sector accounts about 10,000 independent stores across the country (Symphony IRI Group, 2010). About 75% of the total transactions in medicines take place in the pharmacies, whilst 75% of the transactions that take place in pharmacies are prescribed and non-prescribed medicines and the remaining 25% are cosmetics, toiletries, and other paramedical products (Imerisia, 2010). An average pharmacy in an urban area generates sales of about €40,000/month, but there are cases where a single pharmacy can generate sales higher than €100,000/month.

**Table 19:** Pharmacies in Greece

Area	No of Pharmacies	Percentage
Attica	4,178	37.69%
Central Greece	1,470	13.26%
Northern Greece	1,443	13.02%
Thessaloniki	1,264	11.40%
Peloponnesus	824	7.43%
Crete	507	4.57%
Rest of Greece (approx)	1,400	12.63%
Total	11,086	100.00%

Source: Symphony IRI Group, 2010, p. 24; Imerisia, 2010

Opening a new pharmacy is a long and complicated process which usually involves either the acquisition of the licence of an older pharmacist who will be retiring soon or waiting government to issue licences under the law 1963/91. Under that law Greece is divided in zones and the licences are given depending on the density of the population of each zone.

The changes that are proposed to happen in the pharmacy retail sector share a lot of common characteristics to those happened in 1990. Among the changes proposed one can finds the deregulation of the opening hours, and the easing of the geographical restrictions.

Therefore, the competition in the market will intensify and the pharmacists will be asked to develop market skills, like the entrepreneurship in order to keep up with the challenges that will emerge in the market. In order to become a pharmacist in Greece it is essential requirement to obtain the Higher Education pharmacy degree. Approximately 300 new students per year choose the Pharmacy programme of one of the three Greek Universities that offer it; however Pharmacist's training is also a popular choice for Greek students that opt to study abroad. The pharmacists training consists of approximately thirty different modules, however pharmacist only have an optional module on marketing and that is all the business training they get during their studies. Being a pharmacist is a reputable profession in Greece, and pharmacists are well respected and appreciated in the Greek society.

On the top of the market oriented changes a number of cost-containment measures were introduced by the Greek government. Vandoros and Stargardt (2013) summarised them to four general categories:

- a. Price cuts,
- b. The re-introduction of a positive list
- c. Changes in profit margins both for pharmacies and wholesalers, and
- d. Tenders for hospital medicines

It is expected that the adoption of the fore-mentioned fiscal measures will result to the reduction of the pharmaceutical cost by €1Bn, basically through the increased use of the generic medicines (Anastassakou, 2012). However, it must be stressed that pharmacies that are the major retail distribution channel of medicines, are not particularly active sellers of generic drugs. Anastassakou (2012) pointed that only 20% of the medicines sold through the traditional pharmacy format are generics. This may be an indicator of the resistance of the pharmacists to adapt to the changing operational framework, or else a message to the government that they need further support to comprehend the changing context. The liberalisation of the market had another major impact on the pharmacists, namely the profit margin of the pharmacies was capped to 20% (Kaitelidou and Kouli, 2012). This was another blow for the pharmacists who saw their both their sales and profit margins to decrease.

This research looks at how the pharmacists understand the deregulation process and what are the challenges that consider being vital for their future. It is part of a bigger cross-cultural research project that investigates the retail practices that independent pharmacists apply and searches for common patterns among the pharmacy professionals in different places around the world. The research aims to collect data that will offer insight on how pharmacists

understand the challenge of transition, how they will deal with the change, and finally what are their concerns about the change. A conceptual framework will be developed and it will form the basis for further deductive research.

## LITERATURE REVIEW

### *Pharmacists as entrepreneurs*

There are numerous definitions of the entrepreneurial activity. Some focus on the process of managing resources (Tice, 2005), some other focus on a human behaviour that aims to mobilise the market process (Davidsson, 2004). Interestingly, the definitions of entrepreneurship suggest that it involves all the determining factors of the strategic management (internal and external). Apparently, pharmacists are asked to act as trained managers which is a paradox, given that the Higher Education curriculum includes only one elective business related module. Therefore, the understanding of the resource based advantage, the adaptation on the changing environment, and the development and introduction of innovative products and services that can satisfy the needs of niche markets can happen only under the guidance of a trained consultant or they are driven by the intuition of the pharmacist. Another factor that should be taken into account is that the trained pharmacists tend to underrate the role of the retailer that they need to play in the competitive arena as they believe that their scientific background defines their occupation and the retail aspect is the *necessary evil* (Schmidt and Pioch, 2004). More recent research from the U.S.A. shows that local pharmacists have been trained to the entrepreneurial activities, noting among others that pharmacists organise themselves to interest groups utilising the facilities that are offered via networking and social media (Martin, 2011). Martin (2011) also stressed the importance of the community networking, that is seriously exploited by the local pharmacists, as this provides them with the opportunity to link to independent communities, geriatric care managers, and private-pay patients.

Szeinbach *et al.* (1995) suggested that market conditions challenge the one-sided professional identity of pharmacist and push them to behave, consciously or not, as an entrepreneur. They identified four qualities that the entrepreneurial pharmacist must possess that include: a. cost effectiveness, b. customer service, c. political structure, and d. business orientation. Given that pharmacists do not have the background knowledge to act like managers-entrepreneurs formalised methods of management are not expected to be used and this is a challenge for

them, especially during the process of change that require innovative responses. Reijonen and Komppula (2007) researching the understanding of success from the entrepreneurs perspective concluded that obviously there are non-quantifiable measures that the entrepreneurs themselves employ to assess their success. Among them they highlight the autonomy and the ability to balance work and family life that can be undoubtedly affected by the evolution of the market structure, the competition, and the lack of up-to-date knowledge and training.

### *Dealing with change*

Changing, particularly when this change involves a forced and unwanted event, is a major and stressful challenge for entrepreneurs. Kotter and Schlesinger (2008) suggested that change that is implemented through participation and involvement – which is the type of change an independent entrepreneur is going through – depends on time and commitment however they noted that time is an asset that costs, in that case the pharmacist invest their own time on the enhancement of the change, and a misunderstanding of the context may lead to a failure – which is likely given that pharmacists lack managerial training that will equip them with the knowledge to scan the business environment. Lancaster and Brierley (2000) highlighted the need for a holistic transformation during the change process. This change involves acquiring new knowledge, upgrading skills and roles, and also it requires changes on the values, behaviours, and attitudes.

The research on the change management in entrepreneurial organisations shows that change is generally treated with aversion by the entrepreneurs. Gray (2002) stated that change is subjected to numerous entrepreneurial traits, citing among them issues like the mode of earning and the lifestyle of the entrepreneur. For example, a major barrier for change is the fear to lose the existing status or income. Entrepreneurs that have an established position within their community and their income is enough to pay for the expenses of them and their family are reluctant to proceed to any kind of change. Gray (2002) adds that successful entrepreneurs are willing to risk and pursue the environmental opportunities, suggesting that the strategic view of the entrepreneur may be a strong predictor for the successful integration of the business to the emerging business landscape.

### *Change in retail*

Retail change theories are based on the concept that retail enterprises are the key motivators of it, when it is not motivated by socio-environmental factors. Chronologically presented the first theory that evolved is the environmental. Hollander (1966) suggests that socio-economic environments impose limitations on the development of retailing and retail institutions. Brown (1987) notes that changes in the economic, demographic, social, cultural, legal and technological conditions of the marketplace are reflected in the structure of the retail system. Environmental theory is very popular, especially among practitioners, is that it has similarities with auditing frameworks like PEST and SWOT (Roberto and Levesque, 2005). McGoldrick (2002, p.24) indicates that the main strength of environmental theory is its flexibility, focus upon the “uncontrollables” and its applicability in a variety of contexts. The change under scrutiny in this research is initiated by the government changes, namely the deregulation of the sector.

Research in the retail SMEs has shown that the reluctance to embrace or deal with change is a major factor that can lead to the failure of the company. Coca-Stefaniak *et al.* (2005) have found that change that originates from EU/government law or policies that are not positively digested by the entrepreneurs is a major factor that can dictate the future of a small company. This research came to confirm the earlier findings of the research of Joyce *et al.* (1990) who found that there are certain barriers to the change of the smaller retail organisations pointing that the market conditions and the lack of capital are making the entrepreneurs to be reluctant to proceed with any kind of change.

## **METHODOLOGY**

The qualitative paradigm is seen as the appropriate when exploratory research takes place (Ruyter and Scholl, 1998) and it is particularly popular in the entrepreneurship research (Bygrave, 1989; Carson and Coviello, 1996) as it allows the researcher to empathise with the research objects and have a view of the bigger picture of the research context. A snowball sampling technique was employed for this research. An initial contact was made with pharmacists that the authors knew from the past and through them more pharmacists were recruited. Finally, the authors interviewed 16 pharmacists from Thessaloniki (for the purposes of the report of the research they are anonymised and capital letter are used to identify them) in an attempt to understand how the massive changes that will soon take place will influence them. Twelve out of the sixteen pharmacies are based in the centre city of Thessaloniki while the remaining four are based in the suburbs. Other organisational

researchers in similar fields employed a range of interviewees varying from four (Le and Nhu, 2009) to thirty (Beaver and Ross, 2000). Unfortunately no other research has been conducted in the Greek context that can be used for comparison.

Each one of the interviews lasted from 90 minutes to 3 hours. The authors used an abstract interview plan but they were open to follow up the leads that were given by the pharmacists. The major thematic areas that were discussed were the challenges of the deregulation for the pharmacists and the changes that they believe they need to make in order to stay competitive in the emerging sector. Guba and Lincoln (1994) criteria for the assessment of the qualitative research were followed in this research. Table 1 summarises the application of the criteria:

**Table 1: Assessment of the quality of the research, adapted from Guba and Lincoln (1994)**

Trustworthiness	Credibility	The notes from each interview were return to the respondents for approval.
	Transferability	Pharmacists were invited to discuss the entrepreneurial characteristics of their job in addition to the specific characteristics of the pharmacist's job.
	Dependability	The data was analysed separately by each one of the authors of the research and their ideas were then combined for the development of the data analysis section.
	Confirmability	The findings of the research were discussed with another pharmacist that did not participate to the data collection in order to establish that the personal views of the researchers do not skew the data analysis.
Authenticity	Fairness	Pharmacists were allowed time to respond and they had the opportunity to review their responses.
	Ontological authenticity	By reviewing the data the respondents had the opportunity to revisit their own coping strategies as they were presented with an alternative account of their reality.
	Educative authenticity	The respondents had the opportunity to get feedback on the evolution of their business by retail specialists and understand the implication of their choice to implement change or not.
	Catalytic	Some of the respondents pointed that they became clearer regarding the future of the sector and

authenticity	suggested that they will get training on running their pharmacy as a retail premise.
Tactical authenticity	N/A. Up to this point the researchers have not followed up the progress of the majority of the pharmacies. In a single case of a pharmacist that is a social acquaintance of one of the researchers it is reported that he is in the process of moving to a multi-channel distribution strategy that demonstrates that the research influenced him to change.

Thematic analysis was employed and themes were identified. The data analysis was manual as the data set was relatively small and a software package would have made data coding, input and analysis more time consuming (Bryman, 2012).

## FINDINGS

### *The challenges of deregulation*

Even though the interviewees were not asked to provide a definition of deregulation they provided a number of insightful suggestions on what is the content of deregulation. The dominant view was that deregulation refers to a new way of operating, with less restriction but a lot more threats. Interviewee E said for example:

*We will have to operate as the other retail shops. Licensing will ease, there will be no opening hours restrictions, and honestly I am waiting for the big foreign pharmacies to invade and take over! But for me there will still be space for the independents. We have the personal contact with the customers that make us hard to replace.*

Among the other challenges that pharmacists highlighted were the government cuts on health expenditure, which may exceed the €2B per year. This means that on average each pharmacy may lose sales of approximately €100,000 per year or under moderate estimations about €3,000 of net profits. Also, pharmacists suggested that competition will become fiercer. More licensed pharmacies, in addition to the potential introduction of the distribution of generic medicines from super markets increase the players in the market and the market share would need to be split to more companies. Another issue that was mentioned was the potential need – or opportunity – for mergers and acquisitions. Smaller pharmacists suggested that they think that merging with another pharmacy of similar size would be a reasonable

way to keep the costs low and work longer hours. Pharmacist A, who owns a small pharmacy in the suburbs, pointed that:

*“If I, Yannis, and Charra (first names of pharmacists located nearby) could merge, we would be able to move to a bigger store, split the costs, and most importantly work 24/7 as we would probably afford to pay the salary of an early career pharmacist”*

Bigger pharmacists on the other hand suggested that they may be attracted by smaller pharmacies located in remote or rural areas. The demand there is predictable, and a single provider is only based there. Pharmacist C suggested that:

*“A small pharmacy in a place like Dorkada or Pente Vryses (villages about 20km away from Thessaloniki) services about 1,000 people and can easily make €60,000 per year. However, if you centrally manage them, I reckon this may increase by 25%-30%.”*

It was also quite obvious that all the pharmacists were severely concerned about their future as entrepreneurs and what negative impact the shrink of their sales it would have to their families. It was obvious that they felt that their family income is under a serious threat, and they used a number of words to describe that varied from ‘serious’ to ‘vital’. Especially, pharmacists of younger age that only recently started their business commented that the liberalisation of the sector had as an immediate result them to ‘lose all the money they spent only a few years ago to buy a licence from a retiring pharmacist’. Considering that a licence for a pharmacy based in a premium location, next to doctors’ practices or hospitals, may have cost as much as €500,000 this indicates their anger as they point that if they had not paid for the licence they could have afforded to invest not to the modernisation of their stores.

Another issue that was addressed was the lack of understanding of the actual business challenges. Their lack of any business training makes them vulnerable as they do not know how to do even the basic entrepreneurial planning. One of the pharmacists that is married to a business consultant said:

*“You cannot believe how privileged I am. My husband can take care of the book keeping, contact my suppliers (the pharmacists meant suppliers of cosmetics)*

*and negotiate payments, he even make changes to the layout of the shop!"*

(Pharmacist B)

Finally, the vast majority of the respondents suggested that customers will become of outmost importance. Personalised service will become essential. The pharmacist will take the role of the "personal shopper" for the customer. He will provide advice on medicine, basic level treatment, information on cosmetics and toiletries, and also the pharmacy will work long hours and it will be the centre of social interaction for the neighbourhood. Some of the pharmacists suggested that they would be open to offer roof to a doctor that will offer in house advice. In fact, one of the suburban pharmacists already does that offering consultation space to the local doctor.

#### *The necessary changes*

The deregulation itself poses a major change. However the pharmacists highlighted three areas that they believe changes will become absolutely essential. The first one will be the development of Customer Relationship Management programmes, and in specific methods that will enable them to keep customer satisfied and loyal. For example, pharmacist K said that he may introduce a loyalty card, pharmacist A suggested that he may do home deliveries, while pharmacist C said that he may start an own label, handmade cosmetic range of products. However, when they were presented with the rough estimation of the associated costs that may incur from such a change they directly admitted that they had a completely wrong idea about the resources that are necessary for that.

Retail considerations have also become apparent. Space management was discussed by some pharmacists. It was raised as a concern from some pharmacists that own or lease big stores or it was described as a potential opportunity for pharmacist that own or lease small stores. The product mix becomes an important decision as the profit margins in medicines will remain the same – if not reduce – while for cosmetics and toiletries the margins will be uncapped and regulated by the supply and demand. In addition to the home delivery that was earlier mentioned some pharmacists suggested that internet sale will be researched and potentially exploited. Only two of the sixteen pharmacists had a retail sale functional website during the period of the interviews, and she reported very positive experience:

*About 10% of my sales are through the internet now but... this is vital for me as I only sell cosmetics where the profit margins are very high! Yes, I definitely feel happy...(Pharmacist H).*

## DISCUSSION

The purpose of this research was to explore how the pharmacists understand the deregulation process and what are the challenges that consider being vital for their future. The literature shows that the pharmacists struggle to adapt to the identity of the businessman and the findings of this research are consistent to that. Schmidt and Pioch (2004) research revealed that they do not find their entrepreneurial identity as attractive as the professional and scientific identity of the pharmacists and that was also found in this research. The findings show that the entrepreneurial side of the pharmacy operation will become pivotal for the long-term success of the pharmacy. There is a major area of concern for the pharmacists as they believe that the immediate result of the deregulation will be that retail chains will dominate the sector. The companies that will emerge from the mergers and acquisitions will become particularly strong and competing against them will be impossible as they will have both the resources and the market insight to dominate the sector.

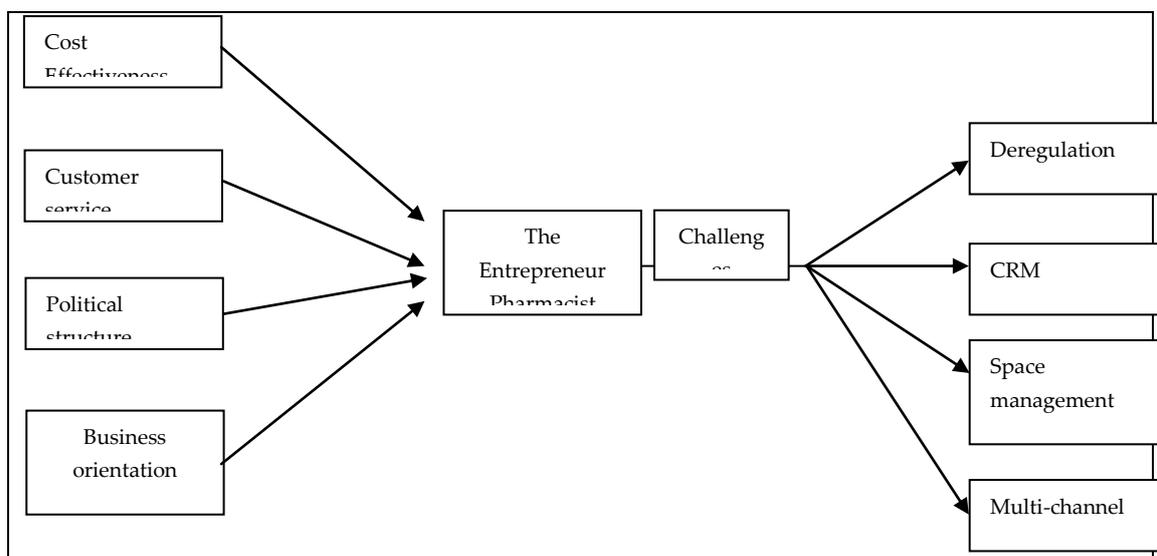
The pharmacists suggested that the deregulation of the sector is unplanned and they do not seem to understand how this will benefit the consumer. Past examples of deregulation show that it takes long time to understand the new landscape and the emerging competitive position in the sector. Evidence from similar change that happened in UK showed that even though pharmacists had a lot of time to prepare themselves to a new, government oriented, environment they lacked the necessary background and experience to deal with and adapt to the new environment (Schmidt and Pioch, 2004). Findings from research that took place in Austria also suggest that the independent pharmacists there struggled to position themselves in the competitive map (Foscht, 2006).

Another area of importance is the negotiation with the competitors. Pharmacists reported that they sense the threat of the competition but they do not have a clear strategy to defend against, or even more retaliate, them. Entrepreneurial strategy development is by definition problematic as it is based on limited information, lack of resources, and massive personal biases. In that case it must be added the lack of business training that makes understanding the environment and the competition an impossible task. Mitchellette (2008)

stressed that entrepreneurs try to take full advantage of their competencies and fully exploit the available resources however they become myopic and focus on this internal to external process. Probably this explains why 90% of the small and small-medium companies fail within 3 years of their start up.

This research reveals a major threat for pharmacists; this is their inherent lack of business training. In an environment where small independent pharmacists will be called to compete against bigger multinational companies it is essential, or even fair, to expect them to be benefited by seminars or workshops that will be organised from the Government or their union particularly for them. Pharmacists need to learn the basics of organising a retail space, managing relationships with customers, understanding the supply chain, and foremost analysing competition and identifying compatible to their resources niches for their products. Figure 1, encapsulates the concerns of the pharmacists and illustrates the reported connections between the causes of the entrepreneurial concerns and the emerging challenges.

**Figure 27: The pharmacists' entrepreneurial concerns**



## LIMITATIONS AND FUTURE RESEARCH

As stated earlier in this paper this is the first output of a bigger project that aims to understand how independent pharmacists across the world understand their retailer role and how they operate under the advantages and disadvantages of their size and capabilities. The

data that was collected for this part of the project comes from Thessaloniki only, so this research will be further benefited from more data that will come from urban, suburban, and rural areas. Obviously, this limited geographic representation reduces the credibility and replicability of the research; however the purpose of this part of the research is exploratory and aims to pilot research techniques and test concepts.

Regardless the unavoidable limitations, the findings of the present study could be a first step towards a better understanding of the deregulation of the pharmacy retail sector and the subsequent changes, where very little research has been done. Considering the gap in the literature as well as the potential managerial interest in the deeper understanding of the topic, future research can build on these results to extent this picture at an international level especially nowadays because of the global economy's unstable shape. Furthermore, it will be beneficial future studies to look into the suggested conceptual framework and to develop it more.

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## **ORGANISATIONAL SEQUESTERING OF WORKPLACE BULLYING: ADDING INSULT TO INJURY**

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### **ABSTRACT**

This paper defines and labels some of the ways that human resource workers, managers, and union representatives respond to complaints about workplace bullying. Using thematic analysis of empirical data from semi-structured interviews with human resources practitioners and targets of bullying, this study found that organisations routinely sequester, or set aside, targets' complaints. Organisational sequestering occurs in three main ways: reframing, rejigging, and rebuffering, as shown in a range of examples. The sequestering of complaints produces an additional source of anxiety and distress for targets of bullying. The examples show how organisations routinely employ a range of tactics to avoid taking responsibility for managing complaints or simply misunderstand the nature of bullying. Some explanations for sequestering are proposed, including the absence of anti-workplace bullying legislation and national cultural attitudes. However, despite special features of the sample, it does appear to link to a broader global phenomenon, as similar behaviours have been noted in India, Canada, and the UK (D'Cruz, 2012; Ferris, 2004; Harrington *et al.*, 2012). The study provides a useful contribution to knowledge by identifying, explicating, and providing terminology for specific behaviours that exacerbate the problems caused by workplace bullying. It concludes with practical recommendations for using organisational sequestering in a more constructive fashion.

Keywords: Workplace Bullying, HRM, Unions, Organisational Sequestering, Reframing, Rejigging, Rebuffering, Zealand.

## INTRODUCTION

This paper explores empirical data from human resources workers (HR) and other employees to identify and define the ways in which organisations respond to complaints about workplace bullying in New Zealand. Despite recommendations that organisations take workplace bullying seriously (Lewis, 2001) and a proliferation of research in this area in recent years, little evidence of any improvements in the management of this problem exists (Harrington *et al.*, 2012). Indeed this study adds to the gloom by providing an account of the ways in which organisations--line managers, HR, and union representatives--fail to take responsibility for the welfare of their employees and members. This paper provides a selection of responses to requests for help from targets of bullying and some possible explanations for these responses. Crucially, it introduces a set of terms for identifying HR, management, and union inaction towards those attempting to resolve workplace bullying situations. This terminology provides a pattern that has not previously been identified and it may ultimately assist with the resolution of previously unnamed behaviours.

## CONCEPTUALISATION

Workplace bullying has no single, agreed, definition. Although the area is still in a state of denotative hesitancy (Lutgen-Sandvik and Tracy, 2012), some key themes have emerged (Einarsen *et al.*, 2011). Therefore, in this study, workplace bullying is defined as repeated, hostile acts that are harmful to the recipient. A diverse range of behaviours may constitute bullying, and examples include shouting and rudeness, belittling and aggressive gestures, through to ostracism and exclusion (Keashly, 1998). Harm is a vital feature of bullying because recipients may interpret the same behaviours in quite different ways, so without harm bullying cannot exist (Lee, 2000; Namie and Namie, 2000; Quine, 1999; Randall, 1997). Harm may be both psychological and physical, and typically targets experience symptoms associated with stress, such as distress, headaches, and nausea (Davenport *et al.*, 1999; Field, 1996; Namie and Namie, 2000; Needham, 2003), insomnia, inability to concentrate, and in some cases Post Traumatic Stress Disorder (Lee, 2000; Leymann, 1990). Persistence is also a defining feature of bullying, so behaviours need to be recurrent and on-going (Einarsen, 1999; Field, 1996; Keashly, 1998; Lee, 2000; Namie and Namie, 2000).

Organisational responses to allegations of workplace bullying have received limited attention from academics. A study in Finland, where there is a legislative requirement to remedy workplace bullying, indicated a diverse range of outcomes for both the perpetrator and the target, including discussions with both parties, dismissal or other sanctions for the bully if allegations are serious and founded, counselling of the target and the bully, and occasionally taking no action at all (Salin, 2009). Conversely, in the UK, where there is no specific legal requirement to manage bullying, a recent study noted that HR practitioners viewed themselves as strategic organisational partners rather than welfare workers, resulting in complaints being treated as outside their remit (Harrington *et al.*, 2012); whilst in India, organisations encouraged employees to view complaining about bullying as unprofessional behaviour (D'Cruz, 2012), with the result that problems were not resolved. Organisational responses are important because they influence the degree of harm experienced by the target and the wider organisation (Ferris, 2004), so in order to identify responses to workplace bullying in New Zealand, this paper addresses the research question:

*How do organisations respond to requests for help with workplace bullying?*

## **METHODS**

Using semi-structured interviews ( $n=40$ ), data was collected from 27 volunteers--including academics, managers, technicians, administrators--and 13 HR workers from Institutes of Technology and Polytechnics (ITPs) in New Zealand. The semi-structured approach was chosen because it allowed relevant, emergent themes to be further explored and gave breadth to the interviews, whilst keeping a focus on the subject area. Interviews lasted 2 hours on average. Interviewees volunteered to participate via a website and they were a purposive group that had experiences of workplace bullying (Nielsen and Einarsen, 2008; O'Leary, 2005). The selection criteria included working, or having worked at an ITP, and wanting to contribute experiences or views of bullying at work; however, it transpired that all volunteers had been targets of bullying according to the conceptualisation used in this study. HR workers were nominated by organisations participating in the study. They were asked to explain their organisations' approach to managing bullying, but four HR workers also described being targets of bullying at work, so their experiences were added to the volunteers' responses, which resulted in 31 sets of bullying experiences.

The digitally recorded interviews were transcribed verbatim then thematically analysed to explore, amongst other things, the ways organisations responded to reports of bullying. Thematic analysis is a qualitative approach used for “identifying, analysing and reporting patterns (themes) in data” (Braun and Clarke, 2006: 79) and by using sections of data incorporating multiple occurrences of the same thread of meaning, a theme developed. Targets who sought help or raised concerns about workplace bullying received a range of responses that suggested that their issues were being set aside; whilst HR workers described the ways in which this occurred. These responses were grouped and this theme is labelled Organisational Sequestering.

What is sequestering? It means to seclude, isolate, or set apart. Previously, the term was used to describe how targets of sexual harassment avoided taking action to resolve their situations, thereby contributing to its continuation (Clair, 1993). The term *Organisational Sequestering* describes ways in which managers, HR workers, and union officials set aside or avoided problems rather than addressing them. The identification of organisational sequestering of workplace bullying complaints is important because problems remain unresolved and difficulties experienced by targets are compounded by its use.

## RESULTS

Interviewees and some HR staff reported the persistent use of various types of aggression, unfair work conditions, dishonesty, and ostracism against them. Several interviewees provided documentary evidence to support their claims, despite this not being requested, and it transpired that their complaints were routinely sequestered by the organisations concerned. Organisational sequestering manifested itself in three key ways: (1) *reframing* the issue, (2) *rejigging* the workplace, and (3) *rebuffing* the target’s complaints, with reframing being the most frequent and complex form.

### *Reframing*

Whilst frames provide patterns for understanding social relations (Fisher 1997), reframing is a way of viewing situations and people from alternative perspectives (Clair, 1993). In this study, reframing comprises the ways in which managers and HR used different perspectives to move the responsibility for bullying outside the organisation or to make the issues appear unworthy of consideration. Reframing occurred when organisations viewed targets’

complaints of bullying as being linked to their private lives or personal views, being easy to resolve or of no importance, denying the existence of issues, and, finally, claiming the target complained to deflect from other issues, such as disciplinary-type action. Both targets and HR workers provided examples of workplace bullying being reframed. These examples are further grouped into (1) reframing as a personal issue, (2) reframing as trivial, (3) reframing through denial, and (4) reframing as defence, as explained below.

*(1) Reframing as a personal issue.* HR workers and interviewees provided examples of ways in which complaints about workplace bullying were reframed as personal issues. Some HR staff accepted that employees felt bullied but said that this was not due to organisational matters. For example, Kristy remarked “There is very rarely just bullying; there’s usually other things, if they’ve got health issues, if there’s been a death in the family, if their workload is particularly high. It tends to put them in a vulnerable place”. This comment appears to blame the complainant’s vulnerability and implies that other issues are at the root of the complaint. Reframing in this way sequesters the issues as personal matters rather than organisational problems, which removes the need for action by HR.

Another way of reframing as a personal issue emerged when several staff complained about a manager’s behaviour and HR worker Evelyn reframed their concerns by saying: “If you know the person and you know their background, you can see that it’s not deliberate, it’s kind of in their make-up, the background of that person. The intention is not to bully at all”. This comment suggests that the manager’s negative behaviour was excused as a matter of personal style by HR, rather than being something that the organisation should address, and the staff were at fault for interpreting it incorrectly. Similarly, when manager Rona tried to get help, HR told her: “There’s no bullying [here], there’s just misunderstandings and what you need to do is understand people’s personalities and some people do lose their temper before others. It’s a personality difference rather than bullying”. These examples suggest that HR reframed complaints of workplace bullying as the personal traits of targets and perpetrators rather than organisational issues. Reframing in this way removes any imperative for action from the organisation and places it back with the target.

*(2) Reframing as trivial.* Some interviewees reported that when they aired their concerns with their managers, the responses suggested that the manager did not grasp the seriousness of the problem and did not understand why the target was upset. For example, Tiffany stated “My boss wanted me to resolve it over a coffee and directed me to go out with [the perpetrator] for a coffee”. Tiffany said this instruction distressed her greatly because her colleague had been

aggressive and she was frightened of him, so it would take more than a simple chat over coffee to correct matters. Similarly, Harry, an HR manager, reported that one of his managers had told two staff members to “Go and have a beer and sort it out”, rather than addressing the issue. Reframing removes the need for any official work by managers and HR, so it may appear to be an attractive option. In the short-term, the organisation reduces the risk of mishandling the bullying case by deflecting in this way; however, in the long term this approach may backfire, as cases may become more complex and serious over time.

Trivialisation occurred in a slightly different way for two female interviewees who spoke of their experiences of bullying by female staff. In separate interviews about unrelated incidents, they both remarked that their managers appeared to reframe their problems as “women’s issues”, which took them out of the range of their male senior managers’ concern. For example, manager Sophia said she was being bullied by a subordinate but when she tried to tell her manager, she was unable to communicate, Sophia explained, “I did speak to my manager. When I outlined it to him, I could tell he wasn’t interested. He saw it as a sort of women’s thing, I think”. Rona reported a similar experience; she said, “The CEO knew that [my manager] was a bully but I think he thought it was just a catfight between two women”. Trivialising the issues meant interviewees were denied support and their negative experiences appeared to have been viewed as minor, easy to resolve, or women’s issues and thus unworthy of consideration.

(3) *Reframing through denial.* Denying the existence of bullying emerged as a further form of reframing. For example, after HR told Rona there was no bullying at her ITP, she tried to get help elsewhere within the organisation. Rona said when she spoke with her manager, a member of the executive team, his response shocked her, she explained “I said ‘I’m starting to feel bullied’ and he said, ‘Don’t use that word’ and started screaming at me and he said, ‘Don’t say bullying; we’re not using that term at this institution’”. By refusing to use the term bullying, the senior manager made it much more difficult for Rona to communicate her issues. A different take on denial emerged through the comments of HR worker Freda, who said:

*I just wonder whether a lot of what gets reported is really bullying. Quite honestly the people that they’ve described as bullies, I don’t think that they’re that kind of person, and I’m not usually a judge of character, but I’ve never met a manager who I would describe as really grumpy or highly strung.*

In this example, Freda appeared to deny that bullying exists because she has not witnessed or experienced behaviour that she considered to be bullying. Indeed, she also framed it as if only grumpy or highly-strung people are bullies. People who lack knowledge or experience of bullying are unlikely to understand its impact and consequently, invisibility occurs, that is, observers are unable to understand problems as individuals are experiencing them (Gilbert and Malone, 1995). These examples suggest that invisibility may have been a factor in the responses, but also there may have been a deliberate effort to deny the existence of bullying.

(4) *Reframing as a defence.* A final form of reframing is claiming that bullying is a defence mechanism or a way of deflecting attention from professional short-comings. For example, Freda believed people claimed to be targets to deflect attention from their poor performance; she stated “People who had known there was something coming up in the future, where their performance was to be questioned, have seen the approach as bullying”. By treating complaints about bullying as a response to being performance managed, Freda reframes bullying as being a defence mechanism. However, none of the interviewees referred to the performance management process in their stories, despite them providing many personal details during the confidential interviews, which suggests this might be reframing to provide HR and managers with a way of avoiding action and ignoring difficulties. However, not all problems were ignored and sometimes attempts were made to rectify situations. The next section discusses the ways in which organisations tried to address bullying.

### *Rejigging*

The second key way in which organisational sequestering occurred was by rejigging. Rejigging refers to the implementation of temporary or partial solutions that enabled interviewees to continue to work with perpetrators but that did not resolve the underlying problems. In this type of sequestering, organisations took some action but this was insufficient to resolve the problems. The label reflects the idea that these actions were relatively minor adjustments to the workplace to partially accommodate targets’ concerns. Rejigging usually dealt with the surface problem, for example, providing support for a distressed target, but did not manage the perpetrator’s behaviour. Overall, this approach resulted in the problems being partially addressed, rather than completely resolved.

Targets talked about the ways in which they were encouraged to work around abusive managers, either by avoiding direct contact or by taking witnesses into meetings. For example, Ken explained that, after he had complained to the HR manager about his dean’s

behaviour, an arrangement was implemented to ensure that anything that was required of Ken by his dean would be requested through the HR manager. He said, “We just circumvented the dean and the management relationship because relating to [the dean] was just too difficult; it was too painful”. Despite accepting that a problem existed, HR rejigged the communication lines to protect the target from direct interactions but did nothing to improve the aggressive behaviour of the dean, so the problems continued.

Similarly, Wiremu reported that HR workers were aware of his difficulties with his supervisor, but they only provided minimal support, he explained, “On my last two appraisals I asked [HR] to be present as a witness and it's been all nice and lovely conversations as a result of that”. However, Wiremu received no other support, nor was any action taken to improve the situation, so his other difficulties with his supervisor continued. These are examples of rejigging because HR supplied interim, surface-level solutions to the problems but in each case they did not manage the root cause.

Some targets received counselling or other forms of personal support to address their immediate problems; however, without action to improve the behaviour of the perpetrator, this approach only provided only a partial solution to the situation. For example, Olga said she had complained about her manager's behaviour and accepted an offer of in-house counselling. She also requested help to resolve the underlying issues, but her requests went unheeded; Olga explained, “[HR] sent me to counselling, which is fair enough, and that was the last I heard of it. I said [my manager's] behaviour needs to be modified, she needs to be supervised but nothing happened”. In this case, Olga's difficulties were effectively rejigged as a health-issue, and beyond providing a partial solution to help her to cope, the organisation took no other action to resolve the situation.

The examples in this section indicate some of the ways in which HR use partial solutions to rejig problems. By treating the immediate difficulties but failing to address the underlying problem, HR sequestered the bullying, effectively supporting the continued use of abusive behaviours in their organisations.

### *Rebuffing*

The third and final form of organisational sequestering is rebuffing. Rebuffing highlights the different ways in which interviewees said they felt pushed away when they requested help to address bullying. Rebuffs were both active and passive.

Active rebuffs involved specific comments or behaviours that appeared to be made deliberately to deter targets from pursuing their concerns. Several targets talked of how they had expected support and guidance from HR staff but instead they felt pushed away. For example, when he was trying to complain about his manager, Gerry felt that HR was trying to deter him, he explained:

*HR said that this would be on my record, this complaint; they went down that road first. They said, "This makes it official" with quotation marks. "This will be recorded and will involve a lot of people. Walls are thin."*

Gerry said that this response worried him and he was reluctant to take the matter further. Similarly, Rona explained how the HR manager rebuffed her when she tried to complain about her manager, "[She] said, 'You can try to do something, you can [complain] then your life will get worse and you will have a black mark against you forever for complaining'". Finally, manager Perry said he received support from HR initially, but he found that their attitude towards him changed when he decided to make a formal complaint against his executive manager; he explained: "The opinions of HR, as an informal discussion, were 'Sorry this is going on, don't agree with it, feel corrupted morally for the comments that they're making', this was informal, but formally they would take a very different [unhelpful] tack". Perry could not understand why HR would provide him with personal support whilst allowing abusive behaviour to continue. These examples illustrate ways in which HR actively rebuffed targets and appeared to have little interest in defending and supporting bullied employees, even when the complainants were managers. This approach had the effect of deterring the targets from pursuing their complaints and increasing their distress.

Rebuffs were not always so obvious and sometimes passive rebuffs were used. Passive rebuffs usually occurred when interviewees were unable to get responses to their complaints from their manager or HR. For example, Felix explained how difficult it was to contact his HR manager, stating, "We send e-mails to make appointments and there's no way you can see the Human Resource Manager". HR's failure to respond to meeting requests resulted in Felix feeling pushed away and ignored, which compounded his sense of abuse. Similarly, Uma's attempts to resolve problems with her line manager were unsuccessful because he did not respond, she said:

*I sent very strong letters, but they just didn't seem to really go anywhere. He'd fob it off [and say] "Oh I'll think about it." You know, that kind of thing, "I'll get back to you later" but he didn't.*

In these examples, the interviewees felt rebuffed by the lack of communication, which made it very difficult for them to take action and pursue their concerns.

Passive rebuffs sometimes occurred owing to an absence of knowledge, or perhaps ability, of how to support targets. Typically, targets received generalised support but it lacked any action or advice about reaching a resolution. For example, after complaining about repeated verbal abuse from her dean, Ngaire stated, "Probably if I'd had better HR advice I think I would have moved to the next level. I think those young women in HR, they were lovely, but they were quite inexperienced as well". Wiremu, who worked at the same organisation, supported Ngaire's view; he described his experience as follows:

*I went earlier this year to HR and spoke to one of the girls there a few times. They were okay, but I really found them a little bit ineffective; they sit there and nod, you know, and that's all.*

This inaction resulted in Ngaire and Wiremu using alternative, less professional, approaches to manage their negative experiences.

A few interviewees received passive rebuffs from unions. Tiffany explained how her union representative sent her on an unnecessarily circuitous route to get help; she said, "I had people along the way going 'we can't be involved in this', because the union delegates are actually members of staff, and they didn't want to be involved. It was horrendous". In this case, multiple rebuffs occurred from people who should have been supporting the target, which caused her considerable and lasting distress.

Sometimes union representatives appeared to lack skills to deal with more complex situations. Rona explained what happened when she took a union representative with her to see the HR manager, "He was completely floored by [the HR manager's response], and he said he didn't know what to do. He said, "I don't know what to advise you"". Rona said the representative's response meant she was denied the help that she had could reasonably have expected to receive. Both of these targets were left feeling helpless by their union representatives' passive rebuffs.

In summary, the results identified many ways in which organisations sequester concerns and complaints about workplace bullying. Some reasons for the use of organisational sequestering are proposed in the next section.

## DISCUSSION

Despite recommendations that bullying is stopped promptly (Vartia and Leka, 2011), the results of this study suggest managers, HR workers, and unions prolonged bullying by using organisational sequestering. In contrast to the range of active organisational responses proposed by Salin (2009), it appears that organisations did little to rectify workplace bullying. The use of organisational sequestering prevented bullying from being resolved and consequently this approach created additional problems for targets. Both HR and targets explained, and sometimes agreed, on the different ways that complaints about bullying were sequestered. The examples in this study suggest that HR staff did not work in the interests of employees but instead acted in ways that minimised their own input, for example, reframing issues as the fault of the target or creating temporary solutions to work around perpetrators. A lack of personal experience of bullying may have made it invisible to HR, and this may explain the less effective responses (Branch *et al.*, 2006; Gilbert and Malone, 1995).

Skills and resources to resolve workplace bullying complaints sometimes appeared to be lacking in HR and union representatives. One HR worker acknowledged the difficulties that targets faced. Jenny explained that sometimes managers simply “refused to manage bullying” and they ignored her attempts to implement her organisation’s anti-harassment policy. This suggests that, even if they do have the necessary knowledge, skills, and motivation, without direction from organisational leaders, HR and union representatives may fail to implement processes that reduce and rectify bullying,

Furthermore, as union representatives are often workers at the same organisation, they may be fearful for their own jobs if they try to manage bullying, providing another reason why they might be willing to sequester issues. More broadly, New Zealand unions have seen their membership reduce dramatically from 55% in the 1970s, (Blanchflower, 2007; Visser, 2003) to the rate of around 30% more recently (Statistics New Zealand, 2005). This reduced powerbase might provide a systemic explanation for the examples of representatives’ reluctance to support union members.

A more culturally specific explanation for the lack of action may be associated with the *She'll be right* approach that is prevalent in New Zealand. This phrase is a frequently used to express the belief that problems will right themselves without intervention (BurrIDGE and Mulder 1999). Typically, this approach has been considered either an optimistic or apathetic outlook, but more recently has been associated with the acceptance of low quality and its use suggests a casual lack of action (Bayer, 2012; Ewing, 2012). The use of the *She'll be right* approach may partially explain the prevalence of organisational sequestering in this context.

Another special feature of New Zealand is the proximity of its population. Much of the country is sparsely populated and consequently settlements are often relatively small or located remotely. This could be a particular problem when HR workers, managers, and union representatives are close to the perpetrator, either as a friend or neighbour, or simply by virtue of working at the same organisation. Close-knit communities, and multiple roles in them, may lead to workers being unwilling to take action, as they have competing priorities; whilst, as previously noted, invisibility may reduce appreciation of the situation from the target's perspective (Gilbert and Malone, 1995).

Typically, the HR workers interviewed for this study were uncertain about how to manage bullying. In the absence of specific anti-bullying legislation in New Zealand there is no requirement for organisational policies; however, as several researchers have noted, even where policies exist they can be ignored (D'Cruz, 2012; Harrington *et al.*, 2012; Vartia and Leka, 2011) and this study suggests that organisations will usually find ways to avoid dealing with the underlying issues and thus, possibly inadvertently, perpetuate problems for targets. However, as commitment to addressing workplace bullying may improve with increased knowledge and awareness (Vartia and Leka, 2011), continuing research and publication in this area provides some hope for its eventual resolution.

## CONTRIBUTION

This study provides an overview of the unhelpful approaches that may be adopted by organisations when dealing with workplace bullying. Denotative hesitancy, (i.e., a lack of clear definitions) is still an issue in this field (Lutgen-Sandvik and Tracy, 2012), so the identification of terminology for organisational responses makes an important contribution to workplace bullying research. Specifically, providing names for elements of the bullying process can help people to see a pattern where they did not see anything before (Rheingold,

2000). The use of the term organisational sequestering and the three ways in which this can manifest itself (i.e., through reframing, rejigging, and rebuffering) should draw attention to the negative role of HR, managers, and unions in the overall process of bullying and lead to the development of approaches remedy it.

## RECOMMENDATIONS

Gaining legal recognition of bullying in New Zealand might provide an important step towards addressing the problem because legal protection would offer incentives to organisations to prevent bullying and provide compensation for targets (Yamada, 2010). Any legislation would need to take into account the ways in which organisations sequester issues and address the *She'll be right* culture, otherwise it is unlikely to be helpful. However, treating bullying as an extension of sexual and racial harassment, which both have legal remedies in New Zealand, might provide a useful starting-point for policy development and training in organisations.

A more practical alternative might be to sequester complaints away from the organisation by using a separate, disinterested, but knowledgeable body to investigate and implement solutions. As previously noted, New Zealand's small population results in problems associated with employees having multiple roles in the workplace and in the wider local community; so sequestering may provide a pragmatic solution when HR and union representatives are too close to the problems. Furthermore, development of a human resources partnership approach with the management team, both in New Zealand and overseas, is likely to present a conflict of interest, especially when HR workers are required to investigate and resolve bullying by their management colleagues (Harrington *et al.*, 2012). Therefore removing the responsibility from the workplace to an independent investigator/consultant might provide organisations with an opportunity to legitimately sequester workplace bullying and result in a greater likelihood of a permanent resolution. This suggestion may also provide opportunities for additional research.

## LIMITATIONS

Like all research, some aspects of the present study limit its findings. Confidential interviews preclude checks of the veracity of the experiences reported and using mainly self-selecting respondents means the sample is not representative of the general population. However, the self-selecting approach may be appropriate when studying groups that have the most severe experience of a phenomenon (Nielsen and Einarsen, 2008) or are affected by invisibility (Gilbert and Malone, 1995), and it may explain the rich vein of experience that the findings reveal. The narrow industry focus and relatively homogeneous sample may limit generalisations and a broader cross section of workers might have produced different outcomes.

## **CONCLUSION**

Organisational responses to requests for help to resolve workplace bullying are usually disappointing and various forms of sequestering are used that do not address the underlying issues. Organisational unwillingness to address the causes of bullying compounds targets' negative experiences, adding insult to the injuries or harm they have already experienced. Whilst it is tempting to simply link these findings to New Zealanders' optimism or apathy, or other special features of the country, the existence of avoidance behaviours in Indian (D'Cruz, 2012), Canadian (Ferris, 2004) and UK human resources practitioners (Harrington *et al.*, 2012), suggests that organisational sequestering might be part of a global phenomenon. By naming and defining the sequestering behaviours of managers, HR workers, and union representatives, it is possible to understand the role these workers play in the continuation of workplace bullying. Those with responsibility for providing a motivated and engaged workforce may consider how they can reduce their negative impact on this phenomenon. A helpful start might comprise taking responsibility for developing and implementing policies, and arranging training programmes to help managers and employees understand more about workplace bullying, especially if these approaches make the problem more visible. Similarly, the senior management team may find ways to provide fair and decisive leadership that leads to an environment where bullying does not have a chance to thrive. Alternatively, removing conflicts of interest from more strategic HR workers or those with multiple roles, by seeking the support of external, independent practitioners, may provide longer lasting solutions.

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## MUTUAL RELATIONSHIP OF WINE INDUSTRY VS. WINE TOURISM; THE ISRAELI PERSPECTIVE

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### **ABSTRACT**

Wine tourism is identified as a symbolic partner of the wine industry. The wine industry in Israel has been experiencing a rapid development from a small wine producer for the Jewish community to a substantial wine industry which exports a wide variety of top-quality wines, which is followed by wine tourism activities. The objective of the research is to determine the perceived strategy of wine stakeholders in relation to the wine tourism, and to indicate future implications. The research applies the Tourism Area Life Cycle (TALC) model and the SWOTCLOCK™ approach. Results show that the 'Leading Strategy' of big commercial wineries is GROWTH compared to the RESPONSE strategy of Small & Family wineries and SURVIVAL of Mid wineries. Government ministries and the Vine & Wine Board (VWB) perceive LEVERAGE to be the 'Leading Strategy'. Findings of empirical data analysis position the current Leading Strategy as RESPONSE and prove validation between the TALC and SWOTCLOCK™ models. The key conclusion and recommendation is that government ministries, VWB and local authorities should take a leading role in leading the wine industry and tourism sector towards the rejuvenation and growth stage.

**Keywords:** Wineries; SWOTCLOCK™; Tourism Area Life Cycle (TALC); GROWTH; RESPONSE; SURVIVAL; LEVERAGE; Leading Strategy;

### **INTRODUCTION**

Wine was mentioned in the Bible when Moses sent two Israelite spies to explore the land of Israel who "cut down from thence a branch with one cluster of grapes and they bare it between two upon a staff" (Numbers XIII, 23), followed by the prophet Micha with his vision

that "they shall sit every man under his vine ..." (Micha IV, 4). Producing wine in Israel reached its peak during the Second Temple, but later on was stopped when the Romans destroyed the Temple and the Jews were sent into exiled. The wine industry was totally wiped out during the period of the Ottoman until the WW I. In the 19<sup>th</sup> century there a few and small isolated wineries operated in Israel, and in 1848 the first commercial winery was established by the Baron Edmond de Rothschild who gave sponsorship and financial support for wine production, and imported varieties of vines from Bordeaux in southern France, as well as technical support of professional wine-makers. The development of the wine industry received a significant boost in the 1980s, when Professor Cornelius of the University of California, claimed that the Golan Heights area was suited for growing grapes of excellent quality. Robinson (2006) noted that according to the World Council Vine (OIV), the area covered by vineyards in Israel in 2003 was approximately 17,000 acres, producing some 57,000 hectoliters of a large selection of high quality wines, part of which were exported. Subsequently Israeli wineries began to participate in international competitions and have won numerous awards and accolades for quality wines. A commitment to high quality and presentation of a variety of new wines have changed the culture and consumption, brought the establishment of new vineyards and professionalism in producing wine and led to the construction of about 200 new wineries mostly small and family (boutique) wineries. There are 5 official wine zones: Galilee & Golan Heights, the Shomron (Carmel Mountain), Samson, the Judean Hills and the Jerusalem mountains and the Negev. There is no formal system of wineries registration in Israel and the general estimate is that approx. 250-300 wineries are currently operating in the wine sector. Although accurate and viable data is difficult to gather (Shor and Mansfeld, 2009), according to Vine & Wine Board (VWB) and the Ministry of Agriculture, planted vineyard area by 2012 covered about 55,000 dunams (1 acre=10 dunamms) yielding approx. 55,000 tons of grapes (Harkabi, 2012), and enabling the production of close to 45 million bottles. The implementation of the PARETO rule groups wineries into 3 major groups: 7 Big wineries with clear commercial orientation (above 2.5 million bottles and about 80% market share), 15-20 Mid wineries, producing 120,000–1,000,000 bottles (about 12% market share), and the Small & Family (boutique) wineries (production of up to 100,000 bottles a year). The establishment of new vineyards and planting new types of grapes at an increased rate was followed by a growing a wine culture and changing consumption habits in relation to wine. Visitor centers, cellar doors, and quality restaurants started offering wine as part of the gastronomic experience, wine tasting competitions started appearing, as well as festivals and early initiatives of 'wine route'.

Although the Israeli wine sector has experienced an impressive development over the last two decades, the wine consumptions per person is estimated to stand steadily at 5.5 liters per person per year, far behind 65-70 liters per person per year in France. This, together with the growth in wine supply beyond the demand of the local current market, import competition and the beginning of wine export, sets tremendous challenge to the wine sector.

## LITERATURE REVIEW

For thousands of years wine accompanied by the development of human society as one of the components which compliments to the food served and has been used to inspire joy and pleasure. Wine as a consumer product begins its supply chain at the initial step of growing grapes as raw material, continues to the second stage of wine production and finishing as one of the vertebrae in the distribution and marketing to leverage the product to the end consumer. For many years the traditional wine center both production and tourism was located mainly in European countries such as Italy, France, Spain and Portugal ('old wine world'). Substantial development in wine tourism, which accompanies the development of new and attracts young people, can be seen in the U.S., Australia and New Zealand ('new wine world'). South Africa's famous wine culture and industry developed at a slower pace, mainly for political reasons. Over the last two decades, there has been more and more research activities related to the wine industry, combined with wine tourism, as the conspicuous phenomenon of focusing on specific areas. Getz (2000), Hall (2000) were among the first who contributed to a deeper understanding of the characteristics of wine tourism. Hall et al. (2000) defined wine tourism as : "visitation to vineyards, wineries, wine festivals and wine shows for which grape tasting and/or experiencing the attributes of a grape wine region are the prime motivating factors for visitors". In order to enrich the visit in the region, the visit has to include some unique quality as defined by the Wine makers Federation of Australia (1998): "visitation to wineries and wine regions to experience the unique qualities of contemporary Australian lifestyle associated with enjoyment of wine at its source-including wine and food, landscape and cultural activities". In line with this definition Getz et al. (1999), Getz (2002), Getz et al. (2004), Sparks and Malady (2004) and Sanders (2004) undertook some more studies on the characteristics of wine tourism. Carlsen and Charters (2006) suggest that wine tourism is based upon 6 major areas: wine tourism setting, regional development, wine marketing and tourism, cellar doors, wine festivals and events and wine tours and trails. In spite of the fact that wine tourism contributes to the increase in wine consumption and that

both of them complement one another, Carlsen (2004) suggested that it is important to recognize that the wine industry and wine tourism are positioned opposite each other in the industrial micro-cosmos spectrum. The conclusion is that much more work should be done in order to understand how wine industry and wine tourism both diverge and also converge through the application of a wide range of economic, culture, geographic and other related factors. This is a fundamental issue for further research and investigation. Shor and Mansfeld (2009) investigated the characteristics of Israeli wine tourists in terms of their lifestyle attributes and wine-related behavior. The findings of the research show that wine tasting is the main motivation for visiting wine tourism sites, especially wineries, where the level of interest was higher than knowledge about wine and its production process. Getz (2000) indicated that wine tourism consists of three major components: wine producers, tourism operators and consumers. As a consequence, wine tourism provides marketing opportunity for wineries to teach and educate wine and potential customers and at the same time to their products, particularly to wine lovers or those who are interested in visiting preferred destinations (Getz and Brown, 2006a; Charters and Knight, 2002). Getz et al. (2007) indicated that "wine tourism is a special interest travel based on the desire to visit wine producing regions...", and extended the connection between wine industry and wine tourism. Understanding the life style of wine tourists and wine tourism experience, can also improve wine marketability and profitability for wineries and other partners in the wine production area. Dowling and Getz (2000) indicated that both the supply of wineries and consumer behavior demand should be taken into account. The concept of synergy of wine manufacturers and wine tourism elements can led to economic growth, particularly at 'new world' wine destinations, such as Napa Valley (USA) and Margaret Valley (Australia). To achieve this, the wine tourism council, in collaboration with wine industry and political stakeholders, should be the leading bodies in the development and marketing of wine tourism through the provision of the necessary infrastructure throughout the wine region. Cambourne et al. (2002) indicated that wine tourism is an emerging broad scope of interest associated with future potential of the wine tourism and industry at regional, national and international level. In that line they indicated that some wineries in Napa Valley have already started meeting the demand by supplementing wine tasting with wine education. Issues influencing future wine tourism and wine industry development are mainly, securing initial funding and regional financial commitments to development wine routes (Europe); loss of agricultural land to urbanization development (Canada) and access to land (South Africa); a lack of constant relevant information and data about impact of wine tourism associated with

wine industry (Canada/UK); ensuring that wineries see a tangible Return On Investment (ROI), which affects wine industry and tourism willingness to invest in product development initiatives (Australia); the unwillingness of the wine industry to commit resources to tourism participation (USA); difficulties in establishing a joint network for the wine and tourism sectors. Skinner (2002) indicated that there are some limits to wine tourism development, which requires detailed studies of elements within and around a wine region. This calls for a careful planning which incorporates all interested parties including local, regional authorities and government, vintners, wineries and wine tourism operators and most especially the local residents. It is recommended that smaller wineries should be regulated as closely as any large corporation. A good example of this is the wine route development in the Bairrada region of Portugal. Correira and Ascencao (2006) indicated the necessary steps of the process in the process of developing a wine route, which enables visitors to meet wine producers. Bras, Costa and Buhalis (2010) emphasized that after some previous failures to promote the development of the Bairrada Wine Route (BWR), it is important to involve a large number of economic partners and to gather public and political support, by organizing first-step actions and increasing network trust and communication. A dichotomous situation was highlighted by Fraser and Alonso (2006), who clearly indicated that wine tourism may present significant downside aspects to the business of making and marketing wine. In their research, it was very clearly indicated by some winery owners that the alleged benefits of wine tourism were insufficient to encourage them to engage in this operation. It clearly appeared that not every grower is willing to commit himself and to get deeply involved in wine tourism. The literature review highlights the fact that wine tourism research concentrates mainly on the characteristics of the wine tourist and on wine travel behavior rather than the wine manufacturer's perspective in relation to his business environment characteristics. Currently, the Israeli wine industry and tourism sector is faced with the dilemma of how to move forward. This emphasizes the need to further study and investigate wineries policy, wine tourism and official and regulator's, concerning the future steps and strategy which will lead the sector towards growth and prosperity.

## **RESEARCH METHODOLOGY AND APPROACH**

In light of the literature review, it is clear that the wine sector embeds both wine production and wine tourism. Intense development has taken place in Israel in the last decade that may lead the sector to reappraise its strategy, with the overall objective of increasing wine

consumption. This has yielded the following research question: 'What is the leading strategy of the wine sector, given the relationship between the wine industry and wine tourism, and what are the implications for the future?'. The hypothesis assumes there is a difference in the 'leading strategy' of various stakeholders groups which reflects their perception as to the strategic position of the wine sector. The study applies the SWOTCLOCK™ (Tirosh, 2010, 2013) and the TALC (Butler, 2006a, b) models. The research operated visits to wineries in all winery zones, as well as in-depth interviews with wineries owners, people at the Ministry of Tourism, at the Ministry of Agriculture, VWB and other stakeholders who are involved in the wine sector. Questionnaires were processed using the SPSS program for significance (OneWay ANOVA, 't-test'). Stakeholders were segmented into 5 groups: government ministries and VWB, big, mid, small & family wineries and independent stakeholders (wine consultants etc.). The sample size of 58 valid questionnaires as to the wineries groups' segmentation proportion is shown in Table 1:

Sample group	size
government ministries, VOB	6
big-size wineries (>1,000,000 bottles)	6
mid-size wineries (100,000-1,000,000 bottles)	9
small & family size wineries (10,000-100,000 bottles)	31
Other (independent consultants etc.)	4
Total	56

**Table 1:**

#### **Segmentation of research sample groups**

Some wineries which were approached, did not participate in the research, stating personal reasons and reservations, resistance to exposing business data and general suspicious. Empirical data concerning trends of vineyards' new plantation had been collected. A regression analysis was applied to test validity and compliance significance between the 'Leading Strategy' determined by the SWOTCLOCK™ model and related characteristics of the TALC model.

## **RESEARCH FINDINGS AND DISCUSSION**

### *Determination of the mutual 'Leading Strategy' of wine stakeholder groups*

The research methodology operates the SWOTCLOCK™ approach (Tirosh, 2010, 2013). The Leading Strategy derived from the SWOTCLOCK™ model reflects an 'equivalent vector'

determined by the relative 'power intensity' of four vectors: Strengths (S), Weaknesses (W) as internal vectors and Opportunities (O) and Threats (T) as external vectors. Bernroider (2002) indicated that the list of the external and internal factors is subjectively determined with reference and prior review. Factors in the questionnaire (Bernroider, 2002) are partly derived from components indicated in the literature review, while others came from the preliminary visits and interviews held at the wineries. 'Level of importance' (Weighted Factor) and 'strategic position' operate as two independent variables in the calculation procedure of each of the 'power intensity' of the four strategic vectors (S), (W), (O), (T).

The 'Level of importance' scores for each group factors should be 100%. Results of the average 'level of importance' (Weighted factors) are shown in Table 2: For the internal factors group, scores for the 'wine sector' show that 'wine know-how & technology' (12.9%) and 'wine culture' (12.9%) are highly important for the sector, followed by 'visitor center facilities' (12.2%), whereas the 'availability of database' factor is the least importance (4.4%). Results of the ANOVA analysis show significant results ( $p < 0.05$ ) for the 'wine equipment & facilities' factor, between Government & VWB and Big and Small & Family wineries, for the 'wine know-how & technology' factor between Government & VWB and Big wineries and Small & Family wineries, and for 'wine pricing' factor between Government & VWB and all wineries. Big wineries group rates the 'wine culture' factor at a lower level than other wineries groups. On the other hand, the 'winery equipment & facilities' and 'wine know-how & technology' factors are more important to Big wineries than to the other groups.

		Gov. & VWB	Big wineries	Mid Wineries	Small & Family wineries	Othe r	Wine sector
<b>Internal Factors</b>	Winery equipment & facilities	4.3	12.0	8.0	11.1	8.3	9.8
	Wine Know-how & technology	7.0	14.6	11.1	14.5	10.0	12.9
	Wines basket variety	3.0	7.6	5.2	5.2	4.3	5.2
	Wine region & terroir	6.5	11.4	12.3	12.4	10.7	11.7
	Wine standard	4.8	9.4	8.2	7.2	14.7	7.9
	Wine pricing	21.8	6.4	10.2	6.0	8.3	8.4
	Visitor center facilities	13.3	10.4	11.8	12.4	12.3	12.2
	Visitor center quality of service	11.5	10.4	8.5	9.3	5.3	9.2
	Wine tourism product variety	7.8	6.0	5.3	5.1	6.0	5.5

		Gov. & VWB	Big wineries	Mid Wineries	Small & Family wineries	Other	Wine sector
	Availability of database	4.0	3.0	6.1	4.0	5.0	4.4
	Wine culture	16.3	8.8	13.3	12.8	15.0	12.9
	Total (%)	100.0	100.0	100.0	100.0	100.0	100.0
External Factors		Gov. & VWB	Big wineries	Mid wineries	Small & Family wineries	Other	Wine sector
	Wine market demand	18.3	18.8	12.9	9.6	5.7	13.6
	Ministry of Tourism policy	6.3	8.4	10.3	8.9	5.7	9.1
	Ministry of Agriculture policy	11.8	7.6	8.1	7.6	7.3	8.1
	VWB policy	6.3	9.4	6.9	6.5	5.7	6.8
	Ministry of Industry & Trade	8.8	9.0	6.5	6.9	7.0	7.2
	Investors willingness	8.5	9.6	12.3	9.6	9.3	10.1
	Economy & security	5.3	9.6	10.4	11.9	15.0	10.9
	Availability of financial support	4.3	8.6	8.2	9.0	6.0	8.2
	Wine trail & tourism development	13.3	10.6	12.8	12.7	15.3	12.7
	HR availability	4.8	3.6	4.2	5.3	3.3	4.7
	Regulations & standards	12.8	5.4	7.4	8.8	11.7	8.7
	Total (%)	100.0	100.0	100.0	100.0	100.0	100.0

**Table 2 Internal and External Weighted Factors (%) by stakeholders groups**

For the external factors group, scores for the 'wine sector' show that the 'wine market demand' factor (13.6%) is the main concern of all groups, followed by 'wine trail & tourism development' (12.7%) and 'economy, security & ecology' factor (10.9%). Least important is the 'HR availability' (4.7%) factor. Regarding the 'regulations & standards' factor, the Government & VWB (12.8%) and Other group (11.7%), rate this factor higher than the winery groups. The 'strategic position' (currently) is determined along a Likert type scale. Calculated results of the current strategic position (average) are listed in Table 3:

Strength score scale: 4, 5, 6 Weakness score scale: 0, 1, 2		Gov. & VWB	Big winer ies	Mid winer ies	Small & Family winer ies	Othe r	Wine sector
<b>Internal Factors</b>	Winery equipment & facilities	5.8	5.5	4.8	5.1	5.7	5.1
	Wine Know-how & technology	5.5	5.5	4.9	4.5	5.0	4.8
	Wines basket variety	3.8	5.0	3.7	4.3	5.0	3.9
	Wine region & terroir	2.3	2.5	1.2	3.2	2.0	2.2
	Wine standard	1.0	1.2	1.3	1.7	2.3	1.5
	Wine pricing	1.0	4.5	3.3	2.5	2.7	2.9
	Visitor center facilities	3.0	3.2	2.3	2.0	3.0	2.4
	Visitor center quality of service	3.3	4.3	4.7	3.6	3.3	3.8
	Wine tourism product variety	3.8	2.2	3.0	3.2	2.3	3.1
	Availability of database	0.5	1.3	1.6	0.7	0.7	1.0
	Wine culture	0.5	3.2	2.6	2.1	1.7	2.1
Opportunity score scale: 4, 5, 6 Threat score scale: 0, 1, 2		Gov. & VWB	Big winer ies	Mid winer ies	Small & Family winer ies	Othe r	Wine sector
<b>External Factors</b>	Wine market demand	0.3	3.2	3.3	3.4	3.00	3.1
	Ministry of Tourism policy	4.0	2.2	2.4	3.0	1.7	2.8
	Ministry of Agriculture policy	5.5	2.6	2.3	3.0	3.3	3.0
	VWB policy	6.0	3.0	2.3	3.1	4.0	3.2
	Ministry of Industry & Trade	2.0	3.2	2.1	2.3	2.7	2.3
	Investors willingness	3.8	4.0	2.9	2.6	3.3	2.8
	Economy & security	1.8	2.4	1.9	1.6	1.0	1.7
	Availability of financial support	2.3	3.6	2.3	2.0	3.7	2.3
	Wine trail & tourism development	4.8	4.0	4.6	4.9	5.0	4.7
	HR availability	4.8	4.4	4.2	3.4	4.7	3.9
	Regulations & standards	1.3	2.4	2.5	2.6	0.7	2.3

**Table 3 Strategic position by stakeholders groups**

For the internal factors group, all stakeholders groups perceive 'winery equipment & facilities' (5.1) and 'wine know-how & technology' (4.8) as very strong areas of the sector, as opposed to 'wine standard' (1.5), 'availability of database' (1.0), 'wine culture' (2.1) and 'wine region & terroir' (2.2) as weak areas of the sector. Significance in difference of opinions among the groups ( $p < 0.05$ ) is found regarding the 'wine pricing' factor, between Government & VWB

and Big and Mid wineries groups. In addition to that, Big wineries consider the 'wine pricing' factor as very strong (5.0) but it drops to 3.7 score for Mid wineries and to 2.5 score for Small & Family wineries. This means that Big wineries perceive current pricing level as a point of 'strength', but that it is perceived as a 'threat' to the Small & Family wineries. For the 'availability of database' factor, a significant difference was found between Government & VWB opinion and Mid wineries. Significant different exists regarding the 'wine culture' factor, between Government & VWB and all wineries groups. For Big wineries group, the 'wine culture' factor score is 3.2 (slightly strong) but drops to 2.6 (slightly weak) for Mid-size wineries and 2.1 (quite weak) for Small & Family wineries. This means that Small & Family wineries seek to increase wine culture, which is important issue for them, more than for Mid and Big wineries. Regarding the external factors, 'development of wine trail and tourism' factor (4.7) is perceived by all stakeholders group as the biggest opportunity for growth, followed by 'HR availability' (3.9). All other external factors' scores are at the break-even position (around 3.0) or below on the Threats side (3.0<). An Interesting result is the significant difference ( $p < 0.01$ ) between the Government & VWB, Ministry opinion as to their perception of their own policy in relation to the wine sector. They rank the 'Ministry of Tourism policy' (4.0), 'Ministry of Agriculture policy' (5.5) and 'VWB policy' (6.0) as big opportunity for the wine sector; however, Big and Mid wineries perceive their attitude as a kind of a 'threat' to them and the Small & Family wineries are indifferent to them (3.0). A significant difference was found concerning 'wine market demand' where the Government & VWB perception was that currently this factor threatens the sector, compared to the other groups which feel that the current wine demand is neither a threat nor an opportunity to the sector.

The intensity value of each of the SWOTCLOCK™ vectors (S), (W), and (O), (T) is calculated as the multiplication of the level of importance score by the current strategic position. The product of the relative weight (100%) in formation of the indifferent '3' score position is:-300. When the vector value of the internal factors is greater than 300 (positive value), it means that the 'organization' is 'stronger' than 'weaker' and vice versa when it is less than 300 (negative value). When the vector value of the external environment is greater than 300 (positive value), it means that there are more 'opportunities' than 'threats' and vice versa. Results of the intensity vectors are presented in Table 4:

No.	Internal Factor	Gov. &	Big	Mid	Small &	Other	Total	Sig. between groups
		VWB	wineries	wineries	Family		sector	
1	Wineries equipment & facilities	24.25	66.00	36.80	54.36	48.33	48.91	0.047
2	Wine know-how & technology	38.25	80.40	53.90	66.88	51.67	62.10	0.171
3	Wines basket variety	8.75	39.00	18.00	19.52	21.00	20.45	0.052
4	Wine region & terroir	15.50	31.20	18.60	33.50	17.70	27.55	0.621
5	Wine standard	5.50	10.20	10.70	11.68	31.33	12.04	0.093
6	Wine pricing	3.50	27.60	29.90	14.80	23.33	18.96	0.020
7	Visitor center facilities	26.00	38.60	26.10	27.84	39.33	29.19	0.680
8	Visitors center quality of service	26.25	47.80	40.50	35.60	15.00	35.83	0.354
9	Wine tourism product variety	20.00	19.00	15.50	17.00	19.33	17.29	0.981
10	Availability of database	1.50	3.60	8.60	3.76	3.33	4.55	0.019
11	Wine culture	5.00	28.40	35.60	29.08	26.67	28.19	0.052
	TOTAL	174.50	391.80	294.20	314.02	297.02	305.06	0.067
300	Internal vector intensity	(125.50)	91.80	(5.80)	14.02	(2.98)	5.06	

No.	External Factor	Gov. &	Big	Mid	Small &	Other	Total	Sig. between groups
		VWB	wineries	wineries	Family		sector	
1	Wine market demand	1.00	61.60	39.60	42.28	30.00	39.47	0.057
2	Ministry of Tourism policy	38.85	22.20	26.00	28.12	10.67	25.68	0.073
3	Ministry of Agriculture policy	63.25	22.40	18.60	22.48	20.00	24.96	0.020
4	VWB policy	55.05	33.20	14.40	20.28	22.67	22.02	0.084
5	Ministry of Trade & Industry	12.00	30.00	13.40	15.56	18.33	16.51	0.044
6	Investors willingness	37.25	40.20	38.60	23.36	30.00	30.00	0.511
7	Economy & security	8.00	23.20	20.30	17.60	16.70	17.89	0.616
8	Availability of financial support	7.75	35.20	20.70	17.80	18.33	19.44	0.213
9	Wine trail & tourism development	72.75	46.40	59.50	61.44	82.00	61.70	0.709
10	HR availability	15.25	14.40	17.90	16.92	15.67	16.64	0.981
11	Regulations & standards	1.25	12.40	19.70	22.64	8.33	18.19	0.056
	TOTAL	312.40	341.20	288.70	288.48	272.70	292.50	0.180
300	External vector intensity	12.40	41.20	(11.30)	(11.52)	(27.30)	(7.50)	

**Table 4 Internal and External Vector Intensity of various groups**

Regarding the internal vector intensity, 'wineries equipment & facilities' (48.91) and 'wine know-how & technology' (62.10) are the core contributors to the strength of the sector, particularly the Big wineries position (66.00 and 80.40, respectively) but significantly ( $p=0.047$ ) opposed to the Government & VWB position (24.25, 38.25). 'Visitors center facilities' (29.19), 'visitor center quality of service' (35.83) are the second most contributors, particularly

for Big wineries (38.60, 47.80 respectively) which operate established visitor centers. Mid and Small & Family wineries score these factors lower and feel that much more should be done to strengthen current facilities and service provided at the wineries (facilities, training etc.). 'Wine region & terroir' (28.19) and 'wine culture' (27.55) are ranked the third important factors contributing to the strength of the wine sector. A significant difference ( $p=0.052$ ) was found between Government & VWB position and other groups regarding the 'wine culture' factor. It was indicated by all stakeholders that a big emphasize should be put on developing a 'wine region' (terroir) and 'wine trails', as well as wine culture awareness program. This will differentiate and enhance wine regions and wine tourism, the domestic market and even more for export purposes. This is followed by 'wine tourism product variety' (17.29 score) with no significant difference among the groups. The overall view is that currently, this factor does not contribute much and therefore there is a need to extend the variety of wine tourism products such as festivals and events, restaurants, B&B and other complementary tourism activities in the wine region. The groups feel that 'availability of database' (4.55) is the least significant contributing factor to the strength of the sector and that at the moment it is not top priority. Contribution of the 'wine basket variety' factor (20.45) is ranked moderately: for Big wineries (39.00), the basket contributes more strength than for Mid and Small & Family wineries (18.00, 19.52), with significant difference from the Government & VWB position (8.75,  $p=0.052$ ). Concerning external vector intensity, 'wine trail & tourism development' factor provides the biggest opportunity (61.70) with no significant difference between the groups. Small & Family wineries perceive it higher (61.44) than Mid wineries (59.50) and Big wineries (46.40) mainly because they rely and depend much more on cellar door sales and the wine tourism system. Next comes the 'wine market demand' factor (39.47) headed by the Big wineries group (61.60) but with significant difference ( $p=0.057$ ) from the Government & VWB (1.00) and 'Other' (30.00). An interesting finding is that Government & VWB group members perceive their own policy contribution as high 'opportunity' (38.85, 63.25 and 55.05 respectively) for the sector, contrary to all other wineries group which rate this significantly below 30 score ( $p=0.073$ ,  $p=0.02$ ,  $p=0.084$ ). The 'investors willingness' (30.00) and 'availability of financial support' factors (19.44) reflect low opportunity level for wine tourism development. Government & VWB as well as Big wineries and 'Other' groups rank willingness higher than Mid and Small & Family wineries, while all are of the opinion that current financial support is not much sufficiently available, particularly Government & VWB (7.75), compared to Big wineries (35.20) which can get financial support easier than Mid and Small & Family wineries. 'Regulations and standards' (18.19), 'economy & security' (17.89),

'HR availability' (16.64) and 'ministry of Trade & Industry' are the factors that provide the least opportunity to the wine sector. The 'Leading Strategy' is determined as the equivalent vector of the calculated relative intensity vector of the internal vectors (S) and (W), and the external factors (O) and (T), and summarized for the various groups as shown in Table 5:

	Gov. & VWB	Big wineries	Mid wineries	Small & Family	Other	Total sector	Sig. between groups
Internal vector intensity	-125.50	91.80	-5.80	14.02	-2.98	5.06	0.047
External vector intensity	12.40	41.20	-11.30	-11.52	-27.30	-7.50	0.073
Leading Strategy	<b>LEVERAGE</b>	<b>GROWTH</b>	<b>SURVIVAL</b>	<b>RESPONSE</b>	<b>SURVIVAL</b>	<b>RESPONSE</b>	

**Table 5 'Leading Strategy' position for wine stakeholder groups**

The 'leading strategy' of the wine sector is perceived as RESPONSE. The Big winery group determines GROWTH as the 'leading strategy', compared to RESPONSE of the Small & Family wineries group, LEVERAGE by the Government & VWB group and SURVIVAL for Mid wineries and the 'Other' group. Resulted leading strategy position of each group is shown in Figure 1.

The small population size of about 250-300 Israeli wineries in total, and the reluctance of some wineries to participate, affect the sample size of valid questionnaires (56) and partly the significance in difference of strategy factors between some groups. The recommended sample size for significance ( $p < 0.05$ ) was calculated by the G\*Power3 model software, based on the results of the 't'-test, and the difference between the average amount of internal and external factors that determines the 'leading strategy'. In the case where the sample size of Big, Mid and Small & Family wineries will be equal ( $n_1 = n_2 = n_3$ ), the required calculated sample size ( $p < 0.05, 0.95$ ) is 95 for each population group. Practically this is not achievable since to such because the number of Big and Mid wineries is smaller than the recommended sample size.

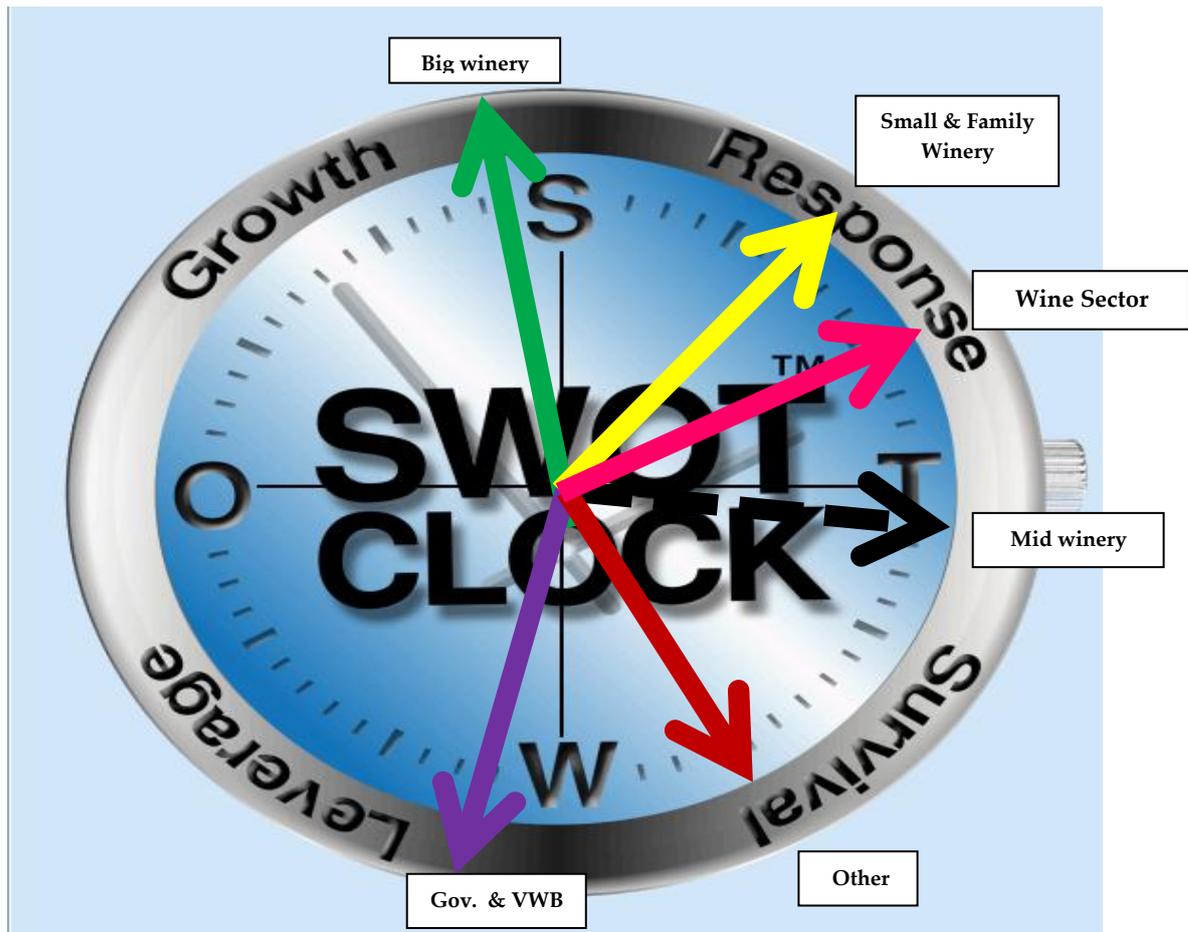
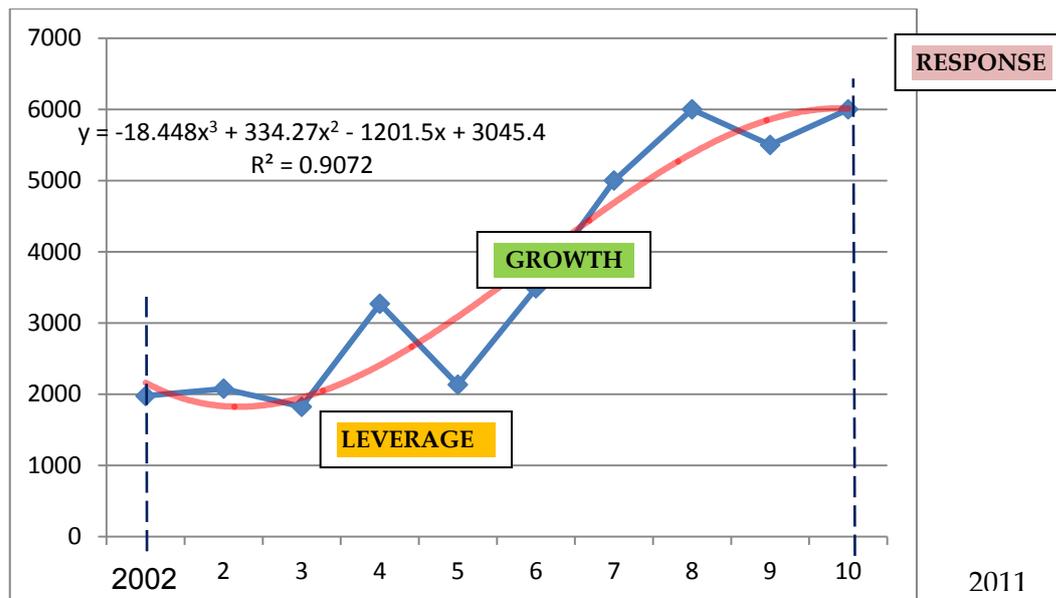


Figure 1 'Leading Strategy' of wine sector stakeholders groups

## ANALYSIS OF EMPIRICAL DATA

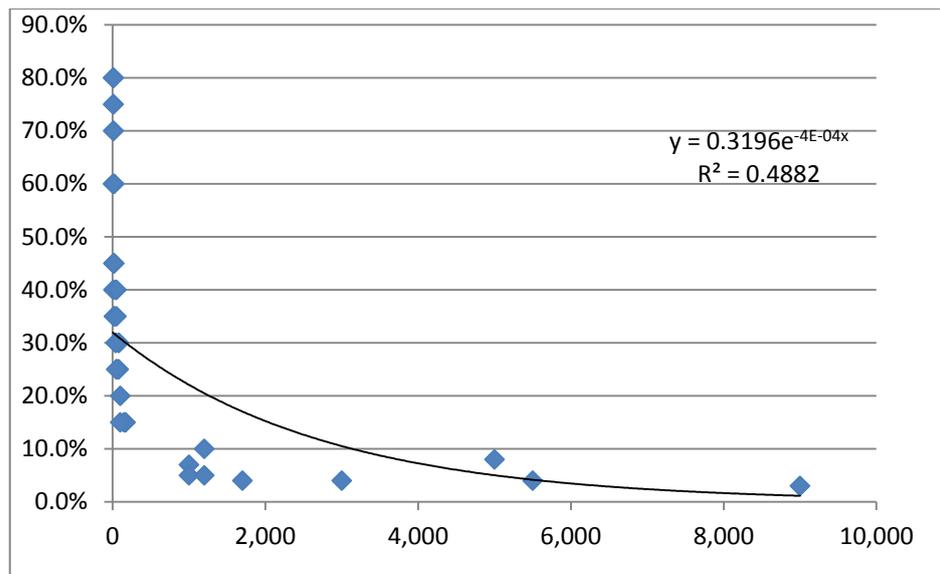
The SWOTCLOCK™ model (Tirosh 2010, 2013) assumes a validation and compatibility between the developmental stages of the TALC model (Butler 2006a, b) and therefore the second research question concerns the compliance between the models. An official database for the wine industry and tourism is almost nonexistence, so the analysis is based on VWB empirical database which tracks vine plantation and it can be used as a yardstick which reflecting the development trend of the sector. Results of the empirical analysis correspond to the characteristics of the TALC model and thus support, confirm and validate the basic assumptions of compatibility to the SWOTCLOCK™ model, as shown in Figure 2:



**Figure 2** New vineyard plantations ('000 m<sup>2</sup>)

The actual new vine plantation has high matching polynomials ( $r^2=0.9072$ ) fit. This behavior shows a trend change in the leading strategy since 2002, from LEVERAGE in 2002 to GROWTH in the period 2004-2009 and turning to RESPONSE from 2010 until today. That is very similar to the sequence of behavior stages of the TALC model, where the 'exploration' stage is followed by 'growth' and then by 'stagnation'. Results of the empirical analysis correspond to the characteristics of the TALC model and thus support and confirm the basic assumptions of compatibility to the SWOTCLOCK™ model.

Big wineries distribute most of their production through wholesale networks. Therefore, the assumption is that direct wine sales in Small & Family wineries are proportionally higher than in Mid and Big wineries. Empirical data of the proportion (%) of direct wine sales at the winery was collated from the questionnaires and the interviews. A regression analysis shows the between the direct Volume of Sales (VOS) (%) at the cellar door and visitors center out of the total VOS of the winery, as shown in Figure 3:



**Figure 3: Direct VOS (%) at wineries**

From the resulting calculated formula and the correlation coefficient ( $r^2=0.4882$ ), it is clear that Small & Family wineries sell most of their wine production on site (VOS > 35%) compared to the Mid wineries (VOS < 15%) and Big wineries, where this take place at the visitors center (VOS < 8%). The conclusion is that Small & Family wineries are much more directly related to wine visitors and that therefore, wine culture and wine tourism are key issues for them more than for Mid and Big wineries. This correlates also to the 'level of importance' perception of the 'wine culture' factor (12.8%) compared to the Big wineries group (8.8%).

## SUMMARY AND CONCLUSIONS

Over the last two decades, the wine and wine tourism in Israel are experiencing rapid growth, regarding production and marketing. That is characteristically the behavior of a fast growing and emerging young industry which is facing the strategic dilemma of 'how to determine the best way to move to sustain and expand growth'. The research questions focus on identifying the strategic positions of various stakeholder groups in the wine sector. Two typologies, SWOTCLOK™ and the TALC models, approached the dilemma different angles and the results of the study show a compatibility and validity between them. Stakeholder groups indicate a different 'leading strategy' for the wine industry and tourism. Big wineries feel that currently the sector operates a GROWTH strategy, compared to the RESPONSE strategy indicated by Small & Family wineries and to the Government & VWB LEVERAGE

strategy and the SURVIVAL strategy of Mid wineries and the 'Other' group. The overall equivalent 'leading strategy' of the sector is RESPONSE. Particularly, a significant difference and gaps were found between the Government & VWB position and the other groups. Currently most wineries operate visitors centers, 'cellar door' and wine tasting activities, but other components of wine tourism such as wine trail, terroir & region tourism network (Bras, Costa, Buhalis, 2010) are only at the early stage of development. This pattern of behavior indicates that the wine sector is reaching a deflection period from 'stability and stagnation' to 'rejuvenation, involvement and development according to the TALC model, and from 'response' to 'leverage', according to the SWOTCLOCK™ model. All groups indicate that the development of wine regions and wine trail is the appropriate step to boost wine culture and wine tourism, which can bring an increase in wine consumption. Gaps found among the groups could be closed if Government & VWB were to play a **bigger and leading role** in promoting wine awareness, culture and education, through intensive advertising schemes, developing wine routes & trails and wine region (terroir), in collaboration with local authorities and wineries. Findings ranked 'wine culture' and 'wine trail & tourism development' as major factors together with the 'winery equipment & facilities' and 'wine know-how' factors, reflecting the strengths of the sector. Since Mid and Small & Family wineries do not have enough marketing and economic power for developing wine regions (terroir) and trails, Government & VWB and local and regional authorities should take the lead role in this area. Although Big wineries market is not directly related to wine tourism activities, as it is for Mid and particularly Small & Family wineries, they should participate given the benefit they can gain from the enhancement of wine culture, education and exposure to wine consumption. Wine tourism in Israel is facing two major regulatory barriers: the restriction on constructing and operating winery (industrial entity) at a vineyard site (agricultural entity); and the Jewish religious restriction stipulating that 'Kosher' winery must be closed on Saturdays and Jewish holy days. The negative affect is that wine visitors and tourists cannot maximize their vineyard and winery visit experience and that some potential wine marketing segments do not have access to wineries visit during the peak time of weekends and holidays. The research findings and recommendations set a big challenge to the wine industry and wine tourism in Israel in order for it to meet overall objectives of increasing wine consumption, attracting more domestic and incoming wine and other tourists, but also enhancing and expanding the export of Israeli wines through the establishment and differentiation of wine regions (terroir), branding and producing top quality unique wines.

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## WORK-FAMILY BALANCE IN CHILDCARE CENTERS: IS SUPPORT RELATED TO PARTICIPATORY MANAGEMENT?

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### ABSTRACT

This article analyses organisational support to work-life balance measures and policies in the childcare centers in the social economy (i.e., excluding the private childcare centers). It shows that the social economy sector is more supportive, and also shows that the mission and management approach (participatory decision-making process) influences organizational support to work-family (WFB) or work-life balance (WLB) and the perception of WLB-related issues. The quantitative data show that this subsector is more supportive than others which we studied. The qualitative part of the research shows that the specificity of the social economy sector, i.e., mission and participatory management, explain the stronger support of WLB in that subsector.

**Keywords:** organizational support, work-family conflict, work-life balance, childcare, early childhood centre, daycare, social economy.

### INTRODUCTION

Work-family balance has been the object of much research over the last three decades. Historically, research has centered on the difficulties facing parents of young children (Guérin *et al.*, 1997), but it now examines the measures and policies developed by organisations to support work-family articulation (Fusulier *et al.*, 2006). Certain studies (Haas *et al.* 2002; Lewis 2001) also analyse the organisational culture and the attitudes and behaviour of colleagues and managers, and highlight their role as key determinants in work-life balance.

Some research has shown that large firms and public organizations might be more favourable to work-life balance, yet Guerin *et al.* (1997) observed that organisational culture

does influence the degree or extent of work-family conflict. It appears that organisations can play a favourable role in the development and implementation of family-friendly practices and policies (Fusulier *et al.*, 2008). However, while comparisons have been made between various types of organisations, we have seen no attempt to test the idea that a participatory management style (as in the social economy) could have an influence on the management of work-family balance. We therefore decided to analyse some organizations of the social economy. Our research is based on Québec early childhood centers in the social economy sector. These are called *Centres à la petite enfance* (CPE), to distinguish them from private daycare centers, known as *garderies* (daycare). When speaking of childcare centers, we will refer only to these social economy organisations (CPE).

We will investigate the incidence of organisational culture on the perceptions of work-life articulation in organisations with a social mission and more democratic management style. We focus on the study of social economy early childhood centers to determine if their social mission and management style has an influence on the organisational support and the perceptions related to work-family balance. Before discussing the findings, we present the research methodology and a review of the literature on organisational support and work-life balance.

## **1. WORK-LIFE BALANCE AND ORGANISATIONAL SUPPORT**

Research has identified various work environment that influence the degree or scope of work-family conflict. Family-friendly practices as well as the support of colleagues and management have been found to have a significant impact to reduce work-family conflict. Some research stresses the importance of organisational culture as well as the attitudes and behaviour of colleagues and managers in the analysis of work-family conflict (Haas *et al.*, 2002; Lewis, 2001). An American survey carried out by the Families and Work Institute (1998) has shown that a demanding job and lack of organisational support tend to stress employees, make them less resilient in the face of difficulties, ill-tempered and less energetic after work, all of which may contribute to reduce personal and family wellbeing. This can generate the transfer of family problems to the work environment, which could reduce employees' productivity. Organisational support to work-family balance thus appears as a key element to increase both organisational productivity and employees' wellbeing.

The survey carried out by the Families and Work Institute (1998) indicates that the most important determinants of the availability of programs and policies, but also, by order of importance: the sector of activity, the size of the organisation, and the proportion of women holding executive positions. This led us to pay particular attention to specific sectors and to retain male and female working environments since the proportion of women in the workforce and the proportion of women in management are generally concurrent. In previous work (Tremblay, 2012) we compared male and female sectors, but did not confirm this observation of female sectors being more supportive. We thus decided to investigate management styles as research has not yet differentiated organisations according to their management mode. We thus investigate a sector with participative or more democratic organisations to see if they differentiate themselves from the traditional hierarchical organisations studied earlier (Tremblay, 2012). Our research thus dealt with large public organisations and social economy organisations, but we concentrate here on the latter. First, we present the social economy sector and early childhood centers.

## 2. THE SOCIAL ECONOMY SECTOR AND EARLY CHILDHOOD CENTRES

Social economy enterprises display unique characteristics. Originally created to cater to the needs of individuals and local communities, these community-based organisations are involved in economic development based on human values. In these organisations, rules and operational processes are designed to recognise and take into account the social dimension that should permeate economic development. The rules and principles that guide the social economy are as follows (from the *Chantier de l'économie sociale* online):

- The purpose of a social economy organisation is to serve its members or the community rather than simply generating profit or securing return on investment (ROI)
- Management is independent from the State
- Statutes and the operations include *democratic and participatory decision-making* processes that involve both users and workers
- In the distribution of its surpluses and revenues, the firm promotes the primacy of persons and of work over capital
- Activities are based on participatory principles, self-empowerment, and on individual and collective responsibility.

The social economy is thus a sector in which social values are strongly conveyed within the mission statement and objectives. We investigated the social economy sector in order to determine whether a democratically managed work environment is more receptive to work-family concerns.

### 3. METHODOLOGY

Our investigation is based on qualitative and quantitative methods (Creswell & Plano Clark 2006; Patton 1990). We first conducted a quantitative survey requesting participants to answer an online questionnaire, followed by a qualitative investigation using semi structured interviews.<sup>31</sup> The online questionnaire consisted of questions on existing measures or policies within the organisation and on measures that respondents expected from the organisation. We wanted to capture the respondents' perception of the support available from both management and colleagues in the workplace regarding family responsibilities. Participants were also surveyed on different aspects of leave for family reasons and on parental leave. Finally, we asked our respondents whether they were satisfied with the way they could balance their professional and family responsibilities.

#### *Respondents' profile*

To qualify as respondents in our survey, participants had to be employees responsible for at least one child under the age of 18. In the social economy sector, 423 persons completed the survey—28 men and 395 women. Among the respondents, 69% work in early childhood centres, 14% in cooperatives and 17% in not-for-profit enterprises (NPO). This article is concerned with the childcare sector, which counts 293 respondents: 289 women and 4 men.

In CPEs, 68% of respondents are employees while 32% are managers. Overall, 94% are employed on a regular basis. Further, more than 80% of our respondents are 45 years old or younger and more than a third (36,2%) have at least one (1) child 6 years old or younger, 52% have at least one (1) child between the ages of 6 and 12, and 50% have at least one (1) child between the ages of 12 and 17. A majority of employees enjoy occupational seniority with

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<sup>31</sup> At the conclusion of the online questionnaire, participants interested in meeting with us were invited to provide their contact information; we were then able to proceed with the second phase of the research in face-to-face interviews.

their current employer: 30% have more than 10 years, 32% between 6 and 10 years, and 37% have 5 years or less. Further, 87% of respondents live with a partner and 53% of the partners have a higher income of up to \$10,000 more for 42% among them, which may have an impact of WLB and the division of duties. Approximately 74% of CPE work environments are in an urban setting and 26% in rural areas (see Appendix for detailed CPE respondent profiles).

## **4. RESULTS**

The quantitative data collected indicate that respondents' perception of and overall satisfaction with work-life articulation is rather positive within their work environment.

### **4.1 An organisational culture generally open to work-life issues**

First, the data clearly indicates our respondents' satisfaction with the organisational support they have for work-family issues. In the online questionnaire, five questions covered organisational culture, the support provided by the supervisor, and the respondents' ability to manage family and professional responsibilities. To the statement "Your organisation is a work environment that supports work-family balance", approximately 10% of participants replied "rather disagree" and "disagree totally", while 80% replied "rather agree" and "agree totally"; 10% of respondents remained neutral.

Statistical analyses were conducted to determine whether differences existed among the types of organisations (CPE, cooperatives, NPO) with respect to work-life articulation. No significant difference exists in this respect: the three social economy sectors concerned equally support work-life articulation. However, when comparing the social economy sector with the social work, nursing and public safety (police) subsectors (presented in Tremblay, 2012), important differences appear among all the groups and the effect size is important ( $p < 0,05$  — large effect size,  $r^2 = 0,285$ ). Therefore, definite differences exist between large public sector work environments and the social economy sector, the latter being more supportive of work-family balance. CPEs are the outstanding subgroup within the social economy sector herein studied and the statistical analysis identifies them as a work environment more conducive to work-family balance.

To the question "Overall, do you encounter difficulties in balancing your family and professional responsibilities?", only 5,6% indicated frequent problems while more than 55%

have no such problems and 30% only occasionally. Likewise, to the statement “I have the feeling that I’m successful in balancing my professional life and my family life”, more than 73% of respondents replied they were rather in agreement or in full agreement with the statement, while 11% remained neutral. We have seen, in the statistical analyses, that the social economy sector is different from the police subsector in this regard among others, but the difference is small here ( $p < 0,05$  – weak size effect,  $r^2 = 0,050$ ) and we were not able to establish significant differences with the other groups under study.

Some 98 % of respondents in CPEs stated that they are satisfied with their job. And only 9% of participants believe that it is not within the culture of their work environment to take leave for family reasons, and less than 5% say the same for parental leave. The CPE work environment is therefore open to work-family issues and work leave for family reasons.

Statistical analyses show that respondents are more satisfied in the CPE subsector and there is a significant difference with the two other social economy sub-sectors (although the size effect is very weak :  $p < 0,05$  – very weak size effect,  $r^2 = 0,026$ ); it is difficult to conclude with certainty since there are few subjects in the “unsatisfied” groups. We were not able to observe any significant difference either among job designations (employer-director, employee), according to the presence of a partner (few do not have a partner) or the presence of a child or children between 0 and 5 years of age.

A large majority of respondents think that their work environment is very supportive as concerns work-family issues and that they succeed quite well in balancing their professional and family responsibilities. Nothing is perfect and a number of issues were mentioned during the face-to-face interviews although not to such extent as was observed in other work environments. Here, in CPEs belonging to the social economy sector, support provided by management and colleagues is definitely higher. In order to better understand such positive perception among our respondents, we asked them to explain or provide examples of how their work environment in the SES (social economy sector) actually supports work-family balance.

#### **4.2 Selecting a social economy job for its work-family measures**

We know that work-life measures are important incentives that attract new employees (Tremblay, 2008). In this sense, social economy enterprises and CPEs in particular seem to

have a very positive reputation concerning their approach to work-life; it would seem that this top-notch reputation is known beyond the social economy sector itself.

Certain persons among our respondents stated that they left a job in the private sector to work in a CPE precisely because work-family balancing would be easier there. For them, the workload and work schedule in their former job did not take into consideration a working parent's family responsibilities. For example, two mothers formerly had a very stimulating career in another sector of activity with a private company but did not find any support regarding their family responsibilities. They decided to change jobs and found what they were looking for in social economy organisations: "When I left my last job, honestly, I gave it up precisely because family and career were at odds [...]. Then, in any case I waited and applied [...] and I was very lucky because it's... it is really a dream come true." Another said: "I was even ready to sacrifice the kind of job, you know, just to have this balance [...] Therefore, I wanted to find balance and I think, for me at least, for our family, we found it and it is working out real well for us."

Other respondents who are thinking of reorienting their career will wait until the children are older in order to take advantage of work-life measures in the CPEs: "No, I will not stay in this job forever. I like it here, it's good for my family. I have young children, 13 and 10 years old, and things are OK for now in my life. But in 5 years, I think I'd rather look for something else. [...] maybe take up a job that is less flexible... For now, however, I need flexibility, that's the critical requirement."

For others, working in a social economy organisation such as a CPE means lower wages than what they could earn or were actually earning elsewhere, but the loss is largely offset by all the possibilities not otherwise available to better attend to one's family. One respondent did not hesitate to leave a well-paid and prestigious job in favour of a position as director of a social economy organisation: "So they told me outright: 'We can't offer you that kind of money. So, what is the rock bottom salary you would accept if you were to help us?' I realized that the job would earn me much less money but I would have comparative advantages, access to work-family measures especially."

#### **4.3. A sector with a human touch for lone-parent families and fathers**

Our data show no difference in satisfaction between lone-parent families and others with regard to one's capacity to balance work-life issues and organisational support in these organisations. For certain lone mothers, the social economy sector is particularly open to their situation. For example, a young lone mother recounts having lost her job repeatedly because of her status until she found employment in a cooperative, where she encounters understanding and support from her supervisor. Other testimonies gathered in the CPE sector support this vision.

One last type of comment shows the openness of CPEs toward work-family balance; according to our respondents, male employees are also concerned with the work-family issue. The participation of fathers in paternity leave following birth or adoption has risen in Québec and almost 80% take leave in one form or another. On average, men in Québec take seven (7) weeks off (Doucet and Tremblay, 2009). Many managers note that when it is necessary to leave work for family reasons (sick child), male employees who live with a partner will take leave more often than their spouse when the latter does not work in a CPE. From management's point of view, the measures available in the specific sector foster leave take up by employees regardless of gender: "For example when we had men working here at the CPE and their wife worked in another field, the man would take time off." Observations by management are substantiated by male employees who estimate that they indeed take leave for family reasons more often than their partners because the latter's work environments are not as flexible. While they recognize that nothing is perfect and that holding a full-time or part-time job involves different constraints, many respondents believe that work-family articulation measures designed for them by their employers are a definite step toward an explicit ideal. In CPEs, the service offered to the community is self-promoting by definition, i.e., it supports the very idea of work-life balance. This in turn leads CPE directors to a more sensible outlook on such issues in their own work environments and to take them into consideration in their management practices.

#### **4.4 CPEs' outlook on work-life balance**

Our respondents identify several factors which can explain CPEs' support to work-family balance, and relate them to the organizational culture. As mentioned above, doing things differently is the social economy's *modus vivendi*. Social economy organisations are indeed different; their history, and above all their social mission contribute to their unique

organisational culture and openness. Further, it should be noted that despite the social mission inherent to the social work sector, which we also studied (Fusulier, Tremblay & di Loreto, 2008), that sector does not provide as much organisational work-family support. Many respondents will spontaneously amalgamate the values of social economy businesses - especially CPEs - and work-family concerns; they consider that their work environment is more receptive to work-family balance. We mentioned earlier that the social economy and the CPE's childcare approach stem from citizens' common concern for needs that are overlooked or ill-served by the state, and respond to individuals' needs as opposed to corporations' needs and profit-making. For our respondents, it is only natural that these organizations support their employees. It is clear that the tradition of advocacy and the non-hierarchical character of the organisation extend the social mission into organisational support to employees, and this is what differentiates CPEs from social work (Tremblay, 2012). For example, according to our respondents, unionist and cooperative values at the root of many community organisations explain why work-family measures are included in the working conditions of employees in the CPEs. Community organisation coordinators respect the social values advocated by the founders of the CPEs in supporting their employees. Another respondent relates work-family issues to community issues and feminism. For him, the employer's openness to family values and fathers' responsibilities are an extension of the values that are at the origin of community-based organisations in the first place.

#### **4.5. Mission, activities and operating rules**

Operational rules and principles that govern social economy enterprises including CPEs promote the well-being of individuals and communities. In addition, according to a most prominent organisation in the field (*Chantier de l'économie sociale*), the main distinguishing characteristic of social economy organisations is to blend economic activity and social mission. The persons we interviewed believe that if social mission is intrinsically part of the organisations' activities and operations, it is only natural that the employer would be sensitive to work-family issues and that the organisation's management would reflect that mind-set.

When we asked a CPE educator if she believed that the availability of work-family measures put forth by her employer had anything to do with the mission of the enterprise, she replied without hesitation: "Yes, yes. It is all included in the childhood centre's policies. It is clearly stated in the organisation's mission that work and family concerns be addressed. [...] Indeed,

yes. Everybody working here naturally considers that family comes first.” For a CPE director, work-family balance and CPEs, the mission is based on a clear rationale: “In our CPEs, our mandate is to take care of children, we spend all our time doing that. And when they are sick, we call the parents to inform them and ask them to pick them up [...] I, for one, ask them: ‘please come and pick up your child immediately.’ So then in similar circumstances, how can I tell one of my own employees ‘no, you can’t leave, forget about your child.”

Many respondents indicated that in their organisations the decision-making process was generally based on team work. As well, we have seen that the social economy organisations integrate within their organisational rules and principles “a democratic decision process involving both users and workers”. While a large majority of persons interviewed work in organisations headed by a management team or coordinating office responsible for the decision process, most of them, whether managers or employees, have indicated that the decision-making process is often done with the employees or at least discussed among colleagues. For example, managers will often submit proposals or ask the employees for their opinion on matters of concern to them. This method takes into account the needs of the employees. We can see that participation, team work and better working conditions are often linked.

#### **4.6. Organisational support and management’s shared values**

The values inherent to the social economy movement appear to be among the founding elements that explain the openness of CPEs to work-family issues and solutions. As well it seems that CPE managers, as in other social economy organizations, adhere to the same values, which results in a significant impact on work-life balance. It is understood that work-life measures deliver little results when managers do not support them with an open mind (Duxbury et al. 1994, 1993; Behson, 2005) and therefore management’s attitude and values are crucial.

In addition to general statements on organisational support as we have seen above, we also studied the offer of specific measures and their use. This confirms that organisational support toward different measures is a reality—whether included in policies or otherwise implemented, and shows that supervisors and colleagues are responsive to work-family needs of employees.

The issue of organisational support was included in the online survey with this statement: “I have the feeling that my supervisor is responsive to the work-family articulation issue”. Among the respondents, only 11% of CPE participants disagreed with the statement against 70% who agreed or were in total agreement; 18% remained neutral. During the interviews, CPE managers regardless of gender spoke of the values that nourish their actions; employees also mentioned the values they perceive in their supervisors. The statistical analyses conducted on all the social economy subgroups studied indicate that there are no differences amongst the groups according to the status of employment (manager, employee), or the type of organisation (CPE, cooperative and other NPO or social economy activities).

## CONCLUSION

Our data show how CPEs offer adequate organisational support toward work-family balance: management support, colleagues’ support, and offer of work-family measures. The situation is to a certain extent similar in other sectors of the social economy (NPOs, cooperatives). Our data pertaining to other sectors that we might have expected to be more supportive (social work, nursing; see Tremblay, 2012) reveal more significant differences and it is clear that social economy work environments and CPEs in particular are open to work-family articulation and offer adequate and relevant organisational support. It may appear difficult to explain why this subsector in the social economy would provide such strong support to work-family articulation while several other sectors offer so little, including work environments with a social mission and mostly managed by women (i.e., social work; cf. Fusulier, Tremblay & di Loreto, 2008). It seems that the values inherent to the social economy sector explain the situation: offering people-oriented services or performing some form of social work cannot in itself explain why work-family articulation is supported. Indeed, such support is not found to the same extent in social work or nursing (Fusulier, Tremblay & di Loreto 2008; Tremblay and Larivière 2010).

One factor that can explain the scope of organisational support in social economy enterprises appears to be managers’ familiarity with the benefits of work-family articulation in their own work environment. The benefits were widely documented (Tremblay 2008; Barrère-Maurisson and Tremblay 2009) and the relevant studies show without doubt that employers may benefit as well in terms of problem reduction (and savings thereof) related to absenteeism, attendance problems including coming in late at work, to personnel turnover,

diminishing allegiance and risks involved in employees' dwindling dependability for lack of organisational support toward their parental role. CPEs are relatively small-sized workplaces and this allows managers to better observe how work-family related measures actually benefit the organisation.

Our research thus shows that the social economy sector is more supportive, and also that its participatory management approach influences organizational support to work-family balance (WFB) and the perception of WLB-related issues. The quantitative data show that this subsector is more supportive than others previously studied. The qualitative part of the research shows that the specificity of the social economy sector, i.e., mission and participatory management, explain the stronger support of WLB in that subsector.

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## RANGELANDS AND REGIONAL DEVELOPMENT: A BIBLIOGRAPHIC APPROACH

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### ABSTRACT

Rangelands constitute major natural resources that contribute to regional development, by offering significant goods and services. The economic value of rangelands includes both their value in use and non-use, which is hard to quantify in certain cases. The contribution of rangelands is particularly important in developing countries, where the rural sector plays a decisive role in economic and regional development.

The use and exploitation of rangelands should be carried out in the framework of a rational management process, in order to avoid the emergence of numerous problems regarding the sustainability of this kind of ecosystems.

**Keywords:** rangelands, regional development, economic value

### INTRODUCTION

The term rangelands is used to describe natural ecosystems with or without native vegetation, which are covered by herbaceous vegetation or shrubs and are a production source of various goods and services (Papanastasis and Noitsakis 1992, Homewood et al. 2001, Ispikoudis 2010). The extent of rangelands worldwide is estimated to cover 47% of the total surface of the planet (Papachristou and Ispikoudis, 2003).

Rangelands are multi-functional ecosystems that offer a number of goods and services (Arabatzis and Kyriazopoulos, 2010). The forage production found there is an important source of food for farm animals and game. They also provide drinking water, suitable

habitats for wild fauna and fish and are a supply source for raw materials, i.e. various minerals and metal ores. In addition, a large number of remarkable archaeological and historical sites, along with particular cultural assets, are often located on rangelands. Finally, through the application of appropriate interventions, they can also contribute to the development of recreation and tourism-related activities (Solomon *et al.*, 2007; Ispikoudis, 2010).

Rangelands comprise a variety of diverse types of vegetation, such as annual reed beds with or without shrubs; land covered in bushes or trees, or even forested savannah-type areas. More specifically, this term divides areas with the above-mentioned characteristics into rangelands, shrubland, forest areas and arable land, based on biophysical parameters, such as the climate, fires, grazing, directed pressure and succession stages, as well as man-made factors, such as changes to land use and population density (Homewood and Brockington, 1999).

## **ECONOMIC SIGNIFICANCE OF RANGELAND RESOURCES**

The total economic value of rangeland resources includes values in use, which are divided into direct and indirect values. Direct values refer to extensive livestock farming, direct economic benefits, and income. Indirect values include tourism development, services, future values which arise from livestock farming and the valorisation of rangeland resources, with a potential future yield and existence or bequest values stemming from livestock farming which, if maintained, will also benefit future generations (Dovie *et al.*, 2006; Hesse and MacGregor 2006; Gombakomba 2008; Kroeger *et al.*, 2009).

More specifically use values of rangeland resources consist of direct value like extensive livestock farming, conservation, input of commercial and raw materials, employment, skills improvement and other prosperity factors, indirect value such as tourism, ecological and livestock farming services, local knowledge and future value referring to future opportunities that will benefit livestock farming. On the other side non-use values refers to existence or bequest value an attribute that deals with substantial benefits for all society and personal benefits through the preservation and continuation of livestock farming (Dovie *et al.*, 2006; Hesse and MacGregor, 2006; Kroeger *et al.*, 2010; Gombakomba 2008; Kroeger *et al.*, 2009).

Stakeholders in a rural area can benefit from rangeland resources directly or indirectly. Direct benefits of rangeland resources consist of required factors for prosperity like production for

domestic and social consumption, input of livestock products (milk, meat, skin), forest resources (fuelwood) and non-wood forest resources (honey, fruit, plants with medicinal properties); Service provision: security, saving and risk management; Other factors: socio-political values, valorization and improvement of cultural assets; economic activity (commercial: sale of animal and plant products. Raw material production: input also affecting other economic sectors, e.g. slaughterhouses, traders, transporters) (Dovie *et al.*, 2006; Hesse and MacGregor, 2006; Kroeger *et al.* 2009).

Indirect benefits of rangeland resources consist of economic activity which comprise agricultural production and tourism) and environmental benefits like ecological and livestock farming services, conservation of balance and stability of rangeland ecosystems, regeneration, conservation of water sources and drinking water production sources (Hesse and MacGregor, 2006; Kroeger *et al.*, 2009).

## **RANGELANDS AND REGIONAL DEVELOPMENT**

It is not easy to assess the contribution of rangeland resources and livestock farming to a country's economic development, and more specifically to the development of a rural area, since a whole range of obstacles and difficulties may exist that prohibit the collection of data by those who will carry out the relevant assessment. More specifically, in several African countries, where there is no highly developed system for recording the various economic data that is used by the productive sectors of each country, various activities such as livestock present grave deficiencies as regards the accuracy and recording of economic data, and thus the official data collected do not represent the size and economic significance of livestock farming and its participation in economic development (Lusigi and Acquay, 1999).

A large percentage of the economic flows stemming from livestock farming and the use of rangeland resources do not go through the country's official markets, but remain within each local community, where livestock farming is one of the main productive activities, since the majority of livestock farmers do not declare a specific annual income from their work and are therefore not taxed upon it. The use of the shadow price method can also not be used to assess the value of livestock farming products, like milk and butter; since it is quite complex and the relative rarity of these products on the local markets can inflate their purchasing value. Even if one used the usual methods of recording the economic input of livestock

farming on a national level, it is still extremely difficult to estimate its value and contribution to the economic development of the countryside (Hesse and MacGregor, 2006).

At the same time, the practice of extensive livestock farming in numerous parts of Africa, gives the opportunity to men and women livestock farmers alike, to collect and process various wood and non-wood forest products (fruit, honey, aromatic plants and herbs with healing attributes), in order to use them domestically (as a nutritional supplement or in making household objects and local, folk, or traditional art objects) or supply them to the local market, thus creating an additional source of income for their household. This practice for example is particularly beneficial for the prosperity and sustainability of rural families, living in the most arid parts of Africa and in certain Mediterranean countries (Shackleton *et al.*, 2001; Papachristou and Ispikoudis 2003; Shackleton and Shackleton 2004; Bugalho and Abreu, 2008).

In their research, Harp *et al.* (2000) attempted to identify the impact on the local economy from grazing on public rangelands in seven communities of Idaho, USA. Through a study conducted at 160 livestock farming units using a semi-structured questionnaire, they observed that in areas where livestock farming is the main economic activity, the economy is quite diversified, since a series of economic activities (pluriactivity) develop, which are related to and depend on livestock farming. This however is not the case in areas where the primary economic activity is not livestock farming, but minerals, wood harvesting and recreation activities.

In a study carried out in rural parts of Spain and specifically in areas where livestock farming plays the main role in agricultural production along with rangeland management, Plieninger and Wilbrand (2001) aimed to examine the prospects for improving the techniques and practices used, so that livestock farming could attract a larger part of the population and contribute to the economic recovery of the areas in question. The areas where the study was conducted are better known in international literature with the term "*dehesas*". Dehesas are "agrosylvopastoral areas with a combination of sparse stands consisting of various types of oak (*Quercus ilex* and *Quercus suber*) with open flat areas suitable for animal nutrition, such as cattle, sheep and goats", which are primarily found on the Iberian Peninsula. These areas are characterized by intense variety as regards their structure and also in relation to the biodiversity they offer. From an economic perspective, the "*dehesas*" support a major part of the population living off agricultural activities, such as livestock farming. The study showed that livestock breeding in the region of Cuatro Lugares in Spain has proven to be quite a

profitable practice, compared to the wages earned by local people working in other production sectors, and also given the prevailing situation regarding the livestock farming sector in other similar (but less favoured) regions in other countries. As regards their rational management, Plieninger and Wilbrand (2001) propose the establishment of a biological reserve in these regions, aiming at their protection and future valorization and conservation, both for economic purposes, and for the preservation of biodiversity.

In Greece, no extensive studies have been carried out in order to assess the value of rangeland resources and the economic benefits offered to livestock farmers (Papaspapopoulos *et al.*, 2010). The first studies related to the economic evaluation of rangeland resources were carried out by Papanastasis and Pittas (1984), whose research estimated that about a third of the total production of milk and meat from farm ruminants is produced on rangelands. Nastis (1984) estimated that the contribution of rangelands to livestock production is equal to 3% of the GDP. More recently, Papaspapopoulos *et al.* (2010) attempted to calculate part of the total value (in particular, the direct value in use) of rangelands used by bovine breeders in the prefecture of Fthiotida, along with the value they attribute to the same rangelands in order to be able to continue using them in future. This study highlighted the difficulties of assessing the value and contribution of rangeland resources to the overall development of the countryside.

Within the framework of the sustainable management of rangeland resources, the increased needs which arise due to the population expansion also require an augmented livestock production. Such a step, however, could lead to a grazing intensity that would exceed the grazing capacity of rangelands and thus result in their downgrading due to overgrazing (Gadamu 1990). Based on the above, their use for livestock farming purposes constitutes a supervisory expression of the interaction between the various dimensions of the matter, and as such, could function as an indicator for assessing the total health and sustainability of a natural ecosystem (MAF 2000). In order to be able to assess the impact of each dimension on the concept of sustainable rangeland management, so as to determine the extent to which it is applicable or not, it is necessary for local rural communities to work together with scientists of various specializations, so that new methods, practices and collaborations are formulated among the organizations interested in the sustainable management of rangeland resources (CSIRO 2003). To achieve this cooperation, there needs to be a balance between science and social values, economic viability, institutional traditions and political will and interest. From the above conclusions, we can observe the multi-variability and complexity of the term

sustainable rangeland management (Azadi et al. 2007). In more recent descriptions, this concept is defined as the science of managing rangeland ecosystems in such a way, that the disasters of the past are avoided, social needs and values are promoted and prospects of future growth are handed to future generations (Box 2002). For all these views to be applied, the basic issues and challenges of sustainable rangeland management need to be understood.

The most controversial and sensitive issue regarding the use of rangeland resources today and in the near future is how to achieve a balance between individual rights and the public interest. This conflict, in most cases, is reduced to the level of clashing local interests which are represented by various social groups, and also involves land use by individuals (overgrazing) and its availability for public use (sustainability) (Box 1995). This situation is better known as the "tragedy of the commons" (Deadman 1999; Zilberman and Alix, 2005). The dispute regarding the issue of overgrazing on public rangelands is related to the ownership status of public land and the rights that livestock farmers can claim over this public land and, in general, over a public natural resource (Box 2002). Each time livestock farmers focus on their individual rights and forget their collective rights and interests, then unavoidably a downgrading of rangeland resources results, which has a direct negative impact on future generations (Azadi et al. 2003). Most rangelands in Greece are downgraded mainly due to their irrational use (Nastis and Tsiouvaras 2009). Uncontrolled grazing is primarily related to the communal land grazing system, which gives access to free grazing to any farmer for a price, with no overall planning being in place. This situation is sustained by the insistence of livestock farmers on unconditional, free grazing, and also by the lack of political will to address this problem (Papanastasis, 1994).

One consequence of this uncontrolled grazing is overgrazing and the reduction of native vegetation (Box 1995). A visible reduction in the density of rangeland vegetation, land cover and encroaching on native vegetation, are leading to a decreased biodiversity and available food for herds on large rangelands, particularly in developing countries like Iran (Mesdaghi 1995). In cases where this phenomenon is observed, the downgrading of rangelands is transformed into an economic threat which reduces the income of livestock farmers, into a social threat which boosts internal migration from rural areas to large urban centres and into an environmental threat, since it can gradually lead to a desertification of large areas of land. As a means of reacting to this situation, numerous livestock farmers attempt to increase the number of their animals and overexploit the available rangelands in an effort – which is linked to the economic and political pressure they are subjected to – to produce more meat,

which they supply to urban centers aiming to maximize their income. In some cases, even governments themselves offer incentives which encourage overgrazing, through their implemented policies (Lusigi and Acquay 1999; Zilberman and Alix 2005). Moreover, without the adoption of relevant decisions for the protection and rational management of rangelands, it is impossible to regulate the intensity of grazing, in line with the existing grazing capacity (Taghi and Jandaghi 1998; Walker and Hodgkinson, 2000).

## CONCLUSIONS

Rangelands bear a great ecological and economic significance for the development of rural areas. Nevertheless, essential resources and suitable strategies are required that will aim at their conservation and management, at the sustainability of their economic benefits and at the strengthening of the social, aesthetic, cultural and traditional values they embody.

Furthermore, rangeland management must also take into account the relation between the former and other natural resources, like forests, agricultural crops and protected areas, aiming at the sustainable development of the areas in which the above-mentioned natural resources are located. The valorization of various financial incentives, which are primarily provided at a European Union level, will further contribute to the rational management and exploitation of rangelands.

As far as the conflicts that arise in some countries for rangeland resources, governments must center their efforts in support and promote livelihood strategies and ways to preserve and enhance them as well as the natural assets of rangelands on which local people depend on to make their living. Additionally, must involve local people and especially stakeholders in the planning and establishment of these strategies from the initial stages of this process to reduce potential conflicts (Kirk et al. 1998a, Ngaido and Kirk 2000 ).

Such attempts could succeed only if local authorities and institutions secure the socioeconomic welfare of their members, namely the local people. Finally, an integrated approach for the sustainable management of rangeland resources considering all the potential attributes that affect and shape the sustainable use of rangeland resources could be very helpful and profitable in order to reduce conflicts among livestock farmers in remote rural areas.

Partnership among scientists, ecologists, economists, policy and legal experts, private and public rangeland managers and authorities is important in order to allow for multiple uses and sustainable rangeland management.

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## COMPARISON OF IFRS AND SLOVAK ACCOUNTING REGULATIONS IN THE AREA OF ACCOUNTING AND RECOGNITION OF NONCURRENT ASSETS

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### ABSTRACT

IFRS conceptual framework deals with the objectives of financial statements, the underlying assumptions and qualitative characteristics. In Slovakia, the basic concepts, the accounting methods and accounting principles are contained in the Act on Accounting and the Measures of accounting procedures.

The major differences are in the measurement of assets, in the recognition of the assets, in the method of assets depreciation, and in the identification of an impairment of assets. The important issue is recognition of investment property, recognition of assets held for sale and recognition of the biological assets. The Statement of Financial Position according to IFRS reflects the mentioned principles compared to Balance Sheet used by the Slovak Accounting Regulations.

The papers contain the comparison which describes the differences between IFRS and the Slovak Accounting Regulations on accounting and disclosure of noncurrent assets of the entity.

**Keywords:** International Financial Reporting Standards, noncurrent assets, depreciation, valuation, impairment

### INTRODUCTION

A financial statement should reflect true and fair view of the business activities of the organization. As these statements are used by various constituents of the society or regulators, they need to reflect true view of the financial position of the organization, and it is very helpful in checking the financial position of the business for a specific period.

The stated goal of the IFRS Foundation and International Accounting Standards Board (IASB) is to develop, in the public interest, a single set of high-quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly defined principles. The year 2005 marked the beginning of a new era in global conduct of business, and the fulfillment of a thirty-year effort of creating the financial reporting rules for a worldwide capital market. During that year's financial reporting cycle, the 27 European Union member states, plus many other countries (Australia, New Zealand, Russia, South Africa) adopted IFRS.

The objective of general-purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. General-purpose financial statements provide information about the financial position of an entity, its resources, and claims against the resources.

The qualitative characteristics identify the information that is most useful in financial reporting. The qualitative characteristics of financial statements include:

1. Relevance (Materiality).
2. Faithful representation.
3. Comparability.
4. Verifiability.
5. Timeliness.
6. Understandability.

The aim of the paper is to describe the IFRS approach to recognition of noncurrent assets, measurement of noncurrent assets, depreciation and impairment of noncurrent assets, and comparing this area with the national accounting regulation.

## HISTORY OF IAS AND IFRS

International accounting standards are accounting standards issued by the International Accounting Standards Board (IASB) and its predecessor, the International Accounting Standards Committee (IASC). Listed companies, and sometimes unlisted companies, are required to use the standards in their financial statements in those countries, which have adopted them. The history of international accounting standards really began in 1966, with the proposal to establish an International Study Group comprising the Institute of Chartered Accountants of England & Wales (ICAEW), American Institute of Certified Public Accountants (AICPA) and Canadian Institute of Chartered Accountants (CICA).

The International Accounting Standards Committee (IASC) was founded in 1973, with the stated intent to release new international standards which must "be capable of rapid acceptance and implementation world-wide". The IASC survived until 2001, when the organization was restructured and the IASC was replaced by the International Accounting Standards Board (IASB). Between those years the International Accounting Standards Committee released a series of standards called 'International Accounting Standards' in a numerical sequence that began with IAS 1 and ended with IAS 41. Some IAS standards were superseded by IFRS standards.

The IASB stated that they would adopt the body of standards issued by the Board of the International Accounting Standards Committee, but any new standards would be published in a series called International Financial Reporting Standards (IFRS). The former Standard Interpretations Committee (SIC) was reconstituted in 2001 as the International Financial Reporting Interpretations Committee (IFRIC).

The first IFRS 1 First-time Adoption of International Financial Reporting Standards was published in June 2003.

The Regulation (E.C.) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards was adopted on 19<sup>th</sup> July 2002, requiring listed companies to use International Accounting Standards by 2005. As a result of the Regulation, all EU listed companies were required to prepare their financial statements following IFRS from 2005.

## LITERATURE REVIEW

In present, good and useful information have the most important role, based on which their users can make decisions correctly (Andrejovská, 2012). The major sources of economic information are financial statements and accounting of companies, which must meet certain requirements (Andrejovská, 2012). According to Cohen, *et al.* (2012) internal users of financial information include, among others, politicians, public managers, employees, while external users include citizens, voters, taxpayers, suppliers, banks, rating agencies. These users should be able to base their decisions on reliable and relevant information about the financial position, financial performance and cash flow of the government (Cohen, *et al.* 2012). An entity is required to present in the Statement of Financial Position (Balance Sheet) short-term and long-term assets and short-term and long-term liabilities as a separate classification (Hakalová, 2010). In accordance with IAS 1, long-term asset is such asset that does not meet the definition of short-term assets. Long-term assets include: intangible assets, property, plant, equipment, investment property, financial leasing, and financial assets if their settlement remains more than one accounting period (Strouhal, 2009). Relevant IAS and IFRS to noncurrent assets are cited in the papers (IAS 16 Property, Plant and Equipment, IAS 36 Impairment of Assets, IAS 40 Investment Property, IAS 41 Agriculture, IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, IFRS 6 Exploration for and Evaluation of Mineral Resources).

## EXISTING IFRS REPORTING FRAMEWORK

Noncurrent assets include property, plant, equipment, intangible assets, investments in associates, and available-for-sale-investments. Noncurrent assets are held to obtain the economic benefits by an entity for a period greater than one year. Measurement and presentation of noncurrent assets involves systematic allocation of cost to accounting periods, and possible write-downs. Components approach to depreciation means that significant elements of an asset are amortized over their various appropriate useful lives.

## **IAS 16 PROPERTY, PLANT AND EQUIPMENT**

This standard outlines the accounting treatment for most types of property, plant and equipment. Property, plant and equipment are used in the production or supply of goods or services, for rental to others, or for administrative purposes. These fixed assets will benefit the entity during more than one accounting period. Property, plant and equipment do not include biological assets related to agricultural activity or mineral sources.

Items of property, plant, and equipment should be recognized as assets when it is probable that: (1) the future economic benefits associated with the asset will flow to the entity, and (2) the cost of the asset can be measured reliably.

This recognition principle is applied to all property, plant, and equipment costs at the time when they incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. IAS 16 recognizes that parts of some items of property, plant, and equipment may require replacement at regular intervals. An item of property, plant and equipment should initially be recorded as cost. Cost includes all costs necessary to bring the asset to working condition for its intended use. This would include not only its original purchase price but also costs of site preparation, delivery and handling, installation, related professional fees for architects and engineers, and the estimated cost of dismantling and removing the asset and restoring the site.

IAS 16 permits two accounting models: (1) Cost model: the asset is carried at cost less accumulated depreciation and impairment. (2) Revaluation model: the asset is carried at a revalued amount, being its fair value at the date of revaluation less subsequent depreciation and impairment, provided that fair value can be measured reliably.

Under the revaluation model, revaluations should be carried out regularly, so that the carrying amount of an asset does not differ materially from its fair value at the balance sheet date. The increase in the carrying amount is accounted for in equity as „revaluation fund“ (credit). Reduction in the carrying amount should be recognized as an expense.

Depreciation of a depreciable asset begins when the asset is available for use and continues until the asset is derecognized, even if it is idle. The depreciable amount (cost less residual value) should be allocated on a systematic basis over the asset's useful life. The residual value and the useful life of an asset should be reviewed at least each financial year-end and, if

expectations differ from previous estimates, any change is accounted for prospectively as a change in estimate under IAS 8. An item of property, plant, or equipment shall not be carried at more than recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. Value in use is the present value of estimated future cash flows expected to be realized from the continuing use of an asset and from its disposal at the end of its useful life. An asset should be removed from the balance sheet to disposal or when it is withdrawn from use and no future economic benefits are expected from its disposal. The gain or loss on disposal is the difference between the proceeds and the carrying amount and should be recognized in the income statement.

## DEPRECIATION OF PROPERTY, PLANT AND EQUIPMENT

According to Mackenzie *et al.* (2012) the costs of property, plant and equipment are allocated through depreciation to the periods that will benefit from the use of the assets. Method of depreciation results in the systematic and rational allocation of the depreciable amount of the assets (less residual value) over the whole expected useful life of the asset. IAS 16 sets the choice of method of depreciation to the entity: to use the straight-line method, accelerated method, and units of production method.

Straight-line method – depreciation expense is incurred evenly over the useful life of the asset. The periodic charge for depreciation is given as:

$$\frac{\text{Cost amount less residual value}}{\text{Estimated useful life of asset}}$$

Accelerated method – depreciation expense is higher in the early years of the asset's useful life and lower in the later years. Two methods of this type of accelerated methods are often used: diminishing balance method and sum-of-the-years' digits method.

- a) Diminishing balance method: using diminishing balance method, entity can calculate the straight-line rate times the net carrying amount at the beginning of the year. The formula is as:

$$\text{Straight – line rate} = \frac{1}{\text{Estimated useful life}}$$

Double-declining balance depreciation is stopped when carrying amount equals to estimated salvage value.

Depreciation = 2 × Straight-line rate × Book value at the beginning of the year

- b) Sum-of-the-years' digit method: another method to calculate a diminishing charge for depreciation is the sum-of-the-years' digit method (SYD).

Depreciation = (Cost less salvage value) × Applicable fraction

$$\text{Applicable fraction} = \frac{\text{Numbers of years of estimated life remaining}}{\text{SYD}}$$

$$\text{SYD} = \frac{n(n+1)}{2}$$

$n$  = estimated useful life

## IAS 36 IMPAIRMENT OF ASSETS

This standard seeks to ensure that an entity's assets are not carried at more than their recoverable amount (i.e. the higher of fair value less costs to sell and value in use). With the exception of goodwill and certain intangible assets for which an annual impairment test is required, entities are required to conduct impairment tests where there is an indication of impairment of an asset, and the test may be conducted for a "cash-generating unit" where an asset does not generate cash inflows that are largely independent of those from other assets. IAS 36 applies to: land, buildings, machinery and equipment, investment property carried at cost, intangible assets, goodwill, investments in subsidiaries, associates, and joint ventures carried at cost, assets carried at revalued amounts under IAS 16 and IAS 38. An asset is impaired when its carrying amount exceeds its recoverable amount.

Carrying amount is the amount at which an asset is recognized in the balance sheet after deducting accumulated depreciation and accumulated impairment losses. Recoverable amount is the higher of an asset's fair value less costs to sell (net selling price) and its value in use. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (IFRS 13).

Value in use is the discounted present value of the future cash flows expected to arise from: (1) the continuing use of an asset, and from (2) its disposal at the end of its useful life.

Indications of impairment are external and internal. External are: market value declines; negative changes in technology, markets, economy, or laws; increases in market interest rates; company stock price is below book value. Internal are: obsolescence or physical damage, asset is part of a restructuring or held for disposal, worse economic performance than expected.

An impairment loss should be recognized whenever recoverable amount is below carrying amount. The impairment loss is an expense in the income statement (unless it relates to a revalued asset where the value changes are recognized directly in equity).

## **IAS 40 INVESTMENT PROPERTY**

Investment property is property (land or a building or part of a building or both) held by the owner or by the lessee to earn rentals or for capital appreciation or both. Investment property should be recognized as an asset when it is probable that the future economic benefits that are associated with the property will flow to the entity, and the cost of the property can be reliably measured.

## **IAS 41 AGRICULTURE**

This standard sets out the accounting for agricultural activity – the transformation of biological assets (living plants and animals) into agricultural produce (harvested product of the entity's biological assets). The standard generally requires biological assets to be measured at fair value less costs to sell. Costs to sell are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes. An entity should recognize a biological asset or agriculture produce only when the entity controls the asset as a result of past events, it is probable that future economic benefits will flow to the entity, and the fair value or cost of the asset can be measured reliably. Biological assets should be measured on initial recognition and at subsequent reporting dates at fair value less estimated costs to sell, unless fair value cannot be reliably measured. Agricultural produce should be measured at fair value less estimated costs to sell at the point of harvest.

## **IFRS 5 NONCURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS**

Assets (or disposal groups) held for sale are not depreciated, are measured at the lower of carrying amount and fair value less costs to sell, and are presented separately in the balance

sheet. In general, the following conditions must be met for an asset (or “disposal group”) to be classified as held for sale:

- Management is committed to a plan to sell an asset,
- The asset is available for immediate sale,
- An active program to locate a buyer is initiated,
- The sale is highly probable, within 12 months of classification as held for sale,
- The asset is being actively marketed for sale at a sales price reasonable in relation to its fair value,
- Actions required to complete the plan indicate that it is unlikely that plan will be significantly changed or withdrawn.

A “disposal group” is a group of assets, possibly with some associated liabilities, which an entity intends to dispose of in a single transaction. Non-current assets or disposal groups that are classified as held for sale shall not be depreciated.

## CALCULATION OF DEPRECIATION

An entity acquired a machine that cost 145 000 € with an estimated useful life of six years and a 5 000 € salvage value. The calculation of three mentioned methods of depreciation is shown in the table:

	Straight-line		Double-declining balance		Sum-of-years' digits	
Year 1	140 000/6	23 333 €	33,33%×145 000	48 329 €	6/21×140 000	40 000 €
Year 2	140 000/6	23 333 €	33,33%×96 672	32 221 €	5/21×140 000	33 333 €
Year 3	140 000/6	23 333 €	33,33%×64 451	21 481 €	4/21×140 000	26 667 €
Year 4	140 000/6	23 333 €	33,33%×42 969	14 322 €	3/21×140 000	20 000 €
Year 5	140 000/6	23 333 €	33,33%×28 648	9 548 €	2/21×140 000	13 333 €
Year 6	140 000/6	23 333 €	33,33%×19 099	6 366 €	1/21×140 000	6 667 €

*Table 1. Calculation of depreciation of asset*

*Source: own elaboration based on Mackenzie et al. 2012*

## CALCULATION OF IMPAIRMENT AND ITS ACCOUNTING

An entity has a group of machines that constitutes a cash-generating unit for purposes of applying of IAS 36. A group of machines have an aggregate carrying amount at the end of the accounting period which ends at December 21<sup>st</sup>, 2012 totaling 145 000 €. Future revenues and costs are apparent and they predict the diminishing productivity of the group of machines. The fair value of the machines after deducting estimated disposal costs is calculated as 100 000 €. Value in use is calculated with reference to the expected revenues and costs, discounted at a rate of 5%. The calculation of net present value of cash flows is shown in the table:

Year	Revenues	Costs, excluding depreciation	Cash flows	PV factors	Net PV of cash flows
2013	95 000	45 000	50 000	0,95238	47 619,05
2014	92 000	50 000	42 000	0,90703	38 095,24
2015	73 000	58 000	15 000	0,86384	12 957,56
2016	25 000	17 000	8 000	0,82270	6 581,62
Total	285 000	170 000			105 253,47

*Table 2. Calculation of value in use of asset*

*Source: own elaboration based on Mackenzie et al. 2012*

In this case, value in use exceeds fair value less costs to sell and thus value in use is selected to represent the recoverable amount of this cash-generating unit. This is lower than the carrying amount of the group of the machines. The impairment must be recognized as of the end of 2012, in the amount of 145 000 € - 105 253 € = 39 747 €. This amount will be included in operating expenses for 2012 (either depreciation or a separate caption in the statement of comprehensive income or in the statement of profit or loss).

## CURRENT NATIONAL ACCOUNTING FRAMEWORK

Accounting in the Slovak Republic is based on the same accounting principles as in other countries, and also uses the same accounting methods. Current national accounting framework consists of two pillars:

- Act on Accounting No. 431/2002 Corpus Iuris, and
- Measure of the Ministry of Finance of the Slovak Republic on stipulation of details of accounting procedures and framework chart of accounts for entrepreneurs keeping double-entry accounting from 11<sup>th</sup> December 2003 No. 25167/2003-92.

Act on Accounting governs the scope, methodology and verifiability of accounting and the financial statements. Accounting principles and methods are contained in the accounting legislation (Measure of the Ministry of Finance of the Slovak Republic of accounting procedures), which is resulting from all legal acts of the European Union in the field of accounting (The Fourth Council Directive 78/660/EEC on the annual accounts of certain types of companies, and The Seventh Council Directive 83/349/EEC on national laws on consolidated accounts).

The Slovak Republic became a part of the Euro zone from the 1<sup>st</sup> of January. After Slovakia's accession to the European Union, there was a need of comparability of accounting information flows between countries, without additional costs to adapt them to the same base.

## **DEFINITION AND RECOGNITION OF ASSETS ACCORDING TO NATIONAL REGULATION**

According to national regulation, assets mean those of an accounting entity's total on- and off-balance sheet assets which result from past events and which virtually increase the accounting entity's future economic benefits, may be reliably valued, and are presented in the financial statements (Act on Accounting). Assets of accounting unit are classified from the timely point of view to long-term and short-term assets. National regulation (Measure of the Ministry of Finance of the Slovak Republic of accounting procedures) has set two criteria: time and value. Firstly, long-term assets include assets whose useful life, agreed maturity or other settlement deadline from the date of origin of the respective accounting case is longer than one year (time criterion). Secondly, tangible long-term assets are considered to be those whose costs are higher than 1 700 €, and intangible long-term assets with costs higher than 2 400 € (value criterion). Unlike IFRS, national regulation is missing the expression “controls of assets”. Long-term assets of which the accounting entity has ownership or rights are accounted and recognized. Measurement of assets after their recognition is reduced only on

cost model. According to national regulation, part of long-term assets covers some types of assets, which are regulated by individual IAS and IFRS. These assets are as follow: noncurrent assets held for sale (IFRS 5), biological assets (IAS 41), investment property (IAS 40), exploration for and evaluation of mineral resources (IFRS 6).

Unlike IFRS, according to national regulation, the estimated costs of dismantling and putting assets into the original state do not enter into the valuation of assets.

## **DEPRECIATION AND IMPAIRMENT OF ASSETS ACCORDING TO NATIONAL REGULATION**

An accounting entity depreciates both tangible and intangible assets in accordance with accounting principles and accounting policies. Land, objects made of precious metals, and objects of art are not depreciated. The accounting entity is obliged to prepare a depreciation schedule and to depreciate assets following such schedule. Depreciation schedule shall take into consideration useful life, number of products or similar units to be acquired with the help of the depreciated asset. The assets shall only be depreciated to the level of their book values. Depreciable amount (IAS 16) is not defined in national regulation. Tangible assets shall be depreciated by the accounting entity over their expected period of use corresponding to the consumption of future economic benefits. Methods of depreciation are based on time and on physical usage. Methods based on time are permitted as follows: linear method, progressive accelerated and regressive accelerated methods. Sum-of-the-years' digit method is not allowed. Depreciation of asset begins when the asset is put into use, and not when it is available or capable to work.

Slovak accounting regulation does not address the specific regulations of impairment of assets like IAS 36: recoverable amount, net selling price, value in use, cash-generating unit. The accounting entity is obliged to adjust valuation of the assets value, to create provisions and to deduct the assets in accordance with the accounting principles and accounting methods to the balance sheet date. The valuation of assets shall be adjusted by adjusting entries if there is a justified assumption of a reduction of assets value under their book value. Adjusting entries shall be cancelled or their value shall be changed if a change of an assumption of value reduction occurs.

## RESULTS AND DISCUSSION

Body of regulation of accounting in the Slovak Republic is the Ministry of Finance of the Slovak Republic. Hierarchical structure of the laws of accounting and preparation of financial statements is as follows: Commercial Code, Act on Accounting, and Measures of accounting procedures and framework chart of accounts for entrepreneurs keeping double-entry accounting. The essential requirement of the Accounting Act is that the financial statements provide a true and fair view of the facts that are subject of accounting, and financial condition of the entity. Unlike IFRS, in Slovakia there is not a document called Conceptual Framework with its mission. Basic concepts such as the definition of assets, liabilities, revenues and expenses, and accounting methods and principles are contained in the Act on Accounting. Definition of fair value is different in national regulation. According to Act on Accounting, a fair value shall be understood as:

- a) Market price,
- b) A valuation by a qualified estimate or an expert opinion if the market price is not available or does not accurately express the fair value,
- c) A valuation laid down by a separate regulation, if it is not possible to proceed according to previous paragraphs,
- d) The value of the works provided by a concessionaire to the contracting authority in exchange for which the concessionaire acquires the intangible assets.

Using fair value valuation after initial recognition may be valued only to selected types of assets and liabilities: securities, derivatives, financial allocations, enterprises or cooperatives being wound up without liquidation, hedging derivatives, real properties in a special interest fund, commodities at market price, and precious metals being in the possession of fund at market price.

The following table shows an overview of the most significant differences between IFRS approach and national treatment.

IFRS	Slovak Accounting Regulation
Conceptual Framework (IASB)	In Slovakia there is no such document with that mission
Controls of assets (IAS 16)	Ownership or rights to noncurrent assets
Definition of assets:	Assets mean those of an accounting entity's total on- and off-balance sheet assets which
Items of property, plant, and equipment	

should be recognized as assets when it is probable that: (1) the future economic benefits associated with the asset will flow to the entity, and (2) the cost of the asset can be measured reliably (IAS 16)	result from past events and which virtually increase the accounting entity's future economic benefits, may be reliably valued, and are presented in the financial statements.
Two accounting models: (1) Cost model, (2) Revaluation model (IAS 16)	Two criteria for asset recognition: time and value. Only Cost model is permitted
Depreciable amount (IAS 16)	Depreciable amount (IAS 16) is not defined
Depreciation of a depreciable asset begins when the asset is available for use and continues until the asset is derecognized, even if it is idle (IAS 16)	Depreciation of asset begins when the asset is put into use, and not when it is available or capable to work
Carrying amount (IAS 16)	Carrying amount is booked value of asset
Methods of depreciation: Straight-line method, accelerated method, and units of production method (IAS 16)	Linear method, progressive accelerated and regressive accelerated method and method based on physical usage are allowed. Sum-of-the-years' digit method is not allowed
Components approach to depreciation (IAS 36)	Components approach to depreciation is permitted
Value in use (IAS 36)	No recognition of value in use
Recoverable amount (IAS 36)	No recognition of recoverable amount
Cash generating unit (IAS 36)	No recognition of cash generating unit
Investment property (IAS 40)	Investment property is a part of noncurrent assets
Biological assets (IAS 41)	Biological assets are part of noncurrent assets
Assets (or disposal groups) held for sale (IFRS 5)	Assets held for sale are not separately reported
Definition of fair value: Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (IFRS 13)	Fair value (the term) is defined in the Act of Accounting: a. Market price, b. A valuation by a qualified estimate or an expert opinion if the market price is not available, c. A valuation laid down by a separate

- regulation,
- d. The value of the works provided by a concessionaire to the contracting authority in exchange for which the concessionaire acquires the intangible assets.

*Table 3: An overview of the most significant differences between IFRS approach and national regulation*

## CONCLUSION

Although both reporting frameworks, IFRS and Slovak Accounting Regulations recognize the assets in the Statement of Financial Position or Balance Sheet, their approaches are different. National regulation is missing the expression “controls of assets”. According to that, long-term assets are those of which the accounting entity has ownership or rights. National regulation framework has set two criteria for assets recognition: time and value. Firstly, long-term assets include assets whose useful life, agreed maturity or other settlement deadline from the date of origin of the respective accounting case is longer than one year (time criterion). Secondly, tangible long-term assets are considered to be those whose costs are higher than 1 700 €, and intangible long-term assets with costs higher than 2 400 € (value criterion). Measurement of assets after their recognition is realized only under the cost model. Fair value valuation is used after initial recognition only to selected types of assets and liabilities. According to national regulation, part of long term assets generally covers some types of assets, which are individually regulated by IAS and IFRS. Methods of depreciation of assets are based on time (linear method, progressive accelerated and regressive accelerated methods) and based on physical usage. Sum-of-the-years’ digit method is not allowed. Depreciation of asset begins when the asset is put into use, and not when it is available or capable to work, unlike the IFRS. According to national regulation, impairment of assets is realized only through adjusting entries, without the recognition of recoverable amount.

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## SIGNIFICANCE OF QUALITY DIMENSIONS IN TOURISM SERVICES AND THEIR IMPACT ON CUSTOMER DECISION-MAKING PROCESS

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### ABSTRACT

Tourism is one of the fastest growing economic sectors. Growing competitive pressure increases the demands on service quality as the requirements and attitudes of customers are constantly evolving and changing. Due to the specific nature of tourism services, the offer may be copied easily and in some sectors, it can differ only in the quality of the services provided. The quality of services is assessed from technical and functional points of view, while individual factors may be evaluated according to customer satisfaction. The objective of this article is to identify the factors affecting quality in the sector of the providers of tourism services (travel agencies) and determine their significance for the selected segments of customers. These factors reflect the dimensions of the service quality that a customer is able to assess without any experience with the service provided (responsiveness, assurance, empathy and tangibles). The output of the study will be the determination of the significance of individual factors from the perspective of a potential customer when selecting a service provider. The factors will be determined based on an analysis of previous scientific research in the context of functional and technical quality of services. The necessary data will be obtained through primary research (1-10 scale of factor importance) among potential customers and travel agencies chosen by random selection.

**Keywords:** tourism service quality, dimension of quality, competitiveness factors, travel agency

### INTRODUCTION

The Czech Republic after 1989 became a popular destination for tourists from all over the world - it was something new, exotic and yet not expensive. This specific competitive advantage increased the tolerance to relatively low quality of services on the Czech market. This trend, however, has ceased and the Czech Republic is currently perceived as a normal tourist destination. Tourism is a very prospective industry, however, its potential has not been fully exploited in the Czech Republic. As tourism, despite temporary fluctuations, has been showing globally long-term sustainable growth, great attention should be paid to quality in order to gain competitive advantage. The Czech Republic is currently going through a stage, when national standards are being formulated in some selected sectors within the National Quality System in Tourism Services. The quality standards, however, focus only on the technical aspects of quality, not the functional ones, and they are not related to the external environment. The functional quality system has not been implemented.

This paper presents the results of the initial partial analytical phase of a research project aimed at defining the best practices and designing a model of comprehensive evaluation of the quality of tourism services in the context of increasing the competitiveness of the Czech Republic in the highly competitive European market. The objective of this paper is to identify the key factors affecting quality in the sector of the providers of tourism services, namely travel agencies, and determine their significance for the selected segments of customers. The article includes classification of various factors into the elementary quality dimensions based on empirical and theoretical support (conceptual support), in literature specifically the initial models developed by Grönroos (1984), Parasuraman et al (1990), and subsequent determination of the importance of these dimensions in selecting a service provider in view of a potential client.

## **MATERIAL AND METHODS**

Due to the specific nature of the services, the approaches to the assessment and understanding of the service quality are very different. Quality can be seen as a component of customer satisfaction, which is closely connected mainly to their expectations and eventually to customer loyalty. The quality of tourism services from the customer perspective is very subjective. Customers form their ideas, their desired ideals on the basis of recommendations and advertisements and then compare them with reality. Customers have a certain idea about the level of quality before consuming the service and therefore its consumption may affect their prejudices and ideas about the service (Cetlová, 2007).

The perception of the service quality may vary between individual customers, but it can also change in a single customer in time. (Vašítková, 2008). One of the most reliable methods of quality evaluation, according to Bartl, Schmidt (1998) and Müller (1995), is a direct contact with a customer and quality evaluation on the part of the customer. The area of service quality management was influenced significantly by Grönroos, Zeithaml, Parasuraman and Berry (e.g. 1988, 1990, 1991, 2007). Their work focused on customer expectations, service quality and customer satisfaction represent major theoretical approaches to service quality evaluation.

Parasuraman et al (1990) draw upon the assumption that the first and most important step in providing quality services is correct identification of customer expectations, which tend to grow and change depending on the current trends. These authors define five dimensions of service quality which have been quantified based on an extensive research and which affect the customer's perception of service quality. These attributes are listed in the order of their importance and their validity is expected theoretically in all types of services:

- Reliability - availability and ability to provide services accurately and reliably;
- Responsiveness - helpfulness, sensitive approach to customers, prompt service delivery;
- Assurance - staff competence, knowledge, courtesy and ability to create in the customer a sense of confidence;
- Empathy - understanding of individual wishes, care and attention paid to the customer, sensitive approach;
- Tangibles - service materialization and influence of environment.

The aforementioned dimensions represent the service functional quality, i.e. subjective perception of the way the service provided to the customer. Kang, James (2004) on the other hand, in their model of quality according Grönroos (1990), takes into account not only the subjective functional quality but also the technical quality, which is represented by objective measurable indicators as well as a factor representing the company image.

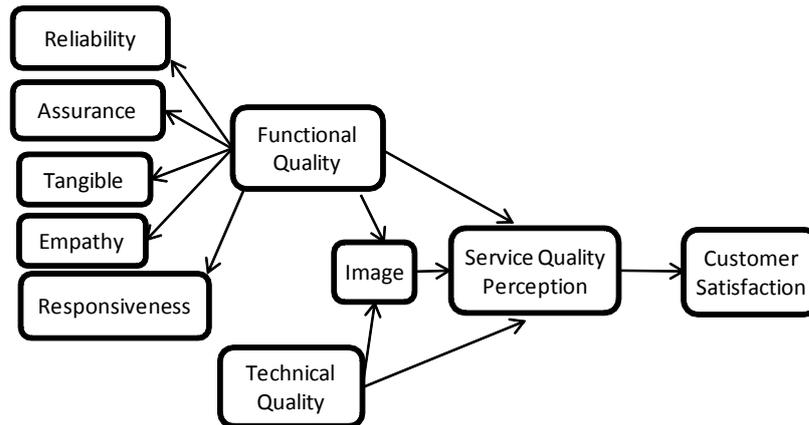


Figure 1: Model of service quality according to Grönroos, Source: Kang, James, 2004

Zeithaml et al. (2006) in their publication state that although in practice the terms of satisfaction and quality are mutually interchangeable, experts claim that satisfaction is generally perceived as a broad concept while the quality of services concentrates especially on the dimensions of services. Parasuraman et al. (1988) clarify the differences between service quality and satisfaction: perceived quality should be regarded as a global state, close to an attitude, while satisfaction refers to a specific transaction. Also, when consumers judge quality levels, they can base their assessment on their opinions and brand image, without any necessary prior experience of the product. However, satisfaction relates to a specific transaction and, for it to be assessed, the consumer must acquire/use the product or service. According to Zeithaml et al. (2006) and their model presented in Figure 2, customer satisfaction is an outcome of product quality. However, mutual relations between satisfaction and perceived quality induce more controversies. Admittedly, Petrick et al. (2004), verified models of relations between perceived quality, customer value, satisfaction, and market behaviour of customers, does not assume such a possibility that satisfaction has influence on quality, in all analysed variants assuming the opposite relation. However, Lee et al. (2004), on the basis of broad studies on the literature, has noticed that research cannot agree on which of the two terms has a wider scope and which of them is the prerequisite of the other. Getz et al. (2001) notice that properly defining relations between quality and satisfaction depends mainly on the way quality is defined. The problem might be even more complicated if additionally customer value is taken into consideration as another term strictly connected with customer satisfaction and product quality (Chen, Chen, 2010; Yuskel et al., 2010; Żemła, 2012).

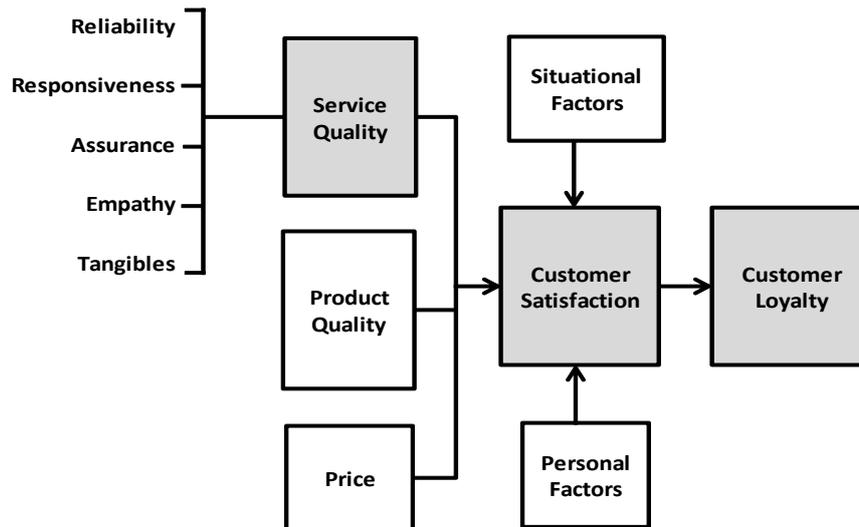


Figure 2: Relations between customer satisfaction and service quality, source: Zeithaml et al, 2006

Baker, Crompton (2000) examined the relationship among quality, satisfaction, and behavioural intentions and they confirm the hypothesis that perceived quality has a major influence on subsequent customer behaviour than customer satisfaction; the measurement of the quality is therefore for managers more valuable than examining customer satisfaction. Examples of further research is the relationship among perceived value, satisfaction, and subsequent customer recommendations (Lee et al, 2007).

For evaluating customer satisfaction we can use not only tools that will provide rather a basic picture of satisfaction to a service provider (e.g. the systems of complaints, mystery shopping, satisfaction survey, simple questionnaire surveys)<sup>32</sup> but also more sophisticated methods (Gap<sup>33</sup>, Kano<sup>34</sup>, PFI<sup>35</sup>, ECSI<sup>36</sup>) that are based on models the aims of which is to operationalize service quality a customer satisfaction in such a way that they become better traceable and measurable.

<sup>32</sup> Kotler, 2001; Kotler, Keller, 2007; Mateides, Ďaďo, 2002

<sup>33</sup> Zeithaml et al, 1990; Zeithaml, Bitner, 2000

<sup>34</sup> Kano, 2001; Mateides, Ďaďo, 2002; Nenadál, 2004

<sup>35</sup> Hill et al, 2003

<sup>36</sup> Fornell, 1992; Mateides, Ďaďo, 2002; Ryglová, Vajčnerová, 2005; Ryglová, 2007, 2011

A primary research was conducted in the form of a questionnaire survey in order to fulfil the goal of identifying the quality factors important for clients of travel agencies. The survey was conducted in autumn 2012 and the sample consisted of 230 respondents who make use of the services of travel agencies. The sample was obtained by random selection. The decisive factors were selected based on the arithmetic average of the scores that each factor was given by the respondents. The factors were then divided according to Grönroos' model into groups expressing technical quality, functional quality and image. The functional quality was further divided into sub-dimensions: responsiveness, assurance, empathy and tangibles. As each quality dimension contains a different number of factors, two most important factors had to be chosen from each dimension for comparison. Dimensions with the highest rating also included decisive factors. These dimensions were then tested in relation to sex, age and education of the respondents. The testing was performed in Statistica programme according to ANOVA analysis of variance. In addition, the homogeneity of variance was tested using the Brown-Forsythe test at a significance level of 5 %. Having rejected the null hypothesis, the HSD method for unequal  $N$  was applied to determine the pairs of mean values which differ from each other.

## **RESULTS AND DISCUSSION**

The Table 1 below shows the order of the key factors ranked to relevant dimension perceived by the client when evaluating the quality of travel agencies.

Order	Factors	Ø value	Dimension of functional quality				Technical quality	Image
			1	2	3	4		
1.	Qualification and knowledge of service personnel	9,27		X				
2.	Helpfulness of service personnel	9,16	X					
3.	Credibility of service personnel	9,14		X				
4.	Kindness of service personnel	9,09				X		
5.	Respect to customer	9,03	X					
6.	Provision of detailed information about accommodation	8,84		X				
7.	Provision of detailed information about transport	8,53		X				
8.	Provision of detailed information about destination	8,53		X				
9.	Provision of detailed information about catering	8,47		X				
10.	Timely provision of services	8,43			X			
11.	Possibility to book holidays via the Internet	7,93				X		
12.	Appearance of service personnel	7,85				X		
13.	Website quality	7,68				X		
14.	Image of travel agency	7,51						X
15.	Provision of catalogues and promotional materials	7,20				X		
16.	Recommendation of relatives and friends	7,19						X
17.	Possibility to pay by card	7,01					X	
18.	Reservation of seats in means of transportation	6,97					X	
19.	Sufficiently long opening hours	6,53			X			
20.	Catalogue appearance	6,51				X		
21.	Good accessibility of travel agency	6,16				X		
22.	Furnishing	6,14				X		
23.	Building appearance	4,98				X		

Table 1: Factors in descending order according to their importance in the context of quality dimensions Source: authors.

Dimension of functional quality: 1. responsiveness, 2. assurance, 3. empathy, 4. tangibles.

The importance of the examined factors ranges from 4.98 to 9.27 on a ten-point rating scale. The most important quality factor, according to the respondents, is the competence and knowledge of the service personnel, as it was assigned grade 8 or higher by more than 90 % of respondents. All the key quality factors were given rating higher than 8.5 points, the most frequent value being the highest score 10; more than 75 % of respondents rated them with scores 8 to 10. The first three factors (qualification and knowledge, helpfulness and

credibility of the service personnel) were rated with scores 9 and 10 by 75 % of the respondents. On the other hand, the least important factors with a value of 6.16 and lower are the accessibility of the travel agency, furnishing and building appearance.

Subsequently, the most important factors were distributed among the relevant dimensions and Figure 3: below shows them in the order of their importance.

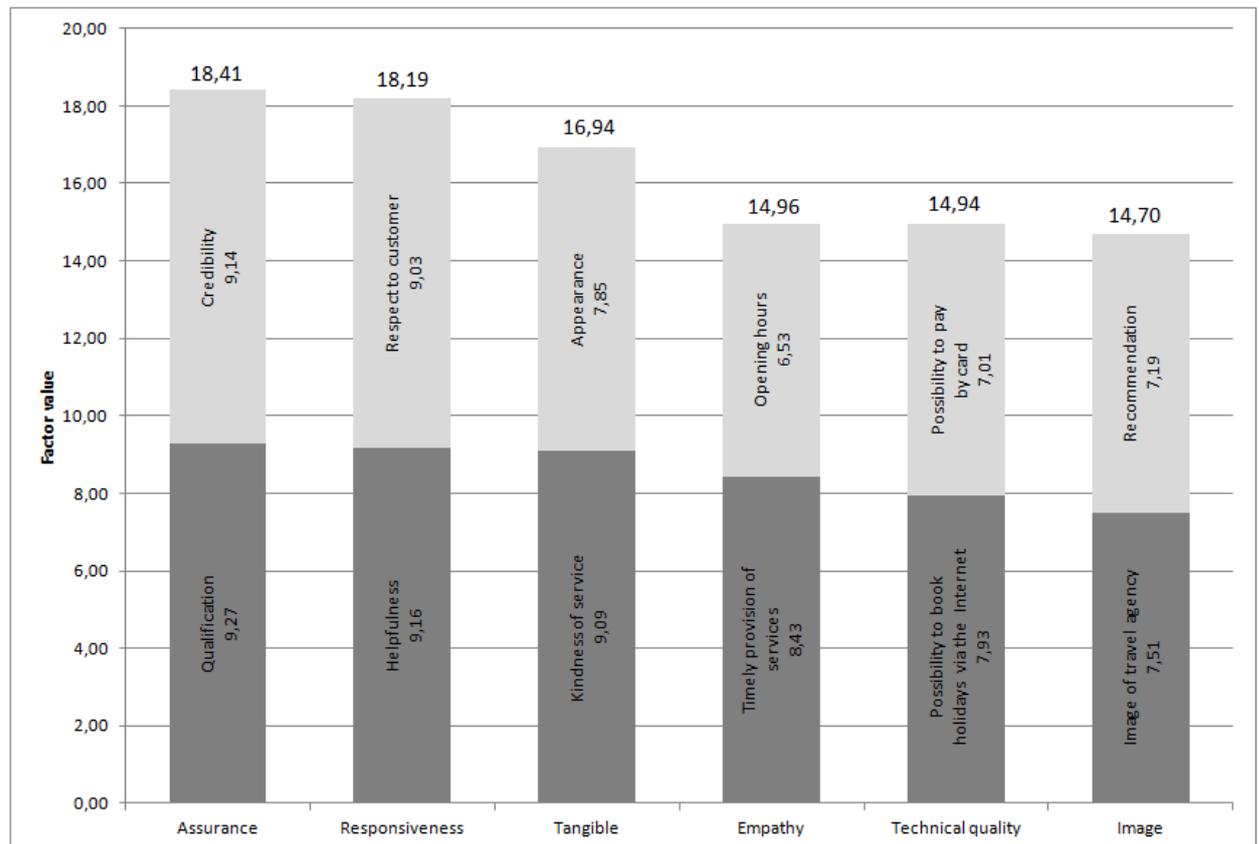


Figure 3: The most important factors distributed among the relevant dimensions. Source: Píšová, 2013

The most important dimension was assurance, followed by the dimensions responsiveness, tangibles, empathy, technical quality, and the least important according to the results seems to be the dimension of image. Hypotheses in the context of the variation of market segments were tested for the three dimensions identified as most important ones after the Brown-Forsythe test by means of ANOVA. The dimension of competence is seen differently by women and men; the factors of the dimension are more important for women, age and the level of education have no influence on this service dimension and the factors of this dimension can be used to improve the service quality for any target group, regardless of age or level of education. The dimension of sensitive approach has distinctly different importance for

women and men; for women the factors of the dimension are more important than for men; on the other hand the dimension independent of age and education. The dimension of the influence of environment on the customer does not depend on sex, age or education.

Figure 4 shows a potential connection between evaluation and a particular chosen market segment. It is a segment of women with secondary education under 25 years of age and a segment of men aged 26-45. The same key quality factors were identified for the selected segments, identical with the results of the entire sample. Only the segment of women under 25 years of age with secondary education showed different order of importance.

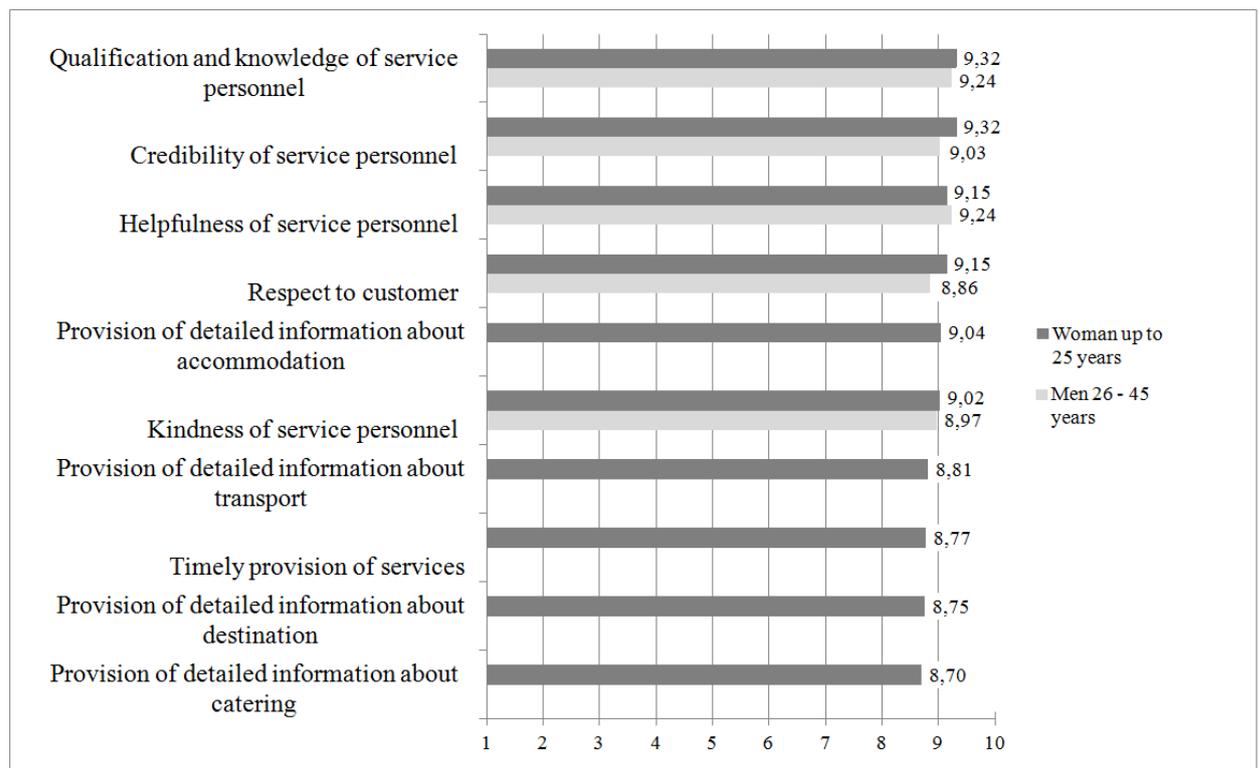


Figure 4: Connection between evaluation and a particular chosen market segment. Source: adapted according Pířová 2013

## CONCLUSIONS

The objective of this paper is to present the results of the partial analytical research aimed at identifying the key factors that the customer sees as crucial in assessing the quality of a travel agency. Partial objectives included: determination of the importance of individual factors, distribution of factors into quality dimensions, determination of the importance of dimensions and subsequent statistical verification of the hypotheses in the context of the variance of the results within market segments. A primary questionnaire survey was applied

to achieve the stated objectives. The crucial factors for the customers of travel agencies are those related to the service personnel. The most important factor is the factor of competence and knowledge of the service personnel, followed by helpfulness, credibility, kindness of the service personnel, respect to the customer and provision of information about transport, destination and accommodation. The key factors were also distributed in the dimensions of functional quality, where the dimension of competence has the highest weight of importance for customers assessing the service quality. On the other hand, the factors related to technical quality and image of a service provider are of the lowest importance for potential customers. The quality of human resources in the field of services, especially of the front-line workers in contact with customers, is the crucial factor in the competitive environment of travel agencies that is decisive for the purchase of services and must be paid utmost attention.

The authors intend to expand the research with prospective target segments of travel agencies (e.g. segments of senior citizens and families with children); the research activities of the authors should also be expanded with investigation on the key factors in other sectors of tourism (hospitality services, attractions, information centres, etc.).

The published results are included in the initial analytical phase of an extensive research project of the authors aimed at defining the best practices and designing a model of comprehensive evaluation of the quality of tourism services.

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## APPENDIX

### Quality Factors

#### Responsiveness

1. Helpfulness of service personnel
2. Respect to customer

#### Assurance

3. Qualification and knowledge of service personnel
4. Provision of detailed information about destination
5. Provision of detailed information about accommodation
6. Provision of detailed information about transport
7. Provision of detailed information about catering
8. Credibility of service personnel

#### Empathy

9. Sufficiently long opening hours
10. Timely provision of services

#### Tangible

11. Building appearance
12. Furnishing
13. Provision of catalogues and promotional materials
14. Catalogue appearance
15. Website quality
16. Good accessibility of travel office
17. Kindness of service personnel
18. Appearance of service personnel

#### Technical quality

19. Possibility to pay by card
20. Possibility to book holidays via the Internet
21. Reservation of seats in means of transportation

#### Image

22. Image of travel office
23. Recommendation of relatives and friends

## COMPARISON OF SERVQUAL, SERVPERF, BSQ AND BANKQUAL SCALE IN BANKING SECTOR

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### ABSTRACT

#### Objective:

The objective of this study was to cross validate the applicability of the SERVQUAL (proposed by Parasuraman, Zeithaml & Berry, 1985, 1988, 1991, 1994), SERVPERF (proposed by Cronin and Taylor, 1992, 1994), BSQ (proposed by Bahia and Nantel, 2000) and BANKQUAL (proposed by Tsoukatos and Mastrogianni, 2010) for measuring service quality of public and private bank in India.

**Design/methodology/approach:** The data was collected at bank and store for period of six months during the evenings and weekends from the customer of bank who have at least six month old account with particular bank and who buy and was willing to respond. Researcher has used instrument SERVQUAL, SERVPERF, BSQ and BANKQUAL for measuring service quality in bank. The research instrument was administered through personal interviews conducted outside the bank and store. The sample size was 1373 and data was analyzed through SPSS 19.0 and AMOS 18.0.

#### Findings:

Based on the finding of bank study, it is evident that different models of service quality have different psychometric properties of measurement model. This reiterates our initial notion that measures developed internationally are of little use in determining service quality of Indian bank. Finding of banks study revealed that SERVQUAL scale has highest reliability followed by BANKQUAL, SERVPERF and BSQ. Different kinds of validity were demonstrated by factor loadings and correlations between factors in CFA model. Research found that Content validity was high in SERVQUAL model because of its popularity and one of the founder models in service quality measurement, but according to Predictive and convergent validity, and Cross validation approach BANKQUAL has high validity than the other models.

**Practical Implication:** View and posit that the cultural differences between countries are likely to have varying effects on the definition of service quality. International

player planning a foray into India would require careful re-thinking before applying their existing perspectives on service quality gained in other countries to Indian store.

**Originality/value:** With respect to its academic value, the study accumulates knowledge that will eventually outgrow the boundaries of academia and pervade management.

**Keywords:** Service Quality, SERVQUAL, BANQAUL, CFA

## I. INTRODUCTION: SERVICE IN 21ST CENTURY

In this 21st century the digital revolution has transformed the economy into a new economy which permitted the customer with new set of skills such as; 1. Contact to greater amount of facts, 2. Broader variety of accessible goods and services, 3. Bigger ease of networking with the service provider. The services sector accounts for around 50 per cent of GDP and is presently the fastest-growing sector of the economy. The sector has the unique opportunity to cultivate due to its labor cost benefit shiny one of the lowest salary and wage levels in the world. The 11th Plan must, therefore, put special focus on this sector so that its potential to create employment and growth is fully realized.

The Retail Banking environment today is changing fast. The changing customer demographics demands to create a differentiated application based on scalable technology, improved service and banking convenience. Higher penetration of technology and increase in global literacy levels has set up the expectations of the customer higher than never before. Increasing use of modern technology has further enhanced reach and accessibility. More amusingly services have also been described as something that can “be bought and sold, but which cannot be dropped on your foot”.

Lovelock (1983) believes that in order to have effective managers in the service sector, they must improve marketing and development skills. Schmenner (1986) warned that service businesses should not consider themselves to be drastically different and remain cut off from each other, because this could increase their fatality rate. As an alternative, businesses in the service sector should consider themselves to be similar, instead of exclusive businesses on their own (Schmenner, 1986).

Stuart and Tax (1996) ensured costs associated with poor service quality include:

- low customer satisfaction, high customer defection rates, lost sales and loss of customer loyalty;
- low employee morale leading to high turnover and absenteeism; and

- excessive costs associated with attracting new customers and overcoming a damaged image.

According to the US news and world report market research on lost customers by major companies shows that 14% for better product, 9% for cheaper product, 68% left because of poor service (service provider's attitude) which can be easily avoided by designing effective customer service process which enables the company to respond. The study clearly demonstrates the significance of soft service quality in relation to product quality.

It is in this context we need to stress on the service quality part as 68% of the customers desert the service provider. The behavioral/attitude component of service is major determining factor on the growth of the company which complements the performance for complete customer satisfaction.

### **Background of the Study:**

Defining the dimensions of service quality is a more daunting task. A number of scholars have developed lists of service quality model. These consist of 5 to 10 dimensions and are general lists which serve as good starting points. But, current research indicates that in terms of service quality, the models and the relative emphases on each are different for different industries. So dimensions developed in one or a group of service industries may not be directly applicable to another group of service industries.

The specific problems relating to the measurement of performance, even though a number of methods have been developed (e.g. SERVQUAL, Parasuraman *et al.* (1988). These problems include:

- Quality measures are very subjective (i.e. quality and its delivery is in the eye of the customer),
- Quality measurement is heavily dependent upon questionnaires and interviews,
- The application of statistics to process control is difficult because every customer is different.

One of the emerging themes from the growing body of literature is that, as is the case with other marketing and management constructs and measures (Benkhoff, 1997; Hofstede, 1990; Yavas, 1997), quality constructs/measures in general (Yavas and Konyar, 2002), and service quality constructs/measures in particular (Mattila, 1999a) that are developed in one culture (notably a western culture) may not be applicable in a different cultural setting.

Even as researchers continue to debate the determinants of service quality a few important issues remain unanswered. Is there a universal set of determinants that determine the service quality across a section of services? Does the service characteristic gets reflected in what customers expect out of delivery of a particular service? Is there an inherent difference in services because they must be delivered in a particular way and does that have a bearing on what becomes important for the customer? Practitioners continue to look for advice and suggestion as to what constitute service quality for their offers and furthermore, if they tend to reposition their offers by varying some characteristics of their offers, for example, by increasing or reducing tangibility or customer contact, etc. What are the operating characteristics of determinants as they together constitute the service quality?

Yavas (2002) argued that despite the recent trend of globalization, the foreign markets are still different from each other. She notes that there are four dimensions of distance-cultural, administrative, geographic, and economic. Cultural distances are the differences in religions, social norms, and languages among countries. Administrative distances are the differences in historical and political aspects, such as the government's actions towards foreign investors. Geographic distances are related to physical differences. For example, the size of the country is definitely a factor affecting the transportation costs of the company. And for the last one, economic distances are determined by the wealth and the income of residents of the countries. Also, the cost of products will affect pricing and may lead to economic distances, too. Hence, because of these four distances, a big global market and standardized products are not possible and adjustments and changes must be made from country to country. If local factors such as cultural background and geographical issues are important factors affecting people's decisions, distances between national markets still exist. In other words, the markets are not converting into one big market and hence people in the East and the West make their consumption choices with different bases. This debate highlights the importance of empirical studies of consumer behavior and service quality across cultures.

Overlooking differences between cultures has recently been shown to limit the ability of service multinationals to expand their activities internationally. Fureret *al.* (2002) argue that the importance and perception of service quality are highly dependent on customers' values and beliefs that might change from one culture to another. This dependence has led to increased concern about the relationship between national culture and service quality.

The literature review proves that Service Quality measurement varies from country to country and culture to culture. Till today all the measurement of service quality were developed and tested in different countries and different cultures. So this is required to test

service quality measurement model in an Indian culture context. Since service quality is a theoretical construct, researchers have defined its dimensions based on the setting used to explore the construct.

## **II. REASONING OF RESEARCH:**

Fretise and Costa (2012), In spite of the numerous considerable published works on the service quality field all over the world, there is still a lack of consensus between the managers and marketing researches concerning about its measurement.

Bhattacharjee, P. K. (2010), found that researchers have explained the importance of quality to service firms and have demonstrated its positive relationship with profits, increased market share, return on investment, customer satisfaction and future purchase intentions or market, rate of customer retention etc. Quality measurement and improvement of service industries has been perceived differently. It is based on different conceptualizations. Various models have been investigated for service quality measurement. Since one of the models is not so accurate enough for measuring and comparing service quality value. Empirical efforts are not well diagnosed for corrective actions in case of quality shortfalls. Moreover, practical implementation to the applicability of these models is very much limited to the service industries in developing as well as developed countries.

Despite its popularity, the concept of service quality in the marketing literature is still ambiguously and vaguely defined. Several measurement models have been proposed, but some of these take into account only the method of measurement and ignore the idea that the same model may not be able to be automatically applied in different industries or in different cultures. Several research projects concerning the relationship between perceived quality and customer satisfaction and loyalty have been conducted, although the majority has been implemented in developed economies, especially the us (Yavas, Benkenstein, and Stuhldreider, 2007).

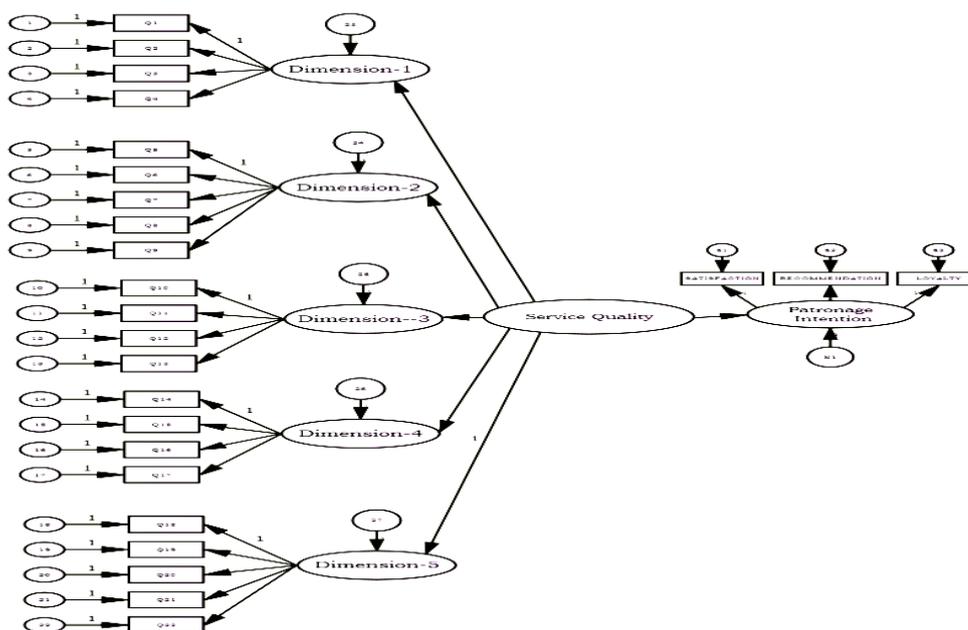
### **Research Objective:**

So, the purpose of this study is to prove better understanding of which Service Quality Measurement Model is effective to measure service quality of Bank sector in Indian context and how managers increase patronage intension among customers. To achieve the stated purpose above and research questions mentioned at the end of literature review, following research objectives will be further investigated. Based on research Gaps and research problems mentioned at the end of literature review following objectives will be studied in this

study. To analyze service quality formulation and its measurement and to assess applicability of service quality constructs to be used for diagnostic purposes in bank.

- To cross validate the applicability of the (proposed by Parasuraman, Zeithaml & Berry, 1985 1988, 1991,1994), SERVPERF (proposed by Cronin and Taylor, 1992, 1994), BSQ (proposed by Bahia and Nantel, 2000) and BANKQUAL (proposed by Tsoukatos and Mastrojianni, 2010) for measuring service quality of Bank in India. This was achieved by examining the reliability, validity and component structures of the Scale.

Figure No. 1: Structural Model of Service Quality



### Research Hypothesis:

H1: Initial first order factor model of SERVQUAL, SERVPERF, BSQ and BANKQUAL is reliable and valid in India. In other words, all the dimensions model are reliable and valid.

H2: Second order factor measurement model of SERVQUAL, SERVPERF, BSQ and BANKQUAL is reliable and valid in India. In other words, all the dimensions of model are adequate to measure service quality of Bank.

H3: SERVQUAL, SERVPERF, BSQ and BANKQUAL are adequate to predict patronage intension of customer. In other words, Service Quality Model is effective to establish relationship with theoretical construct of bank.

### III. SUMMARY OF LITERATURE REVIEW:

Table No.1 Summary of Literature Review

Study	Sample characteristics	Sample size	Country	Data procedure assessing structure	analysis for factor- Findings.....
<b>Carman -1990</b>	Customers of a dental clinic, a business school placement center, a hospital, and a tire store	Ranged from 74 to 600 p across settings	USA	Exploratory factor analysis	Between six and nine dimensions depending on setting with "reliability", "tangibles", and "security" appearing in all settings
<b>Parasuraman et al. (1991)</b>	Customers of telephone company, insurance company, and bank	Ranged from 290 to 487 across companies	USA	Exploratory factor analysis	Five dimensions (six if "tangibles" is split into two dimensions)
<b>Finn and Lamb (1991)</b>	Customers of four different types of retail stores: stores like K-Mart, Sears, Dillard, and Neiman Marcus	Ranged from 58 to 69 across settings	USA	Confirmatory factor analysis	Model fit for a five-dimension structure was poor; no alternative factor structure was examined
<b>Babakus and Boller (1992)</b>	Customers of an electric and gas utility company	689	USA	Exploratory factor analysis; confirmatory factor analysis	(1) Five-factor model not supported; (2) two-factor structure supported
<b>Cronin and Taylor (1992)</b>	Customers of fast food restaurant, banking, pest control, and dry cleaning	Ranged from 175 to 189	USA	Exploratory factor analysis; onfirmatory factor Analysis	(1) Five-factor model not supported; (2) one-dimensional structure supported
<b>Headley and Miller (1993)</b>	Customers of medical Services	159 usable pre- and post-encounter responses	USA	Exploratory factor Analysis	Six dimensions: dependability, empathy, reliability, responsiveness, tangibles, and presentation
<b>Taylor and Cronin (1994)</b>	Individuals in shopping malls who had used	116 (study 1)	USA	Exploratory factor	Six factors (expectations/study1), four factors (perceptions/study1) Seven factors

Study	Sample characteristics	Sample size	Country	Data procedure assessing structure	analysis for factor-	Findings.....
	hospital services within 45 days	227 (study 2)		analysis; confirmatory factor Analysis		(expectations/study2),three factors (perceptions/study 2)
<b>Kettinger and Lee -1994</b>	Undergraduate and graduate students in several courses	342	USA	Confirmatory factor analysis		Four dimensions: reliability, responsiveness, assurance, and empathy
<b>Pitt et al. -1995</b>	Users of online production systems (financial institution); internal users of information system department (accounting and consulting firm, information services business)	237 -181- 267	UK, USA, and South Africa	Exploratory factor analysis		(financial institution); five dimensions (consulting firm); three dimensions (information services business)
<b>Durvasula et al. (1999)</b>	Shipping managers of various organizations (B2B)	114	Singapore	Confirmatory factor analysis		The fit of the SERVQUAL model was acceptable but the one-factor model provides the best representation of the data
<b>Morales Espinoza -1999</b>	Customers of supermarkets	149 (Canada) 169 (Peru)	Canada and Peru	Exploratory factor analysis; confirmatory factor analysis		The SERVQUAL's dimensional structure was confirmed by the Data
<b>Engelland et al. (2000)</b>	Undergraduate college students and career services administrators at campus career services centers	267	USA	Exploratory factor analysis;		The fit of the SERVQUAL model was Poor

Study	Sample characteristics	Sample size	Country	Data procedure assessing structure	analysis for factor-	Findings.....
				confirmatory factor analysis		
<b>Gefen (2002)</b>	Students who had previously bought at Amazon.com	211	USA	Exploratory factor analysis Confirmatory factor analysis		Three factor structure: tangibles, empathy, and a combination of reliability, responsiveness and assurance
<b>Zhou et al. -2002</b>	Bank customers	373	China	Exploratory factor analysis		Six dimensions for expectation scores. Three dimensions for perception and gap scores
<b>Baldwin and Sohal (2003)</b>	Dental care services patients (patients who held private health insurance that provides cover for dental treatment)	354	Australia	Exploratory factor analysis		Four dimensions for expectation and perception scores: skill and ability, punctuality, personal attention, tangibles Four dimensions for gap scores: responsiveness, empathic assurance, reliability, tangibles
<b>Chi Cui et al. -2003</b>	Bank customers	153	South Korea	Exploratory factor analysis; confirmatory factor Analyses		The fit of the SERVQUAL model was Adequate Three dimensions of service quality: tangible, empathy, reliability/responsiveness
<b>O'Neill and Palmer -2003</b>	Visitors to theme parks	135-103	Australia	Exploratory factor analysis		Four dimensions
<b>Kilbourne et al. (2004)</b>	Nursing home residents from ten long-term care facilities in the USA and 15 long-term facilities in the UK	195 (USA) 99 (UK)	USA and UK	Confirmatory factor Analysis		Four factors model for US and UK samples: tangibles, reliability, responsiveness, and empathy

Study	Sample characteristics	Sample size	Country	Data procedure assessing structure	analysis for factor-	Findings.....
Arasli et al. -2005	Bank customers	260	Greek Cypriot	Exploratory Analysis	factor	Three factors: tangibles, reliability, responsiveness, and Empathy
Landrum et al. (2007)	Customers of two army corps of engineers research centers	385	USA	Structural Modeling	equation	Structural equation model fit the data
Sunayna Khurana (2008)	Customer of Retail Store	200	India	GAP Analysis and Reliability		Modern-looking equipment's and fixtures, physical facilities, the ambience and store layout are up to the mark.
Sanjaraspor (2009)	Customer of hotel industry	265	Croatia	Exploratory Analysis	factor	'reliability,' 'empathy and competence of staff,' 'accessibility,' and 'tangibles'
Gilmore, Audrey; McMullan, Rosalind (2010)	Customer perception on tourist destination	100	Spain	EFA, Regression		SERVQUAL is reliable and valid ,making it adequate t o measure the quality of a tourist destination.
Theodorakis Al. (2011)	Professional Football	415	USA	CFA		Overall Service Quality was shown to mediate the relationship between the five dimensions of service quality and fans' satisfaction.
Mubarak Ali (2011)	Customer of Bank	117	India	Regression and EFA		.Exploratory factor analysis was conducted to validate the instrument for the Indian situation.
Swar (2012)	Customer of Bib major Bank of India	600	India	Regression Analysis		Human element of service delivery and Systemization element of service delivery of bank

## IV. RESEARCH METHODOLOGY

### **Data Collection:**

The purpose of this research is mainly descriptive and exploratory. In this study, survey methods have been preferred. Researcher adopts well-known service quality measurement. SERVQUAL, SERVPERF, BSQ and BANKQUAL model for measuring service quality have been used for measuring service quality in bank. Researcher preferred to use a probabilistic systematic random sample method of data collection. Data have been collected from three private bank and three public bank of India. The study has been conducted among six banks of India, viz., State Bank of India (SBI), Bank of Baroda (BOB) and Syndicate Bank in public sector banks being the largest and oldest banks in India, HDFC Bank, ICICI Bank and Axis Bank in the private sector banks being the one of the second largest bank and most successful bank in India. The instrument was administered by a researcher himself and the investigators trained by the researcher till they were familiar with the instrument. The data was collected from the respondents at outside bank. The data was collected at bank period of three months during the evenings and weekends from the customer of bank who has at least three month old account with particular bank and was willing to respond.

Data were collected by means of a structured questionnaire. The questionnaire consisted of three sections A, B and C. Sections A and B required respondents to evaluate the service components of their regular bank. Section C contained questions pertaining to respondent profile. The perception statements were measured on a seven-point Likert type scale with "1" being "strongly disagree" and "7" being "strongly agree". All perception statements were randomly arranged and together made up the dimensions of service quality.

In this study, the research instrument was administered through personal interviews conducted outside the bank. To minimize bias, caused by poor service, prospective respondents were approached and interviewed prior to conducting their intended transactions. The method of personal interviews is superior to self-administered questionnaires in perceptual or attitudinal surveys while face-to-face administration maximizes response rates and field researchers' availability to answer respondents' questions.

### **Sample Profile:**

According to guideline provided by Nunnally(1978) that ten times of total number of items, so sample size for SERVQUAL is 293 and SERVPERF, BSQ and BANKQUAL was 360 respectively, means total sample size was 1373. However, Hair et al. (1992, 1995) cautioned that, if the sample size exceeds 400, the goodness of fit is poor because almost any difference

is detected. Therefore, by considering the constraints of the research setting and theoretical aspect of this study, the targeted sample size was set at 360 ( $n=360$ ) for each service quality model.

### Data Analysis and Tool

For analyzing the data researcher used various test like Preliminary Analysis, Correlation coefficient Analysis, Chi-square test, Multiple regressions Analysis, Structural Equation Model (SEM), Confirmatory Factor Analysis (CFA) through SPSS 19.0 and AMOS 18.0.

## V. RESULT AND DISCUSSION:

Every analysis has some basic assumption for further analysis. Below table shows the some test for fulfillment of advance analysis.

Table No.2 Normality, Multicollinearity, Collinearity and Independence of residual

		Recomm. Value	SERVQUAL	SERVPERF (Bank)	BSQ	BANKQUAL
<u>Normality</u>	Skewness	-3 to 3	-0.170 to -0.755	-1.014 to -0.226	-1.083 to -0.137	-1.083 to -0.137
	Kurtosis	-10 to 10	1.118 to 0.002.	1.24 to -.272	2.081 to -.032	2.081 to -.032
<u>Multicollinearity</u>	Tolerance	>0.10	0.324 to 0.670	0.317 to 0.583	0.322 to 0.511	0.317 to 0.658
	VIF	< 10	1.19 to 3.01	1.714 to 3.151	1.96 to 3.107	1.52 to 3.25
<u>Collinearity Statistics</u>	Correlation between independent variables	< 0.90	0.413 to 0.753	0.393 to 0.736	0.393 to 0.736	0.459 to .800
<u>Independence of Residual</u>	Cook's Distance for Residuals	< 1.0	0.437	0.153	0.109	0.168

Kline (1998) suggested that all variables in the analysis for univariate skewness and kurtosis were satisfactory within conventional criteria for normality i.e. *-3 to 3 for skewness and -10 to 10 for kurtosis*. Multivariate normality (the combination of two or more variables) means that the individual variable is normal in a univariate sense and that their combinations are also normal (Hair *et al.* 2010). The correlations between the variables in your model are provided in the table labeled *Correlations*. Check that your independent variables show at least some relationship with your dependent variable (above .3 preferably). (Pallant, 2005). According to Juie Pallant (2005) have quoted commonly used cut-off points for determining the presence of multicollinearity (tolerance value of less than .10, or a VIF value of above 10). These values,

however, still allow for quite high correlations between independent variables (above .9), so we should take them only as a warning sign, and check the correlation matrix. One of the ways that these assumptions can be checked is by inspecting the residuals scatterplot and the Normal Probability Plot of the regression standardized residuals that were requested as part of the analysis. To check whether this strange case is having any undue influence on the results for this model as a whole, researcher can check the value for Cook's Distance given towards the bottom of the Residuals Statistics table.

### Reliability Analysis:

Tabke No.3 Reliability Statistics

	SERVQUAL	SERVPERF	BSQ	BANKQUAL
<b>Split-Half Reliability</b>				
Part 1	0.921	0.89	0.846	0.884
Part 2	0.932	0.894	0.896	0.908
<i>Correlation Between Forms</i>	<i>0.784</i>	<i>0.752</i>	<i>0.73</i>	<i>0.755</i>
<b>Strictly Parallel Model</b>	0.955	0.933	0.92	0.933
<b>Cronbach Reliability</b>	0.955	0.935	0.924	0.937
N of Items	22	22	31	27
<b>Rank</b>	<b>1</b>	<b>3</b>	<b>4</b>	<b>2</b>

In above table, the items on the scale for service quality measurement in bank are divided into two halves and the resulting half score are correlated. High correlations between the halves indicate high internal consistency. Correlation Between Forms are high in all scale i.e. 0.789 in SERVQUAL, 0.752 in SERVPERF, 0.730 in BSQ and 0.755 in BANKQUAL Scale. According to Malhotra & Dash (2011), the Service Quality scale has good internal consistency, with a Cronbach's alpha coefficient reported of more than 0.60. In the current study the Cronbach's alpha coefficient were >.90. So all the scales can be considered reliable for measuring service quality of Bank.

Table No.4 Reliability of Respective Dimensions of SERVQUAL, SERVPERF, BSQ and BANKQUAL in Retail Bank context

SERVQUAL		SERVPERF		BSQ		BANKQUAL	
Dim.	$\alpha$	Dim.	$\alpha$	Dim.	$\alpha$	Dim.	$\alpha$
Tangibles	0.91	Tangibles	0.82	Effectiveness and Assurance	0.83	Assurance and empathy	0.88
Reliability	0.92	Reliability	0.81	Access	0.76	Effectiveness	0.86
Responsiveness	0.88	Responsiveness	0.84	Price	0.72	Reliability	0.82

Assurance	0.86	Assurance	0.79	Tangibles	0.78	Confidence	0.83
Empathy	0.88	Empathy	0.82	Service Portfolio	0.68		
				Reliability	0.75		
<b>Overall</b>	<b>0.92</b>	<b>0.94</b>		<b>0.924</b>		<b>0.94</b>	

For SERVQUAL scale, the alpha score was comparable to 0.955, which is consistent with previous replication studies. In selected SERVQUAL application like Parasuraman et al. (1991) in their study they found Cronbach's alpha coefficient were ranged from 0.83 to 0.91 in Customers of telephone company, insurance company, and bank. Babakus and Boller (1992) found Ranged from 0.67 to 0.83 in Customers of an electric and gas utility company. Cronin and Taylor (1992) found reliability of 0.89 in banks, 0.90 in Pest control, 0.90 in Dry cleaning, and 0.85 in Fast food. In this study, it is much higher than previous study.

For SERVPERF scale, the alpha score was comparable to 0.935, which is consistent with previous replication studies (Babakus and Boller, 1991; Carmen, 1990; Finn and Lamb, 1991) which had alphas ranging from 0.59 to 0.93.

For BSQ Scale, the alpha score was comparable 0.924, which is consistent with the scale developer (Bahia & Nantel, 2000) which had alphas ranging from 0.78 to 0.96.

For BANKQUAL Scale, the alpha score was comparable .937, which is consistent with the scale developer (Tsoukatos & Mastrojianni, 2010) which had alpha value 0.966.

BSQ	Loading	BANKQUAL	Loading	SERVPERF	Loading	SERVQUAL	Loading
V6	.458	P8	.584	G1	.787	S1	.818
V5	.514	P7	.696	G2	.778	S2	.878
V4	.551	P6	.577	G3	.789	S3	.780
V3	.560	P5	.664	G4	.729	S4	.564
V2	.512	P4	.682	G5	.791	S5	.655
V1	.539	P3	.764	G6	.824	S6	.812
V7	.486	P2	.781	G7	.821	S7	.833
V8	.424	P1	.740	G8	.845	S8	.727
V9	.549	P16	.703	G9	.719	S9	.364
V10	.580	P15	.691	G10	.767	S10	.695
V11	.553	P14	.639	G11	.809	S11	.776
V12	.494	P13	.619	G12	.854	S12	.788
V13	.587	P12	.658	G13	.798	S13	.780
V18	.648	P11	.643	G14	.814	S14	.739
V17	.678	P10	.639	G15	.745	S15	.507
V16	.615	P9	.650	G16	.808	S16	.765
V15	.437	P22	.758	G17	.770	S17	.759

V14	.478	P21	.699	G18	.725	S18	.694
V23	.643	P20	.728	G19	.681	S19	.663
V22	.570	P19	.493	G20	.809	S20	.787
V21	.617	P18	.658	G21	.862	S21	.626
V20	.568	P17	.615	G22	.818	S22	.718
V19	.563	P23	.711				
V27	.771	P27	.706				
V26	.724	P26	.710				
V25	.695	P25	.724				
V24	.575	P24	.674				
V29	.687						
V28	.592						
V31	.723						
V30	.649						

Table No.5 Psychometric Properties of Models

Table No. 5 describe the factor loadings of observed variables are reliability estimates of individual construct. In BANKQUAL, SERVQUAL and BSQ model, all the factor loadings are above suggested limit of .50 by Kline (1998) while in SERVPERF item no. 09 is below .5. All the models of SQ are indicating reliability.

Table No.6 Squared Regression Weight

BSQ		BANKQUAL		SERVQUAL		SERVPERF	
Item	Estimate Loading	Item	Estimate Loading	Item	Estimate Loading	Item	Estimate Loading
V30	.421	P24	.455	Q22	.669	P9	.132
V31	.523	P25	.524	Q21	.743	P5	.429
V28	.351	P26	.504	Q20	.655	P6	.659
V29	.471	P27	.499	Q19	.464	P7	.694
V24	.331	P23	.505	Q18	.526	P8	.529
V25	.483	P17	.378	Q17	.594	P10	.483
V26	.524	P18	.433	Q16	.653	P11	.602
V27	.594	P19	.243	Q15	.568	P12	.621
V19	.317	P20	.530	Q14	.663	P13	.608
V20	.323	P21	.489	Q13	.637	P1	.669
V21	.381	P22	.574	Q12	.729	P2	.771
V22	.325	P9	.422	Q11	.654	P3	.421
V23	.413	P10	.409	Q10	.588	P4	.318
V14	.228	P11	.413	Q9	.517	P22	.515
V15	.191	P12	.433	Q8	.713	P18	.481
V16	.379	P13	.383	Q7	.675	P19	.439
V17	.460	P14	.408	Q6	.680	P20	.619
V18	.420	P15	.477	Q5	.625	P21	.392

BSQ		BANKQUAL		SERVQUAL		SERVPERF	
Item	Estimate Loading	Item	Estimate Loading	Item	Estimate Loading	Item	Estimate Loading
V13	.344	P16	.494	Q4	.531	P14	.546
V12	.244	P1	.547	Q3	.623	P15	.257
V11	.306	P2	.610	Q2	.605	P16	.585
V10	.336	P3	.583	Q1	.620	P17	.577
V9	.301	P4	.465				
V8	.180	P5	.441				
V7	.237	P6	.333				
V1	.290	P7	.485				
V2	.262	P8	.341				
V3	.313						
V4	.304						
V5	.264						
V6	.210						

In addition to table no. 06, In BSQ model, the  $R^2$  corresponding to all observed variable indicate that the respective factors not explains respectable portions of the variance (between .18 to .59 i.e. 18% to 59%). It means that item does not tap the same values dimension. We could also say that the estimated reliability of all items of BSQ is very poor. In BANKQUAL model, the  $R^2$  corresponding to all observed variable indicate that the respective factors explains respectable portions of the variance (between .41 to .61 i.e. 41% to 61%). It means that item taps the same values dimension. We could also say that the estimated reliability of all items of BANKQUAL is reasonable except item no. P6, P8, P17 and P19. In SERVQUAL, the  $R^2$  corresponding to all observed variable indicate that the respective factors explains respectable portions of the variance (between .517 to .79 i.e. 51% to 79%). It means that item taps the same values dimension. We could also say that the estimated reliability of all items of SERVQUAL is reasonable except item no. Q4 and Q9. In BANKQUAL model,  $R^2$  corresponding to all observed variable indicate that the respective factors explains respectable portions of the variance except item no. 04, 09, 15 and 21. It means that item taps the same values dimension. We could also say that the estimated reliability of 18 items of SERVPERF is reasonable except item no. 04, 09, 15 and 21.

Table No.7 Comparative analysis of Models

	Psychometric Analysis	Squared Multiple Correlations-R2	Composite Reliability	Convergent Validity (AVE)
<b>Recommended Value</b>	<b>Above .50</b>	<b>Higher the batter</b>	<b>Above .70</b>	<b>Cutoff level of 0.70</b>
<b>SERVQUAL</b>	.725 to .862	.517 to .79 i.e. 51% to 79%	.75 to .81	.43 to .50
	0 item below .50			21 - $\geq .70$ , 1- <.70
<b>SERVPERF-B</b>	.354 to .833	.132 to .771 i.e. 13% to 77%	.77 to .82	.35 to .41
	1 item below .50			14- $\geq .70$ , 8 <.70
<b>BSQ</b>	.424 to .771	.18 to .59 i.e. 18% to 59%	.47 to .79	.43 to .52
	2 item below .50			29 - <.70
<b>BANKQUAL</b>	.577 to .781	.41 to .61 i.e. 41% to 61%	.71 to .78	.50 to .53
	0 item below .50			12 - $\geq .70$ , 15- <.70
<b>SERVPERF-R</b>	.474 to .723	.22 to .52 i.e. 22% to 52%	.61 to .68	.46 to .51
	1 item below .50			22- <.70
<b>RSQS</b>	.438 to .818	.38 to .67 i.e. 38% to 67%).	.40 to .60	.43 to .52
	1 item below .50			26- >.70

Based on the result obtained, it is evident that that the BANKQUAL and SERVQUAL model are well supported than BSQ and SERVPERF, thus it can be concluded that all r dimensions of BANKQUAL and SERVQUAL scale tested appear to be suited for measuring service quality, particularly in Bank.

#### Hypothesis Testing:

- Hypothesis-1(H1): Initial first order factor model is reliable and valid.

Researcher estimated the structural models yield the following model fit results:

Table No.8 Goodness-of-fit Statistics (Measurement Model)

Goodness-of-fit model index	Recommended Value*	BSQ	BANKQUAL	SERVQUAL	SERVPERF
Chi-square/degree of freedom**	$\leq 5.00$	3.020	2.73	2.16	3.644
GFI	$\geq .90$	.822	.89	.90	.86
AGFI	$\geq .80$	.776	.89	.86	.80
NFI	$\geq .90$	.792	.83	.91	.84
TLI/NNFI	$\geq .90$	.718	.90	.94	.86
CFI/RNI	$\geq .90$	.766	.90	.95	.88
RMSEA	$\leq .08$	.789	.06	.06	.08
Standardized RMR	$\leq .08$	.075	.06	.43	.064

\* These criterias are according to Hair et al. (1998) and Arbuckle and Wothke (1995)

\*\* Ullman (1996) recommended chi-square/degree of freedom value of < 5.00

From the above table, we can summarize the fitness of structural model in service quality of bank. Collectively, these fit indices indicate that the measurement model is acceptable. That is, perceived service quality model BANKQUAL and SERVQUAL have all fit indices with the values recommended by Hair et al.(2010) than the BSQ and SERVPERF. It also suggested that SERVPERF and BSQ are not found satisfactory in first order, so Model-II and Model-III are not supposed to be tested.

- H2: Second order factor measurement model is reliable and valid.

For SERVQUAL, overall fit measures (CFI,NNFI,RMSEA and  $\chi^2$  difference) were used iteratively to determine whether the CFA model fitted data well. Result from running this second-order model showed that all fit indices suggested good fit of data,  $\chi^2=468.55$ ,  $df=204$ ,  $\chi^2/df=2.29$ , NNFI/TLI=.93, CFI=.94, RMSEA=.067 and For BANKQUAL, all fit indices suggested good fit of data,  $\chi^2=1069.31$ ,  $df=400$ ,  $\chi^2/df=2.67$ , NNFI/TLI=.90, CFI=.90, RMSEA=.07. According to  $\chi^2$  difference test, the improvement in fit between the initial first-order and second order five factor model was not statistically significant( $\Delta \chi^2 (5)=38.510$ ,  $p > 0.05$ ). The result suggest that the first-order and second order SERVQUAL and BNAKQUAL models provide the best representation of data in this study.

- H3: Hypothesis-3(H3): Service Quality model is adequate to predict patronage intension of customer.

Table No.9 Second Order Measurement Model

Goodness-of-fit model index	Recommended Value*	SRVQAUL	BANQUAL
Chi-square/degree of freedom**	$\leq 5.00$	2.264	2.67
Goodness-of-fit index(GFI)	$\geq .90$	.88	.90
Adjusted goodness-of-fit index (AGFI)	$\geq .80$	.84	.85
Normalized fit index (NFI)	$\geq .90$	.89	.91
Tucker-Lewis index (TLI/NNFI)	$\geq .90$	.93	.90
Comparative fit index (CFI/RNI)	$\geq .90$	.94	.90
Root mean square error of approximation (RMSEA)	$\leq .08$	.07	.07
Standardized root mean square residual (standardized RMR)	$\leq .08$	.05	.07

Collectively, these fit indices indicate that the structural model is acceptable. That is, the third-order perceived service quality model SERVQUAL and BANKQUAL are robust and theoretically explains the patronage intentions.

Table No. 10: Structural Model Coefficient

SERVQUAL			BANKQUAL		
Dimensions of Service Quality	Second-order Loading Estimates	t-Values	Dimensions of Service Quality	Second-order Loading Estimates	t-Values
Tangible	0.68	9.041**	Assurance & Empathy	0.61	7.915**
Reliability	0.88	10.855**	Effectiveness	0.96	11.533**
Responsiveness	0.94	11.114**	Reliability	0.97	12.43**
Assurance	0.89	11.216**	Confidence	0.91	Λ fixed 1
Empathy	0.89	Λ fixed 1**			

\*\* significant at the 0.001 level (2-tailed).

The structure coefficients linking the five dimensions with second-order service quality (i.e. the second-order loading) are all significant and in the expected directions. Table no. 70 contains the structure coefficient with corresponding *t* values.

The main aim of this study was to assess effectiveness of alternatives service quality measurement model which suit in Indian context. So practitioner and business man can utilized right instrument to measure their service quality and do necessary changes in different aspect of business and its related services.

Number of models and instrument are available in the literature to determine the service quality. Different authors were demonstrated different dimensions and determinants of service quality through empirical as well as conceptual research. All the models somehow appropriate and may be not appropriate due to number of factors like different culture, service setting and socio-cultural aspect of society.

Literature review chapter describe number of arguments regarding service quality formulation, its determinants and dimension. There is no general consensus regarding service quality formulation due to various factors like culture, service setting etc..

Table No. 11: Comparison of overall indices for three model of Service Quality-BANKQUAL

Model	$\chi^2$	df	$\chi^2 / df$	NN FI	CF I	RMS EA	$\Delta \chi^2$
Model-I: An initial first-order five factor measurement model, which was developed by Parasuraman <i>et.al.</i> (1991)	869.15	318	2.73	.90	.90	.06	---
Model-II-Second-order five factor measurement model.	887.30	320	2.77	.90	.90	.07	18.15
Model-I-Structural Model Validity	1069.31	400	2.67	.90	.90	.07	182.01

According to  $\chi^2$  difference test, the improvement in fit between the initial first-order and second order five factor model was not statistically significant ( $\Delta \chi^2 (2)=18.15$ ,  $p > 0.05$ ). The result suggest that the first-order and second order BANKQUAL model provide the best representation of data in this study.  $\chi^2$  difference between in second-order and third model were also not statistically significant ( $\Delta \chi^2 (80)=182.01$ ,  $p>0.05$ ). It means that BANKQUAL model is overall fit for measure service quality of Bank in India.

## VI. CONCLUSION AND IMPLICATION

For this research, three conclusions and recommendation may be drawn. First, based on the finding, it is evident that different models of service quality have different psychometric properties of measurement model. This reiterates our initial notion that measures developed internationally are of little use in determining service quality of Indian bank. All kinds of reliability test suggested following sequence of models for service quality measurement in banking sectors.

Table no. 12: Effectiveness of Model: According to Reliability

	Split-Half Reliability	Strictly Parallel Model	Cronbach Reliability	Composite Reliability	OVERALL RANK
SERVQUAL	1	1	1	1	1
SERVPERF	3	3	3	3	3
BSQ	4	4	4	4	4
BANKQUAL	2	2	2	2	2
<b>1= Most Reliable and descending order</b>					

Finding of banks study revealed that BANKQUAL scale has highest reliability followed by BSQ.

Second, the study provide evidence that initial notion BSQ was not applicable in measuring service quality of Bank in Indian Context. First-order factor model suggested the goodness-of-fit of initial model; second-order factor model suggested that all the dimensions of model

were adequate to measure service quality of Bank. And third order model suggested the overall fit of model with theoretical construct. The study found only BANKQUAL has better fit.

Table No.13 Comparison of overall indices for all three-order models of SERVQUAL and BANKQUAL in Bank Study

	SERVQUAL			BANKQUAL		
	Model-I	Model-II	Model-III	Model-I	Model-II	Model-III
$\chi^2$	430.51	468.44	611.4	869.15	887.3	1069.31
df	199	204	270	318	320	400
$\chi^2/df$	2.16	2.29	2.264	2.73	2.77	2.67
NNFI	0.939	0.93	0.93	0.9	0.9	0.9
CFI	0.947	0.94	0.936	0.9	0.9	0.9
RMSEA	0.063	0.067	0.066	0.06	0.07	0.07
$\Delta \chi^2$	---	38.04	142.96	---	18.15	182.01

Table no. 14: Overall Model Soundness:

	Model-I	Model-II	Model-III
SERVQUAL	Satisfactory	Satisfactory	Satisfactory
SERVPERF-B	Not-Satisfactory	Not- Satisfactory	Not- Satisfactory
BSQ	Not-Satisfactory	Not- Satisfactory	Not- Satisfactory
BANKQUAL	Satisfactory	Satisfactory	Satisfactory

The BANKQUAL validity and reliability in the Indian banking setting indicate that the BANKQUAL can be used to assess the overall service levels provided by the bank and for tracking changes in overall service levels over a period of time.

Third, this study provides evidence that the service quality is multi-dimensional and therefore hierarchical in nature.

This provides usefulness of the scale as a diagnostic tool for providing strategic direction. Bank and researchers applying multi-dimensional service quality scales developed internationally such as the SERVQUAL and BANKQUAL to the Indian context are advised to pay special attention to scale adaptation to ensure that the scale has reliable diagnostic ability. International financial institution like bank planning a foray into India would require careful re-thinking before applying their existing perspectives on service quality gained in other countries to Indian bank.

Due to the cultural differences, global banks and retailers need to be responsive in developing customer service. In this regard, a thoughtful customer research should be conducted to advance an understanding of local customers' behavior and their experience. Bank should

develop a customized service quality measurement instrument because all available tools have some limitation.

However, the issues of “service quality formulation and its measurement” are extensively researched; present study provides original findings that contribute to both academia and practice. It builds on prior research concerning service quality dimension in retail banking.

The BANKQUAL scale also has some limitations with respect to measurement of Service quality. In BANKQUAL model, tangibility dimension is not covered as a part of service quality evaluation. In addition to that, BANKQUAL has also not bothered with electronic service quality measurement like ATM, Internet Banking and Phone Banking, which are extensively used by customer in this cutting edge technology era.

The developments in information and communications technology have provided a platform by which companies can design, develop and deliver services that can be perceived by customers as superior (Surjadjaja *et al.* 2003).

Automated service quality has tended to lag behind because practitioners have focused mainly on issues of usability and measurement of use, with little or no consideration to the issues of service quality (Buckley 2003).

There is a strong requirement to proposed holistic model for service quality measurement which may be tested in further study. On the bases of the literature available on service quality measurement and models, present study would like to propose following research model for service quality for the future study in Indian Context.

1. Tangible
2. Reliability
3. Empathy and Assurance
4. Responsiveness
5. Confidence
6. Automated Service/E-Services

Automated service quality is defined as the customer’s overall evaluation of the excellence of the provision of services through electronic networks such as the internet, Automated Teller Machine (ATM), and telephone banking (Santos 2003).Ruyter et al. (2001, p186) define automated service as *‘interactive, content-centered and internet-based customer service, driven by the customer and integrated with related organizational customer support process and technologies with the goal of strengthening the customer-service provider relationship’*. An automated service

quality dimension covers the electronic service quality aspect of bank. All most all the Private and Public Bank of India, provide ATM facility, Internet Banking and Phone Banking service as a core part of its product portfolio.

ATM service should measures by Sufficient number of ATM , Secure locations, ATM has a user, friendly system,- Conveniently located, ATM functions. Phone Banking should measure by Pleasant musical background, Reasonable number of voice prompts, Short waiting time, Clear instructions, Reliability, Telephone banking options. Internet banking should measure by Availability of information, Easy to use, Secure, Error free transactions, Attractive web site, Website interface accuracy.

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## GREEK BANKS' INTERNATIONAL BEHAVIOUR IN S.E.E. COUNTRIES: BUSINESS COMMITMENT AND POLITICAL DIMENSIONS

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### ABSTRACT

**Purpose** – This research aims to examine (continuing previous study – Vasiliadis, 2013) how Greek banks internationally behave, focusing in South Eastern European countries, in relation of aspects as business commitment and political dimensions.

**Methodology** – Empirical data were collected by using primary data sources. Primary data sources included semi-structured interviews with managers from the banks' headquarters as well as managers of their activities in the region. A total of twelve interviews were undertaken.

**Findings** – The theoretical view relies on the firms' internationalisation and business network theories and the varieties in the behaviour are explained by the degree of business commitment and knowledge. The analysis of the Greek banks' international behaviour, concerning their penetration and expansion in the region, reveals that commitment and knowledge also have political dimensions, which complement business commitment and knowledge.

**Limitations** – The main shortcoming is that the empirical study contains only two cases, which naturally raises the problem of generalisation.

**Conclusions** – Based on the findings, the outcomes of this paper add new knowledge to the Greek banks' internationalisation, for the better understanding of market entry and expansion, offering managerial implications for management of political relationships.

**Keywords:** business commitment; political dimensions; Greek banks; internationalisation process.

## 1. INTRODUCTION

The global financial system is facing a very difficult time. A large number of American and European banks have already gone into bankruptcy. Some of them have had significant cross-border activities, while others have been acquired or rescued at the last moment, following state interventions and liquidity injections of billions. This is a crisis which began, in essence, on the other side of the Atlantic and has spread throughout almost the entire world. The starting point of its evolution has been the bankruptcy of Lehman Brothers, the American investment bank, in September 2008 (Georgikopoulos, 2009). The collapse of Lehman Brothers has brought out, on a global scale, the issue of capital adequacy of financial institutions, the quality of their capital structure and the failure of the global financial system in terms of assessing the risks that had been undertaken.

This exogenous crisis and the adverse global developments in the money and capital markets had a relatively limited impact on the stability of the Greek financial system, compared to the systems in other countries that have been severely affected by this crisis. One of the main factors of strengthening of the Greek banking system is the satisfactory liquidity in the system, which is attributed to the strong growth of the Greek economy during the last few years and the expansion of Greek banks to the rapidly developing countries of south-eastern Europe (Vasiliadis, 2009; Kosmidou et al., 2007; Karafolas, 2006; Mamatzakis et al., 2005; Stubos and Tsikripis, 2005).

The region under consideration includes: the countries of Bulgaria and Romania where the first recently joined the European Union, Croatia is a new EU member since 1<sup>st</sup> July 2013, and the rest of the Balkan countries (Serbia and Montenegro, Slovenia, Bosnia – Herzegovina, Albania, FYROM, Kosovo) still remain basic candidates. All these countries became corporate “targets” for a number of multinational companies which attempted to explore new market segments. The increase of the international capital flows into the emerging markets of South Eastern European countries has been accompanied by the active development of foreign banking occurred at the same time. In all these emerging economies the appearance of foreign banking occurred only after a considerable restructuring of the political environment and the liberalisation of the financial sector (Uiboupin and Sörg, 2006).

Researchers in the field of banking have given their attention to aspects like contestability in Eastern European banking and competition in bank services (Yildirim and Philippatos, 2007). Regarding internationalisation of bank services, aspects like entry mode choices (Álvarez-Gil et al., 2003), FDI motives and growth (Tschoegl, 2002) and trends and obstacles have been the concern of researchers. Further, researchers have described motives and

activities of banks in emerging markets, like the transition markets in Eastern Europe (Miani and Sagan, 2006).

The main contribution aiming this study is to provide an analytical view on the internationalisation of Greek banks in these changing contexts (continuing and strengthening the conclusions of previous study – Vasiliadis, 2013). Thus, it is studied how two Greek banks penetrate and expand into new emerging markets in SEE countries. It is discussed how the penetration and expansion of these two Greek banks into these transition markets evolve, how the internationalisation of the firm affect the evolution of business networks at both levels and how they impact knowledge levels and behaviour. Then this process is investigated empirically. Comparing the two firms' penetration and expansion processes allows studying how their behaviour can be explained, given the different business environment they were confronted with from their first entry in the region. The results reveal the need to add another dimension to the model: commitment to and knowledge of management of political relationships.

## 2. LITERATURE REVIEW

In emerging markets like SEE countries, business networks had to be developed more or less from scratch after the fall of the Comecon network and the Soviet Union. Following Johanson and Mattsson (1988), this study distinguishes four theoretical situations dependent on the degrees of internationalisation of the firm and the market (see Figure 1).

**Figure 1.** A two-dimensional topology of entry strategy and internationalisation.

		Degree of Internationalisation of the Market	
		Low	High
Degree of Internationalisation of the firm	Low	(1) The Early Starter	(2) The Later Starter
	High	(3) The Lonely International	(4) The International Among Others

The degree of internationalisation of the firm is determined by the bank's degree of commitment and knowledge about the market of entry (Johanson and Vahlne, 1977; Johanson

and Mattsson, 1988). The degree of internationalisation of the market, however, refers to the position of the bank in relation to other firms in the market of entry, here the emerging markets in SEE. Next it will be discussed each of the four resulting situations separately (The early starter, the lonely international, the later starter, the international among others).

*The early starter (1)*

The degree of internationalisation of the focal firm as well as the market in general is low, in this situation (1). This means that the firm and also its competitors have little knowledge about foreign markets. As the level of uncertainty is high, the firm refrains from entering into a new market with large commitments but instead builds up knowledge through an incremental entry process. Firms in this situation can, for instance, manage their uncertainty by cooperation with local firms that have market knowledge. For a bank that would like to be close to its customers, but with a lack of sufficient knowledge to make the large commitment of developing a local network itself, cooperative strategies with agents can be a solution. The counterpart in the local market increases the firm's capability to solve different known and unknown problems related to the specific market circumstances. When the counterpart has a good market position, for example through strong distribution or financial connections to others in the local market, the early starter firm can gain an opportunity in filling the market holes (Ghuri et al., 2006). In doing so, it also raises obstacles for competitors wishing to follow the early starter into the market.

*The lonely international (2)*

The firm, in that situation (2), is highly internationalised but its market environment is not. The firm has built a large market commitment and has extended its market activities, but its competitors are far from this stage. The focal firm has knowledge and experience of where and in what they have to invest. More important for international banks is the relationship experience with different market actors. They have to understand different local institutions and cultural differences and to act directly with the foreign market actors. Their position of being alone depends on how they can manage the financial network in the local market. The timing of building and maintaining its relationships in the local network is of vital importance for the firm's penetration and expansion. This is particularly so because of the nature of the product exchanged in the bank industry: the low level of product complexity can easily open the doors for competitors and push the firm to Situation 4. However, highly internationalised firms have access to more resources, partly through their more extensive

network of partners and customers, and have also acquired capabilities for the development of new services in several countries. These advantages will strengthen the ties between the lonely international and its local partners, which can allow the firm to maintain its lonely position at the market.

*The later starter (3)*

In that Situation (3), the market is highly internationalised but the focal firm is not. For entering, late starter firms may observe and copy how other banks have penetrated and expanded or they can be pulled by their network partners. The decision to penetrate and expand requires the firm to undertake risk and commit resource to build new 'second-hand' relationships. The market share of the later starter cannot be high, as the market is already occupied by competitors with a tightly structured network. A very tight local network structure forces the late starter into the development of specialised products to avoid high levels of competition.

*International among others (4)*

In that Situation (4), both the firm and the market are highly internationalised and are predominantly confronted with high levels of competition. Because of the fact that banking networks across borders are highly related in that Situation, a highly internationalised bank can easily move from one country to another: using its knowledge and experience in one market to gain a position in another. For example, the knowledge and experience from other markets can speed up the agency phase and result in further market commitment (Blomstermo et al., 2006). Because of the nature of their products, banks can increase their commitments internationally more easily than industrial firms: coordination between different international units and diffusion of new and specific service happens at a higher speed. On the other hand, internationalisation in banks consists of other aspects that can hinder this speed: economic or political risks or crises, for example, can rapidly affect the financial assets of the firm globally. Banks can spread their risk in different countries with different conditions: issues like size of the bank and the specificity of its service products are of vital importance for strengthening its market position. In order to reach such a major position, banks often join actions with others: mainly through mergers and acquisitions.

### 3. METHODOLOGY

In order to understand of how Greek banks penetrate and expand into SEE countries and how the environment influences the entry and expansion behaviour of those enterprises, it was conducted an in-depth study of two Greek banks' entry processes in these emerging markets. They were selected two large-sized Greek banks that are both confronted with a saturated home market and have started to internationalise more extensively during the 2000s. The case banks did not want to disclose their names in this study, and therefore, their anonymity was guaranteed by using fictitious names in presenting them. Both banks were selected because they have started activities in SEE as part of their increased internationalisation strategy. This will allow to research whether developments in the environment influence the banks' entry and expansion strategies. The banks, that have been called 'Ipsilon' and 'Omega', started to invest in the region shortly after these markets opened up for foreign investment. Data was collected through interviews with managers from the banks' headquarters as well as managers of their activities in the region.

#### Primary Data - Interviews

The most common form of primary research is based on interviews, especially when the researcher is searching for in-depth information about a special phenomenon. Merriam (1998) has identified three types of interview styles that have different characteristics and structures. The interview structure ranges from highly structured, questionnaire driven interviews, to unstructured, informal interviews. From these styles, the interviewer can choose which style to use to get a desired answer from the interviewee.

- The highly structured interviews are more or less an oral survey. The wording and order of the interview questions are predetermined. This can be used to gather social-demographic data from the respondents. It can also be used if the researcher wants the interviewee to answer a statement or define a concept. The problem with the highly structured interview is that it does not allow the interviewee to speak freely about the subject. This can lead to misunderstandings, because an interviewee can wrongfully answer questions due to interpretations mistakes.
- The semi-structured interviews are conducted with some flexibility towards the interviewee. However, the interviewer has a framework of questions that s/he wants answered, but the flexibility will also allow the researcher the opportunity to elaborate on certain topics, as the interview proceeds.

- The unstructured interview style is essentially exploratory and is used when the researcher wants to learn about a topic.

Qualitative research using a semi-structured interview guide (Easterby-Smith *et al*, 1991) as the collection method seems best suited to this study.

### Face-to-Face Interviews

A face-to-face interpersonal role situation, usually associated with qualitative research, was seen as a feasible approach and was adopted in this research, because of the significance to gain meaningful insight to the subject, as well as to obtain extensive information from informants, which are particularly important for the research (Patton, 1990).

In conducting face-to-face interviews were considered to be more suitable than telephone interviews, mainly because of the greater flexibility they are able to offer in exploring issues as they arise, and due to the fact that the population to be interviewed was not spread (Janesick, 1998; Sarantakos, 1998). A core tenet of the data collection strategy was to target, and face-to-face interview, key individuals involved in each stage of the bank's foreign entry process. With that in mind, a 'hit list' was drawn up in the early stages of the research, listing some individuals by generic descriptor – e.g. level of responsibility. The list was drawn up by the researcher's own personal knowledge of the Greek banking sector and the people involved in it, and by taking advice from sector commentators. The interviewees fell into five generic categories, as shown in table 1.

**Table 1:** Generic Categorisation of Interviewees

Generic category	Number of interviewees
International Marketing Director	2
Marketing Manager for international affairs	4
Senior Executive involved with international process	2
Director of foreign subsidiaries sector	2
Consultant for international affairs	2
<b>Total</b>	<b>12</b>

A total of twelve interviews were undertaken. This meant that a total of twelve people were interviewed. The success rate with approaching people for interview was very high at over 90 percent. In almost all cases where the request was declined, it was possible to gain an alternative perspective on particular events from another interviewee and there were no significant gaps in the scope of the interview material generated. The interviews were conducted in the interviewees' offices. An important facet of the interview programme was anonymity. Hence any opinions that were expressed by interviewees would be presented in any published material in such a way that the contributor remained anonymous. Without exception, all interviewees were happy with this arrangement.

The cases were separately analysed comparing the results in a cross-case analysis:

### Findings (in table)

**Table 2:** Case summaries

	<b>Ipsilon bank</b>	<b>Omega bank</b>
<b>Exploration stage</b>	<ul style="list-style-type: none"> <li>• Greenfield entries (branches)</li> <li>• Opportunistic entry in general; expand if successful</li> <li>• Local personnel for links with local institutions.</li> </ul>	<ul style="list-style-type: none"> <li>• Greenfield entry preferred but not possible in general</li> <li>• Local personnel for links with local institutions.</li> </ul>
<b>Penetration stage</b>	<ul style="list-style-type: none"> <li>• Banking licences granted smoothly because of the successful integration in institutional network</li> <li>• <i>Products</i>: simple package</li> <li>• <i>Clients</i>: large multinationals.</li> </ul>	<ul style="list-style-type: none"> <li>• Difficulties in obtaining banking licences in general for branches because of the less immediate success with integration in institutional network: need to acquire local bank in a market; adapted business concept in another market</li> <li>• <i>Products</i>: simple package</li> <li>• <i>Clients</i>: local companies and multinationals in some industries.</li> </ul>
<b>Expansion stage</b>	<ul style="list-style-type: none"> <li>• Expansion also to serve local companies; preferably, acquisition of local company or otherwise expand offices</li> <li>• Expansion of product package when market is "ready"</li> <li>• Expansion to retail banking</li> </ul>	<ul style="list-style-type: none"> <li>• Expansion to serve more client companies in some industries; growth mainly through local clients</li> <li>• Expansion of product offering on demand of and in cooperation with clients</li> <li>• Expansion to retail banking</li> </ul>

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	for private households eventually.	only for private persons in some industries.
<b>Result</b>	Respectable market shares in general.	Small market shares in general, but higher in some industries.

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#### 4. ANALYSIS

Considering the firms' degree of internationalisation, two case banks of this study represent an Early Starter (Ipsilon) and a Late Starter strategy (Omega), respectively. Ipsilon's entry strategy shows that it invested widely in developing relationships with government and other institutions. This is in accordance with the Early Starter pattern. Because Ipsilon lacks experiential knowledge of the SEE markets and cannot use existing network relational paths, it hires local people to develop such network relations. From a country's experiences it seems that hiring the person with the right connections at the Central Bank smoothes the entry process. In other country, the early investment in developing network connections results in bank's strong position in several institutions. Ipsilon also achieved a strong position in the developing business networks in the markets it entered. The bank's managers relate that their early positioning in the market resulted in attracting clients like large multinational companies, whose 'own' banks were not yet present in the region.

Although Ipsilon internationalised in other regions before entering SEE, it adopted a gradual and risk-avoiding approach to enter these markets. It preferred to enter through a branch, i.e., avoiding the control of the local Central Bank and only established subsidiaries when forced by local government. In congruence to Johanson and Mattsson's Early Starter, Ipsilon offered only simple and standard products in the new markets. The bank expanded its product offerings only after increased its local market knowledge and the market showed a certain level of development. Also, Ipsilon extended its focus to other target groups, including groups that are more difficult to reach and that demand a higher level of local commitment, such as private households.

Johanson and Mattsson suggest that Early Starters attempt to solve their lack of market knowledge and uncertainty in foreign markets through cooperations with local companies. In contrast, Ipsilon has not established such cooperations in its first stage of penetration, but instead acquired local knowledge through hiring local managers in important positions. In a next stage, expansion was eventually furthered through acquiring a local bank. This acquisition offered to the bank the network of offices that it needed to expand to target

groups like private households. Ipsilon's Early Starter strategy has proven to bring the bank success because it has provided the bank with a strong position in networks of customers and regulators. Ipsilon has followed a gradual expansion pattern with extensive investments in building a network position, but like Johanson and Mattsson reasoned, this has given it a beneficial position in facing the competition of later entrants.

Omega bank (the second case) has been one of those later entrants. Omega set its first steps in the region, when banks like Ipsilon had already been present and had already built their network of relationships. This is like the highly developed international context that confronts the Late Starter according to Johanson and Mattsson's model. In a country of the region, Omega in order to receive a banking licence is required, against its preferred entry strategy, to make an acquisition. In other country, its withdrawal is partly the result of the market already being taken by competitors and not allowing enough space for another player. Finally in other country, it is the bank's uncertainty about the high level of political risks that stalls further expansion. To build network relations, Omega joins the lobbies of united international banks and also, like Ipsilon, hires local managers with extended networks. To build profitable banks in the region, Omega further cannot rely on its client network of foreign investors alone. In contrast to Ipsilon, Omega is forced to reach out to local companies, also small- and medium-sized companies, to start up their business.

Omega's entry strategy is in accordance with the gradual approach predicted by the theories (Johanson and Mattsson, 1988; Johanson and Vahlne, 1977). Before entering SEE, Omega collected information about these markets from several areas, including competitors that already had entered them. Further, Omega's preferred entry strategy is through a Greenfield office, i.e., an entry mode that demands fewer immediate investments than an acquisition. Like Ipsilon, Omega started with simple banking products first, adding products and developing new ones in cooperation with clients over time.

Besides the heterogeneity in the commitment of these firms because of their degree of internationalisation, it was also found an interesting homogeneous behaviour towards actors. This aspect considers the type of commitments. As the cases manifest, the firms' resource commitment and organisation can be divided into two types. These two types are business commitments, which were related to the business relationships, and the other was the political commitments, which considered the political actors and bureaucrats. As the cases and also the figures illustrate, there was a clear difference between these two types of the firms' commitments. Both firms, specifically in the penetration stage, were faced with the

problem of, for example, having to obtain a licence. These two different commitments developed hand-in-hand, but demonstrated different degrees of internationalisation.

The two banks had two types of commitments, as illustrated in Figure 2, which varied depending on the degree of internationalisation. In the first stage of internationalisation, for example, both firms were in cell 3 as the first commitment was to solve the political and bureaucratic problems. But, as the case of Omega manifested, the firm in the expansion stage considered the business commitment to be high and the political commitment was less. If a firm like Omega conducts a high investment in the political arena for penetration and is not able to move from cell 3 to cell 2, then the only option is exit. Besides the fact that firms hold commitment towards two different political and business markets, the degree of commitments in these two types does not follow similar development. While one is high in one stage, the other can be low and vice versa. In severe conditions, like mergers and acquisitions, both types may stand in cell 4, as the firms require a high level of investment for the businesses and at the same time resolve the political and bureaucratic demands.

**Figure 2:** Types and degree of commitments

		<b>Internationalisation and Business Commitment</b>	
		Low	High
<b>Internationalisation and Political Commitment</b>	Low	1	2
	High	3	4

## 5. CONCLUSIONS

The analysis (continuing and strengthening the conclusions of previous study – Vasiliadis, 2013) contains several interesting conclusions:

1. The first one concerns the internationalisation process model's ability to analyse the firms' entry strategies and expansion in new emerging markets. The empirical study contains facts showing the slow progress in their internationalisation. It is true that firms entered into these markets at different times but their expansion followed the

same slow progress in the increasing knowledge and commitments. Ipsilon's Early Starter has benefited from being one of the first movers: it has gained a very strong position in the local business networks. These strong network relations have been shown to support the success of the bank. Omega, in contrast, has been much less successful in reaching its targets: it has been confronted with higher levels of competition from local business networks resulting in lower chances of starting with a portfolio of foreign investors. This conclusion supports those believing in internationalisation process model and business network.

2. The second conclusion raises questions on definition of the market in the theoretical sense. Specifically, it relates to new emerging markets like SEE countries, as these markets change drastically in their political and business fields. The internationalisation model emphasises on commitment and knowledge for managing the business markets. Actors like customers, competitors and suppliers define a relationship network of a market. These actors are limited by relationship commitments and knowledge. The employment of the business network for these two firms shows new facts besides these explanations. As the cases manifested, the firms' network contained two different types of actors: Business and Institutional. This conclusion verifies the results from other studies (Welch and Wilkinson, 2004), which express the decisive role of the institutional political actors in business network. This conclusion resides on the presumption that political actors belong to a different market because their function is different. Therefore, it can be stated that business firms, specifically those acting in new emerging markets like SEE countries, are functioning in two interrelated markets: the business and the political. The entry and expansion behaviour of the firms relies on how these firms can manage these two markets.
3. The third conclusion relies on the rule of incrementality in the commitment and knowledge. Based on the cases, it can be concluded that there are differences between the two types of business and political commitment and knowledge of the firms. Besides that, the degree of commitment in these two types can vary at different stages of internationalisation. A deeper understanding of the types of commitments at different stages of internationalisation may provide a better understanding of why some firms do not succeed: this is not because of the degree of internationalisation of

the businesses, but because of the hindrances created by political actors in entry or expansion stages of internationalisation. This is an extremely important issue since the political and institutional systems in new emerging markets are not so stable.

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## CHINESE ACQUISITIONS AND THEIR IMPACT ON THE MADE IN ITALY LUXURY SECTOR –

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### **ABSTRACT**

The competitiveness of the Made in Italy luxury industry is in question. Traditionally Foreign Direct Investment (FDI) has flowed from the advanced developed economies into developed and developing countries. More recently a new trend has emerged in the pattern of FDI. Outward bound FDI from emerging economies has begun to increase significantly and has been growing at a faster pace than FDI from the advanced developed world. The proposed project seeks to study the impact of Chinese acquisitions and their impact on the Made in Italy luxury sector and its stakeholders. The proposed project has been funded by Marie Curie CIG grant and just started in June. The overall goal of the project is to establish and implement a substantial research agenda that will assist policy makers in responding to this trend and will be of value to all stakeholders in the Italian luxury industry as they face this facet that inevitably globalization entails.

**Key Words:** Made in Italy, luxury, FDI, Chinese acquisitions

### **1. INTRODUCTION**

While traditionally Foreign Direct Investment (FDI) has flowed from the advanced developed economies into developed and developing countries, more recently, a new trend has emerged in the pattern of FDI. Outward bound FDI from emerging economies has begun to increase significantly and has been growing at a faster pace than FDI from the advanced developed world. Increasingly nowadays Multinational Corporations (MNCs) from Newly Industrialised Countries (NICs) are buying business assets and capabilities in the luxury sector all over Europe.

According to a recent EC report (CEC, 2012), skills shortages, mismatches and gaps may lead to the disappearance of certain activities and knowhow from Europe. Existing trade and investment barriers in third countries make it more difficult for European products to reach new markets and establish distribution networks. The efforts European luxury companies make in creativity and innovation may be hampered by illegal activities, such as intellectual property rights infringements. In the current economic situation, access to finance, which is a key determinant for the start-up, development and growth of businesses in the fashion industry, remains a major difficulty. At this stage, therefore, it is crucial that the European industry be given the conditions and support it needs to take advantage of the existing opportunities.

Italy has a traditional competitive advantage in the production of luxury products and services (Vecchi, 2008). The Italian luxury market has long been regarded as the origin of the mainstream luxury goods and services, including brands like Giorgio Armani, Prada, Gucci, etc. With its rich cultural heritage embedded within these brands, these firms have captured loyal customers and remarkable profits from all over the world. In Italy, luxury brands are deeply rooted in their design, quality, craftsmanship and service and it often has taken decades to build their reputation. These features often appeal to those who want to instantly build a luxury brand and during the recent economic downturn, the main players of the sector have caught the opportunity to reshuffle the cards. For example, recently De Tomaso, a maker of luxury sporty cars has been acquired by Hotyork Investment, a Chinese group. Earlier this year, Shandong Heavy Industry Group of China bought 75% of Ferretti, a builder of luxury yachts that had previously bounced between banks and private-equity funds. In December Eland World, a South Korean retailer, bought 49% of Coccinelle, a firm that makes handbags, for €15.5m; Coccinelle's parent firm, Mariella Burani Fashion Group, went bust in 2010 (The Economist, 17/3/2012). Other examples include Trinity Limited.'s purchase of Italy's Cerruti and and Hong Kong businessman Peter Woo's 8% stake in Salvatore Ferragamo. Overall, an increasing number of the acquiring companies are from China or other emerging economies. A number of major fashion houses have indicated their intent to sell part or all of their stakes in various well known brands—House of Galliano, Roberto Cavalli, Pierre Cardin. The sellers of these brands have made no secret of the fact that they are indeed courting NICs' investors.

The project seeks to assess the broader implications that acquisitions from Chinese MNCs might have for the Italian luxury sector. The ultimate aim is to conduct an inter-disciplinary

project which seeks to develop a framework (relevant both to the Chinese MNCs and the luxury Italian firms targeted) that could lead to a “win-win situation” for all the stakeholders in the luxury sector. In particular, there is the need to develop a framework that would be beneficial to both the interests of the acquired firms and the investors. So instead of the outcome being a win-lose one with the all of the benefits going to the investor the outcome would be one in which the complementarities of both firms would be leveraged in a synergistic mode so that the benefits would be maximized for both to generate a win-win set of outcomes.

## 2. PURPOSE

The main aim of this project is to assess the broader implications that the acquisitions from Chinese MNCs might have for the Italian luxury sector with the goal of ascertaining their impact on the “Made in Italy”. The aim will be achieved by meeting the following project objectives:

Table 1.1: Project objectives

Project Objectives	
1. Clarify and quantify the nature of Chinese acquisitions in terms of the sources of such investment	
2. Gain an in-depth understanding of the expanding international activities of Chinese MNCs	a) The influences and motives driving these firms to invest beyond their borders and in particular into the luxury Made in Italy
	b) The patterns and modes of Chinese acquisitions affecting the different sub-sectors of the luxury Made in Italy
	c) The unique competitive strategies for expanding overseas and the particular challenges that Chinese MNCs
3. Gain an in-depth understanding of the impact of these Chinese acquisitions	
4. Estimate the future nature, pace and magnitude of this emerging phenomenon in relation to the broader Made in Italy and make forecasts for the future	

As the result of the multidisciplinary project, the contribution to knowledge in a variety of functional disciplines will greatly enhance the existing sparse body of knowledge around this topic. The socio-economic reasons for undertaking such a multidisciplinary project are also significant. The European Commission has already recognized the importance of the Luxury sector for growth and employment in Europe. Antonio Tajani, Commissioner for Industry and Entrepreneurship has stated that *“The European Luxury goods sector is a key component of sustainable growth in Europe and on-going Creativity and Innovation. Luxury exports have continued to grow through the financial crisis and the sector is an example of European Cultural Excellence at its best”* (Altagamma, 2010). The luxury goods industry as a whole is of major importance to the European economy. It employs approximately 800,000 people (directly and indirectly) in Europe with an annual turnover of approximately €170 billion. Indeed, the competitiveness not only of Italy but of the entire European luxury industry is in question. While some Chinese investors have acquired stakes in Italian local brands, the focus has been also on acquiring stakes in European brands.

### **3. RESEARCH METHODOLOGY**

From a research methodology viewpoint, in line with the multidisciplinary ethos of the research a variety of methods will be employed. These will include desk research, case studies, surveys, forecasting techniques to include the Delphi method for theory development and extension. Since the ultimate aim of the project is to stimulate ideas around both national level policy responses as to develop a framework that would be beneficial to both the interests of the acquired firms and the Chinese investors, the Delphi method has been deemed as particularly suitable for the task at hand. Desk research will form a major part of the means of seeking to describe and quantify the emerging phenomenon. This research will draw on many of the major international data sources such as UNCTAD, and Eurostat. National databases such as ISTAT will also be accessed and a particular emphasis will be given to the local national sources of data from China. In addition a variety of other sources including company reports and business news media will be utilised to gain as complete a picture as possible of these Chinese acquisitions in the luxury Made in Italy. Similar approaches will be employed to ascertain the nature of acquisitions from China in terms of the sources of such investment and the sectors from which it is emanating. In terms of gaining an understanding of the expanding international activities of investors from China, a number of approaches will be involved. Firm level case studies will be a central element of the

approach. These case studies will be centred on Chinese MNCs who have already invested in the luxury Made in Italy. While the focus of such case studies will be around local brands, operations and facilities in Italy; gaining a complete understanding of the strategic and competitive positioning of these will also involve interviews with key actors within these firms in China at headquarters' level. The selected firms will be representative of different sub-sectors of the luxury Made in Italy (fashion, boats and cars, hospitality etc.). Interviews will also be conducted with key-informants and managers of local firms in the same sectors to assess the competitive impact for local firms of this emerging trend. An evaluation will be made of current policies which promote, attract and facilitate inward investment to Italy to gauge the degree to which they are taking cognisance of this emerging trend. Discussions with local and national policy makers will assist in this evaluation process. In seeking to estimate the future nature, pace and magnitude of this emerging phenomenon, reliance will be placed on surveys of key actors from China and the involvement of experts in a Delphi forecasting process. Finally, in attempting to add to the body of knowledge around the internationalisation process and the extension of existing theory and likely the development of new theory, an integrative process will be deployed. Cross-case analysis will be conducted in different sectors of the Made in Italy and cross-sectoral comparisons will be made. The outcome of these analyses and comparisons will be synthesized and its implications for International Business theory established. In particular, one of the ambitions is to stimulate ideas around national level policy responses as to develop a framework that would be beneficial to both the interests of the acquired firms and the investors.

#### **4. RELATIONSHIP TO THE 'STATE OF THE ART' OF RESEARCH IN THE FIELD**

##### **4.1 OFDI and Internationalisation theories**

The Chinese acquisitions affecting the luxury Made in Italy sector are emblematic of a wider trend. Many emerging economies have benefited from a massive infusion of capital, technology and managerial expertise from the traditional industrialized countries. As a result of this and other factors, companies in some of these countries have amassed sufficient capital, knowledge and know-how to invest abroad on their own. The proportion of FDI accounted for by emerging economies is increasing. According to the UNCTAD (2010), the rate of outward FDI growth by companies from emerging markets has outpaced that by

companies from the industrialized countries. The participation of emerging countries in FDI flows has varied considerably during the past 30 years. In relative terms, emerging markets have increased their share of FDI outflows from 1.29 percent in the 1970s to 11.10 percent during the 1990s, while FDI outflows from developed countries had decreased in proportion from 98.69 percent during the 1970 to 88.61 percent during the 1990s. There is strong connection between the growth of FDI into Europe with the increased economic integration in the European Union (Dunning, 2006).

More recently the global picture of FDI flows belies a more varied regional reality. Most FDI in developing and transition economies has flowed to a small number of countries, mainly large emerging markets (UNCTAD, 2010). In the context of MNCs from NICs, China represents one of the leading player ranked 5<sup>th</sup> among all economies in terms of OFDI flows (UNCTAD, 2011). While China's dominant position as recipient of global FDI flows has been well documented, the overseas investment activities of Chinese companies have received considerably less attention. However, a recent wave of cross-border M&A deals by Chinese firms has brought increased interest in this topic. China's investments abroad registered a significant increase despite an overall decline in foreign direct investment following the 2008 financial crisis (UNCTAD, 2011). This remarkable growth is likely to continue since China's substantial foreign exchange reserves and as a consequence of its monetary policy. Furthermore, UNCTAD (2010) indicates that recovery of FDI in 2012 is likely to be led by cross-border M&As.

Restructuring in a number of industries, as well as the privatization of companies rescued during the global turmoil, will further create cross-border M&A opportunities for Chinese MNCs. Traditionally, much of the FDI from emerging markets has been directed to emerging markets with geographical proximity and similar economic and cultural backgrounds. In recent years, however, MNCs from emerging markets have moved towards other markets outside their regions. In this age of financial crisis and austerity, an increasing number of luxury companies are seeking financial support and alliances with wealthy companies. Meanwhile Chinese MNCs are willing to engage in new investments for gaining market and strategic asset-seeking often at bargain prices. The result is that Europe is experiencing a structural wave of Chinese MNCs acquisitions where annual inflows tripled from 2006 to 2009, and tripled again by 2011 to €10 billion for the current year (Rhodium Group, 2012).

A variety of reasons have been offered for the emergence of FDI from emerging economies (Rios-Morales and Brennan, 2010). These include the support of exports, the expansion of

market presence, the acquisition of established brands and foreign skills and the establishment and strengthening of local distribution networks. The increasing financial strength and the growing international exposure of companies from emerging economies together with greater domestic competition have also been suggested as explanations. Finally, the goals of building international brands, accessing advanced technologies and establishing R&D centres in developed countries help to explain the growing trend.

The surge of FDI in recent years has generated a growing body of literature on FDI with the theory of internationalisation and the Eclectic Paradigm widely utilized. While the theory of internationalisation focuses on entry modes and competitive advantages of a firm, the eclectic theory incorporates a holistic explanation of why a firm moves abroad, suggesting that location-specific advantages arise from using endowments that are tied to a particular location (Dunning, 2006). The theory affirms that the extent and pattern of international production undertaken by MNCs is determined by the interaction of three sets of interdependent variables: Ownership, Localization and Internalization advantages, resulting in the abbreviation and alternative name of the eclectic paradigm, namely the OLI paradigm (Dunning, 2006).

The first competitive advantage represents the ownership (O) of specific resources to be exploited externally. These advantages can be endogenous or exogenous to the company. The first refer to a company's access to income generating assets such as technology, knowledge or managerial and organizational skills. The latter are related to the privileged access to input factors such as raw materials, funding and labor allocation. Penrose (1966) defines the ownership advantage as an asset competitors cannot imitate, copy or otherwise access over the short run, securing the company monopolistic rents. Rugman (1981) calls this advantage as Firm Specific Advantage (FSA) defining it as a unique capability proprietary to the organization and they can be technology based, knowledge based or they can reflect managerial skills. FSAs are property rights and intangible assets advantages such as new process or products and strong brand names. According to Dunning (2006), the O-advantage has to be identified, nurtured and fostered, accessed and capitalized upon by the company. The greater the competitive advantage of the investing firms relative to those of other firms, the more they are likely to be able to engage in foreign production (Dunning, 2006).

The second element of the OLI paradigm regard the host country location attractions (L). In particular, the model refers to the immobile, natural or created endowments which the more they favor a presence in the foreign country, the more they encourage firms to exploit their

ownership advantage by serving market through FDI rather than export. Rugman (1981) defines the L-advantage as the Country Specific Advantage (CSA) that are unique to the business in each country. The author asserts that building on CSAs, the firm makes decisions about the efficient global configuration and coordination between segments of its value chain such as operations, R&D and logistics.

With regard to the last variable of the paradigm, the internalization (I) advantages involve the opportunity to keep firm specific resources within the company rather than exploit them in the market through arm's length transactions (Amighini & Rabellotti, 2010). Dunning (2006) asserts that the greater the net benefit of internalizing, the more likely the company prefers to engage to foreign production itself, rather than license the right to do so to a foreign firm. In his later works, Dunning affirms that the significance and configuration of the above mentioned parameters is strongly contextual and it is likely to vary across industries. The OLI variables explain why internationalization occurs but do not identify the process of internationalization. Thus, the eclectic paradigm has been extended to include the theory of the Investment Development Path (IDP) that was first put forward in 1975 and since then it has gone through various iterations (Dunning, 1981,1988; Dunning and Narula, 1996).

The IDP explains how a country's outward and inward direct investment position change as a result of the economic development of the country ( Dunning and Narula, 1996). The basic hypothesis of the model is that as a country develops, the pattern of the OLI advantages change and that is possible to identify both the reasons underlying the changes as well as the effect on the country's development cycle (Dunning, 2006). The IDP recognizes five stages of development a country might pass through, based on its ability to be outward or inward direct investors (Dunning and Narula,1996). In the first stage, a country is in a period of pre-industrialization and a country's inward as well as outward direct investments are almost nonexistent (Dunning, 2006). Dunning and Narula (1996) explains that in the first case the country has insufficient location advantages and in the second case its firms have few ownership advantages, which is the result of the country suffering from an insufficient economic systems or government policies and poor infrastructure. Depending on its resources, government policies and strategy of the firms, the OLI parameters change so as to attract inward investments, leading to the second stage of development. According to Dunning (2006), a country's L-advantages increase as the country increases its efforts to create an improved legal system, infrastructure and human resources. Therefore, in this early stage the role of the government is especially important. The third phase registers a decline in growth of inward FDI and an increase of outward FDI directed to countries in a lower stage

of the IDP (Dunning and Narula,1996). The O-advantage is less based on domestic natural resources and more on organizational and managerial competences. Countries in stage four are referred to as post-industrial economies with outward FDI growing faster than inward FDI. Companies increasingly internalize to protect their owner-specific advantages by reaching other markets through FDI rather than exports. The final stage of the IDP occurs when there is a balance between inward and outward FDI as a result of some degree of convergence of the level of development and the economic structure of countries (Dunning, 2006).

Dunning and Narula (1996) highlight the critical importance of the government at this stage too, to influence the quality of L-advantages and to set the suitable competitive advantage that allows its firms to exploit the opportunities offered by the global economy. As a result to the internationalization of companies, national boundaries become less significant and the world is increasingly interconnected. Therefore, companies engage in FDI not only to exploit their existing O-advantage in a host location, but also to augment the advantages by acquiring complementary assets or new markets (Dunning, 2006). The theories reviewed so far identify the institutional environment as one key factor of influence on the decision-taking. However, the focus is generally on the recipient country's framework. The OLI paradigm takes into consideration the foreign institutional environment as a potential driver of location advantages, yet, the role of home country institutions and particularly government is key to shaping the process of internationalization of domestic firms (Ramamurti, 2008).

According to Sim and Pandian (2007), the impact of the domestic institutional framework is acknowledged in terms of push-factors triggering the internationalization of a company. North (1990) defines institutions as the 'set of rules', formal and informal, which organizations in pursuit of their own learning and resource allocation goals must follow. This concept includes a wide range of elements such as the legislature and bureaucracy, government structure and customs and beliefs. In accordance to (Williamson, 2000) all of them are interlinked and influence each other. Furthermore, Redding (2002) asserts that the institutional configuration determines the pace and scope of a country's macro and micro level economic development as consequence of the policy provided by government to local and foreign firms. In this respect, Murtha and Lenway (1994) argue that the constraints given by an institutional environment affect the decision-making of a firm by contributing to or underpinning a firm's capability.

In response to the previous criticism to the OLI paradigm, Mathews (2002) has developed a new theoretical framework called Linkage, Leverage and Learning (LLL) to analyze the phenomenon of the MNEs from Asia-Pacific that he calls "Dragon multinationals". The model captures the idea that latecomers use their overseas investments and global linkages to leverage cost leads and learn about new sources of competitive gains. Differently from the OLI perspective, Mathews sees the first phase of MNEs formation as most likely to begin with asset-exploring purpose rather than asset-exploiting motives. He argues that linking with mature market MNCs, a latecomer firm may leverage knowledge, technology and market access with the result of entering in a learning process which can be exploited for further growth (Mathews,2002). In the pursuit of resources and capabilities not otherwise available, the emerging MNC seeks advantages that can be acquired externally. Therefore, a global orientation represent a source of competitive advantage since the global market increase the possibilities to access to new and complementary assets (Mathews, 2006). Partnerships and joint ventures are seen as vehicles to connect with proprietary assets and knowledge and reduce the risks and uncertainties related to international expansions. Chen and Chen (1988: p.446) asserts that resource access may be interpreted as *"an attempt to access external resources in order to offset the weaknesses of the investor"*. According to the LLL model, the degree of international success is related to the extent to which links can be established and resources can be leveraged. The leverage potential is related to the accessibility to these resources in terms of their inimitability, transferability or substitutability. So, one of the main focus of the latecomers is how to overcome such barriers to access to initially lack resources in foreign countries. By repeating the process of linkage and leverage, emerging MNCs benefit from learning to perform such operations more effectively entering in a path of organizational learning. Thus, the latecomer companies are able to take maximum advantage of the new opportunities presented by inter-linkages of the global economy (Mathews, 2006). Moreover, Li (2007) shows how this internationalization process is often interlinked to inward FDI at home that provides to the local firm the unique chance to enter into established global networks and thus enhancing their capabilities. This allows companies to develop their own capabilities and to become more competitive abroad through experiential learning process. The benefits are related to the ability of the firms to leverage external resources and its 'absorptive capacity' meaning the ability to identify, assimilate and exploit external knowledge (Cohen and Levinthal, 1990).

Overall, while the conventional theories of internationalisation such as the Eclectic Paradigm, IDP as well as LLL offer some insights into the changing trends in FDI, they provide an

incomplete understanding of the drivers of this new phenomenon. This suggests that theories of internationalisation need to be developed so that are reflective of the new global context in which the attainment of economic goals are underpinned by cultural and political fundamentals.

#### **4.2 OFDI and their impact on the Made in Italy**

While we have extensive evidence of FDI flows from the Italian fashion sector into developed (Vecchi, 2008) and developing countries such as the UK Romania (Crestanello & Tattara, 2011), we are very little evidence of the opposite trend and to a bigger extent in relation to the luxury industry (Rabellotti & Sanfilippo, 2008; Pietrobelli et.al., 2010). The issue of the Chinese acquisitions and their impact on the luxury Made in Italy is particularly relevant for the competitiveness of the national industry and the rationale for conducting further research in this field is twofold.

First, the production of luxury Made in Italy mostly relies on industrial districts that are characterised by the active presence of both a community of people and a populations of firms (Becattini, 1989). Within this context the presence of foreign investors (Vecchi, 2008) as the Chinese in the Prato district (Dei Ottati, 2009) can significantly affect the district internal dynamic by compromising their future viability (Dunford, 2006; Vecchi, 2008; Dei Ottati, 2009). In essence, when radical changes in the competitive context such as those that Globalisation entails (Vecchi, 2008) it becomes likely that external competitive pressures will cause destructive forms of competition by ultimately undermining the districts equilibrium and the propagation of its competitive advantage (Dei Ottati, 2009). In these instances, districts revival development would require profound changes which cannot merely rely on familiar experience and behavioural models that were previously deemed as strategic (Dunford, 2006). On the contrary, it requires the deliberate construction of a new equilibrium which inevitably see the involvement of some global actors (Vecchi, 2008; Dei Ottati, 2009; Rabellotti & Sanfilippo, 2008). Assessing the role of Chinese acquisitions within this context thus becomes crucial for the viability of the luxury Made in Italy.

Second, the mixed expectations related to China's overseas expansion calls for a better understanding and knowledge of the strategies of Chinese companies entering overseas markets to inform what is becoming an increasingly relevant debate. Although this topic is becoming fashionable in international business studies, the empirical evidence on Chinese FDI in European countries is quite limited and relates mainly to the UK (Burghart and Rossi,

2009; Cross and Voss, 2008; Liu and Tian, 2008) and Germany (Schüller and Turner, 2005). This evidence is even scarcer if we consider Italy and more specifically the luxury sector.

#### **4.3 Originality and innovative nature of the project**

As such, there is a valuable opportunity to conduct further research. The project is original and innovative in a number of ways:

- There is no research seeking to assess the broader implications that Chinese acquisitions might have for the luxury Made in Italy currently underway in the EU research programmes and other European fora.
- It will provide a novel perspective on one of the recently emerged unanticipated effects of the process of globalisation.
- It will develop the space around a new field of enquiry. It will also provide valuable insights for a variety of stakeholders in the luxury sector.
- The project will deliver contribution to knowledge around the areas of internationalisation and Foreign Direct Investment in the luxury Made in Italy sector.
- By providing understanding and insights, it will inform and benefit the various stakeholders in the sector.
- Luxury firms and their managers will gain an appreciation of the competitive strategies of these new entrants and will thus be better placed to develop both competitive and collaborative responses.
- As the result of the research project, the contribution to knowledge in a variety of functional disciplines will greatly enhance the existing sparse body of knowledge around this topic.
- Finally, the project may also have benefits for firms from NICs in better understanding the challenges that they face in expanding into the luxury Made in Italy.

## **5. CONCLUSION**

Due to the increasing intensification of Chinese M&A activities and of the related fears and expectations regarding Chinese MNCs expansion a fuller understanding of the phenomenon is not only desirable but also indeed necessary. As such there is a valuable opportunity to conduct multi-disciplinary research. Overall, there is a widespread fear that by being acquired by NIC's investors the interests of local stakeholders will be subordinated to those of non-local stakeholders with adverse consequences for local firms, employment levels and standards and the overall welfare of citizens by ultimately eroding the competitiveness of the

Italian luxury sector. By researching and analysing the Chinese acquisitions and their implications for the luxury Made in Italy, the proposed project is a timely response to addressing a key part of the manifold issues that are currently arising in Italy as a result of the ongoing process of globalisation. The project will provide quantification and insights around an emerging phenomenon. The project will deliver contribution to knowledge around the areas of internationalisation and Foreign Direct Investment in the Italian luxury sector. By providing understanding and insights, it will inform and benefit the various stakeholders in Italy. This is critically important given the degree of anxiety that stems from the sensitivity of this novel topic. In many European countries, politicians, business leaders, employees and their representatives have in varying degrees expressed alarm about this new phenomenon. The provision of concrete research results can assist governments in supporting the sector with responding to this phenomenon by adjusting their policies so that local economies are able to capitalise on the advantages to be derived while minimising the negative impacts. In this sense, the project will contribute to enhance EU scientific excellence and will support Italian luxury firms and their managers to gain an appreciation of the competitive strategies of these new entrants and will thus be better placed to develop both competitive and collaborative responses. Finally, the project may also have benefits for MNCs from China in better understanding the challenges that they face in expanding into the luxury Made in Italy. A number of conclusions can be drawn at this preliminary stage. There has already been interest in this sector and its players from non-traditional investors. Such interest is likely to continue and grow given the attractiveness of the industry and the prestige associated with it. Non-traditional investors are likely to encompass both firms from the fast growing emerging economies and Sovereign Wealth Funds. Interest in the topic of investment from non-traditional sources has already attracted the attention of scholars (Brennan, 2011). However it is likely that such attention will need to be more sector focused into the future. In that respect, the research plan presented in this paper can serve as a template for other researchers addressing other sectors. Finally it can be noted that the topic of this research lends itself well to interdisciplinary exploration. Indeed such exploration is likely to be essential if the goal of developing win-win responses to this phenomenon is to be realized.

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## **ANALYZING THE REQUIREMENTS OF AN ON-LINE ACCOUNTING PLATFORM IN GREECE: THE VIEWS OF DIFFERENT USER GROUPS**

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### **ABSTRACT**

The ascent of knowledge economy and the advance of information and communication technology (ICT) have placed e-learning as mainstream application by providing knowledge workers with learning experiences that are accessible, timely and affordable. In the business world, accountants are amongst the professional groups whose work has been affected significantly by ICT developments. However, existing literature has not investigated in depth user's requirements of an e-learning accounting platform yet. The scope of the present study is to record how potential users evaluate the usefulness of a web-based platform operating as an accounting educational platform and at the same time as a job-seeking environment in the field of accounting. Moreover, it aims at examining the characteristics that an educational platform and job seeking mechanism should include. Finally, the study aims at exploring differences existing between user groups in relation to an e-learning accounting platform. More specifically, it explores four target groups' opinions on e-learning accounting platform, that is, students, academics, employers and people interested on vocational training. The analysis is based on 451 answers on a structured questionnaire. The analysis is conducted in Greece that is a country with specific peculiarities in terms of accounting, the most significant of which is the strong financial accounting conformity.

**Keywords:** e-learning, accounting education, user needs, accounting educational platform, accounting job-seeker

## INTRODUCTION

The ascent of knowledge economy and the advance of information and communication technology (ICT) have placed e-learning as mainstream application by providing knowledge workers with learning experiences that are accessible, timely and affordable. E-learning is the use of electronic media for teaching and learning anywhere and anytime (Engelbrecht, 2005). E-learning has been viewed as synonymous of terms such as web-based learning, internet-based training, advanced distributed learning, web-based instruction, on-line learning (Khan, 2001; Selim, 2007). Despite the positive trends of e-learning, e-learning poses a challenge for both schools and industry, since e-learning requires the integration of information technology into teaching and learning process (Akour, 2012). For this reason, a number of research initiatives have emerged to explore the conditions that enable an e-learning system to deliver the desired learning outcome.

In the business world, accountants are amongst the professional groups whose work has been affected significantly by ICT developments (Engelbrecht, 2005). The internet has become a powerful tool for governments; legal, financial and accountancy firms to empower accountants with distributed modern information processing capabilities. Besides accounting profession, the importance of ICT has been recognized for the education of accounting (Meade, 2002; O'Neil and Rowe, 2000; Rubin, 1999).

However, existing literature has not investigated in depth user's requirements of an e-learning accounting platform yet. The scope of the present study is to record how potential users evaluate the usefulness of a web-based platform operating as an accounting educational platform and at the same time as a job-seeking environment in the field of accounting. Moreover, it aims at examining the characteristics that an educational platform and job seeking mechanism should possess. Finally, the study aims at exploring differences existing between user groups in relation to an e-learning accounting platform. More specifically, it explores four target groups' opinions on an e-learning accounting platform, that is, students, academics, employers and people interested in vocational training. The analysis is based on 451 answers to a structured questionnaire. Finally, the analysis is conducted in Greece that is

a country with specific peculiarities in terms of accounting, the most significant of which is the strong financial accounting conformity (Dimitracopoulos and Asteriou, 2008)

The structure of the paper is the following: The next section is devoted to the literature review. Section three presents the methodological approach followed in this study. The fourth section is devoted to the results of the analysis while the last section of the paper discusses the conclusions of the study.

## LITERATURE REVIEW

There are several studies that have analysed the critical success factors (CSFs) for e-learning systems. Papp (2000) diagnosed as e-learning CSFs intellectual property, suitability of the course for e-learning environment, building the e-learning course, e-learning course content, e-learning course maintenance, e-learning platform and measuring the success of an e-learning course. Volery and Lord (2000) indentified three e-learning CSFs: technology, instructor and previous use of technology. Soong et al. (2001) found that human factors, technical competency of both instructor and student, e-learning mindset of both instructor and student, level of collaboration and perceived information technology infrastructure are the CSFs for e-learning systems. Dillon and Guawardena (1995) and Leidner and Jarvenpaa (1993) indentified technology, instructor characteristics and student characteristics as variables that affect the effectiveness of the e-learning environment. Finally, Selim (2007) proposed the following university e-learning CSFs: instructor, student, information technology and university support.

However, existing literature has not investigated user's requirements of an e-learning accounting platform yet. For instance, Emgelbrecht (2005) reports students' experience of an e-learning tax program by focusing on three factors: the use of technology, the learning design, and flexibility of the tax program. Students reacted positively to the use of technology, but expressed concern about the lack of interaction between students, and between students and teachers. This study had been implemented within the context of an existing e-learning tax program and focused on students' opinions. Yet, various other target groups' opinion for e-learning accounting program is important. Individuals and firms that employ accounts pose requirements for both their ICT skills and accounting knowledge level. Academics can recognize aspects of the educational process that can be improved by new

technology. People interested in vocational training may have different views than undergraduate students for the context of an e-learning accounting platform.

Moreover, the Greek accounting environment is an interesting setting for the scope of our study. Dimitracopoulos and Asteriou (2008) comment that one of the main characteristics of the Greek accounting setting is the strong financial accounting conformity. The Greek accounting profile is generally characterized as conservative and driven by legal and tax requirements (Ballas, 1994). This tax orientation is considered as being a key difficulty during the transition to IFRS (Street and Larson, 2004).

The formality of accounting knowledge within the Greek accounting environment provides opportunities and challenges for the development of an e-learning accounting environment. Firstly, it affects different users towards shaping uniform requirements for an e-learning accounting platform. Secondly, it provides greater opportunities for associating an e-learning educational with a job seeking environment. As a result, an explanatory study for e-learning accounting systems within the context of the Greek accounting environment will provide valuable findings for the link between electronic education and labour market and the differences between different groups' requirements for an e-learning environment.

## **METHODOLOGICAL APPROACH**

For the purposes of the survey a questionnaire was developed addressing different types of potential users: undergraduate and postgraduate students of accounting, academics in the field of accounting, professional accountants and persons interested in vocational training in accounting. The questions are structured under a 1-5 Likert scale. The questionnaire has been produced in two forms. A hard copy form that has been distributed to the students on the Athens University of Economics and Business and an electronic form that has been sent to academics, professional accountants and persons interested in vocational training.

### *The sample*

Eventually, 451 completed questionnaires were received. More specifically, the sample that participated in the survey is analyzed as follows:

- 354 students, 300 of which are undergraduate and 54 postgraduate students,
- 33 academics, 28 of which have also professional experience in the field of accounting,
- 24 professional accountants working as auditors, head of accounting departments, CEOs, etc., and
- 40 persons interested in vocational training, 37 of which are at the same time practicing the accounting profession.

## RESULTS

All potential users were asked to rate the significance of the existence of an online platform that would operate in two parallel levels: firstly as an accounting educational platform providing theoretical courses in accounting and practical accounting applications, and secondly as a job seeking environment in the field of accounting. From the responses (Table 1) it appears that all groups perceive the existence of both dimensions of such a platform as being “very important”. The only difference worth mentioning was recorded in the group of Students where the existence of the job seeking environment (mean value: 4.27) was rated as more important compared to the educational platform (mean value: 3.87). All other groups rated almost equally the importance of both dimensions, highlighting the necessity of such an on-line platform in the field of accounting. This could be explained by the fact that students are more interested in finding a job after their graduation, while the other groups are already under an employment scheme.

*Table 1: Significance of the existence of a web-based platform (mean values)*

	Students N=354	Academics N=33	Accountants N=24	Vocational training N=40
	<i>Mean value</i>	<i>Mean value</i>	<i>Mean value</i>	<i>Mean value</i>
Educational platform	3.87	4.39	4.33	4.03
Job seeking environment	4.27	4.27	4.33	4.20

*Scale is 1-5 where 1: not important – 5: very important*

Apart from a general assessment of the usefulness of the basic components of the platform, an in-depth analysis of platform's characteristics was sought. Therefore, the respondents were asked to rate their perceptions regarding the usefulness of a set of predefined characteristics.

#### *Educational platform characteristics*

At first, the potential users were given eleven proposed characteristics of an accounting educational platform and were asked to rate the significance of each one. These characteristics were the following (in parentheses their short names used in Table 2) :

- A concise presentation of the theory in the form of text (Theory)
- A concise presentation of the material in the form of slides (Slides)
- Examples – practical applications in various accounting subjects (Examples)
- Self assessment multiple choice questions (Multiple choice)
- Self assessment true/false questions (True/false)
- Links to electronic accounting databases (Databases)
- Links to national and international accounting sites (Sites)
- Proposed further reading for various accounting subjects (Further reading)
- Links to accounting journals (Journals)
- Links to E.U. and national regulations and legislations (Legislation)
- A glossary of accounting terminology in Greek and in English (Glossary)

Table 2 presents the overall ranking of the characteristics' significance, the individual ranking provided by each group and the mean values that was derived from the ratings. All groups agreed that the provision of "Examples – practical applications in various accounting subjects" (total mean value: 4.55) would be the most important feature of such an educational platform. At the overall level, "A glossary of accounting terminology in Greek and in English" (total mean value: 4.06) was ranked as the second most significant characteristic. On the contrary, "A concise presentation of the theory in the form of text" (total mean value: 3.34) was rated as the least significant characteristic. From these results, it appears that users are more in favour of more practical applications on accounting compared to the traditional theoretical approach.

#### ***Table 2: Proposed characteristics of the educational platform***

Overall ranking		Featured characteristics	Students		Academics		Accountants		Vocational training	
Rank	Mean value		Rank	Mean value	Rank	Mean value	Rank	Mean value	Rank	Mean value
1	4.55	Examples	1	4.50	1	4.73	1	4.79	1	4.68
2	4.06	Glossary	2	3.99	2	4.39	6	4.13	4	4.20
3	3.80	Data bases	5	3.59	3	4.36	3	4.46	2	4.39
4	3.79	Multiple choice	3	3.76	4	4.30	8	3.63	8	3.65
5	3.72	Sites	6	3.57	5	4.24	5	4.21	5	4.02
6	3.71	Slides	4	3.73	8	4.06	8	3.63	11	3.28
7	3.61	Legislation	9	3.39	6	4.21	6	4.13	3	4.33
8	3.60	True/false	7	3.49	9	3.91	2	4.50	10	3.55
9	3.53	Further reading	8	3.40	8	4.06	7	3.83	6	3.87
10	3.44	Journals	10	3.26	7	4.18	4	4.25	9	3.63
11	3.34	Theory	11	3.21	10	3.82	8	3.63	7	3.69

Scale is 1-5 where 1: not important – 5: very important

The potential users were also asked to propose any additional characteristics they would like to find in an educational platform. Only Students and Accountants provided additional ideas. Students suggested the inclusion of “Frequently Asked Questions-FAQ” and “feedback to the user”, of a “search machine” and “online communication between users in form of a forum”, of “Step by step solution of the exercises” and “Email-alerts, news for changes on accounting environment and updates”. Accountants on the other hand expressed the importance of providing a feature were “questions could be submitted and answered via email”.

*Job-seeking environment characteristics*

Following the assessment of the characteristics of the accounting educational platform, potential users were asked to rate several applications incorporated in a job-seeking environment. These applications were the following ((in parentheses their short names used in Table 3) :

- Users can upload their CV (Upload CV)
- Users can complete a predefined CV template with several fields (Predefined CV template)
- Users can upload a job seeking ad (Job seeking ad)
- Firms in Greece can upload announcements of job offers (Firms in Greece)
- Firms from abroad can upload announcements of job offers (Firms abroad)
- Users can have direct communication with employers (Direct communication)
- Interviews can be arranged (Interviews)

All user groups indicated the ability given to firms operating in Greece and abroad to upload job offers as the most important feature of job seeker. More specifically, the application “Firms in Greece can upload announcements of job offers” was rated as most important (total mean value: 4.44), followed by the application “Firms from abroad can upload announcements of job offers” (total mean value: 4.29). As least important, although it received a relatively high score, turned out to be the feature “Users can upload a job seeking ad” (total mean value: 3.78). Through these findings it is evident that there is need for creating a stronger bond between studying accounting and seeking jobs on the field.

**Table 3: Proposed characteristics of the job-seeking mechanism**

Overall ranking		Featured characteristics	Students		Academics		Accountants		Vocational training	
Rank	Mean value		Rank	Mean value	Rank	Mean value	Rank	Mean value	Rank	Mean value
1	4.44	Firms in Greece	1	4.43	1	4.48	1	4.54	1	4.37
2	4.29	Firms abroad	2	4.29	2	4.24	2	4.38	5	4.27

3	4.18	Direct communication	3	4.17	5	4.03	3	4.33	3	4.32
4	4.12	Upload CV	5	4.08	3	4.12	4	4.08	2	4.35
5	4.08	Interviews	4	4.09	6	3.94	6	3.88	4	4.28
6	3.79	Predefined CV template	6	3.77	4	4.09	7	3.83	7	3.67
7	3.78	Job seeking ad	7	3.72	7	3.88	5	3.96	6	3.95

*Scale is 1-5 where 1: not important – 5: very important*

Again, the potential users were asked to propose any additional features. Students suggested that such a tool should also contain “advices and guidelines for successful interviews”, “guidelines for CV formation” and “information about relevant seminars”, while Academics proposed the existence of “announcements from public institutions” and “information on vocational training and master programs”.

#### *Differences between user groups*

In an attempt to group the needs of the users, the study proceeded with the conduction of factor analysis. Eventually, three factors were revealed regarding the accounting educational platform and were given the names: “Further reading”, “Self-assessment” and “Theory” (Table 4). The reliability of these factors was verified from the results of Reliability analysis (Cronbach a: 0.856, 0.807 and 0.517 respectively). Regarding the characteristics of the job-seeking environment, no factors were revealed.

**Table 4: Factor analysis outcomes**

Factors	Characteristics (Factor loadings)	Name	Cumulative % explained	Cronbach a
1	<ul style="list-style-type: none"> <li>• Databases (0.760)</li> <li>• Journals (0.760)</li> <li>• Further reading (0.755)</li> <li>• Sites (0.749)</li> <li>• Legislation (0.716)</li> <li>• Glossary (0.643)</li> </ul>	Further reading	31.890	0.856

	<ul style="list-style-type: none"> <li>• Examples (0.532)</li> </ul>			
2	<ul style="list-style-type: none"> <li>• Multiple choice (0.643)</li> <li>• True/false (0.604)</li> </ul>	Self-assessment	48.372	0.807
3	<ul style="list-style-type: none"> <li>• Slides (0.539)</li> <li>• Theory (0.522)</li> </ul>	Theory	64.141	0.517

After formatting the three factors, the survey proceeded by examining the differences in the responses of the different groups. In order to have a better view of the differences between the needs of the users and due to the inequality of the user groups' sizes, the sample was split into two main groups: Students (n=354) and non-Students (n=97; academics, accountants and persons interested in vocational training). By conducting a t-test significant differences between the two groups were revealed in all three cases: "Further reading", "Self-assessment" and "Theory" (Table 5). These differences were also confirmed by conducting non-parametric tests (Mann-Whitney U test). From the results it is apparent that non-Students consider as more important the three groups of characteristics compared to Students, with most noticeable the case of "Theory". Regarding, the characteristics embodied in a job-seeking environment, no significant differences were revealed between the groups (results not tabulated).

**Table 5: Differences between Students and non-Students**

Factors	Name	Students N=354	non-Students N=97	Mean difference	p-value
		<i>Mean value</i>	<i>Mean value</i>		
Factor 1	Further reading	3.46	3.68	0.216	0.015*
Factor 2	Self-assessment	3.59	3.89	0.298	0.004**
Factor 3	Theory	3.65	4.21	0.564	0.000**

*Scale is 1-5 where 1: not important – 5: very important, \*Significant at 5% significance level, \*\* Significant at 1% significance level*

## CONCLUSIONS

The scope of the present study is to record how potential users evaluate the usefulness of a web-based platform operating as an accounting educational platform and at the same time as a job-seeking environment in the field of accounting in Greece.

Our results confirm that there is actually a need in the Greek market for an on-line educational platform in accounting. Moreover this platform should possess all the characteristics that are found in literature as relevant as they are all considered to be useful at a level that is above average (e.g. Emgelbrecht, 2005; Selim, 2007). Nevertheless, different user groups seem to prioritize in a different way the elements included in such a tool indicating that the needs of groups interested in e-learning in accounting is not unanimous.

Also, students have ranked the existence of a job seeking environment as more important compared to the educational platform. Probably this is because this user group is more interested in finding a job after their graduation, while the other groups (i.e. academics, accountants, people interested in vocational learning) are already under an employment scheme.

Finally, non-students seem to appreciate in a higher degree the existence of an on-line platform incorporating features that could fall in the categorization of "Further reading", "Self-assessment exercises" and "Theory" compared to students. Probably, as students are already in the learning environment they do not feel the same need as those that are out of a university educational setting.

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## WHEN WINE MEETS TERRITORY: THE ITALIAN SCENARIO\*

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### ABSTRACT

The topics of wine sector and regional competitiveness are widely debated at international level and their measure is of extreme interest in the academic community. This paper aims at investigating the existence of a relationship between these two dimensions, providing a measure of it with an application to the Italian regions. Despite a large literature on the measurement of the relation between regional and wine sector competitiveness, scarce contributions test the existence of a correlation between them. This paper bridges this gap by supplying a measurement of these factors and of their relation, proposing development strategies. The analysis consists in testing the correlation between the Regional Competitiveness Index (RCI) and the Wine Sector Competitiveness Index (WSCCI) – both built throughout the Delphi method, by involving 40 stakeholders of different provenience throughout semi-structured interviews. The research findings show how RCI is affected by ten dimensions (economic, demographic, entrepreneurial, innovation, internationalisation, infrastructural, urban green areas, agriculture, craft, tourist) while WSCCI by four dimensions (quality, distinctive characteristics, fame and reputation, OCM investments); furthermore, the levels of the two indices depend on few attractive regions, confirming the existence of a positive correlation between them. Despite the importance of the results, this paper must be viewed at the light of several limits relating to the level of exhaustiveness of drivers/indices, chosen throughout subjective criteria; furthermore it is applied to one single specific context. However, it represents a starting point for further applications to other levels of analysis or to other sectors.

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\* Despite this paper is a collaborative effort between the Authors, Prof. Vrontis is responsible for the sections: 'Introduction' and 'Conclusions remarks' while Prof. Viassone is responsible for the sections: 'Literature Review on Competitiveness Measures for Regions and Wine Sector', 'Research Model and 'Analysis and Discussion of Results'.

**Keywords:** wine business; regional competitiveness; Delphi methodology; measure of competitiveness. Track number: 2

## INTRODUCTION

Although the topics of wine sector and regional competitiveness are widely debated at international level and their measure is of extreme interest in the academic community (Tardivo *et al.*, 2011; Vrontis *et al.*, 2011; Jaffe and Nebenzahl, 2008; Zanni, 2004) no research supplies a measure of the relation among them. In 2011-2012, despite the not favourable economic trend, the wine tourism has grown by 12% but it is difficult to think that this trend can continue without a national strategy.

In fact in the wine sector as much as in wine tourism, environmental and cultural proprieties assume a very important role and, when realized, can return a not repeatable result making wine an identity good, able to pick out cultural meanings of a territory (Tardivo *et al.*, 2011).

For this motivation it is extremely important to deeply analyze the wine sector and regional competitiveness and their drivers, in addition to the correlation among them; only in this way it will be possible to support the positive action they can exercise one toward the other. This interest is even higher in a scenario like Italy, the major European wine producer, that counts in 2011 about 42 millions of hl of wine production.

This paper tries to bridge this gap in the literature, by supplying – throughout the Delphi methodology and statistical analysis - an exhaustive measure model both for regional and wine sector competitiveness and by verifying the existence of a correlation between the two global indices.

In the first paper a review of attempts to measure regional and wine sector competitiveness is proposed; after this research model is described and results are analyzed and discussed.

Finally conclusions, paths of action, limits and possibility of application of the model are developed.

## LITERATURE REVIEW ON COMPETITIVENESS MEASURES FOR REGIONS AND WINE SECTOR

Despite numerous attempts to define regional competitiveness (EC, 1999; Storper, 1997) it has been recently defined by Dijkstra *et al.* (2011) as “*the ability to offer an attractive and sustainable environment for firms and residents to live and work*”.

In particular it is affected by 10 drivers: economic variables (Porter, 2003) –very important is business density-, innovative and entrepreneurial factors (Cepollaro *et al.*, 2006), demographic elements (Poot, 2007) - resulting in population size, composition, distribution and growth , internationalization variables (Cotta Ramusino and Onetti, 2006) –i.e. import, export, FDI-, infrastructural variables (Rohm *et al.*, 2004); green areas, agricultural, craft and tourist variables (Viassone and Casalegno, 2011; Franch *et al.*, 2008) able to contribute to the economic growth and to local employment.

Main existent indices used for the measure of its competitiveness are (Viassone, 2009): the World Knowledge Competitiveness Index and the creativity index, Massachusetts Technology Collaborative’s, Science, Technology and Industrial Scoreboard, the Community Support Framework (CSF) 2000-2006 for Southern Italian Regions, the Regional Competitiveness Index Croatia, the UK competitiveness Index and the competitiveness Index for Turkish Regions, Regional Attractiveness Index, the Regional competitiveness framework in Hungary, the Global Provincial Competitiveness Index (Viassone, 2009) and the EU Regional Competitiveness Index (RCI) (Dijkstra *et al.*, 2011).

On the other side, in the wine sector industries and firms are considered competitive when they are able to continue to grow their trade in today’s global environment, through product offers – qualities, prices and services - that are as good as (or better than) those of their competitors (Van Rooyen *et al.*, 2011).

According to Zanni (2004) main drivers affecting wine competitiveness are: quality (Bailet *et al.*, 2010)- expressed through Doc and Docg denominations (Viassone, 2012)- at the base of wine reputation, distinctive characteristics (i.e. the total area planted with grapes, the total regional wine production, etc) (Viassone, 2012), fame and reputation (Gergaud and Livat, 2004), a dynamic signal of quality for the collective denomination of origin and expressed by the awards received by a particular firm or territory (Bailet *et al.*, 2010), technological innovation (Vrontis and Thrassou, 2011); investments that PMI receive from OMC, able to support this sector with the necessary resources to develop itself.

Sporadic attempts of measure of the wine sector competitiveness have been provided by Balassa (1977), Vollrath (1991), Castiglione (1999), Van Rooyen *et al.* (2000), Valentine and

Krasnik (2000), Pitts *et al.* (2001), Esterhuizen (2005), who developed the RTA- Revealed Trade Advantage, used to measure quantitatively to what extent the different wine industries compete internationally; Esterhuizen and Van Rooyen (2006) who applied their Wine Competitiveness Index (WCI) to the South African wine industry; Notta and Vlachvei (2011) and Fischer's (2007) who calculate a composite measure for relative and multidimensional economic performance as measured by profitability, productivity, as well as output growth.

Furthermore Remaud (2006) demonstrated how four items influence the company in the wine industry to be more competitive in its export markets: export staff with good knowledge, expertise and skills, good level of expertise and skills accumulated through its own export experience, the entrepreneurial attitude of the CEO and the aggressiveness of the firm to search for new export opportunities. Several researches have studied the impact of wine tourism on the economic growth of the region, for wine industry and for increasing the profitability and sustainability of tourism in the area; in particular Hall and Sharples (2008) maintained that food and wine events have assumed a key role in international, national, regional and firm tourism and food and wine marketing and promotion strategies. They identified some important advantages created by these events for the region, like increased visitation, retaining travelers within a region.

In fact, food and wine competitiveness have increased their importance in the academic debate and, in particular, researchers are interested in understanding how wine tourism contribute to tourism marketing strategies at the level of both the destination and the firm (Hall, 2003). Wine events can contribute to maintain the profile of a wine region in key markets and assist in differentiating wine regions in a competitive market scenario. For all these assumptions, many wine regions and tourism destinations have realized that the benefits of wine tourism extend well beyond the cellar door to virtually all areas of the regional economy and into the urban areas that generate the majority of wine tourists (Carlsen and Charters, 2006; Carlsen, 1999).

## **RESEARCH MODEL**

This paper aims at testing the existence of a correlation between the Regional Competitiveness Index (RCI) and the Wine Sector Competitiveness Index (WSCCI) – both built throughout the Delphi method (Dalkey, 1969), by involving in their validation and weighing 40 stakeholders of different provenience (bodies, academics, entrepreneurs, builders of indices) throughout semi-structured interviews.

The RCI is built by ten dimensions (economic, demographic, entrepreneurial, innovation, internationalisation, infrastructural, urban green areas, agriculture, craft, tourist) while WSCI by four dimensions (quality, distinctive characteristics, fame and reputation, OCM investments); drivers and sub-drivers are segmented throughout SPSS in 4 different classes of the same size, assigning a different score according to whether they belong to class 1 (the lowest level), 2, 3 or 4 (the highest level). By adding the scores of each sub-driver, it is possible to get 10 different partial indices; their sum generates the Regional Competitiveness Index  $\textcircled{1}$ .

$\textcircled{1}$

$$\text{RCI} = \text{ES} + \text{DS} + \text{ENS} + \text{INN} + \text{IS} + \text{INS} + \text{GAS} + \text{AGS} + \text{CS} + \text{TS}$$

where:

ES = economical scores

DS = demographic scores

ENS = entrepreneurial scores

INN = innovation scores

IS = internationalization scores

INS = infrastructural scores

GAS = green areas scores

AGS = agricultural scores

CS = craft scores

TS = tourist scores

With the same process it has been computed the Wine Sector Competitiveness Index (WSCCI), composed of 4 macro-variables (2).

$$(2) \quad \text{WSCCI} = \text{QS} + \text{DCS} + \text{FRS} + \text{OCMIS}$$

where:

QS = quality scores

DCS = distinctive characteristics scores

FRS = fame and reputation scores

OCMIS = OCM investment scores

Finally the correlation between RCI and WSCCI has been calculated always by means of SPSS.

RCI	WSCCI scores	Level of wine sector competitiveness
0-25	0-25	Low
26-50	26-50	Discrete
51-75	51-75	Good
76-100	76-100	Excellent

*Table 1. Classification of the RCI and WSCCI*

*Source: personal elaboration.*

## ANALYSIS AND DISCUSSION OF RESULTS

This research shows how stakeholders confirm those variables affecting regional (Passeri et al., 2012; Viassone and Casalegno, 2011) and wine sector competitiveness (Zanni, 2004) supported by literature.

The model describing regional competitiveness is characterized by ten dimensions: economics (Porter, 2003), demography (Poot, 2007), tourism, entrepreneurship (Cepollaro *et al.*, 2006), innovation, infrastructures (Rohm *et al.*, 2004), internationalization (Cotta Ramusino and Onetti, 2006), urban green areas (Franch *et al.*, 2008; Pilotti *et al.*, 2011), agriculture and craft, while the model describing wine sector competitiveness is constituted by four variables (Zanni, 2004): quality, distinctive characteristic, fame and reputation and OCM investment scores.

All the dimensions are composed of different sub-variables. Scores of different dimensions have been attributed in an equal way to each variable.

With reference to regional competitiveness it is possible to notice the presence of a single region with a high competitiveness (Lombardy, that instead is in 7<sup>th</sup> position with reference to the wine sector competitiveness), only one region with a good competitiveness (Lazio) and 4 regions with a discrete level of competitiveness: Piedmont, Veneto, Emilia Romagna, Tuscany. Finally the other 14 regions are placed in a low position (Table 2).

RCI	Level of regional competitiveness	Regions
0-25	Low	Campania, Puglia, Marche, Liguria, Sicilia, Friuli Venezia Giulia, Abruzzo, Trentino Alto Adige, Calabria, Umbria, Sardegna, Basilicata, Molise, Valle d'Aosta
26-50	Discrete	Piemonte, Veneto, Emilia Romagna, Toscana
51-75	Good	Lazio
76-100	Excellent	Lombardy

*Table 2. Classification of the RCI*

*Source: personal elaboration.*

This emphasizes the difficulty of Italian regions in offering an attractive and sustainable environment for firms and residents to live and work, that is to be competitive (Dijkstra *et al.*, 2011).

The datum concerning wine sector competitiveness (Table 3) turns out to be non homogenous and it shows 5 regions with a good competitiveness: Piedmont and Tuscany, in the first positions, followed by Veneto, Sicily and Puglia while the most of them (10) are placed in a discrete position while Calabria, Basilicata, Liguria, Molise and Valle d'Aosta are not competitive in the wine sector.

Both Piedmont and Tuscany are famous for the quality (16 D.O.C.G. and 42 D.O.C. for Piedmont and 11 D.O.C.G. and 39 D.O.C. for Tuscany) and reputation (with respectively 72 and 62 "Tre Bicchieri" awards in 2011) of its wines. This confirms the extreme importance attributed by Viassone (2012) and Bailet *et al.*(2010) to these two variables in the composition of the wine sector competitiveness.

WSCI	Level of wine sector competitiveness	Regions
0-25	Low	Calabria, Basilicata, Liguria, Molise, Valle d'Aosta
26-50	Discrete	Emilia Romagna, Lombardy, Marche, Campania, Lazio, Trentino Alto Adige, Friuli Venezia Giulia, Abruzzo, Sardegna, Umbria
51-75	Good	Piedmont, Tuscany, Veneto, Sicily, Puglia
76-100	Excellent	-

Table 3. Classification of the WSCI

Source: personal elaboration.

As shown in Figure 1 this paper emphasizes the existence of a positive correlation between regional and wine sector competitiveness, in particular in terms of tourist flows and investments and vice versa. This is a further demonstration of how wine competitiveness can contribute to maintain the profile of a wine region, increasing its competitiveness and vice versa (Carlsen, 1999, Hall, 2003). The relationship is linear, with a positive direction, and an entity by 0,301: so there is a meaningful correlation at level 0,05 (2-tails) between regional and wine sector competitiveness.

While Emilia Romagna, Calabria, Basilicata, Liguria, Molise and Valle d'Aosta are examples of regions where regional and wine sector competitiveness proceed in the same way, the most

of Italian regions is characterized by a low level of competitiveness (14) and by a discrete level of wine sector competitiveness (10), symptom of a Country that, thanks also to its grape varieties and its wine/food reputation, is famous at world level for its valuable wines but that it is not able enough to attract tourists, investments, resources (Passeri *et al.*, 2012).

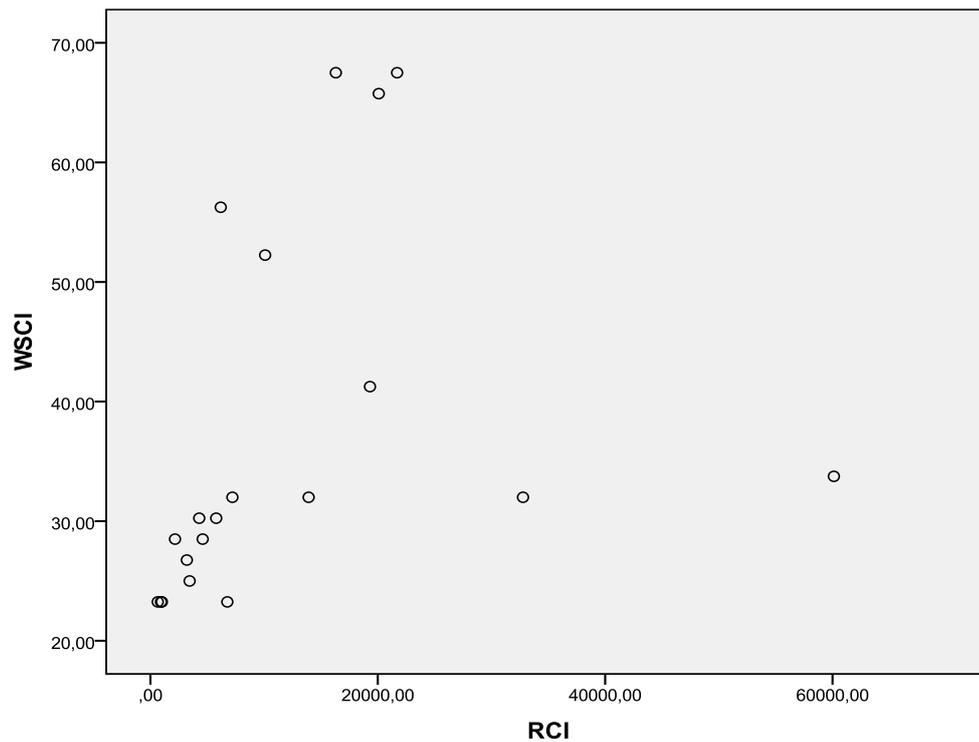


Figure 1. Correlation between RCI and WSCI

Source: personal elaboration.

## CONCLUSIVE REMARKS

The research shows how the level of RCI and WSCI depends on a few variables, confirming the existence of a positive correlation between the two indices; in this way it is evident how a high regional competitiveness can affect the wine sector competitiveness and vice versa. In particular, with reference to regional competitiveness, there are many regions with a low level of competitiveness in different Italian areas while only one (Lazio) with a good degree of competitiveness and one with a high competitiveness (Lombardy). The research shows that, when it comes to wine, consumers' choice increasingly relies on reputation, quality and association with strong territorial socio-cultural aspects. Possible strategies proposed in order to develop the virtuous circle between regional and wine sector competitiveness consist in:

- supporting a strong culture of collaboration in order to strengthen wine sector research capability to better address wine sector issues;
- adopting proper strategic marketing processes;
- increasing the firm dimensions through mergers and acquisitions;
- selling premium wine to market niches or to rich people of developing Countries;
- developing the ability to communicate and improve regional brand in order to increase regional competitiveness;

Despite this paper offers an important contribute to the literature, it shows several limits, in particular with reference to exhaustiveness of drivers and indices and to its application only to the Italian context. With some changes, it could be extended to other levels of analysis (urban, national) and to other sectors (food, tourism, etc.).

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## THE INTERNATIONALISATION OF CHINESE FIRMS: BRAND, ENTRY MODE, AND COUNTRY OF ORIGIN OPTIONS

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### ABSTRACT

This conceptual paper proposes a model to guide the internationalisation options and pathways of Chinese firms with respect to the choices of OEM (contract manufacturer to Western brand owners)-OBM (build own consumer brands); country market (home or foreign); foreign market entry mode (passive export, active export, or foreign direct investment); and production location (home or foreign country market).

Whilst these options are alternatives with their own advantages and disadvantages, underlying this model is the idea that the above dimensions are also inter-related. These linkages are posited to take the following forms. Firstly, some OEM-OBM brand strategies imply certain entry mode strategies. Secondly, some entry mode strategies imply certain production location strategies. Thirdly, some production location strategies imply certain brand positioning strategies and have implications for international competitiveness, resulting from a country of origin linkage.

The paper discusses some literature in these areas and builds towards a model which integrates the options. Finally the paper suggests that the development pathways facing Chinese firms may constitute a form of brand, entry mode, market and sourcing internationalisation cycle.

**Keywords:** OEM, OBM, Internationalisation, brand, foreign market entry mode, country of origin

### INTRODUCTION

This conceptual paper follows on from the research based article 'The OEM-OBM Debate: Factors Influencing Chinese Firms' Branding Decisions in their Internationalisation Process' (Wilson, 2012). That paper developed a model of the factors influencing the internationalisation strategies of Chinese firms in terms of building their own consumer brands (OBM strategy) or to be international players by acting as contract manufacturers for foreign brand owners (OEM strategy). The present paper proposes a model to guide the development decisions of Chinese firms which incorporates additional options to the OEM-OBM choice, namely country market (home or foreign); foreign market entry mode (passive export, active export, or foreign direct investment); and production location (home or foreign country market).

Whilst these options are alternatives with their own advantages and disadvantages, underlying this model is the idea that the above dimensions are also inter-related. These linkages are posited to take the following forms. Firstly, some OEM-OBM brand strategies imply certain entry mode strategies. Secondly, some entry mode strategies imply certain production location strategies. Thirdly, some production location strategies imply certain brand positioning strategies and have implications for international competitiveness, resulting from a country of origin linkage. The paper discusses some literature in these areas and builds towards a model which integrates the options. Finally the paper proposes that the potential development pathways facing Chinese firms suggests a form of brand, entry mode, market and sourcing internationalisation cycle.

## **INTERNATIONALISATION AND OEM-OBM BRAND STRATEGY**

The interpretations of the term 'internationalisation' vary from attitudinal factors through a generally increasing exposure to foreign markets, sources and competitors to the much more specific growth of a firm into more foreign markets and to the progressive use of more and more 'committed' forms of market entry mode strategy. In this paper, the term is mainly concerned with market entry mode strategy decisions and their relationship with branding strategies, a topic which has rarely been discussed in the marketing text literature since it was mentioned briefly by Kotler et al (1996, p.566), but also discusses their interface with country sourcing options.

Wilson (2006) and Fan (2008) have argued that there are close inter-relationships between international market entry mode strategy and branding strategy and country of origin (COO).

Although it may not be seen as a branding decision by the firms themselves, the choice of an OEM business model is a decision not to brand products and which will also largely determine its initial foreign market entry mode strategy. In the first instance, this is likely to be through passive exporting (Clarke and Wilson, 2009) i.e. Foreign Brand Owners seeking OEM suppliers may contract Chinese suppliers to manufacture products for them.

A firm with an unknown brand name, perhaps based in a country with negative country of origin cues, will find it difficult to market to foreign countries. OEM branding is one strategy which by-passes these hurdles. It reduces the costs of marketing dramatically and endorses the product with the customer's brand name. Very importantly, the product is sold through the customer's already established marketing channels. There may be further advantages for the contract manufacturer if the customer provides assistance with technology or perhaps insists on quality controls which improve the manufacturer's quality standards. Large volume orders with programmed delivery schedules may also result in the manufacturer being able to hone their processes so as to further reduce costs and become even more competitive.

Relationships built will increase the manufacturer's learning about its customer and their markets. This may encourage the OEM to then engage in active exporting. Ultimately all this learning, together with the credibility and references resulting from having already sold in the market should make it easier for the contract manufacturer to later supply the market on an OBM basis should it wish to. The (implicit) brand strategy is thus both a stimulus to internationalisation and a determinant of the initial entry mode strategy. A discussion of the advantages and disadvantages of OEM and OBM can be found in Wilson (2012). Figure 1 below summarises into a '14Cs' model the factors mentioned by the research participants as influencing their decisions.

**Cost:** small firms, particularly, perceive the costs of R&D and brand building communications to be a major barrier to brand building

**Competencies:** a lack of skills in terms of creating brands and implementing brand strategies

**Connaissance:** a lack of knowledge, particularly of international market entry mode strategies and foreign marketing channels, can inhibit OBM

**Culture:** a lack of understanding of foreign cultures leading to a fear that suitably adapted OBM products could not be developed

**COO:** a product seen to be made in China by a Chinese brand owner was expected to have a negative impact on foreign final consumers

<p><b>Customer value:</b> the need to build innovation into products in order to persuade consumers to change brand preference</p> <p><b>Conflict:</b> the fear that existing OEM customers would respond by cancelling contracts was a major inhibitor of moving to or adding OBM</p> <p><b>Counterfeiting:</b> such is the threat from Chinese counterfeiters that it was seen as a reason not to expend resources to develop brands</p> <p><b>Competitive advantage:</b> some firms had made the positive decision to specialise in manufacturing rather than try to build the marketing skills necessary for OBM</p> <p><b>Character:</b> the ambitions and personalities of founders and senior executives played a role in determining the value of the esteem perceived to result from brand ownership</p> <p><b>Corporate Social Responsibility:</b> although OEMs were expected to adopt CSR policies, there was more pressure on OBMs to do so</p> <p><b>Co-operation:</b> joint New Product Development with Global Brand Owners may permit some OEMs to gain the benefits of a collaborative relationship without the risks of moving to OBM strategies</p> <p><b>Control – Risk:</b> some firms saw OBM as the mechanism for increasing control over their destiny and reducing the risk of price-based customer defection; others saw control arising from careful management of OEM business without the risks and costs of brand building</p> <p><b>Cash flow-profit:</b> some firms saw OBM as offering higher profits through bigger margins and others felt careful management of OEM produced high volumes with adequate margins and improved cash flow.</p>
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Figure 1: Factors influencing the OEM-OBM decision

## BRAND INTERNATIONALISATION OPTIONS

For those firms which are ready to take the OBM route, the ultimate objective of an international brand portfolio can be developed in a variety of ways. The discussion below also identifies further links between entry mode and branding strategies.

For some firms, the principal route to brand internationalisation has been to take an existing brand to foreign countries, perhaps with some degree of adaptation. According to Barwise and Robertson (1992) this method of *organic geographical extension* is slow, requires a medium

level of investment but offers high control. Well documented Chinese white goods manufacturer Haier has predominantly used this approach but, arguably, not exhibiting the characteristics implied above. Thus, despite failures in some countries (mainly as a result of political unrest), Haier's progress has been widespread and comparatively rapid and a summary of some of its development illustrates some of the options discussed in this paper.

Qingdao Refrigerator was renamed Haier, partly to give itself a Germanic, rather than Chinese, sounding name. Using technology from German Liebherr, it produced several brands for China and then made for Liebherr for the German market (Liu and Li, 2002). This first OEM contract manufacturer based foreign market entry in 1984 was followed by entry into a number of Asian markets, including FDI in Indonesia) and entry into the USA in 1999, where it invested in design, manufacturing and marketing facilities. Success in the USA has been helpful in subsequent moves into additional developed and developing markets with an OBM strategy.

A second associated route is to develop new brands with a world market in mind and then expand in the same way. Electronic products manufacturer Asus began as an OBM in Taiwan but because Taiwan is a relatively small market Asus accepted orders on an OEM basis from famous brand owners in the West and Japan such as Dell, HP, Apple and Sony and this became the major portion of its business. In 2007, however, Asus launched the Asus Eee Pc which was designed for global markets beginning with the USA, followed by China and Japan. Asus thus entered international markets on an OEM basis but has now begun to export some product types under its own brand.

A third route is by forming *foreign brand alliances* which offer a combination of moderately speedy expansion, low investment but also low control. When used primarily for foreign market entry, this type of strategic alliance can also be seen as a form of foreign market entry mode strategy.

A fourth route is *foreign brand licensing* whereby a firm can pay a fee to use an available brand name on particular products for sale in eligible markets for a specified period. In recent years some Asian brands have used this strategy to allow them to use recognised, but often redundant, Western brand names to help their sales in Europe and the USA. In 2004, in a type of hybrid of routes three and four, French firm Thomson set up a joint venture (TTE) with China's TCL, giving to TCL all manufacturing of RCA and Thomson television brands thus

making TCL the global leader in TV manufacturing. Thomson still controls the brands themselves but licenses them to TTE.

A fifth route is the *acquisition of foreign brands*, by which we mean all the assets of the business rather than just the brand name itself. According to Barwise and Robertson (1992) acquisition has the advantage of speed but requires high investment costs and offers only medium control since it is usually difficult to fully integrate acquisitions in terms of values, culture and systems. Again, when used to enter a foreign country this equates to an FDI form of market entry mode strategy.

BenQ tried this strategy in October 2005 by acquiring the loss making mobile phone division of Siemens. As well as obtaining instant manufacturing scale in Germany and marketing presence in Europe and Latin America, BenQ also acquired permanent rights to some 600 technology patents and the rights to use the Siemens brand name for 5 years. Initially a dual branding strategy was used on the new products introduced with the presumed intention to gradually phase out the Siemens brand name. However, the new enterprise produced massive losses and filed for bankruptcy after only 1 year. It also caused BenQ's largest OEM customer, Motorola, to defect. Today, BenQ only markets branded mobiles in Taiwan and continues to operate on an OEM basis elsewhere. However, it is now selling branded mobile internet devices in Italy through Telecom Italian Mobile and is continuing its push to market a broader range of BenQ branded products in foreign markets.

In summary, while probably for most Chinese firms, OBM means developing their own brand organically, there are other options, several of which imply a particular form of market entry mode when used to market to foreign countries. Several of these options may also mitigate the Chinese COO 'problem' but they may also have other implications in terms of competitiveness and sourcing strategy. These advantages and disadvantages are outlined in the next sections.

## **COUNTRY OF ORIGIN, BRAND STRATEGY AND INTERNATIONAL MARKET ENTRY MODE STRATEGY**

A large amount of research has been undertaken in relation to COO (Al-Sulaiti and Baker, 1998), mainly in terms of its impact on consumer perception and product purchase behaviour. COO was originally defined by the 'made in' label but is now more complex, particularly in electronic products, which may be designed in one country, assembled in another from

components sourced in yet other countries. On top of this, COO in terms of brand could be seen as the country where the product brand is conceived or the country with which the brand may be associated.

COO is irrelevant for some product categories but is product specific in others Okechuku (1994). In many situations, where a brand is unknown, consumers use COO (where known) as one means of brand evaluation. In particular, COO has been found to influence consumer evaluation of quality (Khachaturian and Morganosky, 1990) and value (Ahmed and d'Astou, 1993). Despite Western acceptance of some Chinese brands (such as Tsingtao beer) and recognition of China's competence as the 'factory of the world', Chinese COO is still perceived, notwithstanding that the image of China itself is improving over time, by Chinese and non-Chinese consumers to have a generally negative impact on brand image, based on assumptions about quality (Liu and Li, 2006; Tan and Wang, 2010)

. Six out of the eight Chinese firms interviewed by Wilson (2012) cited their expectation, that Chinese COO would be viewed negatively, as one of the several factors inhibiting the development of their own consumer brands (see Figure 1). One firm, for example, was investigating the possibility of achieving a foreign COO brand by either licensing foreign brand names or manufacturing in foreign markets, as a means of addressing the issue. Chinese consumers often also have a preference for Western brands which is rooted in their wish to appear modern and affluent. On the other hand, there is a growing trend amongst Chinese consumers to buy some Chinese brands out of pride and patriotism.

Although it is a contestable assumption that consumers can accurately identify COO (Balabanis and Diamantopoulos, 2008), in the model in Table 1, the brand aspects of COO (COOb) are posited to emanate from the brand name itself and also from any 'made in' labelling. This combination recognises the impact on consumers of 'culture-of-brand-origin' in addition to country of manufacture (Lim and O'Cass, 2001). The COOB associations are illustrative only (market research should reveal 'real' multi-dimensional dimensions peculiar to specific product categories and brands) and solely to convey perceptions which consumers might be expected to have in response to different COO cues. Thus, Chinese brand names may be seen as "routine" to Chinese consumers whereas foreign brands in China often have more positive associations and are seen by Chinese consumers to provide clearer "positioning". Conversely, Chinese brand names may not be "trusted" in some foreign markets whereas local brands will be seen as the "routine" purchase. Purchasing products made in China may appear "patriotic" to the Chinese whereas purchasing foreign products

may be the “pragmatic” response to acquiring the perceived functional and emotional benefits implied by the foreign positioning in China.

Made in China may have perceptions of “value” in a foreign market when marketed under an FBO’s name but negative “quality” perceptions along with the positive value perceptions when marketed as a Chinese brand. When made in a foreign (to China) country both Chinese and foreign brands may have positive “quality” images whereas in the foreign market, made in that market will be “routine” if the brand is local. If the Chinese acquire a foreign brand and make it in the original country, then the made-in label will confer “authenticity”.

### **COUNTRY OF ORIGIN, PRODUCTION LOCATION AND FOREIGN MARKET ENTRY MODE STRATEGY**

Our interest in COO also lies in the fact that COO not only has significant implications for branding but also, in its original manufacturing manifestation as ‘made in’, for foreign market entry mode strategy and for export competitiveness. Figure 2 models these relationships. Thus, by definition, in export entry modes, manufacture takes place in the ‘home’ country while in contractual modes such as licensing and FDI modes such as equity joint-ventures or wholly foreign owned enterprises (whether arising from acquisition or organic investment) production takes place in the foreign destination country.

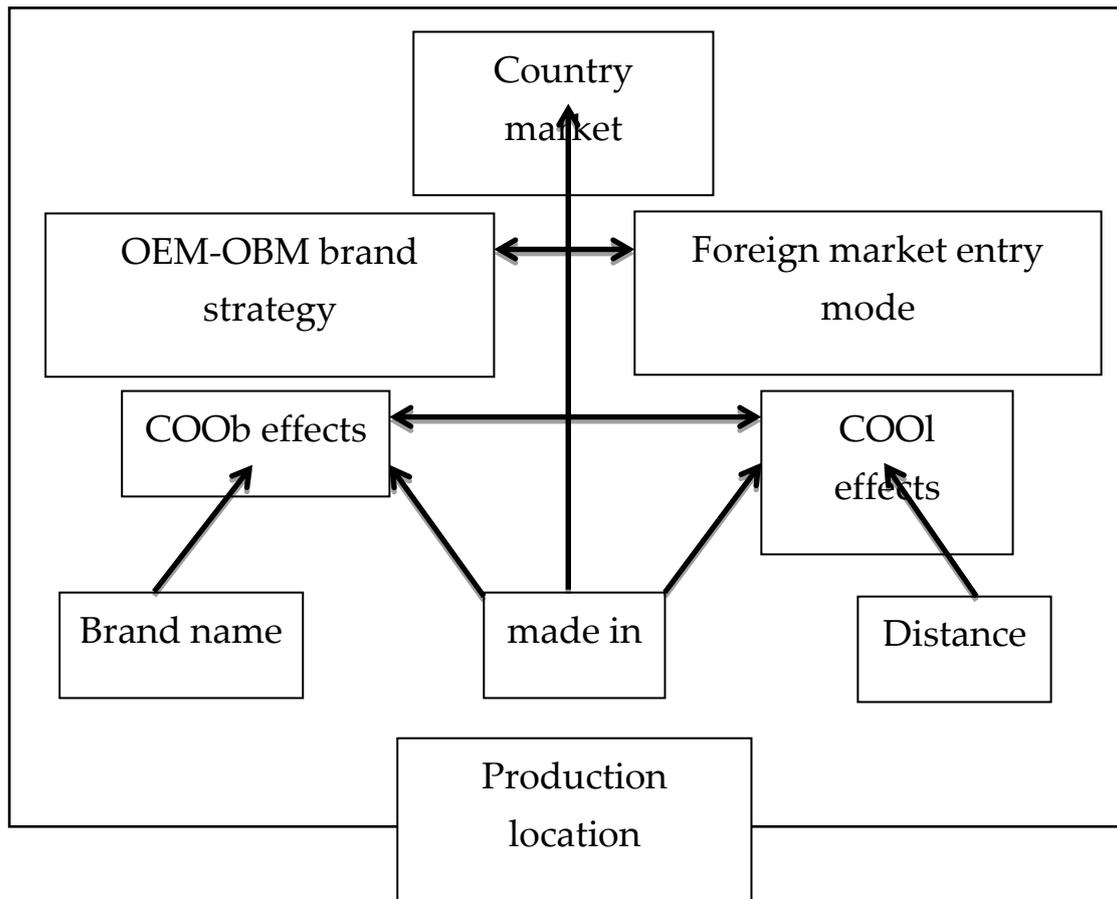


Figure 2: COO, brand and entry mode

**THE (COMBINED) INTERNATIONALISATIONAL OPTION MODEL**

Table 1 shows the main options facing Chinese firms on their internationalisation and domestic growth pathways. It indicates the implications of different strategies for consumer perceptions of brand image and for advantages and disadvantages of location of production for Chinese manufacturers.

Option	Made in	Brand Strategy	Client	County Market	FMEMS	COOb		COOl	
						Brand name	Made in label	Producti on Cost	Distance barriers

1	China	OEM	FBO	China	-	Positioning+	Pragmatic	neutral	None
2	China	OEM	FBO	Foreign	Passive/ Active export	Routine	Value +	+	AG
3	China	OEM	Self	China	-	Routine	Patriotic	neutral	None
4	China	OEM	Self	Foreign	Passive/ Active export	Trust -	Quality -	+	CAGE
5	China	FB name Buy or License	Self	China	-	Positioning+	Pragmatic	neutral	None
6	China	FB name Buy or License	Self	Foreign	Export	Routine	Value +	+	AG
7	Abroad	OEM	FBO	Foreign	FDI organic	Routine	Routine	neutral	None
8	Abroad	AOBM	Self	Foreign	FDI Acquisition	Routine	Authentic	neutral	None
9	Abroad	AOBM	Self	China	FDI Acquisition	Positioning+	Quality +	-	AG
10	Abroad	OEM	Self	Foreign	FDI organic	Trust -	Quality +	neutral	None
11	Abroad	OEM	Self	China	-	Routine	Quality +	neutral	AG

Table 1: Brand, Entry Mode and COO internationalisation options

COOI	Country of Origin - Impact of production location	FB name	Foreign Brand name
COOb	Country of Origin - Brand Image associations	FBO	Foreign Brand Owner
EM	Original Equipment Manufacturer (Chinese contract manufacturer)	FMEMS	Foreign Marketing Entry Mode Strategy
OEM	Original Brand Manufacturer (Chinese brand manufacturer)	AOBM	Chinese acquisition of marketing manufacturing assets of Original Foreign Brand Manufacturer

In the model in Table 1, the production location implications of COO are posited to be production cost and 'distance' between production location and destination market. Production cost assumes that China is a lower cost location than Western countries (though there is increasing evidence that the cost advantage of sourcing in China is eroding as a result of wage inflation and if the full costs of overseas procurement are included).

Distance is a holistic concept which, here, is based on CAGE (Ghemawat, 2001), an acronym for cultural, administrative, geographic and economic barriers. Economic distance includes differences in incomes and costs and quality of resources. Geographic distance refers not only to mileage but also to presence or absence of common borders. Administrative distance includes such things as political hostility, presence or absence of political, colonial and economic ties. The premise is that the larger the distance between two countries, the more difficult it will be to trade. While this is broadly true, individual firms can reduce some of these barriers.

Thus, the model assumes that an OEM branding (with manufacture based in China) strategy will circumvent some of the cultural and administrative distances and perhaps turn economic distance into an advantage while an OEM strategy with manufacture based in the foreign market will not suffer from geographical distance nor any of the other CAGE factors provided it has an associated Marketing operation which engages with customers at a local level. Likewise, OBM strategies will have different distance impacts depending on whether manufacture and marketing take place in China or in the foreign market. Thus, for example, all the CAGE factors will probably be negative when manufacture for foreign markets is undertaken in China while cultural and administrative factors may be positive if manufacture occurs in the foreign market.

As stated previously, it should be noted that – for the sake of completeness of development directions - the model includes options in the Chinese market as well as foreign market options. An illustrative explication of one of the foreign market options facing Chinese firms is given in relation to Option 2. The foreign customer sees the brand as "routine" in that the name suggests Western origin whilst the "made in " label suggests "value –for–money" given its low cost production location endorsed by an FBO. The Chinese contract manufacturer gains from the low cost location but suffers from partial distance problems i.e. geographical

and administrative distances are high but cultural and economic distance are reduced because of the OEM brand strategy.

As yet, few Chinese brands have established themselves as major players on a global basis but firms such as Haier, Galanz, HTC, Huawei and others have become significant forces in some product sectors and market segments in some country markets. Their resources will permit any and several of the above options to be employed. Smaller Chinese firms will, however, need to make choices about their options and subsequent pathways.

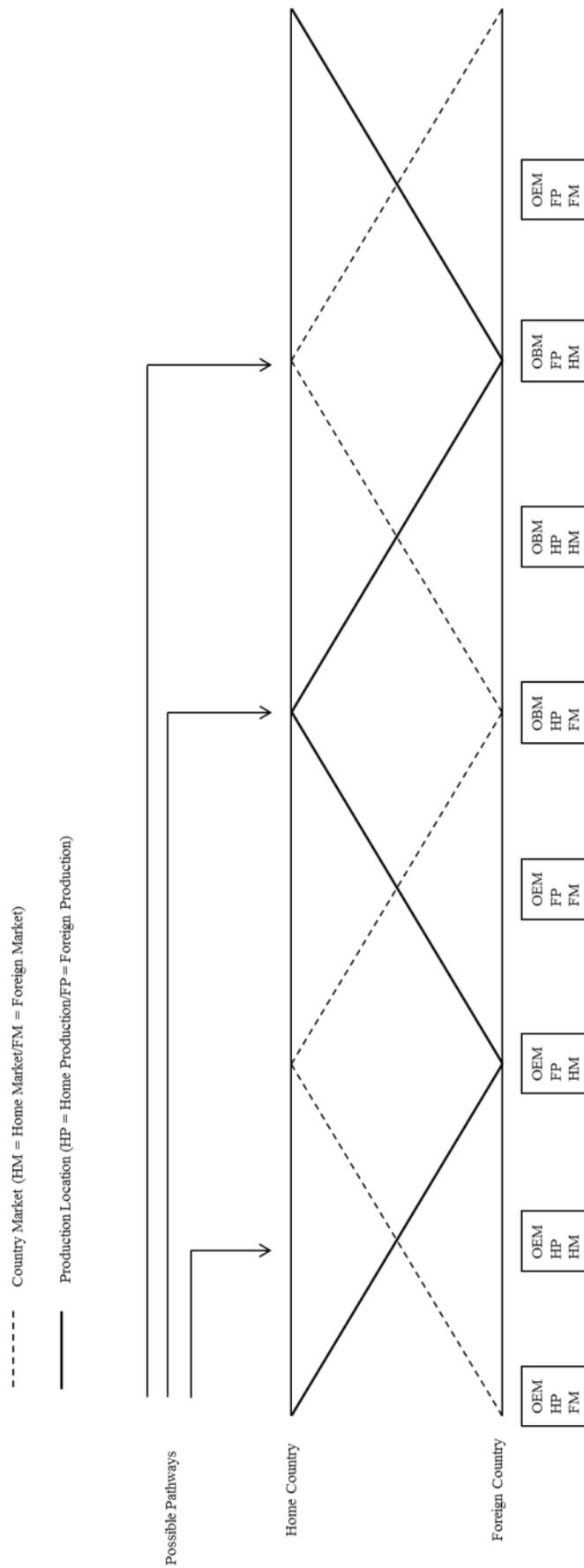


Figure 3: Brand, COO and country market pathways

## **DISCUSSION: ACADEMIC IMPLICATIONS – SIGNS OF A BRAND, ENTRY MODE, COO CYCLE ?**

In a study of the pathways taken by Singaporean garment manufacturers during the 1980s and 1990s, Van Grunsven and Smakman (2005) identified 7 development trajectories among which OEM strategies inevitably resulted in internationalisation as foreign buyers seek sourcing opportunities. Figure 3 illustrates a set of potential pathways in terms of the brand, COO and entry mode options. Of course, any individual firm could omit any of these stages and end the process at any point. Equally, any individual firm could build a portfolio which included many – or even all – of these strategic options.

Nevertheless the patterns of internationalisation of Chinese manufacturers suggest a developmental process in the way that Vernon (1966) postulated for US firms in his model of an international trade and product cycle. Vernon's cycle was stimulated by factors such as the changing incomes of consumers in different countries, costs of production, ease of access to foreign markets amongst others. The 'cycle' proposed here is also prompted by similar forces but also by changing perspectives on branding, COO, sourcing and market destination strategies. One potential pathway for Chinese firms can be summarised as shifting from OEM branded home production for foreign markets (Option 2) to OBM branded foreign production for the home market (Option 11). In between these extremes, the Chinese firm may pass through stages such as OBM export, licensed foreign brand export, acquired foreign brand export, OEM FDI, OBM FDI by acquisition and OBM organic FDI.

Clearly, the precise pathway will be different for each firm but there is a sense of a cycle albeit with an increasing number of spin-offs en route. For example, Chinese internationalisation often begins as the response to FBO sourcing strategy but then widens into a multitude of options. As the attractiveness of the Chinese market increases relative to Western markets, so will Chinese focus shift from abroad to home; as Chinese brands grow in stature, so will there be a general shift from OEM to OBM; and as China becomes relatively more expensive as a production location, so will foreign production increase. (This paper assumes foreign production located in the destination country market. In practice, much production will be re-located to lower cost third countries.

There is a corollary 'cycle' for foreign (Western) brand owners whose involvement in China has often started as an import sourcing strategy for the West and then widened to add

resource seeking FDI in China for Western markets and then market seeking FDI in China for the Chinese and other Asian markets.

It is also possible to see a cycle in the changing relationships of Chinese and Western firms. For example from a Chinese perspective, typically, the Western brand owners begin as customers. As relationships deepen and dependencies increase, the arrangement becomes more of one of collaboration. For those Chinese firms which take or add the OBM route, erstwhile customers and collaborators may well become competitors.

## CONCLUSION

In reality, Chinese firms will also need to take into account more factors than those shown in Table 1 (which focus on the inter-related items of brand, entry mode and country of origin). For example, there is increasing recognition that some Chinese firms are actually internationalising in order to obtain competitive advantages, rather than to exploit existing advantages as in the traditional Western model (Goldstein et al, 2006). Motivation for internationalisation will obviously affect the options chosen. However, whilst the above options model and cycle are clearly slices and simplifications of complex decision making phenomena they may help to highlight and structure some of the key factors. The importance of the issue for Chinese and Western firms suggests that extensive research into the topic would be more than justified.

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## COLLABORATION COMPETENCE DEVELOPMENT: THE CASE OF BIONIC, LTD

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### ABSTRACT

This pedagogical case draws attention to the role of a HR manager as a facilitator / mediator in negotiations inside an organization, aimed not only at conflict resolution, but at dealing with rising of company competitiveness and effectiveness from HR perspective.

Highly structured environment with clearly defined goals of every department in an MNC often provokes 'competition for a client' inside a company. This case allows for deep study of a conflict of employees' interests, and proposes to look for the ways of its resolution with help of the soft management approaches (e.g. using Harvard negotiation project methodology). It also highlights the importance of collaboration competence development in modern business organization.

This case, written in Ukraine, is based on several prominent multinational companies in IT sector and was prepared under the research framework of the SCOPES project (Swiss-Russian-Ukrainian institutional partnership 2011-2013).

**Keywords:** Collaboration competence; conflict resolution; win-win approach; interest; one enterprise approach; negotiation.

### CASE DESCRIPTION

*Competition between employees of the two departments in Ukrainian branch of multinational IT company results in a loss of income, and resources are needed to resolve the conflict. The company decides to develop "cooperation" competence among staff and appoints HR manager to be the leader of this process.*

Increasing competition on the IT services market creates the challenges of improving competitiveness and efficiency of Bionic LTD. Creation of additional resources for improving competitiveness of the company is connected to the development of *one enterprise* approach. This approach means that the priority for the employees is to get the *collaboration* competence. That is why Bionic LTD considers as one of its main tasks to create the corporate culture in which employees connect company's success to their own success. Great possibilities might be provided here by accepting *win-win* approach, concerning solving management tasks as well as difficult challenges, connected to the conflict of employees' interests from different departments in the company.

So the company aims its efforts on development of the *collaboration* competence among employees. The expected result of the development of this competence is that all the employees are motivated to act in the interests of the company, and different departments of the company are trying to sell to clients the services of other departments. At the same time employees consider success of the company as their own.

The development of the new competence, according to company's management, should lead to creation of transparent trusting relations between employees of different departments. This in turn should help creating the environment that encourages the development of creative and innovative thinking among employees and motivates them to look for and to implement the new solutions. This hypothesis is confirmed by the results of new research, conducted within the Harvard negotiation project.

There is hope that the cooperation between the employees of the company, which is based on collaborative relationships, would allow to implement *one enterprise* approach. This move would help:

- To increase cross-selling of the products of the company (from software to consulting),
- To strengthen the company's reputation as the one that provides high-quality and complex services,
- To create conditions that would motivate customers to use legal software,
- To improve the quality of the customer base of Bionic LTD by better information sharing within the company about customers and their needs,
- To provide long sales that would not be limited by selling of software and would allow to develop new services related to customer service;

- To develop new innovative product offerings that would allow being one step ahead of the competition.

Development of *collaboration* competence is especially important for the two departments of the company. The first one is Enterprise group, which works in three directions:

- 1) Major customers,
- 2) Small and middle-sized business customers,
- 3) Government.

The main task of Enterprise group is selling software to the customers of Bionic LTD. In addition Enterprise group is also responsible for coordination of the work with partners of Bionic LTD. These partners are small IT companies that have signed the partnership deal. They provide services to the customers of Bionic LTD (mostly to small and middle-sized business) after delivery of the software.

The second department is the Service group, which provides customers with the services concerning software that was sold to them. The tasks of the specialists of this department are the post-sale services provided to the customers. Mostly these services are consulting services to the major customers concerning implementation and using of the new software. Their services are partly the same as services of Bionic LTD partners.

Thereby Enterprise group has wide access to customers, knows their needs and interests, and trying to satisfy them in a best possible way. Usually representatives of this group keep their hand on the pulse of the customer. And Service group provides consulting services mostly to the clients of Enterprise group.

Until recently Bionic LTD worked mostly with major customers, who are able to appreciate all the benefits of cooperation that is based on *one enterprise* approach. Middle-sized or small companies are mostly the clients of partners of Bionic LTD. Relations with the partners of Bionic LTD are built on the principles of transparency, integrity and mutual aid.

Supply of software is an exclusive service provided by Enterprise group. At the same time, regardless of size and financial capacity, customers of Bionic LTD care about optimization of all their costs including the costs of post-sales support by Bionic LTD. Thus, partners of Bionic LTD potentially become a competition for Service group of Bionic LTD by

“price for services” criteria, even for major clients. Demand for the services of Service group decreases. The company starts to lose profits, and that is why the issue of cooperation between Service group (consulting services) and Enterprise group becomes especially topical.

The situation is complicated by the fact that at Ukrainian market of IT services software users have the possibility to use unlicensed software. Disagreements within the company may lead to increased use of unlicensed software, and thus reduce the demand for Bionic LTD services in general. If the situation in Ukraine is not resolved soon, there is a risk of decrease in sales as well as the risk of financial losses within the company because of the cost of resolving the conflict between the two departments.

The company management placed the responsibility on HR for urgent development of collaborative culture and its implementation inside the company. The company tried to make changes, but presentations by HR manager for the representatives of two departments on how things might be different, did not work.

Unsolved problem leaves all the departments of Ukrainian office without any chance of winning the "Bionic LTD Contribution" competition. This is very sad, because representatives of more than 20 countries take part in this competition. "Bionic LTD Contribution" is a prestigious annual award for those who made the greatest contribution to the company. For winners it is not just a real chance to become well-known in the international branches of the company. Often, even the fact of being nominated have a positive effect on the further career development.

## **TASKS:**

1. Identify the participants of the negotiations and the role of HR manager in this process. Design the negotiations process between two departments (who contacts whom, when and with what kind of issue).
2. Analyze the situation from the point of view of the *interests* and possible options for cooperation development between Enterprise group and Service group.
3. Negotiate with the help of HR manager. HR manager is supposed to play the role of mediator at the meeting of groups' leaders. The main task of this meeting is to find possible solutions and to prepare the common meeting of employees from two departments. In the process of negotiation, make hypotheses about feasible solution

options for this problem. Being HR manager, try to give the parties as much autonomy in looking for possible solutions to address the situation as you can.

4. Discuss the issue of necessary managerial decisions that would contribute to the implementation of achieved agreements and development of "cooperation" competence among staff.

### **CONFIDENTIAL INSTRUCTIONS FOR ENTERPRISE GROUP (ON A SEPARATE PAGE):**

Our Enterprise group has access to customers, knows their needs and interests, and tries to satisfy them in a best possible way. It is difficult to combine the interests of the company, customers, partners, other units and your own interests, including personal. This is understandable. You are rewarded for the performance of your unit, and everything else is not your problem. A client will be able to buy services of Service Group if he still has funds in his budget; if not, then a client has an alternative to buy services from the partners of the company.

In a whole, things are going well in the department. Some inexplicable failures of the software don't influence much on level of clients' satisfaction. However, there is a risk to lose the company's face, because your managers' knowledge is not deep enough to discuss the failures in the software issues with the client. You have to get deep understanding on how to work systematically with clients on the software shortcomings; otherwise it can lead to loss of time and the deterioration of relations with clients.

*One enterprise approach* is being implemented in the company. But it's not that easy, because your account managers do not have competences to offer services of Service Group and Service Group consultants are not always available to take part in meetings with clients. Consultants of Service Group often refuse your invitations to take part in meetings with clients at the stage of product sales because of the work pressure.

And in general, who talks about this problem? For now everything goes as it goes: everyone on his own tries to act in the best possible way. But for whom this way is the best? Orientation on the general success of the company is still important, but we will think about it later, right?

Interesting, who will win the *Bionic LTD Contribution* contest this year? This is a prestigious annual award for those who made the biggest contribution to the development of the company.

### **CONFIDENTIAL INSTRUCTIONS FOR SERVICE GROUP (ON A SEPARATE PAGE):**

Service group provides clients of Enterprise group with post-sale consulting services. If there are some technical difficulties in using the software, then your consultants are always ready to help. This is why the cooperation with representatives of Enterprise group would give substantial additional possibilities for selling services and products of your department as well as other departments of the company. As a result, everyone would earn more. And now the clients' money goes outside of the company, to the partners.

Clearly, it is difficult to sell consulting services without special knowledge that account managers of Enterprise group do not have and therefore poorly explain the benefits of your services comparing to the services of partners. You could more actively provide account managers with expert information and support them during meetings with clients while giving them the initial offer. At the same time, we all are allowed to participate in first meetings with clients while working on the initial offer. However, it is unknown whether it makes sense to do so. Our consultants spend a lot of time on these meetings, but the result is poor. Invitations to meetings with clients often look like a generous gift from a rich uncle and depend on the specific manager's will. Maybe it is better not to go to meetings at all, but then everyone, including the company, loses.

Generally there is a belief that the group plays a minor role in the plans of the company. It is not really clear why your fate is to work only with big clients. Working with representatives of small and medium business should mean opportunities for all, not just partners.

Everyone feels lesser importance of a Service Group in the company's success, and the attitude in the Enterprise group towards you reflects that. But they also have problems! Clients are clearly tired to harass account manager concerning every error in the software, especially since they're still not getting professional help. Your consultants have creative ideas for new services that would allow everyone to save time, nerves and face.

We could think together what to do in order to make time for preparing quality offers more effectively. Perhaps we should prepare a project offer for a client together? But nobody knows if it is really possible. And nobody in the department can understand how to find the proper information about customer needs on time; in what terms an offer should be done; who should make the first step; who is there in Enterprise group that makes a decision on a final offer to the client, and so on.

If everybody could gather and talk to each other as experts, then it could turn out that consultant may improve the image of Enterprise group on meetings with clients. But no one dares to speak first. It is not very comfortable to talk about all these issues. What it would sound like a complaint? No one wants to spoil the relationship. It is hardly possible to implement changes and keep the good relationships between departments at the same time.

No one knows whether there is any positive experience in solving similar problems in other countries. There is feeling that they demand the impossible from Ukraine. The company tried to make some changes, but general meetings of the two departments with the presentations of HR manager on how things could have been different, did not work. After all, sometimes the best intentions are so far from reality!

## TEACHING NOTES

### *Case target audience*

Top and middle level managers (executive level), who are responsible for effective employees' interaction, high-quality managerial decisions and implementation of these decisions in their companies.

The recommended course to include this case study into is: Organizational Culture.

### *The case aims*

1. Development of the skill of non-conflict resolution of complicated managerial tasks
2. Development of mediator competences that include such skills:
  - Management of negotiations process: group members should gain knowledge about effective negotiations with the participation of facilitator (mediator), its six stages (meeting preparation, meeting opening, exploration of interests, finding a solution,

agreement formulation, and organization of negotiation working space). Furthermore, managers should learn to build an effective negotiation process: to define right goals and right participants for a meeting, determine who to meet while preparing negotiations and why, complete negotiations in a right manner (evaluate results and implement agreements).

- **Work with content:** to have an idea of what the interests are, to be able to detect them via asking questions, to analyze, to assist in looking for mutually acceptable solutions through questions, to evaluate them using objective criteria, to deliver SMART solutions (specific, measurable, achievable, realistic, timely), to be able to check actuality of their solutions.
- **Management of relations:** ability to manage emotions, to talk positive language, to have an idea of active listening and to work out skills of active listening while working on the case (silence, summarizing, paraphrasing, etc.), to be able to check the judgments and assumptions about the motives of other people, to form trusty relations.
- **Ability to implement the agreements:**
- Developing of a plan of implementation of the agreement; to understand the barriers within the company that prevent the implementation. To be able to "sell" to top managers the agreements achieved in negotiations process. In particular, they should be able to explain to the company's top management why the implementation of the agreements is important for the company as a whole
- to look for creative managerial decisions.

#### *Case delivery recommendations*

Number of participants in the group: up to 30 people.

Learning activities in this case study:

- Discussions in small groups
- Simulation (role play)
- Discussions in large group (debrief)

Recommended time for preparations:

- Preliminary studies aimed at developing the skills of a mediator among managers (24 astronomical hours).

- Familiarization with the case right before study (20 minutes). Please note that the case study contains general information and confidential instructions to participants. This means that prior to the training participants should be divided into groups (HR manager, representative of Enterprise group, and representative of Service group) and familiar with the general instructions and only with their specific confidential instructions.

Duration of work on the case study in lecture room: 140 minutes

Specific requirements for the teacher: mediator competences.

#### *Case study work organization*

Warning: Samples of steps and possible solutions are listed below. If participants would have other solutions, this should not be counted a mistake.

#### *Step 1. Presentation of the case study (15 minutes)*

The teacher introduces the general plot and purpose of the case study. It is also necessary to remind participants that during a role play they will have to demonstrate the mediator skills.

#### *Step 2. Work in small groups on the first two questions of the case study (40 minutes)*

- Determine the participants of the negotiations and HR manager in this process; design the negotiation process between two departments (who addresses whom, when and with what kind of issue).
- Analyze the situation in terms of interests and possible cooperation between Enterprise group and Service group.

Here you have to divide the participants into three groups: HR managers, representatives of Enterprise group, and representatives of Service group. Discussion on the performance of small groups is to be held at the final stage after the role play (step 4).

Possible answers to the question "What is an optimal design of the negotiation process?"

#### 1. Preparation stage:

- HR manager should hold meetings with the group leaders to exchange thoughts on the vision of the problem.
- After that it would be appropriate to have separate meetings with each group to share information about the causes of negotiations and another testing of hypotheses concerning interests of the parties, which were voiced at a joint meeting of leaders.
- Meeting with leaders of groups to find possible solutions and preparation of the joint meeting. Ability to work in a wider focus group.

2. Negotiations stage (mediation):

- General meeting of representatives of two departments in order to find possible solutions that would be based on the interests of the parties
- Development of the plan on implementation of agreements
- Deciding on what agreements should be agreed with the company's management

If no agreement is reached, you may need to hold several separate meetings of HR manager with representatives of each department.

Possible answers to the question "Analysis of the situation, preparation for the negotiations":

Answering the following questions will help you to analyze the situation and parties' interests:

- What is important for the participants in this situation?
- Why is it important for them?
- What does it mean for them?
- Which interests are the most important for every party (priorities)?
- What are their common interests?

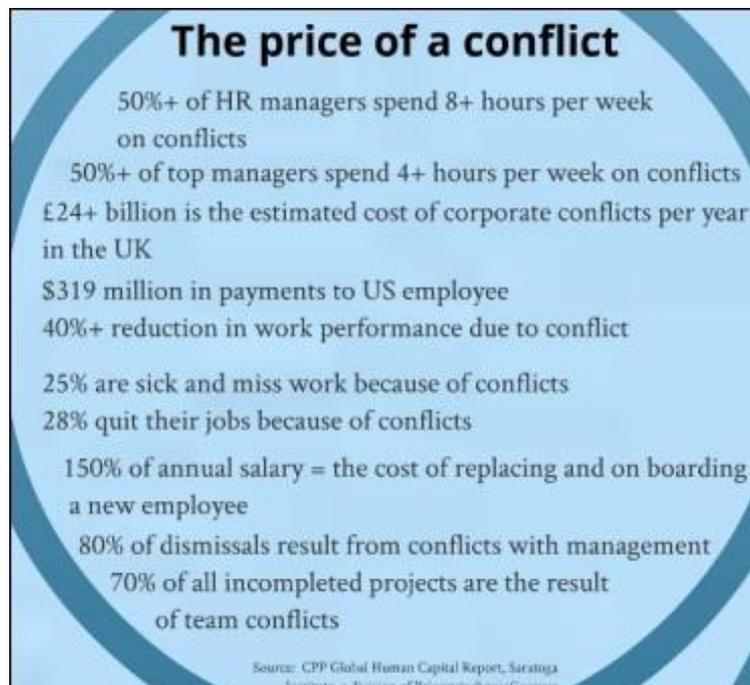
Below are listed just some of the interests appropriate for the participants of the situation. You can also add the interests of clients, HR manager, partners and others to the table. It should be noted that the interests of the company should be one of the criteria for assessing the acceptability of agreement options between the two departments.

Bionic LTD (Ukraine) interests. Interests bearer: top management of the company	Enterprise group interests	Service group interests
Increase in sales	General stability of company's work	<ul style="list-style-type: none"> <li>• To make more money.</li> <li>• Closer cooperation with Enterprise group</li> </ul>

Reduce the cost of conflict resolution and competition within the company	Getting compensation for the sales of additional services provided by Service group	Get more information about the Enterprise group, the needs of potential customers, experience in implementing similar processes in branches of company in other countries
Image and reputation in the faces of the parent company, partners, customers	Improving the image of department within the company, which is achievable if you get prestigious award <i>Bionic LTD Contribution</i>	Upgrading the status of the department within the company
Rapid implementation of the new approach (time)	Saving the face in front of customers in case there is a complaint on the technical failure of the software	The most effective use of the time of consultants
	Retention of old clients and attraction of new ones	General stability of company's work
	Quality and quick preparation of complex offers to clients (including services of Service group)	

*Interests of the key parties of the case study*

Additionally, you may notify participants about the cost of the conflicts in a company:



*The costs of the conflicts in a company*

*Step 3. Role play in small groups: negotiations (40 minutes)*

Participants should be divided into groups with three people in every group (playing the roles of HR manager, Enterprise group representative, Service group representative).

Participants should have negotiations with the participation of HR manager, giving him the role of mediator in negotiations process between Enterprise group and Service group. The purpose of the negotiations is to find possible ways out of the situation. Encourage participants who play roles of HR managers to focus on conducting of the effective process, and representatives of the departments should be provided with more freedom and autonomy in finding optimal solutions in the development of the culture of trust and collaboration within the company.

Remind HR manager about the stages of mediation and the need to keep to them during the negotiations (opening of the meeting, work with interests, creating of the possible ways out of the situation, formalization of the agreement).

HR manager's role in solving the situation:

- Expert. He may express his vision of the situation, including vision concerning the interests of the company
- Mediator in negotiations process between two departments
- Mediator in negotiations between departments and top management of the company

*Step 4. General discussion (45 minutes)*

1. Discuss the question whether the HR manager's role as a mediator in this process was helpful or not? Could the parties agree on their own without an agent? Was the process comfortable for the parties and for the mediator? What mediator's actions contributed to the effectiveness of negotiation process?
2. Sum up the discussions in small groups concerning the optimal design of negotiations process (step 1)
3. Gather the information about identified interests of the parties, priority interests, and common interests into the groups. Put the results of discussion to the following table:

Bionic LTD (Ukraine) interests. Interests bearer: top management of the company	Enterprise group interests	Service group interests

4. Discuss the possible solutions that participants came up with in groups. Compare them to specific experience of the prototype company. Identify solutions that require approval from the top management of the company to be implemented. Discuss the reasons why top management should be willing to make the necessary changes (in terms of its interest).
5. Discuss the skills of mediation that participants used successfully; what should be improved, and what should never be done.

	Negotiations management	Work with content	Organiza tion of relations
Well done			
Needs improvements			
Should never be done			

*Background information for the faculty*

Find below the useful information on a prototype of Bionic LTD and real steps and changes that occurred in the company in connection with the introduction of *one enterprise* approach, and *collaboration* competence development:

- When making changes directed to introducing *one enterprise* approach, negotiations in the form of facilitation proved to be effective, and the role of facilitator and mediator was taken over by HR manager.

- The negotiation process is organized as follows: focus groups within departments were conducted, and then representatives from the two groups were voluntarily selected. Together with the HR manager they started the process of preparing a joint meeting of the two departments. During the preparations questions for the discussion were carefully chosen, their importance was prioritized.
- In order to motivate Service group to implement *one enterprise* approach, the RACI model (responsible, accountable, consulted, and informed) was introduced. Service group received a more active role in making WIN-plans of Enterprise group in terms of services sales. Also Service group is now involved in the preparation of complex proposals for clients of Enterprise groups in the part which refers services. Preparation of proposals concerning WIN-plan takes much less time than participation in regular (together with account managers) meetings with clients.
- Clients are offered a new service, which is called quality insurance. It allows customers of Bionic LTD to make realistic assessment of the added value of Service group's consultants' work. The service is to guarantee the quality of new software products and so-called "after-sales service" for customers long after the sale of the software. This approach allows extending the life cycle of services provided by Service group, and actually creating a new service that cannot be provided by partners of Bionic LTD.
- Consultants of Service group within the quality insurance service collect information on the weaknesses of the software, and develop proposals for its improvement and creation of new services. This is extremely beneficial for managers of Enterprise Group.
- Regular weekly meetings to exchange information on the implementation of the sales plans were introduced. Through shared responsibility for the result (execution plans by RACI model), the leaders of the two units were motivated to participate in joint meetings on the process analysis and sales plans.
- Rewards for the leaders of two groups for the successful operation depend not only on the performance of their unit, but also on the overall result of cooperation between two units and the company as a whole.
- The need to develop soft skills in the conduct of win-win negotiations was revealed. Development of skills of effective feedback was initiated.
- Joint virtual meeting (business calls) with Bionic LTD representatives in Eastern Europe were introduced. Representatives of the two departments take part in these

meetings, which help them to develop team spirit and a habit of thinking based on common goals and shared responsibility. Employees were informed about the positive experience in solving similar problems in the Russian branch of Bionic LTD. The problem of competition within the company has been successfully solved by the joint efforts of all employees of the company and its partners. In particular, due to the introduction of *one enterprise* approach the company's sales growth doubled in two years.

- The company has the possibility of raising the motivation to implement *one enterprise* approach through monthly compensations, Bionic LTD Contribution Award and more.
- The first six months of implementation of the new approach have proved the appropriateness of the chosen direction of development for the company. The bidding volume of new contracts increased at 30%.
- The company has plans for wider involvement of the Service group in the services for SME sector. That might occur through greater direct cooperation of Service group with partners of Bionic LTD.

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## A COMPARISON BETWEEN THE PERCEPTIONS OF THE IDEAL LEADER FOR COLOMBIANS AND CHILEANS USING THE LEADERSHIP PRACTICES INVENTORY OF KOUZES AND POSNER

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### ABSTRACT

Some experts in the study of leadership like Kouzes and Posner (1995) state that leadership can be defined from observable behaviors, this implies that people identify their leaders as they show this behavior, therefore, the effectiveness of a leader will depend in how much the behavior of the leader resembles the behavior expectations people have of what they think an ideal leader is (Haslam, 2004). The objective of this investigation is to determine the behaviors the ideal Colombian and Chilean leaders should show, compare the results and analyze them. Very few studies in leadership have been done in Latin America about the behavior of effective leaders. To develop these studies, an adaptation of the Leadership Practices Inventory of Kouzes and Posner was made, and the samples for the survey were determined, previously establishing the characteristics of the leaders to survey.

The results provides important information for both countries, they suggest that the expectation of behavior of the ideal leader for Chile and Colombia is centered in his or her ability to enable others to act followed by modeling the way. The results also suggest that leaders must be conservative and traditionalist.

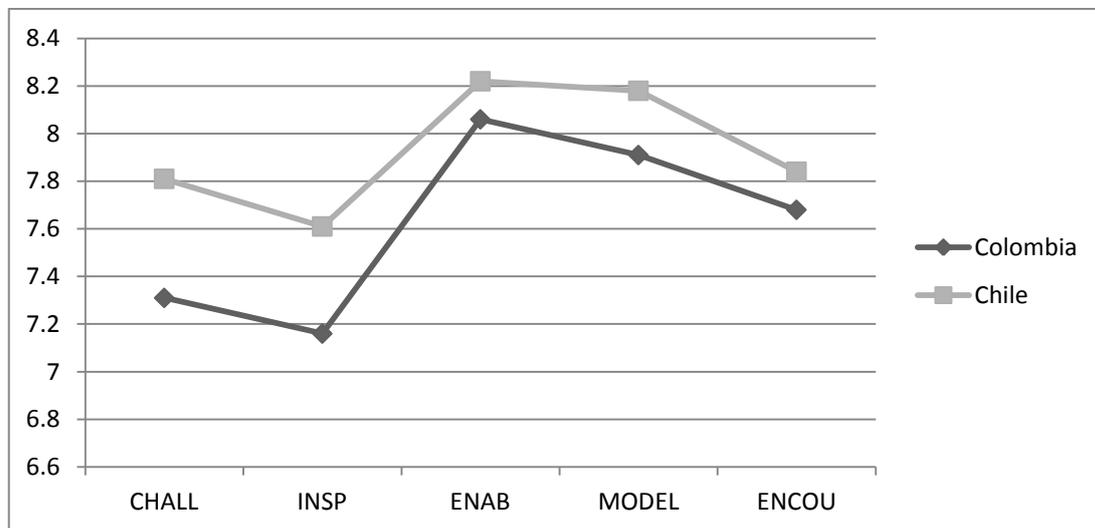
**Key words:** Leadership, Colombia, Chile, Leadership Practices Inventory

Experts in the field of leadership studies, such as Kouzes and Posner (1995) propose that leadership can be defined from observable behaviors; this implies that followers identify and define their leaders through those leaders' behavior. Moreover, since all followers have expectations on right and wrong behavior, the effectiveness of a leader could well depend on how much the behavior of the leader resembles the behavior expectations that followers have (Haslam, 2004). Very few studies in leadership have been done in Latin America about the

behavior of effective leaders. This investigation pretends to determine the 'ideal' behavior that is expected of Colombian and Chilean leaders in order to be considered effective leaders. This investigation also compares the results and analyzes them to see the relation between expectation of followers and actual leadership effectiveness. To develop these studies, an adaptation of the Leadership Practices Inventory of Kouzes and Posner was made, and the samples for the survey were determined to previously establish the characteristics of the leaders needed to survey.

Initial analysis was made to assure the reliability of the data concluding that the alpha of Cronbach result was over 0,70 which according to Nunally (1978) it can be concluded that it is reliable.

Figure 1. General results



Source: Authors

A total of 439 surveys were made, 339 in Colombia and a 100 in Chile. Figure 1 shows the comparison of the general results per country. Each practice is abbreviated as follows: challenging the process (CHALL), inspiring a shared vision (INSP), enabling others to act (ENAB), modeling the way (MODEL) and encouraging the heart (ENCOU).

Table 1 shows the results for each of the variable per country. The results show that there are some differences between the two countries. Chilean's followers seem to have higher expectations from their leaders' behavior. Even though the curves, when the graphs were made (See graphic 1), are similar, the behavior expectation of the ideal Chilean leader, in the 'modeling the way' (MODEL) practice, is much higher than Colombians expectation.

Table 1. Description of the results for each variable per country

			N	%	CHALL	INSP	ENAB	MODEL	ENCOU
AGE	21 – 25	CO	46	13,57%	7,77	7,59	8,48	8,12	7,93
		CH	8	8,00%	8,19	7,98	8,33	8,27	<u>8,38</u>
	26 – 35	CO	201	59,29%	7,20	7,03	7,90	7,78	7,52
		CH	49	49,00%	7,77	7,59	8,23	8,18	7,86
	36 – 45	CO	68	20,06%	7,36	7,24	8,24	8,18	7,96
		CH	35	35,00%	7,82	7,64	8,21	8,12	7,78
46 – 60	CO	23	6,78%	7,09	7,10	8,00	7,78	7,69	
	CH	8	8,00%	7,63	7,15	8,06	8,33	7,48	
GENDER	Male	CO	165	48,67%	7,38	7,28	8,18	8,01	7,80
		CH	53	53,00%	7,83	7,63	8,20	<u>8,21</u>	7,82
	Female	CO	174	51,33%	7,24	7,05	7,94	7,81	7,57
		CH	47	47,00%	7,79	7,58	8,25	8,14	7,86
EDUCATION	High School	CO	4	1,18%	6,78	5,56	8,05	7,00	5,72
		CH	0	0,00%	...	...	...	...	...
	Some College	CO	40	11,80%	7,26	7,26	8,09	7,94	7,64
		CH	19	19,00%	7,89	7,49	8,06	<u>8,19</u>	7,68
	College	CO	198	58,41%	7,13	7,03	7,87	7,71	7,56
		CH	58	58,00%	7,73	7,59	8,18	8,07	7,82
	Graduate	CO	97	28,61%	7,72	7,44	8,42	8,30	7,99
		CH	23	23,00%	7,95	7,74	8,45	8,43	8,03
NUMBER OF DIRECT EMPLOYEES	1 a 2	CO	119	35,10%	7,33	7,16	8,08	7,91	7,64
		CH	44	44,00%	7,87	7,60	8,14	8,07	7,74
	3 a 10	CO	84	24,78%	7,47	7,37	8,07	8,07	7,92
		CH	39	39,00%	7,68	7,53	8,27	8,16	7,84
	10 a 20	CO	22	6,49%	7,49	7,22	8,55	8,19	8,28
		CH	10	10,00%	8,00	7,58	8,22	<u>8,55</u>	7,78
	Más de 20	CO	19	5,60%	7,63	7,61	8,46	8,17	8,22
		CH	7	7,00%	7,91	8,12	8,45	8,43	<u>8,57</u>

Source: Authors

To determine if the differences are statistically significant, a variance study (ANOVA) was made. The results of the analysis show that the differences are not statistically significant as shown in table 2.

Table 2. ANOVA

		Sum of square	gl	Square Mean	F	Sig.
CHALL	Inter-groups	3.404	1	3.404	1.284	.258
	Intra- groups	572.573	216	2.651		
	Total	575.977	217			
INSP	Inter- groups	5.412	1	5.412	1.974	.161
	Intra- groups	592.184	216	2.742		
	Total	597.596	217			
ENAB	Inter- groups	3.926	1	3.926	1.661	.199
	Intra- groups	510.587	216	2.364		
	Total	514.513	217			
MODEL	Inter- groups	5.196	1	5.196	2.186	.141
	Intra- groups	513.288	216	2.376		
	Total	518.484	217			
ENCOU	Inter- groups	7.249	1	7.249	2.377	.125
	Intra- groups	658.648	216	3.049		
	Total	665.897	217			

Source: Authors

## CONCLUSIONS

The results provide important information for both countries, they suggest that the expectation of behavior of the ideal leader for Chile and Colombia is centered on his or her ability to enable others to act followed by modeling the way. The results also suggest that leaders must be conservative and traditionalist in their behavior.

Each country's human resources departments can use the results of this study to define the characteristics of each country's leaders and in that way determine selection and hiring

policies. They also contribute to the preparation of transnational leaders of organizations that want to operate in Colombia and Chile.

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## EXPLORING THE ROLE OF TRUST IN BUSINESS RELATIONSHIP WITHIN THE CHINESE SHIPBUILDING INDUSTRY

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### ABSTRACT

China's rising shipbuilding industry offers an extensive market opportunity to the world's shipbuilding industry. The Chinese shipbuilding industry is characterised by being mainly state-owned enterprises (SOE) and has a legacy of a previous planned economy. These state-owned enterprises operate under governmental control as well as, receive governmental support. European co-operations with Chinese state-owned enterprises face major roadblocks in terms of pattern of agreements, understanding with shippers, or coping with government's policies and requirements.

The research will discuss the role and influence of trust affecting the business relationship between European suppliers and Chinese SOE shipbuilding industry. It will provide suggestions on how to build up trust for a solid business partnership. The interest's trilogy (government, relationship and trust) should be taken into account in order to avoid tension between the supplier's interest, state's interest and SOE's interest.

The methodology applied in this research will be of qualitative nature using a case study with in-depth interviews. It conducts exploratory and descriptive methods to get a deep understanding of how trust and relationship are developed in a market entry strategy with Chinese SOE.

The outcome of the qualitative research will reveal the role that trust plays in Chinese SOE shipbuilding industry, leading to the development of a new model which is based on trust and relationships being regarded as the success factors for European shipbuilding industry when entering in the Chinese market being under governmental supervision.

**Keywords:** Trust and relationship, market entry strategy China, culture, China's shipbuilding market, shipbuilding Industry

## INTRODUCTION

Over the past years, China has drawn attention of the world shipbuilding industry because of its rapid development. According to Salles (2013) China, hold the 45% of market share in 2012, and it was in the first position ahead of the rest of the world.

China's rising shipbuilding industry offers an extensive market opportunity to the world shipbuilding industry. After having conducted a preliminary investigation of the Chinese shipbuilding market, the researchers found out that the Chinese shipbuilding industry is predominantly state-owned enterprises (SOE). This finding is confirmed by Mattlin (2009) who explains that this situation occurs as a legacy of the planned economy in China. After 1978, economic reforms in the People's Republic of China lead to dramatic performance improvements in Chinese SOEs (Groves, et al. (1994); Xu and Wang (1999); Li (1997); Cao, Qian, and Weingast (1999). In spite of that, Mattlin (2007) highlights the dual role of big Chinese state-owned enterprises as both corporations and arms of the state machinery. This could be the case as he further explained, because China has never embraced privatisation of state-owned enterprises as a central policy goal. Instead, it has been China's ambition to build a national team in several key industries including automotive, pharmaceutical, electronics and petrochemical in which SOEs have a dominant presence (Nolan, 2001).

Due to these SEO characteristics, shipbuilding industry concerned with international trade face inevitably complicated pattern of agreements and understandings with shippers and in this case with Chinese government policies like governmental protection or governmental support (Karakaya, 2002, Stopford, 2009). The Chinese government can make corresponding preferential policies like preferential tax or financing convenience, moreover, the government subsidies, promote and support its developments. Needless to say, that the Chinese government has enough influence on the state-owned shipbuilding companies with products, technology and even with the prices. (Li, 2011)

Conclusively, it can be seen the remarkable role that the government plays in the shipbuilding market, suggesting that for European companies entering into the Chinese shipbuilding market will have no other chance that getting in contact with the Chinese government.

In this context, the researchers will explore the role of trust and relationship building with Chinese government to provide important insights to European suppliers who want to enter in the shipbuilding industry and share the significant Chinese market. The researchers will discuss theoretical and practical implications on trust and relationship building for a successful business relationship in Chinese SEOs.

## RESEARCH QUESTIONS AND OBJECTIVES

Considering these idiosyncrasies with the government, relationship and trust in the shipbuilding market, call the researchers to focus the research on exploring how the three issues are influencing each other and try to find a solution of how to smooth the business relationship (Figure 1). The main questions under consideration are what role does trust play in the business relationship? and how to build up trust in the Chinese shipbuilding market?

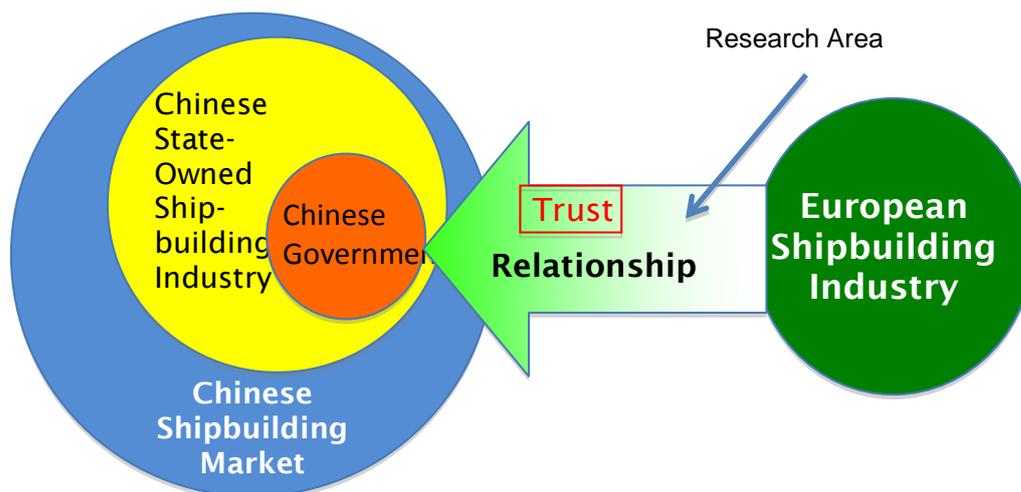


Figure1: Research Core Area (Source: developed by the researchers)

To answer the research questions, the main objective of this paper is to study the role of trust in the governmental relational context in Chinese shipbuilding industry. Following the detailed objectives are provided:

RO1: Explore the different understanding on trust and relationship building between European and Chinese shipbuilding companies;

RO2: Instigate the roles and influences of trust in the interrelationships among the European suppliers and Chinese SOE shipbuilding industry;

RO2: explore how business behaviours can influence trust building and develop the best practice by providing a set of tactics and recommendations on how to build up trust with Chinese SOE for a successful business relationship.

## TRUST'S DEFINITIONS

The trust phenomenon has been studied within a long history. According to Rotter (1967, p.651) trust can be defined as “a generalised expectancy held by an individual or group that the word, promise, verbal or written statement of another individual or group can be trusted”. In addition, Morgan and Hunt (1994) identified three attitudes on what trust is based upon: reliability, integrity, and competence. In the same line, Mayer, Davis, and Schoorman (1995), confirmed attitudes of integrity and add benevolence and ability. Whereas, Sharkie (2009) focuses more on interpersonal trust highlighting as well as confidence in the ability, character, integrity and truth of a person, being a vital element in all social interactions.

Though the importance of trust is has been emphasized in the business field, however, there is few literature related to how people in different cultures trust each other (Chua, Morris and Ingram, 2009). The researchers find out, that the understanding and the importance of trust in the business world is different between Europe and China. Confucian philosophy, the basis of Chinese culture, argues that the most important thing to be successful in management is to get the trust from others, that one only gets business done, if he can get the trust from others, and one without trust cannot stand in the society (人无信不立). More and more Chinese scholars emphasize the role of the trust. Tong and Yong (1998) and Xu (1999) argue that Chinese are dependent more upon “xinyong” (personal trust) rather than trust to conduct businesses. Leung et. (2005) point out that trust is an important governance mechanism in the Peoples Republic of China (PRC). Jiang et. al. (2011) value the interpersonal trust between executives especially critical in China, and argue that when doing business in China, trust-building should be seen as a strategic dimension for foreign companies; Kriz and Keating (2010) also analyses the role of trust in Chinese business at a significant strategic level that trust “may seem at odds with the military doctrine of stratagem where victory requires tactics of deceit that can actually promote distrust” (Kriz and Keating, 2010, p.7).

In this context of Chinese trust relationship, Jiang et.al (2011) studied the cognition and affect-based trust which were categorized by McAllister (1995) and found out that the

different cultural ethnicity and different firm size (which cause different institutional endowment like government support) have different influence on building trust. Therefore, when dealing with firms with these different characteristics trust-building, culture and commitment should become key priorities.

## **TRUST AND BUSINESS RELATIONSHIPS**

It has been already acknowledge that in doing business with Chinese partners, relationships play an important role. When European companies need to interact with Chinese government, the development of trust in business relationship should be carefully taken care for and nurture. Fukuyama (1995) points out the significance of trust and its critical meaning as one of the components of relationships in international business markets. Furthermore, Pearce and Robinson (2000), Kriza and Keating (2010) underline that trust is critical and may actually be the most important step to develop in business relationships with China. Leung et. al. (2005) find out that in China, relationship has a strong influence on personal trust and suppliers should use relationship to generate buyer's perception on personal trust whilst maintaining a reasonable level of buyer satisfaction with their products and services. Additionally, Sanchez-Bengoa and Neuhauser, (2013) identified that the creation and development of trust as an executive function can effectively save time, money, nerves and improve personal and company relationships being beneficial for the Chinese and European business cooperation. Finally, Kriza and Keating, (2010, p.22) stress that an in-depth understanding of trust "appears pivotal to the future of Sino-Western interrelationships".

## **METHODOLOGY**

Choosing the research methodology depends on several factors including: the researcher's beliefs and understanding about the real world (ontology), and how he/she distinguishes true (adequate) knowledge from false (inadequate) knowledge (epistemology), the purpose and goals of the research, the founders of the research and the position and environment of the researchers themselves (Crotty,1998).

In this case, the researchers have adopted an interpretivist approach. The reason for that is because in the interpretive approach "the researcher does not stand above or outside, but, is a participant observer, who engages in the activities and discerns the meanings of actions"

(Carr and Kemmis, 1986, p.88). In this case, the researchers search for an understanding and explanation of the phenomenon through systematic association of variables, and by the identification of individual meanings will provide a picture of the research's reality (Szmigin and Foxall, 2000). As a result, as explained by Hammersley, Mackenzie and Knipe, (2006) the researcher will interpret his/her own experience to the research area and remain open to incorporate the attitudes and values of the participants.

The qualitative method is associated with an interpretative philosophy (Saunders et al., 2012). As interpretivist gathers highly specific qualitative information and data to analyze phenomena which are deduced from general models (Remenyi, 1998). This research conducts exploratory and descriptive method to get an understanding of how trust and relationship are developed in a market entry strategy in Chinese SOE.

The researchers consider the topic under research as a complex issue, involving various global, societal and cultural factors. For this reason, to support the exploratory and descriptive nature of this research, the researchers conduct in-depth interviews based on a case study with the intention to develop a model for cooperation between China and European Shipbuilding companies. According to Yin (1989, p.48) "a single case study is warranted or appropriate in the basis that the case is revelatory". In this research, the researchers have chosen the case with CSIC, a state-owned company which covers 46 industrial subsidiaries, 28 R&D institutes, owes total asset for a value of 28 billion US\$ in 2010, and has a workforce of 140,000 employees. It has been transformed from a defence-focused, socialist monolith into a thriving commercial enterprise, which still gets strong support from the Chinese government, and plays an important role in Chinese shipbuilding market. With this case study, the researchers will identify the potential problems which European supplier encounter with Chinese SOEs during the market entry, and to describe the implications and influence of trust during this process.

## **SAMPLE AND CONTENT ANALYSIS**

Within an interpretivist framework, Travers (2001, p.37) advises that researchers will simply need "enough data to explore and document a range of themes". In order to answer the research questions, twenty in-depth interviews are to be conducted with representative staff from different segments acting in the case study, CSIC Management (8), Chinese Officials (4) and European Supplier (8). The CSIC Managers are the directors of products and production

department, purchasing department and R&D department who have strategic responsibility; The Chinese officials are coming from the government, they have been selected because they could explain the policies and strategies of the government; the European suppliers are those with an operational experience, usually the international marketing manager. The three interviewees' backgrounds are chosen with the aim of providing a substantial and varied range of viewpoints within the cooperation between European and Chinese shipbuilding industry.

To analyse the results of the interviews, content analysis will be adopted. The reason why to choose this method is that, content analysis can describe phenomena and analyse documents systematically and objectively with the purpose of providing knowledge, new insights, and a practical guide to action (Krippendorff, 1980). It suits to the research objects and allows the researcher to test theoretical issues to enhance understanding of the data (Elo and Kyngäs, 2007). The content to analyse is determined by the research questions and objectives (Robson, 1993).

In the analysing process, the researchers choose inductive content analysis. This process includes open coding, creating categories and abstraction (Elo and Kyngäs, 2007). The researchers will make notes and headings while reading the data, to describe all aspects of the content (Hsieh and Shannon 2005). Then the notes and headings will be grouped to several categories according to the similarity. The purpose of creating categories is to provide descriptions of the phenomenon, to understand and generate knowledge (Cavanagh, 1997).

## **FUTURE FINDINGS**

As the current research is part of a DBA program, the empirical part is still on an on-going process. Nevertheless, to gain new knowledge throughout the research, in this case, market opportunities and risks on the basis of building up trust and relationship for European suppliers, the researchers seeks for a holistic framework to explore consisting of three steps (Figure 2):

The first step in the framework tries to develop an understanding on a macro level of the market dynamics of the state-owned shipbuilding industry in China with the single case study by CSIC. The critical areas to be analyzed are: Economic - rate of growth of GNP, level of inflation, incomes; Social - people, demographics, culture, sub-culture; Political - risk, instability, attitudes to "foreigners"; Technology - current, rate of change, infrastructure;

Resources - money, manpower, materials, acquisitions, joint ventures; Fiscal - taxes, exchange rates; Institutions - money markets.

The second step of the framework tries to conduct an analysis of the existing cooperation with the Chinese state-owned shipbuilding industry, like the market entry modes, cooperation methods, in different segments like product, service, technology, finance, to analyze the role of trust and relationship in governance, such as any shifts in regulatory policies that might have a marked impact on the industry structure.

Finally, the third step of the framework is a competitive analysis (Aspnes and James, 1998) of strategy identifying: building up of trust and relationship in market entry strategy for European suppliers and the development of core benefit proposition.

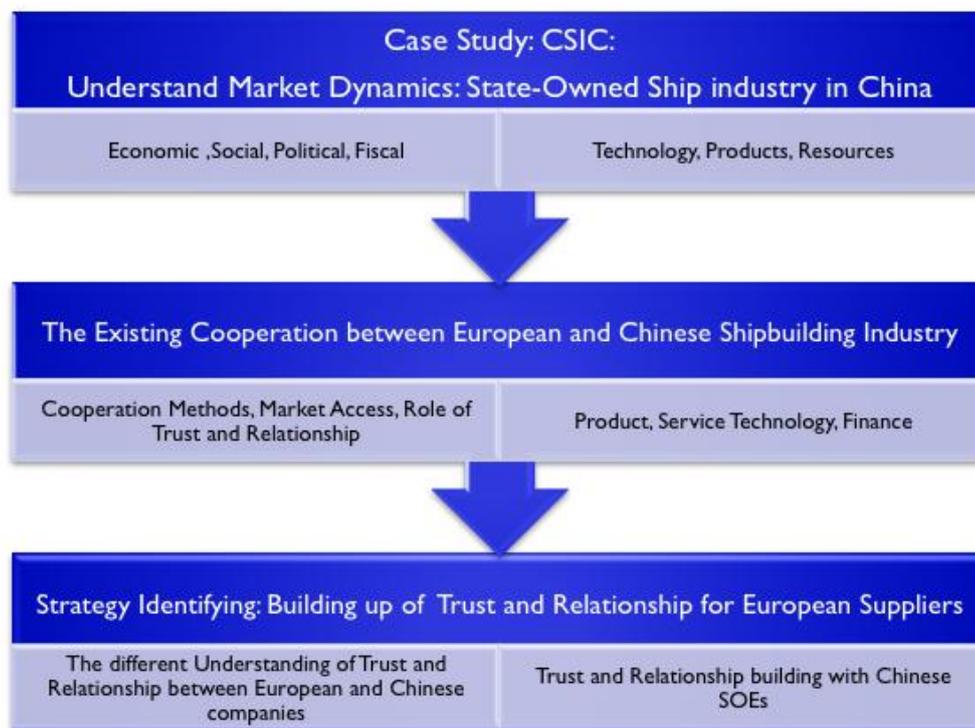


Figure 2: Holistic framework to enhance trust in the shipbuilding industry

(Source: developed by the researchers)

## CONCLUSION

The literature review has provided an awareness of the potential difficulty for European shipbuilding industry in the Chinese market. These difficulties can be found on the nature of the Chinese state-owned enterprises being somehow under governmental control.

The importance of trust and relationship building indicates the path to follow for European companies wishing to enter in the Chinese market, although this is still pending to confirm. In order to find out the answer, the above holistic model needs to be tested and see whether trust will affect the business relationship with Chinese SOE in shipbuilding industry or not; explore how trust can influence political relationships which affect business decisions and to forward some suggestions on how to build up trust for a further solid business relationship on the process of market entry.

To sum up, this research explores the role and the importance of trust in a kind of trilogy relationship compound of Chinese government, Chinese shipbuilding SOEs and European suppliers (Figure 3), in order to avoid tension between the supplier's interest, state's interest and SOE's interest, and to provide a set of tactics and recommendations on how to build up trust with Chinese for a successful bilateral business relationship.

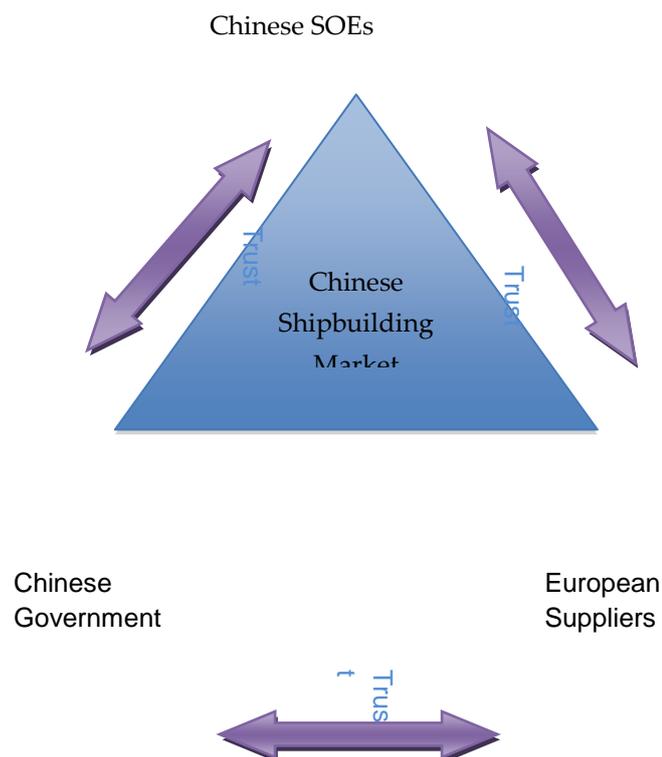


Figure 3: The interest's trilogy (Source: developed by the researchers)

## LIMITATIONS

The researchers have used the case study of the (CSIC) Chinese company. Although a very big

and important company in the sector, the results obtained cannot be generalized. Nevertheless, an initial conceptualization will be the result of the research which can be taken further by testing the model with more Chinese and European companies involved.

The data collection would also be a challenge because as identified by Marschan and Welch, 2004, p.17) "qualitative data is very context specific and harder to bring into conformity with universalist assumptions of scientific rigour and make internationally appealing and publishable than quantitative data". In many situations, qualitative researchers can seldom specify exactly what their data collection methods entailed (Zalan and Lewis, 2004), what adjustments they made as a result of the location in which they conducted the research (especially in international business research), or how they validated their findings (Andersen and Skaates, 2004).

Another key point is how to ensure the credibility and validity of the interpretation of the qualitative case analysis as foreign researchers. It embraces different cultures, complex background knowledge and even language skills, being these issues potential barriers for proper interpretation.

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## WEB TECHNOLOGY AND BUYERS' PROFILES

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### ABSTRACT

The idea of segmenting buyers according to their decision making profiles which stem from personality characteristics is not entirely new. In practice however, quite some problems emerge in terms of testing consumers' psychological inclinations. Following what people do with and on the internet makes it possible to ascertain their buying styles in an unobtrusive and ever more accurate way. The paper discusses various approaches and methodologies used. With the technology continuously evolving and the available data getting more comprehensive, marketers are well advised to better identify the correlates of the buying styles as a useful tool to cluster the consumers.

**Keywords:** Neuromarketing, Buying Styles, Consumers, Web Data, Profiling

### INTRODUCTION

The neural correlates of personality affect how consumers select what they buy. Apart from determining different objects of desire fitting the personality, two other important connections play a role. Namely, different personality types might focus on different attributes (benefits) of the offerings and deploy different mental evaluation processes. Accordingly, mapping out different styles of responding to environmental stimuli, sensitivity to various emotions and the patterns of executive functioning can hint at some universal patterns displayed by an individual regardless of whether s/he is contemplating to purchase a new car, a vacation package or health insurance. The processes applied by individuals to cope with buying situations indicate new dimensions along which to segment the consumers.

Whereas practitioners have for quite some time developed "shopping styles" based on behavioral observations and survey data, the theory seems to lag behind. It is only recently that advances in neuroscience brought us closer to viewing and codifying buying profiles as a direct consequence of the shopper's combination of personality traits .(Zurawicki 2010, Venkatraman et al. 2012).

Connecting personality with consumer behavior has never been an easy task. The more so, that the focus on the ultimate buying results is misleading – the outcome (e.g. purchase of something)

may be the same, yet the underlying individual selection criteria and processes different. In terms of applicability to segmentation, two non- mutually exclusive novel approaches emerge. The first suggests modeling buying styles as connected to the specific mixes of personality traits.

As an illustration, we quote below the most apparent associations corresponding with the “Big Five” categorization of personality. This should not exclude other classifications, though, which can be useful in pointing at such characteristics as “competitiveness”, “family orientation”, the dedication to fitness and a host more.

The personality trait of openness is suggests a person’s high interest in novelty, exploratory tendencies, and curiosity about other cultures and aesthetics. In terms of who the innovators and the early adopters in the product diffusion process are, the “open” demonstrate stronger explorative tendencies and are clearly in the avant-guard of newness. Consumers at the lower end are deemed to be conservative and slower to embrace innovations.

Conscientious people tend to be responsible, methodical and plan ahead. They are more frugal and they pay more attention to value rather than fashion. People on the low end are more prone to impulse buying. They might be attracted to high precision and more complex products. Some more speculations may imply that a conscientious person is more interested in checking on the energy bill the monthly usage and be happy to see the decrease. Equally so, s/he would be more concerned about the sustainability, or be a disciplined car driver.

Extroversion as contrasted with introversion is a critical attribute to influence social encounters including networks, participation in the live events, team sports and seeking recognition from peers. In turn, introverts require less outside stimulation; tend to be more contemplative and individualistic. On a practical note, extroverts and introverts differ substantially in their eagerness to establish and to cultivate frequent interactions as stipulated by the proponents of the relationship marketing. Hence, spending effort to force a relationship with the less prone customers is counterproductive as by their nature they prefer to remain detached and, perhaps, independent. Consequently, the extra/introversion in interacting with the companies, their brands, salespeople and other product users becomes a relevant dimension for segmenting the clients.

Agreeableness is a measure of kindness, empathy, concern for others but also reflective of conformism and social opportunism. This trait stimulates philanthropy and a general tendency to avoid confrontation (like in bargaining).

Deficit of the emotional stability is labeled neuroticism and synonymous with variability, hence lower predictability of behavior. Lack of assertiveness leads to limited self-confidence and uncertainty about one's decisions as well as higher than average risk aversion.

Obviously, it is not single traits viewed in isolation which impact consumers' mental processes. Those separate predispositions are actually strengthened when some combinations of traits are present. For example, people with higher "g" – a measure of intelligence--who are also more conscientious and open, might be willing to adopt a more rigorous and relaxed evaluation process. When contrasting the diligent, analytic and logical method of reviewing offerings with the holistic and associative glancing over the information, the first approach tends to correspond with high ratings on Openness and Conscientiousness and a positive self-concept. In turn, the experiential processors are extrovert, rate high on Agreeableness, and underperform in categorical thinking. Such individuals, however, display higher than average creativity. Hence, depending on the requirements of the situation, the puzzle-solvers are better equipped to calculate which solution is more economical whereas the experientially inclined consumers can prove imaginative in finding multiple uses for the product or ways to improve it (Novak and Hoffman, 2009)

High scores on Extraversion and Agreeableness suggest a potentially strong impact of the individual's social networks upon evaluation and choice (higher "g" may, all other traits kept constant, further account for a higher number of individual's connections to the networks). Low conscientiousness can translate into impatience and impulsivity and high neuroticism adds anxiety and unpredictability and indulgence in "comfort" product and services. Neuroticism alone may stimulate feeling of guilt for decisions deemed unsound.

Brand choices appear to be linked to the attachment styles which theoretically stem from the early childhood bond with the caregiver. The type of connection shows along two dimensions which at the negative end reach their peak expressions in anxiety and the avoidance of others. These phenomena impact upon the adult life of a consumer. People with a negative view of self, i.e. anxious, are more sensitive to "brand personalities" – they use them for the purpose of signaling to the important others. The paradigm of "I am what I buy" should in that case be substituted by "I buy what fits my dream profile." As for the combination of anxiety with

avoidance, consumers who are anxious and more avoidant of interpersonal relationships showed preference for the brands deemed “exciting” and more flamboyant. In contrast, people who are anxious but amenable to a close liaison opt for a solid “sincere” label (Swaminathan et al. 2009).

Overcoming boredom appears a natural response when the consumption reaches satiation level. However, focusing on fresh uniqueness as a coping strategy by novelty seekers sets them apart from those consumers who just look for variety within the set of familiar brands (Helm and Landschulze 2009). Neuroticism tends to promote the latter without affecting the former tendency.

The second approach—a micro orientation—points to the specific emotional responses to involving stimuli, for example such as a sensation of surprise upon exposure to a humorous joke. In that way, the researchers can learn about the prospects’ susceptibility to various marketing ploys. To study such detailed reactions requires systematic monitoring and, beyond simple observation of general response patterns, resorting to custom crafted experiments which manipulate the stimuli of interest. For example, they may examine which customers are/are not more influenced by the rich communication format of “sight, sound and motion”.

## **WHAT METRICS CAN BE PROPOSED**

How to label distinct buying styles is a big question, the more so that we are dealing with continuous rather than discrete variables. A helpful idea is to start with a general perspective and move on to specific relations consistent with the active conceptualization of traits which emphasizes how traits explain why and how people buy and what they prefer.

Beyond just previous history of shopping, the researchers are well advised to focus on consumers’

- Degree of the emotional component in envisioning one’s needs and desires.
- Susceptibility to impulse buying, self-indulgence
- Inclination to seek information and interact with peers.
- Individual level of self-dependence in the decision making.

- Information-processing skills and the approach to problem solving: simplicity seeking vs. comprehensive solution. Also, their willingness and ability to establish benchmarks (reference points) for considered buys. The negativity/positivity bias in interpreting the data.
- Level of intentional self-control/involvement
- Curiosity factor and the degree of risk proneness/aversion in making decisions.
- Proneness to feelings of guilt or regret in connection with purchases planned/ made or foregone.

Figure 1 shows a preliminary model to address the relevant interactions along the above lines.

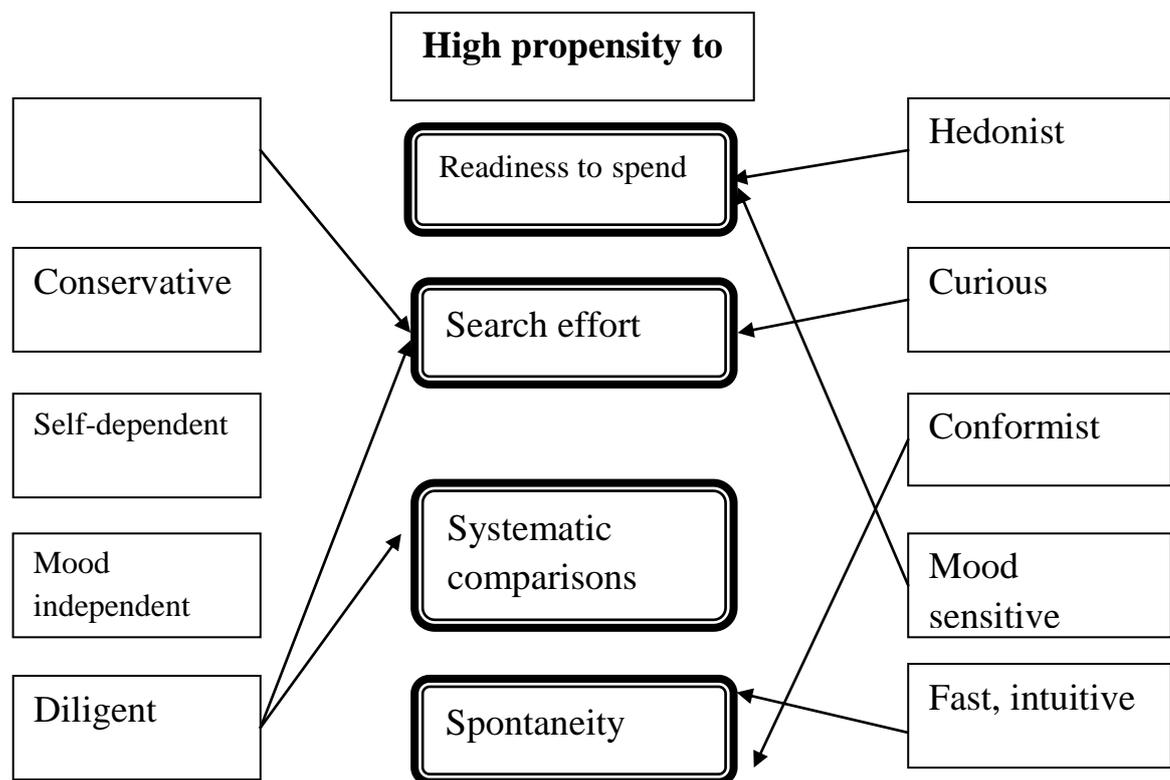


Fig. 1 Select personal characteristics and linkages to the variables of the buying style

## WHAT DOES WEB HAVE TO DO WITH IT?

In using internet to detect the users' buying styles, two converging avenues can be pursued:

- Assumptions about users' personalities help infer their buying styles
- Buying styles can be inferred from the actual browsing patterns and completed/abandoned transactions.

Practical success in segmenting consumers according to their neuropsychological predispositions hinges upon the marketers' ability to gather the personal (and personality) data on the consumers or making inferences about them. In that respect, web technology can prove useful. Firstly, it appears that personality can be reliably and efficiently measured by the tests administered via the internet (Buchanan 2009), and, in certain contexts (the dating services, travel services, job search, not to mention the social networking websites) a substantial amount of such data is voluntarily provided. For example, proliferation of sites offering to rate the personality traits for the benefit of the consumer (among others, by suggesting the suitable vacation destination) is a step in that direction.

A lot can be learned from the comments/reviews posted on various sites (for example, tripadvisor.com specifically dedicated to travel and hotels). Accordingly, YouTube or Vimeo are top websites where people "rant" their opinions on many subjects. Their videos are frequently produced using a simple webcam at the person's face while s/he comments on specific issue (for example, product experiences). As such, the video comments allow for using the emotional recognition software based upon the facial expressions. This in turn tells marketers a lot about the character of the person and her affective (often subconscious) attitude to the items consumed or communications received.

Word mining and even sheer statistics shed an interesting light on the reviewers' expertise, activism, preferences, demands and rigor. Linguistic analysis of the comments can reveal the emotionality of the person, ability to organize thoughts, affinity for specific words (e.g. "smart" as a correspondence to one's own self confidence) and even a hint as to whether the reviewer is an expert or novice in the subject matter. In turn, the users of reviews reveal quite a bit about themselves through the selection of comments (e.g. positive v. negative), attention to various attributes covered and the demonstrated (dis)trust in the opinions consulted.

It is certainly helpful that some personality traits can be assessed without a need to resort to personal quizzing. Individuals who see themselves as generally independent from other

people are more attracted to angular shapes, and people who feel they are more impacted by others find rounded shapes more pleasing. Similarly, dominant individuals favor the vertical dimension of space more than individuals low in dominance. They are more capable of shifting attention vertically and are quicker at processing information that appears in the vertical dimension of space (Zhang et al. 2006; Moeller et al. 2008). So it is just a question of time that the visual approach methodology to measure the implicit personality will be perfected for the Web use. First attempts of showing the optical icons via internet and collecting the responses without asking intimate questions do seem promising (Scheffer and Manke 2009).

Monitoring the surfer's navigating style on the web page especially in the interactive context can tell a lot not only about the personal interests but also about this individual's personality (Ho 2005). Especially, when the records are pulled together from various sites visited, the total amount of data obtained gives a good approximation of the web user individuality. It may suggest whether s/he is systematic in retrieving information or rather fast-forwarding as a function of emotional associations with the content, be it when shopping or knowledge seeking.

When shopping for flights, for instance, consumers often reveal whether price or more hedonic concerns related to comfort (e.g. number of stops, departure/arrival times, and type of seat) are a priority. The amount of time and effort spent on a particular problem attests to perseverance, and the interest in and the subsequent consideration of the reviews published by other users, points to conformity seeking, to name just some implications. A special case in point is computer gaming on the internet – to a skilled observer supported by advanced software the pattern of playing can reveal the participant's approach and avoidance tendencies, individualistic vs. group strategies, the choice of characters in the game, affinity for violence or the pace of learning. In doing all that, players have luxury to act differently than they do in everyday life without experiencing negative consequences—thus showing a bit of the darker side of their true nature.

In sum, a vast amount of data generated on the internet makes it possible nowadays to speculate not only about consumers' buying interests based on the past history. More importantly, we can learn what kind of decision makers those individuals are without a need to ask a single question. This in turn should help marketers develop the nuanced strategies to successfully communicate to different profiles.

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## **BOOK OF CONFERENCE ABSTRACTS**

## FACTORS AFFECTING INNOVATION IN THE HOTEL INDUSTRY

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### ABSTRACT

Services have a key role in the hospitality industry with the growing concern of hotels to satisfy guest's needs through innovative services. Competition is based on providing similar products and substitutes and service innovation aims to achieve gains in efficiency in the processes but also to achieve competitive advantages in terms of business strategy.

This paper is a literature review on the state-of-art of innovation in the hotel industry and aims to organize the theories and concepts according to: theoretical approaches, chronology, empirical studies done by researchers, and other criteria.

Our intention is to provide a framework that, on the one hand provides a basis for future research, and on the other hand, allows practitioners to choose the most suitable model according to the type of business and its goals.

The study also identifies the different drivers of innovation and the factors affecting innovation in hotel services, including innovation culture, organizational leadership, human resources and information technology.

**Keywords:** innovation, services, hotel industry

## A REVIEW OF BOYCOTTS AND BRAND LOYALTY IN INTERNATIONAL MARKETING

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### ABSTRACT

Boycotting consumer behaviour has been damaging for several business in recent past. This abstract provides a critical review of the boycotting literature from 1900 onward. The review seeks to answer the following questions: What are the gaps and omissions in the boycotting consumer behaviour research? How may they be overcome?

To answer these questions, the review scrutinizes blind spots in the treatment of boycotting behavior, role of religious, cultural and political influences in boycotting behavior research in both positivist and critical scholarships. We reviewed systematically 115 academic articles published in 25 top marketing journals ranked in the ABS (Association of Business Journal Schools) Review covered publications from 1990 -2013. Focus was on journals ranked from 1 – 4 and we used the EBSCO and ProQuest search engines using the keyword Boycott as it represent a precise and specific meaning in marketing journals and.

The theoretical contribution is threefold: first, the review demonstrates that contemporary framing of boycotting behaviour literature should be expanded to cover aspects of boycotting behaviour beyond its external influences i.e. organisers – promoters- and the boycott target and put the focus once again on individual consumers. Second, the review explains why and how other strands of boycotting behaviour than religion also manifest as salient causes of difference in boycotting consumers. Third, the review reveals that political and religious context has explanatory power in boycotting behaviour. Boycotting literature should capture the intertwining influences of religion, politics and consumer culture. The paper also provides a set of useful recommendations to capture and operationalize methodological and theoretical changes required in the consumer boycotting behaviour literature.

## LITERARY PORTRAITS OF LISBON: IMAGE AND PROMOTION OF A TOURIST DESTINATION

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### ABSTRACT

This paper looks at the role played by literature in the formation process of Tourist Destination Image (TDI). The research reported in the article analyzed the content of three books written by German-speaking authors - Thomas Mann, Erich Maria Remarque, Pascal Mercier - in which Lisbon is the setting of a part of the story. German-speaking tourists, who visited Lisbon, were surveyed to determine if they had perceived identically the city. In the end, the survey results are compared with the items focused on the official Lisbon promotional video and suggestions are given in order to include or strengthen items to attract more German speaking tourists to this tourist destination.

**Key words:** Tourist Destination Images, German Written Literature, Lisbon.

### INTRODUCTION

Based on the review of published literature on TDI, the first part of the article presents some definitions of the concept and underlines its importance for the tourism industry. It also presents the main theories about its formation process, underlining the role played by literature. The second part presents the objectives and the research methodology used. The third part presents and discusses the results of the research. The closing remarks point out the limitations of the study and suggest concrete actions in order to achieve a more effective promotion of Lisbon in the German speaking market.

### LITERATURE REVIEW

Most authors agree that TDI originates and evolves through a formation process in which two main kinds of information sources play an important role: organic (present in daily life of individuals, who don't need to look for it) and induced (produced by the official promoters of the destination).

The media, movies and songs, as well as literature, provide the potential tourists information about places, contributing to a more detailed and complex image of those places. It is the value that the receiver of those contents awards the place, together with his curiosity and interest, that makes him travel to that destination (or not).

## **OBJECTIVES AND RESEARCH METHODOLOGY**

### **Objectives**

The research aimed to verify the following hypothesis:

- 1-Information about Lisbon, allowing readers to anticipate their experience of the city, can be found in each of the three books.
- 2-German speaking tourists (who answered the survey) perceived the attributes of the city mentioned by the writers in a similar manner.
- 3-The official promotional video of Lisbon highlights the most valued attributes of the city pointed out by the writers and the enquired German speaking tourists.

### **Methodology**

After reading the three books, a content analysis was undertaken. The passages containing references to Lisbon became the analysis corpus; they were encoded having in mind the attributes of the city reported by the writers.

A survey, made out of citations from the three books, using a Likert scale 1-10, was answered by around 400 German speaking tourists who spent at least three days in the city.

Afterwards the official promotional video of Lisbon was analyzed in terms of the importance given to those attributes.

## **RESULTS DISCUSSION**

**Hypothesis 1** – All three books contain numerous and detailed references to attributes and districts of the city, allowing the readers to anticipate their experience of the destination, provided that they do not spill their experience beyond the mentioned territory/areas.

**Hypothesis 2** – The results show that tourists almost or fully agree with the descriptions of two attributes (heritage sites and public means of transport, like the old trams). The results also show a gap between the description of other attributes (weather/light and smells) and the tourists' experience.

**Hypothesis 3** – There are several attributes that are overly highlighted in the video, whereas different ones have been emphasized by the writers and the tourists (showing they have strong potential) and cannot be seen in the video.

## CONCLUSIONS AND SUGGESTIONS

The research carried out allowed, on one hand, to establish the attributes highlighted in the literature (organic information) and, on the other hand, to know if tourists perceived the attributes identically.

Comparing the above results with the official Lisbon Tourism Association's promotional video (induced information), the following was found:

- Several emblematic places of Lisbon, tropical flora, funiculars and the harbor/estuary, which are perceived by writers and tourists do not appear in the promotional video, or appear in a fleeting way;
- Light and sunshine are little or not perceived by tourists and appear explicitly in the promotional video, creating possible dashed expectations;
- Ferry trips, theatrical scenic views, vegetation in blossom, smelly food (sardines and chestnuts) are perceived by the authors (although not identically perceived by tourists) do not appear in the promotional video but have potential for Lisbon's tourism promotion.

With the results of the present article, the Lisbon Tourism Association agents (or agents from any other tourism destination) are challenged to make a content analysis of their promotional materials (induced information) and to compare them with the content of organic sources of information (such as literature). It will allow them to evaluate the dissonance/consonance between both and to introduce corrections whenever necessary.

## **MOBILE MARKETING AND SO-LO-MO CONVERGENCE: THE NEW TRENDS IN MARKETING**

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### **ABSTRACT**

The main purpose of this research is to introduce and highlight the importance of marketing through the mobile channel. Mobile marketing is one of the latest direct marketing promotional channels and is getting quite popular among marketers and business owners owing to an array of benefits that it offers to the potential customers as well as to businesses. The definition of mobile marketing emphasizes the fact that it connects businesses and each of their customers through their mobile devices at the right time and at the right place with the right message and requires the customer's explicit permission and/or active interaction. Mobile marketing and mobile advertising are the next big challenges in the marketing community. This is mainly because of the latest technological advancements which brought about a totally new era in the mobile world. Furthermore, marketers are always searching for innovative, cost-effective, and highly influential methods in order to increase revenue; however, considering today's shrinking economy small businesses as well as marketers look for ways to increase customer response rates by designing targeted marketing campaigns. Mobile marketing is the most appropriate medium to achieve these goals particularly because of the several benefits that it offers such as guaranteed distribution of marketing messages, simplified and flexible marketing campaigns, marketing campaign integration, quantifiable outcomes, and the viral potential of the marketing messages. In other terms, mobile marketing is helping to make ubiquitous computing a more realistic and everyday technology.

Structurally, the paper investigates the value of incorporating mobile marketing into the marketing mix, and especially direct marketing practices of business enterprises. It subsequently, identifies the benefits that the mobile channel offers, particularly by using a multi-channel marketing strategy known as the Social, Local, and Mobile (SoLoMo) marketing. SoLoMo marketing is a novel concept of providing smartphone/tablet PC users access to locally-focused promotions and store offerings through mobile search based on their current location. Furthermore, mobile-enabled social networking platforms are quickly

becoming the conduit for not only peer-to-peer interactions about interests and intent, but also consumer-to-marketer conversations. Additionally, SoLoMo marketing requires the businesses to simultaneously embrace adaptive planning in order to make real-time decisions based on social, local, and mobile responses from the target customers. As its name indicates, the social part of SoLoMo marketing is related to the various social networking platforms like Facebook, Twitter, Pinterest, etc. that enable potential customers to have a dialogue with a specific business of their interest and to share their opinions and comments with others. The local part of SoLoMo marketing is based on geo-targeting which allows businesses to target their marketing messages to potential customers in a specific geographic location. Geo-targeting can be accomplished when customers provide their address or more commonly, when they let companies know their location based on their smartphone/tablet PC use of different Location-Based Services (LBS) like Foursquare, Where, etc. The LBSs enable users to take full advantage of spatial information using technologies such as GPS, Bluetooth, and Near-Field Communications (NFC) which provide, update, and monitor users' location-based information. Finally, the mobile part of SoLoMo marketing highlights the fact that the social networking and location-based services can be easily used on the smartphones/tablet PCs by downloading their relevant mobile application.

The paper successively discusses the utilization of various mobile marketing communication tools and ultimately develops a conceptual contemporary mobile strategic marketing preliminary model in the context of contemporary consumer behavior.

Methodologically, the research is theory-based and enhanced by secondary data. The theoretical findings are further conceptually developed to construct a mobile marketing provisional framework towards empirical validation. Both the framework and its underlying theoretical foundation have been preliminarily validated through interviews with specialists. The interviewees consisted of academics specializing on the subjects of electronic marketing and/or strategic marketing; and executive practitioners with experience in the subject. The interviewees acted as controls and enhancers of the theoretical development of the framework. Nonetheless, the latter are empirically untested and therefore de facto provisional. The research findings do however add to the growing knowledge on mobile marketing and set the basis for a more refined understanding through a more comprehensive perspective on the topic.

**Keywords:** mobile marketing; mobile advertising; direct marketing; digital marketing; SoLoMo marketing; consumer behavior; strategic marketing

## PERCEIVED JUSTICE OF LOYALTY PROGRAM AND CUSTOMER RETENTION: QUANTITATIVE STUDY IN THE CASE OF TUNISIAN MOBILE PHONE SECTOR

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### ABSTRACT

Loyalty programs have been the subject of many previous studies (Meyer-Waarden, 2002; Mimouni and Volle, 2003; Pez, 2009) because they form a strategic issue for loyalty and retain customers especially in a competitive environment. But with technological developments and the emergence of ICT, the relational paradigm has undergone profound changes that encourage researchers to choose to study the effectiveness of these programs and their impact on customer behavior. However, the majority of research has deducted that loyalty programs have a tangible impact on satisfaction (Mimouni and Volle, 2003; Gilad et al., 2010). Others have found that these programs have a significant effect on satisfaction and retention (Lewis, 2004). According to others, the impact of such programs on behavioral loyalty is only low and transient (Sharp and Sharp, 1997; Dowling and Uncles, 1997). Hence, the purpose of this study seeks to identify the attitudinal and behavioral variables that influence the consumer behavior to become faithful and retained to its operator. And to better understand the effects of loyalty programs.

The present study was designed to investigate the effect of perceived justice programs on the relationship between the satisfaction with the program and relationship satisfaction and its consequence on customer loyalty and retention. In the first step, we developed a preliminary chapter that describes the evolution of relationship marketing, and we explained the concept of loyalty based on the presentation of various tools and loyalty reward mechanism. Secondly, we have built our conceptual model and our research hypotheses (direct and indirect effects) and especially the moderating effect of perceived justice on the relationship between satisfaction toward the program and relationship satisfaction, and the consequences on loyalty by commitment and retention. In the third step and to answer to our research question we opted for a confirmatory analysis: the multiple regression method (calculating equations of determination  $R^2$ , ANOVA) to highlight the moderating role of perceived justice and to analyze our hypothesis. This empirical study has been carried out in the Tunisian

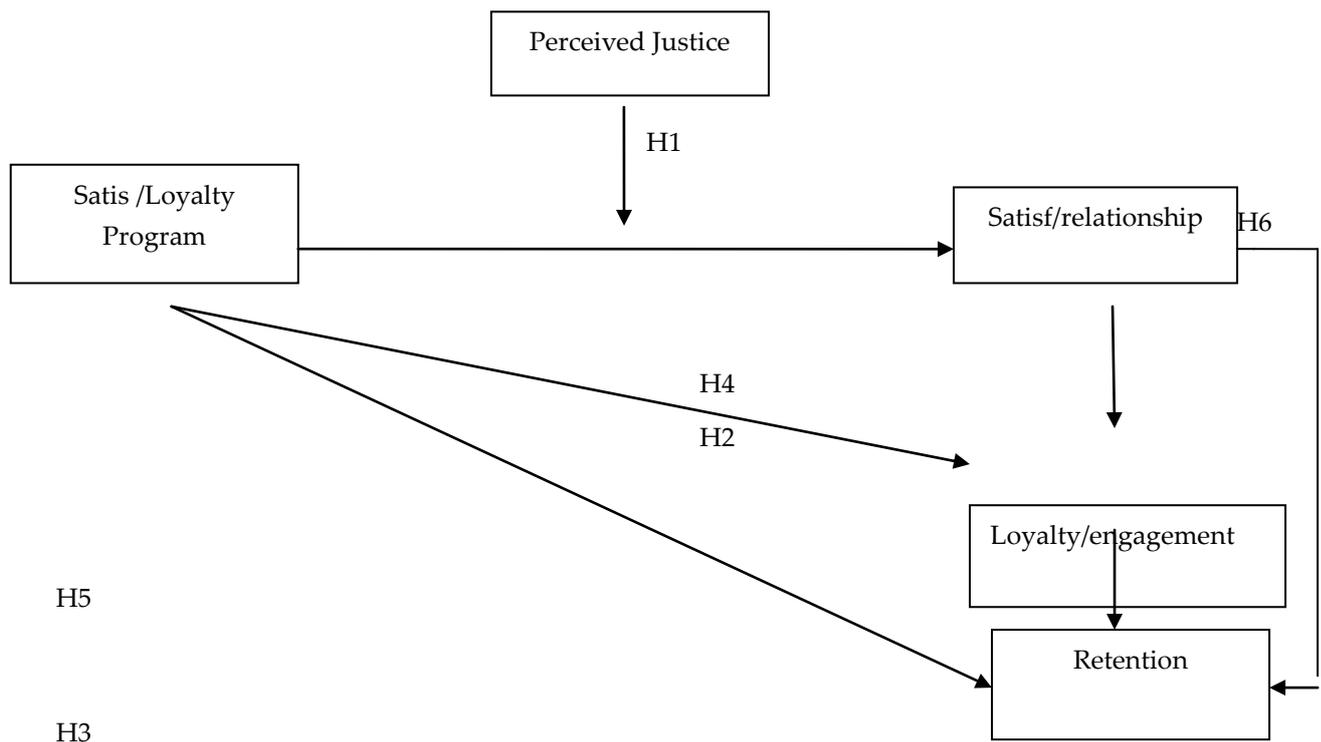
mobile phone sector and surveys were conducted with 220 people receiving at least one loyalty program with its operator.

The results show that these programs can generate behaviors and attitudinal reactions. In others worlds, more a satisfied customer of loyalty programs, the more he is satisfied with his experience with the operator. The analysis showed also that perceived justice is not a moderating variable. This result can be explained by the new structure of the perceived justice in the Tunisian context (bidimensional construct). The lack of communication on different parts of the loyalty program has affected the customer's perception. Therefore, the client is really unable to compare its investment compared to its winnings or rewards through the loyalty program. These last are also not yet well developed in Tunisia. The results gave us that the customer's satisfaction through the experience with his operator has a positive effect on the loyalty by commitment. It gives a strong sense of allegiance to the brand.

However, this satisfaction does not directly affect customer retention; but the satisfaction with program was able to improve the customer's retention. In conclusion, we can say that the perceived justice program does not moderate the relationship between the two satisfactions; however the satisfaction with program significantly affects retention and loyalty. So, these results encourage us to conclude that the operators need to pay more attention to the main elements of the programs, and encourage them to develop and communicate more clearly their conditions and their characteristics.

For future research, we suggest that it be possible to apply loyalty programs in other sectors (retail, service ...), it is also suggested to study dimensions of perceived justice (distributive, procedural, interactional) and the behavioral dimension of commitment (commitment calculated).

**Keywords:** Perceived justice, satisfaction (with the program & relationship), loyalty/engagement, retention, loyalty programs.



**Fig. 1. Research Model**

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## COMPREHENSIVE APPROACH TO CRISES MANAGEMENT

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### ABSTRACT

The complexity of the contemporary crises appears as a direct consequence of globalization, with factors such as the diffusion of information, market interconnectivity, political ambitions and military actions acting as catalysts.

The economic disorganization characteristic to state and local administrations, along with the public security disturbances has weakened the international markets. As the latest crises demonstrate, one ought to find the multidimensional responses to economic downturns, themselves being multidimensional. Thus, the exit from the crisis must be centred on three independently connected pillars that ensure a country's stable state, namely: political security and stability, economic growth and social development.

The nature of these pillars underlines the necessity of an inter-ministerial approach, included in a multinational frame, which would enable to effectively and efficiently resolve the crisis. Under these conditions, the stake for the international community is to know how to answer with proper means to the threats regarding security, and to find a lasting solution for economic crises.

**Keywords:** economic crisis, political stability, efficiency and effectiveness, multidimensional approach

### INTRODUCTION

Maintaining the peace offered by the United Nations (UN) is an essential goal, but not a universal ambition. The implementation of the mandate regarding "operations of maintaining multidimensional peace" is enlisted in a more ample temporal frame and targets the sustainability of state structures by identifying lasting solutions for terminating the existing conflicts and building a solid peace.

The incorporation principle, validated in 2008 by the General Secretary of UN, is applied in a different manner through 19 missions, of which 9 are conducted by the political

affairs departments (in which there is no military or police component). Firstly, this principle is applied in an internal plan by the UN, depending on the type of mission, the local environment and the personality of the main actors. It only partially responds to the challenges of managing the complex relations between the authorities and the local or regional actors.

The comprehensive approach is an intercession which targets the lasting and rapid regulation of a crisis, by coordinating the actions of all actors concerning governance, security and economic and social development. It links the collaboration between the actors who share the same final vision and the coordination, with the other actors present in the theatre. It requires, as much as possible, an approach through the host nation or the local representatives. It has as main point of application the population. Finally, it tries to associate the regional actors with this effort. As a consequence, the comprehensive approach is a strategy of resolving the crises, particularly in states with limited institutional effectiveness.

## **COMPREHENSIVE APPROACH: APPLICABILITY IN THE CRISES MANAGEMENT.**

There is a debate over the historical fundamentals of the expression “comprehensive approach” (Frunzeti, 2012). Some place the origin of the term in the elaboration of the UN documentation at the end of the 90’s and present Kofi Annan (Wendling, 2007) as one of its first promoters. Others invoke a Danish influence near NATO, which is presented as the organization which defined the expression, especially during the Bucharest Summit in 2008.

For certain militaries, as well as for certain humanitarian actors, the bonds between civilians and militaries have existed at all times. There are, for example, historical references for the “together action” or the “global manoeuvre”, as source of the global approach concept.

Regularly, NATO and UN have acted accordingly to their visions of crises management. Thus, NATO has used the concept of “comprehensive approach” and the UN has adopted the concept of “integrated approach”. The European Union (EU) has used both military and civil instruments, without structuring its external action, in order to resolve the crises on the European continent.

The comprehensive approach of the crises management is demanded by a series of motives, as following:

- achieving a bigger efficiency in the missions of resolving the crises in the conditions of budget restrictions;
- obtaining a bigger coherence in the actions made by the actors involved in the various operations theatres;
- finding a better legitimacy of the action for certain actors (for example, NATO);
- the will to reduce the number of inefficient states which represent a security threat in today's world;
- the political emergency of regulating the conflicts, bound by the fact that the citizens are increasingly less willing to accept the long term military losses.

Hence, the necessity of comprehensive approach is to cover the entire continuum of the crisis management, from prevention to normalization. The comprehensive approach can be analysed through three stages, namely: prevention of the crisis, control of the crisis and international engagement<sup>37</sup>.

Another important element is represented by the specificity of the cooperation between civilians and militaries, in the management of crises. Currently, in the operations theatres, where states take action under UN mandates in order to resolve a complex crisis, both military actors and civil actors are present. In this context, the interaction between civilians and militaries must be an efficient, continuous and concerted process, as much as possible. Thus, four degrees of interactions can be defined between actors of the comprehensive approach:

- *reciprocal knowledge of different actors who intervene in the theatre* - enables them to have a greater objective visibility. It allows them to limit the discrepancies between their activities;
- *accession* - is the information exchange between the actors who intervene for certain actions, in order to avoid their interferences in the theatre.
- *coordination* - results from the acknowledgement of sharing the objectives by the actors who intervene in the theatre. It is translated through an increased exchange of information and through the following of synergy in their activities;
- *collaboration* - must lead to a veritable effort to unify for a common purpose. It relies on the share of: evaluating the situation; long term vision, and also on the intermediary target objectives; identifying the discrepancies; target approach and allocated means; evaluation criterion of the intervention progress;

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<sup>37</sup> Approche(s) globale(s) - actes table ronde, [http://www.ihedn.fr/userfiles/file/debats\\_fond/approche-globale/Approche\\_globale-actes\\_table\\_ronde\\_06mai2010.pdf](http://www.ihedn.fr/userfiles/file/debats_fond/approche-globale/Approche_globale-actes_table_ronde_06mai2010.pdf), p.11

These different levels target the appearance of national coordination needs (inter-ministerial crises management), international coordination needs (role of different international organizations, international relations between different countries present in the theatres) and theatre needs (joint interaction of the actors on field).

## CONCLUSIONS

Through the comprehensive approach, the resolution of conflicts and the management of crises can be achieved, by integrating civil and military elements. Government and non-government instruments should be incorporated with full respect of each other's responsibilities. In this complex and dynamic frame, the armed forces must highlight, in all echelons, the determinants of military efficiency in a joint project. In parallel, they must entirely understand the other actors in the purpose of insuring the global coherence and the targeted results.

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## POLITICAL AND MILITARY ACTION FRAME OF THE EUROPEAN UNION WITHIN THE CRISES MANAGEMENT

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### ABSTRACT

The European Union is one of the active non-state actors on the world scene concerning the crises and conflicts management. Therefore, it operates by voluntarily assuming a large variety of political and military roles for preventing and resolving the crises and conflicts, which can occur in the European space and its strategic vicinity.

Continuing the process of enlargement of the Union has permitted the development of a systematic political dialogue concerning the security issues on a larger scale between Brussels and the candidate countries. In this context, the combination of the "civil" power instruments, which result from the first pile of the Union's activities, in the External Policy and of Common Security, and in the project of Europe's defence, as is built now, that EU could, in time, gain an international political dimension to match its economic state.

In order to appropriately assume its roles, EU has developed its societal structure and networks with institutions, civil and military capacities, able to significantly enhance the crises and conflict processes management no matter the place in the world. The European Union also disposes of other resources to achieve its objectives - such as policies and programs to handle the crises from both civil and military areas.

EU political-military role in its internal and external plan

The European Union, acting in its capacity of regional organization, has a highly recognized status, additionally assuming a large variety of political and military roles. The political roles are assumed by the EU both internally and externally.

Internally, it insures the social peace through specific guarantees and insurances for all its citizens – from the right to life to freedom of speech. The social protection and assistance within the Union generate a beneficial climate for all citizens. The reunification of the

continent is another major political role assumed by the Union and the member states. With the disappearance of the ideological barriers, the destruction of communism on the continent and the dissolution of the USSR, the European Union has started a new, long and complex process of enlargement. By receiving new members, from the ex-communist states, new challenges have emerged. One of the main preoccupations of the European institutions consists in guaranteeing and insuring the security of its citizens. "The 21st century Europe continues to deal with security issues"<sup>38</sup>. In order to guarantee an efficient process that ensures the member states' security the EU must adopt a constructive attitude in the relations with its neighbouring regions. These neighbouring regions are: the Southern Mediterranean, the Balkans, the Caucasus and the Middle East. On the other side, it must protect its military and strategic interest through its alliances, especially NATO, and the emergence of consistent European security and common defence policies.

The military roles are exercised both by preventing the internal and external crises and conflicts and by their adequate management. In this purpose, the EU and the member states are actively, voluntarily and responsibly committed to insuring the security of the European citizens.

In the external scene, in accordance with its charter, the EU has various roles on the European continent as well as in other regions. In principle, the EU can exercise its influence both within its borders and abroad.

The political roles of the EU outside its borders consist of its different external politics, through which relations maintained with numerous partners form all around the world. To this end, different instruments are utilized, such as cooperation agreements and financial programs.

The principal domains where the political roles of the EU manifest themselves are:

humanitarian help – the EU tries to help the victims of the natural or human catastrophes, by offering financial and material help;

cooperation development - the EU has a cooperation development policy for eradicating poverty in emerging countries, in order to sustain a sustainable growth model. Through this policy, the EU encourages good government and searches to protect human rights throughout the world;

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<sup>38</sup> L'Union Européenne: pourquoi?, [http://europa.eu/abc/12lessons/lesson\\_1/index\\_fr.htm](http://europa.eu/abc/12lessons/lesson_1/index_fr.htm), p.2

human rights promotion policy - the respect for democracy and human rights is a fundamental principle of the EU, which is promoted in its relations with third parties. The adherence to these principles is a condition sine-qua-non for the initiation and continuation of cooperation agreements. The EU can punish their violation, by suspending its agreements or by imposing restrictive measures (embargos or circulation interdictions) for a country or a group of persons;

Diplomatic relations - the European Union has good diplomatic relations with most states. It has concluded strategic partnerships with the main international actors (especially with USA, China, Russia, Japan and India), and cooperates with most emerging economies. Outside its frontiers, the Union is represented by a network of 136 delegates, which fulfil a role which is similar to that of European Embassies.

In order to ameliorate the relations with its neighbours, the EU has elaborated and applied the European Neighbourhood Policy<sup>39</sup> (ENP). Through this document, the EU offers its neighbours a privileged relation, based on mutual engagement and common values – sustainable democracy, the rule of law, good government, principles of market economy and sustainable development. The European Neighbourhood Policy is applied to the direct terrestrial or maritime neighbours: Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Moldova, Morocco, Palestinian National Authority, Tunis and Ukraine. The EU relations with Russia are founded on a strategic<sup>40</sup> partnership which covers four common areas. The ENP targets the security of the external EU frontiers, creating a “circle of friends” which shares its peace, stability and prosperity objectives. These countries participate in various activities, through political, security, economical or cultural cooperation. By applying these policies, the EU tries to promote peace in the world, being involved more frequently in crises management operations, prevention of conflicts as well as police and military operations abroad.

The military roles of the European Union are accomplished through its external and security policy. Acting in its quality of international actor, the EU uses diplomacy, commerce, international aid to resolve conflicts and to contribute to the international agreements. Thus, the EU is actively and responsibly committed to preventing crises and conflicts by executing peace maintenance and stability missions. The EU has sent peace mission in various regions

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<sup>39</sup> La politique: Qu'est-ce que la politique européenne de voisinage?, [http://ec.europa.eu/world/enp/policy\\_fr.htm](http://ec.europa.eu/world/enp/policy_fr.htm)

<sup>40</sup>Haukkala, Hiski. *The EU-Russia strategic partnership: the limits of post-sovereignty in international relations*. Routledge, 2010, p. 48-55.

on the brink of conflicts. Thus, in 2008, it has negotiated a cease fire between Georgia and Russia and proposed observers for the surveillance of the situation. Additionally, the EU has played a decisive role in the Balkans, where it has helped the project for stabilizing the situation in seven countries. In December 2008, it developed a Kosovo mission consisting in 1900 police officers and jurists, with the objective to help the maintenance of public order.

#### The Lisbon Treaty and the security aspects linked to crises management

By establishing the Lisbon Treaty, the European powers have followed the introduction of a series of new security aspects. In this sense, we can mention:

increasing the decisional efficiency concerning the liberty, security and justice areas. In this domain, the Council of Ministers will vote with a qualified majority and the European Parliament will dispose a co-decision power;

providing a system of frontier management and enforcing the Frontex powers - the surveillance agency of the Union's frontiers;

supporting the prevention and control of illegal immigration and human trafficking;

generating uniform rules, which define the penalties for a certain number of trans-border crimes (terrorism, drug trafficking, arms trafficking, money laundering, sexual exploitation of females, informatics criminality);

acknowledging the existence of the European Police Office (Europol), designed to support the actions of the national police in obtaining data and analyzing information.

The military roles assumed by EU were obtained by a series of provisions of the Lisbon Treaty<sup>41</sup>. In this sense, we can mention:

the mutual defence clause - it stipulates that if one of the member states of the EU is the object of an aggression, the others have the duty to assist it;

the solidarity clause - invites the Union and each member state to offer assistance, by all its means, to each member state which suffered human tragedies, natural catastrophes or terrorist attacks;

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<sup>41</sup> Thierry CHOPIN, *Le Traité de Lisbonne et l'action extérieure de L'union Européenne*, [www.robert-schuman.eu/doc/divers/lisbonne/fr/fiche10.pdf](http://www.robert-schuman.eu/doc/divers/lisbonne/fr/fiche10.pdf)

the extension of the action possibilities of the Union in the fight against terrorism;

the permanent structured cooperation;

The existence of the European Defence Agency, in the perspective of developing a real institution which will coordinate European policy;

## CONCLUSIONS

The realities of the European security environment, as well as that of its vicinity, demonstrate the necessity of developing political and military instruments for security reasons. These can also be called upon for crises management actions. Documents like the Action plan for civil management of crises<sup>42</sup> and the documentation linked to the Global civil objective from 2008<sup>43</sup> clearly show the will of the EU Council, to actively contribute to long-term stability and development. A better understanding and assessment of the necessities are required in order to support adequate policies.

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<sup>42</sup> *Proposition de résolution relative à la gestion civile des crises*, [www.senat.fr/rap/100-160/100-1603.html](http://www.senat.fr/rap/100-160/100-1603.html)

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## MANAGING THE CRISIS IN THE EUROPEAN UNION

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### ABSTRACT

Civilian crisis management has become an important part of the EU security policy. However, the provision of civilian capabilities is a challenge for the European Union. The effectiveness of numerous missions is limited, reflecting, on the one hand, the current crisis of resources to conduct “state-building”missions and explains, on the other hand, the EU deficits as the absence of strategic interventions. A level of differentiated ambition at regional EU level is thus required, given the increasingly critical commitment of weak states.

The civilian dimension of the EU Common Security Defence Policy (CSDP) has evolved dynamically in recent years. As such, specific institutions have been created to plan and implement EU civilian missions. As the military capabilities have developed, civilian capabilities have been established for civilian crisis management. The overall objective of 2008 targeted six priority areas for civilian crisis management: police, rule of law, civil administration, civil protection, observation missions and supporting EU special representatives. The overall objective of 2010 highlighted the importance of simultaneous planning of interventions, training staff and the multilateral exchange of verified practices.

### THE CHALLENGES AND SHORTCOMINGS OF THE EU CRISIS MANAGEMENT

Since 2003, the EU has conducted 17 civilian CSDP missions<sup>44</sup>. Of 14 missions in progress, 11 are civilian in nature. Even if military operations often catch the interest of the media and the political world, civilian crisis management is of paramount importance in the security policy of the EU. Its geographic range has expanded continuously. Thus, EU civilian missions have been conducted in the Western Balkans, Southern Caucasus, Africa, the Middle East and Asia. The tasks performed were diverse and also include the security sector reform. The staff for EU civilian missions increased on the one hand: so far, in Kosovo, 1,700 international experts

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<sup>44</sup> *Gestion civile des crises de l'UE: un bilan intermédiaire*, [www.css.ethz.ch/publications/pdfs/CSS-Analysen-87-FR.pdf](http://www.css.ethz.ch/publications/pdfs/CSS-Analysen-87-FR.pdf), p. 1

are working for the police and justice missions. Missions in Georgia and Afghanistan count 300 international experts<sup>45</sup>.

Despite these dynamic developments, the EU still faces major challenges in the field of civilian crisis management. One can distinguish spiny quantitative and qualitative deficits in providing capacity. The absence in some missions of a higher strategic framework in the sense of EU policy objectives on the manner of concrete conflict resolution and modelling of relations with the countries concerned, the public's growing scepticism to support interventions across failed states and the enormous pressure exerted on national budgets of many European countries are other challenges the potential development of EU civilian crisis management will be facing in the coming years.

Moreover, we believe that there are skill shortages related to deficiencies such as:

- *recruitment of experts for tasks in state-building proves difficult* in the EU. Police and justice officials are especially lacking. The problem is explained in part by the EU recruitment system, based primarily on national squads. Some Member States have taken steps to ensure the availability of more significant and better staff resources for international missions. The national recruitment centres as the UK Stabilisation Unit, Zentrum Berlin für Internationale Friedenseinsätze or the Crisis Management Center in Finland train experts and offer structured courses. The EU also has civilian response teams, a number of experts from Member States readily available. But bottlenecks remain and, under EU missions, hundreds of experts than initially expected are lacking;
- *involvement of many national ministries in civilian crisis management*. The Ministries of Foreign Affairs, the Interior, of Justice and of Finance have different priorities and the fact that they do not often agree with the issue of funding recruitment, training and deployment represents an additional difficulty;
- *limited effect of actions taken*. The effectiveness of EU civilian crisis management is currently not reviewed systematically. Yes, it is sufficient to take a steady look at the missions to find that balance is so far quite modest, which explains, on the one hand, that local realities are often difficult. Also, there is the need to diagnose the deficits of the EU as a security policy actor.

The "state-building" concept, developed in the '90s by Western political actors in the sense of commissioning a modern state and transforming the state and society according to

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<sup>45</sup> *Gestion civile des crises de l'UE: un bilan intermédiaire*, [www.css.ethz.ch/publications/pdfs/CSS-Analysen-87-FR.pdf](http://www.css.ethz.ch/publications/pdfs/CSS-Analysen-87-FR.pdf), p. 1

democratic principles and the rule of law, is in crisis. It has been demonstrated not only in the great “state-building” missions in the Balkans and Afghanistan, but also in smaller and less publicized operations, such as the EUPOL mission in Congo. The resilience of local elites to external intervention in the balance of power often prevents progress in state-building.

In states where the security situation is precarious, the task is still more difficult. The trend, in particular in the U.S., to focus in more and more similar cases on simple arguments of efficiency and to neglect legitimacy in the sense of civil establishment of security forces also raises problems. In Afghanistan, the EU has had difficulty in reconciling the paramilitarization of police established by Washington with the traditional understanding of the security sector reform.

Finally, local political changes could also mine the processes of state reconstruction. The EU mission assigned to protect the borders between Gaza and Egypt (EUBAM Rafah) is suspended from the takeover of power by the Hamas in Gaza and the EUPOL COPS police mission limited to the West Bank<sup>46</sup>.

Regarding the EU deficits, it must first be noted that some missions do not have enough staff to be more than just a political symbol. On the basis of experience gained in recent years, we should rethink the EU mission objectives, which were often far too little oriented to local realities and defined by an obscure manner. Also, coordination with international partners such as the UN, NATO and the U.S. needs to be improved and criticism to overlapping skills and capabilities such as in Afghanistan should not be reserved for the EU. However, the central deficit is the absence of the strategic framework of CSDP operations, which translates into insufficient integration of numerous missions in a global policy and vision.

## **LACK OF A STRATEGIC FRAMEWORK**

At EU level we can appreciate a problematic situation regarding the development of global regional conflict and concrete strategies, beyond general principles. The interests and priorities of the Member States are too different. The common EU institutions are too weak for them in relation to Member States to compensate for this lack of political leadership. Therefore, field missions do not have all the necessary facilities to protect staff in their

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<sup>46</sup> *Gestion civile des crises de l'UE: un bilan intermédiaire*, [www.css.ethz.ch/publications/pdfs/CSS-Analysen-87-FR.pdf](http://www.css.ethz.ch/publications/pdfs/CSS-Analysen-87-FR.pdf), p. 1

performance. It seems that a consensus on the final result of an intervention and an exit strategy is often lacking.

In this respect, EULEX Kosovo is a revealing example. Initially launched with the aim of demonstrating the EU's ability to protect stability in the Balkans, today the mission supports the dissension between Member States regarding the independence of Kosovo. Setting a Kosovo police, a judiciary system and an administration with no mandate to promote sovereignty is proving extremely difficult. Even if EULEX performs limited executive duties, political issues and spiny areas as the fight against organized crime are more excluded in practice.

The fact that many Member States grant the civil dimension of CSDP a rather low importance complicates further intrinsic differences. The political will to take the necessary measures and provide resources to increase the effectiveness of crisis management is not always detectable. Rhetoric and practice often diverge. Civilian-military cooperation within CSDP, concerning integrated missions, is for this reason only one of its hesitations. The harmonization of civilian crisis management with the EU development policy and election observation activities also proves difficult. Therefore, civilian CSDP missions often lack both political and operational contextualization.

## **AMBITION LEVEL IN TERMS OF CRISIS MANAGEMENT**

As regards the EU's ambition level in terms of crisis management, we can make some estimates. Thus, given the debt crisis in Europe and the growing public scepticism toward international stabilization and "state-building" missions, challenges in EU civilian crisis management are likely to continue to grow. The need for such missions should continue to grow simultaneously, especially as the security threats on the West will emanate in the near future rather from failed and significantly affected by conflict states rather than from the new great powers. Against this background, the EU would do well to define a realistic and differentiated ambition level for crisis management.

On this topic, we should assess, on the one hand, which regions are of central strategic importance for most EU Member States. On the other hand, it should be noted that the EU may especially influence sustainably the national transformation with the tool of accession prospects and potential enlarged trade agreements. Therefore, the EU regional context results as the geographic centre of gravity for more extensive and complex state-building

missions. But, as an accession perspective should remain limited to the Balkans in the near future, we should examine further leverages to achieve a national transformation process in regions such as the Southern Caucasus or Central Asia. A closer knitting of civilian CSDP missions with other tools used in the European Neighbourhood Policy is required to be considered. Finally, in the case of civilian CSDP operations beyond the regional context, it seems preferable to limit the ambitions and to strengthen simultaneously the powers of regional actors such as the African Union and ASEAN, to speed crisis control and stabilization of states.

## CONCLUSIONS

The European Union, through its economic strength, population, political will, civil and military capabilities available to the Union and the Member States, the level of ambition displayed, the attitude of Member States for crisis management in civilian and military areas, is an important actor on the international stage. Its high status recognized by other state and non-state actors in the world is highlighted by assuming a wide range of economic, political, military, social and environmental roles, materialized around the world, wherever the interests of stability, peace and security may require it.

For the purpose of highlighting the roles in security, the European Union has created and developed military and civilian capabilities. Crisis management has become an important part of the EU security policy. However, the activation of civilian and military capabilities remains a challenge for the European Union. The effectiveness of many missions is limited, which, on the one hand, reflects the current "state-building" crisis and explains, on the other hand, the deficits of an EU strategic framework for action. Given the more and more critical commitment in failed states, a regionally differentiated level of ambition must be developed for the EU.

The European Union has set-up institutions aimed at accomplishing the Common Security Defence Policy, but these institutions and the actors involved in the CSDP must find a coherent and effective operation manner in all circumstances. Thus, it appears that human resources for civilian crisis management are trained with difficulty and are time consuming. Hence, the necessity of the establishment of training centres for civilian staff - experts in the rule of law, civil administration, justice, and police - either at EU level or its Member States that is willing and can do it.

Crisis management operations led by the European Union are defined by at least two features. First, due to restrictions imposed to its ambition level and means, the EU tends not to favour recourse to its military capabilities. When it does, the EU ensures that the policy objective is perfectly defined and engages in a limited space-time for well-defined tasks. Then, through its various and numerous tools, the EU always adopts a multidisciplinary approach in crisis management, is mainly interested in the causes and conducts priority targeted interventions either within an overall treatment of a situation in time, such as in Bosnia, or for obtaining a partial effect, such as in D.R. Congo, in Aceh or in Palestine. This approach seems to enjoy less visibility, but a guaranteed success.

In addition, the involvement of civilian capabilities for crisis management seems to be more appropriate than resorting to military means. For example, using the EU Stability and Neighbourhood Policy Tools or financial support in development appear to be more effective and with lasting effects in resolving crises, because they help give hope to those affected, as they are based on the satisfaction of basic economic, social and human needs in the states where the crisis is being managed.

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## NEGOTIATORS' ATTITUDES TOWARD FORMAL CONTRACTS: A SEVEN-COUNTRY ANALYSIS

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### ABSTRACT

This research investigates negotiators' tendency to sign formal contracts. Drawing on a sample from Austria, France, Germany, Greece, Israel, Luxembourg and Turkey, it examines the influence of horizontal and vertical individualism-collectivism, ethical idealism and trust propensity on business people's attitudes toward negotiated formal contracts. A survey questionnaire was translated from English to French, German, Greek, Hebrew and Turkish, and two thousand one hundred and sixty-six responses were collected from employees in the seven countries. The research findings suggest that higher levels of individualism and ethical idealism increase negotiators' tendency to sign formal contracts, while higher levels of trust propensity decrease negotiators' tendency to value formal contracts. This study contributes to the literature of formal contracts offering original implications for the international negotiations theory and practice.

**Keywords:** Formal contracts, negotiation, horizontal-vertical individualism, horizontal-vertical collectivism, ethical idealism, trust propensity, Austria, France, Germany, Greece, Israel, Luxembourg, Turkey.

## A SYSTEM APPROACH TO BUSINESS CHALLENGES: CORPORATE SOCIAL RESPONSIBILITY IN RUSSIA AND TURKEY

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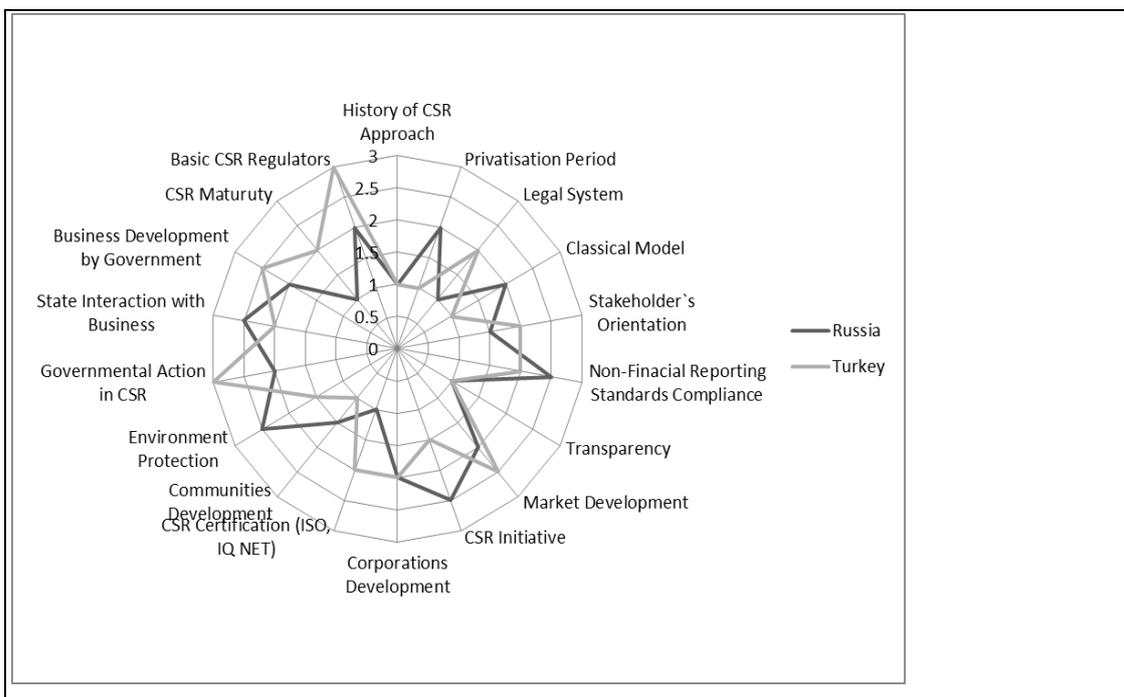
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### ABSTRACT

**Purpose** Almost a decade long global financial and economic crisis made visible the level of readiness to changes in the different types of corporate and government organizations throughout the world. The social and economic programs implemented by governmental and corporate sectors as remedies for the economic and political crises have widely produced mostly negative consequences for populations, especially in the emerging markets countries if not in the core countries. Since one of the suggested remedies is CSR, a wider version of “responsibility” adjusted with a “corporate social responsibility-CSR” must be implemented. This paper mainly analyze the different underpinnings of this larger and more humane approach within the conditions of two countries, sharing an important function in the global economy, Russia and Turkey, which have uniquely different pasts of political systems but nevertheless had experienced similar economic structural changes, and same shortcomings of the last decades of economic shuffles. For a beginning, issues within the framework of corporate and social systems and ethical considerations are elaborated. Then, the authors attempt to define and establish a general model to find the place of Russia and Turkey on the world map of corporate social responsibility, comparatively with theoretical underpinnings, suggesting a new macro social and a new micro economic system.

**Design/Methodology** Russia and Turkey are border countries very distant from each other. In many cases, both countries had shown hostility towards each other and had not appeared in good terms in terms of power politics beginning from the Tsarist Russia and the Ottoman Empire. But surprisingly, in both political geographies, same economic and political transformations had historically taken place concurrently and similarly in terms of Westernization. Since, management styles and corporate practices are highly depended upon political structures and cultures rather than economic imputes and motivations, this roughly “common” and relevant background is vitally important. So that an attempt becomes possible to show the recent economic similarities and differences occurred in both countries in terms

of management structures and organizational and corporate social responsibility activities. For instance, relevant to our discussion, a question can be asked that twenty so years of the liberal market economy in Russia have definitely built a new social and economic system; but, has Russia changed fundamentally in the management techniques? The same question can be asked for Turkey who shares as briefly shown above almost similar cultures of political and economic management styles with Russia. These historical resemblances of both countries conveniently give a base to build a sound model of measuring corporate social responsibility, comparatively, for international practitioner's perusal which is the main intention of this paper. To study the CSR profile we choose a list of basic descriptors. Selected characteristics (lines) are represented graphically in the form of vectors of the polygon. Typically, this method is used in strategic management to determine the profile of employees, company, or industry. Profile is the sum of characteristics, in our case - the sum of the characteristics of corporate social responsibility models. Imposing polygons on each other, we can see similarities. Further, the models of CSR in Russia and Turkey were compared based on these characteristics by using the list of criteria in order to identify similarities and differences between these models. Parameter estimation was based on the preceding analysis. (Figure 1).



**Figure 1.** CSR Models Match in Turkey and Russia

**Findings** In this paper the authors attempt to generalize all the factors making for relaunching an innovative CSR business model in Russia and Turkey. From our point of view, it's just this model that the economy needs to improve the investment attractiveness of

both the country's business and the country at all. The institutional contour of the built Russian model of social responsibility should consider essential types of ideological, economic, political and the public work, directed to harmonization of the balance of interests of all stakeholders. The borrowed and unique lines of the Russian model are starting to take a steady form.

Despite big similarity, Russia and Turkey stand at different steps of CSR implementation. In the studied countries along with «the advanced» socially responsible group of companies there is a negatively minded group of businessmen and local residents. On the one hand, many companies in both countries consider CSR as the unnecessary western concept, on the other hand – as a trading barrier. CSR is not only the tool of the social problems management in the region. The companies in the countries consider CSR as a businesses' dealing's part, the tool to increase of competitiveness of the company, possibility to enter new markets, and also to strengthen mutual relations with suppliers, investors, and buyers. The pragmatism and economic benefit expectation force the companies to put huge investments into social and ecological spheres.

Latest publications suggest Russia and Turkey to follow the world trend of "socialization" of business. One can also find methods of struggle against those businessmen refuse to follow the given trend. Unfortunately the majority of the Russian and Turkish companies is quite far from the universal trends and is forced to struggle daily to survive here and now.

**Originality/Practical Implications** Observance of the certain specification in the field of CSR can be a necessary condition for corporate membership in any branch association. The specifics of the Russian CSR include its basic initiator– the State (instead of a society or business acts). Although the pattern remains the same, in Turkey there is little public awareness for CSR. The concept of social and economic development of Russia and of Turkey declares an intention to build the mechanisms promoting strengthening of social responsibility of business and distribution of the corporate social reporting. Corporate social activity in Russian business is still often associated with PR and remains isolated in the relevant departments. This is almost the same in Turkey. Consequently, the public at large is only fed limited and favorable information rather than the true picture of corporate social activity with all its natural perplexities and problems. In general this situation unfortunately reduces the CSR role both in Russia and Turkey to a 'cosmetic' rather than a strategic one. The paper identifies very different levels of CSR *penetration* in the studied countries. Finally

the paper finds that firms which operate internationally are more likely to engage in CSR and to institutionalize it through codes than those that don't, suggesting that globalisation (and not westernisation) is a key CSR driver. Even the modes of CSR deployed by domestic and international companies are broadly similar with the exception of the greater use of partnerships in community involvement and codes in employee relations by the international cohort. The Content of CSR and Business Ethics has evolved with the time, depending on the historical, legal, political and societal changes, and also the drivers changed. This also call for the new model framework based on the novel structure of stakeholder's engagement and compliance to both international and domestic standards and also cultures.

**Key words:** CSR, business ethics, country social responsibility models, cross-cultural analysis

## ESTABLISHING A SUSTAINABLE GROWTH FOR A SME

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### ABSTRACT

The European Commission estimates that more than 99% of all European businesses are SMEs, providing about 70% of the private sector jobs and more than 50% of the European GDP. They are the primarily responsible for wealth and economic growth and play a key role in innovation and R&D.

Many SMEs are led by a family, and the company represents the main source of wealth and incomes for its members. According to evolutionary theory (Emlen, 1982), the individual pursues the improvement of its disposable resources to continue its own specie. Transposing these concepts to a family (Nicholson, 2008), the family leader should set a mechanism that provides resources in order to grant to present and the future generations at least the same resource level per capita. When the company is the mean through which the family generates these for the continuation of the specie, the family goals impact the company goals. In particular, the company's growth rate should be the one that allows to a growing number of family members to have the same income and wealth level. This means the expected return of Family-led SMEs, is different by large Non-Family companies, where theories like CAPM (Fama et al., 2004) are usually applied.

The purpose of the article is to discover if the growth rate of a family SME is compatible with the need for incomes and wealth generated by the increase of family members in the long term.

In order to answer the question we developed a model connecting the family growth, which depends on the average life expectation and on the fertility index of the family, with the company growth in terms of net incomes.

The results reveal that for a SME led by a family that generates 2 new branches each generation, the annual company growth rate in real terms is far lower than the MSCI annual growth of the last 40 years.

**Keywords:** SME growth, Family controlled, Long term return

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## STATE OF ART ABOUT THE TRADITIONAL, UNIDIRECTIONAL INTERRELATION AMONG CONSUMPTION PATTERN AND SOCIETAL AND CORPORATE DEVELOPMENT

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### ABSTRACT

Faced with the pressures of a modern, open society, the traditional economic approach has become an important subject of debate among economic thinkers and business planners. The economic development leading to a globalized market, with independent commercial and financial business moving towards new social and societal models, brings forward additional arguments in support of an enhanced quality of life. Change has become the word of the day. It takes a variety of forms from a wide spectrum of options. As the economic literature presents, the implementation of change (structural change, technological changes, social and political changes) represents the basis for endogenous and sustainable growth.

**Keywords:** globalization, complexity dynamics, change, risk, added value, reflexive modernity, economic crises.

### INTRODUCTION

Previous studies have noted the intricate relationship which exists between economic restructuring and development and the general wellbeing of the population (Vasile, Viciu and Costea, 2012).

A thorough assessment of changes at all levels, brought into discussion an element that was hardly noticed less than a decade ago. The fast development of commercial activities determined a new orientation of studies in both commercial and financial life, with significant consequences at the decision making level, with implication in the social, cultural and societal fields. The changes generated have been wisely motivated by the new distribution of power inside the society where, the "awesome global might of corporations has outstripped government control and objectivity" (Rothschild, 2001).

The free market has represented the first priority in the process of building an open and democratic world (Rothschild, 2001). The results registered by the largest multinational companies, dramatically influenced life at societal level.

The structure and performance of three important sectors represented the prerequisites for this phenomenon:

1. The stability and effectiveness of the political or executive sector - represented by the government and the public institutions;
2. The profitability of the corporate or economic sector- represented by businesses and financial authorities;
3. The general trends and directions of other parts of society - described in various ways and influenced by cultural, ethnic or ethical factors.

Solow (1986) asserted that changes in technology offer the drive for economic growth and the only possible alternative to avoiding a Malthusian trap (Hansen and Prescott, 2002). On the path to liberalism and economic freedom, the expectations met strong barriers in the form of tradition, culture and religion. The clash between the new approaches and these factors brought corruption, regional politics and personal interests which, in turn, contributed to a strong polarization of society. The phenomenon was exacerbated by the emergence of a new distribution concept that affects the general and individual consumption pattern.

Under the banner of democracy, the elites of society (comprising formal leaders and large economic entities) have “politically” empowered the decision-makers to develop and replace the views of an “ideal” society with a network of complex social structures which require organization planning and leadership. This represented the moment when the new ideology of a durable, commercial, efficient and quality-oriented transition changed the policies from the search for fast profit to a pursuit of wellbeing and sustainable development. The social and economic results are significant and may benefited society at all levels.

This outcome has been supported by previous research (Costea et al. 2010) which underlined the flows of the short-term profit maximization attitude of policymakers and business leaders. Once the sentiment matured into a general purpose and strategy, the development moved from a local to a global scale.

A society which is fundamentally grounded in freedom (Handy, 2002) and competitiveness proves capable of permanently enforcing the right policy, even in situations when political and economic entities ignore the general limits or expectations. These

situations require a complex and dynamic analysis, which takes into account the fragility of the theoretical equilibrium when the stakeholders are not sufficiently studied and the expectations are not realistically defined. Research in this direction typically abandon the course of neoclassical thinking and enters the relatively new epistemological approaches of complex studies, evolutionary economics and evolutionary game theory (Keen, 2001; Vasile, Costea and Viciu, 2012).

Therefore the purpose of this paper is to bring into discussion the concept of consumption pattern and determine its relationship with societal and corporate development, through a complex assessment that incorporates the conditions and outcomes of the globalization phenomenon.

Nowadays, the consequences of globalization are widely presented and discussed, being considered by most scholars as the long-run processes with significant implications at economic and social levels. It can be noted that the macro-indicators are analyzed and justified through different approaches which depend on the specific research or policy objectives.

To ensure a durable development, there is a need to find the best solutions for socio-economic problems. These rely on several important issues connected to a better understanding of the relationship between production, environmental protection, general wellbeing and societal soundness, with direct implication for both individuals and corporations.

The macro and microeconomic levels have become intertwined, both being affected by a very wide range of global phenomena. Since most industrial products are either totally or partially made in different parts of the world or delivered at different locations by multinational suppliers, the business studies must be complemented by research in fields such as geopolitics, international studies and regional development.

This brings into equation the new characteristic of contemporary life, consisting in a multicultural, knowledge-based and complex-networked economy. While remaining a widely disputed concept, the process of globalization generates opportunities as well as risks (or threats) for business owners and managers. With the introduction of globalization, a “revolution” emerged in the field of economics, enabling entrepreneurs and businesses to

obtain profit by using global resources and capitals. This led to the creation of a new society, which generated new rules for sustainable development.

## CONCLUSIONS

Global markets offer greater opportunities for people. Expanding to larger markets around the world permits easier access to extra capital flows, technology, cheaper raw material, appropriate labor and larger distribution or consumption opportunities. Global investment and trade generate positive externalities in the form of technological spillovers (Baldwin et al. 1999; Fosfuri and Motta, 1999). However, globalization does not necessarily ensure that the benefits of increased efficiency are shared by all members of society. Markets promote efficiency through competition and the division of human resources. Specialization allows people and economies to focus on what they do best. Governments and decision-makers should also accept the increasing integration of economies around the world and act accordingly to support future development. This remains an important concern for scientists.

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## **CHALLENGES FOR EXECUTIVE RECRUITMENT IN THE LIGHT OF THE WAR FOR TALENT IN GERMANY**

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### **ABSTRACT**

#### ***PURPOSE***

Goal of the research shall be to identify the significant trends in the recruiting-business and their implications for skilled employees – especially executive candidates.

### **INTRODUCTION**

In Germany, the “War for Talent” is becoming a reality for more and more organizations. Competition in identifying and hiring as well as maintaining talent has increased. “All developed economies face a strong and increasing excess demand for skilled labor, fostered by technological change, population aging and a subsequent decline in the future native European workforce. The upcoming needs cannot be satisfied sufficiently by the local labor force or the educational system in the particular countries. Europe is more and more drawn into a competition to attract international skilled labor to fill the gaps.” (Zimmermann 2004, S. 2) Additionally, in a more service- and know-how-driven industry, the general value of human capital in has grown significantly. “Human resources are strategically the most important company resource, even though it cannot be expressed in numbers form a financial point of view.” (Myskova 2011, S. 101) On the candidate side, the increase in diversification of the workforce, the increase of workforce mobility and the higher flexibility in changing to a new position, make it easier for candidates – especially on a higher career level – to turn to a new employer and turn the labor market from a sellers’ market into a buyers’ market.

### **DESIGN/METHODOLOGY/APPROACH**

The paper will contain a summary of a literature review of current popular trend-studies in HR focusing on recruiting trends and qualitative and quantitative studies conducted among Executive Search Consultants and Company Recruiters / HR-managers.

In addition to the view of the recruiting party, the requirements of job-seeking (employed and unemployed) executives and professionals in Germany will be presented as counterpart, to understand the gap between demand and supply in current recruiting.

## **FINDINGS**

Looking at the current literature and research, the needs of the two groups for recruiting can be derived. Since the “War for Talent” has been raised as topic, not much has been done on the recruiter-side. Organizations are seeing a decline in quantity and quality of applications as well as the signing-quote of job-offers has declined while the fluctuation of existing employees has gone up. (Kienbaum 2011, S. 6–8)

The regular job posting will not be enough to get the right employees applying for open positions. Similarities can be found in the prioritization of the communication channels chosen by the recruiters and the candidates in the preference-building process. Finding the “Employer of Choice” is a complex selection- and decision-process of an employee looking for an employer. (Petkovic 2008, S. 61) To attract the “best talent”, more companies are creating initiatives targeted towards the acquisition of highly qualified specialists and managers. HR-managers (Kienbaum 2011, S. 6–8) as well as Executive Search Consultants (Experteer 2011, S. 9–10) see Employer Branding as important factor for attracting Senior Talent. “[The Employer Brand] is meant to significantly enhance the publicity of the organization as employer, to ensure that employees include the employer in their relevant set. Moreover, the perceived advantages (Brand value) should immediately reflect in the preference-decisions of the target audience and at the same time enable a sustainable differentiation to competing offers of competitors.” (Beck 2008, S. 33) Employer branding is not only a recruiting strategy, but it entails a full framework for governing the everyday experience of employees through communication and behavior (Mosley 2007, S. 132), which make it hard to extract and improve for better recruitment. However, there are clear guidelines, which can be derived for employers to successfully recruit executive talent.

## **LIMITATIONS / IMPLICATIONS**

This study is a review of current analyses of the current recruiting situation mainly in Germany, with a focus on executive talent. It is only an assessment of the current best practice and needs for recruiting.

## **ORIGINALITY/VALUE**

Research currently provides rather limited theories for research. This research is providing an overview on the current problems in recruiting and is giving an overview on the current theoretical solutions such as employer branding. It is a basis for deriving further research questions.

**Key Words:** recruiting, war for talent, human resources, jobsearch, candidates

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## PROFITABLE INDEX ON TOURISM PROMOTION ON MADEIRA – A FINANCIAL MODEL

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### ABSTRACT

As the resources for promotion are limited, it is important to create and implement a model to valuate at priori the investments made and a continuously monitoring of the return obtained.

Concerning the valuation of the investments made, there are no evidences that, at a regional level, in Madeira, this politic actually exists as a previous valuation that can assist the decision of invest or not.

When this rule for the profitable index of the promotion is applied, based on the valuation model created, we can verify that according to the strategic targets, and in harmony with the previous agreed plans, the value obtained is for a return on investment is under the historic level obtained, that is about 47 times.

The model is created to generate a full process on establishing main objectives of political investment, fully related with the amount spend on investment.

A new matrix of profitable index is made, relating two main index; a) growth on outbound market; b) market share.

**Keywords:** Touristy Promotion; Return on Investment; Tourist incomes; Profitable index; Profitable index Matrix.

## **BUSINESS MODEL FOR ASSEMBLE IT YOURSELF FURNITURE RETAILERS –A DEVELOPING ECONOMY PERSPECTIVE**

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### **ABSTRACT**

Organizations venture out of their domestic market with a view to garnering better market share and ensuring continuous growth. This method of growth is most certainly not new in business and has been the most popular route employed without much difficulty until the past decade. Business entities from a developed economy venturing into the market of another developed economy did not experience any specific barriers on one hand but on the other did not experience the anticipated rewards too. This could be attributed to a number of factors like competition, matured economy, to mention a few. On the other hand we have in the past decade and also currently witnessing the increasing propensity of businesses to venture into developing markets with a very clear objective of encash on the potential growth prospects and in their quest for growth overlook crucial aspects which are latent but nevertheless could cast the difference between success and failure.

One such business which is set for this venture is the modular assemble it yourself furniture brand leader. This paper attempts to study the current model of this business entity and discusses the issues which could impede its implementation in developing economies. One of the objectives of this paper is to suggest a workable model after careful consideration of socio-cultural and psychographic aspects in developing economies.

**Keywords:** Globalization, Entry Strategy, Business model, Adaptation, Socio-Cultural Aspects, Investment

## **SOCIAL DISCOURSES TOWARD HEALTHY EATING: EVIDENCE FROM ROMANIA**

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### **EXTENDED ABSTRACT**

#### **PURPOSE**

Existing research on healthy eating has been criticized with regard to its emphasis on individual beliefs. This is problematic because everyday decisions about food, although being individual acts, are also deeply embedded in societal norms (Ristovski-Slijepcevic, Chapman & Beagan, 2008). Chrysochou et al. (2010) proposed a framework that builds on social food and health discourses. The framework was employed in a northern European country (Denmark) and used to identify health-related segments. This paper aims to provide further evidence of the robustness of the framework in a southern European context, and more specifically in Romania. The objectives are: (a) to identify health-related segments based on the underlying discursive subject positions of the framework, (b) to validate and further describe the segments based on their socio-demographic characteristics and attitudes towards healthy eating, and (c) to explore differences across segments in their response to food labels.

#### **DESIGN/METHODOLOGY/APPROACH**

A study was conducted in Romania during 2012 (N=428). The questionnaire included the scale measuring the social discourses toward healthy eating (Chrysochou et al., 2010), attitudes toward healthy eating, and consumers' response to food labels. More specifically, a set of the most used food labels in Romania was measured in terms of awareness, perceived knowledge, usefulness and trustworthiness.

#### **FINDINGS**

Results show that the framework can successfully be applied in a different food cultural setting than the one originally developed. Three segments were revealed and were named as the Common, the Idealists and the Pragmatists. The segment that can be categorized as the

most health-conscious one was the Idealists. The Idealists were more likely to be women, married and of higher age, tended to have higher levels of education and income, were responsible for grocery shopping in their household, had good perceived healthy eating knowledge and diet quality and reported to rely on food labels. Moreover, that segment declared to be more aware of the food labels while they showed higher levels of understanding, trust and perceived usefulness.

## RESEARCH IMPLICATIONS

The proposed a framework provides a useful conceptual scheme for market segmentation purposes. The main implication of this study concerns the targeted interventions that could take into account the different discursive subject positions of the proposed framework as a basis for addressing dietary-related behaviour.

## RESEARCH LIMITATIONS

Data have been collected using a web-based survey, something that has skewed the sample toward more educated consumers. Therefore, results should be interpreted in the context of the characteristics of the sample.

## ORIGINALITY/VALUE

This study is the first to provide evidence on the robustness of the framework on food and health social discourses proposed by Chrysochou et al. (2010) on a different cultural setting than originally developed.

**Keywords:** Healthy Eating; Food; Food Labels; Segments; Social Discourse

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## **SOCIAL MEDIA, PREDICTIVE ANALYTICS, AND TOURISM**

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### **ABSTRACT**

Recently social media has been shown to provide information on tourism and politics. In recent studies that we have conducted, wine sales and tourism trends have been forecast using machine learning algorithms and hundreds of thousands of blogs, online news articles and Twitter tweets. Our previous research has shown that mining of social media can predict in real-time market penetration figures and can also forecast social and business trends in tourism. We extend the research further to evaluate the predictive value of Social Media in forecasting trends for the value of publicly traded Hospitality and Tourism companies.

### **RESEARCH BACKGROUND**

In this follow up study we continue to investigate whether public mood as measured from large-scale collection of social media is correlated or even predictive of publicly traded Hospitality stock values. Our research and publications to date on this issue, as well as those mentioned above suggest that models which include text mining and sentiment mining of internet based data repositories and specifically blogs, online dailies, Twitter, and Facebook can provide predictive power for financial markets. Specifically we monitor the stock measures of publicly traded Hospitality mid-sized and large firms. To date there has not been published work of this kind on this subgroup. This research additionally augments methodologies already established and will provide tools and models which will be transferable to other quantitative research.

As found in a number of papers, sentiment mining aims at extracting features on which users express their opinions in order to determine the user's sentiment towards the query object. There has been a flourish of articles in the academic literature on

market correlations to various sentiment measures of social media starting in about 2009. Our efforts at collection of data began in that year as well and we have published several papers in this field. However no work has been published on Hospitality and Tourism companies and the possible links that their market value may have to Social Media. Our study of the same type looked at social media sentiment about tourism in Thailand amid the unrest in that country during the early part of 2010 and further whether analysis of micro-blogs can be used to discern the effect of that unrest on Phuket's tourism environment.

There is a treasure trove of hidden information in the textual and narrative data of various social media that can be deciphered by text-mining techniques. The information provided by these methods can provide a basis for artificial intelligence and help support or improve any kind of analysis but in particular the verification of market valuations. To date we have devised a buy, hold, and sell strategy with accuracy of approximately 70 percent for seven large stocks that sells on the NYSE. In this paper we develop this methodology for medium and midsized Hospitality and Tourism companies on the NYSE by the collection of data from blogs, and other forms of social media.

## **METHODOLOGY**

We selected a small sample non representative portfolio of Hospitality and Tourism stocks whose companies hold a significant presence in English based social media and a global footprint. Over 800 million micro-blogs and 25,000 reviews were collected and analyzed to gain knowledge regarding Hospitality and Tourist sentiment on Hotels in various destinations such as New York, London and Tokyo. Sentiment was measured using a binary choice keyword algorithm and a multi-knowledge based approach was proposed using, Self-Organizing Maps and tourism domain knowledge in order to model sentiment. A visual model was developed to express this taxonomy of sentiment vocabulary and then this model was applied to maximums and minimums in the time sentiment data. The results showed actionable knowledge could be extracted.

We obtained a collection of public media (such as Facebook, blogs, news, Twitter) for a period of 3 years. Software was written to account for location and language and a means was designed for implementation of machine translation of text from non-English sources. Domain specific models of sentiment are developed in order to achieve robust models. We further looked for correlations between sentiment and various financial indicators such as closing stock prices on public markets.

Testing of the models included periods of substantial volatility and periods with little volatility. Data sets of varying lengths were also tested (short -3 months, medium -8 months, and long -15 months). For each stock, a minimum of 10 data sets was tested against a minimum of 12 artificial intelligence algorithms including decision trees, Bayesian methods, Neural Networks, and Regression models. Aspects of traditional times-series modeling were also employed.

## **RESULTS AND FUTURE WORKS**

The preliminary results indicate that significant correlations exist between sentiment and various business measures. The most significant of these has been between sentiment and share price. Given these correlations our next steps will involve constructing forecasting models.

Further innovations will include the incorporation of geo-location data in order to improve the precision of the predictive analytics. We have already developed software which can match a tweeters location based on characteristics of the tweet. With the growing prevalence of Android and iPhone smart phone technology GPS data is becoming increasingly available. Further innovation will be introduced through the inclusion of language indicators. The innovative inclusion of both of these factors may help avoid geographical and cultural sampling errors.

**Keywords** Social media, Hospitality stocks, Micro Blogs, Text Mining, Business Intelligence, Sentiment Mining, Business Analytics, stock valuation.

## MANAGEMENT ACCOUNTING SYSTEMS AND SMES: EXPLORING THE EFFECTS OF THE FINANCIAL CRISIS IN GREECE

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### ABSTRACT

The role of Small and Medium Enterprises (SMEs) in all economies is crucial, since they constitute the vast majority of the firms' population. SMEs are characterized as a "vital" and "key" force for an economy's well-being (Mitchell *et al.*, 1998; Mitchell and Reid, 2000; Nandan, 2010). However, literature presents several reasons that make this business sector prone to failure (Ballantine *et al.*, 1998) leading many SMEs to struggle for survival. These include, among others, the limited management skills of the owners-managers (Kirby and King, 1997), the dependency on limited number of customers and the production of standard products (Nandan, 2010). According to Hopper *et al.* (1999) SMEs receive intense pressures to reduce their costs, and at the same time to retain high quality. Nevertheless, this sector of economy is viewed by Organization of Economic Cooperation and Development as a major driver of economic growth and adjustments (OECD, 2010). Despite several shortcomings, SMEs are considered to be more flexible, entrepreneurial and innovative, react quickly to changing markets, are less bureaucratic and "in-touch" with reality compared to large companies (Peel and Bridge, 1998).

Under normal financial conditions, the appropriate use of management accounting information is characterized as a crucial attribute for the survival and even success of a small or medium-sized enterprise (Mitchell and Reid, 2000). However, the recent financial crisis has been a major challenge for organizations of all types by revealing a plethora of shortcomings in terms of culture, structure, planning as well as accounting practices (Hopwood, 2009; van der Stede, 2011). The great pressures that the crisis is putting on management accounting are "undeniable" (van der Stede, 2011; p. 606) and the need for various readjustments more than evident (Hopwood, 2009). Within the context of a financial crisis, SMEs are considered to be more vulnerable to the intense pressures and often struggle to survive. Therefore, interesting

research questions arise regarding the impact of financial crises on SMEs as well as the defense mechanisms that SMEs have developed against the financial crisis in order to overcome the extreme pressures. After all, SMEs are considered to be less complicated compared to larger firms, and therefore offer a more accessible setting for researching management accounting issues (Mitchell and Reid, 2000).

The present study examines the reaction of Greek SMEs in terms of adjusting management accounting practices and techniques, within the context of the financial crisis that started becoming evident in Greece since the end of 2009. More specifically we explore the application of budgeting and cost accounting systems as well as other management accounting techniques by the Greek SMEs and whether these changed as a response to the pressures deriving from the financial crisis. Greece constitutes an interesting setting for the purpose of such a study as the country and the organizations operating within have faced and are still facing extremely intense pressures from the extensive financial crisis (Matsaganis and Leventi, 2013). Moreover, Greece constitutes a characteristic example of a country where the vast majority of enterprises are small and medium-sized (Eurostat, 2008).

The study adds to international literature by examining the implications on management accounting systems deriving from the financial crisis. According to Hopwood (2009) and van der Stede (2011) this is an area of research which is understudied and therefore requires further analysis. Moreover, the study contributes to literature by exploring the management accounting practices and techniques that are applied by SMEs; another field where research is not extensive (e.g. Drury and Tayles, 1993; Marriot and Marriot, 2000; Wijewardena and De Zoysa, 2001). For the purpose of the study a questionnaire has been developed and disseminated to 3.000 e-mail addresses of SMEs in Greece, retrieved by the dataset of ICAP. For the selection of the SMEs the European Commission's definition of SMEs issued in May 2003 was adopted (i.e. workforce ranging from 10 to 250 employees and turnover from 10m to 50m euro). The analysis is concentrated on comparing the characteristics of the budgeting and costing systems in SMEs in 2009 the year when the crisis started and in 2013, a period that is characterized by witnessing the severe effects of the crisis.

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## ACCOUNTABILITY AND DISCOURSE: IDENTITY CONSTRUCTION OF 'ÁGUAS DE PORTUGAL, S.A.'

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### ABSTRACT

In the process of focusing on Schweiker's [Schweiker, W. (1993), "Accounting for Ourselves: Accounting Practice and the Discourse of Ethics", *Accounting, Organizations and Society*, Vol.18 No.2/3, pp. 231 – 252.] arguments over the essential role of the act of giving an account as to enable organizations to develop an identity as moral agents within community. This paper seeks to examine the way in which discourse acts over organizations in constructing their sense of accountability. Giving that accounting is a social practice, accountability is founded upon the moral responsibility felt by the self to account for itself to another, dependent on the active subjectivity and intersubjectivity of both parties regarding a particular social reality. The self is regarded here as a corporative agent, its identity enacted through communication. This stresses the role of the accountant in the process of the enactment of corporate identity, as it reflects on one's duty of giving an account of the organization.

By conceptualizing the act of giving an account as a narrative, interpretative and discursive act, accountability, since it is grounded upon the moral responsibility of the self to respond to the other's expectations to account, is rendered as a function of three variables, the self, the other and the community, exposing it to what constraints the act of giving an account may be liable to. This allows for the ethical relationship sustaining accountability to be studied, resulting in identity never being able to claim full authorship by the self as its accounts are not properly its own, resulting instead in a complex exertion of several forces through time. Because discourse crystallizes these forces into power, one's identity as a corporation is a discursive one. As a result, accounting, as a communicative act, is tantamount to being a constructive act of an identity, reflective of an (im)balance between different forces looming and weighing behind what discourse accounts purposively convey, as the corporate subject, through the accountant, is indeed an agent in shaping its own identity.

As is a critical examination of what discursive stance is both articulated and adopted by the practice of accounting *for* the corporate subject throughout time, this paper, by investigating the way discourse in accounting information acts and reacts to the exertion of forces

comprised within a set framework, searches to grasp a better understanding of how accounts, far from being the result of a neutral bystander, express a wide range of forces acting upon what identity is intended or allowed for the corporate subject. It takes therefore a participant's view over the social phenomenon being analysed, as it reveals the observer's perspective, thus its interpretation, about the 'specific reality' whose meaning he himself wishes to understand.

Buttressed on the current economic environment, Portugal's water sector has been increasingly pressured to open itself to privatization through a prevailing discursive stance of being the best solution to the sector's inherent problems. With its leading role in coordinating water supply, 'Águas de Portugal, S.A.' represents the central focus of such pressures, making it liable to the full exposure to discourse's enabling and constraining powers on rendering its identity as an accountable being. The shifts that have been experienced by 'Águas de Portugal, S.A.' in the discourse conveyed through its accounts, reveal to be of particular importance in understanding the process of identity construction of a corporate agent, in turn reflecting its sense of accountability.

Within the field of accountability research and the role accounting has in shaping it, case studies consist on a recurrent approach in exploring the ways distinct forces are able to mould the specific framework within which identity construction takes place. In this paper, a new strategic plan for the water sector set by the Portuguese government for the period comprising 2007 to 2013 serves as the background for conducting this study. Albeit narrowed to a sample of one, as it expresses the inevitability of conducting an analysis within a regulated, practically monopolized public sector, this case study has the potential of enabling a better understanding of how the discourse conveyed through accounts reflects/affects the deployment of forces acting upon a corporate subject's accountability within processes intending for major social change.

**Key words:** Accountability, discourse, identity construction, water sector.

# AN INTEGRATED APPROACH TO VALUE BASED INNOVATION ENVIRONMENT CREATED BY CROSS SECTOR STAKEHOLDERS INTERACTION

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**Keywords:** innovation environment, knowledge management, stakeholders' collaboration, institutional analysis approach, integrated approach

## INTRODUCTION

The research is taking into account the latest trends related to the change of paradigm in management sciences, as a consequence of the development of global network organizations, importance of intangible assets and growing role of new information and communication technologies. The field of research is based on innovative, flexible, high-value organizations, as they are able to adjust to the challenges of a changing and increasingly uncertain environment most efficiently. For transformational change in knowledge management, it is important to identify key stakeholder-related sectors that influence stakeholders' participation and the domains where the integration takes place in innovation diffusion.

Improvement of the innovation is an important challenge, especially in the post-crisis era. After the period of prosperity based on competitive advantage, countries have to face the competition based on knowledge economics. The basic cost advantage is not working anymore, so further development depends mostly on ability to create creative and sustainable economy. Increasingly apparent limitations of traditional models of economic growth based on resources and production factors show that a balanced approach, based on integrated values may be the only alternative to giving the chance to build a new variety of the welfare state model.

## ACTOR INTERACTIONS

The first analytical block deals with the identification of actors (individual and institutional) relevant for the design and implementation of market-based mechanisms, understanding of their roles, responsibilities, preferences, resources and the patterns of interactions emerging among them. The set of relevant actors is delineated by the nature of the problem, although it may involve actors located outside the system if their decisions affect its management.

This block relies on the techniques of stakeholder analysis, which studies stakeholders on the basis of their attributes. Four actor attributes can be identified:

- *Resources* (actor's access to stocks of capital, labour, technology, and social influence)
- *Individual preferences* (what actors want to achieve)
- *Information-processing capabilities* (the way actors acquire, process and use information)
- *Selection process* (the selection criteria actors use in decision-making process).
- The resources that different actors or groups of actors possess determine their relative strength vis-à-vis their counterparts, and endow them with the capacity to establish or change rules, or act in accordance to the existing rules to satisfy their individual preferences. The information-processing capabilities of actors and the decision-making criteria they follow to determine the extent to which individual and group interests can be matched and opportunistic behavior can be prevented or overcome. All these attributes are particularly sensitive to the socioeconomic, political and institutional setup in which interactions occur (Polski and Ostrom 1999).

## INNOVATIVE ENVIRONMENT

The main obstacle to achieve this goal is the lack of cooperation and strategic attitude towards main stakeholders of that process: inefficient public sector, society with growing but still low awareness of sustainable way of thinking, and underdeveloped education and research industry. The emerging grassroots social movements increasingly emphasize the need for sustainable development with transparency, value and trust, taking into account the common good of society, which seems to be optimistic.

This article analyses an interdependencies of main stakeholders of sustainable development process based on innovation improvement. I start from the meaning of sustainable development in the cross-sector relations, examining to what extent lack of interdisciplinary strategic thinking and innovative attitude can be the main obstacle in sustainable development of innovative economy. Technological gap in the sense of the new ways of construction, distribution and utilization of collaborative knowledge supporting sustainable development, placed the whole economy below the potential sustainable growth level.

The experience of the past years shows that there is no discretion to treat imbalances as the driving force of the economy. The sustainable development ability in cross-sector cooperation is quite substantial. However this potential is rather used in line with the institutional order on the rational behavior base, instead of mindfulness developing process. The main reason of that is the existence of systemic barriers and the lack of cooperation and strategic attitude.

However the successive generations bred in the Internet age seem to be increasingly aware of the environmental consequences of economic activities and the strength of its impact on the global level - sustainability means also balance among generations (environment, labor market, but also public debt).

The theory and practice of business management form methodological foundations of the scientific used for aiming at combining micro, macro and personal level in order to investigate and show how to increase the value through innovation. Therefore the output depends on organizational management model that have the potential to reduce barriers, and to produce sustainable outcomes for innovative performance.

## **INSTITUTIONAL ANALYSIS**

The aim of the article is also to derive suggestions and recommendations to policy- and decision-makers concerning the creation of the pro-innovative environment and to provide insights into the most adequate design of such mechanisms. I define institutions as the rules modeling human behavior, assigning roles to different actors and structuring their relations and interactions. Other actors are the players of the game, with a limited capacity to "set the rules". Institutions can be defined as the "rules of the game" which shape human behavior by giving rise to social practices, assigning roles to different actors and structuring their relations and interactions (Young 2002). Institutions, therefore, differ from actors and organizations that are the "players" of the game, with a capacity to act upon their interests. Institutional analysis sheds light on the sources of a possible mismatch between design rules, actors' interests, and other existing policies. Enhanced understanding of their complementarities and contradictions contributes to improved design and performance of these mechanisms and helps policymakers develop successful instruments.

## **SYSTEMIC APPROACH**

Further question is how institutional or governmental policies should supporting this movement. In the analysis I adopt an institutional analysis approach to examine questions related to ways in which public institutions and private sector are effectively working together around new ideas and technologies, creating the channels of collaboration.

Systemic change towards pro-sustainable approach can help better organize cross sector cooperation improving their strategic attitude. Limited public resources can be better located thanks to civil society involvement and active role of the R&D sector. All those can be

achieved by balancing creative sustainability approach with the interdisciplinary strategic thinking. The sustainable solutions in the macro scale can be implemented only by the cooperative and aware stakeholders. There is a growing recognition of the need for sustainable approaches to value management. While innovation has been acknowledged as a tool for growth and for creating local knowledge sharing culture, it is presumably that conflicting interests of multiple stakeholder groups can hinder innovation in achieving equally social and economical objectives. The integrated approach to innovation environment combines institutional background, company management tools, and personal attitude provide a holistic and collaborative innovation system.

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## AIRLINE SERVICE QUALITY IN SOUTH AFRICA AND MALAYSIA - AN INTERNATIONAL CUSTOMER EXPERIENCE APPROACH

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### ABSTRACT

Research into airline service quality has increased rapidly since its relationship with passenger satisfaction and profitability has been established. Nowak and Newton (2006) report that there is a direct linear relationship between customer satisfaction and profitability, which implies that with increased satisfaction, comes increased profits. This point of view is supported by Park (2007) and even initiated by Park, Robertson and Wu (2004), noting that high quality service rendering to passengers is essential for the airline industry to survive. During the last decade the airline transportation industry has gone through dramatic changes that were due to ever changing customer demands and expectations as well as responding to amongst other the technological and political environmental demands and the deregulation of the airline business (Rhoades & Waguespack, 2008). It is often argued that merely satisfying customers is not enough to significantly increase behavioural outcomes such as customer retention, word of mouth and profitability. Service quality conditions are influencing companies' competitive advantage by either causing to loose or retain customer patronage depending on their experience. This influences market share and consequently profitability. The rapid increasing rate of airline passengers to developing countries like South Africa and Malaysia needs to be synergised with good planning of all necessary services and facilities, of which transport is vital, but often a neglected area (De Jager, 2010). For this reason it is important to ensure that all passengers, local and international, are satisfied with the services provided by domestic airlines. This can be achieved by managing service quality with an emphasis on customer experience management (CEM).

This study attempts to identify the various service and value factors that matter most too domestic airline passengers in South Africa and to benchmark it with the domestic airline industry in Malaysia that has similar airline services. Data collected from both countries travellers were considered. A survey methodology involving face-to-face interviews was employed to conduct interviews with 196 participants from South Africa and 189 from

Malaysia. Respondents were targeted on a convenience basis. While this is not a particularly sophisticated method of sampling, it is often used as part of exploratory studies. Despite the use of this non-probabilistic sampling method, the data that were yielded showed high levels of internal consistency. A random splitting of each of the two datasets (i.e. South Africa and Malaysia) and subsequent comparison of firstly, demographic characteristics and secondly, the average ratings of key items revealed no significant differences, thus confirming repeatability or reproducibility of measurement. Trained fieldworkers assisted with the interviews and the data collecting phase span over a six week period. The findings revealed the following. The **research objective** identifying those aspects that respondents typically consider most and least important when travelling on a domestic airline. The mean importance ratings obtained for each of the service items were calculated and ranked from highest to lowest scores. The items were ranked within the three broader service dimensions for the two samples. The first dimension is labelled 'convenience of booking' and encompass elements such as adequacy of information on airline's website, allowable weight, availability of airline website on the internet, convenience in making reservation/booking, online booking facility and pre-seating options.

The results reveal considerable similarities between the two samples, with both South African and Malaysian respondents rating online booking opportunity and convenience in making reservation/booking as the two most important aspects within these dimensions. Of the six items rated, pre-seating options and allowable weight were rated least important. The average ratings of these items were significantly ( $p < 0.05$ ) lower than the top two rated items amongst both samples. The second service dimension investigated in the study, namely 'cabin service scapes' relates to those service elements that passengers typically encounter during flight. These service elements mostly encompass elements such as food offered (quality, variety, amount and timeliness) and cabin features (cleanliness, ventilation, seating). The three items that were rated most important by both South African and Malaysian respondents were comforts of the seats, cabin cleanliness and quality of the food served. The three items that obtained the lowest ratings were amenities in aircraft, timeliness of food and drink service and amount of the food served during flight. The third service dimension labelled 'cabin crew' relates to their ability to answer questions, ability to speak foreign languages and close attention by cabin crew. Cabin crew's credibility obtained the highest average importance rating, followed by cabin crew's ability to answer questions, and physical appearance of cabin crew rated lowest. The latter items were rated significantly less important than the other two items ( $p < 0,05$ ). Inspection of ratings across all items show that

despite the very similar views of the two samples regarding the ranking of items from most important to least important, the South African sample showed more variation in ratings than the Malaysian respondents. Management of both countries airlines should take note of the findings and incorporate it in their respective business plans.

**Keywords:** airline industry, service quality, customer experience

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## **TRAVELING TO RISKY DESTINATION: THE MEDIATING EFFECTS OF RISK PERCEPTIONS \***

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### **ABSTRACT**

#### **BACKGROUND**

Tourism is one of the major economic sectors which many countries depends on. Yet, incomes attained in this important economic branch tend to be volatile due to the effects of various significant events such as natural disasters and terror attacks. Understanding the factors contributing to the intention of people to travel abroad is therefore important in an attempt to mitigate the long term negative effects of such events on tourism.

The current study examines the factors affecting the intention of students from Israel to travel to four destinations: Egypt, Turkey, Japan and India. We chose these countries so as to capture the effect of terrorism (in Egypt, Turkey), health hazards (Egypt and India) and the effect of natural disaster (Japan) on the intention to travel abroad. The model we propose includes the following mediating variables: attitudes toward destination safety and risk perceptions (regarding health, terrorism and natural disaster). These mediating variables on the one hand are affected by the individuals' travelling experience and exposure to terror events and on the other hand affect the intention to travel to risky destinations.

#### **METHODS**

The research participants were 585 undergraduate and graduate students in academic institutions in different areas in Israel, who filled out questionnaires during class time in 2011. The questionnaire consisted of the following parts: (1) items requesting socio-demographic information and regarding experience with travelling abroad (number of times travelled

abroad) (2) whether or not the individual was exposed to terror events (not via the media) (3) questions concerning risk perceptions about traveling to destinations with different types of risks, which were measured on a 5-point scale ranging from 1 ("certainly agree") to 5 ("I definitely do not agree") (e.g., "it is preferable to avoid travelling to destinations in which there were terrorist events during the current year.") (4) the preference to travel to a list of destinations (Japan, Turkey, Egypt, and India) and reasons not to travel; (5) perceptions about risk tendencies in general measured on a scale ranging from 1 (avoid risk at all costs) to 10 (involved in risky activities) (6) evaluations with respect to travelling abroad (i.e., I feel nervous about travelling right now) on a 5-point scale ranging from 1 ("I definitely do not agree") to 5 ("certainly agree").

## RESULTS

Of the total sample 461 (82%) had experience with travelling abroad, 447 (78%) of the participants were exposed to missiles or terror attacks. The research results shows that only 40% of the respondents intend to travel to Egypt or Turkey, while 62% intend to travel to India and 85% to Japan.

The results of the analytical model (regression analyses) show that according to the research model previous experience with traveling abroad has a negative effect on individuals' perceived risk, travel risks and attitudes toward destination safety. In particular, more experience with previous trips abroad tends to reduce risk perceptions of the prospective traveler. In a similar vein, we found that past exposure to missile attacks has a negative effect on perceived travel risk; namely, mitigates risk perceptions.

In turn, attitudes toward destination safety and risk perceptions were significant predictors of the intention to travel to all four risky destinations. More specifically, it was found that the intention to travel to Egypt or India decreased as travel risks in general and attitudes toward health hazards increased. In addition, the intention to travel to Turkey decreased as the perceptions of terror risks and perceived travel risk increased, and the intention to travel to Japan or India decreased as the perceived destination safety increased.

The results of the study emphasize the importance of previous experience with travelling and the exposure to terror events (with no damage or injury) as mediators of risk perceptions with

respect to risky destinations. These findings can contribute to policy making and strategic planning potentially expanding tourism in risky destinations.

**Keywords:** tourism, terror, natural disaster, risk perception, traveling experience, decision-making.

## WHY POSITIVE FEEDBACK FOR FUTURE ORGANIZATIONS STRATEGY DESIGN?

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### ABSTRACT

The organizations, the same as natural systems, are complex and volatile, so that they are non-linear systems, acting in the far-from-equilibrium status.

The paper is aiming to discuss the opportunity of considering the positive feedback, characterizing the non-linear complex systems, which reinforce the organization, being in the balance with the negative feedback that brings the adjustments for organization return to predetermined equilibrium. In this research two hypotheses have been presumed: the managers usually do not give importance to weak signals from the environment when designing a strategy and the managers are relying on the organization's strategy design mainly in terms of the market demands. A questionnaire survey based on three questions with 19 answers has been conducted in order to demonstrate the hypotheses and the top managers from several (36) organizations responded. The questions relate to: the way the managers have designed their organization's strategy; the general evaluation of strategies' success or failure and the causes that have led to strategies' failure (if such be the case). The processed empirical data have demonstrated the hypotheses confirmation. The conclusions lead to the conclusion or suggest that managers need to avoid success failure by considering the weak signals from the environment and knowledge from outside the industry when designing organization's strategy. They also need to balance among the positive feedback when the long-term strategy and negative feedback when the short-term strategy are designed within equilibrium's boundaries.

**Keywords:** positive feedback, negative feedback, non-linear systems, equilibrium, strategy design, organization, strategic option, weak signals

## METHODOLOGY, FINDINGS AND CONCLUSION

The aim of this paper is to highlight the positive feedback use by the managers when designing the organization's strategy. Natural sciences are usually models for organizations. As organizations are complex and non-linear systems in their structures and relations, having 'the capacity to rebuild themselves' (Deffuant and Gilbert, 2011), as it happens in nature, the adaptive responses to the external environment volatility are necessary. In this respect, the organizations' strategies must be flexible and organizations themselves responsive to positive feedback for "creating their own futures" (Hamel and Prahalad, 1994) to be able to amplify the direction of small change in order to reinforce themselves, because the "positive feedback denotes a self-reinforcing process" (Sterman, 2000). The positive feedback is associated with weak signals from the external environment that usually are ignored by managers when making strategies, because they lack to explore outside the known areas, but "the need for new conceptualization and design" (Esposti, 2012) is required in the strategies.

On this basis we conducted a regional survey on how the organization's strategy was designed and a fair general evaluation of the formally designed and carried out strategies success from the manager's point of view. The top managers from 36 companies in Brasov County (Romania) were questioned in March 2013 to find their opinions. The "portfolio of strategic option" model (Williamson, 1999) inspired the questionnaire, emphasising the use of the positive feedback in the strategy design. Three questions with 19 answers were developed for the identification of the general trend. The statistical data processing results have been interpreted in the light of the hypotheses presumed: the managers usually do not give importance to weak signals from the environment when designing a strategy and the managers are relying on the organization's strategy design mainly in terms of the market demands.

The results obtained show the following issues. When designing strategies managers are mainly focused on customers' preferences, competitors' behaviour and developing organization's capabilities to gain or keep the competitive advantages (over 65%). An important direction in strategy's projection is to analyse and select strategic options (56%). Less importance is given to developing internal processes and strategic resources, combining planning with the opportunities and looking to the future (34-45%). The managers do not pay much attention to suppliers' knowledge or to knowledge collected from other industries (15-25%). However, the managers mostly did not use the weak signals from external environment (only 5%), but they focused on the market demands. Nevertheless 89% of the

managers recognized that most of their strategies failed in success. The answers showed that the main causes of the strategy failure were: the competitors' success (83%), the lack of financing (78%), the customers' satisfaction unconsidered (45%) and others. The hypotheses considered have been confirmed.

The findings lead to the conclusion that the positive feedback is not really recognized when strategy is designed. The weak signals from environment act as positive feedback for the organization that becomes capable to reinforce itself by a flexible attitude, structure and culture in long-term strategy. The approach of the positive feedback does not neglect the negative feedback in the strategy projection, because the organizations usually need constant adjustments to return to their "far from the environment pressures and risks" position, gaining stability in short-term strategy to efficient control and stability. But, considering the long term strategy, the managers ought to find the balance among positive and negative feedback, 'far from equilibrium' (Peters, 1996). This approach of the strategy design using the positive feedback and based on reality is new and could be applied in the management practice.

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## **BIO-ECONOMY AND BIOECONOMICS. WHAT HAS SOCIAL MARKETING TO DO WITH?**

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### **ABSTRACT:**

The paper aims to raise awareness on two concepts related with the economic development. A new concept (bio-economy) and an older one (bioeconomics) can cohabitate together and provide deeper insight on the global social challenges that people must face it. A dramatic change of human behavioural is needed in order to achieve the ambitious goal of smart and green growth. Social marketing arises as a practical solution to generate awareness and to educate people and to persuade people to accept the change.

*Keywords:* bio-economy, human behavior, bioeconomics, sustainability, smart and green growth, social marketing

### **BIO-ECONOMY – A VIABLE ALTERNATIVE TO RESTART THE ECONOMIC GROWTH**

In order to overcome the current crisis and his long term effects, Europe needs to radically change its approach to production, consumption, processing, storage, recycling and disposal of biological resources. Europe 2020 Strategy calls for a bio-economy as a key element for smart and green growth in Europe. The bio-economy concept refers to the unique opportunity to address inter-connected societal challenges while achieving sustainable economic growth.

This strategic orientation requires a consistent change of mentality and social behavior. Reshaping behavioural patterns is not an easy task to achieve; it requires outstanding strategies, good methods and a strong motivation coming from policy-makers. In this context, Social Marketing tends to be seen as a viable solution, offering a wide range of methods and techniques meant to influence social behaviours.

A strategy to address the Bio-economy was launched in February 2012 at EU level and the accompanying Action Plan was designed to pave the way to a more innovative, resource efficient and competitive society that reconciles food security with the sustainable use of

renewable resources. The Bio-economy Strategy aims to improve the knowledge base and foster innovation to achieve productivity increases while ensuring sustainable resource use and alleviating stress on the environment.

In general, strategies are designed to give a clear and well established orientation and the action plans are meant to implement these strategies using a mix of resources, in an efficient way.

But, if we neglect the human nature or human behaviour patterns, the most perfect strategy will still fail just because people involved need to understand the change and to accepted it, they must contribute collectively to make it happens. Thus an adequate communication and powerful and persuasive message are required. Using social marketing approach a consistent and persuasive message will emerge and effects will be identified in behavioural changes.

Well-informed interaction is needed between EU research and innovation and the priorities of bio-economy supporting policies (EU documents). A responsible bio-economy calls for participatory models that engage citizens and end-users in order to redesign the relationship between science, society and policy making. More informed dialogues will allow science and innovation to provide a sound basis for policy making and informed societal choices, while taking into account legitimate societal concerns and needs in the bio-economy.

## **LOOKING BACK – THE PAST TURNS TO BE CURRENT REALITY. TWO CONCEPTS –TWO PERSPECTIVES, SAME ISSUE- SUSTAINABILITY**

*Definition (1) Bioeconomics is a progressive branch of social science that seeks to integrate the disciplines of economics and biology for the sole purpose of creating theories that do a better job of explaining economic events using a biological basis and vice versa.*

*Definition(2) Bio-economy is an economy that is based on ecological sensitive products and services produced by the use of biotechnology and renewable energy sources.*

The two concepts were selected to bring into attention semantic similarities and conceptual differences, for the unique purpose to suggest further research on how the bioeconomics theory can be used to study the evolution of the bio-economy and his specific trends. The Bio-economy concept was explained above from the perspective of EU policy, being recently introduced as a strategic option for green and smart growth.

At least one question arises: is this objective achievable? A deeper insight is required and a new innovative approach in research, also.

The concept of bioeconomics, introduced by Nicholas Georgescu-Roegen, rests on two pillars: the exo-somatic nature of human evolution and the fundamental importance of qualitative and irreversible, truly novel changes in the economic process (Mayumi, 2001). Georgescu-Roegen's bioeconomics is a new style of scientific thought: it is not a new branch of economics, but a new discipline that combines elements of evolutionary biology, institutional economics and bio physical analysis associated with energy and mineral resources (Mayumi, 2001; Miernyk, 1999).

What is really interesting is the fact that recent concerns about "sustainability" bring into attention the theory of economic development, institutional change and biophysical constraints developed by the Romanian-born economist. Georgescu-Roegen's bioeconomics emphasizes the biological origin of the economic process and all the human problems associated with, especially the scarcity of resources unequal locally or regionally distributed. He insisted that the human-mode of existence neither by biology nor by economics alone. Contemporary with Milton Friedman and being significantly influenced by Schumpeter's work, Georgescu-Roegen turns to be an inspiring source of wisdom for young economists from all over the world, but not from his homeland, Romania. Georgescu Roegen 's bioeconomics rises new challenges for researchers, especially today when the policy-makers discourses are oriented to promote the strategic objective of smart and green growth.

It is true that economic growth and advancement of science and technology through exosomatic evolution resulted in the increased material comfort typically attained by the Western World. According to Georgescu-Roegen (e.g., 1977a, 1986), the exosomatic evolution brought about three formidable predicaments to human beings: the exhaustion of fossil fuels, social conflicts, inequalities among different exosomatic "species". Today, we are "enjoying" all of them.

It is up to humankind to reflect upon, stop and restart all activities, to generate real and sustainable behavioural changes. People are need to be educated to appreciate the energy production efforts by reducing the waste, to direct their creativity into innovation, especially social innovation that make them able to cope with the pressure of social issues, as population ageing.

## **INSTEAD OF CONCLUSIONS**

Social marketing - these two words 'Social' and 'Marketing' can appear to be antagonistic. 'Social' programmes, politics and movements are about making the world a better place; whilst commercial sector 'Marketing' is the process of developing value and wealth for people who already possess resources and capital. The potential clash of basic philosophy is

clear and raises the fundamental question: 'is it possible to apply any form of 'Marketing' thinking when attempting to tackle 'Social' issues? The answer is definitely YES (French, 2011).

In 1971, Kotler and Zaltman published, *Social Marketing: an approach to planned social change*. This paper marked the first time the phrase 'Social Marketing' was used in an academic journal, but in reality social marketing approaches were being applied from the 1960s.

Social marketing is the use of marketing principles and techniques to influence a target audience to voluntarily accept, reject, modify or abandon behaviour for the benefit of individuals, groups, or society as a whole (Kotler, Roberto & Lee, 2002).

A better communication in making bio-economy "visible" at society level can be sustain through social marketing tools and equally promoting new paths in social sciences research (as bioeconomics) means to make scientists aware of.

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## EXAMINING THE ROLE OF TRUST IN USER PERCEPTIONS OF QUALITY AND SATISFACTION IN THE PUBLIC SECTOR: EMPIRICAL EVIDENCE FROM THE HEALTH SECTOR

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### ABSTRACT

In the last decades, public sector organizations have been on the forefront to deliver more efficient and citizen oriented services. This applies particularly to health care services in which more informed and demanding users increasingly require better quality and customized services. To face these challenges, healthcare services need to go beyond the scope of past reforms managerial changes by involving users in a more visible and effective way. Recent developments in Services Marketing reflected in the emergence of the co-creation paradigm (Prahalad and Ramaswamy, 2004; Vargo and Lusch, 2004) is particularly relevant to address such goals. Thus, in accordance with this new approach, the user is recognized as an active participant in the services provision. This contributes to more fully integrate the user in the service delivery process while reinforces trust and confidence on the healthcare providers. From an academic perspective, researchers have been focused on the potential value of trust as a way of assessing the health system performance (Gilson, 2003; Zhang *et al.*, 2006; Devadasan *et al.*, 2010). Additionally, several authors acknowledged that trust in the healthcare provider increases health prevention since patients are likely to respond more proactively by adhering to the therapies proposed by doctors (Thom *et al.*, 2004).

Considering the above, the purpose of this study is to examine the role of trust in user perceptions of quality and satisfaction in relation to two key healthcare professional groups as that of doctors and nurses. Specifically, this study aims at analyzing the predicting impact of SERVQUAL dimensions (tangibility, reliability, empathy, assurance and responsiveness) on both satisfaction and trust. The study adopts a predominately quantitative methodological design, in which a survey was applied to outpatients of healthcare services in the North of Portugal.

In light of the above considerations, the major contribution stemming from this research is to

conceive an integrative model that simultaneously incorporates the various interactions of trust (public, institutional, interpersonal), service quality and satisfaction. The current study contributes both theoretically and empirically to the body of knowledge surrounding the assessment of user satisfaction in the public health care context.

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## CHILDREN'S CONSUMER SOCIALIZATION: THE ROLE OF MARKETING

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### ABSTRACT

Consumption society, as it is experienced today, has a very significant impact in people, and its influence starts very early. From their earliest stages in life, children are influenced by the advertising they are exposed to, the consumption experiences they are subject to and the paths they take when they go shopping with their parents. This influence fosters in children the development of a vast range of brands and products. It is in this context that companies started developing marketing for children, not only due to consumptions they can make, but also the influence they can have in the family setting. Sales strategies for children are all the more powerful as brands were built in a manner that makes it simple to interpret, process and store the information they receive. This consumption learning in children has been analyzed in a wide variety of studies to try and understand how consumer socialization is done. It is the goal of the present research to understand how children organize their representation of brands. To this end, a two-part inquiry was conducted, one of quantitative nature qualified with a questionnaire, where children were characterized and their media behaviours (TV and internet) were identified by means of an open question asking them to indicate the brands they know. Six hundred and two children from 8 to 12 years old were surveyed. The other part was qualitative, involving two focus groups with parents regarding their children's consumption habits. Nineteen parents participated in these focus groups, from a middle-class area and from a working class area. The main conclusions show that the representation universe of these children is extremely vast, that they spend many hours during the week and on weekends watching television and surfing the web, with higher incidence on the male than the female gender, who apparently engage in more entertainment activities. As regards consumption representation, data were processed aggregating brands by product categories using a specific software programme, involving lexicographic analysis, which highlighted a mental representation anchored on two centres: one connected with food, which aggregates a wide range of product categories in a star; the other centre is connected with clothes and is cognitively more complex, forming stars and circles. The

gender analysis showed that girls have a clearer cognitive representation, centred on two large stars, one focused on food and the other on clothes; by contrast, boys place clothes in a much more scattered manner. This may be in accordance with the gender stereotype that girls are more concerned with what they wear than boys, while the latter are more concerned with sports and the social element. This cognitive structure is consolidated with age and education. Parents confirmed this report, expressing their opinion that advertising has a huge influence on their children, that they frequently take them shopping, and that the brand repertoire, especially regarding food, greatly influences the diet they are subject to.

## THE INNOVATION BASED ON DYNAMIC CAPABILITIES

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### ABSTRACT

The talent development has become the basis for the competitiveness, innovation and continuous. The companies, increasingly, demand that executives provide greater value to organizational results, using continuous training as a means to stimulate the development of new capabilities. Among the topics that are required today, to develop the talent in the enterprise are those that stimulate the development of soft skills, and those who generate additional element of differentiation or promote organic growth of enterprises. Thus, the training of executives on the topic of innovation has begun to awaken an interest in business, since it allows generating a synergistic effect based on a set of dynamic organizational capabilities.

This study, based in a research business executives about the challenge that must be assumed to innovation and how to address their development and implementation within companies, it was identified that support the innovation dynamic capabilities and how they contribute to a synergistic effect. It is part of the thesis that the development of soft skills is not dependent on a single component, but its attainment is achieved as a result of the interaction of a set of capabilities that dynamically interact. The results allow us to show that the innovations processes could be developed dynamically into the enterprise.

**Keywords:** talent, dynamic capabilities, knowledge, innovation, strategy growth, learning process, competitiveness.

## ORGANIZATIONAL CHANGE AND INTERCULTURAL MANAGEMENT INTO THE MERGER AND ACQUISITIONS PROCESSES

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### ABSTRACT

The purpose of this paper is to develop a management perspective on the influence of the organizational change (OC) and intercultural management (IM) in the processes of mergers and acquisitions (M&A), as a growth strategy. The companies, for achieve the international expansion, implement growth strategies based in mergers and acquisitions processes.

The need for business expansion based on inorganic growth strategies has increased dramatically in recent decades. However, empirical evidence shows that many of these processes end in failure by not taking into account the proper integration of the businesses. The failure rates are estimated between 45% and 82% of the mergers and acquisitions in the last forty years. Other indicators of levels of failure mention that 7 out of 10 mergers fail to deliver on the promises of the merger process. The main factors influencing the failure of growth strategies correspond, on one hand, to issues related to intercultural management, stability, order and control, and, on the other hand, to the capacity for integration, collaboration and exchange, which is generated by the growth process itself. These aspects are often ignored in the attempt to attain prompt profitability of the merger or acquisition.

It is common practice for companies to reach international expansion based on M&A strategies, where mergers and acquisitions take on a greater significance. However, the results of these processes have not been successful. This review reflects that M&A processes are influenced by elements linked to the intercultural management, organizational change and cultural. It delves into the issue of the organizational change variable describing the possible scenarios where M&A processes may have a better performance and how the intercultural management will influence in the whole process. We propose a model that connects the cross cultural management, the organizational change and the corporate culture to create a situation of positive synergy that ensures the generation of value promised to shareholders in M&A projects.

**Keywords:** Merger and acquisitions, strategy growth, intercultural management, organizational change, corporate culture and learning process.

## EFFICIENCY AND PROFITABILITY: AN APPLICATION OF DEA TO GREEK SMES

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### ABSTRACT

SMEs play a significant role in all economies and are the key generators of employment and income, and drivers of innovation and growth (OECD, 2009). A firm with less than 100 employees is considered as SME in Greece (Voulgaris et al., 2000). SMEs are very important in the Greek manufacturing sector (Voulgaris et al., 2004), while most of them are family businesses. They originate from a variety of different industrial sectors such as food and beverages, textile, machinery etc. Several attempts have been made on the performance of the Greek SMEs. First, Thomadakis and Droucopoulos (1996) examine the growth of Greek SMEs over the period 1983-1990 (i.e. after Greece became a full member of EC) and report a slow growth. Spanos et al. (2001) use data from 500 Greek SMEs and large firms (collected in May 1999) and show that firms place emphasis on offering high quality products/services and on lowering costs. Voulgaris et al. (2003) show that factors that influence significantly manufacturing SMEs' growth in Greece are profitability, liquidity, reliance on long-term debt, employee productivity, fixed assets turnover and restricted sales credit terms. Caloghirou et al. (2004) show that financial and marketing competencies are key factors significantly affecting the performance of Greek manufacturing SMEs. Further, Agiomirgianakis et al. (2006) examine financial factors affecting profitability of Greek manufacturing firms over the period 1995-1999, and show that firm size, age, exports, sales growth, reliance on debt on fixed assets and investment growth, as well as efficient management of assets, influence profitability. Finally, Halkos and Tzeremes (2010) show that the levels of foreign ownership have a positive effect on SMEs' performance in Greece.

Due to the fact that most European SMEs are the first victims of the 2008 financial crisis (OECD, 2009), we focus on the Greek case to see if Greek SMEs have the possibility to increase the level of their profitability. In this paper we extend previous studies on the performance of Greek SMEs by examining their efficiency and profitability. This study contributes to the existing literature in two ways: (1) this is the first study that uses data from

all Greek manufacturing SMEs and covers the period before and after the 2008 financial crisis, and (2) this is the first empirical investigation of DEA approach on the effect of efficiency on profitability. In particular, we consider a large amount of recent data (source: ICAP), and apply several DEA methods (under different inputs and outputs) to see the importance of these factors in estimating efficiency and profitability of SMEs.

We use efficiency scores as indicators of firm performance (Mok et al., 2007). The efficiency estimates in our study are obtained using the DEA, which is originated by Charnes et al. (1978). We then examine the relationship between DEA efficiency scores and profitability (ROA, ROE) by regressing the profitability level on the efficiency scores using an OLS model. We further examine to what extent the profits of Greek SMEs are influenced by internal factors (firms' characteristics) using a one-system GMM specification. We adopt a dynamic profit specification and test whether the profitability of SMEs persists over time.

Our results show that there is a positive relationship between efficiency and profitability for most firms/sectors. The results (along with policy implications) reported in this study are highly recommended to financial managers of Greek SMEs.

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## **TOURIST DESTINATION IMAGE: A STUDY ON LISBON'S DESTINATION IMAGE**

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### **INTRODUCTION**

The authors studied and analyzed the tourist destination image of Lisbon. The literature review demonstrates the considerable importance of tourism to national economies. Also, knowing the tourist destination image structure of a specific location can have a significant impact in its tourism strategy and marketing, by analyzing what are the factors that influence tourists and the composition of the image itself.

This study was based on the tourist destination image model (Baloglu and McCleary, 1999) that divides destination image in three components: cognitive image (destination physical and tangible characteristics); affective image (emotional perception of the destination) and overall image. The model presents two key points: overall image depends from cognitive image and affective image, and cognitive image influences the affective image; demographic variables, psychological variables and previous experience influence overall image, by influencing cognitive image or affective image. The study measured and analyzed the three components as well as the motivations to visit Lisbon.

### **METHODOLOGY**

First, the authors interviewed five professionals in the tourism area using a semi-structured type of interview. The information gathered was used in the development of a survey. Then, the authors performed a quantitative research based on an online survey with twenty one questions. There were two hundred and ninety six people responses and one hundred were valid. All respondents fulfilled the requirement of having visited Lisbon at least once. The survey included questions about the respondents' demographic profile and traveler's profile (e.g., number of visits to Lisbon and number of trips per year). Cognitive image was measured by the classification of twenty one items that included physical and environmental characteristics, in a scale of one to seven. Affective image was measured by the answers to four bipolar scales. Motivations to visit Lisbon were measured by the rating of fifteen sentences, describing different motivations, in a scale of one to seven.

The authors performed a statistical analysis with SPSS to measure the relationship between the various components under analysis, as theorized in Baloglu and McCleary (1999) model. The authors also performed an importance-performance analysis to cognitive image, in order to achieve a better understanding of the current image perceived by tourists.

## RESULTS ANALYSIS

According to the survey results, Lisbon's cognitive image is very positive. Most attributes that were considered by the respondents as important to a destination cognitive image were rated high (above 4) in the performance scale applied to Lisbon. Even though the sample did not include prospective new tourists, these results can help the development of future marketing strategies for Lisbon's image as a tourist destination, as they identify areas of improvement and key perceived attributes. Cognitive image was also tested in terms of its relationship with demographic factors (e.g., age and educational level). The results showed no significant relationship between them, confirming the results of previous studies.

Affective image proved to be very positive, according to the survey's results. The authors tested the relationship between affective and tourists' motivations. The results showed a weak relationship between affective image and motivations, which indicate that affective image has other determinants. However, it is still important to know which motivations are rated the highest in order to understand what tourists expect when they visit Lisbon because this information can help to develop a more appropriate tourism offer that will lead to higher levels of satisfaction. Also, knowing a specific target's motivations to travel can help to develop more targeted and efficient promotion campaigns. The three most important motivations items were those related with Relaxation, Excitement and Knowledge, pointing to the fact that Lisbon promotional campaigns could use this knowledge to better focus its targets.

Finally, overall image relationship with cognitive and affective image was tested using an ordinal regression. The results showed that overall image is composed and influenced by the perceptions on cognitive and affective image and, moreover, that it is greater than the sum of these two images. From the study results on the impact of variables on Lisbon's overall image as a tourist destination, its affective image impact on the perception of overall image was higher than its cognitive image's impact. Affective image was the variable with the highest parameter estimate (with a value of 1.444), which means that when affective image increases

by 1, overall image increases 1.444, if all other variables remain constant. Furthermore, cognitive image influenced directly the overall image and also the affective image.

In sum, both affective and cognitive image should be well managed in order to improve the overall image of Lisbon as a tourist destination.

Survey results also showed that there is a clear and positive relationship between overall image of Lisbon and likeliness to recommend it as a tourism destination to others and likeliness to revisit Lisbon within a three years period.

## CONCLUSION

This study applied a theoretical model to research how the tourist image of Lisbon is structured and presented results on the assessment of the current cognitive and affective images of Lisbon.

The authors proved that there is some kind of structure in Lisbon's image as a tourist destination and that overall image is larger than the sum of cognitive and affective perceptions. Managing these perceptions will help to create a positive experience for visiting tourists that will generate a high positive word-of-mouth effect and also increase the probability of the tourists' return to Lisbon. To know the structure, what influences it and what is the current position of Lisbon's image can provide guidelines for the future strategy and marketing of Lisbon as a tourist destination.

Further research can be developed in the future including an analysis with more variables or similar analysis with a larger sample.

Also, the application of research models and studies' outputs to the standard satisfaction surveys can help understanding and managing tourism destinations.

This study is pioneer in integrating a theoretical model with an empirical research study applied to the city of Lisbon, which is a very important tourist destination for Portugal with a strong impact in its economy. Future works based on this current study may provide relevant inputs to the Portuguese tourism sector and its economy.

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## WHEN WEST MEETS EAST: COMPARING THE USE OF HIGH PERFORMANCE WORK SYSTEMS BETWEEN IRISH AND CHINESE PROFESSIONAL SERVICE FIRMS

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### ABSTRACT

### BACKGROUND

Facing fast changing environments especially the economic crisis, organisations have experienced significant pressures in recent years to deliver effectiveness linked to employee resourcing, pay and performance. In light of these pressures, organisations require staff to be engaged in their jobs and deliver high performance. High performance work systems (HPWS) are regularly used as a label for strategic human resource management (SHRM) (Combs et al., 2006; Datta et al., 2005; Evans and Davis, 2005; Guthrie et al., 2009; Way, 2002). As described by Datta et al. (2005), HPWS are “a system of HR practices designed to enhance employees’ skills, commitment, and productivity in such a way that employees become a source of sustainable competitive advantage” (p. 136). HPWS involve the use of selective staffing, extensive training and development, performance management, incentives, and information sharing (Fu et al., 2013; Gittell et al., 2010; Takeuchi et al., 2007).

HPWS have been found to be positively associated with organisational performance such as financial outcomes (Guthrie, 2001; Huselid, 1995), turnover (Richard and Johnson, 2001), productivity (Guthrie, 2001), efficiency and flexibility (Evans and Davis, 2005), and employee commitment (Youndt et al., 1996). Most of research on HPWS has been conducted and tested in Western countries in Europe (e.g. Guthrie et al., 2009) and South America (e.g.

Huselid, 1995). In light of the fact that China, India, Japan and the rest of the East are playing a greater and stronger role on the world stage, management research in Eastern countries is gaining increased attention. However, to date, management research in Eastern countries is still scarce. Some exceptions include studies by Takeuchi et al. (2007), Sun et al. (2007) and Gong, Law, Chang and Xin (2009). Nevertheless, these studies on HPWS studied Eastern countries solely; they did not provide a comparison between the West and the East, which is the purpose of our study. In the present paper, we compare the use of HPWS in one Western country – Ireland to the use of HPWS in one eastern country – China.

In addition, the present study addresses another research gap found in the existing research, that is, the lack of attention on the HPWS in professional service firms. Human resource is the most valuable resource in PSFs as they embed the knowledge used for meeting clients' need (Løwendahl, 2000). Therefore, PSFs are an important context for exploring the use and examining the effects of HPWS.

## **OUR WORK**

To fill in the above research gaps on the comparison of HPWS in Eastern and Western countries as well as the systematic study of HPWS in PSFs, this paper presents the results based on a survey from 120 Irish and 112 Chinese accounting firms on using HPWS. Due to cultural differences, we anticipated the use of specific HPWS practices to differ for Irish versus Chinese accounting firms. In addition, in both contexts, we expected a positive link between HPWS and firm performance. The results from multivariate analysis of covariance (MANCOVA) indicate that there is no significant difference between overall HPWS index but that there are significant differences for staffing, performance management, remuneration and training. The results from the hierarchical regression analysis confirmed the positive relationships between the HPWS and organisational performance in both Irish and Chinese PSFs.

## **SCHOLARLY IMPLICATIONS**

Theoretically, this study helps fill in two research gaps identified in the existing research on HPWS. First, our study helps to advance the HPWS research by a cross-cultural examination of the use of HPWS and their effect on firm performance between West and East. In this study, we compared the differences and similarities between one Western country – Ireland and one Eastern country – China on the use of HPWS. Therefore, our work

contributes to the existing HPWS research by linking West and East. It also helps the researchers and practitioners to better understand the uses of HPWS across West and East.

Second, this paper extends the HPWS research context by exploring the use of HPWS in a professional service context. HPWS research has been largely focusing on manufacturing firms. The context of professional service firms has been neglected except for two recent studies by Fu et al. (2013) and McClean and Collins (2011). As human resource is the most valuable resource in PSFs, PSFs are an important context for exploring HPWS. On the other hand, the existing studies on PSFs are limited in their systematic investigation of HRM impact. Until recently, Fu et al. (2013) explored the impact of HPWS on professional service supply chains in PSFs. Our study contributes to filling in these gaps by exploring the impact of HPWS on firm performance in both Irish and Chinese PSFs.

The comparison on the use of HPWS between Western and Eastern countries provides a clear picture on how HPWS are operated differently in both contexts. Interestingly, we found that Chinese PSFs are investing more in selection and remuneration and less in training and performance management. This finding can be explained in light of the existence of high collectivism in the Chinese culture. Chinese people place a great emphasis on groups and focus on relationships, links and networks. Therefore, in operating HPWS in a highly collective culture, Chinese firms tend to emphasize loyalty to the firm more than performance. In contrast, Ireland is a culture with strong focus on high individualism and therefore tends to have more transactional and exchange-based management. In operating HPWS in a highly individualistic culture, Irish firms place emphasis on hiring and promotion decisions based on merit or evidence of what one has done or can do.

## **MANAGERIAL IMPLICATIONS**

Through the comparison on the use of HPWS between Irish and Chinese professional service firms, we address an important issue faced by current managers. During the economic crisis, every firm starts to look out for survival and higher performance. Both the reality and practice requires the quick link between West and East, i.e. knowing each other. As said in an old Chinese words, “know the enemy and know yourself, and you can fight a hundred Battles without defeat” (Zhi Ji Zhi Bi, Bai Zhan Bu Dai). Some differences in the use of HPWS between the West and East have been identified in this study. It will help Western practitioners to understand more about Eastern management, e.g. Chinese culture does not embrace hard performance management. It also helps Eastern practitioners to learn more

about Western management, e.g. Western culture focuses more on precise management – evidence-based management.

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**Keywords:** High performance work systems, Professional service firms, Cross-culture

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# CANONICAL CORRELATION ANALYSIS AS A CONFIRMATORY METHOD OF PRINCIPAL COMPONENTS ANALYSIS. APPLICATION TO FINANCIAL INFORMATION

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## ABSTRACT

The aims of this paper are, firstly, to prove the usefulness of Principal Components Analysis (PCA) in reducing financial information expressed as ratios, and, secondly, to justify the achieved results in terms of variable selection, by the application of Canonical Correlation Analysis (CCA). In the empirical analysis where both methods are applied, it is shown that they are complementary and it can be concluded that the correlated variables to the extracted factors in PCA are also important variables in defining the canonical variates in CCA.

**Keywords:** Principal components analysis, canonical correlation analysis, financial information, ratios

## INTRODUCTION

Advances in the information and communications technologies over the last decades have fostered the generation of huge amounts of data, whose processing involves a high cost in terms of timing and resources. In order to simplify and make the decision-making process easier data reduction statistical methods are needed and one of the most employed methods is Principal Components Analysis (PCA) when dealing with quantitative data, such as accounting information expressed as financial ratios. It allows us to reduce the number of variables to a smaller group of factors which explain a high percentage of the original variance, with the advantage of removing the redundant information (García-Ayuso, 1996). Besides, it helps to solve the problem of multicollinearity among variables, since factors are uncorrelated (Lizarraga, 2002).

In order to show the possibilities of PCA in the field of financial analysis, we will focus on the study of business insolvency or failure, which is explained by a set of financial selected on the

basis of their use and popularity in business failure prediction models (Wu, 2010). Our aim is to determine those ratios which best explain that event, as they are selected by PCA. Complementarily, a Canonical Correlation Analysis (CCA) is applied in order to study the relationship between the group of selected ratios by PCA and the group of removed ratios, which confirms the results of the former.

### **VARIABLE SELECTION: PRINCIPAL COMPONENTS ANALYSIS (PCA)**

In order to consider those ratios which measure the key dimensions of a firm, they were selected so they belonged to the following six groups: liquidity, profitability, leverage and solvency, turnover and activity, cash-flow and economic structure. An initial list of 27 ratios was chosen, on which PCA was applied, resulting that the first six extracted factors explained 58.08% of variance of the original variables.

So as to increase this percentage, those ratios that did not correlate to any of the extracted factors or did contain redundant information were deleted in successive steps. Finally, six factors were extracted, which explained 85.02% of the original variance and were correlated to 15 ratios. According to the correlation between factors and ratios, they can be described as:

- Liquidity: correlated to the ratios of current assets and cash on current liabilities, as well as the acid test, together with the firms' ability to pay current debts with their resources, both internal (cash-flow) and external (equity).
- Liability structure: correlated to the proportions of internal and external resources and current liabilities on total assets.
- Economic profitability: correlated to ROA and assets turnover, which are the two components of profit margin.
- Turnover: correlated to two ratios on sales (financial expenses and working capital).
- Current position: correlated to the ratio of current assets and working capital on total assets.
- Cash-flow, measured on total debt and current liabilities.

### **RESULTS FROM CANONICAL CORRELATION ANALYSIS (CCA)**

CCA was applied in order to confirm PCA results, since its objective is to analyse the relationship between two sets of variables: in this case, the group of 15 ratios selected by PCA and the group of 12 ratios removed from the analysis.

Twelve canonical variates, which are linear combinations of variables in each set that have the maximum correlation, were obtained, although only five of them were significant. The redundancy index, proposed by Stewart and Love (1968), measures the proportion of variance in each set that is explained by the other set. Specifically, the group of selected ratios explained 47% of the variance in the other set, which means those ratios contained some of the information expressed by the removed ratios. This served to justify their removal from the analysis and, therefore, the results from PCA.

Regarding the definition of the canonical variates, these are the results for the five significant ones:

- The first two canonical variates are defined by the proportion of fixed assets and total liabilities on total assets in the set of removed ratios and by the proportion of current assets, equity and current liabilities on total assets in the group of selected ratios, adding the ratio of working capital on total assets in this group in the second one.
- The proportion of equity on total assets in the first set and the ratios of fixed assets and total liabilities on total assets in the second one define the third canonical variate.
- The fourth one is defined by the ratios of working capital on sales and current assets on operating income in each set respectively.
- In the fifth variate, the ratios of cash on current liabilities and working capital on total assets are significant in the group of selected ratios, whereas in the other set, the ratio that defines the variate is the proportion of cash on total assets.

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## **WINESUCCESS® FRAMEWORK: AN EMPIRICAL ASSESSEMENT IN THE FAMILY WINERIES OF CYPRUS**

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### **ABSTRACT**

Honestly, how simple or complex is for a family-owned winery to introduce a succession? What if there are no competent successors apparent? What if, although there are talented successors, they are not interested in exercising entrepreneurship in this challenging and particular business sector? What if competent successors have other work obligations “behind the scenes” and are not “allowed” being innovative agents of change? Instead, such successors simply pursue the steps of a dominant incumbent! And what if incumbents tend to face succession as a simple and static event “whose timing is never right”. And then, how vulnerable is a sudden death of the existing leader, leaving the business to face difficulties and rivalry from competitors? These and many other complex dilemmas remain unanswered and risk the development prospects of the Cyprus wine sector as well as the versatile role of rural areas planted with vineyards for the national competitiveness in general. For all the above reasons, this research work proposes a firm and inclusive theory. This is the WineSuccess Framework (WSF) which if adequately applied and managed, provides a solid and fundamental strategy for succession effectiveness in the medium-long run.

### **DESIGN/METHODOLOGY/APPROACH**

The research philosophy has been driven from a vision! This is the best benefit of the family wineries, wine, and rural sector development in Cyprus. The backbone of the WSF (Georgiou, 2013) is previous research works that has been achieved over the last thirty years, which provided conceptual and empirical insight into the nature and various aspects of effective succession. Hence, using a deductive approach and throughout the process of literature review (Georgiou, 2010), a certain number of factors and variables surfaced and thus are believed to foster succession effectiveness. The fruit of this generic theory that has been proliferated from reflective and reasonable associations among the reviewed studies is a Preliminary Conceptual Framework towards Succession Effectiveness, with broad

exploitation and value (Georgiou *et al.*, 2011; Georgiou and Vrontis, 2012; 2013). That draws a lot from Le Breton-Miller's *et al.* (2004) succession model. Nevertheless, the "wine factor" is missing from that preliminary theory, which is far from related specialization. Virtually, the concluding WSF which is proposed on the basis of post-positivism (Popper, 1992) and action research paradigms (Lewin, 1988; Kemmis, 1985), proposes a new concept that originally, substantially and specially contribute towards succession effectiveness in family wineries (Georgiou, 2013).

## **FINDINGS**

The WSF is presently pointing out the merging and synthesizing endeavor of various findings and theorizes on certain elements which are commonly named as succession "process" and "context" factors. These are in brief outlined as follows: a. incumbent characteristics and qualities, b. incumbent tenure, c. successor skills and attributes, d. successor training and development, e. successor origin, f. incumbent-successor expectations, g. succession ground rules, h. family dynamics, i. board of directors, j. organizational performance, k. organizational size, l. organizational age, m. transfer of capital, and n. succession monitoring and reflective feedback. Via empirical and action based research in the family wineries of Cyprus, central and statistically significant elements of the WSF are the "expectations" of the incumbent and his or her successor(s) prior to the working together period, as well as the so called "winery specific ground rules" (Georgiou, 2013). Such vital empirical factors positively provide for particular specialization and professionalization of succession as much as possible, and safeguard family tradition as much as necessary (Poutziouris, 2001). Last but not least, the "institutional role" of national authorities is either underpinned to have a principal importance for the context of succession (Georgiou, 2013).

## **ORIGINALITY/VALUE/MANAGERIAL IMPLICATIONS/LIMITATIONS**

In contrast to the conceptual understanding (Georgiou, 2010; Georgiou *et al.*, 2011; Georgiou and Vrontis, 2012; Georgiou and Vrontis, 2013), family wineries of Cyprus are facing succession as a situational and static event rather than a never-ending and dynamic process, which indisputably risks not only their future development but also their existence.

In addition, none of the reviewed studies has been located in the literature to deal with the topic of succession effectiveness in the arena of family wineries in Cyprus, which is the empirical research base, implying that “unlike other countries, this is an industry that is difficult to research from inside” (Vrontis et al., 2001, p.260). It was also observable that theoretical orientation of past research has been placed on the basis of strict quantitative research approaches (Boeker and Goodstein, 1993; Dalton and Kesner, 1985; Schwartz and Menon, 1985). This is in contradiction with the socio-political roots of succession (Cannella and Lubatkin, 1993) which is anthropocentric process.

Hence, this research work which for the moment is exclusive in the topic of succession effectiveness in the family wineries of Cyprus, it offers a firm and inclusive theoretical basis, for further research development and practical application, on a more particular basis. In addition, its practical application may be true for elsewhere, especially for countries in the European-Mediterranean basin, in which family wineries are practically managed with similar to Cyprus cultural norms and value system.

**Keywords:** Succession; succession effectiveness; Cyprus; wine sector; family wineries; empirical; WineSuccess Framework (WSF)

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## THE PORTUGUESE NATIONAL HEALTH SERVICE AND THE IMPLEMENTED ACCOUNTING STANDARDS: THE PROBLEMATIC OF CONSOLIDATED FINANCIAL STATEMENTS

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### ABSTRACT

Within the context of the reforms implemented by the Portuguese Government following the philosophy of the New Public Management, this study examines the Portuguese National Health Service (NHS), specifically in what concerns the consolidation process regarding all the legislation issued. The specificities of this particular sector, which involves both entities belonging to the Public Administration Sector and to the Business-like Sector of the State, makes it a peculiar case in what concerns the consolidation accounts process.

This study adopts an interpretive perspective by applying the lenses of New Institutional Sociology [DiMaggio and Powell (1991), *The New Institutionalism in Organizational Analysis*. Chicago, IL: University of Chicago Press]. As Meyer et al. (1997, p. 152) [Meyer, J. W., Boli, J., Thomas, G. M. and Ramirez, F. O. (1997). "World Society and the Nation State", *American Journal of Sociology*, Vol. 103 No. 1, pp. 144-181] stated, nation-states exhibit a great deal of isomorphism in their structures and policies; they make efforts to live up to the model of rational actorhood, are marked by considerable decoupling between purposes and structures, intentions and results, and they undergo expansive structuration in largely standardized ways. As result nation states are modelled by exogenous world culture and are characterized by extensive internal decoupling and they encompass a higher level of structuration than what they would have if they were only influenced by local cultural, functional, or power processes (Meyer et al., 1997, p. 173). Therefore, decoupling refers to the situation in which an actual organizational practice is different from the formal organizational structure or practice, meaning that the adopted practice is not integrated into the organizations managerial and operational processes (Dillard *et al.*, 2004, p. 509) [Dillard, J. F., Rigsby, J. T. and Goodman, C. (2004), "The Making and Remaking of Organizational Context Duality and the Institutionalization Process", *Accounting, Auditing & Accountability Journal*, Vol. 17 No. 4, pp. 506-542]. The advantage of decoupling, as shown in this study, is that possible inconsistencies

and anomalies of technical activities are effectively hidden from public view and it is assumed that formal structure is really working as set or predetermined.

The study is based on a documental analysis, namely: the Official Plan of the Health Ministry (POCMS) and other legislation, applied to NHS; the 2008, 2009, 2010 and 2011 consolidated financial statements of the Portuguese NHS prepared by the controlling entity *Administração Central do Sistema de Saúde* (ACSS) [Central Administration of the Health System] (ACSS); and the reports issued by the Court of Auditors concerning the auditing of NHS. Particular attention is devoted to the role played by the ACSS, the accounting practices followed by ACSS in the consolidation process with particular emphasis in some issues, and the role played by the entities responsible for promulgating accounting standards for the public sector, in particular for the public health sector.

The study reveals that several problems emerge in the consolidation process due to the absence of legislation or guidelines concerning this issue in this sector. This problem is even more acute since it is recognized that “the consolidation principles of IPSAS [International Public Sector Accounting Standards] don’t cover practical issues of consolidation of general government financial statements with regard to specific features of government budget and financial management” [European Commission (2012), *Public consultation - Assessment of the suitability of the International Public Sector Accounting Standards for the Member States*, Luxembourg, p. 8]. This study highlights the urgency of the the promulgation of accounting standards concerning consolidation in Portuguese public sector accounting. The study contributes to the debate concerning the fact that public sector accounting systems implemented to satisfy government mandates are rarely used for internal decision-making and control and that the primary use of elaborate, mandated management accounting systems is legitimating the organizations activities to external constituencies by creating the impression that the agency is well-controlled and demonstrating that resources are being used rationally.

**Keywords:** New Public Management, New Institutional Sociology, Decoupling, Health Care System, Consolidation, IPSAS

## ORGANISATIONAL JUSTICE IN INTERNATIONAL MERGERS AND ACQUISITIONS: THE IMPACT OF PROCEDURAL AND INTERACTIONAL JUSTICE ON EMPLOYEE COMMITMENT.

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### ABSTRACT

Despite being one of the main means for international expansion, Mergers and acquisitions (M&A) performance continue to be dismal with scholars reporting very high rates of failure (Gregory and McCorrison 2005; Knapp et al. 2005; Mayer-Sommer et al. 2006; Panchal and Cartwright 2001; Papadakis 2005; Schoenberg 2006; Tuch and O'Sullivan 2007; Weber, Tarba and Reichel 2011). An important M&A research strand focusing on merger integration seems to indicate that human factors are recognised as major reasons for failure (Birkinshaw, Bresman & Håkanson, 2000; Björkman, Stahl & Vaara, 2007; Calori, Lubatkin, and Very, 1994; Cartwright & Schoenberg, 2006; Gomes, Cohen and Mellahi, 2011; Gomes, Weber, Brown and Tarba, 2011; Gomes, Angwin, Weber and Tarba, 2013; Ranft and Lord, 2002; Schweiger and DeNisi, 1991; Stahl & Javidan, 2009; Teerikangas & Very, 2006; Very, Lubatkin, Calori & Veiga, 1997; Weber & Drori, 2008; Weber and Tarba, 2010; Weber, Shenkar & Raveh, 1996; Weber, Rachman-Moore and Tarba, 2012).

However, despite the significant amount of research carried out on the human side of M&A, the psychological dimension of the phenomenon has been disregarded. Whilst there is substantial literature exploring the relationship between management practices and organisational fairness, there is considerably less that researches the topic from an international perspective (Lowe and Vodanovich, 1995, Greenberg, 1987, McFarlin and Sweeney, 1992, Greenberg, 1993), particularly with regard to cross-border acquisitions ( Ellis Reus and Lamont, 2009; Luo, 2008, Meyer, 2001; Klendauer and Deller, 2009). In this present study, we will therefore draw on organisational justice theory to address this gap in the literature. While Ellis, Reus and Lamont (2009: 138) refer to “justice as the activities initiated by an acquirer and aimed at the integration of a target in a fair manner”, in this study organisational justice refers to the extent to which employees perceive workplace procedures and interactions as being fair. Understanding fairness perceptions is important they can

influence employees attitudes and behaviour and subsequently on organisation's performance (Baldwin, 2006). Colquitt et al., (2001) identify four types of organisational justice: distributive, procedural, informational, and interpersonal. In this paper we consider three types of justices but, in line with (Klendauer and Deller, 2009; Luo, 2007), we combine interpersonal and informational justices, referring to it as interactional justice. This seems to be adequate because interactional justice refers to the feeling of being treated with respect and dignity during interactions with managers from the other partner in the alliance (Bies, 1986; Luo, 2005; Mikula et al., 1990), thus requiring good communication between the parties. This type of justice is important because it helps to create good relationships and enhance the interaction and integration of employees and managers from both merging entities (Ellis, et al., 2009). Procedural justice, is defined as the perception that governance structures used to manage the acquisition and the procedures and processes in decision-making are fair (Thibaut and Walker, 1975; Greenberg, 1987; Lind and Tyler, 1988; Luo, 2005; Ellis et al., 2009). This type of justice is important because employees want to be treated with respect and dignity (Lind and Tyler, 1988; Ellis et al., 2009).

Within this context, this study aims to investigate whether interactive and procedural justice perceptions exert an influence over positive attitudes such as employee affective and calculative commitment. Past research has mainly focused on the effect of organisational justice upon a firm's performance (Ellis Reus and Lamont, 2009), whilst the analysis of the impact of organisational justice on employees attitudes and, in particular, employees commitment. Analysing the impact on commitment in the context of a major organisational change situation such as M&A is critical because perceptions of fairness may help minimize employee turnover and facilitate the necessary change management to combine the merging entities. Thus, the dismal success record of M&A in general and the acknowledged importance of organisational justice in influencing employees' attitudes and subsequently merger performance, clearly justify the need for this research.

Several studies have made use of the organisational theory in the context of large scale change situations (Brockner, 2002; Konovsky, 2000; Korsgaard, Sapienza, and Schweiger, 2002), very few studies have investigated the link between organizational justice and M&A. The strategic alliance literature have made some inroads to explore the impact of organisational justice in the context of inter firm collaboration (see Arino and Ring, 2010; Gomes, Cohen and Mellahi, 2011; Luo, 2005, 2007, 2008, 2009). However, the existing M&A literature on the topic is still incipient and very few studies (see Edwards and Edwards, 2012;

Ellis Reus and Lamont, 2009; Klendauer and Deller, 2009; Lipponen et al., 2004; Meyer, 2001; Melkonian et al., 2011; Meyer and Altenborg, 2007; Steensma and van Milligen, 2003) have used the organisational justice theory in the context of M&A. While some authors have only focused on studying the role and effect of procedural justice on employees identification (Edwards and Edwards, 2012), responses (Lipponen et al., 2004) and on organisational power structures (Steensma and van Milligen, 2003), others have combined different types of justice. While Ellis Reus and Lamont (2009) have analysed the combined effect of procedural and informational on M&A value creation, Meyer (2001) and Meyer and Altenborg (2007) have investigated the effects of procedural and distributive justices on process allocation and social integration in M&A.

Contradictions and inconsistencies are not uncommon within the existing research on organisational justice. In studies that attempt to derive which dimension has the greatest impact upon outcomes such as commitment, trust and co-operation, academics differ in their findings. Klendauer and Deller (2009) for example believe interactional justice to be most important for its effect on the communication through the corporate hierarchy whereas other studies such as that by Folger and Konovsky (1989) have argued that aspects of outcome are greater predictors of commitment than those of procedure. Further to this argument, the variety of research is ambiguous. Studies cover various case companies and different methods of corporate partnering across both domestic and international markets. The ability to draw supporting conclusions between each study is difficult considering the complexity of each case. The correlation between commitment and each dimension of justice appears largely inconsistent. Furthermore, none of these studies considered the direct effects of procedural and interactional justice on employee affective and calculative commitment.

Therefore, this research expects to contribute to the limited existing literature that specifically links the extensive body of research on organisational justice to that of international acquisitions. The study will attempt to analyse how perceptions of fairness impact employee commitment within the acquired firm. This study is important for several reasons. We aim to extend the organisational justice theory, not only by investigating its applicability to different contexts but also by providing evidence for how the two types of organizational justice are interrelated in affecting post-acquisition employee affective and calculative commitment. Furthermore, we aim to expand the existing literature on organisational justice specific to international acquisitions by evaluating the perceptions of non-managerial employees as opposed to solely management personnel. It is hoped that this will create a deeper

understanding as to the how the perceptions of procedural and interactional justice change throughout the organisational hierarchy. Thirdly, we intend to determine how well the two dimensions of organisational justice (procedural and interactive) predict two types of commitment (affective and calculative) amongst employees and find out which dimension of organisational justice is the best predictor of commitment. Fourthly, we intend to investigate whether the two types of justice have an interactive and mutually reinforcing effect on employee commitment. To our knowledge, this is the first study in proceeding with such investigation in the context of M&A, Alliances and International Business in general.

This study uses a mixed-method approach to explore the acquisition of a small-medium sized Japanese firm by a global company, XYZ corp, exploring the perceptions of organisational justice amongst non-managerial employees within the acquired firm as well as the perceptions of fairness felt by management in both the acquired and acquiring company. XYZ corp is a leading information services company providing data and analytical tools to customers across the world. Due to their size and access to resources, the company acquire firms worldwide on a frequent basis. The reason behind each acquisition varies and the size and industry of each acquired company is dependent upon the motives behind each business venture. The unit of analysis for this study will be ABC corp, a recently acquired Japanese firm in the technology sector. The acquired organisation (ABC corp) as well as the acquirer (XYZ corp) are in the business of providing information services and offer data and analytical tools to customers. The rationale behind the acquisition was largely to extend geographic reach, a strategic move that would not only create presence in Japan but a decision that would also expand XYZ corp's principle activity of marketing services. The acquisition offered the opportunity for XYZ corp to capitalise on the digital marketing activities that ABC corp had already established as well as the client base that they had built. The individual success of ABC corp was considered to be a substantial advantage in the acquisition. The firm was already accomplished in the market with a strong client base that would enable XYZ corp's profile to be raised amongst the existing clients throughout Japan. The company's decisions to undertake acquisitions in unexplored markets are largely driven by a strategy to expand international presence worldwide.

This study followed a mixed-method approach. This approach was considered to enrich the case study design by offering a deeper understanding of the complex issues within the study. A tradition is apparent within social-science research that advocates the combination of several approaches, both quantitative and qualitative, for the view that each approach is complementary of one another (Jick, 1979). The merits of this convergent approach to

research are often explained in the concept of “triangulation” as explained by Denzin, (1978:291) who defines it as ‘the combination of methodologies in the study of the same phenomenon’. The greatest argument in support of triangulation is the ability to cross-check the results of the experiment. This method enabled the results of the questionnaire to be reviewed against the interviews conducted at a later date. This allows greater confidence in the results produced. Further to this it can be argued that multiple perspectives are required to gain a deeper understanding of a subject. This is particularly important through this study in the attempt to analyse perceptions of different organisational justice dimensions.

Firstly, a survey was distributed amongst non-managerial employees within the acquired firm and secondly, semi-structure interviews were conducted with management in both the acquired and acquiring firms. The data was collected almost two years after the acquisition was completed. There were about 400 employees working in ABC corp during the time of the study. The questionnaire was administered online through a popular survey software. The employees were invited to the survey through an e-mail sent out by the CEO of ABC corp. The invitation e-mail explained the purpose of the study and the consent given by the senior management for the study. The invitation e-mail also had a link to the online survey. The questionnaire was administered in Japanese. A total of 128 responses were received, out of a sample of 151 non-managerial employees within the firm. This produced a response rate of 85%, a rate considered very good for a self-completion questionnaire distribution (Mangione, 1995). Within the responses, there were only ten responses deemed to be unusable due to incomplete responses. In the sample of respondents, 74% were male and more than 80% having at least an undergraduate degree. The average age of the respondents was 34.3 years.

To help us better understand some of the aspects related to the two organisational justice dimensions, we undertook additional qualitative data collection. Following careful consideration of the different qualitative methods of research, semi-structured interviews were selected for their ability to offer a deep understanding of the subject matter and also their ability to uncover the internal aspects of the acquisition process (Bryman, 2008, Kvale, 1996). This technique offers a degree of flexibility in that it is not essential for researchers to follow an exact question path; interviewees may wish to go off at tangents, give examples and expand their experiences and feelings towards a topic (Bryman and Bell, 2007). Despite variations in responses, by and large all the questions were asked with similar wording and under a similar format. This enabled the researchers to analyse results and identify similarities across the sample. Semi-structured interviews were conducted with a sample of

five managers involved in the acquisition process (see Table 1). It is often difficult for researchers to provide valid reasoning behind why candidates are chosen for interview, as the rationale can be circumstantial and based on convenience motivations. This was the case in this research project. There were tight restrictions as to which members of management could be selected. These limitations were based on language skill and involvement within the acquisition.

Table 1: Summary of Personnel Interviewed in Qualitative Research

Name	Position in the company	Date of Interview
John Mayakovski Interviewee 1	XYZ corp Line of Business Manager	15 <sup>th</sup> August 2012
Lay Cheng Tan Interviewee 2	XYZ corp M&A Lead	23 <sup>rd</sup> August 2012
Eugene Hashimoto Interviewee 3	ABC corp Integration Manager	20 <sup>th</sup> August 2012
Hideki Yamashita Interviewee 4	ABC corp IT Manager	16 <sup>th</sup> August 2012
Koji Kohayashi Interviewee 5	ABC corp Development Manager	20 <sup>th</sup> August 2012

Interviews were conducted using a conference calling system and were recorded using a Dictaphone. There was no ability to conduct interviews face-to-face due to the geographic distance and the constraint of time within the study. Despite this, the technique used enabled each response to be closely recorded. This enabled accuracy when transcribing scripts. Language proved to be the largest barrier to the interview method. Consequently, it would only be those in senior management positions that would be suitable for the interview as they had the greatest linguistic skills. An interview structure was created based upon the themes of the pre-distributed survey. This technique was motivated by the desire to reflect upon perceptions of organisational fairness throughout the corporate hierarchy. Further to this, it was hoped that using questions that explored the characteristics and experience each candidate held, an opportunity would arise to see how these factors may impact each person's response to the study. No incentives were offered for participation in the study other

than an understanding the results of the study may be used to help the company with future acquisition processes.

The complete data collection took place over a five week period from July to August 2012. With consideration of delays in company approval of the study and the time constraints of the study it was initially anticipated those two weeks would be sufficient to collect the necessary results. This was based upon the support and distribution process via the company CEO. Despite achieving a good response rate it was decided that this would be extended to further increase participant numbers. In the final week of data collection, interviews were carried out. Time differences and management schedules meant that these were run at precise times and dates. The process was completed in five working days.

The paper will be structured as follows: firstly the extant literature surrounding organisational justice will be reviewed with subsequent review in relation to international management practice, specifically that of cross-border acquisitions. This will be followed by a methodology which will outline the case companies, research methods used and the data analysis techniques proposed. The findings will then be summarised and finally, conclusions will be drawn and suggestions made for further research.

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## NARCISSISM AND CREATIVITY OVER TIME: TOWARD A DYNAMIC MODEL OF GROUP CREATIVITY

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### ABSTRACT

The literature on group creativity is representative of most research on groups: Rather than incorporate a dynamic view of the creative process it has largely viewed creativity from a static point of view (Cronin, Weingart, & Todorova, 2011). Here, we focus on an example of this static approach: Research linking narcissism to group creativity (Gonçalo, Flynn & Kim, 2010). First, we review the evidence that narcissists can contribute to group creativity. We uncover three critical gaps: The research focuses narrowly on one stage of the creative process while neglecting other stages, it neglects the fact that events in one stage can impact subsequent stages, and it assumes a dynamic process that is not tested empirically. Second, we propose a new dynamic model that addresses these gaps and thus generates a series of novel and testable propositions. Finally, we suggest an empirical approach that might be useful for studying group creativity over time.

A creative idea is one that diverges from existing solutions in an appropriate or feasible way (Amabile, 1996). As the organizational environment becomes increasingly competitive, creative ideas are viewed as an important advantage because they may lead firms in a profitable new direction (Amabile, 1996). In order to meet the demand for creative solutions, organizations have employed a variety of strategies, including the formation of teams (Paulus & Yang, 2000) to promote idea generation. In her comprehensive review of the literature on creativity, George (2007) noted that most of the research on group creativity has been conducted in the laboratory with groups that have no history of interaction nor any expectation that they will interact again. This stream of laboratory research has yielded many important insights that are useful for managing short term interactions between people who meet for the first time to generate a wide range of ideas; a brainstorming process that is foundational to creativity in organizations (Paulus & Yang, 2000).

Yet, there has been wide agreement for many decades that the creative process unfolds in stages that may extend over a longer period of time (West, 2002). In other words, teams must not only generate new ideas but they must also decide which ideas to implement

and then undertake the process of bringing their favored idea to fruition (West, 2002). Moreover, merely generating a wide range of solutions does not guarantee that those ideas will be identified as creative nor that they will be implemented (Rietzschel, Nijstad & Stroebe, 2006). Indeed, many organizations claim to want creative solutions, but fail to pursue them when they have the opportunity to do so (Mueller, Gonçalo & Kamdar, 2011; Mueller, Melwani & Gonçalo, 2012).

Unfortunately, the literature on group creativity is therefore typical of most research on groups and teams: Rather than incorporate a dynamic view of the creative process over time it has largely viewed creativity as a static process (George, 2007). In this paper, we focus on a particular example of this static approach: Recent research linking narcissism to group creativity (Gonçalo, Flynn & Kim, 2010). We intend to use this concrete example to illustrate how time can be fruitfully incorporated into our models of group creativity and to highlight the potential insights that may emerge from a more dynamic perspective. First, we review the evidence that narcissists can contribute to group creativity (Gonçalo et al., 2010). Our critique uncovers three critical gaps in this research: It focuses narrowly on one stage of the creative process while neglecting other stages; it neglects the fact that events in one stage can impact subsequent stages, and it assumes a dynamic process that is not actually tested empirically. Second, we propose a dynamic model that, at least in part, addressed these gaps and in doing so generates novel propositions that can be tested in future research. Finally, we conclude by suggesting an empirical approach for studying group creativity over time.

**Key words:** Group processes; Creativity; Personality; Group Composition; Narcissism; Stage Models; Time; Innovation; Conflict; Dissent

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## CONSUMING THE CITY, SPACES OF CONSUMPTION: COMMODYING AND AESTHETICISING CARDIFF'S EVERYDAY LIFE

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### ABSTRACT

In a world where the pace of change is increasingly staggering, contemporary urban cultures and societies are characterised by unparalleled mutability, uncertainty, and social disengagement and it is in consumption that individuals now seem to find some sort of comfort and consolation and that they mould their identities and come to resemble their peers.

Contemporary cities are the privileged loci for the ubiquity and conspicuity of consumption, which has been strengthened by the soaring aestheticisation and commodification of everyday life that have prioritised the post-modern visual spectacularisation of the urban environment to attract global investment and international tourism. This present "hyperaesthesia of late modern consumer capitalism" (Howes, 2003) has found resonance in the promotion of ephemeral hedonistic prospects, new forms of leisure and entertainment, including a plethora of possibilities of consumption and festivalised urban spaces aimed at attracting more mobile and eclectic audiences whose meanderings interweave with urban dwellers' daily routines, producing peculiar rhythms in the urban fabric.

When understanding the everyday, it is essential that the different rhythms that compose it at different times are scrutinised. The everyday in contemporary cities and societies "is increasingly being made into a resource for the economy" (Lury in Bennett and Watson, 2002: 140) and this is particularly visible in the rise of consumerism, with the proliferation of spaces of consumption that now constitute everyday venues in their own right. This never-ending summoning to consumption is influenced by and introduces profound changes in the way people relate to the urban environment, to others, and ultimately to themselves, as well as in the process of endorsement of certain lifestyles and in the formation of individual and collective identities (Allen in du Gay and Pryke, 2002: 41) that are constructed and negotiated in the urban fabric and determined by people's "spatial

practices" (de Certeau, 1984) and "experience of consumption in the city" (Miles and Miles, 2004: 3).

According to Ungersma, Cardiff, the capital city of Wales, "is a textbook example" of how the growth of consumerism has had significant physical and cultural impacts on cities (2005: 157). In the late nineteenth century, Cardiff was dubbed the world's 'coaltropolis' and the coal industry was underpinned by an increasing multiethnic working-class labour force. However, as the demand for the 'black gold' declined throughout the first half of the twentieth century, the city endured an acute process of deindustrialisation in tandem with high levels of unemployment. The need to address this reality and to diversify its economic base, as well as to lever in investment and tourism, led Cardiff's policy makers to adopt a sound re-imag(in)ing rationale that aimed at positioning the Welsh capital as a leading business and tourism destination in the UK and overseas. Driven by the buzzword triad of civic boosterism, cultural regeneration, and consumption upheaval, new attractive landscapes embodied in city centre urban regeneration and waterfront revitalisation projects have bolstered the city's economic rejuvenation and have assigned new values, meanings and symbols to Cardiff's social and cultural spheres. New ways of consuming the city and its spaces have thus emerged and leisure time is now occupied with activities as diverse as cultural entertainment, the practice of sports and the attendance of sports events, or through people's engagement in conspicuous consumption in the different venues available in the city, including arcades shops, department stores, shopping centres or drinking and dining areas.

Stemming from theoretical groundwork on how consumption has transformed and been transformed in/by contemporary cities, the methodological approach adopted in this paper privileges empirical research, namely participation observation and detailed fieldwork undertaken in the city of Cardiff in the past decade. The findings of this research show how consumption has indeed come to embody the quintessential backbone in Cardiff's cultural resurgence, which emphasises the city's powerful bond between culture and the economy. Cardiff has thus been re-ima(gin)ed "as a consumption centre whose physical and social attributes have become aesthetic commodities to be sold and consumed by a number of target audiences" (Kompotis, 2006: 168). As in many other European cities, Cardiff's cultural atmosphere has experienced the outcomes of a growing capitalist commercial culture, characterised by increasingly competitive companies and corporations in the areas of drinking and dining, shopping and entertainment.

But consumption has also created intricate paradoxes. It *“divides as much as it provides”* (Miles and Miles, 2004: 2), contributing to widening the gap between the most privileged and the most disadvantaged. The latter, Bauman’s *“collateral damage”* (2011) are those who are kept socially and economically at arm’s length from contemporary consumer spaces because they lack the disposable income that would allow them to integrate into the new and coveted social and economic order. Therefore, the commodification and aestheticisation of everyday life seem to have been contributing to establish social hierarchies and foster contradictory feelings towards the city and its consumer spaces, feelings of belonging versus alienation, and of inclusion versus exclusion, depending on how people feel addressed by and integrated in this pervasive mainstream discourse of consumption and aesthetic urban spectacularisation.

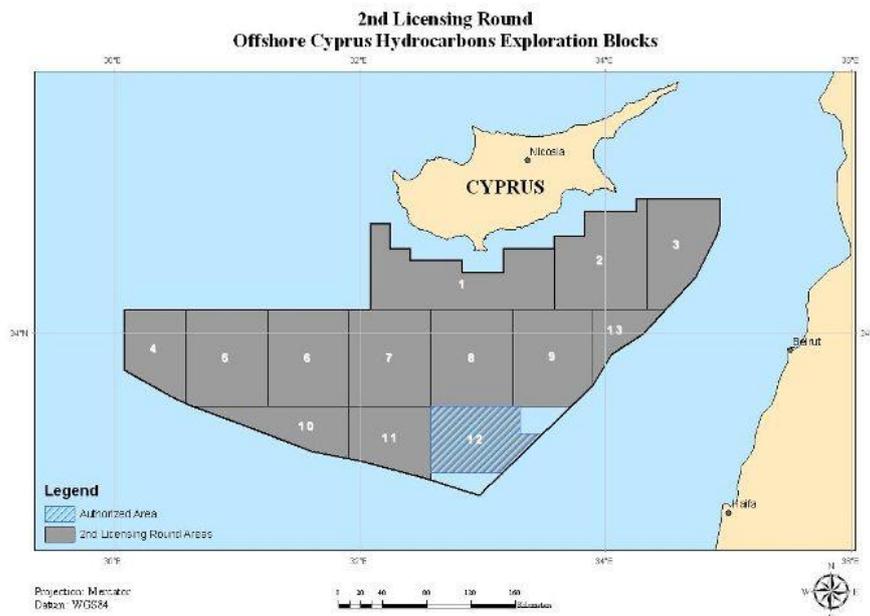
**Keywords:** Cardiff, Consumption, Commodification, Aestheticisation, Everyday Life

## CYPRUS OPTIMAL NATURAL GAS WEALTH MANAGEMENT MODEL. GOVERNMENT PRODUCTION CONSUMPTION (GPC)

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### ABSTRACT



Blocks offered in the 2012 Cyprus Bid Round (green shading). Source: [PetroView®](http://www.petroview.com)

[http://www.mcit.gov.cy/mcit/mcit.nsf/dmlhcarbon\\_en/dmlhcarbon\\_en?OpenDocument](http://www.mcit.gov.cy/mcit/mcit.nsf/dmlhcarbon_en/dmlhcarbon_en?OpenDocument)

Cyprus is located at the crossroads of Europe and Middle East destinations. The Country's strategic location and infrastructure makes it a reputable international business and services center. In 2004, Cyprus became a full member of the European Union (EU). In January 2011, Noble Energy announced the discovery of some of the largest offshore natural gas reservoirs in the world, 90 kilometers west of Haifa which the development of its offshore fields may take a long time but surely it would benefit Cyprus as well as Europe. The natural gas revenue can change the national economy and will have an impact on the people's livelihood. According to Cyprus government officials, the recent findings of the natural gas could strengthen the Country's financial position, wealth, and the standard of living of Cypriots in near future. The country's standard cost of living indicator, known as income per capita, is related to national accounts. Usually the wealthy countries are known as countries with high GDP (Gross Domestic Product) or GNI (Gross National Income) and factors like

housing, corporate income taxes, dividends, undistributed corporate profits, wages, consumption, investment, government, export, import, foreign & domestic income from labor and the net capital inflow, are affecting the GDP and GNI. According to Friedman's theory expected future income changes influence consumption. Modigliani's theory also claims people make consumption decisions based on resources available to them over their life time and their current stage of life. These theories have provided important predictions for the economy as a whole; they predict that the aggregate saving of country is depending on the rate of growth of national income. According to Campbell McConnell (1993) economics is "the study of the behavior of human beings in producing, distributing and consuming material goods and services in a world of scarce resources." <sup>1</sup> and as mentioned in Peter Drucker's writings in his management books, management is the discipline of organizing and allocating firm's scarce resources to achieve its desired goals and objectives. These two definitions explain the relationship between economics and managerial decision making. Scare resources such as oil and natural gas will have serious impact on a country's future economic structure. If risks and uncertainties are not taken to account, the future of a country after finding such resources might differ from what expected initially. It is interesting to observe how often countries with oil or other natural resources have failed to grow more rapidly than those without; this phenomenon is known as "Natural Resource Curse" and there are many studies trying to identify the reasons behind it. Reasons such as: Dutch disease, under-investment in human capital and macroeconomic instability. On the other hand there are also studies that show the optimal management of natural resource revenues which is often gained by consumption smoothing, inter-generational equity and other investment choices. One of the ways that most researchers used to avoid the fails and to envisage possible solutions for specific cases is to study other countries with natural resources and critically evaluate their practices and experiences. The stories of different countries show that a poorly designed fund management of natural resources can harm the economy and people's wealth but having a well-designed one, will bring a good budgetary process integrating, a sustainable fiscal policy strategy and institutions that are competent, transparent and accountable. It can build public awareness and support for a policy of wise and long-term management. Revenue management is a managing process to maximize revenues. Cyprus has now initiated the gas explorations which are likely to possess considerable natural gas revenues. The critical question is: "Are there any plans in Cyprus on how to use/distribute the revenues?" "There are no concrete plans yet" - talk given by the former Finance Minister of the Republic of Cyprus and member of the working group on

economic matters in the Cyprus reunification talks. This is also a view indicated by the former Director of the Energy Service of Cyprus. As mentioned above there isn't any natural gas revenue management model for Cyprus yet. The major issue in Cyprus economic policy is "how to use the oil and gas income?" The dilemma facing the government is whether the domestic use of oil and gas revenue could partially reduce the Cyprus political, popular and economic pressures. Therefore, it is necessary to form a wealth management model adapted to Cyprus to ensure the long-term sustainability of public finances, the highest possible return on investments, and inter-generational equity. This can be achieved by looking at what has been done in a selected range of countries, including both successful and failed practices in order to highlight pitfalls that should be avoided and using the successful proved practices. This study, therefore, mainly aims at preventing Cyprus from the "Natural Curse" and developing a model investigating in different parts such as future generation, public wealth, growth in mainland GDP, renewable energies, controlling the exchange rate and inflation, research and development, technology and management methods leading to higher productivity and higher income as well as economic expansion and growth. In order to reach these purposes the successful and unsuccessful revenue models of different countries will be studied in order to create a new model for Cyprus. According to the aim and objectives of this study, case study strategy and inductive approach is going to be applied. The structure of this research is not numerical so qualitative information and primary data focusing on depth interviews will be used, but getting help from the secondary data is also useful. For this study interviewing is particularly important; Cyprus government respondents who are mostly responsible for the wealth management of natural resources, especially natural gas will be interviewed and semi-structured interviews with open-ended questions will be conducted. In this research suitability of the study is very important so the purpose of this study is demonstration of the real result and avoiding the unethical issues.

**Keywords:** Oil and Natural Gas, Wealth Management, Government, Tax, Income, Growth in mainland GDP, Recession ,Economic Stability, Public Wealth , Natural Resources & Renewable Energies

## NORMS AND NON-CLASSICAL NEGATIONS

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This research aims to connect several components among which: a) the theory of truth functions of classical bivalent logic interpreted in natural language; b) the logic of norms (von Wright, 1968, p141-167); c) the concept of elementary event or transformation (von Wright, 1982, p39-45); d) nonclassical negations (D. Gheorghiu, 2004, pp250-255).

Thus is created a conceptual framework for the analysis of a very important theorem of the logic of norms according to which the obligation entails permission. Then, the same framework can be applied to other judgements on the logic of norms.

The part concerning the truth value functions derives from a previous research. This refers to the following idea: starting from the type of opposition that exists between the conclusions (Popa, 2000, p57-59), one can deduce the type of the opposition that exists between premises. To check this we carried out two approaches on the truth functions table:

- a) I built a tree of the immediate logical consequence relation (Iliescu, 2010, p. 172).
- b) I analyzed the opposition relations that exist between each of the sixteen pairs of truth value functions.

According to the point a), all the truth value functions are successively premises-functions and conclusion-functions except inconsistency and tautology function. Some of these functions are connected by an immediate logical consequence relation, for instance, inconsistency and conjunction. Other functions are connected by the mediate logical consequence relation such as conjunction and disjunction. It is understood that both functions that are in immediate logical consequence relation and in mediate logical consequence relation are connected by the logical consequence relation. According to point b), for every function there is a contradictory to it, noted „-“.

Thus, the symmetrically spaced truth functions from the central line are mutually contradictory. The contradiction is a type of classical opposition.

On the other hand, between the truth functions there is classical opposition: the contrariety, noted „ $\neg$ “ (Gheorghiu, 2004, p251) and subcontrariety, noted „ $\neg$ “ (Gheorghiu,

2004, p252). Some of the truth functions are in mutual contrariety. Other of them is in mutual subcontrariety. That means for some of them, say  $\varphi$ , there is such a list of functions  $\{\gamma_1, \dots, \gamma_n\}$ , that  $\varphi$  is mutual contrary to each of the functions  $\{\gamma_1, \dots, \gamma_n\}$ , and  $\gamma$ , can illustrate the succession by the  $n$  mentioned function. I used the notation  $\neg(\varphi)$  equivalent to the list  $\{\gamma_1, \dots, \gamma_n\}$ .

By applying contradiction-negation on each function  $\gamma$ , I obtained a list of  $\{\sim\gamma_1 \dots \sim\gamma_n\}$  functions that are conclusions of  $\varphi$ , noted down as  $\text{Con}(\varphi)$ . Which means that if we are in the possession of the list  $\{\gamma_1, \dots, \gamma_n\}$  of contraries of a given function, we can find the list of its conclusions by simply applying the negation-contradiction. So, we can get conclusions without using the deduction.

It also means that there are functions, let's call them  $\psi$ , for which there is a list of functions  $\{\delta_1, \dots, \delta_n\}$ , so that  $\psi$  is in the mutual subcontrariety relation to each of the functions  $\{\delta_1, \dots, \delta_n\}$ . And  $\delta$  can be exemplified, gradually, by the  $n$  functions specified in the index. On the other hand, we can use the notation  $\neg(\psi)$  that will be equivalent to the list  $\{\delta_1, \dots, \delta_n\}$ .

By applying contradiction-negation to each function  $\delta$ , we will get a list of functions  $\{\sim\delta_1, \dots, \sim\delta_n\}$  as being premises of  $\psi$ , noted down as  $P(\psi)$ . That means that if we are in the possession of the list  $\{\delta_1, \dots, \delta_n\}$  of subcontraries of a given function  $\psi$ , we can find out the list of its premises by the simple mechanical application of the contradiction-negation. So, we get premises, without using the deduction as an obtaining procedure.

We have unified the notation for the  $\gamma$  and  $\delta$  functions. The truth functions table shows that the  $\gamma$  functions are conclusive in relation to  $\varphi$  and that the  $\delta$  functions are premises in relation to  $\psi$ .

But the same functions  $\{\gamma_1, \dots, \gamma_n\}$  are both conclusions of  $\varphi$ ,  $\text{Con}(\varphi)$ , and subcontraries for  $\psi$ ,  $\neg(\psi)$ . The same functions  $\{\delta_1, \dots, \delta_n\}$  are, also, premises for  $\psi$ ,  $P(\psi)$ , and contraries for  $\varphi$ ,  $\neg(\varphi)$ . In fact  $\{\delta_1, \dots, \delta_n\}$  is the same with  $\{\sim\gamma_1, \dots, \sim\gamma_n\}$  which allows a unified notation. It means that the same functions  $\{\sim\gamma_1, \dots, \sim\gamma_n\}$  are both the premises for  $\psi$ ,  $P(\psi)$  and the contraries for  $\varphi$ ,  $\neg(\varphi)$ . From here we can deduce that there exist a mutual contradiction relation (*Ctr*): between the conclusions of  $\varphi$  functions,  $\text{Ctr}(\text{Con}(\varphi))$  and the premises of  $\psi$  functions,  $P(\psi)$ ; between the premises of the  $\psi$  functions,  $\text{Ctr}(P(\psi))$  and the conclusions of the  $\varphi$  functions  $\text{Con}(\varphi)$ . As a result of these we obtained the chains of equivalences:  $\text{Con}(\varphi) = \text{Ctr}(\neg(\varphi)) = \neg(\psi) = \text{Ctr}(P(\psi)) = \{\gamma_1, \dots, \gamma_n\}$ ;  $P(\psi) = \text{Ctr}(\neg(\psi)) = \neg(\varphi) = \text{Ctr}(\text{Con}(\varphi)) = \{\sim\gamma_1, \dots, \sim\gamma_n\}$ .

In the practical part of this article we selected the material implication from the truth functions. We compared the status of this expression with one of its particular case, that is deontic conditional: *If the authority forces an agent to make a state of things p, then the same authority allows that agent to do that state of things:  $Op \supset Pp$* . What makes it not only important, but also interesting is that a variant of its negation would violate the principle of non-contradiction, and another variant violate the principle of excluded third (Gheorghiu, 2005, p114-115).

Although considered negative variants are equivalent however distinct principles are violated. Also must be said, that deontic thinking is concerned, at least, by compliance with logical principles of thinking. But the same formula is a theorem of P deontic logic axiomatic system. Its demonstration starts from some tautologies such as:  $(A \vee B) \supset (\neg B \supset A)$ ,  $Pp \vee P\neg p$ , and from the definition  $\neg P\neg p \equiv Op$  (Popa, 1982, p. 303).

We also compared the theorem status of this expression with the one of possible element of the truth function table on the basis of the implicative function that it contains. We have reached some conclusions: On the one hand, because it is a theorem, it is provable within the system of tautologic premises. On the other hand, from here derive theorems that are tautologic conclusions. But the truth function of material implication has only premises-functions and not also conclusion-functions. And this theorem has, as the main operator, the truth function of the material implication. As a conclusion, it should have only premises, not both premises and conclusions.

We also instantiated the previous mentioned chains of equivalences by this theorem, thus evaluating it as a particular case of function deriving from premises. Some of the inferences look simple, easy acceptable, others may appear as being strange but they are sustainable by calculation.

The deontic event and the nonclassical negation are other issues that we have approached. Starting from the events theory by von Wright and from the classical negation of the contradiction type, we built nonclassical deontic events. The event-expressions contain, both in the initial state and final state, deontic expressions. They render, states of things that are possible, at least from the logical point of view, in relation to the history of law, according to which possible norms are maintained as imperative, they start being imperative or they stop being like that. The expressions for the events by means of which something appears or disappears, or is continuously absent, typically contain classical negation. But we replaced the

classical negation by non-classical negations: contrariety and subcontrariety and thus we obtained new kind of events. For some of them we propose names such as quasi-appearance, quasi-disappearances or the conservation of absence with regard to the obligations, permissions or forbidances. In the events of which final states contains the subcontrary negation, we replace it gradually with the the set of subcontraries of the given function. The same proceeding is applicable to the other deontic operators and to the contrary negation.

So, we have reached the following conclusions:

Some truth functions that are placed in simetrically oposed positions from the center of the truth function table and that are mutually contradictory are *complementary*. While one of the two functions, mentioned above, has premise-functions and subcontrary-functions, its contradictory has conclusive-functions și contrary-functions. Other pairs of functions that are also symmetrical opposed, are each of them *complete* and *similar*. So, each of the two functions has not only premises-functions and conclusions-functions but they also have subcontrary-functions and contrary-functions.

In the presented context, classical negation and contradiction-negation has a “medium-term” role. In relation to a given function, there is a moving from the premises-functions to the subcontrary-functions or vice versa. In relation to other given functions, there is a moving from the conclusion-function to the contrary-functions or vice versa. The importance of such an organon can be see not by studying it separately from any context, but precisely by studying it within such a context and by taking into account the result that is obtain by using it and it also should be extended to the domain of the investigation that is the logic of norms.

The functions that are contrary and subcontrary-negation of some given functions within the truth functions table were obtained by applying the matrix definitions of the two non-classical negations on truth functions of the classical logic. And that comes in line with the claim of the author of these definitions, according to which the classical logic of the order 0 is extended to include contrary and subcontrary-negation. So, founding the process of expanding classical logic to express non-classical negation, one found that non-classical-negation functions of classical truth functions are other truth functions that are also classical. Non-classical aspects are dispersed in classical logic, so that we do not have a net separation between classical and non-classical logic.

It should be considered for the future: that these *chains of equivalences* can stand for what I proposed to be called *epistemic situations or contexts*; that even under the syntactic relation, there is possible to *redefine the logical consequence relation* on the basis of these chains of equivalences and that this relation stands also at the basis of the logical norms; that, *applications of the chains of equivalence* on the logic of the norms are possible; that it is also possible to use the calculation of the order 0 to approach some meta-theoretical problems of axiomatical logic of norms. Thus an ordinary conjunction can be theoretically upgraded as the conjunction of the meta-theoretical properties of completeness and inconsistency of the systems of the logic of norms, properties that no judgement can live without. Much less can miss these properties from the reasoning on the rules governing the human's condition.

**Keywords:** Truth function, bivalent logic, contradiction, contrariety, subcontrariety, opposition, negation, premises, conclusions, material implication, logical principles, inference, deontic event

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## BEYOND THE LIMITS OF CRISIS

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### ABSTRACT

The recurrence of economic crises serves to illustrate the limits of neoclassical economics and the contemporary established models. The study of complex systems, evolutionary economics and interdisciplinary research offers the possibility of new developments. The concept of emergence represents an insightful argument against the well-planned and ordered nature of the social sciences universe. Complex systems research represents the viable alternative for sustainable growth in the following decades.

**Keywords:** systemic crisis, sound development, societal innovation

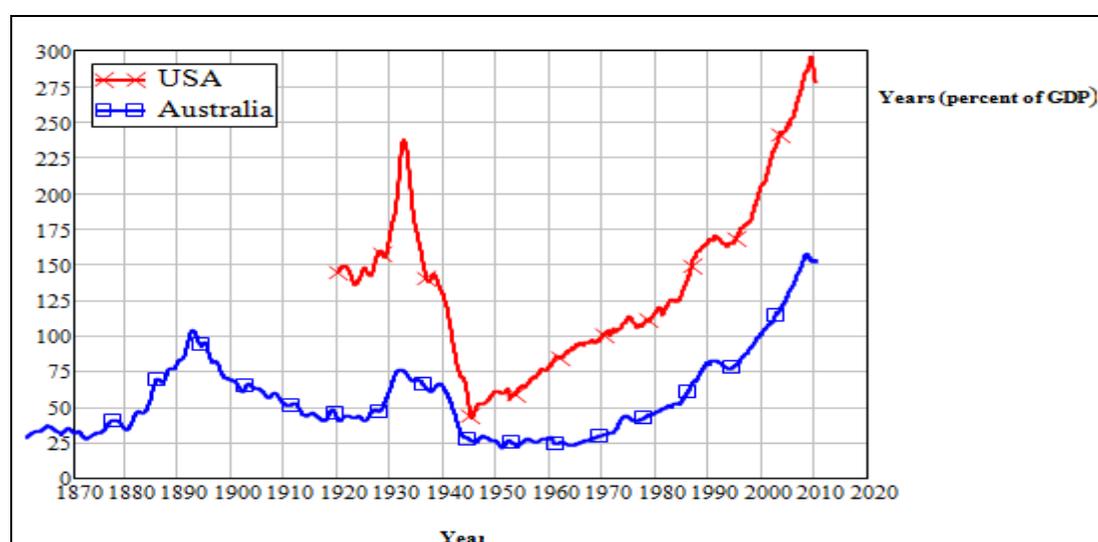
### INTRODUCTION

The previous economic downturns have placed significant strains both on the real economy and the economic theory. Policymakers have been struggling to rise to the challenge, but as Stiglitz (2003) points out, in the process of shock therapy, the markets have received “too much shock and too little therapy”. Several text books analyze the crisis from different perspectives. Tantalizing insights on the economic crises are shared by Donnella et al. (1972) as a vision of the entire world in their book regarding the limits to growth. They described Planet Earth’s obvious limits and the need for growth through complex development models. Separately, the Club of Rome Report demonstrated that ignoring such approaches may bring the society and the environment into overshoot and on the edge of a total collapse. Nowadays academics and researchers have the strength and positive attitude to talk about the untold reasons of such crises development. The new philosophy has taken root, stating that what stands before us and what lies in front of us pales in comparison to what resides within us (Emerson, 1993). A majority of the 16 individuals identified by Bezemer (2009) and Fullbrook (2010) as having anticipated the Global Financial Crisis followed non-mainstream approaches to economics, with most of them identifying as Post-Keynesian (Dean Baker, Wynne Godley,

Michael Hudson, Steve Keen, Ann Pettifor) or Austrian (Kurt Richelbacher, Peter Schiff). The theoretical foundations of these authors therefore differ substantially from those of more mainstream neoclassical economists.<sup>47</sup> In this paper we will restrict our attention to the Post-Keynesian subset, which we will hereinafter refer to as the Bezemer-Fullbrook Group.<sup>48</sup>

These authors made frequent references to the ratio of private debt to GDP, and the ratio of asset prices to commodity prices—both indicators of financial fragility that were emphasized by Minsky (1982) in his financial instability hypothesis, which is a common thread in the credit-oriented analysis of the Bezemer-Fullbrook Group.

**Figure 1. Debt to GDP ratio for Australia and the US**



Since these indicators are not commonly considered in mainstream economic analysis, key data are shown below to make the differences from Ben Bernanke analysis of the Great Depression.

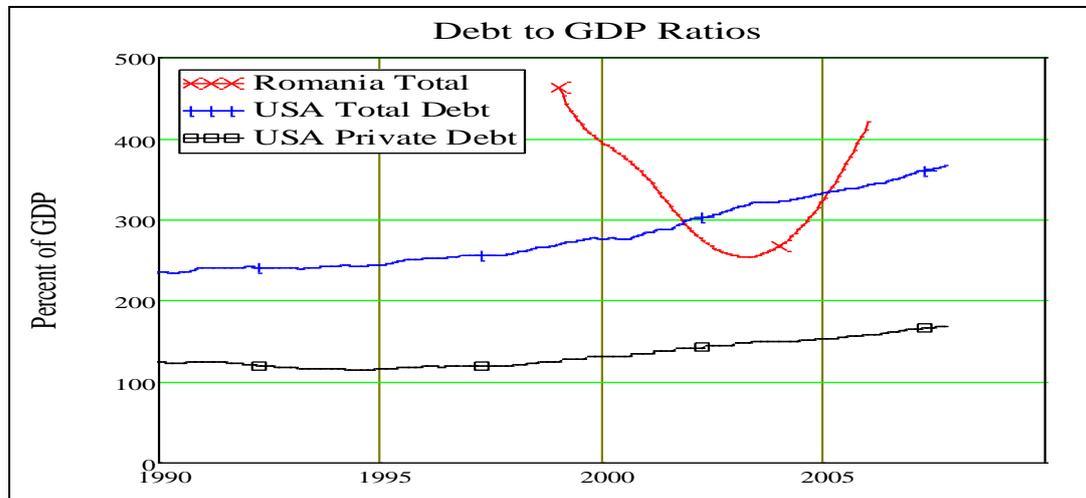
<sup>47</sup> Bezemer's list included four economists who could be regarded as close to the neoclassical mainstream, though all are to some degree mavericks: Nouriel Roubini, Robert Shiller and Jakob Madsen (together with his then student Jens Sørensen). The finalists for the Revere Award added two more maverick Neoclassical economists—Paul Krugman and Joseph Stiglitz. Fred Harrison applies Georgist economics.

George Soros's non-equilibrium approach of reflexivity cannot be classified in any of these more conventionally recognized schools of thought. Eric Janszen's approach blends both Austrian and Post Keynesian economics, while expressing allegiance to neither.

<sup>48</sup> However, though there are in turn significant theoretical differences between Post Keynesian and Austrian economists, the shared focus on the role of credit in a disequilibrium environment generates substantial empirical overlaps in their analysis.

By observing figure 1 and 2 one can notice the fact that a similar pattern starts to emerge in developing economies such as Romania.

**Figure 2. Debt to GDP ratio for Romania and the US**



Contemporary research can benefit from numerous developments. The availability of techniques such as computer modelling or simulation techniques as well as the understanding of specific elements as dynamics, feedbacks, behaviours and network structures, permits researchers to implement a great policy shift. This phenomenon is comparable to the moment when big government structures first became fashionable in the twentieth century.

The evolution process represents an intricate interaction between organisms, the environment and life itself in a constant stride for improvement. Transposed from biology to the field of economics and social sciences, the evolutionary process takes a societal approach and represents the dynamics of populations, behaviours or market activities based on external stimuli and repeated interactions (Vasile, Costea and Viciu, 2012). Individuals can be seen as the cells of a large super-organism which experiences evolutionary pressures. Once a critical mass has been reached in behaviours or activities, the world undergoes a stage of spontaneous evolution (Lipton, 2010).

Successful policy development requires several different perspectives. This fact was illustrated in the context of policymaking in security and infrastructure. Generating the right analysis is an essential element, asking the right question is an important starting point and getting support across the spectrum for a new research approach is the key. The right analysis

has to address the right question. An example of this statement resides in the question: 'Is this railway worth paying for?' This is a good question and it searches for the entity that will pay for it and why. This is followed by additional questions regarding the payment between passengers or property developers and the taxpayer role in getting welfare benefit.

The fundamental questions have remained without an absolute answer. This is, in fact the challenge for scientists and analysts when providing models to decision makers. As models cannot incorporate everything, decisions are to be taken with regard to their simplification. Outcomes are inherently uncertain. They need to show the appropriate range of outcomes with specific degrees of robustness. Once policy makers get answers to such pragmatic questions, their work will definitely be inspired by academic thinking, and stride for the general wellbeing of society.

## **HOW CAN THE DIRECTION BE FOUND IN A CLOCKWORK OR UNCERTAIN UNIVERSE?**

The manner in which we regard social systems is basically rewritten in the latter years by the emergence of complex systems. Stuart Kauffman (2010) adequately describes this in his work 'Reinventing the Sacred' where he contrasted the Laplace view of a clockwork universe with one of an inherently creative and uncertain universe.

A fundamental difference between the clockwork universe and the one dictated by uncertainty is the concept of emergence. In a simplified definition this represents the property of elements to combine and generate new elements which have distinctive characteristics than those which were initially introduced. This places emphasis on complex systems research since simplified static models are no longer considered accurate and efficient in describing social phenomena. Indeed, the notion that past representations and models have begun to show signs of ineffectiveness, is already present in numerous fields of activity. In economics, the neoclassical approaches have repeatedly been placed under the critical lens.

In his assessment of mainstream economic thinking, Keen (2001) underlines the intrinsic flaws of the current establishment and proposes evolutionary and complex systems research as a possible alternative. As Witt (2008) argues, the evolutionary economics approach represents a clear shift from the concept of equilibrium and optimal solution, which are so entrenched in neoclassical thinking.

A critical approach is required in any development process, as growth is expected to take place following creative destruction processes (Aghion and Howitt, 1990). Stable endogenous growth can only be achieved on solid ground. The solid basis of any model is represented by valid and flawless theory. As numerous holes have begun to appear in neoclassical thinking when it comes to the impossibility of profit maximization, macroeconomic utility and rational behaviour, the existent scenarios have begun to seem out of touch with market activities.

The road towards a new economy starts at the realization that the current theory is not suited for future development. Furthermore, increased interest and attention should be given to branches of research that deal with:

- The rational exploitation of natural resources;
- The economic challenges which will be ushered in by climate change;
- The limits to introducing and maintaining green growth;
- The limits and basis of wealth creation in a global environment;
- Avoiding “uneconomic growth” (Daly and Bergh, 2002).

## CONCLUSIONS

Important changes have to be incorporated in the path to future development. The current economic models are flawed in their interpretation of the social environment and continue to be prone to crises and inefficiency. New economic thinking requires an integration of both human beings presence and influence together with other elements such as the rational allocation and utilization of resources, the limits of current models, the challenges of climate change and the risk of uneconomic growth. The first step in this new direction is represented by developing and disseminating a greater awareness and understanding of the phenomenon.

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## IDEA EXPLOITATION AND VALUE APPROPRIATION: THE EXPERIMENTAL LAB

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### PURPOSE

The research sets out to analyze experimental labs through the adoption of a cognitive perspective and the use of Boisot's (1998) I-Space. The aim of the work is to make a contribution towards the understanding of knowledge dynamics within experimental labs, highlighting related issues of value generation and appropriation.

### UNIVERSITY ECOSYSTEMS

The University Ecosystem (UE), a new way to be an entrepreneurial University as conceptualized by Curley and Formica (2012), is a community of professors, researchers, students, external professionals, etc., that interact with each other and with the external environment to generate entrepreneurial innovation. Sharing and collaboration in such an ecosystem is structured in a variety of forms: common research projects and papers, people to people and patent exchanges, cross-licensing agreements, shared copyrights. The UE identity is shaped like a "starfish", i.e., decentralized, with non-hierarchically ordered social norms, without walls to protect ideas, and built on openness and connectivity, in contrast to a "spider-like" identity, which is centralized, built on social norms, rules and power relations (Brafman and Beckstrom, 2006). As it is from knowledge flows and collaboration that "entrepreneurial innovation" can emerge, Universities have to exploit their knowledge base and collaboration opportunities to encourage and support entrepreneurial initiatives and ideas.

### EXPERIMENTAL LABS

In this perspective, entrepreneurial Universities should adopt *experimental labs* in order to provide aspiring entrepreneurs with rich soil and strong network to get from an idea to a start-up. The experimental lab is a network of individuals, "federated" from Universities, research labs and firms, who become part of an innovative ecosystem rather than relying only

on their own capabilities (Andersson et al., 2009). In experimental labs high expectation entrepreneurs explain their business ideas to receive feedback from “outsiders” in a peer to peer exchange, to make the idea ready for launch in the marketplace. Labs lead an entrepreneur from “pattern recognition” of an idea, which is innate, to “pattern completion” (Curley and Formica, 2008). Through labs, aspiring entrepreneurs can access to competences, capabilities and experience of a network to explore, analyse and define their ideas. The experimental lab therefore works based on a paradigm able to react to current uncertain context, leaving the presumption to go from a business idea to a business model, to proceed by trial and error in an environment in which no failure is a failure, but rather a valuable lesson to reshape the starting idea. The new paradigm is: TECHNOLOGY/IDEA-IDEA TESTING- SIMPLEST SOLUTION- MARKETING/SALES.

## **VALUE CREATION AND APPROPRIATION THROUGH EXPERIMENTAL LABS**

The daily work of an experimental laboratory builds upon members’ knowledge; the goal is *sharing to improve*. However, even though knowledge sharing across different individuals by means of experimental labs is deemed to be a lever for new venture creation, it can be considered a necessary but not sufficient condition for knowledge creation and exploitation. In order to analyze the characteristics, evolution and value dynamics of knowledge assets within experimental labs, we use Boisot’s (1998) I-Space theoretical framework which, absorbing and enlarging the traditional distinction between tacit and explicit knowledge (Nonaka and Takeuchi, 1995), studies knowledge assets through the joint use of three dimensions - abstraction, codification and diffusion - and highlights that knowledge assets have to be intentionally managed as they have a paradoxical character: the more useful they become, the more difficult they are to hold on to. Therefore we argue that it is important to invest in deliberate cognitive activities in order to leverage lab members’ cognitive assets. More in particular, we believe that it is necessary to find a balance between two potentially contrasting needs in order to make knowledge sharable within the network. The first is the need for externalization through the adoption of mechanisms fostering the conversion of the tacit knowledge of people involved in experimental labs into more explicit cognitive assets, thus making individual knowledge easier to get diffused within the network. The second need is for appropriation by the adoption of (isolating) mechanisms allowing members to extract value from the knowledge they contribute to generate. We are working at the

development of a virtual platform for the sharing of business ideas and knowledge flows, as a tool to sustain the activity of the experimental labs.

**Keywords:** experimental labs, university ecosystem, start-up, knowledge assets, knowledge sharing, I-Space.

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## ROMANIAN INTERNATIONAL MIGRATION AND SUSTAINABLE DEVELOPMENT IN RURAL SENDING AREAS: MIGRANT INVESTMENTS IN HOUSES

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### ABSTRACT

The paper discusses the impact of Romanian international migration on environmental sustainability, knowing that a great part of migrants' incomes are invested in home improvement projects or for buying/building a house in the country of origin. We use a qualitative fieldwork conducted between 2009 and 2012 in the village of Marginea, Suceava County – one of the “champion” areas of Romania's international migration. Between the many aspects that affect environmental sustainability, we focus on the transformation of the rural dwelling in migrants' homeland, a major aspect to consider when addressing the issue of sustainable development.

**Keywords:** Romania, international migration, environmental sustainability, houses, homeland, investments

### INTRODUCTION

Sustainable development is a multi-dimensional concept, used by different disciplines, with a concern for future generations' well-being. In this paper, we focus on the interplay between environmental and social dimensions of sustainable development, observing how international migration affects environmental sustainability. The definition of environmental sustainability is drawn from the Millennium Development Goals Report: “Environmental sustainability means using natural resources wisely and protecting the complex ecosystems on which our survival depends” (United Nations, 2005:30). Nevertheless, environmental sustainability cannot be isolated from its social context. The new practices, values and beliefs acquired in the host country shape migrants' consumption patterns and the ways in which they interact with the natural and built environment. Furthermore, international migration facilitates the circulation of cultural factors, as well as the

transmission of technical, social or formal innovations. All these influence migrants' approach to traditional knowledge and culture and the way they manage renewable and non-renewable resources.

## ROMANIAN MIGRATION AND INVESTMENTS IN HOUSES

Romania occupies the second position in the top 10 most mobile countries of the EU, concerning the number of foreign residents in the UE-27 member states (EUROSTAT, 2011). According to World Bank reports, in 2007, Romania was in the top 10 remittance recipients, with an inward remittance flow of \$ 6, 8 million – representing 6 % of the GDP (Anghel and Horvath, 2009). Then, after a maximum reached in 2008 (\$ 9381 million), remittances fell by almost half in 2009 (\$ 4952 million), continuing to decrease in 2010 to \$ 3.883 billion. Instead, in 2011 we see a slight increase. This decline is largely due to the crisis that affected the main destination countries of Romanian migrants: Italy and Spain.

Tracing the profile of the Romanian migrant by period of migration, area of origin and age group, Sandu (2010) observes that about half of them have rural origins, not surprising if we consider the share of rural population (45%) in Romania's total population in 2010. According to Dumitru (Dumitru et al., 2004), the majority of migrants' investments are directed toward houses, housing utilities and cars. Indeed, a survey in 2008 on «Romanian communities in Spain» revealed that, no matter their return intentions, about half of the Romanian migrants considered buying/ building a house in Romania (Sandu, 2010). In addition, the SOROS-IASCM survey in 2011 confirmed this preference for house building (Alexandru, 2012). Similarly, in another fieldwork conducted in 2001 in a rural community in Teleorman County, the researchers observe: „Building new houses (mostly large houses) / buying apartments in nearby towns [...] seems to be a constant feature of the household that includes at least one migrant” (Șerban and Grigoraș, 2000:52). Building a nice home in the country of origin is more a symbolic or an emotional investment than a financial asset (Anghel, 2008), being related to the display of migrants' new status and social identity: „Many migrants invest their earnings in large new houses, clothes and cars” (Anghel, 2011: 40). Besides, the honour of the family (Diminescu, 1999) is a must in a rural community and the house is an effective means for showing migration success in this competition between households: „The first wish of villagers from both Temeseni and Piatra who are earning money abroad is to build a new house. Not any house but a big house, if possible bigger than the neighbor's house” (Stan, 2005:11). By contrast, the old, traditional homes are „a source of

shame” for the families that „continue living in them and cannot build another `modern` house» (Moisa, 2009:3). The large and cosy houses built in the home country constitute a „Physical evidence of a migrant’s success abroad” (Uccellini, 2010:79) and, along with other signs of wealth displayed on different occasions, „provide strong incentives to other potential migrants” (Uccellini, 2010:79). Hence, a new culture of migration emerge among the community of origin, which is maintained by the new individual behaviours and consumption patterns, related to the host country: "As migration grows in prevalence within a community, it changes values and cultural perceptions in ways that increase the probability of future migration” (Massey, 1998:47).

## **METHODOLOGY**

The paper is based on both primary and secondary sources (such as official documents, statistical databases and other derived works) related to international migration and on a fieldwork carried out between 2009 and 2011 in the village of Marginea, using the observation method and the informal and semi-structured (qualitative) interviews. The informants (near 100 people) were selected from the group of migrants as well as from the non-migrants. Several in-depth interviews were conducted with about 45 migrants and non-migrants. The majority of the respondents were gathered using local social networks (kin, friends, neighbours), a sort of a snowball sampling method, thus the sample is not statistically representative of the population of Marginea. The observed material and interviews were recorded on camera or using sketches and notes.

## **MARGINEA**

The village of Marginea is located in the northern part of Romania (Suceava County), close to the Ukrainian border and along important national routes, in the vicinity of important churches and monasteries, some of them belonging to UNESCO patrimony. Mentioned in historical documents since 18th century, Marginea is known for its black pottery, made using traditional techniques. Between 1930 and 2011, the population of Marginea has experienced continuous increase (10 529 inhabitants in 2011), the locality being the largest village of Suceava County. According to official statistics, 2500 people were living abroad in 2009 and 2153 in 2011 (Institutul National de Statistica, Directia Judeteană de Statistica Suceava, 2012). However, according to unofficial sources, the number might be higher. In 2011, the main destinations countries are Italy and UK. Initially, migration reasons

were primarily economic. The collapse of agriculture, plant closures, lower wages, poor development of the tertiary sector, high cost of housing construction are all factors that contributed to the migration abroad. Remittances and other foreign wages constitute the main vehicles of material transformations brought by migration. The construction sector occupies an important place, concentrating migrants' investments and efforts (Cingolani, 2009). Over 16 per cent of new houses are built on former pastures, on the basis of a land lease agreement. This is largely due to an increased demand for housing and to local real estate market conditions. Another reason is that more and more villagers stopped keeping and raising cattle.

In contrast with migrants' new homes, old rural dwellings, which passed from one generation to the next, are an "instrument of memory" (Rautenberg, 2007). These traditional houses and annexes of Marginea were very well adapted to the climate, natural environment and its traditional occupations, while the new migrant's house lost all its regional features and distinctive character. In the old residential areas, the proximity of homes corresponded to extended family networks, while in the new neighbourhoods this kind of relationship is absent. The change of neighbouring relations and social relations is also materialized through the new types of gates and fences. Unlike old gates, which allowed entering the courtyard at any moment of the day, when the owner was at home, the new automatic gates are designed to «protect property and privacy» (Cingolani, 2009:157). Moreover, the symbolic repertoire was removed, along with its support: the traditional gates and fences. This tangible cultural heritage - i.e. traditional houses, annexes, gates and fences - could be a powerful contributor to environmental sustainability, through the promotion of cultural and creative industries. In a similar way, craftsmanship (like pottery making, basket weaving or textile weaving and embroidery) is a sustainable income-generating activity that may preserve Marginea's cultural heritage.

Assuring an appropriate thermal comfort remains a problem to solve for any new home project because, during the winter, the temperature might drop to  $-35^{\circ}\text{C}$ . Before 1989, people had only one option: wood-burning stoves. It was also an economic solution as the forest was close to the village. Today the firewood is still used, either for wood-burning stoves or for central heating systems. Traditional dwellings had only one or two wood-burning stoves (one of them being used as cooker too), so, during the winter, the whole family was grouped inside the heated rooms. The new houses, with many rooms and wide openings, are difficult to heat and require large quantities of fuel, hindering the sustainable and efficient use of natural resources.

Public utilities (except electricity) are almost non-existent. Most of the households use wells (equipped with electrical water pumping systems) and in several cases solar panels were adopted for water heating and (eventually) electricity. The bathroom has been a rarely encountered element within the rural home of Marginea, and until 1990 the majority of households had a toilet outside the house. Migration helped villagers to gain access to improved sanitation facilities and other utilities. Indeed, the indoor bathroom rate increased from 16 per cent in 2002 to 50, 7 per cent in 2011.

## CONCLUSIONS

The impacts of international migration on environmental sustainability are both positive and negative. When remittances and other foreign wages are mainly used for house construction and daily living expenses (Mara, 2012) they can foster but cannot trigger sustainable development in migrants' homeland. Indeed, migration contributed to the elevation of standards of living, in terms of sanitation facilities and an increase in the average dwelling space per capita. It also enhanced the level of human capital (Ambrosini et al., 2011), affecting individual choices and actions of the returnees, such as, for example, the use of renewable energies. International migration is closely connected with social capital (a key element for sustainable development) and one particular quality of social capital is its "convertibility – it may be translated into other forms of capital [...]" (Massey, 1998:42). Therefore, public-private partnership should enhance this social capital, and especially the link between rural sending-communities and Romanian enclaves abroad, targeting to encourage trans-national entrepreneurial initiatives without altering the well-being of future generations. In addition, any sustainable development agenda has to support good housing practices and techniques, appropriate to community needs and specifics, as well as to its natural environment. There is need for proper policies, aiming to direct migrants' investments toward a sustainable exploitation of nearby forests (e.g. for ecotourism and other recreational uses or for non-timber forest product collection and marketing) and to stop forest destruction resulting from logging. Finally, policies should promote traditional knowledge and cultural industries, bridging the gap between traditional knowledge and the new technologies and requirements, brought by migration.

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## LOSING QUALITY ON THE WAY FROM THE MEADOW TO THE CONSUMER'S PLATE

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### ABSTRACT

During the past decades the food industry in Europe has become extensively complex and internationalized. Despite the existence of an abundant body of laws and principles governing it, the increasing scale and the intricacies of the food supply chain resulted in a variety of dysfunctional gaps. Importantly this worst case reflects that, as far as higher order values such as public health & safety, animal welfare and, especially, food quality is concerned, more concerted approaches between macro and micro decision makers are perceived paramount. Against the backdrop of an overview of EU food trade developments (Rae and Josling, 2003; Baldwin and Winters, 2004; FAO, 2012; The Manufacturers' organization, 2013), a characterization of the various actors of the European food supply chain (Chopra and Meindl, 2008; Europe Economics, 2012), a summary on European basic principles and principles of good practice (European Commission, 2011; Regulation (EU) No 1169/2011, paragraph (1); European Commission, 2013; European Union, 2013) and international management strategies applied by supply chain members (Malanoski, 1996; Malanoski, 1997; Ball, 2006), this exploratory and conceptual paper aims to provide holistic conceptual factors on how to systematically identify and remedy the current gaps combining internal supply chain factors with external ones. This paper intends to be an exploratory basis on which to develop an urgently needed comprehensive research agenda to ensure sustainable quality of food. The nub of the problem of the European horse scandal has still not been found and rather than passing the buck to national food standard agencies, food manufacturers, brokers, auctions, wholesalers, dealers and traders, primary and secondary processing plants, agents and distributors trying to blame the scapegoats, scientific research is needed to identify the roots of the problem as a basis to sustainably solve and prevent future problems.

The specific characteristics of the food supply chain relating to biological processes of production entailing variability and risks, perishability as well as concerns related to health and safety, environmental issues and animal welfare (Aramyan, 2006) render the quality focus within the food supply chain as being of central importance. Repeatedly pointing to the interdependence between macro and micro gaps, the scandal casts a murk cloud on both consumerism related topics, which, if not considered and treated carefully, lead to commercial damage inflicted on manufacturer and retail brand equity and profitability (National Geographic, 2013). Both, macro and micro decision makers' first order of the day is suggested to be the re-creation of consumer confidence and trust. Recent polls reflect reduced sales of beef related products, declining trust levels in product labeling and altered consumers' shopping and eating habits (Kantor Worldpanel, 2013; Hutchison & Baghdjian, 2013; The Economist, 2013) as well as to innovative investment schemes favoring more localized shorter supply chains to enhance food authenticity and trust. A further consumer related gap refers to low Price/Cost- Quality dichotomy. The increasing consumer demands for low end food products triggered by recession are in diametrical contrast to high production and transport costs for beef related products. This implies that achieving sustainable quality cannot be achieved without dedicating sufficient resources by all stakeholders to it, and that there is a limit to budget cutting on a macro level. Essentially, this means that there is a trade-off between reducing budgets and production costs and reducing the concerns for food safety (Rong and Grunow, 2010; Hallier in Kaufmann and Panni, 2012; Lawrence, 2013). Relating to further macro gaps, a discrepancy exists between regulating (EU) and actually implementing (national authorities) the regulations (Alemanno, 2013). Compounding this regulation gap, self- auditing of the industry (National Geographic, 2013; Lawrence, 2013) did not prove to be efficient. Summarizing, a first important research focus should be put on empirically researching this cognitive dissonance with regard to communicated quality awareness on the one side and the lack of preparedness by all players of the food supply chain to dedicate sufficient resources for quality protection on the other. Again integrating macro and micro decision makers, a further gap refers to a lack of coordinated and systematic planning and control. Based on supply chain related models (Chase et al., 2000; Duclos et al., 2003; Aramyan, 2006) this paper suggests explanatory research to elicit cause and effect relationships of the factors explaining sustainable quality in the European food supply chain. Due to the "the high level of interdependence between the elements of Supply Networks, their inherent feedback loops, non-linearities, and delays" (Remplanet project, 2010, p.6) it should be investigated to what extent simulation modeling

approaches and computational decision support systems in addition to analytical approaches (Sony and Kodali, 2013) would contribute to sustainable food quality (Van der Forst et al., 2009; Remplanet project, 2010). Relating to a control related micro gap, Fischer's (2013) view on various trust levels in the agri food supply chain might be relevant. He defines the most important trust determinants in this context as "effective communication and positive collaboration experience". At retailers' and processors' level, relationships tend to be more formalized, with larger use of contracts. The reason appears to lie in the fact that retailers deal with many and large corporations. On the other hand, processors and farmer relationships appear to rely more on trust, due to the representatives of each group tending to know each other when dealing in the local and regional markets. A solution put forward is to create exclusively formalized rather than informal trust based systems in the food supply chain. Consequently, a suggestion in order to improve the efficacy of Aramyan et al's (2006) model to measure performance in agri-food supply chains could be to validate a fifth factor called "level of formality" or "degree of formality" among the actors of the supply chain in further research. Summarizing, based on the illustrated macro and micro gaps existing in both, practice and literature, the paper will suggest a research methodology based on triangulation to better explain sustainable quality in the food supply chain.

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## **SOCIAL ENTERPRISES: PANACEA FOR CRISIS SITUATIONS AND CHANGE?**

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### **ABSTRACT**

Emerging trends such as an increasing ageing population (ec.europa.eu; www.telegraph.co.uk) and, in its wake, stressed public budgets for health care systems or a structural change in the workforce created by an increasing ageing population, calls, according to Murray (2008) for paradigmatic shifts towards more anticipatory, responsive and agile business models. Relating to the Billion Minds Foundation and Minevich (2007, in Murray, 2008) the author points to newly required traits of a social knowledge entrepreneur and perceives the social enterprise the enterprise of the future. In the context of increasingly ageing personnel, Rabl's (2010) research on German employees points to enhanced anti-discrimination efforts by leaders and HR towards the ageing workforce who, contradictory to existing stereotypes, do not fall short of achievement motives compared to their younger colleagues. In the same vein, Lu (2012) investigated factors influencing intentions to continue working in older age and calls for research informing company policies on continued employment and management of the ageing colleagues' future careers. From a more positive perspective, Easson (2013) foresees huge benefits to society and local communities when keeping older people integrated in employment or even encouraging them to become social entrepreneurs themselves. In addition to Rabl's (2010) unflinching motives for achievement, Easson (2013) regards local knowledge and expertise as potential so far being underutilized. Consequently, this paper contributes to the debate if social enterprises might be regarded as the business paradigm of the future, and, as their corporate values revolve around social responsibility, to what extent employment of ageing population could be a viable HR strategy for them.

The aims of the paper are threefold: first, to validate conceptual frameworks on elements of successful business models for social entrepreneurship and societal impact of social enterprises- the conceptualization is based in particular on the theories provided by Kaufmann, Davies and Schmidt (1994) on Identity Development of Eastern German

entrepreneurs, Grossmann (2008) on across-the-sectors- partnerships, Murray (2008) on social knowledge entrepreneurship, Rabl's (2010) research on ageing employees as outlined before and Paerenson's call (2011) for impact evaluation of social entrepreneurs; second, to investigate the conditions and perceptions for employment of the increasing ageing population in social enterprises and third, to suggest a research methodology for a comprehensive comparative cross-cultural research study to contribute to newly triangulated knowledge in the field. The previous conceptualizations (see objective 1) were derived inductively by three case studies in Eastern Europe : Ágota Foundation in Hungary, Narko-ne Association in Bosnia Herzegovina and Marijin Dvor Lužnica in Croatia (Kaufmann, Mewaldt and Sanchez, 2012). The current setting of the research method case study is Cyprus referring to two innovative social enterprises and ageing community workshops. The research techniques applied are in-depth interviews, focus groups and participant observation as to the activities of the two company social enterprise cases and in currently existing ageing community workshops. Purposive sampling with social entrepreneurs and representatives of the ageing population and employees (social enterprise cases and community workshops) will be applied. The data will be analysed applying content analysis. The two, on various occasions interacting, social enterprises are Materia Group and Second Life.

Materia Group's mission is to contribute to a healthier, happier and more empowered elderly population in Cyprus. The group responded to pressing social needs in Cyprus for a new model on elderly care services due to increasing life expectancy rates, changing family structures and lack of quantity and quality of existing services in Cyprus. The management team disposes of multidisciplinary knowledge and expertise, emphasizes care for and involvement of the human capital of the enterprise and focuses on effective ethical and socially responsible client-centred services (i.e. based on individual medical, family and psychological knowledge). Efforts are made to re-invest any profits into new services or improve existing ones. The following wide range of services should provide for a 'one-stop shop for older adults and their families: care, nursing and rehabilitation units; dementia units; programs for home care services; day care services; kids playground; pet therapy program; consultation services such as psychologists and gerontologists for older adults and their families to prepare them to deal with ageing related changes; training courses for foreign untrained employees caring for older adults at home.

Second Life, a NGO, created by the Youth Employment and Training Foundation (IEEN), collects, sorts, cleans, re-packages and re-sells items such as toys, books, clothes, shoes, push chairs, car-seats... for children aged 0-10 years old. The company aims to redress the balance of increasing waste arising by overly massive consumption of children related products i.e. on oversized birthday parties or baptisms. However, Second Life is offering a greener and cheaper alternative to recycling. As Cyprus doesn't have its recycling plant on the island, the cost and ecological footprints made the social enterprise opt for re-using rather than recycling. Compounding the matter, in a society such as Cyprus that values materialistic wealth highly, second hand is traditionally perceived negatively. Having researched the negative perceptions, the company's communication strategy is to convert negative perceptions into positive ones like looking like new, second life toys tell a story, and the consumer is part of the process. Latter aspect is reflected in the intriguing pricing strategy to let the consumer choose the value of the respective item which are distributed through various self-service Second Life stands in Schools (also supporting the collecting of items), banks or other public institutions. A further missionary aspect of Second Life is to bring generations together: at various events, teenagers get the chance to collaborate with elderly, i.e. when toys are sorted, cleaned and prepared in inter-generational workshops hosted by Maternia Group.

Summarizingly, as both companies are focusing on and co-operating with ageing people, they are regarded valid settings for this research which will provide knowledge contributions on the efficiency of business models of social enterprises and on their societal impacts in general and innovatively including the antecedents and consequences on potentially employing ageing population in particular. In addition, the paper will provide a methodology for a wider quantitative cross-cultural survey validating the qualitative findings so far. Practical contributions of the paper refer to provide social entrepreneurs and public decision makers with criteria to assess the effectiveness of Social Enterprises and social entrepreneurs with factors to adjust their HR strategies and corporate culture to the newly emerging ageing dimension.

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## HOW TO ACHIEVE PERFORMANCE EXCELLENCE: THE CASE OF COCOMAT, WINNER OF THE EFQM EXCELLENCE AWARD

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### ABSTRACT

#### Purpose of the Study

Due to economic globalization and the increase in global trade, business organizations have implemented Total Quality Management (TQM) and establish Excellence Awards or Quality Awards in order to improve to world-class organizations and face the global competition. Business organizations measure their progress towards TQM by using the Excellence Awards criteria as a guideline. Powell (as cited in Stading & Vokurka, 2003) believes that companies that implement TQM practices have used Excellence Awards as models for benchmarking, self-assessment and improvement.

European companies recognizing the importance of quality performance to business survival and success formed the European Foundation for Quality Management (EFQM) with the endorsement of the European Commission. The main objective of the EFQM was to improve the position of European industry and commerce and achieve global competitive advantage. The EFQM Excellence Award winners are those who have excelled in the European marketplace (Ghobadian and Hong Seng Woo, 1996).

The EFQM Excellence Award is based on nine criteria which five of these are “enablers” and four are “results”. The “enabler” criteria cover what an organization does (Leadership, strategy, people, partnerships and resources, processes/products/services) and the “result” criteria refer to what an organization achieves (customer results, people results, society results, business results). Thus, the assumption is that “results” are caused by “enablers” (Wongrassamee, Gardiner, and Simmons, 2003).

The **purpose of this study** is to present and examine in depth the implementation of the EFQM Excellence Model criteria at COCOMAT, a business organization which has successfully obtained the EFQM Excellence Award. The authors will also present the methodology used by COCOMAT for meeting the EFQM Excellence criteria in order to achieve excellence in the development of an effective TQM management system.

## DESIGN/METHODOLOGY/APPROACH

- (a) This is a qualitative study (case study). A case study approach is often the best methodology for addressing issues in which understanding is sought in order to improve practice. In addition, this approach focuses on a particular situation such as COCOMAT, winner of the EFQM Excellence Award, and seeks holistic description and explanation of the way which was used by COCOMAT in order to achieve Performance Excellence.
- (b) Interviews were conducted with COCOMAT managers who participated in the assessment process of the EFQM Excellence Award (General manager, Marketing Manager, Financial Manager, TQM Manager, Supplies Manager, Sales Manager, and Production Manager).
- (c) Review of COCOMAT's TQM related documents and training materials.
- (d) Observation of physical environment, people interaction and behavior in the workplace.

## FINDINGS

The authors will present the COCOMAT's methodology in meeting all the criteria of EFQM Excellence Award and finally be the Winner.

*"Enabler" criteria:*

- Leadership: The authors will examine how leaders develop and clarify a vision statement, values-philosophy-culture and mission statement that propose TQM and organizational improvement.
- People: The authors will present how COCOMAT handles its employees and their knowledge in order to improve its business processes.
- Strategy: The authors will examine how COCOMAT formulates its strategy, communicates its strategy, evaluates and continuously improves its strategy, taken into account external environment factor such as political, economic, social, technological and competitive.
- Partnerships and Resources: The authors will examine how COCOMAT manages and utilizes external partnerships and internal resources effectively in order to develop effective business performance.

- Processes/Products/Services: The authors will present how COCOMAT's activities related to products and services are designed, managed and improved in order to satisfy its customers.

*"Result" criteria:*

- People results: The authors will examine how COCOMAT measures employee satisfaction.
- Customer results: The authors will present how COCOMAT measures customer satisfaction.
- Society results: The authors will present how COCOMAT satisfies the needs and expectations of local, national and international societies.
- Business result: The authors will present how COCOMAT measures its business performance.

Although only few companies are able to win the EFQM Excellence Award, managers may use these nine criteria to carry out self-assessment and benchmark data for organizational improvement.

To conclude, business organizations in order to achieve competitive advantage must give emphasis on customer satisfaction and business results and thus, TQM implementation is imperative. Winners of the EFQM Excellence Award are companies like COCOMAT which demonstrate the highest standards in operating and implementing TQM practices.

## ORIGINALITY/VALUE

If a company wants to achieve excellence, the EFQM Excellence Award criteria (which are based on the TQM management system) should be met. COCOMAT a winner of the EFQM Excellence Award in Europe is presented in this study using a unique and innovative way in meeting the standards of the EFQM Excellence Award

**Key words:** Performance Excellence, Total Quality Management, EFQM Excellence Award.

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## IMAGES FROM LITERATURE AND THE ARTS IN CONSTRUCTING GASTRONOMIC CULTURAL TOURISM

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### ABSTRACT

Gastronomy, not only through its cultural facet (Literature, Painting, Cinema, the Decorative Arts) but also as an identity factor for a region or nation, has configured and determined the multiple *imagotypes* conveyed through Literature and the Arts.

Despite the *de-traditionalisation* of *hypermodern* «molecular» gastronomy, in serving up unprecedented combinations of flavours drawn from foods and beverages stripped from their usual regional and national contexts as a means of spurning the trend towards standardisation driven by globalisation, traditional flavours have also proven a resource for promoting tourism. Correspondingly, gastronomy proves a means of affirming the respective associated identity characteristics.

That's why the ingredients and specialities of national and regional dishes become not only a type of resource, of greater or lesser value for inclusion or exclusion by other peoples and/or cultures, but also a positive and appealing factor in the construction of the images feasible for tourism destinations.

In the Portuguese case, tourism products and services related to Literature and Gastronomy have been launched, as is the case with some literature tour routes and some foundations and or writer/artist house museums. However, we would consider they have failed to gain their due level of impact and profile both nationally and internationally.

Hence, we first set out a brief approach to the interrelationship between Gastronomy, Literature and the Arts, secondly, highlighting some of the most significant examples in terms of the range of products and/or menus based on gastronomic-literary references expressed by intellectuals whether directly in their works, in regions and/or in House-Museums.

In addition to the efforts already undertaken, we would propose far greater investment, internally and externally, in promoting Portuguese gastronomy as a tourism product associated with Literature and the Arts.

Our methodology makes recourse to literary texts, to art, cinema and geography as well as other sources deemed necessary in order to attain the objectives of this paper.

Based upon the documental research undertaken, the material resulting was subject to analysis in order to cross-reference evidence from various different sources as, in accordance with Yin (2005), the purpose of documental research is to enhance the evidence and the sources encountered. Within this framework, the documents collected were subject to analysis and interpretation with the objective of identifying their incidence, occurrence, content and characteristics as well as their mutual links and bonds.

**Keywords:** Gastronomy, Arts, Literature, Tourism

## EMERGING MODELS OF UNIVERSITY GOVERNANCE: EMPIRICAL EVIDENCES IN THE ITALIAN CASE

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### ABSTRACT

**Purpose:** This paper aims to explore the model of university governance that is emerging in Italy after the introduction of the law n. 240/2010. Because of the new law Italian universities have changed their by-laws in order to renew the organizational structure and the composition of their collegial bodies. The process of change has involved important choices for their future.

This topic could be studied in several dimensions. This research has firstly revealed competing trends in models of university governance across the United Kingdom (CUC, 2004), the United States (Trakman, 2008) and Australia (Carnegie, 2010). Then the different models of governance have been analysed: university governance by the academic staff, corporate governance, trustee governance, stakeholder governance, business governance.

The review provides a framework for discussing the aim of the paper and the empirical results on a sample of 56 Italian Public universities.

**Design/methodology/approach:** The framework presented is based on (a) an in depth literature review of governance of public and private universities, as well as literature about governance of public organizations, (b) analysis of official data collected through a Report, (c) analysis of the results of structured interviews with experts in the field.

**Findings:** The data collected clearly show that the majority of the sample analyzed has chosen a numerosness of 11 members (that was the maximum prescribed by Law) rather than the other possibilities. The predominant component in boards is still the academic one, but the presence of professional members is more relevant than in the past. More details about the emerging model are analysed in the paper.

**Practical implication:** The framework opens the door to follow-up research: data collection of best practices in Italian boards of directors, analysis and comparison with other international data sources.

**Originality and value:** In Italian Public Universities the presence in boards of professional members, as internal or external components trained and experienced in corporate policy and able to guide management efficiently, is considered more relevant than in the past. This may lead to innovative basic and applied research.

**Keywords:** University, Models of governance, Italian case

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## THE KEY SUCCESS FACTORS IN THE FIELD OF KNOWLEDGE-INTENSIVE MARKET SERVICES: EMPIRICAL EVIDENCES IN THE ITALIAN CASE

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### ABSTRACT

**Purpose:** In the field of knowledge-intensive market services Italy turned out to be one of the European countries with the highest number of Small and Medium-sized Enterprises (SMEs) in 2011. Anyway more than 99% of all European businesses are SMEs. Nine out of ten SMEs are actually micro-enterprises with fewer than 10 employees. Hence, the mainstays of Europe's economy are micro-firms, each providing work for two people, on average. This is probably one of the EU's best kept secrets (ECORYS, 2012).

Nowadays a lot of SMEs have problems to identify the key success factors in the process of internationalization, as well as to determine their strengths and weaknesses (Kubíčková, L., Peprný, A., and Nováková, S., 2012). Some scholars underline the relevance of the effect of network competence (Torkkeli, L., Puumalainen, K., Saarenketo, S., Kuivalainen, O., 2012) and others affirm that the innovative capabilities of knowledge intensive market services do actually differ from other industries (Ferreira, J.J.M., Raposo, M.L., Fernandes, C.I., 2013).

This paper aims to explore the factors of SMEs' success in the Italian field of Legal & Accounting with reference to their capabilities to survive and compete in the market in relation to their dimension and the geographical distribution.

The literature review provides a framework for discussing the aim of the paper and the empirical results taking into account a selected sample of 20 Italian micro-firms.

**Design/methodology/approach:** The framework presented is based on analysis of the literature and on empirical model that summarizes structured interviews and personal conversations with experts in the field. The sample has been selected with reference to different key success factors: dimension (number of employees), juridical form, geographical area, degree of internationalization, professional capabilities.

**Findings:** SMEs are becoming aware of the value of cooperation and of the relevance of being part of a network in order to acquire all the competences they need in the process of internationalization.

**Practical implication:** The framework opens the door to follow-up research: data collection of best practices in Italian SMEs, analysis and comparison with other international data sources.

**Originality and value:** For all European SMEs is, in any event, very important to know which factors are the key factors for their success and this require the collaboration of interdisciplinary teams. This may lead to innovative basic and applied research.

**Keywords:** SMEs, knowledge-intensive market services, Italian case

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## INNOVATIVE APPROACHES IN ROMANIA EDUCATION SYSTEM - ELEARNING SOLUTION PROVIDED BY SIVECO

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### ABSTRACT

The exponential development of information and communication technology in the last decade has led to the registration of a true revolution in computer assisted learning. The roadmap of eLearning development domain has different forms and approaches, many of them marking common knowledge that good practice that is taken over, multiplied and at the same time generating new theoretical guidelines. The evolution of e-learning practices in recent years is associated with a tremendous increase in complexity. By associating the concept with all situations and contexts educational nature in using new technologies to improve or complete the process, components, steps, to obtain a broad range of activities and products that are under the sign of innovation in education in the last twenty years.

Using computerized solutions for education is beneficial and generate positive effects on society - education specialists say. ELearning solutions meet the needs of the whole educational system, providing useful tools for all levels - from the makers of ministries to students, teachers, parents and even the general public. ELearning-based learning methods manage to adapt to the real needs of the educational process and gives students access to relevant and updated.

The major benefits of eLearning are considered to be: development of individual skills and team work, develop skills of analysis and synthesis of information and ability to put into practice the theoretical information learned in school. These skills are considered to be acquired due course content 91%, informal learning training 92%, training indirect 70%, and collaborative learning 84%. Summarizing, eLearning fully meet labor market demands and modern society and help create more economic and social opportunities, locally and globally.

Education specialists believe that in recent years there have been many changes in the educational system of the country they represent, most for the better. Globally, eLearning

plays an increasingly important role in education and the effects of introducing new technologies in schools without major effects, helping to develop the whole society.

ELearning solution delivered to Romania, the SIVCO lay the groundwork for new approaches and methodologies in the development of digital content transdisciplinary integrated multi-touch interactive devices.

Multi-touch technology that supports integrated transdisciplinary education system was used for the first time in the world in high schools in Romania. Appreciated for its high degree of innovation and the significant role that it plays in access to quality education, eLearning solution developed by SIVCO Romania for this technology, within the project initiated by the Ministry of National Education "Vision competencies educational process optimized knowledge society ", entered the finals prestigious European competitions IT & Software Excellence Awards.

The collaborative learning assisted with the most recent computer technologies, as is the multi-touch technology, is one of the most promising innovations in efforts to improve the teaching / learning. Not only does this approach encourages students to work together to solve exercises and projects that combine knowledge from multiple disciplines, but also helps to diversify and increase the attractiveness of learning activities.

The overall objective of the Ministry of National Education developed between December 2009 - November 2012 was the orientation of the educational process at the school in accordance with the competencies required by the current socio-economic and which are not addressed in traditional learning. ELearning solution developed by a team of specialists from SIVCO was to develop and implement a new school curriculum for Mathematics, Science and Humanities disciplines and applications support multi-touch interactive devices that support collaborative learning. ELearning solutions developed by SIVCO received two nominations in the competition: the project of computerization of education in Kazakhstan and one of the most innovative approaches to current eLearning - project development and implementation of educational content for interactive multi-touch devices.

An important advantage of this solution is given by the methodology that is based and enables teachers to create new lessons consistent with those already developed in the curriculum.

SIVCO is the leading international provider of innovative solutions in education. The company also had the opportunity to be involved in a project of great technological

complexity and strategic importance to the modern educational system in contributing to the foundations of new approaches and methodologies for the development of transdisciplinary educational materials for the school. At this point, we can say that Romania is a concrete case study approach integrated transdisciplinary learning methods.

**Key words:** eLearning, innovation, education, development, opportunities

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[www.siveco.ro](http://www.siveco.ro)

## BIO-ECONOMY: TRANSITION FROM THE ECONOMIC PARADIGM TO THE NEW GLOBAL ECONOMY

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### ABSTRACT

This paper aims to explain some important aspects of sustainability, to define what is meant by Bioeconomy and to show how sustainability can be achieved in this time of crisis. It was introduced bio-economy concept as a new paradigm based on the principles of biology and economy to replace the old economic paradigm. It was also performed a review of the old economy that promote wealth creation, but with much poverty and externalities man-looking wealth at the expense of human sacrifice.

We mention that the bioeconomy is currently in the attention of EU policy-makers and even a Bio-economy strategy and Action plan was adopted (Brussels, 13 February 2012 - COM(2012) 60 final). The European Commission "has adopted a strategy to shift the European economy towards greater and more sustainable use of renewable resources. With the world population approaching 9 billion by 2050 and natural resources finite, Europe needs renewable biological resources for secure and healthy food and feed, as well as for materials, energy, and other products. The Commission's strategy and action plan, *Innovating for Sustainable Growth: a Bioeconomy for Europe*, outlines a coherent, cross-sectoral and interdisciplinary approach to the issue. The goal is a more innovative and low-emissions economy, reconciling demands for sustainable agriculture and fisheries, food security, and the sustainable use of renewable biological resources for industrial purposes, while ensuring biodiversity and environmental protection. The plan therefore focuses on three key aspects: developing new technologies and processes for the bioeconomy; developing markets and competitiveness in bioeconomy sectors; and pushing policymakers and stakeholders to work more closely together.

The term *Bioeconomy* means an economy using biological resources from the land and sea, as well as waste, as inputs to food and feed, industrial and energy production. It also

covers the use of bio-based processes for sustainable industries. Bio-waste for example has considerable potential as an alternative to chemical fertilizers or for conversion into bio-energy, and can meet 2% of the EU renewable energy target." [www.ec.europa.eu]

"The Strategy has three main pillars:

1) Investment in research, innovation and skills for the bioeconomy. This should include EU funding, national funding, private investment and enhancing synergies with other policy initiatives.

2) Development of markets and competitiveness in bioeconomy sectors by a sustainable intensification of primary production, conversion of waste streams into value-added products, as well as mutual learning mechanisms for improved production and resource efficiency. As an example, food waste costs the European taxpayer between €55 and €90 per tonne to dispose of, and produces 170 million tonnes of CO. This waste could be transformed into bio-energy or other bio-based products, creating jobs and growth.

3) Reinforced policy coordination and stakeholder engagement, through the creation of a Bioeconomy Panel, a Bioeconomy Observatory and regular Stakeholder Conferences." [www.ec.europa.eu]

Also this paper presents the pros and cons regarding the bio-economy, this new economy that must achieve the overall objective of global sustainable development.

At the end of the speech, the reader was warned that humanity should act as a main force and is responsible for the harmful changes to the Earth and must, therefore, act as the root causes of imbalances. The authors argue that biological resource depletion, biodiversity loss, social and economic inequality, environmental degradation, contamination and lack of ethics, stresses the need for a change in thinking and action in this regard, making a proposal relating to the concepts of sustainability and development science and sustainability of the bioeconomy, establishing objective optimal balance between economic efficiency and optimal biological use.

This paper presents opportunities beyond bioeconomy crisis. It ends with a call to all to take seriously the education of persons who are related to well-being and sustainability of humanity.

**Keywords:** bioeconomy, sustainability, crisis, globalization.

## DIGITALIZATION OF THE NATIONAL PATRIMONY OPPORTUNITIES IN RESEARCH PROJECTS AND E-LEARNING: THE RESOURCE HARVESTERS IN THE CASE OF ROMANIAN LITERATURE

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### ABSTRACT

Radiography of a moving world, the paper *Digitalization of the national patrimony, opportunities in research projects and e-learning: the resource harvesters in the case of Romanian literature* by Luiza Marinescu analyzed the influence of the digitalization of millions of documents, books and newspaper from Romanian literature, as a social innovation, over the research projects and developing e-learning programs, in the case of the university education.

The hiatus, the discontinuity, the pause or the interruption in knowledge caused by the changing the medium of writing, (which was a characteristic of the centuries in which evolution in writing has occurred) was replaced in our century by a change in the paradigm: the digitalization of the libraries. As a new Noah's ark going upon the face of the waters, the digitalization of national patrimony offers opportunities in research projects and e-learning. It pays to plan ahead until the waters are dried up from off the earth. From the point of view of social innovation facing bio economics the paper illustrates the intercultural mission of the resource harvesters in the case of Romanian literature.

The strategic objectives of the paper entitled *Digitalization of the national patrimony, opportunities in research projects and e-learning: the resource harvesters in the case of Romanian literature* are:

- I. the affirmation of the intercultural missions of the university education, as an integrant part of the everyday work;
- II. the affirmation of the intercultural logic as a fundamental mission, despite the field of exertion (the policy of human resources or of material resources);

There are three operational objectives for medium and long term regarding creating a specialized team interested and involved in applying and getting EU project funding regarding :

1. *The Intercultural Atlas*
2. *The teaching of Romanian language through the foreign languages*

### 3. *Translations bridges to communication*

This paper illustrates the fact that a community development strategy is the result the contribution of higher education. The community's knowledge potential is enriched by the leveraging on technologies and the forging of a concrete link between the university and life long learning, as a pillar for human capital development. Facing bio economics, the university social innovation is compared to a forest: if you are outside, it is dense; if you are inside, you see that each tree has its own position. There are different trees in a forest. The wind may fell the massive oak, but bamboo, bent even to the ground, will spring upright after the passage of the storm. Analyzing the resource harvesters in the case of Romanian literature, the paper has the following chapters:

#### 1. **The optimization of the discounted present values**

- a. *The digitalization of the cultural patrimony*
- b. *The importance of being updated and in touch*

#### 2. **Unregulated harvesting or the reunification of the two worlds: manuscripts and printings**

- a. *The Atlas of the Old books: survival elements and causal interactions*
- b. *A "biological" evolution of the opportunities for researchers*

#### 3. **The digitalization of Romanian literature in terms of "Bio economics"**

- a. *The new territories of knowledge or the soil's fertility*
- b. *The seeds of e-learning: strategies, concepts, ideas and organization that extend and strengthen civil society*
- c. *Television and education? The spread of the seeds*

#### 4. **Investment in harvesting capacity**

- a. *The documentary politics of the University between modernization and personalization*
- b. *Why and how can you meet the Author?*
- c. *The polyvalent professionals*
- d. *The construction of an efficient cooperation*
- e. *The archiving and the diffusion of the results of research*
- f. *Preserving the harvest for another cycle of knowledge*

**Keywords:** the resource harvesters, digitalization, national patrimony, e-learning, Romanian literature, library, research, television, university education, documentary professionals.

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## THE MANAGEMENT OF SUSTAINABLE TOURISM DEVELOPMENT IN CYPRUS: BALANCING THE ECONOMIC, ENVIRONMENTAL, SOCIAL AND CULTURAL IMPACTS OF TOURISM

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### ABSTRACT:

The objective of this paper is to determine how tourism development in Cyprus impacted its Society, economically, environmentally, socially and culturally. More specifically, this paper will examine the positive economic impacts, as well as, the negative environmental, social and cultural impacts and suggest alternative ways to balance the positive with the negative impacts, in order to achieve sustainable tourism development. The methodology employed involved primary research through selected interviews of experts in the field of tourism management in Cyprus, as well as desk research, including a literature review of journal papers and a bibliographical review. The overall analysis will attempt to reveal both the positive economic effects, as well as, that the unprecedented tourism expansion is contributing to the observed negative change in the environmental, social and cultural character of Cyprus. These effects and impacts will be related to the current tourism theories, as identified in the literature review. Hence, the need for balancing the impacts of tourism, in order to achieve sustainable development. Recommendations, conclusions and suggestions for future work are reported at the end of this paper. Lastly, an attempt will be made to demonstrate the likely contribution of the research to the tourism field, with emphasis on managerial practice in the tourism industry of Cyprus.

**Keywords:** tourism management; sustainable tourism development; tourism; sustainability; economic impacts; environmental impacts; social impacts; cultural impacts; Cyprus.

## THE IMPORTANCE OF THE BRAND IN THE PORTUGUESE MOULD INDUSTRY

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### ABSTRACT

The recent creation of a collective brand to promote the Portuguese tooling cluster in international markets, as a means of appropriating value, highlights the need to understand the importance of the brand for Portuguese companies. This involves assessing the positioning brands are taking in clients' minds, as well as their level of awareness and recognition.

The present study aims to analyse the importance of the brand for the various stakeholders of this cluster, namely companies, education and R&D institutions, suppliers, associations and clients.

Since this study was carried out at an early stage of the implementation of the «Engineering & Tooling from Portugal» brand, it becomes apparent that this is seen as an important factor for Portuguese companies' competitiveness, although brand recognition is very low. The starting question was "What is the importance of the "Engineering & Tooling from Portugal" brand for the Portuguese tooling sector?", subdividing it in six hypotheses.

Considering the defined objective, and the hypotheses stated, this research, which started by a thorough literature review, was based on a quantitative methodology, resorting to the use of questionnaires designed and developed on paper and electronic versions. This enabled replies to be collected from businessmen, clients and suppliers of the Portuguese tooling industry.

The questionnaire used included open and closed questions. The choice of this type of questionnaire aimed at trying to obtain qualitative information to complement and contextualize the quantitative data.

The methodology adopted bore in mind the early stage of brand implementation, namely as regards the definition of the variables and questionnaire design. Thus, certain variables of

Keller's brand equity model were approached lightly, since it was not reasonable to expect the subjects to have much knowledge of the brand.

This study also aims to suggest guidelines which enable the cluster to maximize brand value; a reinforcement of the promotion plan is proposed, as well as the focus on the key brand attributes.

## SOCIAL NETWORKING SITES: WORKPLACE IMPACT

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### ABSTRACT

**Purpose** – This paper aims to research the effects and / or consequences are of using Social Networking Sites such as Facebook, Twitter, and LinkedIn on peoples' professional life and workplace environment, such as productivity and relations among colleagues.

**Design / Methodology / Approach** – The current literature review aims to research and identify the findings of previous studies on how Social Networking Sites affect our workplace environment and relations, as well as how we can possibly influence and impact a potential employment opportunity.

**Findings** – The findings of the studies are not definitive and more specific research and further studies are required. Some indicate that Social Networking Sites can promote collaboration among colleagues within different departments and countries, thus empower employees to work more and be more productive. Some studies indicated that a lot of people can express themselves easier and better through these Sites than face to face and employee interaction can increase with enhancement in knowledge sharing. A sense of "freedom" within the workplace makes employees feel "in control" and their productivity can increase.

Other findings though show that using these Social Networking Sites for personal purposes that are not related to the working environment can lose the company millions of dollars due to wasted and unproductive time, as employees instead of working are pre-occupied with these Sites. As a result a lot of companies in the US have banned access to such Sites.

Moreover, some other studies revealed that employers before hiring, they are likely to screen an individual's profile on Facebook, Twitter, LinkedIn® or any other type of Social Network Account, and according to what is posted and published pertaining to what that individual, a decision can be made that decides whether that candidate would be a suitable fit for the target position.

**Originality / Value** – Studies for the Social Networking Sites in the workplace are still a bit conflicting. This paper addresses the upsides and the downsides of using such Sites within

the workplace as well as the how these Sites can impact the individuals' prospects for a new employment opportunity. The paper also highlights that Social Networking Sites can enable workplace productivity by enhancing the collaboration and communication among employees, by knowledge sharing.

**Keywords:** Social Networks, Workplace conflicts, Productivity, Cyprus, Facebook, Twitter®, LinkedIn®, Workplace, Personal privacy.

## CORPORATE RECRUITING: E-RECRUITMENT IN CYPRUS

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### ABSTRACT

Everyday more and more companies enter the digital world by creating their own Facebook page, their LinkedIn profile and/ or a Twitter account. Social Media proved to be an effective advertising medium with a lot of advantages over traditional media but are they an effective tool to find and recruit employees as well?

E-recruiting and especially through the use of Social Media is a popular method used by many companies abroad to locate and attract young talent. The integration of Social Media Sites in almost every online system, especially recruiting software, provides easy access to vast information, fast filtration of data and better analysis of results in a shorter time period, which leads to decreased costs. Consequently, it is becoming one of the most frequently preferred methods by companies as all need to cut back their costs due to the financial crisis affecting the economy these days.

As the financial crisis expands in Europe and affects Cyprus as well, almost all Cyprus companies seek to decrease their expenditures and recruit only when it is extremely necessary for their operations and usually this means that they seek skilled employees. Even then though, companies avoid the use of social media or a web application and fail to take into advantage of the opportunities offered by their proper use, either because they do not know how or because they are afraid of losing precious time and money in a process that will “fail”. As a result, only a hand full of companies tries to implement this new method of recruitment in Cyprus. On the other hand young individuals seeking employment tend to search more online as there are more opportunities and choices available from around the world with better prospects.

In Cyprus the majority of businesses are small retail shops that offer repair services for their products, as well. Furthermore, there is another large group of companies considered as medium in size with operations spanning from production of goods, imports, exports and distribution. The owners of those shops and companies find it more difficult to recruit employees that have the skills required for the jobs as they usually need individuals with

specific knowledge and skills. For example today it is very difficult in Cyprus to locate experienced individuals that know how to assemble and repair bicycles or how to create and/or repair a shoe or how to make furniture. By accessing the internet, a larger pool of candidates is reached, hence allowing for a higher chance of finding the desirable individual. The research will attempt to provide prove that using social media as a tool could prove to be very beneficial for them. Furthermore, the study could become a guide to all type of companies, on how to exploit the functions of social networking in order to locate and attract skilled talent by using a number of tools.

**Purpose** Through the research an effort will be made, to assess if a company has the right tools to find employees online or through social networking. This will be attempted by investigating what the advantages and disadvantages of e-recruiting are, what legal issues exist, and which tools are required. In order to identify the reasons companies avoid e-recruitment in Cyprus and collect information regarding the key features and tools required for the online recruitment process a questionnaire will be formulated. Through the use of the collected information a general guide of the tools required so as to be able to engage in online recruitment will be formed. These tools will be in a general form that can be implemented by all organisation types and sizes.

**Practical Implications** By identifying the legal implications of employee screening, the advantages and disadvantages of this method and tools which can be used in order to succeed, recruiters can assess their options and make a clearer decision on whether they would like to adopt online recruitment or not.

**Originality/ Value** The paper reviews the available literature on online recruitment from a number of different angles in order to provide a spherical view of the subject. It will form the basis on which a methodology will be developed on the key elements required in online recruitment.

**Keywords:** Recruitment, Social Media, Employee Screening, Social Networking, Internet, E-recruitment, Employee Selection, Legal Issues

## **INTEREST RATES VS. INCOME TAX IN WEALTH CREATION OR WEALTH DESTRUCTION**

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### **PURPOSE**

The paper aims to analyse the relationship between bank deposit interest rates and income tax in six small countries from Europe compared to the E.U. average levels. It proposes a model and a series of interconnections that lead to a special combination that shows that high interest rate environments and low corporate tax lead to an imminent future financial distress. The study looks into the data of 36 months average interest rates and income taxes in the Eurozone compared to the same type of data for the same period in other countries with relatively lower income tax level (Cyprus, Ireland, Malta, Iceland, Lichtenstein and Luxemburg). The study aims to expand the research into the impact of corporate income tax to small countries' economies by analysing the role of bank deposit interest rates in the economy.

### **DESIGN/METHODOLOGY/APPROACH**

The paper uses RIRP, Taylor rule, monetary and fiscal policy tandem among theories to derive the main research approach. The approach opted for a set of secondary data and event methodology related to the countries experiencing so far this combination within their economic environment. The data is taken from Eurostat, Bloomberg, European Central Bank and IFM. Also, all data were complemented by literature review on the topic, documentary analysis and a test of the economic model suggested. Regression analysis and Spearman statistics are utilised as part of the methodological tools. The data analysis procedure in this study involved the use of numerical data from these countries top 3 banks' published accounts 36 months prior to their economic crisis or until end of year 2012.

## **FINDINGS**

The paper provides several empirical insights about how the combination between a high deposit interest rate awarded to investors and a low income tax can lead to financial turmoil. It suggests that this is also associated not only with the size of the economy, country reduced diversification level, but also to the neighbouring countries (E.U.) modified disequilibrium of funds as well as their lack of a unitary fiscal policy. Additionally, the tandem monetary-fiscal policy has centred on the role and policies of the Central Banks.

## **RESEARCH LIMITATIONS/IMPLICATIONS**

Because of the case study comparative research approach, the study results may lack generalizability. Therefore, researchers are encouraged to test the proposed propositions further in time in other environments and various size economies.

## **PRACTICAL IMPLICATIONS**

The paper includes implications for the development of smaller economies and governments in terms of rethinking and re-balancing interest rates and taxation with country diversification and investment strategies, as well as implications for the private and public economic agents in measuring the timing of their investments in these countries.

## **ORIGINALITY/VALUE**

This paper fulfils an identified current need to study how smaller countries' economies can be safeguarded from anticipate financial distress, by rebalancing their interest rate and income tax relative gap and how they can redress this economic balance in case of financial crisis.

**Keywords:** bailout, economic crisis, Eurozone, fiscal union, interest rate, tax, wealth creation

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## THE POLITICAL ECONOMY OF THE *PUBLIC-PRIVATE PARTNERSHIPS* ACCOUNTING

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### ABSTRACT

The research stream concerning the Political Economy of Accounting (PEA) argues that the standard setting due process – far from being a mere technical matter – is inherently political as it exerts a significant impact on the distribution of income, wealth and power between the parties involved in the corporate reporting “supply chain” (Tinker, 1980; Cooper and Sherer, 1984; Sunder, 1988). Therefore, analyses of political factors lying behind the standard setting due process and of the intended and unintended economic consequences provoked by the accounting standards appear to be fundamental in order to deeply understand the evolution of accounting principles (Zeff, 2002; Bruggemann *et al.*, 2011).

This study analyzes the recent development of the PPP accounting under the light of the PEA. In fact, a general agreement in the scientific community has been reached on the usefulness (in terms of relevance and representation faithfulness) of a “substance over form approach” to deal with this topic. However, a strong debate is currently stirring among academics, professionals and regulators over the determinants of the economic ownership, and three different accounting criteria have been proposed: a) the “risks and rewards” approach; b) the “control” approach; c) the “rights and obligations” approach (Broadbent, Laughlin, 2002; Heald and Georgiou, 2011). Notwithstanding the high degree of insecurity concerning the best accounting treatment for PPPs, the International Public Sector Accounting Standards Board has recently issued a new accounting standard (IPSAS 32, *Service Concession Agreements: Grantor*, September 2011) requiring public sector entities to switch from a “risk and rewards” to a “control” criterion. The introduction of the “control test” introduces important changes in the accounting treatment of the PPP contracts. Indeed, quite unlike the “risks and rewards” model (generally applied to account for PPP), the “control” approach implies that most of the PPP arrangements will be considered as on-balance sheet operations by the government units, with a consequent increase in the amount of debt and deficit reported by the grantor in its financial statements (Hammami *et al.*, 2006).

The paper adopts a positive-descriptive research methodology (Watts, Zimmerman, 1986). Therefore, it aims to better understand the source of the pressures driving the accounting for

PPPs, the effects of various accounting rules about PPPs (“risks and rewards” vs. “control” vs. “rights and obligations” approaches) on different groups of individuals and lobbies and, consequently, why various groups are willing to expend resources trying to affect the standard setting process.

The paper demonstrates that the development of service concession accounting has been historically driven by political factors, rather than technical considerations. Indeed, the traditional adoption of the “risks and rewards” approach is mainly attributable to governments wishing to keep privately financed assets off public sector balance sheets and outside fiscal rules and to the influence of the neo-liberal program of privatization. The recent shift of the IPSASB towards the “control approach” – that requires an accounting treatment often leading to opposite results with respect the “risks and rewards” criterion – can also be explained as a consequence of the sovereign debt crisis and of the intent of some groups and organizations to impose austerity measures on some eurozone countries. In fact, it is important to notice that – on February 2012 – soon after the issue of the IPSAS n. 32 introducing the “control approach”, the Eurostat has issued a “Public Consultation Paper” on the suitability of the IPSAS for EU Member States. The adoption of the “control approach” for the statistical treatment of PPPs is therefore probable in the next future.

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## INTERACTIONS BETWEEN THE VOLATILITY OF FINANCIAL MARKETS AND INVESTORS' BEHAVIOUR

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### ABSTRACT

#### PURPOSE

Numerous studies of stock market volatility focus on two areas: the information side showing how the rate of news dispersion affects movements of stock prices and alternatively how human behaviour influences investment decision making.

Risk and uncertainty are pervasive in economic life, playing a role in almost every important economic decision. Understanding individuals' attitudes towards risk is intimately linked to the goal of predicting economic behaviour. There appears to be significant agreement among researchers that individuals' tolerance of financial risk is related to a number of broad demographic factors. Determinants of risk attitudes of individual investors are of great interest in a growing area of finance known as behavioural finance. Despite great interest in this area, not much research looks at the underlying factors that may lead to individual differences and play a significant role in determining people's financing and investment strategies. This study specifically deals with small rather than institutional investors' risk profiles, because of all investor groups, individual investors seem a priori a likely candidate for a group that might be subject to systematic behaviourally induced errors.

However, significant literature gaps still exist concerning: a) small investor's risk tolerance and possible interconnections of the latter to market volatility and b) the mediating/driving role of cultural factors in shaping these links. The aim of this research is to determine interrelations between market volatility and investors' risk attitudes. Antecedents such as demographics, culture and other socio-economic characteristics and their effects on small investors' attitudes toward risk will have to be identified and evaluated. To the best of our knowledge, this question has not been thoroughly tested before.

## **DESIGN/METHODOLOGY/APPROACH**

In this research, the deductive approach is applied; foundations for the development of an adequate theoretical framework and hypotheses were provided by the literature review making the deductive approach possible in this study. In addition, all theories described in the theoretical framework will be compared to the empirical findings of the study. The research will adopt different methodological tools for its different aspects, combining quantitative with qualitative methods, as well as primary and secondary data.

Secondary data from an extensive literature review in order to construct a solid theoretical basic on which empirical research will be based and helps to access the techniques used by other researchers, to formulate appropriate testable hypotheses and built the research instrument regarding

- volatility market data publicized
- interconnections with market volatility and risk-tolerance of individuals under the perspective of behavioural finance
- culture and its consequences, with a special focus on risk-tolerance in general and investment risk-tolerance in particular
- effects of demographics on risk-tolerance

Primary data collection involving: quantitative data from a cross-sectional survey and questionnaires, on a small investors' sample; qualitative data derived from focus groups, in depth interviews with market experts who have a deep understanding of how the market interacts.

## ***EXPECTED IMPLICATIONS***

Understanding small investors' attitudes towards financial risk will be beneficial for all parties concerned; academia, financial services firms and investors. It adds considerable value to academic knowledge on the fundamental discussion on small investors' risk taking profiles, small investors' benefit of knowing their risk tolerance drivers will be in a way that will widen the array of choices according to their needs. With respect to academia it will address a wide-open literature gap and will attempt to initiate a new research stream on small-investors' risk tolerance profiles. As regards practice, financial services firms need to enhance their understanding of the antecedents of prospective investors' risk-tolerance profiles in order to appropriately segment their markets and being proactive in designing investment packages especially fit for specific market segments. On the other hand small-

investors will be given investment options designed before-hand to fit their own needs and preferences.

A number of possible future studies using the same experimental set up are apparent. Large randomized controlled trials could provide more definitive evidence. This research has thrown up many questions in need of further investigation. Various additional theoretical perspectives would also need attention on the basis of this research, in addition to widening the scope of the research.

## **ORIGINALITY/VALUE**

Since published research on this research area is rather limited there is significant opportunity for this proposed research project to provide theoretical and practical means for considerably enhancing current understanding on the subject and initiate an investigative stream for future research. The proposed study is original in that its address the specific research subject under the light of both demographic characteristics and personal cultural values. The importance of the research relates to its focus on the culture characteristics which are largely overlooked by existing research. Also it will contribute a related framework to the existing literature. In that respect, the value of this research is expected to be significant.

**Keywords:** volatility, investors' behaviour, risk tolerance, behavioural finance, Cyprus stock market, demographic factors, culture

## **LEADERSHIP FOR 21ST CENTURY: TOWARDS A TRANSCENDENT FRAMEWORK**

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### **EXTENDED ABSTRACT**

#### **BACKGROUND**

In today's business world, projects and project management (PM) are the way most works are being done (Schwarber, 2005). In the heterogeneous and enormously complex construction industry, organizations are delivering products through PM systems which could have been achieved only with great difficulty if processed in traditional ways (Winch, & Kelsey, 2005; Meredith, & Mantel, 2000). Despite the growth in the PM literature, projects particularly construction projects continue to fail at an astonishing rate in the traditional measures of cost, time, and performance parameters (Winch, & Kelsey, 2005; Atkinson, 1999). However leadership in modern times has been challenged perhaps as never before, by forces of globalization, political and social dynamics, rapid technological advances, and societal upheavals over sensational examples of gross corporate misconduct (Bruns, 2013; Gardner, & Schermerhorn, 2004). This situation needs change. The paper is based on the author's ongoing post doctoral research on leadership, pragmatism, and partly on the recently completed PhD Thesis (2012) on strategy, program and project management at the SKEMA University Business School, France.

#### **EMPIRICAL BASE OF RESEARCH FOR REDUCTION IN PROJECT FAILURES & SUSTAINED GROWTH**

The construct of the paper include investigations: 1) contextualized integrated planning and DM process (Ives, 2005; Wick, & Walter, 2008) in PM; 2) experiential learning (e.g., from the team DM process) and from the facilitation process of sharing leadership with expert team members (Li, Mobley, & Kelly, 2013; Hirst, Mann L, Bain, Pirola-Merio, & Richever, 2004); 3) relationship building between organizational practitioners and key stakeholders for collaborative best performance and outcomes across domains of 'self', team members, and the

organization; 4) as a by-product, propose a structured DM framework for practitioners use at multiple levels of PM (Mota, Almeida, & Alencar, 2008). The field study was constructed by partial mixed methods (MM) research with application of pragmatism (Woolley, 2009; Johnson, & Onwuegbuzie, 2004; Moon, & Moon, 2004; Wright, 1992) which is one of the latest approach in business research, and new particularly in construction PM discipline. The empirical base included evidences gathered from successful business leaders (project managers) in global markets (Mukerji, 2012); emerging literature; and the author's pragmatism from lifelong cross cultural experiences as academic, consultant, and executive practitioner in multinational companies.

## PROJECT MANAGEMENT CHALLENGES

Construction projects' are getting larger with increasing vertical integration and complexities, and exposures to global market pressures (Shenhar, & Dvir, 2007; Bennatan, 2000). The uniqueness of the construction industry makes the PM a distinct discipline as it is dealing with major challenges in various contexts (Toor, & Ofori, 2008). It encompasses industry specific challenges, general business challenges, and operating environmental challenges (socio-cultural, economic, technological, legal and regulatory, and ethical). Nevertheless, under pressure from the customer and/or competitors, the project board or the steering committee sometime succumb to timeframe or deadline that is too short for the project to be completed on time and within the budget. Moreover, the critical parameters of the project are often agreed upon during the initial phase of contract negotiations when the things are usually not fully known and thus the estimates without adequate details and provisioning of sufficient contingency allowances.

In this context, the organization specific PM operational challenges comprises under-defined projects with uncertainties in scope, dimensions and predictability of processes; underpinning relationships and coordination of external stakeholders (subcontractors, supply chain, consultants, and client) on many of whom the project manager do not have direct control (Toor, & Ofori, 2008). *The challenges are exacerbated by the acute shortage of skilled people, changing needs of clients, impossible delivery dates, and inadequate risk allocations* (Atkinson, Crawford, & Ward, 2006).

## LEADERSHIP FOR SUSTAINED GROWTH IN FAST CHANGING ENVIRONMENT

Based on Douglas McGregor teachings (from his 1960 book *The Human Side of Enterprise* cited by Gardner, & Schermerhorn, 2004), the author assumed when the practitioners are well aligned with the emerging new PM knowledge and technology as well as with their innate 'self', team and the organization, properly coached, and trained for one's best capacities (e.g., in talent, creativity, and willingness to take responsibilities of personal growth); motivated and have supportive organizational culture and leadership infrastructure the practitioners would deliver thriving performance and all-round growth for *win-win* outcomes for all.

### *Transformational-transactional Leadership Model*

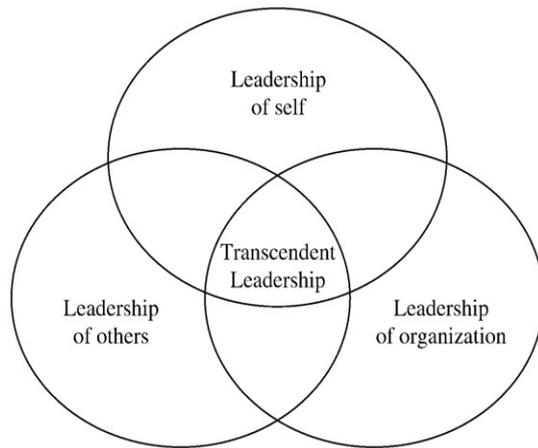
For reduction of construction project failures, the paper proposed a situational blend of transformational-transactional (TT) leadership (Hermel, & Ramis-Pujol, 2003; Tannenbaum, & Schmidt, 1958) model for masterly facilitation by the project manager for collaborative teamwork for effective DM of major planning problems at multiple levels of PM. It became clear that in today's highly dynamic environment enduring business performance is really driven at a much deeper levels including leader's "self" management and a focus on 'leadership strategy' coming from strategic leadership culture of the organization and careful and continuous development of leadership at multiple levels of PM (Atkinson, Crawford, & Ward, 2006; Avolio, 2007). The scope of the paper is limited to leadership for operational accomplishments of quality planning at multiple levels of PM. The paper, project manager and junior team managers are described as practitioners or leaders.

The research is process oriented and the proposed situational TT model would promote masterly facilitation by the project manager (Gardner, Avolio, Luthans, May, & Walumbwa, 2005; Ives, 2005; Tannenbaum, & Schmidt, 1958) of the expert DM team members for sustained performance excellence (Wick, & Walter, 2008) at multiple levels of PM. The proposed strategy of integrated planning and DM in the complex construction (Wick & Walter, 2008) was validated by field studies and case examples as useful in reduction of project failures.

Leadership theories abound, but the literature is focused almost exclusively on leadership of others. It does not pay proper attention to the critical integrating component of leadership of 'self' (Odusami, 2002; Gardner, & Schermerhorn, 2004) in the leadership process. Thus, in the context of unprecedented increase in complexity (e.g., ethical meltdowns across domains) and other challenges (e.g., operational, and changes) the research explored advancing the leadership process by combining the TT model with 'transcendent' leadership for an integrated and comprehensive framework toward *total* development of the 'leader' and the 'leadership process' for one's best leadership of 'self' and others. The proposed transcendent leaders are expected to grow beyond the TT leadership for strategic leadership process within and across multilevel domains of self, others, and the organization for sustained growth with concerns for the wellbeing of all (Crossan, & Mazutis, 2008). This multilevel framework is described simply as 'transcendent leadership'.

#### *Transcendent Leadership*

Broadly, *Transcendent Leadership* is a process by which the leadership relationship promotes leader and team members raising one another to higher levels of performance and innovation for greater motivation, morality and consciousness thereby co-creating the future in the essence of "spiritual humanism". The process manifest in the core values of trust, respect, love and integrity/mindfulness. Transcendentalism is a philosophical movement which appears rooted German idealism generally and in the transcendental philosophy of Immanuel Kant (1724 -1804) a German philosopher who researched, lectured and wrote on philosophy and anthropology (and of German Idealism more generally), In this context Leadership of self include taking responsibility of self-awareness, self regulation and optimal self-growth toward self-actualization (Collins, 2001; Hermel, & Ramis-Pujol, 2003) by transcendental process (Crossan, Vera, & Nanjad, 2008) and by lifelong experiential learning which are vital in today's highly dynamic and ethically challenging environment.



**Figure: Transcendent Leadership, Source: Crossan, Vera, & Nanjad (2008)**

The operational process of transcendent leadership comprises leader's behaviours and motives in making goals and values transparent and leading by setting exemplary personal examples (Avolio, & Gardner, 2005). The transcendent leader (e.g., project manager and team members) would be proactive in key aspects e.g., effective DM, in masterly facilitation of expert organizational and external diverse stakeholders for collaborative process and steering discussions across domains for his/her own as well as team best performance (Bruns, 2013). On the issue of how organizations achieve successful transformations Kotter (1980) postulated "It may be obvious that if people spend 98-99% of their work time on the job [on doing], and only 1-2% (at most) in formal training then most learning must occur on the job." The TL Collaborative process comprise helping relationships, in promoting "reflection" within (solo, sub-groups) for problem solving and in observing other members' reflections [and why, how aspects] all of which serve as valuable sources and motivations of experiential learning and in transcending to higher levels introspection, innovation and productivity (Avolio, & Gardner, 2005; Hirst, Mann, Bain, Pirola-Merio & Richever, 2004), as well as in developing colleagues and stakeholders (Crossan, Vera, & Nanjad, 2008; Crossan, & Mazutis, 2008). Thus, TL provides practical ways of valuable learning from all possible sources.

One of the most formidable PM challenges is in coordinating specialized work carried out by external stakeholders (e.g., subcontractors of trans-disciplinary disciplines, and the supply chain members) on many of whom the project manager do not have direct control. Successful cross-domain collaboration is a practical way to improve upon this situation and in promoting mutual cooperation, new knowledge-generation (Bruns, 2013). In this context, matured transcendent leaders are able and are motivated to offer game changing performance toward reduction of construction project failures and in harmony across

management domains. Thus, the transcendent leader aligns his/her values with the strategic intentions, plans and regular reviews of actions for sustained improvements and growth.

## ENDNOTE

Situational transformational=transactional (TT) are processes that tend to be compared and broadly distinguished by explaining: transactional leader exchange tangible rewards for the work and loyalty of workers. However, the transformational leaders engage with followers, focus on higher order intrinsic needs, and raise consciousness about the significance of specific outcomes and new ways the outcomes might be achieved. These two modes have been experimented to diverse degrees of success particularly in highly organized organizations but the crisis in leadership (e.g., corporate corruptions in post Enron, WorldCom era continues) remains unabated rather the trend is increasing. As noted earlier, leadership in modern times has been challenged perhaps as never before by the fast changing governing market, ethical/moral forces (Gardner, & Schermerhorn, 2004) and the key aspect of effective leadership 'trust' has been blown away. Clearly a new leadership paradigm is needed to bring human efforts to higher levels of synergy for higher effectiveness involving a more diverse range of people in true shared leadership process (Crossan, & Mazutis, 2008; Dvir, Lipovetsky, Shenhar, & Tishler, 2008). Hence the TT modes were integrated with the dynamic "transcendent" approach. The metaphors of transactional, transformational, and transcendent leadership (or simply transcendent leadership) provided construct to blend the evolution of theory and practice of leader's self management and business leadership process (Avolio, & Gardner, 2005; Hirst, Mann, Bain, Pirola-Merio & Richever, 2004). The process offer a progression for the analysis of the theory and practice of shared leadership/governance across diverse participants as defined by its six major characteristics: 1) rising above selfishness, climate of trust, and ethics/moral; 2) information sharing; 3) meaningful participation and collaboration; 4) effective DM at multiple levels of PM; 5) relationship and cross-cultural exchanges; and 6) continuous experiential learning for transcending to higher levels introspection, innovation and productivity (Bruns, 2013; Collins, 2001; Li, Mobley, & Kelly, 2013; Wick, & Walter, 2008; Gardiner, 2006).

As noted earlier, the proposed transcendent leadership framework has sound philosophical underpinning, support of emerging theories e.g., authentic leadership, as well as validation by pragmatism from global experiences. The paper provides answers to leadership challenges of the day and future. Though the transactional, transformational, and transcendental modes

were tested to varying extents, further research is necessary to comprehensively study the impacts and needs of transcendent leadership for leader and leadership success.

**Keywords:** Construction, Project Management, Leader Development, Leadership Development, Transcendent Leaders

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## A MATRIX OF INVESTMENTS IN SOCIAL RESPONSIBILITY AND SUSTAINABILITY

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### ABSTRACT

Social responsibility and sustainability are complimentary concepts.

Based on the reality and the concepts' definitions, briefly presented in the introduction, this study is aiming to underline the conceptual meaning of social responsibility and sustainability as it is understood and applied in Romanian companies and to make suggestions on how to act ethically in investments processes to support these two concepts in practice. To respond to this aim the companies' sustainable strategies have been gathered from the websites, analyzed and compared. The study is using real experiences from Romanian companies to underline the understanding of these concepts, the failures of understanding investments in social responsibility and sustainability and to provide suggestions in applying the European policies and standard in the right way.

A matrix of investments in social responsibility and sustainability has been proposed to be used by the organizations' managers.

**Keywords:** social responsibility, sustainability, investments, European standard and policies, Romania

### FINDINGS AND DISCUSSION

The methods used in this paper are based on the real facts observation, judgment and comparison of the investments practices in terms of the social responsibility and sustainability in Romanian companies.

Even the legal framework is issued according to the European Union and United Nations principles in Romanian companies the social responsibility investments are mostly seen as a

waste, even the good practice transferred by the international corporate companies offer a fair example for the national organizations (Yves Rocher, Danone, McDonalds, Astellas Pharma Europe and many others). In this respect, in the last years, the actions towards civil society have increased and several projects have been implemented to bring “a better world” to some communities. Other companies are focused on sustainable social responsibility (Dacia Renault or Ursus Brewery), which understand their responsibility in recycling the materials, avoiding the waste of energy, keeping the jobs. The problem observed is that the most of the actions, even if they have attractive slogans, are focused on charity, for example: the internal campaign, “Santa’s knapsack”, a collection of toys, books and clothes for children living in placement centre in nine cities (GDF SUEZ Energy Romania in 2009), advertised as “the engagement is more than a value for the company, is an implication in society”, or the campaign for collecting 10,000 books for rural sites school (OTP BANK in 2012). Another way of “social responsibility” is to sponsor NGOs, because the fiscal code allows the use of up to 2% out of tax on revenue for sponsoring NGOs, for example sponsoring sports competitions, shows, concerts or scholar awards (Free scale Romania in 2011 and 2012).

The brief examples presented above emphasize that many companies are using the social responsibility concept to help disabilities, poverty and low financed activities if at all to become more visible in communities, which nevertheless is not a bad thing. In fact, it is not far from what is to invest in reputation. But, it is no doubt that a wrong policy in using the charity expenditures investments as social responsibility and sustainability has been adopted. In order to differentiate the social responsibility from sustainability and to use the investments in complimentary approach a matrix of investments on social responsibility and sustainability has been generated (figure 1) to be a useful tool for managers.

<b>Core topics</b>	<b>Social responsibility</b>	<b>Sustainability</b>
Investments aim	Stakeholder impacts	Social, economic and Environmental impacts
Investments means	Philanthropy; Volunteering; Engagement plan; Standard ISO 26000:2010	Equipment acquisitions; Standards ISO 14000: 2004-2012
Investments relations	Public relation; Business development	Public-private partnership
Strategy	Ethics; Fair business; Benchmarking; Relations; Communication	Total Environment Management

Core topics	Social responsibility	Sustainability
Managers' negative behaviour	Insincerity; Hypocrisy	Insincerity; Hypocrisy
Managers' positive behaviour	Employee engagement; Social and economic justice	Employees' flexi-security and health
Investments effects for companies	Shared values; Profit; Reputation	Survival; Development; Profit; Recognition
Investments effects for communities	Shared values	Added values; Living security; Resources conservation; Jobs

Figure 1. The Matrix of investments on social responsibility and sustainability

In Romanian companies the investments in social responsibility and sustainability are often wrong understood and applied. The harmonization of the two concepts in practice is approached by investments with the two targets: social responsibility and sustainability. The matrix proposed might better clarify the challenges that Romania managers have to face in order to respond to the European principles and to gain success and recognition regarding their activities' outcomes.

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## INFORMATION TECHNOLOGY AS AN ENABLER IN PRODUCE WASTAGE OVOIDANCE

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### ABSTRACT

The challenge of food wastage or food loss (food material that is discarded or unable to be used) is a topic of great concern and requires urgent action on the part of all stakeholders. As of 2011, 1.3 billion tons of food, about one third of the global food production was lost or wasted. Loss and wastage occurs at all stages in the food chain.

This research-in-progress paper focuses on the IS-based prevention of food waste alongside the food supply chain, beginning with the food production, via the food transport and distribution (whole sale and retailers) up to and including the food storage and consumption in the households. Besides other loss-prevention supporting activities, state-of-the-art information systems together with current technology can provide an opportunity for reduction of this loss in different stages of the food supply chain. This research paper delivers a systematic and structured overview of contemporary IS-based concepts and solutions to reduce food waste right through the food logistics chain and also the use of systems in wastage and its elimination through education.

For this paper, fresh water is not treated as food.

**Keywords:** Food wastage, IT, technology, Produce logistics, technology aided preservation

## EFQM EXCELLENCE MODEL AS A BASIS FOR SELF-ASSESSMENT: A STUDY OF ELECTROMECHANICAL SECTOR IN TURKEY

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### ABSTRACT

Because of the increasing demand for energy in Turkey as well as in the world, production and distribution sectors of energy have been developing rapidly and continuously for long years. By this study, it is aimed to get a snapshot of Total Quality Management activities of Turkey's low voltage equipment producers in electromechanical sector.

In this study, research is done under the circumstances of Excellence Model developed by European Foundation for Quality Management and its self-assessment form is used as survey tool. Amongst the findings are that many companies are aware of TQM in management and national and international quality awards encourage them on their journey towards quality. It was also found that companies from this sector should improve themselves on leadership, people and partnerships & resources criteria in order to gain competitive advantage.

**Keywords:** TQM, EFQM Business Excellence, Turkey's electromechanical sector, self-assessment

Track Number: 10 (Total Quality Management, EFQM Excellence Model)

### INTRODUCTION

Compared to western countries, the foundation of electromechanical sector in Turkey has started late and been developing slowly. Small enterprises began all their activities by producing only one kind of product without being coordinated by any nationwide organization. By the beginning of planned development period, Turkish state has started supporting investments and production of all machines and equipment attributed semi-

finished goods. Moreover; obtaining international capital and technology transfer by making license and know-how agreements with international companies has also been positively influencing continuous development of Turkey's electromechanical sector. After 1980's by the implementation of liberal economic policies, Turkish companies got more opportunities to export worldwide. Thus; Turkey's electromechanical sector has adapted itself easily for quality standards of international business environment.

This study focuses on Total Quality Management (TQM) activities of Turkey's low voltage electromechanical equipment producers. It begins by a short summary about EFQM Excellence Model and Self-Assessment. Then, it explains methodology of research and concludes with results obtained from the survey. Although Turkey's electromechanical sector exports continuously, employs thousands of employees and has important turnover rate, governmental and non-governmental associations and organizations haven't done any important and effective studies about this sector. By this study, it is aimed to point out more consideration in Turkey's low voltage electromechanical sector and it is hoped that this study will be a pioneer for further studies in this field.

## **EFQM EXCELLENCE MODEL AND SELF-ASSESSMENT**

The EFQM Excellence Model was created in 1991 by the European Foundation for Quality Management (EFQM) as a framework for applicants for the European Quality Award. It is used as a diagnostic tool to get a holistic view that is used more than thirty thousand organizations regardless of size or sector. This model can be accepted as a tool with nine criteria that helps organizations to identify their actual strengths and areas to improve (EFQM - The EFQM Excellence Model, 2013)

These nine criteria are divided in two groups; enablers and results. The five enablers criteria help to find out what an organization does and how does it, other four results criteria help to identify what is achieved by the organization (EFQM – The 9 Criteria, 2013). Moreover, EFQM Excellence Model is a dynamic model and every three year it is reviewed by academics, EFQM Partners and Assessors. Thus, in this study the last version of 2010 is preferred to use.

In social psychology, self-assessment is described as the process of looking at oneself to assess aspects that are important to one's identity (Sedikides, 1993). The self-assessment for management is also similar with psychology's approach. It is also a way for management

teams for the availability of resources and condition of their allocation by a process of increased awareness (EFQM – Self assessment, 2013)

Although there are many self-assessment methods of EFQM Excellence model, they are generally classified into three groups; simple perception based approaches, facilitated workshop approaches and awards submission or stimulation methods (Wallmüller, 2013).

## **METHODOLOGY**

This research is done to get a general view of low voltage electromechanical producers' situation according to TQM activities. The target is to find out companies' opinions about EFQM Excellence model and if they started practicing this model to identify their works situation.

Companies of the sample were chosen among the member lists of Electromechanical Industrialist Association of Turkey and the results obtained from internet search engines. For better research; cable producers, engineering and contracting companies etc. are not considered in our sample. The set of sample is selected from low voltage power distribution and electrical installation technology companies. Because these companies are generally international corporations which have better structured organizations and have an important role in electromechanical sector by their big turnover rates.

Design of the research is built on multiple-case studies and face-to-face interviews. The survey tool of our study is Quick Check is a MS Excel based tool. Because there is no scoring in Quick Check 2010, the scoring knowledge of the Radar is not required (Fisher, 2010).

The questionnaire considers sample companies in three dimensions. First, it asks qualitative descriptions of managerial applications to the measures. After that, the maturity and perceived strategic importance of the measures are rated on a five point scale and then they are summed up to calculate rating of each measure (Sozuer, 2011).

In Quick Check 2010 v0.2, first "Input Sheet" is completed, in which the common approaches used to implement the EFQM Excellence Model that are listed. For each approach, what is done in organization is briefly described and then from the drop down menu "Current Status" of this approach is selected. Then, the "Strategic Importance" is rated based on how the important this approach is to achieve organization's strategic objectives. The rating of status and perceived strategic importance are summed up to calculate each

measure's "Rating". Then all approaches are listed from high to low based on the measures of "Rating" so this indicates the priorities of approaches (Fisher, 2010). Measure Ratings of 8 and above are assumed as significant areas that require improvement according to the EFQM Excellence Model (Sozuer, 2011).

## AN ANALYSIS OF HUMAN RESOURCE EMPOWERMENT: A CASE STUDY IN THE HEALTH CARE SECTOR

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### ABSTRACT

#### PURPOSE OF THE STUDY

Empowerment, teamwork and organizational commitment enhance organizational performance (through improved service quality), of frontline hospital staff (administrative and nursing staff) in the public health care sector of New Zealand (Ashill, Carruthers, & Krisjanous, 2005). Moreover, research has suggested that human resource empowerment has positive effects on organizational members and increase organizational effectiveness in the health care sector (Spence Laschinger, Finegan, and Shamian, 2001).

Human resource empowerment refers to a change strategy with the objective of improving both the individual's and the organization's ability to act and to operate more effectively in an extremely competitive environment (Papaioannou, *et al.*, 2009). The primary purposes of this study were: (a) to determine the extent to which human resource empowerment is applied to a public hospital, and (b) to examine the relationship between human resource empowerment and health care managers' gender in a public hospital.

#### DESIGN/METHODOLOGY/APPROACH

The particular research project is an on-going research and up to now data has been gathered from a random sample of 20 health care managers (from medical, nursing and administration services) of a public hospital in the region of Peloponnese.

The study was a quantitative design and the analysis was exploratory in nature. Descriptive statistics and T-test were used to examine the purpose of the study, using SPSS software (version 17). For the purpose of this study a 30-item questionnaire, was used

(developed by Vogt & Murrell, focused on the issue of empowerment, was modified and simplified by 1990 and modified and simplified by Kriemadis, 2011 & Papaioannou, 2011), in order to provide information on how health care managers see themselves in terms of the human resource empowerment process and demographic characteristics, using a five point Likert scale. The scales represented three different managerial styles which were: (a) the “empowering style” of management, (b) the “middle-ground style” of management and (c) the “controlling style” of management. In the first case the manager has a managerial style that reflects the manager who creates and shares power. In the second case the manager has a managerial style that combines the two styles of controlling and empowering in equal proportions, and in the third case, the manager is concerned with control or seldom shares, creates or empowers subordinates. The reliability of the scale was found to be:  $\alpha = .82$ .

## **FINDINGS**

From the analysis it is shown that health care managers used 65% “empowering style”, and 35% “middle-ground style” in the six key factors of human resource empowerment (Total of all Managerial functions). Furthermore, there was a significant difference in the implementation of the human resource empowerment process between women and men health care managers, and more specifically, in the key factor of empowerment: “Total of all Managerial functions”, where women ( $M=3.59$ ,  $SD=.507$ ), had significantly a lower level of human resource empowerment than men ( $M=4.00$ ,  $SD=.000$ ) ( $t(16) = 3.35$ ,  $p=.004$ ). The findings of the present study are consistent with previous studies in the service sector (Hechanova, Alampay, and Franco, 2006), and show that the implementation of the human resource empowerment process is related to the managers’ gender, and propose that the policies dealing with human resource empowerment should therefore be gender sensitive (Smith, & Greyling, 2006).

## **RESEARCH LIMITATIONS**

The study was delimited to a questionnaire designed to collect data regarding human resource empowerment according to Vogt and Murrell (1990).

The following were acknowledged as the limitations of the study:

- **The honesty, accuracy, and objectivity of the respondents when completing the questionnaire**
- The respondent's level of understanding of the empowerment vocabulary.

A useful investigation might be undertaken to research if human resource empowerment affects private hospitals' performance. Areas of further research could also include measuring the impact of human resource empowerment on the loyalty of customers.

## ORIGINALITY/VALUE

This study is useful in extending the concept of human resource empowerment to the health care sector. The study will be useful in helping health care managers to their further understanding of the human resource empowerment process in their respective organization.

**Keywords:** Human Resource Empowerment, health care sector, public hospitals.

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## INNOVATIVE MARKETING STRATEGIES IN FAMILY OWNED BUSINESSES: A WORK IN PROGRESS FRAMEWORK TO INTEGRATE SOCIAL MEDIA

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### ABSTRACT

The specific aim of this research is to understand: 1) how Family Owned Businesses (FOB) use new innovation and technology, in particular social media, in their business; 2) how customers evaluate the adoption of social media by FOBs; 3) how social media enhance business performance and customer loyalty 4) how the gaps can be filled by an innovative marketing strategy. A quantitative approach is employed to answer the research questions. Several modern statistical techniques are employed to analyze the data. Finally, an innovative framework on integration of social media into marketing strategy of a typical FOB is provided

### BACKGROUND

Family Owned Businesses (FOB), with a long and remarkable business history, deliver a fundamental contribution to economic development and help create our quality of life as they are major vehicles for the generation of employment and income. Although there is no exact statistics about the contribution of family firms to employment and economy/GDP, most researchers agree on the high level of contribution of FOBs to national development and well-being (Astrachan and Shanker, 2003). Two thirds of all enterprises worldwide are said to be FOBs or managed by families (Gersick et al., 1997). Due to this high importance of family firms, academia has recently begun to recognize their significance as a research object (Chrisman et al., 2006; Bengtson et al., 2005).

Our literature review reveals that FOBs have been studied from different aspects, for instance, Kraus et al. (2011) has recently studied entrepreneurship orientation comprehensively. Nevertheless, despite the progress made especially in the last decade, research on family firms remains a new field which is trying to gain legitimacy within management studies (Hoy, 2003; Dyer, 2003). This topic is particularly important given the challenging economic

climate and the need to understand the distinctive characteristics of FOBs that help them to endure from one generation to another.

Social media is a great way to form closer relationships with customers. Recent development and the high-adoption level of social media among customers/people attracted academia and practitioners to probe more into the subject and propose how social media can be initialized within corporations (Keitzmann et al., 2012; Kim et al., 2010). Social media offers an opportunity to connect and interact with customers, promote brand, drive traffic to website, protect and build the digital reputation of corporations, e.g. FOBs (Evans, 2012; Kaplan and Haenlein, 2010) since whether FOBs want it or not, conversations (through word-of-mouth) occur with or without them.

## **METHODOLOGY**

To test the model we decided to perform a cross-sectional survey. In particular we selected a sample of Japanese FOBs belonging to the most representative industries for the Japanese economy (metal products and machinery equipment; furniture; chemicals and food). In particular to identify FOBs we first of all followed the definition of FOBs of the Japanese. We will use West and East Directories (2012) to identify our target companies in Japan. To ascertain the psychometric properties of the third version of scale, a systematic random sampling method will be employed. Data will be collected by means of a mail survey questionnaire completed by owners located in different provinces in Japan. Managers and owners comprise the key informants for their participation in innovation and new service development (Tajeddini, 2010; Tajeddini and Trueman, 2012). Thus, after the process of refining and finalizing the questionnaire, a systematic random sampling procedure will be adopted to draw a sample of our target companies located in Kyushu, Osaka, Kyoto from our database.

## **RESULTS**

A study on adoption of social media in FOBs aiming to exploit an innovative marketing strategy for FOBs is needed. Our research strives to build a bridge between FOBs and social media. In fact, we attempt to answer such research questions as: what are the attitudes of FOBs toward social media, how do they evaluate its importance, benefits, obstacles and challenges in adoption of social media, and finally what methods exist to embed social media with their (current) marketing strategies.

The specific aim of this research is to understand: 1) how FOBs use new innovation and technology, in particular social media, in their business; 2) how customers evaluate the adoption of social media by FOBs; 3) how social media enhance business performance and customer loyalty 4) how the gaps can be filled by an innovative marketing strategy.

A quantitative approach is employed to answer the research questions. Several modern statistical techniques are employed to analyze the data. Finally, an innovative framework on integration of social media into marketing strategy of a typical FOB will be provided.

**Keywords** Family Business, Family Owned Businesses, FOB, Social Media Marketing, B2C, Innovative Marketing, Word-of-Mouth, Evaluation of Social Media, SMEs, Entrepreneurship.

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## GOVERNMENT - ACADEMY DIFFERENT APPROACHES TO TECHNOLOGY TRANSFER

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The paper will present the conflict between the natural preference of Technology Transfer Organization (TTO)'s regarding commercialization for the licensing option and the government preference for Spin-Offs. The conflict regarding preference for one of the two main Technology Transfer options: the first, the licensing or selling of the technology and the right to use it to existing commercial entities; the second the spinning –off of firms, in which new firms are formed, to which the technology is transferred. It will further suggest that the less than expected results, are due to the conflict.

The recent prevalence of TTOs and TT support tools, (e.g. professional training, hand-books, seminars, associations etc.) are evidence of the effort to affect technology transfer from the Academy to the Industry (Fontana, Geuna and Matt, 2006). The Academy or Research Organization are organizations dedicated towards the creation of knowledge and in most cases (e.g. universities) also teaching. However, another function is the transfer of the knowledge created from these organizations to society, and in most cases that would mean the industry. For that purpose, the Academy employs internal units (the exact legal entity is depended upon the national legal system) specializing in the transfer of that knowledge – Technology Transfer. The two main avenues for Technology Transfer (TT) are Spin-Offs which is the creation of new (start-up) companies owning the technology created by the Academy (these start-ups by nature are small and therefore are included in the sector of Small and Medium enterprises – SMEs), and Licensing - in which the technology is transferred by licensing to existing companies which make use of it in their products and services. In recent years, the EU Commission (EU 2009; EU-IPR, 2010; EU-SME. 2010; FP7, 2010), has been advocating such transfer and has been promoting the transfer not only of technology but also of expertise and research capabilities (e.g. FP7 IAPP), and at the same time has put a lot of emphasis on the applicability of research results (EU, 2003; EU, 2009; EU-IPR, 2010; EU-SME, 2010). It seems however, from various reports (EU, 2006) and from the emphasis on strategies like, venture capital (EU, 2011a; EU, 2011b), that the main policy of the government is that of encouraging start-ups or spin-offs from Academia.

That policy is understandable from a governmental point of view, start-ups promise the immediate job creation that can be directly linked in an obvious way to the effort of Technology Transfer. It is therefore both, direct and measurable. In this aspect, licensing while it increases the employment of the firm by receiving the technology but presents some obvious difficulties regarding the casualty of the employment and the Technology Transfer. Licensing also makes it more difficult to measure the additional investment resulting from the process than a start-up, where all investment can be directly linked to the TT.

Therefore, for governments, interested in a measurable, direct and obviously linked to their efforts economic growth, start-up formation is a preferable solution. Additionally, SMEs make the economy more robust. The SME are faster, more resilient, require smaller markets to survive and even when they fail they discharge a smaller number of employment seekers than large firms. Building mechanisms for the easy creation of SMEs is, therefore, an economic necessity for an economy competing in international markets. Furthermore, there are additional side benefits to the Spin-Off support policy.

The evident side benefit is the formation of a service sector, the venture capital sector, which is by offering an alternative venue for investment, makes the entire financial sector more robust. That sector can attract international investment from large multinationals, creates jobs, and as a byline for its activity helps circulate the funds in the market.

For most countries where there is an increasing number of PhD holders, not in academic track, the development of the start-up sector offers another side benefit, as an outlet for the surplus of PhD holders, without burdening the academic sector. From SMEs it would spill over to the other firms in the industry.

The direct benefit as well as the side benefits explains the government preference for Spin-Off support policy. Therefore, when looking to promote that activity and deciding to help the research organizations in the process – by forming the TTOs, financing them and offering other support measures, that preference was naturally made obvious to the TTOs. However, several questions arise, as what is best for the source of the knowledge, the universities and research organizations (Luukkonen, 1998; Luukkonen, 2000)? Do they have the same preference (Laursen, and Salter, 2004)?

A research organization would have an obligation, even if only implied, to transfer its knowledge in a way that would best benefit society. Most research organizations are

supported by either official public funding, such as government budgets, or by other "public" funds, such as donations. These create an obligation to act in the public's best interest. To make sure, for example, that knowledge created by them is used to benefit the society. If they discover a drug candidate that can help cure cancer, then they should make it available to the pharmaceutical industry, so it can get it approved and then produce and sell it to the people who need it. If the new knowledge is a new communication algorithm that requires less energy and can, therefore, save energy, reduce radiation, it should be transferred to the relevant industry to improve the lives of the users.

Based on that understanding, as well as being interested in the economic benefits to be derived, the universities in most cases embraced the TTO formation. However, after consideration of the process involved it would seem that the licensing track is more attractive. When forming a start-up, there are risks involved that have nothing to do with the technology, as there are issues of managerial mistakes, not enough VC funding available and any number of reasons start-ups fail (EU, 2011a; EU, 2011), plus it takes time for that start-up to crank up the marketing and sales infrastructure that will allow to maximize economic returns. Of course the start-up may not grow up to return the high yield expected after all the works. There are heavy investments to be repaid etc. which make that Spin-Off a riskier and in the short term a less economically viable choice.

At the same time licensing to existing companies may create revenue almost immediately, depending on the licensing agreement and sector, there may be interim payments during development, and registration of the products to the TTO / research organization, which cannot be expected from a start-up. Further to that, once the product is ready for sale, the licensee would have a fully developed production and marketing infra-structure in place to capitalize on the investment. It would, therefore, seem faster and less risky for the TTO to opt for the licensing choice when available.

Along this route, a very relevant question may come up, as what happens when the two, the government preference and the TTO preference clash? That would depend in many cases on the funds available for the TTO, the nature of its knowledge and similar factors. The TTO would prefer to license but would spin-off when there is little choice, or when there are funds available for that almost exclusively. That is the case when the government concentrate efforts on the creation of financial tools for start-ups in preference to other options. Since that would make the TTO generate less income, and would make the economic independence of the TTO more difficult to attain, it would certainly take more time to reach this stage, it will make the

TTO seem less profitable and reduce that attractiveness of the TT process as an academic endeavor.

At the end an alternative is presented. The alternative suggests supporting the natural tendency of the TTO and allowing for excess activity to "Spill-Over" to the Spin-Off activity. That alternative is based on the assumption that strong TTOs encourage all venues of Technology Transfer, and have the power to sustain even less lucrative venues, or long term activities. By creating support mechanisms for the licensing activity or for the TT process in general, and allowing the TTO to select the best venue, new TTOs would be able to show economic results that would boost their activity and the transfer of knowledge to the industry. Additionally since not all knowledge can be effectively licensed, the TTOs will pursue the venue of Spin-Offs when appropriate, and in time will also create new start-ups. In that way more knowledge would be transferred and new firms would be created, with all the side benefits mentioned above. All that while the TTOs will be stronger and the TT process will have a more attractive image for the Academy in general.

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## IS THAT THE DIASPORA CAN BE A NETWORK OF INFLUENCE IN THE CREATION OF BUSINESS IN ITS COUNTRY OF ORIGIN ? CASE OF THE LAO DIASPORA.

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### ABSTRACT

This contribution is intended to supplement the work of researchers in innovation networks (Dicken 2001, Bathelt and Taylor 2002, and Hamdouch Depret 2009, Ter Wal and Boschma 2009) [1] , an empirical study of Johanson and Wiedersheim Paul (1975), which describes internationalization as a slow, gradual [2] and the work of Ferrary, Pesqueux (2004) on the network organization [3] . The question of the role or the impact of influential networks in the internationalization of high-tech SMEs highlighted through four case studies such as those of Colombia (Prefontaine, Ferro, Skander) [4] leads us to make a comparative study against a diaspora network in entrepreneurship specifically the People's Democratic Republic of Laos.

Our problem is a first step to a typology of diaspora network in addition to that of Marc-Hubert and Depret Abdelillah Hamdouch (2009) on "logical clustering to work in high-tech sectors" ! secondly to analyze whether this kind of network can lead to value creation in an economy like communist.

Two hypotheses emerge from our study, firstly if the Lao diaspora network is understood as Barnes (1954) and Mercklé (2004) "networks or social groups" or following the sociological approach of Granovetter (1985) as "concrete personal relations and structures that generate trust and discourage malfeasance [5] Castells (1998) defines it as" a new technological paradigm and a new organizational logic "And Voisin (2004) "relationships that the organization and its environment " (Ekaterina in Le Pennec), on the other hand, the assumption that the organization has a weight, structure recognition, a notion of influence of French and Raven (1959, 1965) or lobbying in the sense of economic intelligence.

Our methodology uses temporal organization in the sense of Orlikowski (2002) for which the structure of time guide, directs and coordinates activities over the next *Chrosnos* and *Kairos*, ie the extent and purpose or propriety sought. It shows a long-term study, an analysis in the

time since the beginning of the formation of the diaspora and continues for almost four decades. The history of diaspora networks Entrepreneurship edited by Ina Baghdiantz McCabe, and Ioanna Gelina Harlaftis Pepelasis Minoglou explain why some countries have done better than others in the globalized competition. Diaspora networks highlighted at a conference in Cyprus under the direction of Georges Prevelakis explain how major cities become hubs of diasporas : a key to the analysis of the world of the XXI century.

Our field of research is the management sciences interdisciplinary management but is not excluded since we also use philosophy, psychology, sociology, geopolitics to achieve our result. These classical philosophers named Platon, Aristote, Epicure, Saint Augustin, Saint Thomas described by Hannah Arendt (1958) in "condition of modern man" and Jean François Revel (1994) direct us to our result.

In this study, a model was released, "sharing-effort-forgiveness-liberty". This effort defined by the dictionary as "an energetic action of the body or the mind towards a goal" and above all to share or forgiveness to be free out the human condition, the sine qua non of success.

The contribution of our research is complementary to the science research management, field management and innovation for the development of entrepreneurship, but it remains limited in practice due to the complexity of the man, the organization, strategy manager or stakeholders, the tension between the rights and the law described by Yvon Pesqueux (2009) "Network, stakeholder theory and deliberative democracy".

**Keywords** : Network, diaspora, entrepreneurship, processing, dissemination, information.

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## **HORIZONTAL MERGERS AND ACQUISITIONS: HOW WINNERS AND LOSERS DIFFER: A MARKETING PERSPECTIVE**

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### **ABSTRACT**

A majority of mergers and acquisitions are horizontal, combining companies within the same industry, motivated by a desire to achieve revenue and profit growth, with cost efficiencies being a secondary agenda. However, most research on post-merger performance has focused on cost efficiencies achieved through asset disposals, and economies of scale or scope. This paper argues that there are far greater gains to be made by deepening our understanding of post-merger performance from a marketing perspective, by investigating whether and how acquisitions achieve revenue gains, particularly the relative contributions of market expansion and product portfolio optimisation. Jaguar/Land Rover provides an excellent case study for an exploratory analysis of this topic. Tata Motors has had considerable success with a much more marketing focused strategy.

### **INTRODUCTION**

It is well-known by now that mergers and acquisitions (M&As) come in waves and we have witnessed a major wave through the 1990s and up to 2007 when the value of deals reached an all-time record level of \$4.4 trillion representing 76,000 transactions (Martynova and Renneboog, 2008). Given this very active market for corporate assets, mergers and acquisitions have received extensive research attention from several disciplines, with most from Finance and Accounting, and least from Marketing. Each discipline looked at M&A transactions through its own lens, with one section of the literature concerned with the causes and characteristics of M&A transactions, and another concerned with the gains and losses resulting from M&A transactions.

Despite the extensive volume of research and the variety of the methodologies applied, the evidence is extremely mixed, with a broad consensus that mergers and acquisitions do not

add value (Andrade et al., 2001; King et al., 2004; Tuch and O'Sullivan, 2007; McNamara et al., 2008). A meta-analysis based on the results of 93 studies representing 206,910 companies conducted by King et al. (2004) provides a comprehensive summary of the accounting and finance research. They studied post-merger performance of acquiring firms measured by return on assets (ROA), return on equity (ROE) and return on sales (ROS) over a series of event windows (days 1-5, 6-21, 22-180, 181-3 years and greater than 3 years), using both operating performance and stock market data. They found that, after the day when the merger is announced, all of the 'abnormal returns', that is, returns over and above the norm for the industry, for the acquiring firms are either insignificant or negative. These results strongly suggest a conclusion that anticipated performance outcomes are not realised by acquiring firms.

The mixed findings of financial measures of post-merger performance may be attributed to the wide variety of methodologies used and thus are not directly comparable. Furthermore, none of these studies examined the factors influencing merger performance, i.e. what makes a merger successful or otherwise. This suggests an opportunity to add value to the literature on post-merger performance by bringing a marketing perspective to the study of why some mergers succeed while others fail. This paper reviews the little evidence that does exist with regard to M&A performance on a range of marketing variables, and identifies gaps in our knowledge and understanding around those topics. This review is brought together in a summary model that identifies a set of propositions concerning possible marketing strategies and objectives for M&A. A preliminary test of these propositions is carried out by means of a case study analysis focusing on the Jaguar and Land Rover Group which was acquired by Indian automotive company Tata Motors from Ford Motors in 2008.

## **LITERATURE REVIEW OF POST-MERGER MARKETING PERFORMANCE**

While the vast majority of earlier post-merger performance studies took either the shareholders' or accounting managers' perspective, only a handful of studies have tried to detect gains from mergers and acquisitions in the form of increased sales revenue and market share. Others have contributed some evidence with regard to what happens to marketing costs post-merger. These few marketing studies are listed in Table 1, and the evidence their findings are summarised below.

**Table 1: Studies on post-merger marketing performance**

Study	Sample size and country	Industry	Variable examined	Findings
Goldberg (1973)	44 conglomerate mergers. 1950s and 1960s. USA	Mixed	Market share	Market share increase for 28 firms and decreased for 13 firms
Mueller (1985)	209 M&A, 1950-1972, USA	Manufacturing	Market share	Declined
Gugler et al. (2003)	1250 M&A, 1981-1998, Different countries	Mixed	Sales	Declined
Ghosh (2004)	2254 M&A, 1985 to 1999, USA	Mixed	Market share	Increased

In sum, a majority of the studies that have investigated the sales revenue following mergers and acquisitions have produced disappointing results. Gugler et al (2003) concluded that “no study of which we are aware has found significant increases in either the internal growth rates of merging companies or their market shares following acquisition, and several have reported significant declines”.

## **A NEW MODEL FOR STRATEGIC MERGER MOTIVE AND POST-MERGER PERFORMANCE**

As a way of summarising this literature and to help identify gaps for research, we have developed a typology of strategic objectives for horizontal mergers and acquisitions, building on the classic Ansoff strategy matrix (Ansoff, 1957). This model views M&A as driven primarily by marketing objectives, in particular, expansion of market coverage and product portfolio extension, or some combination of these two. This model is shown in Figure 1.

The general premise underpinning this model is that firms making acquisitions are typically driven by the desire for growth, and this growth can come from expanded market coverage or an extension to their product line, or some combination of these. It is further assumed that

these objectives are valuable in their own right, even if they do not appear to gain in terms of financial metrics. In other words, a firm might succeed in increasing its product portfolio strength and market coverage, which is a valuable outcome, even if it does not make any significant gain in profit margins or share price in the short-term.

**Figure 1 Marketing Objectives for M&A Transactions**

	Same market	Different market
Same product	Consolidation /Cost synergy	Market Coverage Expansion
Different product	Product Portfolio Extension	Market and Portfolio Expansion

These marketing benefits come at a cost, however, most particularly in the price paid for the acquisition, but also in integrating the acquired business, and in the marketing investment required to build the acquired business so as to extract the perceived growth potential. These costs and benefits are finely balanced and, a misjudgement in managing them can easily mean a negative outcome from the whole transaction. Greater understanding of these risks and trade-offs through further research can only help to improve the probability of success, and filling that knowledge gap is the challenge for future marketing research. The case of Tata Motors acquisition of Jaguar/Land Rover seems an interesting example with which to explore these topics.

## **TATA MOTORS' ACQUISITION MOTIVES**

Before the acquisition, Tata was at best a regional player but the purchase created the opportunity to expand its presence in the passenger car market beyond India and gave it the clout necessary to compete with global automotive players. Acquisitions of these two renowned brands helped Tata to enter the luxury segment of the auto industry. Tata Motors stated that “we believe that our acquisition of the Jaguar Land Rover business will enable us

to expand our product range and extend our geographical reach..... Jaguar Land Rover has given us the opportunity to participate immediately in the luxury performance car and premium all-terrain vehicle segments with globally recognized brands and has diversified our business across markets and product segments” (Tata Motors, Form 20 F 2008)

It thus appears that the Tata acquisition was motivated by a revenue-based synergy through capitalizing on the strength of these two brands and expanding into other geographic markets, although it was also motivated by opportunities for synergy in other areas of operations as well.

### **TATA MOTORS GOT MORE THAN WHAT THEY PAID FOR**

Tata Motors paid more than the price the market expected for JLR, but this was still about half what Ford originally paid. Ford paid USD 2.5b for Jaguar and USD 2.73b for Land Rover in 1989 and 2000, respectively. In addition, Ford Motors paid USD 600m for the pension plan. Tata Motors acquired these two iconic brands combined for USD 2.3bn in cash. The acquisition price paid by Tata included global businesses relating to JLR including three vehicle manufacturing facilities, a worldwide sales and dealership network, one veneer production facility, two advanced design centres, 26 national sales companies, intellectual property rights (including perpetual royalty free licenses), and brands and trademarks (Tata Motors Annual Report, 2008).

Industry analysts commented at the time that Tata got these two brands at a bargain price (Economist, 2008). Tata bought these two brands at a price (USD 2.3b) below the book value of the assets of these two brands (USD 2.46b).

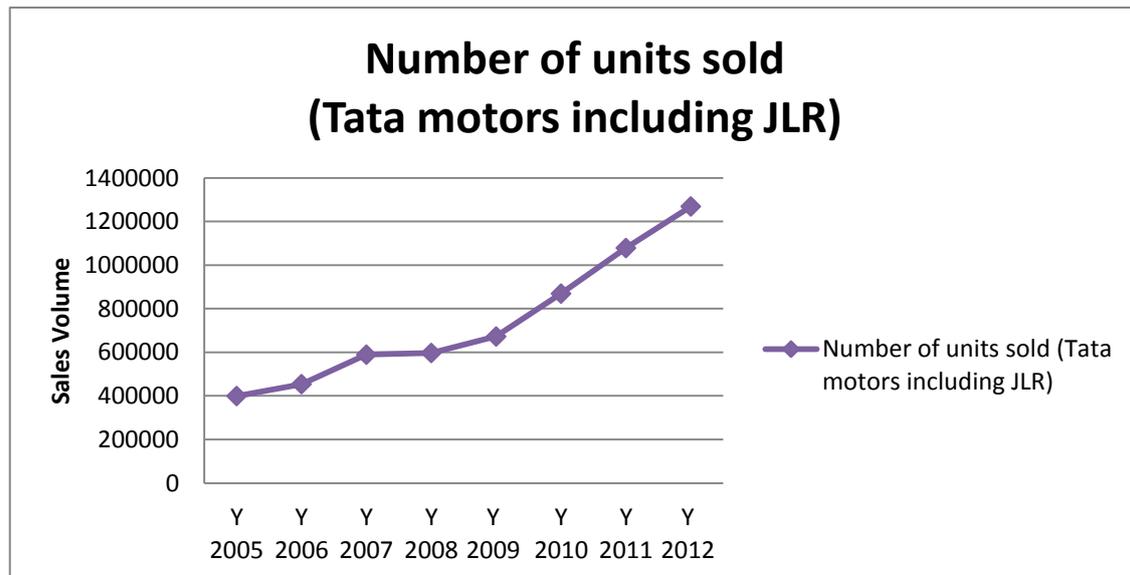
### **EVIDENCE OF GAIN FROM BRAND PORTFOLIO AND MARKET EXTENSION**

Below we have analysed the performance of Tata Motors including JLR in the pre- and post-acquisitions years.

### Sales Volume

Figure 2 below shows the number of cars sold by Tata Motors in the pre- and post-merger years. The graph demonstrates that Tata Motors sales volume grew rapidly in both pre-merger and post-merger years.

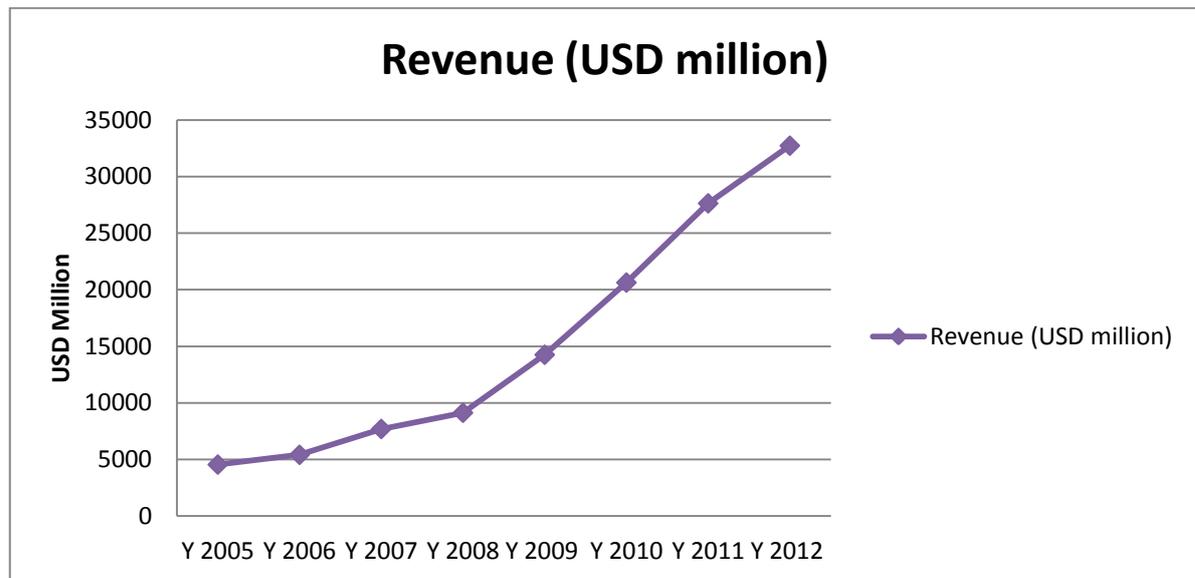
**Figure 2 Consolidated Sales Volume of Tata Motors**



Tata Motors has been performing better than the industry average both in the pre and post-acquisition years. The average global automotive industry growth rate in the three years before the merger was 4% whereas Tata Motors grew by 45%. The average global automotive industry growth rate in the three years after the merger was 23% whereas Tata Motors grew at an astounding 71%. It clearly demonstrates that the acquisition of Jaguar and Land Rover helped Tata Motors to further enhance its performance. The three year average sales growth difference between the global auto industry and Tata Motors was 41% in the pre-merger years and this difference in the post-merger years rose to 48%. It thus may be assumed that the additional growth rate of 7% (48-41 %) was because of merger synergy.

### REVENUE

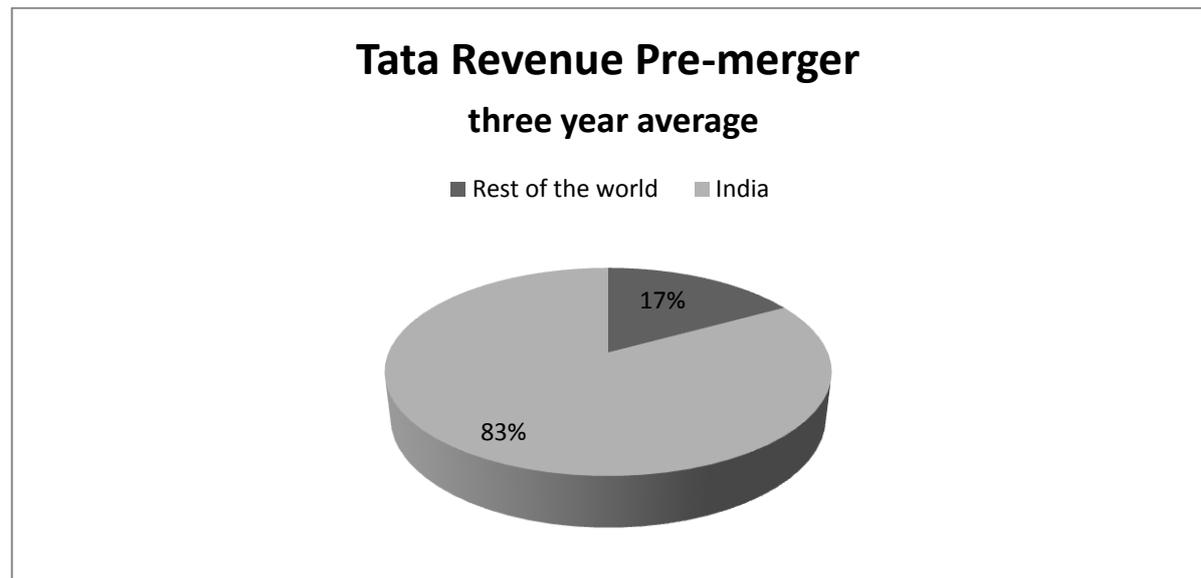
Figure 3 below illustrates that Tata Motors annual revenue also improved significantly following the acquisition in 2008.

**Figure 3 Tata Motors Consolidated Revenue**

The three years average revenue growth in the pre-acquisition years (2005-2007) was 34.38%. On the other hand the four years average revenue growth in the post-acquisition years (2009-2012) stood at 38.32%.

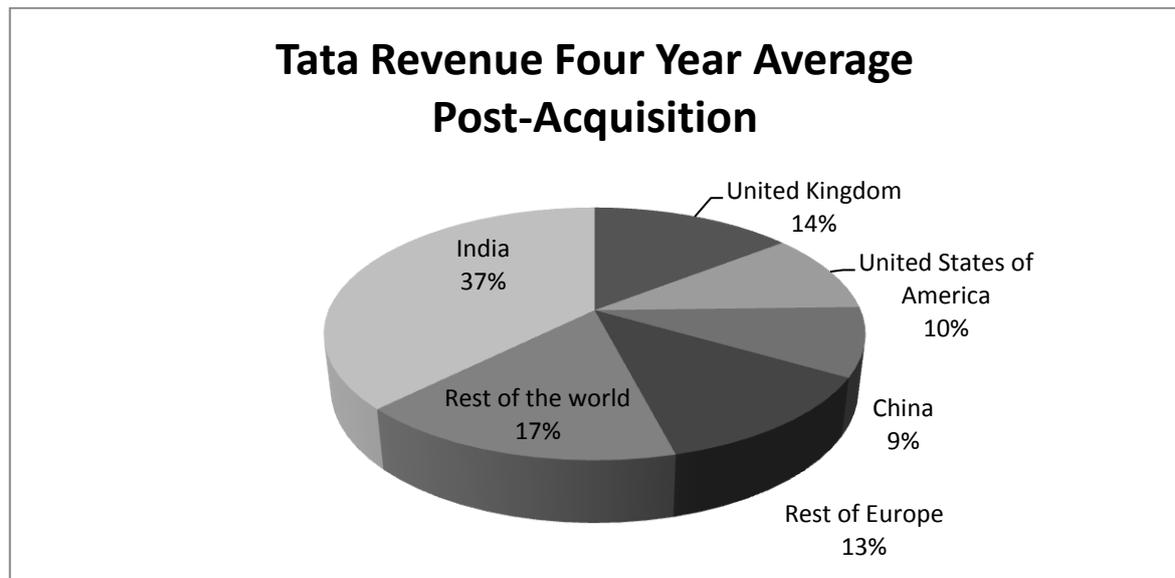
### **CONTRIBUTION OF GEOGRAPHIC MARKET MIX TOWARDS REVENUE**

The main focus of Tata Motors was on the Indian automotive market before acquiring Jaguar and Land Rover. As shown in Figure 4, more than 80% of revenue came from the Indian market while only 17% of revenue was generated from the rest of the world market. This is not surprising given the fact that Tata Motors brand portfolio mainly consisted of organically grown brands with little or no brand equity outside the Indian subcontinent.

**Figure 4 Tata Motors Geographic Distribution of Revenue Pre-Acquisition**

The pie chart in Figure 5 shows that the acquisition of Jaguar and Land Rover turned Tata Motors into a global company by way of adding global luxury brands to its brand portfolio. The average revenue contribution in the four years after the acquisition from the Indian market was only 37% while revenue from other global markets stood at 63% in the four years following the acquisition of Jaguar and Land Rover.

It can be concluded therefore that the addition of Jaguar and Land Rover brands benefited Tata in two ways. First, the merger gave Tata exposure to new geographic markets and, second, inclusion of these two brands helped Tata to fill in its brand portfolio with two complimentary brands. More importantly, the acquisition helped Tata to lessen its dependence on one single market, i.e. India.

**Figure 5 Tata Motors Geographic Distribution of Revenue Post-Acquisition**

## SUMMARY AND CONCLUSION

It appears from the above analysis that Tata Motors successfully turned around the ailing JLR brands and made them profitable in a very short span of time. Our analysis revealed that the motivations for Tata's acquisition of Jaguar and Land Rover were two-fold: firstly, to extend the brand portfolio of Tata Motors which was mainly comprised of brands focused on the Indian market. Acquisition of Jaguar and Land Rover transformed Tata's brand portfolio into a global one. The second motivation for the acquisition was to extend the market coverage of Tata motors. We analysed a number of performance measures to gauge the impact of brand portfolio and market extension. We found that brand portfolio and market extension have positively affected the performance of Tata Motors.

We found that the sales volume and revenue grew significantly in the post-acquisition years compared to the pre-acquisition years. It can be concluded therefore that Tata motors was able to achieve revenue synergies through extension of its brand portfolio and geographic markets. Moreover, Tata Motors was able to transform itself from a local company into a global one through acquisition of Jaguar and Land Rover. Before the acquisition, 80% of the revenue of Tata Motors came from India. After the acquisition, only 37% of revenue was earned from the Indian market. Tata was able to increase the sales volume for both Jaguar and Land Rover.

Our analysis further proved that variables which earlier M&A research found to have an impact on post-merger performance did not negatively affect post-acquisition performance of Tata Motors. We examined such variables as price paid for the acquisition, method of acquisition, and the mood of the acquisition. Tata Motors bought these two brands at a bargain and the price paid was below the book value of these two brands. Studies have shown that many M&As fail because of over-payment. Tata Motors got off to a good start by buying two global brands at a bargain price. Moreover, Tata bought these brands on a cash-free and debt-free basis which means that it avoided the debt burden and this gave it enough leeway for future planning for these two brands.

Secondly, the mood of the acquisition was friendly which is borne out by the positive attitude of JLR's stakeholders including employees and dealers. The employees throughout JLR and dealers welcomed the acquisition which made it easy for Tata Motors to put the two firms together despite huge national cultural difference between the two firms. Because of being a friendly takeover, the post-merger integration was smooth which facilitated performance improvement post-acquisition.

Furthermore, Tata Motors embarked on a massive plan for new product development through heavy investment and capitalized on the two iconic brands acquired by introducing a number of new models into the market. Our analysis has revealed that the new models introduced were hugely successful such as Land Rover Evoque.

In sum, this single case study provides preliminary evidence to suggest that our model of merger motivations has strong face validity, and provides encouragement to continue our study of this topic, based on a larger cross-sectional sample.

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## **A CAUSAL MODEL OF THE INTERNATIONALIZATION OF SMES AND OF THE TRANSMEDITERRANEAN: THE CASE OF MOROCCAN SMES**

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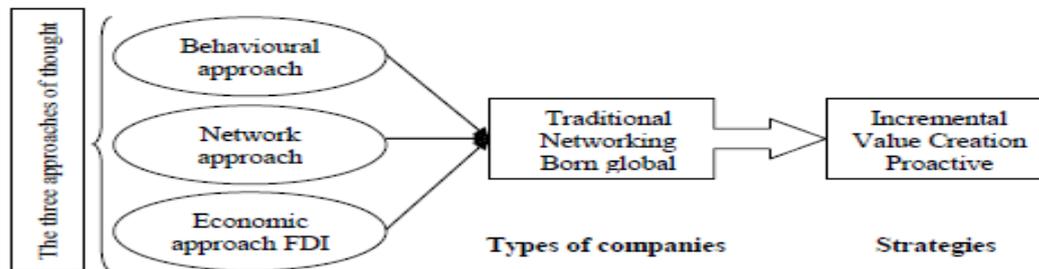
### **ABSTRACT**

### **INTRODUCTION**

In search of the ways to developing opportunities offered by markets around the world, several large and small companies are still trying to adopt approaches and structures cross-border. These behaviors of international openness have aroused abundant literature. They are rare the texts that focus on the process of internationalization of small and medium enterprises (SMEs), particularly in developing countries. However, local bases are increasingly mentioned as key factors explaining the behavior and performance of firms (Audretsch and Dhose, 2007). The objective of this research is therefore to highlight the specificity of the process of internationalization of SMEs in the southern Mediterranean countries and develop a causal model of this process and of the Transmediterranean factor. How this model allows it to explain the internationalization process of Moroccan SMEs?

Among the changes in the Mediterranean, two mainly have led companies to increase their presence in the international trading system. On one hand, is the integration into a model of regionalism, and on the other hand, the progress of multilateral liberalization (The signing of the GATT / WTO agreements). The increasing integration of economies is not without effect on the behavior and strategies of the companies. It is therefore important to understand how and by which means companies will be able to relay and reinforce the movement of internationalization. To do this, we must turn to the available literature on this subject. We consider the statement in Etemad and Wright (1999) and Mtigwe (2006), in which the issue of the internationalization of SMEs refers to a holistic approach resulting from the joint consideration of three schools of thought: i) incremental thought developed by the behavioral approach, ii) the thought of alliances with network theories and iii) economic approach with theories of foreign direct investment (FDI). Figure (1) describes how these three schools combine to contribute to the emergence of a unified theory of the internationalization of SMEs.

**Figure 1 - The characteristics of the three schools of thought in the theory of internationalization**



Source: prepared by the authors.

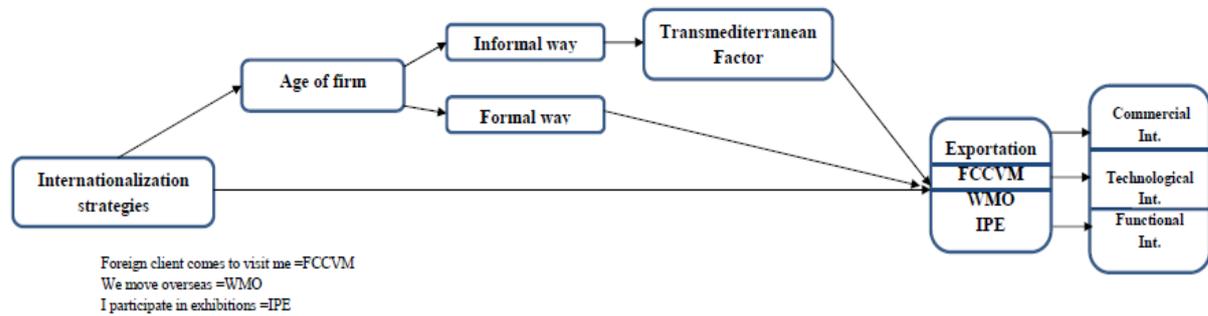
Thus, we refer to the technological internationalization affects systems and modes of production, functional internationalization modifies operating modes and organization of firm and commercial internationalization that focuses on the flow of goods, exporting, importing, outsourcing, subcontracting, etc. (Perrault and St-Pierre, 2008).

## EMPIRICAL ANALYSIS

The empirical data of our study were collected by means of an ad hoc survey conducted on 22 Moroccan companies during the first semester of 2012. A questionnaire, managed face to face, related to information about business characteristics, motivations and challenges of internationalization. The conclusions of the analysis were supported by descriptive statistics, factor analysis and logistic regression analysis.

We have shown that the majority of companies do not belong to the Transmediterranean trading networks, to a network of Transmediterranean entrepreneurship nor a Transmediterranean exchange platform. In our analysis, 15 respondents indicated having no strategy for the expansion of Maghreb to Europe. Of the respondents, 17 considered the Maghreb as a reinvestment place of Maghrebian. This is explained by the informal ways of their investments in their countries of origin. In other words, the international development of these companies depends on the Maghrebian diaspora. We analyzed our causal model to test the relationship between the process of internationalization of Moroccan SMEs and the influence of Transmediterranean factor. Figure 2 presents the main results of our research.

**Figure 2 - The causal relationship between the internationalization of SMEs and the Transmediterranean**



Source: prepared by the authors.

Our results showed that the age of the company seems to play a key role in the involvement in Transmediterranean relations. Older firms (between 20 and 49 years) are more involved in the Transmediterranean aspect than younger (less 20 years). More a Mediterranean company is elder more the Transmediterranean factor is part of his internationalization strategy.

According to our empirical analysis four classes appear. A first class is composed of companies that take into consideration the Transmediterranean factor in their internationalization strategy. However, to date, they applied only the functional internationalization (FI) because the CEO of these companies moves overseas to identify new opportunities (WMO). They also participate in exhibitions to build networks with foreign companies for possible cooperation (IPE). These firms operate organizational and functional change in order to follow the development of their international activities. A second class gathers non-exporting firms that consider the local market is sufficient (LMS) and these firms remain unresponsive about the existence of a Transmediterranean factor. They are anchored locally and international development does not influence their strategy. The third class includes companies that anticipate their internationalization by having visits of their foreign customers (FCCVM). They are involved in a process of technological internationalization (TI) but they have never tried to establish a foreign subsidiary and do not take the Transmediterranean factor in their internationalization strategy. These companies are trying to change their production methods to improve their competitiveness in the domestic market and to face competition from multinationals. A fourth class includes the traditional companies who engage in the traditional form: commercial internationalization (CI) via export.

The analysis of the relations in Maghreb of surveyed companies identifies three types of attitudes. The first type corresponds to profiles of companies that do not consider the Maghreb as a place of reinvestment; they do not put up expansion strategy towards Europe

and do not consider Transmediterranean relationships as specific items because they are not established by the Maghrebian in Europe. These companies are involved in a process technological internationalization (TI), they have made changes in their production methods and, for now, develop the local market in order to face the competition in this market. A second type gathers exporters mainly engaged in a commercial form of internationalization (CI). They consider that there is no need to develop a specific strategy to international trade between the two sides of the Mediterranean. They are confined to the more traditional aspect that concerns some international clients with whom they used to work and focus on some exports without seeking to strengthen their presence on both sides of the Mediterranean. The third type includes companies that consider the Maghreb as a privileged place of reinvestment of the Maghrebian from Europe. They emphasize the existence of a strategy of openness towards Europe. They believe that the Transmediterranean relationship is based on the Maghrebian from Europe, and it is necessary to develop a new exchange strategy between the two sides. These companies are conscious of business opportunities between the two sides of the Mediterranean. That is why they have started a functional internationalization process to adapt in advance.

## CONCLUSION

In conclusion, the support measures could be more effective if these companies were reorganized. It would be better to focus on the experience of the entrepreneur and the development of his qualifications, including the ability to create networks rather than the characteristics of the company. When reading the results, a question is worth asking: It concerns the willingness of entrepreneur's opening. This survey does not allow to determine whether the SMEs are not very internationalized because they encounter insurmountable obstacles in their efforts or because they have never considered internationalization as an economic opportunity. In addition, it is possible that many SMEs do not realize that the process of internationalization affects them even if they operate mainly on the domestic market, since internationalization is often equated with export. The availability of data on the subject of our study can only help to provide answers to these questions and, subsequently, to offer devices that overcome barriers to internationalization of Mediterranean SMEs.

**Keywords:** Internationalization, SMEs, Transmediterranean, Behavioral approach, Network approach, Foreign Direct Investment (FDI), Regionalism, Morocco.

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## INNOVATION THROUGH INFORMATION AND COMMUNICATION TECHNOLOGY (ICT) IN ROMANIAN EDUCATION

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### ABSTRACT

Our world, the society we live in is in continuous development. It is a dynamic environment in which man is forced to live in a fast pace and is always on the run. Our society is a blend of exceptional promise and unsettling perspective, desirable developments and technological uncontrollable outbursts, by man depends meaning evolution: progress or toward destruction.

In a few decades education at school it was, in most cases, sufficient for the entire life of an individual, today the situation changed dramatically. Education modern human must go beyond education focused on a certain level (limited in number of participants and time period) and to focus on continuing education, able to prepare peoples wherever they are and unlimited time.

Not long ago, the computer was a rare and exotic object being considered a luxury that many people in Romania do not dare to dream and said it was something unnecessary for humanity, a waste of time. But years passed, and attitudes of Romanians people were changed, now things sitting in a different light, this time in favor of technology.

In the era of new information and communication technologies, the Internet has revolutionized almost all areas of social and professional, including learning and education. Education through Internet is a new way of learning the pupil / student, but also a new way for teaching of teacher. It is vital that all students have access to the Internet to know the new technologies. Thus, in support of education interferes new information society technologies - information and communication technology (ICT).

Technological education has a specific inter-and transdisciplinary character, but also has dual purpose: scientific and technological, theoretical and practical. It also aims to training

practical skills and systematic thinking essential for development and stimulating student creativity and initiative, technical centered thinking.

Technological education acquires new valences, becoming a basic component of modern Romanian education, discipline designed to integrate more effectively into society the student after graduation.

In school, introduction the Internet and modern technology lead to significant changes in education process. Thus the act of learning is no longer considered to be the effect of the evolution steps and the teacher's work but also the result of student interaction with the computer and collaboration with the teacher. This change in the education system followed some well structured objectives, namely: increased efficiency of learning, developing communication skills and self-study

Due to information and communication, technology has opened new areas, previously unsuspected and has revolutionized the old ones. And these include education too, which reached new standards and has an amazing evolution. Like any other method of learning and teaching computer assisted have advantages and disadvantages.

As advantages we mention:

Stimulating innovative learning ability, adapted to the rapid social change;

Increased yield coherent properties of knowledge by immediate appreciating of student responses;

Strengthening students' motivation in the learning process;

The effect of personal self-improvement and competitiveness;

Development of visual culture;

Awareness that the already learned concepts will find useful later;

Fast data processing facilities to perform calculations, display the results, output graphs, tables;

Introducing a cognitive style, effectively, an independent work style;

Make the choice and use of appropriate strategies to solve various applications;

Providing a permanent feedback, the teacher being able to redesign work based on previous sequence;

Develop thinking so that starting from a general method to solve a problem student finds alone the answer for a specific problem;

Stimulate imagination and logical thinking;

Various teaching methods;

Relational perspective is enhanced by establishing human and social relations between students and teachers.

### **WE ALSO HAVE SOME DISADVANTAGES:**

The overuse of computer can lead to loss practical skills and investigation of reality;

Excessive individualization of learning amount to the denial of dialogue teacher - pupil;

Using computer randomly without a specific purpose during the hours can cause boredom, monotony;

The high costs of the latest technology which is an impediment for a good part of the population of Romania, is accessible to people with a good financial situation.

Researches in the last five years in various countries at global level have shown that use information and communication technologies in education contributes to a great extent in improving student achievement. But however many teachers, whether you prefer traditional methods of teaching, either a general reluctance and indifference to new technologies reject dynamics hours and stimulating student by computer internet and all other associated tools.

In Romania today we see a growing concern of the executive, civil society and the education system (universities and schools) to implement an effective system of e-learning, although we have to admit, there are many gaps in this area.

We hope in the near future as in all universities and schools in Romania to have a dynamic growth in the field of educational software and teaching techniques, using the computer, which will mean encourage innovation teaching, modernization process and e-learning

programs, and on the long term the opportunity for graduates to continue learning and training.

**Keywords:** innovation, education, development, information and communication technology (ICT)

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## FOREIGN DIRECT INVESTMENT AS A MEANS OF ECONOMIC DEVELOPMENT

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### ABSTRACT

**Purpose** – In the era of globalization, foreign direct investment (FDI) has been acknowledged as an essential factor in the development of the economy. In recent years, creating a better investment climate has therefore been a policy priority for many governments. However, only a small group of countries have attained relative success in attracting quality FDI and using it as a method of economic growth. The purpose of this study is to identify important aspects of policy strategies of countries that have been successful in attracting FDI and using it as means of economic development and growth.

**Design/methodology/approach** – This is a conceptual paper based on secondary data obtained from various official entities of countries that have been successful in attracting foreign direct investment and using it as a method of economic growth and development. The information gathered has been analyzed, synthesized, tested and evaluated. From this appraisal, a holistic model which incorporates government's role in using FDI as a method of economic growth is developed.

**Findings** – The evidence suggest that it is a futile endeavour attracting FDI in the absence of the necessary conditions for economic development. The creation of a competitive market site requires certain conditions to be in place across a host of areas. For FDI to be an instrument of economic growth it must be approached via holistic policies framed within a national economic development plan based on long-term development goals.

**Originality/value** – The extraordinary role that FDI plays in economic development and growth has impelled interest among scholars. Despite the growing body of scholarly research in this field, scholarly literature that appraises policy strategies of countries that have been successful in FDI remains limited. Moreover, this study pioneers the development of a holistic model which incorporates government's role in using FDI as a method of economic development.

**Keywords** – International Investment Treaties, Bilateral Investment Agreements, Double Taxation Treaties, Foreign Direct Investment

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## THE IMPACT OF INTERNATIONAL INVESTMENT AGREEMENTS ON FOREIGN DIRECT INVESTMENT: THE SWISS EXPERIENCE

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### ABSTRACT

**Purpose** – The liberalization of the foreign direct investment (FDI) regulatory framework has encouraged the increase of foreign investment and prompted strong competition among countries to attract FDI; as foreign direct investment has been recognized as an important driver of economic growth. A number of investment strategies have been used to promote FDI; among the most important strategies utilized are international investment agreements. The economies with the most international investment agreements are led by Germany, China, and Switzerland. Among the developed world, Switzerland is one of the most successful economies in attracting FDI. The purpose of this paper is to evaluate Switzerland's strategies attracting FDI, especially appraising bilateral investment treaties (BITs) and double taxation treaties (DTTs) and their impact on inwards FDI.

**Design/methodology/approach** – This is a research paper based on secondary data analysis; data is obtained from various official entities. This study uses statistical and machine learning techniques in order to detect meaningful relationships between investment strategies and inward investment. A predictive and highly significant model has been constructed.

**Findings** – Our findings suggest that the formulation and implementation of sound policies to promote investment play an important role in attracting FDI to Switzerland. The results also indicate that in some cases the formation and implementation of international investment agreements are important determinant of FDI inflow.

**Originality/value** – The availability of comprehensive datasets and the very limited set of empirical studies related to international investment agreements in Switzerland have motivated us to integrate quantitative resources and assess the significance of government policies and strategies in relation to international investments agreement in Switzerland.

**Keywords** – International Investment Treaties, Bilateral Investment Agreements, Double Taxation Treaties, Foreign Direct Investment

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## FACTORS IMPACTING CUSTOMERS' FOOD AND GROCERY RETAIL FORMAT CHOICE IN PAKISTAN

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### ABSTRACT

Food and grocery retail has shifted significantly from traditional stand-alone small scale shops to modern and complex superstores. This trend is especially evident in emerging economies, which experience intensified competition with the opening of their markets in recent years. The current study seeks to capture customer sentiments and motivations to shop in either traditional or modern retail formats. It does so based on a survey of 471 Pakistani consumers from Lahore. Results indicate that relative proximity to residence and perceived lower prices are the main influencers on shopping in traditional stores, while product variety, staff courtesy, store atmosphere, and household income levels are the main factors influencing consumers' preference for modern stores. Moreover, age, gender and family size demographics don't seem to impact consumer choices of food and grocery retail store format.

**Keywords:** Store Format, Food and Grocery, Retail, Pakistan, Staff Courtesy, Product Variety, Store Atmosphere, Price, Location, Convenience

### INTRODUCTION

Food and grocery retail has shifted significantly from traditional small scale stand-alone shops to multi-dimension and multipurpose modern superstores (Sexton, 2010). A traditional store format can be defined as any retail outlet that is managed locally by the owner or the

caretaker of the shop, including small neighborhood stores, street vendors, and 'mom and pop' stores (Raja, 2011). Such outlets lack technical and accounting standardization, and their supply chain and sourcing are locally embedded (ICRIER, 2005). A modern store format can be defined as any retail outlet that is professionally managed including supermarkets and hypermarkets with complete shopping experience under one roof (Raja, 2011). A store is termed as 'modern' if it has accounting transparency with proper usage of management information system (MIS) and accounting standards, as well as organized supply chains with centralized quality control and sourcing mechanisms (ICRIER, 2005).

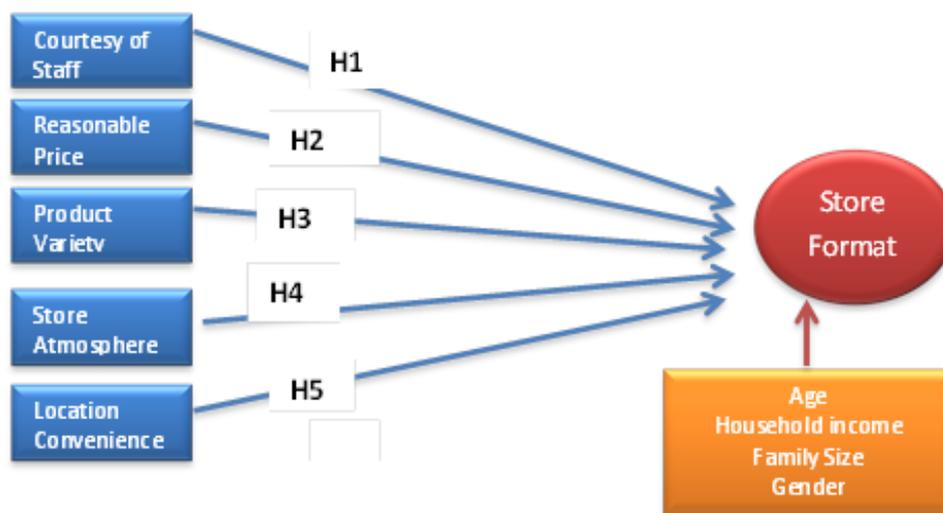
In emerging markets, the gradual opening up of economies, as part of global trade liberalization, has led to large scale introduction of modern retail formats and growing competition between retailers. And, hence, the current study seeks to understand consumer mind-sets in such environments in terms of their motivations to shop in modern versus traditional retail store formats.

More specifically, the current study will examine customers' preferences for food and grocery retail formats in the Pakistani market. Pakistan was deemed as a suitable context for such an analysis, as until recently it has been dominated by small-scale independent neighborhood shops (EIU Economist Intelligence Unit, 2010, FIAS Foreign Investment Advisory Service, 2005), locally known as 'Kiryana Stores' (Raja, 2011). However, in the last decade, the entrance of global retailers such as Dutch-based Makro, German-based Metro, and French based Carrefour (locally branded as 'Hyperstar'), has led to the de-facto introduction of new style of food and grocery retailing in Pakistan (Aman and Hopkinson, 2010).

Based on a literature review of earlier studies examining food and grocery store choices (i.e. Bhatnagar and Ratchford, 2004, Carpenter and Moore, 2006, Prasad and Aryasri, 2011, Seiders et al., 2000), preferences (i.e. Thang and Tan, 2003), patronage (i.e. Arnold et al., 1983, Zameer and Mukherjee, 2011), perceptions (i.e. Dalwadi et al., 2010, Farhangmehr et al., 2000), and loyalty (i.e. Huddleston et al., 2004), a model was suggested.

The model includes five independent variables capturing store characteristics as perceived by customers, and four control variables capturing customer demographics. Variables are included based on either their dominance in earlier studies (i.e. perceived price, store atmosphere, and locational convenience), or controversy concerning their actual effects (i.e. courtesy of staff, product variety, and demographics).

**Figure 1: Factors impacting Store Format Choice**



## METHODOLOGY

Data was collected through a structured questionnaire which was administered via on-site face-to-face short interviews with customers in key commercial areas, in seven different quarters of the city of Lahore in Pakistan. Overall, 471 completed questionnaires were collected and used in the analysis.

While the dependent variable – store format preference, was captured through a dichotomous variable (traditional vs. modern), as used in Zameer & Mukherjee (2011), the independent variables were mostly captured via multiple item scales mostly adopted from Dalwadi et al. (2010), who conducted a similar study in India. An exception here was store location convenience, which also included items from Yilmaz et al. (2007) and Prasad & Aryasri (2011). Nevertheless, a factor analysis of the relevant items did require measurement changes.

These included the removal of 1 item from measurement of location convenience, 1 item from measurement of courtesy of staff, and 2 items from store atmosphere in order to achieve the required factor structure and satisfactory internal reliability levels.

Once no problems of multicollinearity were ensured (see VIF and tolerance values in Table 1), the analysis proceeded with a logistic regression.

## FINDINGS AND DISCUSSION

Results (see table 1) indicate that relative proximity to residence and perceived lower prices are the factors influencing preferences to shop in traditional stores. Product variety, staff courtesy, store atmosphere, and household income levels influence consumers' preference for modern stores. Moreover, age, gender and family size don't seem to impact consumer choices of food and grocery retail store format.

**Table 1: Logistic Regression Analysis**

	B	S.E.	Wald	df	Sig.	Exp(B)	Collinearity
Tolerance/VIF							
LOCATION	-.716	.129	30.915	1	.000	.489	.974
1.027							
VARIETY	.839	.148	32.221	1	.000	2.314	.719
1.390							
CoSTAFF	.419	.132	10.002	1	.002	1.520	.856
1.168							
PRICE	-.520	.130	16.066	1	.000	.594	.993
1.007							
ATMOS	.644	.143	20.247	1	.000	1.905	.662
1.511							
Family	-.094	.059	2.575	1	.109	.910	.952
1.050							
Income	.366	.093	17.969	1	.000	1.485	.919
1.088							
Age	.014	.065	.050	1	.823	1.015	.938
1.066							
Gender	.408	.248	2.702	1	.100	1.504	.979
1.024							
Constant	-3.303	.825	16.044	1	.000	.037	
Chi-Square (df=9)			210.356			.489	
-2 log likelihood		422.540	Significance		0.000		

Cox & Snell  $R^2$  .363 \* $P < 0.05$ ; \*\*  $P < 0.01$

Overall, our study contributes to the growing body of knowledge on consumer store format preference in the food and grocery sector in general, and in developing markets contexts in particular. While not fully solving existing controversies, our study does contribute to the discussion by suggesting both measurement refinements and concrete observations in support of particular effects.

In terms of practical implications the study suggests both short and long term implications. In the short-term, retailers using different formats can cling onto those aspects attracting customers to them, as core advantages in their positioning strategies, and their manifestations in promotional efforts. However, in the long term, the resource-rich firms behind modern formats, with their scale advantages, may also enter neighbourhood location with smaller shops. Under such scenario, repositioning of competition may require that traditional shops improve their service quality via greater staff courtesy, as well as specialize in narrower product range, but with greater variety within specific product categories.

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## EXPLORING THE INTERRELATIONS BETWEEN CODES OF CONDUCT AND FINANCIAL PERFORMANCE: EVIDENCE FROM GREECE

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### ABSTRACT

Extensive research regarding the interrelations between corporate social responsibility and a firm's financial performance has been carried out over the past 30 years (Bromiley et al., 1989; Ingram, 1978; Cochran and Wood, 1982). However, surveys' outcomes were controversial; some appeared to reveal no relationship, while others to indicate either a positive or a negative relationship. Many factors may account for such variances; for example, the criteria used for the measurement of corporate social responsibility or financial performance, the timeline used and so on. Furthermore, the debate on the definition of corporate social responsibility still exists (Davis, 1973; Carroll, 1979; McWilliams *et al.*, 2006), adding controversies and further complicating the issue.

A code of conduct is a tool used by many companies in order to apply their social responsibility principles into practice and to declare their core values. It facilitates companies in recording and classifying their values, policies and procedures regarding issues like treatment of employees, the environment, consumer safety etc. Deployment of a code of conduct by companies is sometimes legally mandatory. Recent literature has been showing great interest on issues such as the existence, the content and the code of conduct's enforcement within companies (Lefebvre and Singh, 1992; Farrell *et al.*, 2002). Furthermore, many authors have examined the underlying ideas behind the use of codes of conduct (Weaver, 1993; Farrell *et al.*, 2002). Weaver (1993) for instance, perceives ethical codes as distinct, not particularly related to any other company policy manual, while McDonald (1999) refers to codes of conduct as the first step in applying an ethical culture.

Our research focuses on specific aspects of applying a code of conduct in companies listed in the Athens Stock Exchange companies. We first examine the existence of a code of conduct, its content, and certain aspects of its. Furthermore, we investigate the relation between the use of a code of a conduct and financial performance bearing in mind that, not only the deployment of a code of conduct may affect the company's financial performance, but that the company's

financial performance may also affect the deployment of a code of conduct. For the purposes of the survey a questionnaire has been developed and is currently in the process of dissemination to the Internal Audit executives of the Greek listed firms.

In order to examine the relation between financial performance and the code of conduct, certain criteria of measurement must first be determined. As far as the financial performance measurement is concerned, we rely on the methodology used by Parket and Eilbirt (1975), who calculated three different financial ratios, for each company (i.e. earnings per share, sales margin and return on equity). With respect to the content of the codes of conduct, we classify the rules according to a tripartite distinction: the rules that center on the company, the ones that center on employees and those that regard society in general. And finally we further differentiate, according to the method used for the composition, communication and enforcement of the code of conduct.

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## A QUALITY MODEL FOR INTEGRATED HEALTHCARE IN POLAND

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### ABSTRACT

#### PURPOSE

The main purpose of this paper is to identify the indicators of quality management model for integrated healthcare settings in Poland. The idea of the integrated healthcare lies within the provision of healthcare services through the coordination of different activities (diagnostics, therapy, rehabilitation, health promotion), where the patient is the final beneficiary (Stranberg-Larsen and Krasnik, 2009). A coherent set of services is planned, managed and delivered to individual service users across a range of healthcare organizations and by a range of co-operating professionals. The lack of a consistent set of elements and a generic quality management model, which would suit Polish healthcare settings, provides the mainspring for this study. Therefore the objective is to assemble knowledge of indicators (elements) of integrated healthcare and to construct an overall quality management model, based on these elements, that covers chronic patients segments and integrated healthcare settings in Poland. The research questions are:

- 1) what are crucial items for developing integrated healthcare in Poland?
- 2) how can these elements be logically segmented and labelled in order to build a quality management model?

#### METHODOLOGY

This project has been financed by National Science Centre, based on the decision No. DEC-2012/05/B/HS4/02213. In order to construct the model a combination of three methods were applied.

Firstly, a literature study on elements of integrated healthcare was performed. Wherein, an element of integrated care has been defined as an activity concerning realization, improvement, innovation or sustainability of integrated healthcare, based on the quality continuum of Feussner (Feussner *et al.*, 2000). The EBSCO database was searched on recent reviews (2003 onward) in English with search terms “integrated care” and “quality

management". As a result we obtained 270 records, which were reviewed and refined, focusing on the elements of integrated healthcare. This stage of the research let us reach the international perspective and state-of-the-art studies in quality management. The reviewed papers referred mainly to healthcare systems in West-European countries and United States. Among many of them, there were works conducted by Armittance, Suter et. al (2009), Goodell, Boderheimer and Berry-Millet (2009), Kroger, Touringny et. Al (2007) and Ouwens, Hulscher et. al (2009).

Secondly, Delphi methodology has been applied. In this way expert-based knowledge has been used to complete and restrict the list of elements of integrated healthcare, derived for the literature study. In a Delphi study, carried out by the means of CAWI, 34 experts experienced in integrated healthcare, commented and prioritized 95 items in two anonymous rounds. Respondents were asked, using Likert rating scale, to rate the importance of each element for developing integrated healthcare in Poland. This Delphi procedure let us come out with a final list of indicators for the design of a quality management model for integrated healthcare settings in Poland.

Finally, Concept Mapping was applied in order to cluster the elements, position them on a map and analyze their content. During three-hours long session with the expert panel, each expert was asked to individually cluster the identified dimensions with a maximum of 12 segments. The data generated by the experts were used for the statistical procedure. Multi-dimensional scaling and cluster analyses have been used to design the model. After that, experts were divided into nine groups. Each group labeled and described one cluster.

## FINDINGS

The literature study and then two Delphi rounds generated a set of elements that formed a basis for a quality management model for integrated healthcare settings in Poland. The hierarchical cluster analyses resulted in a nine-cluster representation. The additional statistical analysis of sort similarities between experts finally demonstrated values between 0.59 and 0.89, showing a high similarity in clustering. Based on the experts' subgroup discussions we received the following labels of the nine clusters: 1) "structural integration", 2) "patients' support", 3) "clinical decisions' support", 4) "patient centeredness", 5) "information integration", 6) "management of patient pathways", 7) "cross-sectoral cooperation", 8) "coordination of activities", and 9) "trust and commitment". Each cluster has

been composed by from 4 to 17 items. A final step in the Concept Mapping procedure resulted in the four poles, corresponding with the clusters' contents: "internal processes", "external process", "delivery system" and "performance management".

## **PRACTICAL IMPLICATIONS**

Polish healthcare managers could use the model proposed in this study as a useful tool for quality management. The model has thus a potential to serve evaluation and improvement purposes in integrated healthcare settings and to make more informed managerial decisions. The above presented findings provide the basis upon which healthcare managers could design effective quality strategies. It is possible to put the results to further use, especially in designing:

- the quality indicators in integrated care settings;
- the evaluation framework to assess integrated healthcare practices;
- the improvements' programmes focused on quality management concerning both internal and external processes;

The research findings let us draw the conclusion that in the competitive environment in which Polish healthcare providers now operate, understanding quality indicators that encompass the holistic approach towards healthcare delivery is essential. The proposed model exhibits new dimensions that strongly focus on effective collaboration and conditions for integrated healthcare.

## **RESEARCH LIMITATIONS**

The present study develops a basis for further research in quality management in integrated healthcare settings in Poland. Firstly, the nature of the literature study and the use of expert-based knowledge cannot fully guarantee that no important quality items are omitted. Secondly, there is a need for further methodological studies to assess validity and reliability of multidimensional cluster analysis in healthcare sector. To date, published research in the area is scarce. The external validity could be improved by replication of the study in other healthcare systems. Contextual variables such as health reforms, history of quality and management practices could have an impact on the results. Thirdly, more research is

recommended into the involvement process of other stakeholders of health sector, especially chronically ill patients.

## ORIGINALITY

The paper contributes to the discussion concerning the methodology of quality management for integrated healthcare. The application of hierarchical cluster analysis made it possible to observe the multi-dimensional character of quality indicators in health sector. This systematic approach can be treated as a promising framework for developing quality management model also in other service sectors. It offers quality managers a chance to see the quality process in the innovative way and to boost the satisfaction of both external and internal customers of their businesses.

The study contributes also to theory building. It adds value because it creates a conceptual model of complex concept, by identifying quality elements and bringing them together in clusters. Proposed model is well-suited for health sector in Poland. It extends existing quality concepts by adding new dimensions, i.e. network cooperation and process integration.

**Keywords:** Poland, Integrated Healthcare, Qualitative Research, Quality Indicators, Multidimensional Statistical Analysis

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## **THE IMPLEMENTATION OF FORMAL AND INFORMAL HRM PRACTICES BY MIDDLE-MANAGERS IN THE PUBLIC SECTOR: THE CASE OF CYPRUS**

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### **ABSTRACT**

Research on public and private sector organisations asserts that organisational actions are managed via formal and informal practices. The term formal practices is used to describe the practices that are designed by governmental authorities and are included in the formal documentation of the public sector organisations. These define the procedures, rules and instructions according to which people management is formally organised (Kotey and Slade, 2005). Informality refers to policies of management of people in an organisation that are mainly based on unwritten customs (Cunningham, 2007) but are equally important for the day to day operation of any organisation, public or private. As Truss and Gratton (2006) add, if something is formally planned, this does not mean that it will be implemented, and if something is not planned it may be implemented but through an informal way. They argue that the fact that some HR practices may be implemented without explicit prior planning or that some planned HR interventions are never implemented, has never been explored in detail. Kotey and Slade (2005) also explains that the term 'formal' is linked to prescribed documented practices and include procedures, rules and instructions that are formally designed. Taking into consideration both the formal and the informal aspects of the HRM strategy of a public organisation, it has been suggested that in order HR function to be successfully implemented, both a formal strategy and daily operations (day to day reality) should be adopted and implemented successfully (Human Resource Management Strategies, 2005).

Relating to the formal and informal matters of an organisation, the role of managers in public sector is to find a balance between the broader institutional context and the organisation-specific Human Resource Management (HRM) practices (Gestel and Nyberg, 2009). Their role seems challenging as they are expected to combine both formal and informal practices on a day to day basis. However, the role of managers in relation to the adoption and implementation of HRM practices is strictly connected with the character of a public system. Cyprus belongs to the Mediterranean/South European Tradition with a strong centralised

traditional system (The Impact of Individual Assessments, 2007 and Georgiou, 2012). The majority of Southern European countries (75%) have centralised public systems (The Impact of Individual Assessments, 2007). Specifically, it is a public administration tradition country and all the HR policies, practices and principles are controlled centrally (Georgiou, 2012). Via this study a completed picture of managers' role in centralised institutional context will be pursued. The aim of this study is to assess the extent to which a range of factors such as centralisation, impact the extent to which formal and informal HRM practices are adopted by middle-managers. Therefore the contribution will be to unfold the rationale of HRM practices adoption by managers, in a modern-centralised public- sector government and to explore empirically the conditions that affect this adoption in order to assist the recent public centralised sector in the design and revaluation of this system.

In private organisations, there is extensive research on how managers perform their role in centralised organisations with strong bureaucratic elements and strict central policies, rules and regulations (Francis, 2006). The level of formality and informality of HRM practices in small private firms has been examined largely in the past; mainly in order to identify if there is a link between the size of the firm and the formality of HRM practices (Hornsby and Kuratko, 1990; Kok and Uhlaner, 2001). It has been concluded that not only the company's size, but also the organisational strategy and resources, the practices by CEO (Kok and Uhlaner, 2001), the culture (Daft, 1998) and also the owners-managers' control have an impact on the level of formality in small private organisations (Kok and Uhlaner, 2001). A research accomplished by Mayd (2009) in private organisations (in small and medium enterprises of Sri Lanka), discovered that the informal HRM practices are positively connected with higher organisational performance. *"While formalization enhances the level of professional and management control, the informal culture can be a source of competitive advantage of SMEs"* (Mayd, 2009, p. 564).

However, in public sector this kind of research is not so widely extended. As far as the public managers' role is concerned, theoretically it has been suggested that further research is needed for addressing managers' role in relation to the formal HRM practices and implementation (Alnagbi, 2011). McConville (2006) argues that it is necessary to research the expertise and investigate the conditions according to which managers perform effectively their role. Furthermore, it has been suggested that while there is concern for the certain government strategies from a theoretical perspective, there should be given more concern on the actual effective implementation of those practices on a local level. The practices adopted

even by a public organisation must meet the needs and the requirements of the specific organisation (Human Resource Management Strategies, 2005).

In addition, Hayton (2005) and Kok and Uhlaner (2001) believe that a theoretical explanation that will address the formal and informal aspects of HRM is in need. This study is based not only on the exploration of HRM practices but specifically designed to identify the extent that middle-managers implement formal and informal HRM practices in the public centralised sector. It will identify the extent and the way that managers implement formal and informal practices in the public sector organisations of Cyprus, and also the parameters and factors that affect their adoption.

Consequently, a conceptual framework that will elucidate and further clarify the adoption of formal and informal HRM practices will be developed. The purpose of this study is to create and test a model that predicts the adoption and implementation of formal and informal HRM practices by middle-managers of modern-centralised public sector. This framework therefore aims to aid middle managers of centralised public sector to effectively blend HRM formal and informal practices.

For the collection of primary data, a combination of qualitative and quantitative methods will be employed. Semi-structured interviews will be conducted with the middle-managers of the public organisations (ministries of the Republic of Cyprus), in order to identify: a) the level of implementation of both formal and informal HRM practices and b) the reasons, the circumstances, the conditions and even the barriers that picture this situation in recent centralised public organisations. Following this, a questionnaire consisted by closed-questions (using a five-point Likert scale) will be distributed to the employees of the organisations in order to enable a triangulation regarding the implementation of formal and informal HRM practices by middle-managers in public organisations.

**Keywords:** Cyprus HRM, Formal Practices, Informal Practices, Public Sector, Centralisation

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## **SOCIAL RESPONSIBILITY AS DRIVER OF COMPETITIVE SUCCESS IN SMEs IN THE REGION OF EXTREMADURA**

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**Keywords:** Social Responsibility, SMEs, Competitiveness, Competitive Success, Innovation, Performance, Extremadura.

### **INTRODUCTION**

The small business environment today is very dynamic and competitive. The contribution of Small and Medium Enterprises (SMEs) has been recognized as main actors for sustaining economy because of their capacity in enhancing local economies output and fostering regional development and population welfare. On this basis, this paper assesses the specific relationships between Social Responsibility and competitive success in SMEs. Moreover, firm performance and firm innovation are also considered very important mediator variables in this primarily relationship.

The paper is structured as follows. First we indicate the problem and objective of the paper developing the conceptual framework. Later, we define the methodology and show the analysis and results. We finish with some conclusions and future research.

### **SOCIAL RESPONSIBILITY AND COMPETITIVENESS IN SMEs**

SMEs are considered as main actors for sustaining economy because of their capacity in enhancing local economies output and fostering regional development and population welfare but, unfortunately they are not always managed to assume social responsibility as an important axis of their strategies to get competitive advantages. The purpose of this paper is to present an empirically-tested model showing the social responsibility orientation is a factor of success SMEs. It attempts to bridge social responsibility orientation with competitive success.

Competitive success has been identified as a key achievement of firms who have been undertaking SR actions, understanding success to include results that go beyond just the financial sphere. We considered that a firm has competitive success at regional level when it is able to attain a favorable position in the market and obtain superior results, while avoiding the need to have recourse to an extremely poor retribution of the factors of production. To measure competitive success, we considered aspects of competition related to human resource management, the managers' capabilities, aspects of marketing, the quality of products or services, and the levels of quality in organization and management, technological resources and information systems, financial management, shared corporate values, and adequate organizational structure and know-how.

## **METHODOLOGY**

The methodological approach, a structural equations model (SEM) has been selected because it allows incorporate directly unobservable abstract constructs (latent variables), as is the case of SR and competitiveness. Despite the heterogeneity of the results and conclusions to be found in the literature, most of relevant contributions indicate that firms which are carrying out actions of social responsible actions perform better. In the proposed model, SR of a firm has being considered a second order construct being reflected in other three sub-constructs according with the Triple Bottom Line defined by Elkington (1994): a) The economic dimension; b) the social dimension; and c) the environmental dimension. Firm performance and firm innovation are also considered as mediator variables.

A questionnaire was elaborated to inquire into the manager's perceptions concerning each construct, with responses on a 10-point Likert scale. The sample, representative of regional SMEs in Extremadura (Spain), comprised 758 firms with their corresponding predetermined substitute firms to control the non-response index.

## **RESULTS AND CONCLUSIONS**

The results suggest that managers and owners in SMEs are also concerned in assuming social responsibility principles. SMEs must ensure that internal and external aspects of SR management are taken into account in order to implement their strategies to be successful in their markets. SMEs need to be more proactive, trying to include responsible

actions in their management. Understanding social demands they would make enterprise efforts in competing much more likely to succeed.

The results of the current study are context specific. In the near future, authors will expand the study to other regions in Spain and other countries with a large representation of SMEs as Portugal for instance, to test the validity of the model and to be able to generalize conclusions. The present work is just a beginning, and further work on a variety of regions in the Mediterranean area will be necessary if a reliable picture of SR as key success factor for business competitiveness is to emerge. The authors trust that this article may represent a first step towards the further examination of the relationship between SR and competitiveness in the Mediterranean SMEs.

## **AN EXAMINATION OF HUMAN RESOURCE EMPOWERMENT APPLIED TO THE PUBLIC SECTOR: THE CASE OF GREEK RESEARCH CENTERS**

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### **ABSTRACT**

#### **PURPOSE OF THE STUDY**

Human resource empowerment has come to be seen as a vital strategy for the organizational success and improvement in the public sector (Fernandez & Moldogaziev 2011). Research has pointed out the critical role of empowerment in the public sector in promoting employees' effectiveness (Nyhan, 2000; Fernandez & Moldogaziev 2011). A critical part of the public sector is the research centers which, if they are to be successful in accomplishing their mission and objectives, should be staffed by people with vision, people who innovate, people who promote knowledge, people who create knowledge. Various researchers have looked at the dimensions of empowerment through different perspectives. The literature on employee empowerment can be divided into two groups: managerial empowerment and psychological empowerment (Papaioannou, 2009). Human resource empowerment refers to a change strategy with the objective of improving both the individual's and the organization's ability to act and to operate more effectively in an extremely competitive environment (Papaioannou, et al., 2012). The primary purposes of this study were: (a) to determine the extent to which human resource empowerment is applied to research centers of Greece, and (b) to examine the relationship between human resource empowerment and managers' educational background of the research centers.

#### **DESIGN/METHODOLOGY/APPROACH**

The study was a quantitative design and the analysis was exploratory in nature. Descriptive statistics and Independent samples T-test were used to examine the purpose of the study, using SPSS software (version 17). The authors addressed the research to all research centers of

Greece (12 research centers, which are inspected by the General Secretariat of Research and Technology of the Ministry of Education and Religion, Culture and Athletics) and involved 145 senior researchers (who lead the research teams) who were the most knowledgeable regarding personnel management issues. Responses were received from 120 head researchers of 12 research centers with a 82.7% response rate. For the purpose of this study a 30-item questionnaire, was used (developed by Vogt & Murrell, 1990, focused on the issue of empowerment, and modified and simplified by Kriemadis, 2011 & Papaioannou, 2011), in order to provide information on how senior researchers see themselves in terms of the human resource empowerment process and demographic characteristics, using a five point Likert scale. The scales represented three different managerial styles which were: (a) the “empowering style” of management, (b) the “middle-ground style” of management and (c) the “controlling style” of management. In the first case the senior researcher has a managerial style that reflects the manager who creates and shares power. In the second case the senior researcher has a managerial style that combines the two styles of controlling and empowering in equal proportions, and in the third case, the senior researcher is concerned with control or seldom shares, creates or empowers subordinates. The reliability of the scale was found to be:  $\alpha = .80$ .

## FINDINGS

From the analysis it is shown that senior researchers used 65% “empowering style”, and 35% “middle-ground style” in the six key factors of human resource empowerment (Total of all Managerial functions). Furthermore, there was a significant difference in the implementation of the human resource empowerment process between senior researchers in accordance with their educational background ( M.Sc. & Ph.D. educational levels). More specifically, in one of the key factors of empowerment, titled “project-planning, organizing, and system-integration skills”, the holders of Master’s degrees ( $M=3.40$ ,  $SD=.569$ ) had a significantly lower level of human resource empowerment when comparing with the holders of Ph.D degrees. ( $M=3.72$ ,  $SD=.595$ ) ( $t(118) = -2.94$ ,  $p=.004$ ). This result is consistent with previous studies on human resource empowerment and educational background of managers, in public sector (Pitts, 2005), and shows that the level of empowering style which senior researchers exercised in the research centers is related to their educational background. Moreover, the results confirm the theory which suggests that the good level of education, the knowledge, and the skills of

directors can lead to better implementation of the human resource empowerment process (Vogt & Murrell, 1990). No other significant differences were found. Our study implies that empowering style is applied to a mediocre extent by the senior researchers of research centers. Considering that empowerment plays a crucial role in ensuring that organizations will survive and prosper, the senior researchers of research centers can be encouraged to implement it in a greater extent. This could happen by developing an empowering culture based on a series of specific principals such as: (a) collaborative process of decision making, (b) evaluative systems, which build on the process of “valuing” and not of “criticizing”, (c) participative planning process, (d) reward systems which encourage team work and cooperation, and (e) developmental plans that emphasize career goals but also set out the training, experience, and growth in skills needed to make a progress in the organization (Vogt & Murrell, 1990).

## RESEARCH LIMITATIONS

A total of 120 (82.7%) of the senior researchers of research centers responded to the survey. According to Babbie (2004), a response rate of 50% or more is generally considered an acceptable response rate in the surveys. Based on this fact and the high response rates, it appears that the results of the study could be generalized to the target population (all Greek research centers). The limitations of the study might be the honesty of the respondents and the way that each of them understands the human resource empowerment vocabulary.

## ORIGINALITY/VALUE

This study is useful in extending the concept of human resource empowerment to Greek public sector, and more specifically to research centers. The study will be useful in helping directors and senior researchers, to their further understanding of the empowerment process in their respective organizations.

**Keywords:** Human resource empowerment, public sector, research centers.

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## CREATIVE ADVERTISING, CLASSICAL LEARNING AND PRODUCT IMAGE

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### ABSTRACT

Research into classical learning theory and marketing generally focuses on a variety of topics: the visual and verbal content in advertising (e.g., Kim, Allen and Kardes 1996; Rossiter and Percy, 1980); the impact of repetition in absorbing advertising messages (e.g., Gorn 1982; Janiszewski, Hayden and Sawyer 2003); the influence of branding on memory; music conditioning (e.g., Blair and Shimp, 1992); and the influence of negative and positive conditioning attitudes towards a brand (e.g. Blair and Shimp 1992, Cunha and Laran 2009, Gresham and Shimp 1985, Janiszewski and Van Osselaer 2000). Recent research papers in marketing used classical learning theory to propose a monetary, goal-based model for evaluating products and consumer choices (Van Osselaer and Janiszewski 2012).

Interestingly enough, a review of the marketing literature indicates that there has been no research into the creative side of advertising from the perspective of the photographer and graphic designer whom the advertising agency employs. These individuals are the professionals who create advertisements by using creative design elements to influence a brand's evaluation and image. This paper presents research that was carried out to test the impact of three creative elements on product image. Using a group of six experimental designs, two different color backgrounds, two types of clothing and two kinds of watches were compared.

The results of the current research are based on an on-line sample of 60 participants aged 20-35 who were divided randomly and equally into two groups. One group rated three pictures with backgrounds that were hypothesized to have more prestigious unconditional stimuli; the other group rated the three other unconditional stimuli which were hypothesized to be less prestigious. Each participant completed a questionnaire with nine questions about an unknown pen, the conditional stimuli, and three questions for each picture. The more prestigious unconditional stimuli contained a black background for the pen; a person using the pen dressed with a white shirt and tie; and a Patek Phillip watch placed next to the pen.

The less prestigious unconditional stimuli used a light blue background for the pen; a person using the pen dressed with T-shirt; and a Swatch watch standing next to the pen.

As hypothesized, the pen ratings (the conditional stimulus) were significantly higher when the pen was associated with the more prestigious unconditional stimuli than with the more prestigious unconditional stimuli. More specifically, an ANOVA was used to test the rating differences in between the black color backgrounds for the pen as opposed to the light blue color; a person using the pen dressed with a white shirt and tie compared to the same person in the same position dressed in a T-shirt and a Patek Phillip watch standing next to the pen versus a Swatch watch placed next to the pen.

The results showed that the black background compared to the light blue background caused the participants to attribute more quality to the pen (a mean of 7.13 versus 5.46;  $F=7.341$ ,  $P=0.011$ ); more luxuriousness (a mean of 6.73 versus 5.20;  $F=6.733$ ,  $P=0.015$ ); and somewhat more reliability (a mean of 7.53 versus 6.33;  $F=2.380$ ,  $P=0.134$ ). Putting the pen in the hand of a person dressed with more respectable clothing (white shirt and tie) compared to the same person holding the pen but wearing more simple clothing (T-shirt) caused participants to attribute somewhat better quality to the pen (a mean of 7.13 versus 6.00;  $F=3.383$ ,  $P=0.077$ ); more luxuriousness (a mean of 7.00 versus 5.53;  $F=6.297$ ,  $P=0.018$ ); and greater reliability (a mean of 8.06 versus 6.40;  $F=8.768$ ,  $P=0.006$ ). A similar impact on the perception of unknown pen's quality, its prestige and reliability occurred when a luxury brand watch was displayed next to the pen. The pen when placed near a luxurious watch brand (Patek Philippe) and then a simpler watch (Swatch) caused participants to evaluate the pen as associated with increased prestige (mean of 7.60 versus 5.93;  $F=7.622$ ,  $P=0.010$ ), higher quality ((mean of 7.10 versus 6.06;  $F=2.524$ ,  $P=0.123$ ) and more reliability ((mean of 7.53 versus 5.93;  $F=9.164$ ,  $P=0.005$ ).

Based on Pavlov's learning classical conditioning theory, the research presented here shows that the image of an unknown product or brand can be influenced by simply using pictures with background that has a meaning to the receiver. In advertising, pairing colors, people and brands with meaning with an unknown brand will affect how this unknown brand is perceived. Further research is necessary in order to test how many repetitions of this pairing are required beyond the original time of exposure in order to influence the memory (Janiszewski, Hayden and Sawyer 2003) of those who perceive the image.

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## FANS' BRAND COMMITMENT TO THEIR FOOTBALL TEAM

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### ABSTRACT

Sport marketing literature has dealt with the concept of fans' loyalty (e. g. Mahony, Madrigal and Howard 2000) and fans' satisfaction (e. g. Kennett. Sneath and Henson 2001). However, research in sport marketing did not examine the concept of fans' commitment to their team. The current study suggests that in sport marketing as in the commercial world, commitment to sport team is more than just loyalty and satisfaction. Following Shuv-Ami's (2012) 4E's scale, the present research suggests that in sport marketing fans' team commitment has four underlying dimensions. Two representing the affective component and two the calculative component of commitment. The affective component is underlined by the feeling of loyalty that represents the emotional attachment and by the degree of involvement with the sport team which represents the engagement attachment. The calculative component of commitment is based on satisfaction which reflects attachment caused by experience with the team and relative perception of brand performance as the functional or evaluative attachment.

The 4E's (Evaluation, Experiential, Emotional and Engagement) attachments to the brand commitment scale are reflective (Shuv-Ami 2012). That is, the direction of causality (Jarvis et al. 2003) is from commitment to the calculative and affective components of commitment and from them to the specific measures of the 4E's. Brand commitment, defined here as "a degree of attachment" to the brand, is reflected in each of the four dimensions that underline it. It is a reflective model that affects the overall commitment and whose dimensions reflect a high correlation (Jarvis et al. 2003). These four related constructs have been widely discussed in the marketing literature. This scale combines loyalty, involvement, satisfaction and performance to represent the degree that the 4E's are attached to the brand or brand commitment.

The hypotheses regarding both the measurement and structural parts of the brand commitment's nomological net with four oblique first-order factors - involvement, satisfaction, loyalty and performance – are sufficient to account for covariations of the brand commitment scale items. It was also expected that the two oblique second-order factors –

affective and calculative - explain the covariation among the four first-order factors and that an overall brand commitment underlies the two second-order factors.

Two studies were conducted. In the first study a sample of 320 Israeli football fans were used (ages ranged from 17 to 69 with a mean age of 36.6, 60% were males, and 56% had an academic education). In this study the 12-items of the 4E's Brand Commitment Scale were subjected to exploratory factor analysis with oblique rotation. According to the criteria of eigenvalue  $> 1$  and Scree test (Hair et al., 2006) four factors were extracted. On the basis of hypothesized structure and items content, labeled in four factors of involvement, satisfaction, performance and loyalty. These factors accounted for 85.6% of the common variance, above the recommended minimum threshold of 60%.

In the second study, 245 Israeli football fans participated (ages ranged from 17 to 77 with a mean age of 37.5, 59% were males, and 56% had academic education). In order to validate the hypothesized one-third order factor model, Confirmatory Factor Analysis (CFA) was used. The CFA results for the hypothesized model and the additional three comparison models showed that the one first-order factor model had unacceptable fit indices suggesting that the most restricted model is inappropriate for explaining the scale's inter-items covariation. The hypothesized one third-order factor model, the one second-order factor model, and the four correlated first-order factor model showed acceptable fit to the data.

The two studies suggest that brand commitment, as measured by the 4E's scale, is a valuable and valid concept in measuring fans attachment to their football team. Future research may study the impact of this measure of Brand Commitment on the behavior of such fans toward their football team, toward other teams in football or in other types of sport.

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## THE IMPACT OF THE FINANCIAL CRISIS AND AUSTERITY IN A LOCAL HOSPITAL: THE CASE OF ANTIBIOTICS CONSUMPTION AND ITS COSTS

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### ABSTRACT

The 1990s were a period of reforms for the Portuguese Public Administration. Within the philosophy of the New Public Management, hospitals from the government business enterprise sector have at their disposal a set of instruments associated to private management which allows them to implement a more efficient trading policy, controlling, therefore, the costs of resources.

Portugal is going through a serious financial crisis, and the Memorandum of Understanding (MoU) is forcing public expenses to be considerably reduced. The health care system is a sensitive one, where the reducing of expenses has to be dealt with additional care and is organized around a National Health Service (NHS), whose main source of funding is Government budget's transfers. In fact, some of the proposed measures regarding health care sector contained in MoU, aiming at introducing mechanisms for future control of expenditures, were already present in the recommendations of the report commissioned by the Portuguese government on the financial sustainability of the NHS [Barros, P. P. (2012), ]. "Health Policy Reform in Tough Times: The Case of Portugal", *Health Policy*, Vol. 106 No. 1, pp. 17-22].

Through a combination of Resource Dependency Theory and Institutional Theory as an integrative conceptual framework, this study aims at understanding how environmental and organizational factors had impact in the introduction of management practices, particularly in what concerns antibiotics and its costs. For this purpose a longitudinal case study research of a hospital, belonging to the government business enterprise sector, in the North of Portugal, is developed, for the period 2009-2012.

The study makes use of a combination of quantitative and qualitative data. The quantitative data consist in a set of 35639 observations for the above mentioned period of time, concerning

the expenses with the consumption of antibiotics, which are one of the most important costs for hospitals and have a significant weight in the total of pharmaceuticals. The choice of antibiotics is reinforced by the fact that these drugs are subjected to very standardized measures of prescription by doctors. The qualitative data is obtained through in-depth interviews with key agents in the organization.

Being such a particular drug with a significant importance in the costs of hospitals, the study demonstrates that the combination of trading policies, exceptional measures to reduce public expense, the adoption of generics in the Portuguese market, and the competition among pharmaceutical companies has implications in management practices, and these practices influenced the consumption and costs supported by the hospital and in the hospital's performance indicators.

**Key words:** New Public Management, Health Care System, Drugs, Hospitals' Costs and Performance Indicators, Resource Dependency Theory, Institutional Theory.

## ACHIEVING QUALITY AND EFFICIENCY BY IMPROVING PHYSICIAN MEDICATION ORDER ENTRY IN THE HOSPITAL SETTING

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### ABSTRACT

**Purpose:** The purpose of this study is to evaluate the implementation of a computerised physician order entry (CPOE) system in the hospital setting.

Healthcare systems are, currently, under great pressure to reduce costs and to increase productivity while meeting efficiency and quality goals. Within the context of budgetary constraints, such concerns are widely shared across the globe by governments and public agencies. Thus, the need to balance growing demands on the system with sustainability objectives implies the adoption of more effective management frameworks. In the public hospital setting, several reforms have been implemented during the last decades to respond to such pressures. Although assuming different contours, a common theme in most programs and initiatives were target at improving the quality of information technology systems required to support more rational and cost effective management decisions (Mosebach, 2009; Robbins, 2007; Simonet, 2008).

Within the context of hospital organisations, CPOE systems have been increasingly adopted. These systems integrate a complex set of standardised routines which also include electronic prescription and integrated drug management facilities. In general terms, its use is often associated with error prevention in prescribing and dispensing (Schiff and Rucker, 1998). In the present study, the implementation of a drug prescription system derived facility (stop-orders) conceived to automatically determine the period associated with antibiotics therapy prescription is analysed. In particular, we examine the impact of stop-orders implementation on the patterns of antibiotics consumption in a large Portuguese Hospital Trustee. CPOE systems have been the focus of much research addressing different aspects which include but are not restricted to patient safety, cost and efficiency, alerts, time, satisfaction and usage (Eslami, Abu-Hanna and Keizer, 2007). However, research undertaken to examine the impact of a stop-order computerised system in the hospital setting is rare. Therefore, this study is

particularly relevant, considering that the prevention of medication errors and the delivery of better health care services are critical issues in the public health agenda.

**Design/Methodology/Approach:** A quantitative methodological approach was used to appropriately address the purpose and objectives of the study. This research was undertaken in large Hospital Trustee located in the North of Portugal. Data was obtained from a sample of 35,680 records related to the prescription of antibiotics for a total of 19,933 admission episodes reported between June 2009 and July 2011. In the present analysis, two different periods, corresponding to the year before and after the implementation of a stop order functionality in the CPOE system, were therefore considered.

**Findings:** In the data analysis, statistically significant differences were found in the consumption of antibiotics in the period before and after the implementation of the electronic tool, evidencing a significant decrease in quantity and value on the daily average consumption of antibiotics. A more detailed analysis also demonstrated that this trend is particularly noticed in the daily average quantities reported for the prescription of 17 different antibiotics (representing approximately 60% of its consumption). Therefore, this study demonstrates that significant cost reduction was achieved with the implementation of a stop orders computerised antibiotics prescription and management system.

**Practical Implications:** Findings of the present study may assist physicians, hospital managers as well as public policy makers to improve quality in healthcare delivery by promoting efficiency in the prescription of antibiotics medical orders. In addition, these results may encourage other health units to develop and implement similar functionalities in their CPOE systems.

**Originality/Value:** This study underscores the importance of evaluating the use of a computerised automatic stop-order system in the hospital setting. We have shown evidence of meaningful benefits associated with the implementation and usage of CPOE related functionality as that of stop-orders. In essence, this study concludes that the system under analysis promotes a more efficient and autonomous medication ordering with respect to antibiotics.

**Keywords:** Computerised physician order entry, healthcare, drug prescription, Antibiotics, Efficiency

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## THE ECOTOURISM EXPERIENCE AN EXPLORATORY STUDY IN A TUNISIAN CONTEXT

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### ABSTRACT

The purpose of the present study is to explore and analyze the specific motivations of the ecotourism experience among domestic tourists and to investigate about the role of the existential authenticity in this experience. An ethnographic research is led in Tunisia among a domestic ecotourism club and its members. Results show that the ecotourism experience is multi-faceted, recovering such experiences as group and social interaction, self construction or bodily feelings. The various motivations identified converge towards the quest for existential authenticity.

**Keywords:** ecotourism, consumption experience, existential authenticity, ethnography.

### CONTEXT AND RESEARCH OBJECTIVES

The modern consumer is in permanent quest of emotions and new experiences (Hollbrook and Hirshman, 1982). Tourism industry is considered as “the business of selling experiences” (Mannell & Iso-Ahola, 1987; Waitt, 2000 ; Ooi, 2002). New and alternative forms of tourism are gaining in popularity. One of these forms is Ecotourism, where tourists’ main motivations are to observe and appreciate nature in a responsible way and to respect local traditions. It has emerged since the early 70s in the developed countries, in response to mass tourism and to new environmental and social consumer concerns. The materialistic character of modern life (consumption society) has led some tourists to look for “authentic experiences” (McCannell, 1976 ; Wang, 1999). Nature based tourism offers favorable conditions for such experiences. Ecotourism can be ranged as an extraordinary experience that offers consumers intense feelings and vivid memories (Kim, 2010).

The concept of authenticity has played an important role in understanding tourist motivation and experience. In early tourism studies, researchers emphasize objective authenticity where Tourists experience original, genuine objects and displays offered to them (.....). Later, Wang (1999) introduced the concept of “existential authenticity”. Feelings of authenticity are not related to objects but to an internal state of being, activated by the activities of the tourists, especially when engaged in an “extraordinary” experience. (Kim and Jamal, 2007). Wang (1999) identifies two main dimensions of authenticity: interpersonal and intrapersonal dimension.

In Tunisia, a south Mediterranean country, this form of tourism is at its beginning. There is no specific government interest for ecotourism, and therefore, very few investments are devoted to this area. Besides, domestic population sensitivity to environmental issues is not important and there is almost no specific culture of ecotourism among local population. However, in recent years, we can observe the emergence of some domestic groups, using social network or social to organize and practice based nature tourism activities.

The research questions of the present study are the following: What are the deep motivations of these domestic tourists? What drives them to be interested in the ecotourism experience in their own country? What relationship do they have with the self, with others and with nature? And what place for existential authenticity in their nature based experience?

The purpose of this research study is then to explore and analyze the specific motivations of the ecotourism experience among domestic tourists and to investigate about the role of the existential authenticity in this experience.

## **METHODOLOGY**

An ethnographic approach is adopted. The ethno-methodological approach helps exploring individual motivations, but also understanding the group members’ behaviors (Fetterman, 2010). Ethnography was led among an eco-tourists group “Eco Vadrouille Club de Tunis” identified and contacted through Facebook, the most popular social network in Tunisia. This club was founded in 2008 by two friends who were nature lovers and wanted to discover natural sites of their country. We checked the profile of the group adherents, examined their blog and the photos published in their facebook account. The ethnography lasted 11 months. We participated to six visits to eco sites ranging from mountain to sea sites, interviewed main

club members and participants, had continuous contact with the main founding members of the group, took pictures and wrote down all our observations and thoughts.

## RESULTS

The immersion in the “Eco Vadrouille Club” universe, supported by the participant interviews and other ethnographic material allowed identifying the main motivations of the participants in the ecotourism experience. This experience is multi-faceted, recovering such consumption values as group and social interaction, self construction, bodily feelings, etc. Group members are indeed driven by various motivations of different intensities, but all these motivations converge towards the quest for existential authenticity as conceptualized by Wang (1999). This search for authenticity is allowed by the interactions of each member of the group with others, and with nature. Wang identified two main existential authenticity dimensions, interpersonal and intrapersonal. However, little research has been carried out on the meanings and components of these main dimensions.

*Interpersonal dimension of existential authenticity:* interaction with the different members of the group but also with the local inhabitants is among the main experiences looked for by almost all the participant. As suggested in Wang (1999) authentic human relationship constitutes for our informants an important axis of tourism experience. Feelings of confidence and solidarity as well as a sense of community are frequently evoked by the Club members. Meeting with the local population has grown in importance over the time, to become a ritual. The social exchange with the local inhabitants covers two dimensions: a utilitarian dimension (asking for information about the site) and a “human” dimension (discussing with villagers, sharing meals). This social exchange of experiences is also an opportunity for ecotourists to think about their lives, and to question some of their attitudes and behaviors.

*Intrapersonal dimension of existential authenticity:* the quest for self through environment and nature interaction. The natural environment in which takes place the ecotourism experience offers participants a variety of vivid emotions: wonder, fear, risk taking, discovery. Participants are in continuous search for their identity and authentic self. The intrapersonal dimension of this experience covers two main facets: *body feelings* generated by the contact with nature (excitement, anxiety, sensation of lightness and well being) and the *self reconstruction* resulting from the break with the daily norms and routine, the discovery of cultural and ecological heritage and the emergence of an alternative self. Ecotourism activities can release

individuals and their body of the binding rules and help him regain his authentic self not controlled by social norms.

In conclusion, we can argue that the concept of existential authenticity in the sense of Wang (1999) provides a relevant conceptual framework to explain the experience of ecotourism, where nature is the central axis of the experiment. Our research study emphasizes the specificity of the natural element in this experience. The particular context of this ethnographic research (local tourism in developing countries) have helped to identify some features of this experience, such as the importance of the local population contact and the contribution of the ecological heritage discovery in the reconstruction of the authentic self.

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## **A REVIEW OF THE CURRENT SITUATION OF GENDER DIVERSE CORPORATE BOARDS AND THE IMPACT OF MORE DIVERSITY**

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The paper gives an overview over the number of women serving on corporate boards and will analyse the development and find plausible explanations of the present situation as women in Western countries hold only about 15 percent of board seats. A discussion about how to increase the number of women on the boards of corporations is prominent, followed by a debate about if a mandatory legal framework or a voluntary regulatory framework is the best method to increase the gender balance in business leadership.

We will introduce recent research papers in this field and explore the impact of more diversity on firm performance. We will address the question: Are more gender diverse boards likely to perform better than firms lacking the diversity?

The evidence in the research papers show that gender diversity on corporate boards can contribute to more effective corporate governance through a variety of board processes, but do not show up as a direct influence on the firm's bottom line and thus is inconclusive of the effects of gender diversity on firm performance, but better performing firms tend to have more women on the board.

Why are so few women on corporate boards considering in Europe and the USA, women account for approximately six out of every ten university graduates and represent almost half of the labour force. Lack of gender diversity in business leadership has been in the spotlight, both in Iceland as elsewhere in Europe.

There are many potential explanations for this gender imbalance. The main assumption is that there is a glass ceiling, an invisible barrier to the advancement of women at the top levels in the business sector. Norway was the first country to introduce a quota for women on company boards in public limited companies (plc) and the Norwegian quota law can be seen as a direct regulatory push to break the glass ceiling. Since its introduction the number of women on board has reached 40 per cent as required by the law. But did the diversity and increased number of women on boards have positive influence on the number of women in top management positions in the same firms? The data from Norway did not support the hypotheses that women's presence on corporate boards leads to a greater number of women in management positions (Teigen, 2011).

Research by Adams og Ferriera (2009) and Böhren og Ström (2010) show the correlation between the size of the firms and women on boards. The increase in the number of women board members was partly achieved through an increase in board size, firms respond to external pressure for board diversity, or firms have developed internal preferences for diversity. All would account for a greater demand for female board members.

In several European countries a debate has begun on how to increase the number of women in leading positions in business. Many European countries are currently debating whether or not to impose quotas and legislation in this respect. The question of whether or not quota legislation is needed to reach this goal is highly contested.

There is significant opposition to this process and the main concern is that increasing the number of women on boards would increase a sense of tokenism (Storvik og Teigen, 2010). Erkut, S., Kramer, V. W. and Konrad, A. M. (2008) find that such issues are reduced when there is more than one female director and this opinion is shares by Adams og Ferreira (2009) Terjesen og Singh (2008).

Another main counter-argument is that regulation of the gender composition of corporate boards would is not fair. Recruitment to corporate boards should not be based on the gender of candidates. The owners should have the right to select the candidates they find most suitable to sit on the board and board appointments should be made on the basis of business needs, skills and ability.

Iceland is the 2nd country in Europe and in the world, after Norway, to implement quotas on gender in boards of corporations. In March 2010 legislation on a minimum of 40% of either gender on boards for companies (with more than 50 employees) was passed in the Parliament with an adaptive period until 1 September 2013. Women hold only around 20% of boards seats and similar number of women is in top managements in Iceland.

There is a large international economic literature that has analysed the relationship between women in leadership and on boards and the economic performance of firms. Still, there is no consensus about the direction and strength of these relationships (Terjesen and Singh 2008).

Although we find evidence that women tend to serve on better performing firms it is difficult to see whether more profitable firms demand women on board or the women seek and choose to be on the boards of the better performing firms. Therefore, we fail to find convincing evidence that gender diversity in the corporate boardroom is a value enhancing strategy.

Different types of measures of economic performance are used in some of the more recent studies. The results suggest that there is a statistically significant positive relationship

between having members of both genders on the board of a company and its performance. The most common empirical proxy is market value of the firm per unit of book value (Tobin's q) and measures such as Return On Assets (ROA) and Return On Equity (ROE). There is no body of research which demonstrates how the appointment of female directors can improve a company's performance.

Adams&Ferrera (2009) point out that the evidence on the relation between gender diversity on boards and firm performance is difficult to interpret and appears to be complex as one key challenge is to isolate the causal effect.

The Norwegians Böhren og Ström (2010) find that the current politics of board design cannot be justified by valuation arguments and evidence does not provide support for quota-based policy initiatives. Mandating gender diversity in the board room should be considered an inherent part of a broader political program to ensure equal opportunities. Proposals for regulations enforcing quotas for women on boards must then be motivated by reasons other than improvements in firm performance. Implementing such a program seems costly for stockholders, but may still be beneficial for society at large.

**Keywords:** board composition, corporate boards, diversity, gender, firm performance, women

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## THE INTRODUCTION OF ACCRUAL ACCOUNTING IN THE ITALIAN PUBLIC SECTOR: THE 'EXCEPTIONAL' ACCOUNTING TREATMENT FOR FINANCE LEASE

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### ABSTRACT

Starting in the early 1980s, the major English-speaking countries<sup>49</sup> adopted sweeping innovative processes in the public sector. In different ways and with different degrees of intensity, these processes eventually affected the great majority of the western democracies (Pina and Torres, 2003).<sup>50</sup> These changes, following the New Public Management (NPM) model (Anselmi 2003, Barzelay 2001, Gruening 2001, Hood 1995), were inspired by managerial approaches aimed at eliminating bureaucratic obstacles (Barzelay 1992) and raising efficiency, accountability and results-orientation in the complex world of public administration (Seccolini 2003).

A fundamental role in this reform process is played by changes in accounting measurement and recognition systems (in this case, the literature speaks specifically of New Public Financial Management – Guthrie, Humphrey and Olson 1998; Jackson and Lapsley 2003). It has been characterized by a gradual shift from cash accounting, which aims to control processes, to accrual accounting, which is typically used in the for-profit sector and aims primarily to evaluate results (Pina and Torres 2003, Hepworth 2003).

Though the trend to adopt accrual accounting in the public sector has not been uniform in its path or its pace, over the years it has had an increasingly universal impact and can no longer be considered a prerogative of the English-speaking countries. To the contrary, the fact that a great part of the literature, both technical and academic, makes continuous reference to Australia and New Zealand as pioneers of a full-accrual accounting system may have limited the consideration and analysis of the experiences of a growing number of countries around the world that are now implementing this radical change, and in some cases have already done so (Carlin 2005; Deaconu, Nistor and Filip 2011; Grossi and Soverchia 2011; Osterkamp 2007; Paulsson 2006). Even in those parts of continental Europe and Latin America where

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<sup>49</sup> Meaning here Australia, Canada, New Zealand, the United Kingdom and the United States.

<sup>50</sup> Regarding the process of putting public administrations in Italy on a business-like footing, see inter alia Anselmi 2001, Borgonovi 2005, Steccolini 2003.

historical, cultural and structural aspects have limited its diffusion, today it is hard to find instances of the use of a solely cash basis accounting system (Morphett 1998).

The following table summarises the status of accrual accounting in the public sector of different countries.

*Table 1*

Public sector accrual accounting	
Country	Introduction of accrual accounting in the public sector
Austria	Accrual accounting only partly introduced: assets are recognized, but no depreciation; stocks and provisions are not recognized, but income and expenditure are on an accrual basis.
Belgium	No or not known.
Czech Republic	Accrual accounting for fixed assets and stocks but not for tax revenues.
Denmark	During the 2000s.
Estonia	During the 2000s.
Finland	During the 1990s on central and sub-central level.
France	During the 1990s on local level; 2007 on central level.
Germany	After 2000 on local level; around 2005 in some federal states (Berlin, Bremen, Hamburg); no present consideration for the central level.
Hungary	Pure cash accounting on all levels of government.
Italy	After 2000 on local level; no present consideration for the central level.
Latvia	During the 2000s.
Lithuania	Accrual accounting for fixed assets and stocks but not for tax revenues.
Luxembourg	No or not known.
Malta	Under consideration.
Netherlands	During the 1980s on local level; planned introduction on the central level postponed.
Portugal	No or not known.
Romania	2007.
Slovenia	No or not known.
Spain	During the 1990s on central and sub-central level.
Sweden	During the 1970s on local level; during the 1990s on central level.
United Kingdom	In the early nineteenth century, accrual accounting in most major municipalities; shift to cash accounting in 1866. During the 1990s shift back to accrual accounting on central and sub-central level. The reform started in the early 1990s with the introduction of accrual accounting in the British National Health Service.
EU Commission	2005.
Switzerland	In some Cantons in the 1940s; all Cantons agreed to accrual accounting in 1977; after 2008 on national level.
Australia	1997, but only on the central level; on the local level the change is currently under way.
Canada	2001.
Chile	1973 during the economic reforms under Pinochet.
New Zealand	1990; at present on of the most advanced accrual accounting countries.
USA	1997, but only on the central level; on the local level the change is currently under way.

*Source: The table has be compiled from: FEE 2007, Tiron-Tudor and Mutiu 2005 and Wynnne 2003.*

Italy, whose public sector is still tightly tied to cash accounting, recently took an important step forward by enacting Legislative Decree 118 dated 23 June 2011, which contains provisions regarding the harmonization of accounting systems used in the General Government Sector (meaning local and territorial government entities). This decree was intended to revise the structure and operation of the accounting systems used by Regions, provinces and municipalities (and their agencies). As of 2014, after a two-year period of

experimentation (starting January 1st, 2012),<sup>51</sup> these entities will be required to use accrual accounting alongside their chief accounting system – i.e., cash accounting – in order to increase the information content of their accounting reports as regards both their economic performance and changes in their net worth (Ranucci 2012).<sup>52</sup>

Analyzing the correlated evaluation criteria, it is interesting to observe the ‘exceptional’ accounting treatment required for finance lease. In contrast with a formal and legal approach, typical of the Italian accounting tradition, it has been substantially authorized the use of capitalized lease method according to IPSAS 13 – *Leases*.

Considering this background and the explicit recognition of leasing as a suitable financial operation for the Italian General Government Sector (Finance Act 2007), the paper describes the key elements of IPSAS 13 and focuses on the accounting treatment to use in Financial Statements of both lessee (principally) and lessor (less).

As a result, the author shares some observations on the possible effects generated by the application of this international accounting standard within the Italian public sector context, describing the advantages in terms of external (or political) and internal (or managerial) accountability that this kind of ‘exceptional’ accounting treatment could produce.

**Keywords:** accrual accounting; public sector; Italy; leasing; IPSAS 13

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<sup>51</sup> Pursuant to the Prime Minister's Decree dated 28 December 2011, 85 local-government entities (5 regions, 12 provinces and 68 municipalities) were involved in the two-year experiment (2012-2013). By 13 July 2012, six out of the 68 municipalities (Turin; Grazzanise; Sospirolo; Naples; Frosinone; Porto Cesareo) had been excluded from the experimentation.

<sup>52</sup> Encouraging the use of accrual accounting in the public sector was not a totally new idea in Italy. Law 142/1990 and Legislative Decree 77/1995 had already required local government entities to file balance sheets and income statements; these rules were reenacted in 2000 in the Consolidated Text on Local Government Entities (“TUEL”).

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## THE WORKPLACE MOBBING: THE NEGOTIATED CODES OF CONDUCT AS EFFECTIVE CONTRAST AGENTS

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### ABSTRACT

#### PURPOSE

The phenomenon of “workplace mobbing”, or also, more restrictively, “bossing”, is taking today, in Europe, but not only, substantial proportions, also regarding to the generalized social instability on many fronts, from the ethical to the economic, that had an effect also at the organizational level.

It is therefore worth examining what are the more suitable organizational tools to avoid that employees are affected by this phenomenon, considering, apart from the primary direct negative effects on the single individual, its negative redundancy on corporate productivity.

Consequently, this study, leaving out the specific legislation - in Italy, for example, it still does not exist - aims to verify if in the European context codes of conduct already exist not only as a result of a management choice, but also as an outcome of enterprise bargaining, such as to prevent the emergence of mobbing through the cogency of organizational behaviors and / or methods explored by the organizational science (private sector) / science of administration (public sector), eventually promoting the “workplace decency”.

It's true that many codes are written by factories, and the corporate codes with more employee participation in general are set by workers' organizations or prepared by multi-stakeholder organizations: so it is interesting to examine if there are codes, with a specific section or articles devoted to mobbing, arising from the collective agreement of employers and workers; moreover, if it is possible to think to a new example to such a code of conduct.

## DESIGN/METHODOLOGY/APPROACH

The first part of the research focuses on the examination of codes of conduct at the enterprise level in Europe, covering “antimobbing” measures, such as the *appointment of a Confidential Counselor or a Company Counselor, as determined by* the EU Resolution A3-0043/94.

In the second part the paper particularly stresses the importance, to face mobbing, of any codes of conduct resulting from corporate collective bargaining, highlighting the opportunity of a preventive bargaining as “close” as possible to the workplace: to this purpose it shows an appropriate rigorous demonstration.

By an experimental approach, in the third part the paper proposes a detailed model of an “antimobbing” code of conduct framed in a broader model of decentralized collective bargaining, showing its better quality (stability - effectiveness) compared to the classic examples.

The conclusions consist in a global inductive evaluation of the previous findings.

## FINDINGS

The research primarily demonstrates the importance of the collective bargaining instead of, or in addition to, the unilateral granting of codes of conduct, in whole or in part devoted to counter the phenomenon of the workplace mobbing. In particular, it offers a new model of such a negotiated code.

## ORIGINALITY/VALUE

The main originality of this research is to develop a new model of decentralized collective bargaining agreement providing detailed organizational measures to prevent the workplace mobbing. This is made from the established knowledge in the organizational sciences and from the most current examples in this field.

**Keywords:** Workplace mobbing, bossing, organizational behavior, codes of conduct, HR management, corporate collective bargaining.

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The abstract is written in a personal capacity and does not bind the Administration to which the author belongs.

## THE BALANCE SHEET AS A MODEL FOR SELF-ASSESSMENT AND PERSONAL BRANDING

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### ABSTRACT

Brands are everywhere and so are people's accomplishments. A brand carries a signature, a unique attribute that is infused in the outcome of a specific value-adding process. This signature inspires feelings of respect from the brand's environment that come to be the actual and sustainable trust for the unique value it holds.

From a broad perspective anything can be a product and by extension any product can have a signature, but having a signature does not make any object a brand. A product is anything that can be offered within a market that *might* satisfy a want or a need. In contrast, a brand has to be earned. A brand is not a commodity and it is not a product. A brand is a life partner for its valued customers that has come to be an unchallenged part of their lives.

When *The Coca-Cola Company* replaced its cash cow with New Coke in 1985, its hotline received 1,500 complaint calls per day and the psychologist hired from the company to monitor the calls remarked that some people sounded as if they were discussing the death of a family member (Oliver, 1986). Coca-Cola is a brand.

Brands have come to be unique cultural attributes of our world that have satisfied profound needs and provided unsurpassable value. This is the narrow approach, for it may seem general, but brands are so much more...more in what they consist of, since brands are not only products of a firm and more in how they come to be, since brands are entities that more accurately resemble systems in themselves than outcomes of systems.

One million years ago, fire itself was a brand for *Homo erectus*; whereas today the latest brand to take over the world via the uncontested global internet democracy is the meme *Harlem Shake*, instigated from a single YouTube upload in the beginning of February 2013 that led to thousands of viral replications. As a result, the world spent roughly 2,782 years watching Harlem Shake videos in one month (Feb. 2013). With human life expectancy being 67.2 years (global average, 2010), this means that in only one month people globally spent collective

time that is equivalent to over forty individuals watching the Harlem Shake internet meme from birth to death ceaselessly.

Branding (brand management) is not a conceptual marketing element, but a function that is certain to be one of the underlying factors of a sustainable competitive advantage. A brand may be a project in perpetuity (and even if it is not it should be considered as such) and since one of the key conceptual principles of a firm is permanence (Brealey *et al.*, 2012), the same principle must be applicable to its brand(s). In addition, all major components of strategic management apply in branding. What a firm utilizes and implements in regard to a brand is not some arbitrary execution of production, financing, marketing and management activities, but a never ending quest for excellence.

In 2004 the concept of lovemarks intended to replace the concept of brands, asserting that brands inspire high respect but low love and that only lovemarks inspire love and respect simultaneously (Roberts and Lafley, 2004). This under consideration, there may be brands that might not inspire love, but in the present context the brand is considered the ideal (even if this means that it is no longer a brand but a lovemark).

The principles of branding can be effectively applied to individuals and not because people can be thought of as products, but because by correlating brand management with self-management, the individual is given a powerful conceptual framework towards self-motivated and self-driven accomplishment. The ethics of branding (Lair *et al.*, 2005) along with marketing myopia (Levitt, 1960), corporate or personal misconduct and fraud are instances that must only be mentioned; since branding is not a tool to be utilized in order to befool. Branding practiced for any activity other than adding value consists of branding abuse (Gall, 2010) and will inevitably lead to inadvertent situations as can be observed in our modern systems of financial, political and social intercontinental crises.

Self-assessment is considered to be one of the key contributing factors in the effectiveness of accomplishing one's goals, in improving performance (Trujillo, 2009) and is the first step towards a personal branding project. Through the utilization of the fruits of the research community, along with concepts rooted in project management and strategic management, a value-system consisting of ten distinct parameters is proposed, containing the components that may be included in personal branding. This value-system is interwoven with the principles and structure of the balance sheet in order to provide a concise and practical framework that is able to aid the personal branding project of any individual, not as much in

the wave of self-help philosophies but in the direction of a *transparent* branding being (Hewer *et al.*, 2013). Said value-system is differentiated from other self-assessment instruments since it utilizes a projected assets approach that can include needs assessment as well as the strategies in order to obtain these assets; though instead of sources and applications of funds one will have sources and applications of values.

**Keywords:** Personal branding, self-assessment, balance sheet model

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## CONCEPTUALIZING A NEW MODEL OF SOCIAL INNOVATION IN ONLINE ENVIRONMENT

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In time when crisis give no other chance, business people become innovative at the limit law. This research have canvassed the way that crisis has affected the business in Romania, identifying in this particular mode the innovative services that lead to sustainable development in times of crisis. Corroborating all these data, in one stream of investigation it is conceptualized a four dimension model of social innovation environment, taking into account the real opinion of people who face problems on this market.

**Keywords:** crisis, model, innovation, online, clustering, networking

### RESEARCH METHODOLOGY

Gallouj and Weinstein (1997) outlined six innovation models that could be used for describing service innovation. They distinguish between radical innovation, improvement innovation, incremental innovation, ad hoc innovation, re-combinative innovation and formalization innovation.

Pim Den Hertog (2000) presented four dimensions for service innovation: the service concept, the client interface, the service delivery system/organization, technological options.

Innovation in services, rarely represent just changing certain characteristics of a service. Offering a completely new service may differ considerably from offering an existing service using a new distribution channel. For example the reason why most of the companies didn't survive in the online environment is that they didn't have a particular concept for online. More than that, they did not follow a precise strategy that can approach them with customers. The way the service provider interacts with the client can itself be a source of innovation. They didn't take into account the technological innovation. The linking between these four dimensions is very important, because a complete new service will mean that a new service delivery system will have to be developed, employees will have to change the way they work or relate to customers (the client interface), the way IT is used in business processes, while a new service concept may also be involved.

## RESULTS

Based on the principles of Gallouj, Weinstein and Pim Den Hertog and after a detailed review upon the business environment from Romania this research proposes for analyze a four-dimensional model of social innovation in the online environment.

The four dimensions are: client, strategy, promoting, clustering and networking

### **The first dimension: The client**

In times of crisis, the one from which you must start when you develop / open your business is the client. Unlike the traditional sale when you are the one who is looking for the client to sell, in the online environment, the client is the one that is looking for you, and if the page that represent you has a constantly updated content and enrolled in several directories, than the client will find you without too much effort. Furthermore, the client must be involved in designing and structuring the product range.

## **THE SECOND DIMENSION: THE STRATEGY**

The strategy is always the best response to a crisis situation. In times of crisis, whatever its form of manifestation, the random action without any direction and without clear objective is likely to result in impulsive and risky behaviors with adverse effects. The strategy is the one that lucid examines the growth and potential that organization demonstrates, analyzing its efforts to specific, controllable and reproducible objectives.

### **The third dimension: Promoting**

Most companies have fallen into the online environment because they have no longer allocated financial resources to marketing and promotion with the coming crisis. Promotion is the key to success in the online environment. Internet advertising campaigns are very facile and at a very low cost to anyone. An unfrequented site is something nonexistent. As a site to be visited, to reach his goal, should be visible to his current and future clients and visitors.

### **The fourth dimension: Clustering and networking**

Affiliation and the creation of new networks offer benefits to the sites. The evidence of development that have appeared until now demonstrates that relations of cooperation and joint action are most likely to occur when companies operate in proximity. Proximity in the online environment means to be part of the same groups or clusters. Besides the fact that fixed costs are smaller the websites are easier to be coordinated, being fostering mutual knowledge and trust. Proximity in terms of the distance to the client means a mouse click away.

### Linking the four dimensions

Any social innovation in the online environment involves some combinations of the above-mentioned dimensions. A completely new service or product is the more difficult to be sold online, than on the traditional market. The four-dimensional model that we propose, can be observed in figure no. 1.

To cope with competition, and to maintain on the market, the product must respond exactly to the customers' needs, in this case to the needs of a customer that experiment an economic crisis. In times of crisis, customers place great emphasis on the financial resources, because this is what they lack.

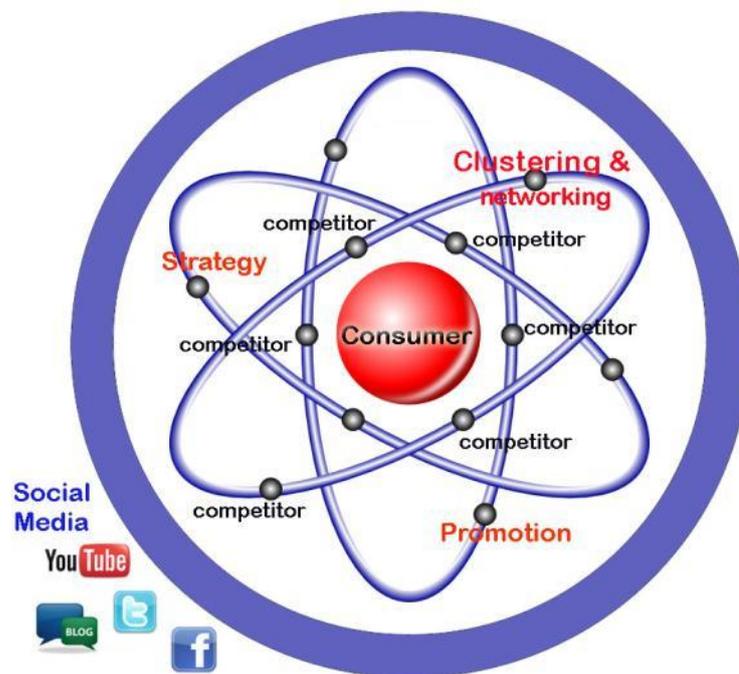


Figure 1. A four-dimensional model of service innovation in online environment  
(original material)

The non-stop electronic businesses are the solution for companies that want to be competitive in the new digital economy. For this purpose, the companies must fulfill some basic conditions: to operate nonstop, to be present on the Web, to maintain permanent contact with the clients, partners, employees, suppliers, to have networked storage solutions that allows the management of a huge volume of information, to have solutions for virtual applications through which to ensure the permanent availability, scalability, performance and security.

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## ABNORMAL INVESTOR RESPONSE TO THE INDEX EFFECT FOR DAILY AND INTRADAY DATA

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### ABSTRACT

The stock index is the basis for the existence of various index instruments such as ETFs and index funds. Consequently, events in the index are of considerable importance in the investment world. One of the most important of such events involves updating the index, an event taking place once or twice per year, with effects on the capital markets that are known as the 'index effect'. This anomaly draws one of strongest and most influential long-term effects on the capital markets. Using two different methods, I examine in this study the broadest impact of the index effect on the Israeli capital markets. I shall examine the three leading market indices, the Tel-Aviv 25 index (TA25), the Tel-Aviv 75 (TA75) and the Tel-Tech 15 index (TECH15) for entering and exiting firms both for daily and intraday data. In the first examination, I divided the sample based on each of the three market indices and examined the effect using daily data. This analysis shows that the market responds differently for firms entering and exiting the Tel-Aviv 25 index, than it does to the two other indices. For the second examination, the sample was divided based on each stock's volatility during the period prior to the event, using intraday data. This analysis shows that more volatile stocks respond stronger to the indexing event.

**Keywords:** Index Effect, Investment Behavior, Market Efficiency, Event Studies Approach.

## INCREASING ECONOMIC NEED SATISFACTION ON THE PUBLIC SOCIAL SOFTWARE PLATFORM FACEBOOK – INSIGHTS FROM THE AIRPORT INDUSTRY

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### ABSTRACT

**Purpose:** The adoption of public Social Software Platforms (SSP) by individuals and business organizations is no longer in a state of infancy, but on “the verge of commoditization” (vor dem Esche and Hennig-Thurau, 2013, p. 30). 92.6 % of German Internet users have registered with at least one SSP, while the average German Internet user maintains a profile on three SSP (ibid, p. 13). SSP can be described as “digital environments that support human communication and collaboration. Contributions and interactions are globally visible and persistent over time” (McAfee, 2006, n.p.). SSP provide the infrastructure for business organizations to extend beyond organizational boundaries and establish network connections with their customers. Network ties that cross organizational boundaries, i.e. bridging social capital, have been acknowledged by scholars of various disciplines as a major source of competitive advantage. However, as Porter (2006, p. 225) noted, “the mere presence of firms, suppliers, and institutions in a location [i.e. SSP] creates the potential for economic value, but it does not necessarily ensure the realization of that potential”. The purpose of the paper is to explore, if airport organizations are able to increase their economic need satisfaction when interacting with their passengers on the online social network Facebook. Facebook captures the majority of German Internet users with an audience of 38.6 million unique visitors per month and 25.0 million registered active users (ComScore, 2013).

**Design/Methodology/Approach:** The paper adopts a Strategy Map approach (Kaplan and Norton, 2004) to propose cause-effect-relationships between leveraging the intangible asset ‘bridging social capital’ on SSP and economic need satisfaction of airport organizations. The Strategy Map framework considers intangible assets “as the ultimate source of competitive advantage” in today’s knowledge society (ibid, p. 10). Strategy Maps vary by industry and strategic focus of organizations (Kennerley and Neely, 2003). Hence, a generic airport industry Strategy Map was developed by the author. Based on the developed Strategy Map five economic needs were identified: ‘customer insights’, ‘operational process efficiency’,

'innovative strength', 'customer advocacy' and 'customer satisfaction'. As economic needs are theoretical constructs they were operationalized by indicators.

A semi-structured questionnaire was constructed and distributed to six out of the eight major German airports (annual passenger volume > 5 Mio.). The airports Berlin (Tegel/Schönefeld) and Cologne-Bonn were excluded from the study. The existing airports in Berlin will close down due to the planned opening of the new airport Berlin Brandenburg International. Cologne-Bonn focuses predominantly on the low-cost traffic segment and is therefore only to a limited extent comparable to the other airports in the sample, which have a rather balanced traffic segmentation. Based on the questionnaire face-to-face interviews with the airports' Corporate Communications Managers responsible for social software activities were conducted in the time period from November 2012 to January 2013. The questionnaire included both open-ended questions and likert-scale ratings. The likert-scale ratings report to what extent the respondents agree that Facebook increases the economic need satisfaction of airports as compared to traditional communication channels, such as e-mail, call-center or corporate website. The interviews were recorded and transcribed. The results were submitted to quantitative analysis (aggregation of likert-scale items to variables, analysis of distribution of variables) and qualitative analysis (text analysis, item identification based on frequency of occurrence). As SSP are a relatively recent and fast changing phenomenon and little knowledge currently exists regarding the adoption of SSP of organizations, it was necessary to integrate quantitative with qualitative analysis to be able to draw meaningful conclusions.

**Findings:** While airport organizations already experience some increase in economic need satisfaction when comparing SSP to traditional communication channels, they are not yet able to tap into their full potential. Despite that the number of Facebook users connecting to airports is constantly increasing, the critical mass for passenger insights and feedback to be fully representative is not yet reached. This currently restricts the utilization of Facebook as an instrument for market research or active involvement of passengers in innovation processes. Currently, communication goals, i.e. fostering positive word-of-mouth or faster information dissemination in case of air traffic disruptions, have priority over other business process-oriented goals. This is not surprising, as the Facebook activities of airports are anchored in the Corporate Communications Department. Airports are currently only at the beginning of a transition process for a more interdisciplinary approach to Facebook management. Hence, they are currently facing the challenge of adapting organizational structures, routines and resources.

**Limitations:** The study reports on German airport organizations. This restricts the generalizability of research findings to other countries. As SSP are a still emerging phenomenon a longitudinal study would be beneficial to assess changes in economic need satisfaction of German airport organizations caused by an increasing adoption of SSP by passengers. Notwithstanding the study focuses on the airport industry, it can be adapted to any other industry by adopting an industry-specific Strategy Map approach.

**Originality/Value:** The Balanced Scorecard / Strategy Map framework has been criticised by scholars for being too internally focused, while failing to consider relations maintained with the external environment (Bontis, 1999; Mooraj *et al.*; 1999; Norreklit, 2000; Saint-Onge, 1996). By integrating the intangible asset bridging social capital into the Balanced Scorecard / Strategy Map framework the paper responds to the need for acknowledging the extended value chain as an “essential element of today`s networked organizations” (Mooraj *et al.*, 1999, p. 482). From a practitioners’ point of view the paper contributes to an understanding of the organizational challenges that need to be addressed by airport organizations to be able to exploit the full potential of SSP.

**Key Words:** social capital, social software, strategy map, economic needs, airport industry

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## THE DETERMINANTS OF E-GOVERNANCE AND HOW TO ESTABLISH A SUCCESSFUL RELATIONSHIP WITH CITIZEN

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### ABSTRACT

The knowledge based socio economy is more and more emerging due to IT tools and innovation changes of markets in any fields. Social innovation is part of our lives but usually we don't notice its effects. This paper focuses on the value created by the emergence of e-governance concept, shaped in different processes. It emphasizes on the important role in meeting citizen's needs and solving their problems by using resources and technologies. More than ever the request for electronic services and programs are needed for the interaction with citizens. The result should be the general well-being, social satisfaction and a consolidated relationship between the state and its citizens.

Most of the things that are now granted in our lives usually appeared for the first time as an innovation. Geoff Mulgan describes how in specific periods in our history, civil society provided the perfect scene for creating social innovation. The wave of industrialization and urbanization was accompanied by various forms of social enterprise and innovation: building societies, cooperatives, trade unions, etc. (Mulgan, 2006).

Social innovation represents all the activities and services that are motivated by the goal to meet a social need and are spread through organizations that have a social activity core. The starting point for innovation is usually an idea of a need that is not being met. Ideas are generated by needs which involve searching for alternatives and solutions. In the current conditions of a volatile social, political and economic environment, the ability to use the information in an intelligent way requires a coherent strategy and vision in order to identify the essential points of leverage. This is where the concept of social innovation and business intelligence interferes.

Social innovation results are permanently present in our lives: zero carbon housing schemes, when we talk to a telephone help line or the community wind farms they are all

examples of social innovation because they bring new ideas that work in order to meet people's needs and improve their lives in the same time (Mulgan *et al.*, 2007).

The concept of smart communities refers to the locus in which such network intelligence is embedded. A smart community is defined as a geographical area ranging in size from a neighborhood to a multicounty region which citizens, organizations, and governing institutions deploy an NICT (National Institute of Information and Communications Technology) to transform their region in significant and fundamental ways (Eger, 1997). Clusters and communities should become interlinked, and they must be viewed and treated as parts of a local ecosystem where interests converge as communities grow. This is the path proposed by the concept of smart communities.

*"A truly smart community will need to develop comprehensive plans to address, in more depth, the issues surrounding access and education to ensure that all citizens and all organizations converge on the opportunities to benefit from the knowledge-based economy"* (Coe *et al.*, 2001). Furthermore, while there is little doubt about the increasing importance of the local nexus of the government and smart communities, technology alone cannot transform how people and organizations interact and promote their collective interests in processes that are fundamentally different from what is currently happening.

E-governance is a form of social innovation, a platform within the public sector and a significant discipline within the field of public administration. It is an online platform of the government, where it delivers services and programs, provides information and interacts with citizens. Public institutions will need to make sure that the e-governance platforms are user-friendly, interactive and easy to access (Riley, 2003). Some of the main benefits after a proper e-governance implementation are: a simplified process of information for both users and businesses; empowerment of the citizens to gather information related to any department of government and to get involved in taking decisions; citizen participation at all levels of governance; services automation; the elimination of corruption; transparency; better delivery of services and most important the strengthen relationship between the two parts involved.

We require social innovation because we need smart ideas to improve our lives. E-governance will become more and more important due to its important role: supports and simplifies governance for all parties: government, citizens and businesses (Backus, 2001).

Particularly, by using an e-governance platform we offer society the chance to improve its capacities in solving its problems. Moreover, while the current paper represents

an introduction to the determinants of the e-governance and citizen relationship success, further research in the field of social innovation and e-governance is needed in order to test the validity of the most important expressed ideas. Using the anchors provided, concrete steps should be taken to increase the efficiency of the relationship between citizens and government. Also, some differentiators that have a high contribution in deciding the nature of the relationship should be emphasized. Furthermore, a study on the Romanian market will lead to results in a thorough knowledge of how e-governance platforms permit the development of a new level of communication between Romania's citizens and public institutions, so that the individuals will use the information in achieving their goals. The research will have its limitations since in Romania there are less than 50% Internet household users.

**Keywords:** social innovation, smart communities, innovation, public administration, e-governance, business intelligence, social satisfaction

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## GENDER ROLE STEREOTYPES AND REQUISITE MANAGEMENT CHARACTERISTICS: EVIDENCE FROM GREECE

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### ABSTRACT

#### BACKGROUND

Although the number of women pursuing management careers has grown quite rapidly in the last decades, women *remain* substantially *underrepresented* in upper-middle and senior management positions while the number of female CEOs in large corporations remains extremely low. Quite a number of theories attempting to explain this phenomenon appear in the literature, including lack of line experience, inadequate career opportunities, gender differences in socialization, the “old boy” network etc. (Schein, 1973, 1979, 2001, 2007)

Alternative explanations involve gender-role and requisite management characteristics stereotyping by men and women (Schein, 2001, 2007; Eagly and Carli, 2003). In this respect, seminal is the work of Helen Schein who in 1973 introduced a 92-item Index (Schein’s Descriptive Index) of human personality characteristics that was subsequently used to unveil gender-role and successful managers’ stereotypes; that is, determine genders’ perceptions of each other and managers with the view to developing adequate understanding of perceptual barriers limiting women's progress towards occupying management positions. Schein’s (1973) “think-manger, think-male” aphorism was subsequently and up to the present day researched in quite a multitude of settings (Brenner et al., 1989; de Pillis et al., 2008; Dodge et al., 1995; Schein et al., 1989; Orser 1994; Booysen and Nkomo 2010) with reported results considerably varying. With a few distinct exceptions (e.g. Booysen and Nkomo, 2010) however, most published studies report findings from, allegedly egalitarian, protestant societies. To the best of the authors’ knowledge no published study exists on evidence from Greece.

Not having researched a particular topic in a specific culture would not justify per-se setting up a study if “gender paradoxical” findings hadn’t been reported proposing gender role stereotyping and gender – related personality differences to be significantly larger in more

gender egalitarian cultures as compared to less egalitarian ones (Costa et al, 2001; McCrae et al., 2005). Hence, pursuing further the investigation of gender role stereotyping across different cultural settings will supplement existing knowledge on the subject and certainly add to the literature.

### **Purpose**

The purpose of this study is to follow the research trail on the relationships between gender role stereotyping and requisite management characteristics, originated by Schein (1973), on evidence from Greece that reportedly stands quite apart (e.g. Hofstede, 2005) from the protestant – egalitarian societies that so far have hosted studies on the subject reported in the literature.

## **DESIGN/METHODOLOGY/APPROACH**

This study is quantitative in nature. Data was collected through a research instrument built around Schein's Descriptive Index (SDI) (Schein, 1973) in two stages. Stage one dealt with collecting evidence on respondent's perceptions of personality characteristics of managers while stage two with collecting evidence on respondents' assessment of own personality characteristics. Questionnaires were administered on-line to two separate samples of  $n_1=134$  and  $n_2=101$  respectively. All items, except demographics, were rated on identical 7-point Likert scales. Intra-class correlation coefficient ( $r'$ ) (Hays, 1963) was used to assess resemblance of stage one and stage two respondents' responses across the 92 SDI items.

## **RESULTS**

Data analysis resulted in findings directly challenging Schein's "think manager think male" maxim and, on the other hand, offering support to previous culturally paradoxical findings suggesting gender role stereotyping being larger in gender egalitarian societies. (Costa et al, 2001; McCrae et al., 2005). This study resulted in findings indicating that: a) perceptions of managers' personality characteristics between men and women are matching, b) the idea that managers should have masculine characteristics is challenged and c) no differences between men and women were revealed in relation to identification of own personality characteristics.

## IMPLICATIONS/LIMITATIONS

This study's findings yield important implications to both academia and practice. In relation to academia the study adds to the literature on existing relationships between gender role stereotyping and perceptions of managerial personality characteristics. As regards practice the study unveils lack of gender role stereotyping and significant similarity of personality traits across genders, both leading to the conclusion that popular aphorisms such as "Think manager – Think male", "Old Boys Club" etc. are seriously challenged in Greece, even though the countries cultural position is not considered as being among the most egalitarian in Europe and the world. Limitations of this study are certainly related to: a) drawing evidence from a convenience sample and b) surveying through the internet. However, due care was taken so that sampling bias was excluded.

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## DELIBERATE LEARNING MECHANISMS AND ALLIANCE MANAGEMENT CAPABILITY: A PILOT STUDY

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### ABSTRACT

Basing on a dense activity of literature review and on the results of a pilot study, the purpose of this work is to analyze the role played by deliberate learning mechanisms in building an alliance management capability, thus improving a firm's alliance performance.

In today's competitive environment, firm's ability to manage interorganizational collaborations, defined *alliance management capability*, has been identified as an important source of competitive advantage (Dyer *et al.*, 2001; Ireland *et al.*, 2002; Schreiner *et al.*, 2009). As a consequence, several scholars have addressed the question of how firms should develop such a capability. Building on organizational learning and evolutionary economics, most of these studies assume that a relevant antecedent of a firm's ability in managing collaborations, and therefore of alliance success, is previous alliance experience (Anand and Khanna, 2000; Kale *et al.*, 2002; Zollo *et al.*, 2002; Sampson, 2005). However, as highlighted by several scholars, alliance experience can be considered as a necessary but not sufficient condition for building an alliance management capability, thus improving alliance performance (Simonin, 1997; Kale *et al.*, 2002; Heimeriks and Duysters, 2007). Simonin (1997) suggests that the lessons of experience have to be internalized by the firm and drawn into specific know-how in order to achieve benefits from future partnerships. Similarly, several scholars have stressed the importance of investing in *deliberate learning mechanisms* in order to leverage a firm's previous alliance experience (Simonin, 1997; Zollo and Winter, 2002; Draulans, *et al.*, 2003; Heimeriks and Duysters, 2007; Kale and Singh, 2007). The use of these mechanisms is aimed at interpreting previous collaborative experience, deriving lessons that can be used in future partnerships and diffusing alliance management knowledge within the organization.

In this study we focus on the role played by such mechanisms in improving alliance performance. More specifically the investigated research question is: Which is the effect of different types of deliberate learning mechanisms on the alliance management capability building process?

In particular, this work presents the results of a pilot study conducted on 11 aerospace firms in the Campania Region (Italy).

The aerospace industry was chosen because it is a high-tech and innovation-based industry where alliances are fundamental for firm strategy and success and, therefore, alliance management capability can be considered a key asset for a firm's competitive advantage.

We aimed at evaluating whether alliance experience (as measured by the number of alliances a firm had entered in the previous 10 years) and different types of deliberate learning mechanisms (such as: formal meetings for the exchange of relevant knowledge, alliance training systems, rotation across different partnerships of experienced alliance managers, databases containing the firm's alliance history, manuals and/or checklists for managing collaborations, etc.) have a positive effect on alliance performance. Moreover we investigated whether firms have an alliance manager or a dedicated alliance function, that is a function responsible for coordinating all alliance-related activity within the firm (Kale *et al.*, 2002).

A mail survey questionnaire was sent to firms (followed by telephone calls) and assessed by managers responsible for the firms' alliances. According to responses on alliance performance the 11 firms were divided into high, medium and low performers (Table 1).

	Number of firms	Average number of employees	Total number of alliances	Total number of deliberate learning mechanisms in use	Number of firms with an alliance manager	Number of firms with a dedicated alliance function
High Performers	4	138	55	9	0	1
Medium Performers	3	131	30	5	2	2
Low Performers	4	22	17	3	1	0

Table 1 – Results of a pilot study on alliance experience and the use of deliberate learning mechanisms in 11 aerospace firms in the Campania Region (Italy)

The findings reveal that, on average, high and medium performers not only entered more alliances but also made use of a higher number of deliberate learning mechanisms than low performers. Moreover, the study shows that only a few firms have an alliance manager or a dedicated alliance function.

The pilot study has been used in the pre-testing phase of the research design in order to evaluate the suitability of the questionnaire to be used in a subsequent quantitative analysis as well as to detect any biases arising from it, whether in its formal structure or in the semantic nature of the variables/questions used. Future analysis should allow to investigate more in depth the issue, focusing on the relation between the specific characteristics of firm's alliance experience and adopted deliberate learning mechanisms on the one hand, and on the link between different types of mechanisms and alliance performance on the other.

**Keywords:** Alliance management capability, Alliance experience, Alliance performance, Deliberate learning mechanisms

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## SUSTAINING BUSINESS EXCELLENCE IN UNCERTAINTY

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### 1. INTRODUCTION

The quality management discipline is strongly rooted in business practice. This link with practice has resulted in quality models (like the Business Excellence Models) that appeal to managers and, as a result, have been used widely. Research has shown that a universalistic approach is inappropriate because quality management is in fact context dependent (Sousa and Voss, 2001). The management control discipline has acknowledged the importance of the business context already more than a decade ago, and can provide important insights for quality management. In this paper we will discuss these insights and argue why they can benefit quality managers.

### 2. CONTROL SYSTEMS

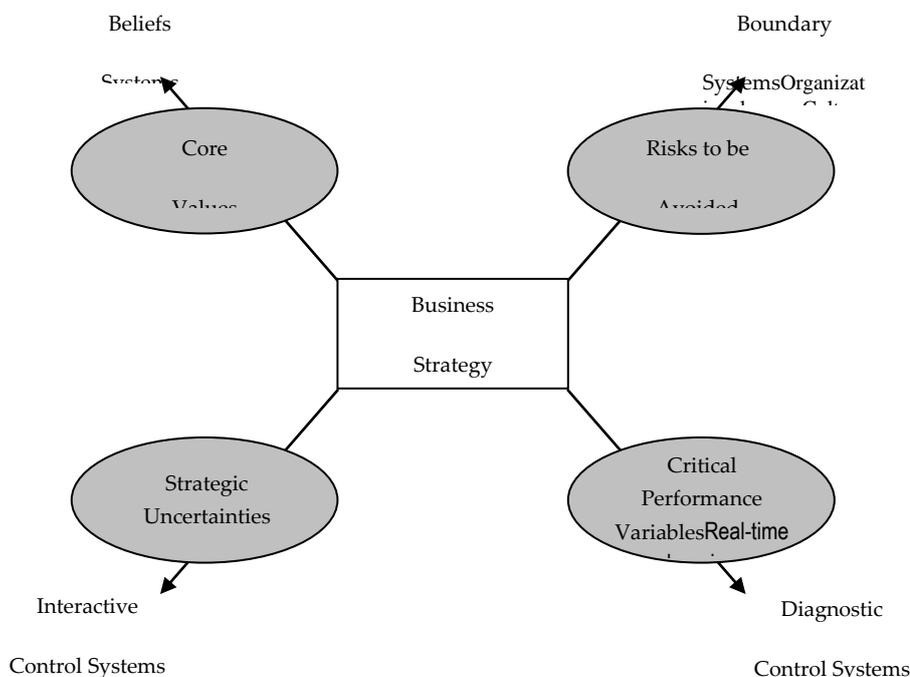


Figure 1. Simons' Four Levers of Control Model (Simons, 1995)

It can be argued that quality management can be seen as a management control system since it is aiming to control an organisation's processes and to improve these processes in response to all kind of changes and developments (technological; economical, social etcetera). This view of quality management is further strengthened by the conclusion of Merchant and Simons (1986) that definitions of management control generally contain two key concepts: "A focus on the behaviour of organizational participants and a concern with the effect of this behaviour on organizational outcomes". Simons' Four Levers of Control Model is displayed in Figure 1.

Simons' Four Levers of Control Model is used to balance control mechanisms in an organization in order to realize the business strategy. The model distinguishes four different types of control mechanisms: (1) beliefs systems, (2) boundary systems, (3) diagnostic control systems, and (4) interactive controls systems. Two of these four levers increase individual freedom (i.e. beliefs systems and interactive control systems), and two restrict individual freedom (i.e. boundary systems and diagnostic control systems). The four levers are explained below.

- *Beliefs systems*

Beliefs systems are used to inspire and direct the search for new opportunities. Managers use beliefs systems to indicate to subordinates in what direction they want the organization to go.

- *Boundary systems*

Boundary systems are used to set limits on opportunity-seeking behaviour. Boundary systems define the limits within which the management wants employees to operate. These limits are based on defined business risks and strategic choices.

- *Diagnostic control systems*

Diagnostic control systems are used to motivate, monitor, and reward achievement of specified goals. Diagnostic control systems are essentially feedback systems, which are fundamental to traditional management control. Diagnostic control systems have three distinguishing features: (a) the outputs of a process can be measured, (b) the existence of predetermined standards against which actual results can be compared, and (c) any deviations from these standards can be corrected. Because of these three features, they are designed to ensure predictable goal achievement.

- *Interactive control systems*

Interactive control systems are used to stimulate organizational learning and the emergence of new ideas and strategies (Locke and Latham, 2006). Based on the unique strategic uncertainties they perceive, managers use these systems to activate search. Interactive control systems focus attention of employees and force dialogue throughout the organization.

### **3. RESEARCH METHODOLOGY**

An analysis of an organisation's quality systems by means of Simons' control model enables managers to look at quality from a different perspective. The model makes it possible to take strategic aspects and characteristics of the business environment into account when assessing an organisation's quality management systems. As such, it helps managers to make the switch from a universalistic approach, towards a context dependent approach to quality management. By determining in which of the four levers each of the existing quality systems fits, an overview of the dominant levers emerges. Management can then assess whether their use of each of the levers fits the environmental uncertainty and complexity. Given the fact that the business environment evolves over time, the dominant focus in terms of the control levers may be out of sync with the business environment. Simons' control model then makes clear which type of quality systems is overrepresented in the quality strategy, and which type of quality systems is underrepresented, and therefore needed for future business success.

### **4. CONCLUSION**

What do leading European companies see as the major challenges they are experiencing in managing quality in their organizations today? Our research findings - based on interviews over a period of three years with three companies: Novaled (Dresden), Trimo (Ljubljana), Dubai World (Dubai) - indicate that uncertainty is a key issue and leading companies realize that they have to be more aware these days of uncertainties in relation to their key processes.

In order to manage the crucial uncertainties it is not enough to measure and control what is going on now. Moreover, management's time and attention, which are scarce, have to be devoted to these uncertainties in interaction with the other players that are involved in those key processes. From a management control perspective, this means that besides the diagnostic control systems that are most of the time well developed in organizations, there is a need to pay attention to the more interactive control systems. The balance between

diagnostic and interactive control systems will have to shift in the direction of the interactive systems or the diagnostic systems have to be used in a more interactive way.

## THE IMPACT OF 'CREATIVITY' ON STUDENT EMPLOYABILITY\*

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### PURPOSE

The year 2009, has been designated as the European Year of Creativity and Innovation (EUROPA, 2009) as an attempt to highlight the importance of creativity not only for Europe's economic prosperity, but also for our social and individual well-being. Nevertheless, despite its increased recognized importance, specifically within the European Higher Education Area (EHEA), universities have made little adjustments to their teaching practices, their curricula and to their relationship with the industry to help nurture creativity.

### SCOPE AND OBJECTIVES:

more specifically, the scope and objectives of the paper are directed by a set of aspiring guiding principles identified during the literature review, as follows:

- 1 The need to generate pioneering research that will enhance and improve the current largely unchallenged teaching methods.
- 2 The need to rethink how we can teach and generate knowledge that can prepare university students to cope with the current economic challenges and which will allow them to adapt, to work in currently undiscovered jobs and face the unpredictable.
- 3 The need to involve employers in the design of the undergraduate curricula that is more relevant, as well as innovative, to the needs of the work environment.
- 4 The need to promote good teaching practices which foster creativity and enhance the quality of undergraduate competencies and skills specifically in the university sector.
- 5 The need to respond in practice to the European Commission strategy of establishing an "Innovation Union" by 2020.

The development of creativity skills for both academics and students at teaching/ learning and research levels is more important now, within the context of the economic crisis experienced in many E.U. countries, than ever before. Over the past two decades the massification of higher education coincided with a record of high unemployment rates. In fact, the European graduates of 2013 especially from South Europe are facing one of the most difficult employment challenges of the last century. During these difficult times there is an urgent need to explore the quality of the learning experiences these students receive. "It is no longer sufficient in this new society, to produce knowledgeable and erudite students. Rather,

we must produce students who can manipulate, transform and create new knowledge” (Caridad Garcia-Cepero, 2007, p.3) that is currently in much demand in revitalising the economy. Certainly, our focus on creativity skills does not imply a lesser need for critical thinking and problem solving in higher education, on the contrary it looks at creative and alternative ways of finding solutions to nowadays problems, existing theories as well as in reaching innovations. The latest represent the purpose and the link with the employers who are searching for creative labour force to overcome the increasingly uncertainty future of their businesses.

## **DESIGN/METHODOLOGY/APPROACH**

The current paper makes a serious attempt of introducing new knowledge that is innovative and original and that is the direct result of empirical research findings that can transform creativity, and in particular ‘small c’ creativity (Begetto and Kaufman, 2007, Schilling, 2005), into specific pedagogical methods and strategies across disciplines. The paper aims to fill a missing gap of research regarding teaching in *Cypriot* universities. Many local researchers appear to focus on making their findings applicable to the entire education system, paying little attention to issues specific to the HE sector and the cultural patterns of their area. In order to reach these goals, the study has produced a critical analysis of the literature in the field and based on its findings and gaps has prepared a methodological framework, predominantly a constructivist one, which comprises of a set of 100 quantitative questionnaires to academics, a set of 6 qualitative focus groups and 30 semi-structured interviews with major stakeholders: the students, the academics and the industry. The obtained set of data has been processed under an interpretative inquiry approach, aiming to answer the gaps found in the literature review and those emerging from the interviews. This approach is commonly accepted ways of thinking about creativity, and how this is reflected in the university classes and in the industry at large.

Thus, in this paper, an attempt is made to link the ‘creative capital’, as defined by Florida (2002), and the pedagogical practices of faculty, by outlining a number of principles that, when taken together, may represent a structure for coordinating a learning environment that prioritizes the curriculum design and that which enhances creativity in universities.

## **FINDINGS**

In the anticipated findings it appears that the part of the approach of creativity is contextual to the individual creativity thinking versus the societal creativity and that there are many ways of measuring creativity, where appropriateness (Hocevar, 1981), error and rewards (Mihai-Yiannaki and Savvides, 2012) are subjective. Moreover, when linked to employability, there is a subliminal researched link between creativity and dishonesty, bringing thus a dark shade over the concept in the industry (Gino and Ariely, 2011), which makes us pay attention to the ethics issue when delivering creativity at University level. Eventually, we found at local level that originality, awareness, the students and academics environment, the teachers creativity, the play factor, the assessments, the learning processes, the policy makers flexibility and the link with a flexible industry accepting creativity fosters it further and brings students satisfaction.

## ORIGINALITY/VALUE

Finally, this paper is putting a case forward: that creativity can be fostered and learned and universities can play an influential part. At the heart of this approach is the understanding that employability, creativity and effective learning are closely linked and relate closely with the qualities rated highly by employers (Yorke & Knight, 2006).

*Keywords: creativity, higher education, employability, learning, universities*

\*The paper is based on the work elaborated for the project funded by IPE Cyprus on the topic: "Teaching for Creativity in Universities: Towards Pedagogical Practices in Promoting Students Employability".

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## AN INSIGHT INTO THE RATIONALITY OF ECONOMIC ENTITIES: EMERGING FROM CRISES WITH NEW APPROACHES TO SOCIAL SCIENCES

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### ABSTRACT

Mainstream economic thought has grappled with the concept of rationality as a premise for most macroeconomic scenarios. Nevertheless, the notion that entities operate solely based on the information available and are constantly searching to maximize their utility has been placed under scrutiny in various situations. Simplistic assertions have been formulated in support of neoclassical models, disregarding the intricate nature of social phenomena. Contemporary economic developments are characterized by complexity, and consequently, require an updated methodology.

**Key words:** Rationality, Bounded rationality, Maximization, Social science, Behavioural Science.

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### INTRODUCTION

The dynamic nature of markets has repeatedly underlined the limits of most economic models and constructions for social phenomena. The failure to determine the behaviour of large populations or the inability to accurately predict economic cycles constitute telling examples of the confines in economics and business planning. Keen (2001)

considers that a systemic flaw in neoclassical thinking consists in the presumptions of perfect rationality and profit maximization.

Earlier scholars have indicated the inappropriate manner in which neoclassical economics has considered the notion of rationality. In contrast to other social sciences, this strand of thought has considered behaviours as being uniform and consistent in time, has formulated the claim that entities are objectively rational in relation to their environment and has remained silent in regard to the goals and values of individuals (Simon, 1986).

Prior to assessing the approach to this matter, one should define the concept and identify its full implications. In simple terms, rationality describes the ability of entities to become aware of their condition and pursue the realization of their goals and objectives. In the study of economics, rationality has been associated with the efficient allocation of scarce resources (Simon, 1978). Furthermore, Simons describes the term as being characteristic to individuals who are “maximizers”, meaning that they consistently seek to optimize their solutions.

In game theory and negotiation studies, participants are considered rational when they are aware of their available strategies and potential payoffs. Additionally, the participants are perceived as being intelligent when they are rational and are concurrently aware of the rationality of others (Moorthy, 1985).

In keeping with the previous definition of the concept, rationality revolves around individual utility and the stride for its maximizing. The essential problem or inconsistency with its application resides in the generalization of utility. It is fundamentally flawed to consider that individuals share the same goals, values, preferences and beliefs. Thus, in negotiations or in macroeconomic models, it proves difficult to determine the rational response of all participants.

In the field of negotiations, a clear limit on projecting a correct rational approach to others consists in the cultural differences which exist between people of different nations, regions or backgrounds. An example of this assertion may arise in the business communication between Western companies and their counterparts in other regions such as East Asia, the Middle East or the Arab World (KhaKhar and Rammal, 2013).

## **A DISCUSSION ON CLASSICAL AND EVOLUTIONARY APPROACHES TO MARKET BEHAVIOUR**

As Haltiwanger and Waldman indicated (1985), rationality can be understood in two different ways, initially in a broader definition which is characteristic to individuals in society, and secondly, in a meaning specific to economic studies. This paper, in keeping with most business and economic literature, focuses on the latter understanding of the term, describing rationality as the ability of entities to effectively process information and correctly establish their objectives. The same authors highlight one essential problem in the assumption of rationality which is frequently expressed in the support of equilibrium and macroeconomic models. This problem consists of the heterogeneity of market participants (Haltiwanger and Waldman, 1985). A fact which is often ignored in generalizations and theoretical interpretations of intricate phenomena is that there remains a significant variance in the ability of individuals to acquire, assess and act upon information from their environment.

For a comprehensive presentation of the various hypothesis and results employed or generated by the classical and evolutionary strands of thought, the discussion incorporates, among others, key elements from game theoretical constructions in social sciences. Classical game theory has been acclaimed as the “universal language” which provides valuable insight and unity to behavioural sciences (Gintis, 2000). Initially developed by von Neumann and Morgenstern (1944), the principles and mechanism were adopted and expanded by numerous scholars such as Raiffa (1957), Harsanyi (1986) or Khun (2004). The theoretical endowment accumulated has represented a valuable instrument for delving deep into the interactions found in multiple fields of research, from international relations, military strategy, market behaviours and business negotiation.

The realization that entities operate differently, based on the same available information, gave rise to the introduction of games in incomplete information (Aumann, 1987) and subsequently to the notion of bounded rationality patented by Herbert Simon (Simon 1956, Simon 1991, Gigerenzer and Selten, 2001). Bounded rationality has come to represent decision making depending on environmental factors and the access to information (Simon 1991). Models which incorporate this latter concept have renounced the theoretical drive for optimization or maximization (Gigerenzer and Selten, 2001) and focused on the evolutionary or adaptive aspect of behaviours.

A distinct strand of thought that has focused on the dynamics of phenomena by abandoning the notion of rationality driven equilibrium has been that of evolutionary economics (Dosi and Nelson, 1994). Deriving from biological and natural processes, the same

principles, when incorporated in the game theoretical background have generated the methodology of evolutionary game theory. Generalizing Darwin's doctrine of survival, this approach connects the size of the payoffs with the perpetuation of a particular strategy or behaviour in a given population (Weibull, 1995). By utilizing a probabilistic assessment of behaviours, the models are able to eliminate the hypothesis of perfect rationality, and can focus primarily on the adaptive nature of entities and the stability of their behaviours. Applications of evolutionary scenarios to market phenomena have been proposed (Friedman, 1998) and included in previous studies in relation to issues such as market competition or cooperation (Vasile et al. 2012).

In the absence of a consensus on the nature of economic entities, the pattern of their behaviour and the intricate mechanisms of markets, concepts such as rationality, in its pure or bounded forms will continue to occupy the scientific agendas of scholars going into the next decades.

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## **COST BEHAVIOR OF SELLING, GENERAL, AND ADMINISTRATIVE COSTS AND EARNINGS MANIPULATION.**

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### **ABSTRACT**

This study focuses on earnings management as a significant determinant of the sticky cost phenomenon, for explaining both firm-level cost behavior and cross-country differences in cost behavior. We combine firm-level incentives to manipulate earnings with country-level differences in earnings management practices, to provide a richer understanding of the effects of these practices to cost stickiness. We find that cost stickiness is mitigated in the pervasiveness of earnings management. Our research design firstly addresses the global nature of the sticky cost phenomenon.

The traditional assumption in cost accounting literature states that the relation between costs and activity volume is mechanistic, contemporaneous and linear symmetric towards both volume increases and decreases (Noreen 1991). Anderson et al., (2003) challenged this assumption by introducing a different way of thinking about cost behavior. Focusing on the behavior of selling, general and administrative expenses, they built a new concept named as “cost stickiness” which postulates an explicit role for managers in affecting cost behavior. Managers maintain idle resources after volume declines and as a result activity costs falling less with decreases in activity volume than rising with increases.

According to the literature, managerial discretion is intricately linked with earnings management. There are different methods available to isolate the effects of managerial discretion on earnings management (Jones, 1991, Leuz, 2003, Gopalan and Jayaraman, 2012). Drawing on the earnings management literature we build on the concept of sticky costs by examining the following research question: Are the differences on the degree of cost asymmetry attributable to firm-level and cross-country differences on the earnings management practices? The subject of our study is the impact of the different management accounting practices on managerial cost behaviour and as a result on cost stickiness. Furthermore this study examines the global nature of the sticky cost phenomenon. It differs

from the past individual country research by documenting the asymmetric cost behavior of SG&A expenses for a panel dataset that comprises of firms that operate in the G-7 countries.

**Keywords:** Sticky costs, cost behavior, earnings management incentives.

## THE CONTEMPORARY "HOMMO ECONOMICUS": DEFINING WELLBEING AT THE CROSSROADS OF ECONOMIC GROWTH AND BUSINESS ETHICS

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### ABSTRACT

The concept of Hommo-economicus is constructed around the notion that wellbeing can only be maximized through the optimum allocation of resources throughout society. Thus, the measure of a sustainable development resides in the relation existing between socio-economic growth, having as proxy the human development index, on one side and business ethics seen through the magnifying glass of corruption perception index and democracy index, on the other. The paper seeks to enquire into the characteristics of individual and national wellbeing into the role and effects of corruption and to determine the manner in which these elements influence each other, and how they impact decisions of business planners and policymakers.

**Keywords:** Business ethics, Corruption, Quality of life, Wellbeing, Economic development.

### INTRODUCTION

One of the cornerstones of the modern commercial activities is represented by business ethics. According to Zhuang (2007), this notion examines the ethical rules and principles within an economic enterprise, numerous moral or ethical problems derived from the business environment and any other special obligations applied to individuals who engage in commerce.

Economists have been driven by the concept of "homo-economicus", corresponding with the rational understanding of utility and the consequent efficient allocation of scarce resources (Dinu, 2007).

Sustainable development advocates abandoning of short term profit goals, characteristic to numerous emerging economies (Costea et al. 2010), in favour of a

reorientation towards long term ethics and values. These two concepts are seen as drivers of robust economic growth. The challenges faced by businesses in terms of ethics reside in the intricate process of establishing the correct decision or response to market evolutions, as former US President Lyndon B. Johnson once stated “[...] doing what’s right isn’t the problem; it knows what’s right”.

Quality of life or wellbeing has become a key element to be taken into account in the policy making process, due to the fact that individuals are more aware of their place in society and have ever increasing demands. Understanding and influencing this factor has become a hallmark for business planning, as companies are realising that they can attract and retain more customers by addressing their fundamental needs. Furthermore, nowadays a major concern of any government is the wellbeing of its citizens (Fleche et al. 2011).

The approaches in defining and measuring quality of life can be divided into two broad categories: first one, the objective approach, dominated by the discipline of economics, where quality of life is measured by indicators such as reported income; and, secondly, the subjective approach, generated by social scientists where quality of life is measured by indicators such as reported happiness with life (Manrai et al. 2000).

Subjective wellbeing can be measured using indicators that have an intrinsic value for individuals that often are considered to be intangible and to some extent abstract (Viciu et al, 2012).

An accepted objective measurement for national wellbeing, as proposed by Fleche et al. (2011), is the Human Development Index (HDI). This indicator incorporates numerous parameters that portray a state’s social, political, economic evolution and stability.

Subjective wellbeing and its evolution depending on the level of income have been considered by certain research (Luhmann et al. 2011). Improvements in subjective wellbeing are considered to be the result of a comparison between current levels of income and previous or standard ones. With the passing of time, both the actual level of income and the standard are modified, increasing or lowering the perceived wellbeing of individuals.

One of the factors that influence both the individual and national wellbeing is corruption. This liaison will be referred further in to the paper.

Following a definition provided by Transparency International, corruption represents “the misuse of entrusted power for private gain”. The democratization process of emerging markets was characterized by widespread poverty, weak civil society and institutional inefficiency. These three aspects have been identified as prerequisites for an environment where corruption flourishes (Dillon et al, 2006). Subjective wellbeing of individuals is

negatively influenced by corruption as the latter generates frustration and apathy among a country's citizens.

Corruption can be present in various sectors of activity. A highly significant strand of corruption that influences the values, the culture and the professional training of individual scan be found in the educational system (Rumyantseva, 2005). Corruption in the educational sector generates a wave of social and economic problems in the long term, as the labour market is distorted, the civic structure is modified and the quality of potential future leaders is altered.

There is a strong argument in favour of the notion that quality of life is dependent on the efficient and sustainable exploitation of resources (Knight and Rosa, 2011). As a consequence, unethical or non-transparent dealings in natural resources, unavoidably encroaches on the wellbeing of individuals.

This uneasy relation between corruption and quality of life is supported further by the fact that subjective wellbeing is enhanced by: voice and accountability of persons, political stability, and government effectiveness, and regulatory quality, rule of law and control of corruption (Abdallah et al. 2008). Moreover, since studies have shown that individuals gain utility from procedural fairness and the possibility of participation in political decision making process (Brereton et al. 2009, Stroup 2007), one can assert that the lack of transparency with regard to public institutions and private corporations unavoidably reduces the actual level of quality of life.

## DATA AND RESULTS

By utilising a cross-section analysis for 176 countries, this paper identifies and assesses the correlation between the Human Development Index, the Corruption Perception Index (CPI) and the Democracy Index (DI). Through this empirical inquiry, the impact of unethical behaviour is measured.

*Table1 "The correlation coefficients between HDI, CPI and DI"*

	CPI	HDI	DI
CPI	1		
HDI	0.665565226	1	
DI	0.635407917	0.388705933	1

*Source: Constructed based on data from: United Nations Development Programme- Human Development Report, Transparency International and The Economist Intelligence Unit.*

Further attention must be given to the significance of these results by applying T-student test.

$$t \text{ calculated} = \frac{\vartheta}{\sqrt{\frac{(1 - \vartheta^2)}{n - 2}}}$$

where:  $\vartheta$  represents the correlation coefficient

$n$  represents the number of observations

As the values of t calculated for the three correlations are 11.58, 10.98 and 5.58, by comparing with the Student's distribution table, one can assert that the results are significant for confidence level of at least 95%.

The economic evolution of recent years has brought about significant changes in policy making and theoretical thinking. Efficient markets are changing their focus from the factory planning economy towards a service and customer based phenomenon. This latter concept can be defined only by understanding individual needs and the level at which there are fulfilled. Thus, quality of life becomes a key element in long term policy making and business planning.

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## **CREATING A BUSINESS COMPETITIVENESS INDEX: AN APPLICATION TO GREEK MANUFACTURING FIRMS**

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### **ABSTRACT**

#### **PURPOSE**

The purpose of this paper is to construct a single index that reflects, as fully as possible, the measurable factors constituting firm and sectoral level competitiveness. In this research we investigate the competitiveness on company level, identifying a competitiveness Index which classifies the competitiveness of companies into three different group categories, based on micro economic factors. The study is undertaken on selected manufacturing sectors in the Greek industry, in the pro and post economic crisis era, based on firm level financial and qualitative data and firm exportability and attempts to identify critical determinants of competitiveness in the manufacturing sector.

#### **DESIGN/METHODOLOGY/APPROACH**

We present a framework to understand the meaning of competitiveness and its applications based on firm level financial data. Initially, a set of financial and economic ratios is investigated in the firms' competitiveness prediction context. The research is based on a balanced panel data set of over 771 firms from the sectors of food, beverages and textiles for the period 2003-2011. Discriminant analysis is used to test the Index and multivariate logistic regression to test the different competitiveness groups. With the help of the competitiveness index we create three categories of companies in the research sample, i.e. leading, average and falling behind. The index score will be used to classify the firms into those categories. Independent variables used are financial ratios of market share, market share growth, profitability, profitability growth, efficiency, capitalization rate, liquidity, etc. We seek to create a relatively robust index in the sense that small changes in the weighting of indicators do not greatly alter the rankings of manufacturing firms' sub-samples.

#### **FINDINGS**

Although it is an ongoing research, we seek to make comparisons of the firms' ranking on the basis of the value of each index, and to underscore core characteristics in firms'

competitiveness ranking. The results suggest a competitiveness index, which uses the same fixed weights applied to every firm (or group of firms).

## ORIGINALITY/VALUE

Other studies and research on competitiveness in Greece have measured factors in isolation and have not sought to produce an overall index. The present study aims to fill this gap. The method has wide applicability to the general issue of comparing performance across different firms based on exporting and non-exporting activity and other performance variables, as well as on features that enhance firms' performance especially in the post crisis period.

## POLICY IMPLICATIONS:

The index described above, can be used to measure relative company competitiveness in the Greek manufacturing sector and can give an insight to managers of firms and State officials to reinforce appropriate policies and strategies to improve the competitiveness of the Greek manufacturing firms. The development, growth and job creation of the Greek economy and every economy, is to a great extent based on its manufacturing sector. Therefore the results of this research are very important for both academics, firm executives, banks and policy makers.

**Keywords:** Firm competitiveness, financial performance, panel data, exports and financial performance, manufacturing, competitiveness index.

*The paper is result of the research which is undertaken under the Arximidis III project, Υποεργο 2, of TEI of Crete. The authors are members of the research teams.*



## **DETERMINANTS OF USER ADOPTION OF E-GOVERNMENT SERVICES AND THE ROLE OF CITIZEN SERVICE CENTRES (CSCS), IN GREECE.**

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### **ABSTRACT**

The aim of this research is to investigate e-Government users' behaviour and the role of 'Citizen Service Centres' (CSCs) in e-Government adoption. The ultimate aim is to contribute to the understanding of the citizens' intention drivers or barriers at the local government level in adoption and diffusion of e-Government realms in Greece, by building a theory and proposing a validation research framework using a quantitative research approach. At the practical level it aims to provide guidelines and recommendations that would help e-Government policy decision makers and web designers to better plan e-Government, design and implement policies and strategies to increase the take up of e-Government services.

Although European Union has invested heavily in e-Government implementation in all country members, these implementations have varying results and delayed outcomes. The empirical findings illustrate that the adoption and diffusion of e-Government in Greece comes second last, in the 27 EU countries (European Commission, Digital Agenda scoreboard, 2010).

In Greece and other countries besides government portals the public service delivery is offered through channels like CSC offices (KEP, in Greek). These have been launched by the Greek government to facilitate service delivery and seamless interaction to citizens, to communicate their needs; to help increase accessibility of e-services by offering more points of availability of services for the public and to support the training and education needs of citizens, by facilitating the assisted use of technology. This should enable the gradual transition of citizens to 'self-using' new technology (Griffin and Halpin, 2004).

Nowadays 1.086 CSCs are running under the supervision of Greek local municipalities, operating all over the country and mostly work on behalf of citizens as a front-end of government agencies to deliver e-services (Tambouris et al., 2004). So far, they have enjoyed citizens' trust (Kalogridis St., 2007) and they are gradually being transformed to e-CSCs,

following government legislation and technical requirements in terms of security, data protection and electronic transactions.

Research in IS, in the topic of e-Government has done much to improve the e-government adoption by the end users. Recently, various theories and models have emerged on new technology and e-Government dissemination and explain adequately the phenomenon under investigation (i.e. TAM, TPB, UTAUT). However, there are remaining determinants not fully explored to be applicable for the Greek context. The reason is that e-Government acceptance depends on various factors that differentiate among different group members, particularly with regard to expectations, cultural variations, level of use and interaction, and commitment to the e-Government initiatives. Thus further research is needed.

This study following a quantitative approach uses a survey to understand citizens' perspectives regarding the role of CSCs in e-Government adoption. A conceptual model was created by extending the UTAUT (Venkatesh et al., 2003) theoretical model with the trust factor. Lack of trust is one of the most important barriers to e-service adoption, especially when personal or financial information is involved (Al-Sobhi et al., 2009).

To empirically test the extended theoretical model a measurement instrument by the form of questionnaire was used. It was constructed and tested on an appropriate sample of CSC and e-government service users. The research has refined the model by conducting exploratory research and then confirmed the hypothesized model using relevant data. The final model was tested empirically, by using the Structural Equation Modeling (SEM) approach.

This research has identified as the most important factors that affect adoption of e-Government in Greece the following: 'effort expectancy', 'trust of intermediary' played by CSCs, 'trust of the government', 'trust of internet', 'social influence' and finally 'performance expectancy'. It has also identified financial security and integration between different government departments as the most prominent issues impeding e-Government implementation and diffusion. CSCs should deliver services as e-CSCs support the training and education needs of citizens and increase their efforts for gradual transition of citizens to 'self-using' the new technology. This way Greek government supposed be able to encourage Greek citizens' e-service usage, bridge digital divide and make steps forward to electronic age.

Findings contribute to theory by understanding the drivers of e-Government adoption in local government level. It has practical implications for practitioners and web designers on

how e-citizens might increase their willingness to interact online. It will also help strategy makers to further enhance delivery of e-services to citizens through multi-channel service delivery. This study emphasises the role of CSC in assisting communication with citizens online and acting as a trusted gateway towards e-services. This clearly indicates that if Greek government works closely with CSCs, e-Government usage will increase. Further it can be concluded that e-Government websites alone do not influence citizens' attitude to adopt e-services as they are likely to seek help in CSCs to interact with government online.

It is anticipated that it will stimulate discussion among the e-Government research community, particularly in Greece but also in other countries with similar characteristics across key variables, in the planning of e-Government uptake.

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## THE HYBRIDIZATION OF HRM PRACTICES WITHIN MNCS: SHIFTING FROM RECEPTIVE TO LEARNING SUBSIDIARIES

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### ABSTRACT

The aim of this paper is to highlight the characteristics of a learning subsidiary. Recently, more attention has been focused on the role played by these entities within MNCs. For Birkinshaw and Hood (2001), the subsidiaries could be autonomous, contributory or receptive. While the two first aspects value the contribution of the subsidiaries, the last one leads them to submission logic. To overcome this position, certain “rebels” subsidiaries change the knowledge and the practices transferred by their parent company to make them fit better the local context (Milano et al., 2002). Thus, the hybridization of the knowledge received may inspire other subsidiaries embedded in similar contexts. The importance of this new type of subsidiary led us to formulate this research question: How to transform a totally receptive subsidiary into a learning subsidiary?

To answer this question, several aspects could be taken into account: the role of the parent company, the Group's strategy, the characteristics of the local market and the characteristics of the subsidiary. For this paper, we chose to focus on the latter, considering the subsidiary as a learning organization. More precisely, we are interested on the identification of the characteristics that promote learning in receptive subsidiaries. The concept of the learning organization "*describes the internal capacity of organisms to learn from experience, to consider and adopt new ideas and transform them into policy and action plans in order to obtain a competitive advantage*" (Mitki and Herstein, 2011, p 455 ). Several studies have attempted to identify the dimensions of this type of organization (Senge, 1990; Pedler et al, 1991. Gardiner and Whiting, 1997; Watkins and Marsick, 1998; Garvin, 2000; Griego et al, 2000). Therefore, most of these studies were more focused on the domestic learning. To our knowledge, no study has been made on the international learning.

For this study, we chose to focus on the international context and mobilize the five dimensions of Senge to have a more holistic approach. In fact, Senge (1990) has introduced five disciplines to define the learning organization. The *Systems thinking* is focused on the interrelationships between different parts and helps apprehending the complexity of reality.

The *Personal mastery* is based on individual development and self-criticism. It combines a lucid perception of reality and the knowledge of personal motivations. The *Building shared vision* provides the necessary motivations to progress towards common aspirations. The *Mental models* are based on the articulation of existing knowledge. They aim at improving the representations that one has when observing the functioning of the environment. Finally, the *Team learning* is achieved through communication, discussions and creative thinking.

Despite the theoretical character of these attributes (e.g. Smith, 2008), it is also important to study their importance within the subsidiary unit. In this context, we carried out a study within two Tunisian subsidiaries of French MNCs. We conducted a non-participant observation and semi-structured interviews with 16 local managers from different departments and 4 HR from both parent companies. The interviews focused on the HRM practices transferred by each parent company to its Tunisian subsidiary (recruitment, compensation, performance appraisal and career management), the level of these practices' reception, use and learning by the locals.

The analysis of the data collected showed that the hybridization process starts as soon as the knowledge transferred by the parent company does not fit the local context of the subsidiary (Djelic, 1998; Boyer, 1998). Through a continuum of the transferred HRM practices, this study shows that the subsidiaries may modify certain global practices into a hybrid one that we call "double-iteration" learning. While other practices are totally adopted without any change that we call the "single-iteration" learning (Argyris and Schon, 1996). This different reaction is primarily due to the learning characteristics of each subsidiary. It appears that subsidiaries which are part of double-iteration learning are characterized more by three main dimensions (among the 5 of Senge (1990)): personal mastery, mental models, and team learning. In contrast, the subsidiaries which are part of learning without changing routines are characterized by a more systemic approach and a shared vision. This shared vision is fostered by different variable linked to the contextual similarities of the educational system, the labor code, the cultural influences, the strength of the corporate culture, the fascination effect, and the dominance effect.

**Keywords:** Learning, hybridization, subsidiary, HRM practices

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## **"SOME CUSTOMERS THINK THE SERVICE INCLUDES ME" – SEXUAL HARASSMENT BY CUSTOMERS TOWARDS WOMEN SERVICE PROVIDERS**

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The twenty-first century has been labeled "The Service Age". It seems that the traditional role of family and community in meeting human's needs, has been supplanted by other social structures, mainly service organizations. In other words, we live in a society in which most human needs are supplied by organizations (Cook, Gogh and Chung, 1999). A unique quality of service organizations lies in the intensive encounter between service-providers and the organization's customers (Lu-Ming, 2013; Yagil, 2008). As such, services-providers are in danger of customers' bullying in general (Grandey, Dickter and Sin, 2004; Goussinsky, 2012) and sexual harassment in particular (Guerrier and Adib, 2000; Lu-Ming, 2013; Yagil, 2008).

The current study seeks to hear and give voice to the personal experiences of female services providers in Israel who were sexually harassed by customers.

Empirical research suggests that customers' sexual harassment is quite common for women services-providers (Guerrier and Adib, 2000; Lu-Ming, 2012; Yagil, 2008). Sexual harassment is one of the main reasons for work-stress burnout (Ben zur and Yagil, 2005; Rosen and Martin, 1997; Yagil, 2008). However, there is relatively little research conducted on the problem of customers' sexual harassment in general, and of its impact on the functioning and stress of women service-providers in particular. Since services-providing has become a major occupation in the western work market, it is important to look into this impairing phenomena and to learn more about its influence on women who experienced it.

Sexual harassment at work is defined widely as unwanted sexual behaviors that are forced in an unequal relationship, against the will of the victim of these behaviors. It includes verbal sexual suggestions (en vivo and via telephone calls), unwanted sexual stares, impersonation of body parts and actions, presentation of pornography, and any unwanted touching, fondling, attempts of rape and actual rape (Folgero and Fjeldstad, 1995; The Merriam-Webster Unabridged Dictionary, 2013).

The study is a part of a larger scale project. The present study examines the themes from a qualitative research with 30 women services-providers from Israel. The participants are all

"first-line" service providers (= in a direct contact with customers) of different services (such as shops, cellular service centers, hotels and restaurants, etc.). Their age range from 21-35, they are all Jewish, and all of them have been sexually harassed at least once by a customer in the year preceding the research interview. The interviews were in-depth, semi-structured interviews conducted by my research- seminar female students and lasted between half an hour to an hour. The participants were selected by my students because they knew them as study and work associates and through "snow ball". The only criteria for participation was being a first line service provider, a female, and having experienced at least once sexual harassment from a customer. Some of the students (three) who collected the data asked to be interviewed by others because they wanted to voice their own experience. The sensitivity of the subject, the need to receive informed consent, and the importance of privacy and secrecy were taught and discussed as part of the classes dealing with ethics in research. I received my students' agreement to use the raw data (i.e. the transcribed interviews) for this study.

The interviews included questions regarding the setting and context of the sexual harassment incident, the influence it had on the personal and working life of the interviewed women, the organizations' attitudes to it and the means it was / should be handled.

Two major themes that emerged from the interviews will be presented: 1 – The emotional and behavioral effects of sexual harassment on the life of the harassed women. 2 – Means of dealing with the harassment at work and in the harassed women's personal life.

The findings and their implications to service organizations and their policy will be discussed in light of the high burnout and soaring stress inflicted on women service – providers by customers' sexual harassment (Ben Zur and Yagil, 2005; Deery, Walsh and Guest, 2011; Goussinsky, 2012; Guerrier and Adib, 2000).

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## FRAMING TEAM LEADERSHIP FROM A STRATEGIC HUMAN RESOURCE MANAGEMENT PERSPECTIVE

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### **ABSTRACT**

In cross-cultural management as well as strategic human resource management research, there is a lack of a shared conceptual understanding of organizational culture. Sustainable organizational culture is increasingly defined as a frame or a set of psychological commonalities shared by a group that prescribes codes of conduct and consequently an organizational behavior. Granting that individuals have shared experiences with members of several groups within organizations, they share, to different degrees, the cultural characteristics in each of several groups. Thus, we are all multicultural to the extent that we belong in various cultural groups within organizations. Yet, the patterns of behavior and roles played by both teams and individuals differ particularly with respect to their different contexts.

After reviewing the literature regarding organizational culture and its implications on leadership and teamwork, we have first employed Belbin's team role profile model (1993) based on role theory and typology among a few managers in the graduate class. Our research questions are: In an emergent market where transactional "solo" leadership is salient, under which organizational culture may "team" leadership according to Belbin, that is, transformational leadership (Bass, 1985) develops? Our assumption is that team leadership is a behavioral process or competency cluster which can be learned; however, it needs a supportive environment.

Most of the prior research has focused on the linkage between personality traits and team roles, we have suggested that the context is significant in the execution of team leadership. Moreover, the literature on successful teams does not focus on context in relation to leadership styles or competencies. Although the general management literature views effective leadership as a critical success factor for the high performance of organizations, the enabling and disabling contextual factors are often overlooked.

We have employed mixed methodology to be able to confirm our research questions. Thus, we have first employed Q sort methodology among 10 to 20 managers to understand how leadership and team are perceived with a spectrum of viewpoints. Then, an empirical research exploring the differences between organizational culture and/or leadership dimensions of employees in different organizations is employed. A survey is conducted for 75 employees in the three organizations that the graduate students are working. A questionnaire on organizational culture which are based on Harris and Morgan's (1994) cultural dimensions is used so that investigating the cultural differences between different kinds of organizations (e.g., multinational versus local or manufacturing versus service firms) in more detail.

On the whole, an intercultural dialogue in organizations is not concerned solely with behavioral patterns, but with perceptive and evaluative habits. While mainstream socialization promotes an attitude that equates "context blindness" with the engine of future growth as a consequence of which criteria of "objectivity-neutrality" and a search for "universality", analyzing unique contexts, patterns and subjective cultural differences pave the way for multiple readings of facts and behaviors with more focus on the past and/ or present. However one does not have to replace the mainstream thought, which is perfectly adequate when the context is not complicated and the implicit premises can be taken for granted. Instead, one may enhance it with a more thorough framework of reference. That is why, we will make both a quantitative and qualitative inquiries. Then, contextualizing and framing of specific intercultural issues at workplace through intersubjectivity (e.g. Q-sort technique or 360 framework of Belbin) is possible either with hindsight or with foresight. We will finally try to link the theoretical framework with the empirical findings, while making suggestions for further query.

*Keywords:* SHRM, Leadership and Teamwork, Organizational Culture, Values and Framing.

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## LINKING PSYCHOLOGICAL CONTRACT VIOLATIONS TO CONSUMER SATISFACTION: WHAT MATTERS?

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### ABSTRACT

### BACKGROUND

All the transactions are conducted through contract. Contracts play an important role in the society, economics, law and politics. Contracts have changed in quantity and quality especially in explaining the consumer behavior due to the fact that the society and technology are becoming more complex. After one transaction such as having a meal in a restaurant, the consumers may not remember the items about the seller's responsibility in the written contract. They have their own opinions about the sellers' responsibilities. The explicit contract cannot explain consumer behaviours well and therefore, implicit psychological contract become one of the theoretical underpinnings in understanding consumer behaviours.

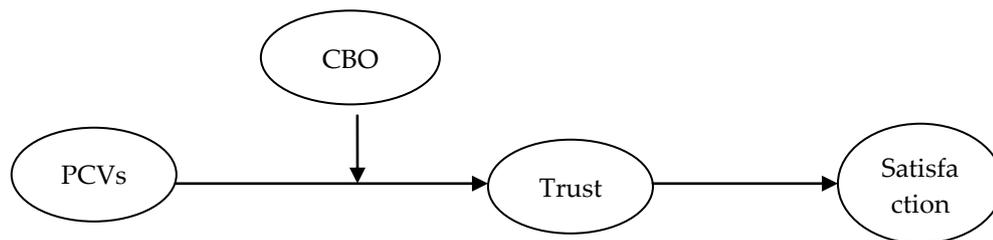
Consumer psychological contract is defined as customers' beliefs concerning mutual obligations of seller and themselves. Consumer psychological contract provides a different view of understanding consumer behaviours.

### OUR WORK

Psychological contract has been studied well in the employee-employer relationships (Rousseau, 1995). In principle, it is a general concept involving two parties (Roehling, 1996), such as consultant and client (Boss, 1985), husband and wife (Dunahee & Wangler, 1974), and student and teacher (Kolb, Rubin, & McIntyre, 1984). It also includes the clients and service providers in marketing field (Pavlou & Gefen, 2005). In this study, we applied psychological contract theory to explain the antecedents of consumer's attitudes toward the service provider. Particularly, we examined the negative impact of psychological contract violations on consumer's satisfaction through the mediator of trust. In addition, the moderating role of consumer's beliefs obligations of themselves is tested in the psychological contract violations and trust link. Figure 1 presents the theoretical model.

By surveying 450 restaurant consumers, the results using structural equation model analysis and structural equation multi-group analysis show that trust mediates the relationship of consumer psychological contract violation and satisfaction, and this effect is moderated by customers' beliefs concerning obligations of themselves.

**Figure 1. Conceptual model**



Note: PCVs = psychological contract violations; CBMO = customers' beliefs concerning obligations of themselves

## RESEARCH IMPLICATIONS

This study finds that psychological contract violations reduce customers' satisfaction through reducing customers' trust. The customer's beliefs concerning obligations of themselves moderates the link between psychological contract violations and customers' trust where the link is weaker at higher level of customer's beliefs concerning obligations of themselves. By doing so, this study enriches the research of psychological contract in a different field – from the traditional employer-employee relationship in organizational behaviour to service provider-customer relationship in marketing. For practice, this study highlights the importance of trust for managers in the service contexts. It also demonstrates that more attention needs to be paid to enhancing customer's beliefs concerning obligations of themselves as it can reduce the negative effect of psychological contract violations. Overall, this research on psychological contract violations in service context is interesting and meaning for both researchers and practitioners.

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**Keywords:** psychological contract violation; trust; satisfaction; customers' beliefs obligations of themselves

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