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A Philosophical Basis for Globalization Debates: From Bretton Woods to the Foreign Corrupt Practices Act and Beyond

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Abstract

In a previous paper on the Foreign Corrupt Practices Act, the authors concluded that, overall, the act has not been effective in its objective of curtailing the bribery of foreign government officials by U.S. corporations. We situated the act within a larger historical context focused on the difficulties experienced by several U.S. administrations in realizing foreign policy objectives that covered both the supervision of the global financial system under the Bretton Woods agreement and the pursuit of U.S. national interests. To determine why the act has been ineffective, our current paper addresses this dichotomy between America's foreign policy interests and its global responsibilities, with specific attention focused on the political conflicts in the U.S. between proponents of "idealistic" multilateral universalism and the "realpolitik" of the bilateralism that has characterized America's anti-communist foreign policy. However, the end of the cold war has not decided the issue in favor of the idealists, and in the ongoing globalization debates between "idealists" and "realists," proponents of realpolitik has now turned to Hobbesian arguments to provide ethical justification. We argue that these Hobbesian arguments (specifically those formulated by David Gauthier) do not justify the realist position and we use ethical positions developed by John Rawls and Thomas Donaldson to argue for a global social contract that stipulates a minimum set of human rights and establishes effective multilateral frameworks for coordinating international treaties, trade policies, UN declarations and the OECD anti-bribery convention, the international agreement resulting from the Foreign Corrupt Practices Act.

Introduction

For postwar America in the twentieth century and imperial Britain in the nineteenth, the problems of global dominance have had political, diplomatic, military, financial and moral dimensions. Both nations reaped the benefits of having the preeminent global currency, but the difficulties of administering global trade and financial systems in an impartial manner conflicted with the exigencies of advancing national interests through foreign policy. Great Britain had some initial successes in navigating thorny issues of extraterritoriality and moral imperialism: when England and Russia went to war in the Crimea in 1854, the Russian government was able to borrow from London banks to finance its military campaign. But by the 1890's, Britain could no longer use its "impartiality" to counteract the increasing global trends towards protectionism and imperialism, much of which was instigated by the "realpolitik" of Bismarck's Germany. A century later, the United States had the opposite experience of eclipsing its foreign rival, the Soviet Union, without war. Yet the prospect of realizing a free, global market founded on nation states rapidly transforming themselves from totalitarian to democratic forms of government has not inspired the United States to assume the leadership role of a world to be governed by multilateral institutions and founded on global treaties, concordats and agreements with universally recognized standards of human rights, environmental protection and arms control. Under the new presidential administration of George W. Bush, the United States appears ready to revive discarded, anachronistic policies of missile defense, bilateralism and realpolitik.

In a previous paper,[i] the authors examined the U.S. Foreign Corrupt Practices Act, an act criminalizing the bribery of foreign government officials by U.S. corporations and citizens, within this global context. We situated the act within the conflict generated by America's post war responsibility to supervise the global financial system under the provisions of the Bretton Woods Agreement and to support and maintain its key institutions: the IMF and World Bank, while simultaneously maintaining a viable, anti-communist foreign policy. We noted how the act came into existence during the moral idealism of the Carter administration and recorded the moral vision that was articulated on its behalf by U.S. legislators

Bribery of foreign officials by some U.S. companies' casts a shadow on all U.S. companies … [and] creates

> severe foreign policy problems. The revelations of improper payments inevitably tend to embarrass friendly regimes and lower the esteem for the United States among the foreign public. It lends credence to the worst suspicions sown by extreme nationalists or Marxists that American businesses operating in their country have a corrupting influence on their political systems.[ii]

However, the act was not vigorously enforced during the subsequent Reagan administration, preoccupied as it was with the realpolitik of its anti-communist foreign policy agenda. Enforcement efforts increased substantially during the Clinton administration, and under its aegis, the OECD implemented an anti-bribery convention, thus escalating the criminalization of bribery to a global stage. Yet, the authors concluded that the FCPA had not been effective, in part because of America's relatively low stature on Transparency International's index of bribe paying nations. And given the policy shifts of the new Bush administration against multilateral global accords, the UN agreements against small weapons and land mines, the Kyoto Accord, and the International War Crimes Tribunal, among others, the authors now question whether recent global initiatives against bribery will be shelved or not vigorously pursued.

Other major studies of the Foreign Corrupt Practices Act have raised similar concerns. Steven R. Salbu has grave reservations about both the act's effectiveness and its future, arguing that it raises serious concerns in foreign jurisdictions with respect to issues of extraterritoriality and moral imperialism, claiming that demand side issues in developing countries need to be addressed.[iii] Salbu detects anachronistic strains in the act, an attempt to create a globalized legal framework without addressing the need for international moral consensus on bribery issues, and all this at a time when the U.S. is refusing to accept new global commitments and is backing away from existing ones.[iv] But Kenneth Surjadinata presses this line of criticism much further, arguing on the basis of his skepticism as to the efficacy of universal legislation that the FCPA could be repealed because the global market itself would itself effectively regulate corruption.[v]

Surjadinata thus draws criticism of international bribery legislation into a larger context of debates on globalization, taking the position that players in the international market, governments and corporations alike, should organize "communities of interest" based on realpolitik or on realist commercial and political agreements between interested parties that eschew the need for laws and regulations and focus solely on the pragmatics of commercial objectives. The opposing "idealist" view, set forth by Hans Kung,[vi] argues on behalf of a "global ethic," a universal framework that would guide legislative agenda and would be capable of promoting human rights and advancing a worldwide consensus on a minimum set of ethical norms by which all global activities with economic, trade, or environmental consequences could be regulated. Kung creates an historical foundation for his argument, tracing the origins of globalization, idealism, and realpolitik back to their nineteenth century roots. He presents today's multilateral global organizations, the UN, WTO, IMF, World Bank, etc., (organizations that came into existence in the immediate postwar era and in response to its exigencies for a global framework conducive to political and economic stability), as justified in their pursuit of universal agreements, treaties, and concordats that will promote a global ethic based on the establishment of democratic principles for nations emerging from years of totalitarian rule. Bilateralism, on the other hand, is a relic of nineteenth century realpolitik and its preoccupation with the balance of global power and alliances of interest. Kung takes the realist position to be dominant in today's politics, but aspires to take back the realist mantle by merging realism and idealism, thereby forging an intersection of "a realistic policy" with "a realistic ethics," and thus creating "a responsible economics" and "a responsible politics" capable of providing good governance for an increasingly globalized world.

In seeking to situate the FCPA and the OECD anti-bribery convention within a globalized context, this paper will first reestablish the groundwork for globalized debates established by Hans Kung, setting forth the historical background and the debates between realists and idealists that dominate the current thinking on the future directions of globalization. We will then search for justifications for both sides of the debate in current ethical theory, taking the works of David Gauthier as underwriting the realist position, while finding justification for the idealist position in arguments established by Thomas Donaldson and John Rawls. We will dispute Gauthier's position and demonstrate negative ethical consequences found in the realist position established by Robert Kaplan. We then seek to promote an alternative vision of a global social contract, drawing on Donaldson's arguments for universal standards of risk assessment for global commerce, which in its turn derives justification from Rawls' theory of justice.

We believe that elaborating such a theoretical position justifying the idealist stance on globalization is crucial for setting a future direction for studies of the Foreign Corrupt Practices Act and likeminded legislation, legislation that implicitly draws on universal moral standards and seeks positive responses from host countries and voluntary corporate initiatives, legislation that will always be prone to charges of extraterritoriality and moral imperialism. Making all such legislation effective depends on the perception of impartiality with respect to the actions of the U.S. government and its multinational corporations by all global players. In our first paper, we pointed to the postwar failure of the United States in separating its foreign policy interests from its global responsibilities for aiding and supervising the global financial system. With its recent rejection of the Kyoto Accord and the International Criminal Court in the Hague, the new Bush administration appears ready to return to the bilateralism and realpolitik of the Reagan administration and to reject any accountability to any international tribunals or any standards of law or ethics which it cannot directly control or influence. International law and any global ethic must be seen to be impartial and to command the assent of all nations. The moral imperialism entailed by the realist stance gives justification to dictators like Saddam Hussein or Slobodan Milosevic, who condemn international courts and institutions as appendages of U.S. interests. As U.S. Senator William Proxmire once advocated on behalf of the FCPA, the actions of U.S. corporations overseas and the American policy interests thereby reflected must be seen to be representative of the best ideals of American principles of democracy and freedom.

Historical Background

An historical background for globalization debates should originate with the industrial revolution of the nineteenth century, as the technological advancement it facilitated made it inevitable that such advances would be exported around the world, driven by an accelerating flow of foreign investment. The repeal of the Corn Laws in England in 1844 marked the beginning of an unprecedented era in global prosperity brought into existence by free trade, an era made possible by the recognition that England's industrial prosperity depended on trade liberalization. The industrial revolution had both an economic and a moral dimension. On the one hand the vast productivity improvements it facilitated broke a pattern of stagnation in labor productivity that had lasted since the height of the Roman Empire and had made possible a labor theory of value relied upon by both Adam Smith and Karl Marx. The staggering increases in standards of living made possible by machine technology ultimately broke the credibility of Say's law of supply and Classical Economics in general, leading to the recognition that distribution constituted a separate domain from any science of economics. From this came the moral mandate from utilitarianism that government was to be charged with the responsibility for formulating effective principles of public policy, distributive justice and political economy. The technological progress afforded by the industrial revolution also demanded the establishment of large business enterprises with sufficient scale and agility to adapt to a business environment built on rapid innovation. As supply bottlenecks and price fluctuations led naturally to the development of business monopolies, trusts and cartels, the social imbalances created by the self-correcting activities of business brought the necessity of government regulation of business to the front burner as a means of establishing and regulating necessary monopolies and facilitating joint large-scale projects between government and business that would come to fruition during and after World War II.

However, this rapid transformation of technology would propel both Germany and the United States at a faster rate than Great Britain, which held the responsibility as global superpower for facilitating world commerce through the management of sterling as the world currency, through the maintenance of world trade by means of the power of the British navy, and through the global power of its empire, its banks, and its insurance companies. Britain's failure to maintain its global preeminence led increasingly to a concomitant failure to separate its national interests from its global responsibilities, and thus growing protectionism began to curtail the benefits of free trade. After World War I, Britain's failure to use the gold standard to revive sterling as a global currency and restore free trade preceded a new round of protectionism and the collapse of the global economy during the Depression. The United States had initially attempted an idealistic approach to the establishment of a global order based on a global ethic with President Woodrow Wilson's fourteen points, but realist interests prevailed in American politics during the 1920's. However, the collapse of global markets and the rise of totalitarianism during the 1930's led the global powers to the realization at the close of World War II that a strong framework based on strong global institutions and international treaties, institutions and protocols was required to maintain a worldwide political and economic structure that would be both strong and stable.

The Bretton Woods Agreement of 1944, the design of which benefited from significant input by the British economist John Maynard Keynes, provided a global framework for monetary and fiscal management by nation states. A gold exchange system fixed the value of the U.S. dollar at $35 per ounce, and the dollar in turn provided the basis for a global system of fixed exchange rates. Nations experiencing short-term fiscal problems could borrow from the International Monetary Fund and could also choose to devalue or stabilize their currencies. The World Bank could then provide long term financing for major infrastructure projects. The United States thus assumed the status held by Great Britain a century earlier as custodian of the global financial system. The U.S. dollar was now the preeminent global currency and the United States would soon follow the British example by rapidly escalating foreign investments in plant and equipment overseas.[vii] U.S. multinational corporations proliferated overseas: first to Europe to take advantage of the consolidation of the European trading zone which would soon put up trading restrictions to imports from domestic U.S. firms, and then to lesser developed nations. The tightly knit relationship between the U.S. government (particularly the military) and multinational corporations, exhibited in numerous high-scale scientific projects (nuclear energy/weapons, missile defense, etc.) was aptly described by President Eisenhower as the military-industrial complex and evidenced the strong influence corporations could exert on both government and on public policy.

However, the U.S. would soon run into the same difficulties the British experienced in dividing its national interests from its international responsibilities. A case could be made that the Americans agreed to accept their international role for political reasons; to protect their nation from international financial instability as the Cold War began to heat up and the competition with the Soviets for international domination and influence began.[viii] As Cold War tensions heightened during the 1960's and the escalating costs of the Vietnam War, Great Society programs and the space race led first to a dollar overvaluation and then a dollar decline, the same difficulties in foreign relations that undermined the ability of the British to serve as global financial guardians began to affect the Americans. Escalating tensions with both France and Germany over dollar valuation policies led to the U.S. decision to break the dollar/gold link in 1971 and with it a conversion to a floating rate regime was initiated. As the Nixon administration was abandoning its global responsibilities under Bretton Woods, its foreign policy gravitated more explicitly to the realpolitik of Secretary of State Henry Kissinger. The Watergate investigations (and the revelations as to the extent of the bribery of foreign government officials by U.S. corporations) caused a profound shift in public sentiment towards the foreign policy idealism of Jimmy Carter (and the passage of the FCPA during his tenure). But Carter's weak dollar policies caused another backlash of public opinion, and Ronald Reagan was able to restore public confidence in government through the restoration of the dollar and the cultivation of a strident anti-communist foreign policy that restored Kissinger's realpolitik under the Kirkpatrick doctrine. The U.S. thus (re) established bilateral relations with numerous corrupt nations with poor human rights records, so long as they backed America's anti-communist stance – and built up their military strength to prove it.

With the fall of communist regimes in the Soviet Union and Eastern Europe at the beginning of the 1990's, the U.S. might have been expected to return to its role as an impartial guardian and promoter of global democracy. Instead it has retreated from numerous global accords and provides only token acknowledgement of the need to develop human rights protections and genuine democratic institutions in the many states that have emerged from totalitarianism during the past decade. As the tide of globalization debates has now swung decisively in favor of the realist position, it is time to examine this position more thoroughly in the context of U.S. foreign policy.

Robert Kaplan and the Hobbesian Stance on U.S. Realism

Hans Kung's principal rival in globalization debates is Robert Kaplan, who establishes his own version of the realist/idealist debate and draws on much of the same historical background as Kung. But whereas Kung draws on quasi-religious foundations to transform an idealist approach into a realist one, Kaplan suffers from no such illusions and draws on Hobbesian sources to depict a modern world of deteriorating, ineffectual nation states on the verge of collapsing back into a violent state of nature. There are no illusions here of the possibility of a global ethic, not even the illusion of a world that can be transformed into a pluralistic model of democratic nation states. The center will not hold for Isaiah Berlin's liberal utopia, let alone Kung's.

In contrast to Küng's vision of consensus-based, global democracies founded on an ethical framework of peaceful coexistence and environmental responsibility, Kaplan anticipates a chilling future of environmental catastrophe, in which primitive, internecine warfare is conducted between localized cultures over scarce resources and where paramilitary organizations have become the successors of moribund nation states throughout the third world. Kaplan thus articulates the realist justification for America's decision to abandon its global responsibilities at the very moment they became fully possible at the end of the Cold War. On this view, democracy for third world nations is possible only as a derivative of authoritarian rule, when the rule of law and a functional middle class have made democratic institutions possible. In Kaplan's version of realpolitik, the premature effort to establish worldwide democracies now in nations only recently liberated from totalitarianism will only hasten their return to authoritarianism.[ix] New, multi-party democracies will only exacerbate tribal or ethnic divisions and will thus fail to deliver peace, security, or economic growth to their citizens. Corrupt elites, who will continue to maintain control in new democratic regimes, will undermine any effort to form or strengthen civil society and will hasten the return to autocracy whenever it is politically feasible to do so. Kaplan is unconcerned with the failure of repressive regimes to protect human rights, taking Greece as an example of a modern democracy that could only establish democratic institutions after ethnic cleansing was conducted by an earlier regime. Citing the priority of wealth and security over political freedoms, Kaplan sardonically asks: "Doesn't liberation from filth and privation count as a human right?"[x]

Kaplan sees this ossification of civil society mirrored in wealthy nations, whose citizens increasingly abandon their civic responsibilities in favor of material acquisitions and cultural self-indulgence. National and state governments will become less important as political power devolves to "communities of interests," which may be formed by corporations, by market surveys, or in cyberspace. Geographic communities will become more self-enclosed, racially segregated and security conscious. The truly powerful players in Kaplan's future will be multinational corporations, which will find increasing scope for exercising their global power and increasing freedom from regulation or ethical constraint. Such firms will increase their influence on universities, even to the extent of influencing curricula. (Kaplan seems entirely unconcerned with the increasing loss of independent, peer-review science in the process of public policy approval of corporate products.) In contrast to the authors' view that corporations are licensed by and derive their authority from nation states,[xi] Kaplan advances a Hobbesian argument providing a corporate genealogy that makes them a law unto themselves: "Corporations are like feudal domains that evolved into nation states; they are nothing less than the vanguard of a new Darwinian organization of politics."[xii] Legitimate or justifiable practices of corporate secrecy will increasingly be assumed by states and political organizations, which will become less transparent and grant security and intelligence agencies a much higher profile and increasing responsibilities in concert with military activities.

There are numerous grounds for criticizing Kaplan's position. There is a false analogy in the comparison of tribal regionalism in the third world to the increasing regionalization of Canadian politics, as well as the slippery slope that links the breakdown of nation states in Africa with the decreasing influence of national and state governments in the developed world. But Kaplan also derives a far weaker historical justification for his realist position than Küng does for the idealist side. Kaplan, like fellow realist Henry Kissinger, is much enamored with strong authoritarian leaders such as Cromwell and Metternich, men who ruled a pre-industrial era. While there are modern leaders (Bismarck) who presided over a period of rapid industrial growth up to the level of world leadership in technology, advanced technological innovation, the hallmark of our present era, does seem to require the political framework of a liberal democracy – unless, of course, Kaplan is right in arguing for the increasing self-containment of corporate political power. Apart from the historical fact that governments did acquire increased power in the late nineteenth and early twentieth century based on the moral justification of regulating industry and providing distributive justice, the nation state itself was made the lynchpin of the post war era, the foundation of the United Nations and the Bretton Woods system and the numerous universal declarations, accords, treaties, development policies and standards that have flowed from these global institutions.[xiii] No nation, no matter how oppressive, could entirely ignore its obligations to its own people without being censured by the international community. The UN's universal declarations set global standards and provided ethical benchmarks, regardless of the extent of non-compliance by individual nations. The moral licensing of nation states, which constitutes the foundation of these global institutions and their commitment to a world comprised of equal states, originated with the concept of human rights and the objectives of self-determination and expanded to include utilitarian principles of distributive justice. The UN charter itself explicitly dedicates the organization to the objective of social justice by employing "international machinery for the promotion of the economic and social advancement of all peoples."[xiv]

If Kaplan is correct in claiming that the breakdown of third world nation states will advance to such a level that "existing distinctions between war and crime" will be difficult to determine, then this would entail a serious abnegation of responsibility by the members of the UN Security Council and a de facto abandonment of the universal principles of multilateral organization established at the close of World War II. A key element of the mandate of all the global institutions established at this time was the assistance to be provided to former colonies making the transition to statehood. The interest of the authors in global corruption would be significantly affected, since corporate payments to private or semi-private militias in nations bereft of laws, armies or transparency in order to procure security, access to needed resources or safe operations would not be considered bribery but legitimate payment for services rendered.[xv] The whole moral basis for establishing the responsibility for bribery curtailment to the "supply side" depends crucially on internationally accepted universal standards that would be considered supervenient on third world governments in the absence of their direct compliance. For Kaplan, it is the principles of liberal democracy that represent extraterritorial intrusions on third world nations, not the universal application of anti-bribery legislation.

Does Kaplan's Realism Acquire Ethical Justification From Hobbesian Moral Theory?

There are direct consequences of Kaplan's realism that are of a much more practical nature than issues of universal principles and global institutions. Despite Kaplan's efforts to ascribe responsibility for the coming environmental disasters that will trigger a wave of localized conflicts to the destitute third world nations themselves, the fact remains that the United States is responsible for 25% of the world's greenhouse gas emissions while the negative consequences are largely borne by third world nations such as Bangladesh, which will suffer enormous flooding and crop loss as a result of the global warming that these emissions cause. Whether or not this issue can be settled under international law, an important ethical issue has been raised: whether the United States (along with other wealthy nations) can claim ethical justification for its freedom to despoil the environment without regard for the negative effects on other global citizens. If an issue of global externalities can be raised by this question, then a further moral issue can be derived concerning the moral justification of corporations to form contracts with foreign governments, agencies or suppliers involved in the exploitation or abuse of citizens of foreign nations, citizens who, for whatever reason, have no legal recourse to protection from or redress of grievances with their home state. The answers to these questions would seem to have a negative impact on Kaplan's realist stance, to the extent that he might wish to seek an ethical justification for his views beyond the cursory reliance on Hobbesian positions that he offers in his book.

But remarkably, Kaplan can indeed claim ethical justification, based on the modern reworking of Hobbes offered by David Gauthier in the moral theory he develops at length in his treatise, *Morals By Agreement*.[xvi] Gauthier sets forth a contractarian justification of modern market society that offers extensive freedom to agents in forming agreements and associations with others in the pursuit of the maximization of private self-interest in the market, a freedom that affords remarkable liberty from external regulation.

Gauthier starts with Hobbes' formulation of the state of nature, a pre-contract condition in which men interact without civil organization or contractual restraint. In his seventeenth century writings, Hobbes viewed this state as "the war of all against all" in which life would be "nasty, brutish and short." Concerned to escape this dreadful condition, men come together and bargain about the division of their material goods and the surplus product made possible by rational cooperation. As such a bargain must, in Gauthier's view, be founded on a strict calculus that will compel the self-restraint required for a final agreement, it is important that the preconditions for the bargain be devoid of moral constraints, as all moral principles must be generated from the constraints imposed by the social contract itself. To achieve this objective, Gauthier postulates a perfectly competitive market, an unrealizable, utopian alternative to the social contract that men realistically find in their best interests to enter. This market functions as a "moral free zone," and it is from its inevitable breakdown (caused by externalities) that the only morality possible, the ethics of constrained market behavior, is derived. Thus, self-restraint by market agents must exhaust the domain of morality, and Gauthier realizes a remarkable improvement over Hobbes' position by dispensing with any need for a sovereign agent to enforce agreements struck by market agents.

Gauthier's theory has staggering implications for Kaplan's global realism, since nation states, the essential component of the post war regime of universal principles and global institutions, are no longer relevant to worldwide markets based on contractual relations that in themselves have sufficient ethical justification. Gauthier's contract is hypothetical, an ideal that nonetheless has strong explanatory value and is applicable to real people who are deemed to continue acting and contracting with each other on the basis of a tacit, comprehensive social understanding of it as an ideal. However, while the contract applies to and binds those market participants who exist together in a geographically compact culture and who voluntarily consent to constrain their self-interest, it is not a contract that extends its application to those who do not participate in the original bargain; i.e., it does not necessarily involve stakeholders, voluntary or involuntary, whose persons or properties are placed at risk by the bargaining/contracting parties. As Gauthier's theory is one of private utility maximization that seeks to derive the values of self-imposed constraint from the fact of rational self-interest functioning within a perfectly competitive market or within a hostile state of nature, it makes no concession whatsoever to any pre-existent rights of any individual, whether involved in the contract or not. Although Gauthier seeks to impose a Lockean proviso on parties in the original bargaining position, one that compels them "to leave as much and as good left over" and thus limits their bargaining claims (to the extent that the externalities that cause the market breakdown that compels the parties to bargain in the first place necessitate inclusion of affected third parties whom Gauthier presumes to be individuals who have market value in themselves), the upshot is that those excluded from the contract process have no justifiable claims whatsoever on the bargainers and exist in a hostile relationship with them based on "the state of nature." Although the contract is intended to be highly inclusive with respect to the geographical domain of the original contracting culture, no such consideration is granted to foreign nations, which are explicitly deemed to exist together in this state of nature.[xvii] Thus, for the purposes of our argument, it is clear that the American producers of greenhouse gases, oil company executives and SUV drivers alike, are perfectly justified, both ethically and legally, to create environmental conditions destructive to third world citizens who, disabled by their flooded croplands, are unable to provide the minimum conditions for their own survival.

Gauthier's theory is fraught with numerous difficulties, much of which has been documented in the extensive literature devoted to his theory.[xviii] For our purposes, we are concerned to deprive Kaplan of any ethical justification for his position. But since refuting a realist stance requires us to go further and undercut the rational basis for such a stance, we propose to demonstrate that Gauthier's theories, like Kaplan's, are founded on historical inaccuracies sufficient to undermine their practical viability. We have briefly indicated the historical victory of utilitarianism over the calloused, rational scientism of economics during the nineteenth century and the fact that this victory licensed governments to pursue a distributive justice mandate and to legislate nascent corporations unable to procure security through false supply side laws in economics and unable, in consequence, to remedy their situation without recourse to socially destructive policies (combines, cartels, price fixing, etc.) that validated government regulation of their corporate activities. We then demonstrated that morally empowered nation states have been recognized in the UN charter and in international law as the foundation of universal accords, principles and institutions aimed at providing global human rights protections and economic/social developmental opportunities. We argue that Kaplan's prognosis of a coming breakdown of national states cannot occur without a complete repudiation of global responsibilities by members of the UN Security Council. If this is true, then there is global recognition that national self-interest is bound up with the recognition of universal principles, and this recognition will then have become an undeniable historical fact that cannot be undermined without also undermining global realist stances of the type set forth by Kaplan (since the global circumstances he outlines are founded on this fact). This recognition would then validate Hans Küng's claims on behalf of a global ethic, claims based on and corroborated by the further recognition (also contained in the UN charter) that the potential for global catastrophe entailed by world wars is of such a magnitude that universal principles preventing a recurrence of such catastrophes are essential.[xix] With the subsequent developments of the potential for nuclear war and environmental catastrophe since the close of World War II, this magnitude has increased enormously, and Kaplan has no justification in disguising these catastrophes by pointing to localized conflict as a future trend. We concur with Küng that the pace of technological development is such that multinational corporations cannot be granted the unlimited moral and legal license proposed by Kaplan, and that universal principles and institutions are justified on the grounds of setting public policy limitations on these technological advances.[xx] To this we would add Thomas Donaldson's observation that international law cannot be instrumental and is not exhausted by its mandate to service national interests, that fundamental principles (the right to national self-defense, the duty to observe treaties, etc.) are enshrined in international law as intrinsic values.[xxi] We thus believe that the credibility of the Kaplan/Gauthier position is crucially dependent upon undermining this historical moral mandate for nation states and we argue that Kaplan (by omission) and Gauthier (by subterfuge) try to accomplish exactly this objective.

Whereas Kaplan paints his dystopic scenarios without reference to the extensive efforts that first world nations would almost certainly make to uphold the integrity and viability of nation states (e.g., the threat of AIDS to create a cataclysmic social, economic and political disaster in Africa and Asia), Gauthier, whether deliberately or inadvertently, makes his theory dependent upon a historical revisionism that attempts to undermine the historical victory of utilitarianism and the moral mandate thus given to government interventionism. Gauthier certainly benefited from the fact his treatise, *Morals By Agreement* was published in 1986, a time when Reaganite academics were much enamored of Arthur Laffer's attempts to undermine Keynesianism by resurrecting the long-discredited concept of "supply side," this time as a theory of taxation. But Gauthier's theory attempts to resuscitate it in a much more literal sense. In his efforts to create a moral free zone out of the standard economic concept of a perfectly competitive market (as previously noted, necessary for Gauthier's project of concentrating all moral considerations at the point of contract, when self-interested individuals are compelled to accept the need for constraint), Gauthier introduces his argument through a paean to Adam Smith,[xxii] who himself was also concerned with creating a market structure that would be so constrained by laws, customs and practices that all transactions processed through it would be morally correct. A morally correct market would transform the natural self-interest of men into unintended social benefits for all, thereby facilitating the "invisible hand." But the invisible hand also required the absence of hoarding and monopolies, which would transform market transactions into not so beneficial results. But Gauthier's project also requires the absence of monopolies and hoarding, not only because they would negate the perfectly free market he requires but also because they would require market players to make pre-market moral judgments as to the desirability of deriving unearned benefits to be attained from the ability to set prices or derive rents. The modern use of perfect competition by economists is largely heuristic and generally focuses on the concept of "perfect competition" or "perfect equilibrium," rarely attempting the difficult undertaking of constructing a fully realized (even if only imagined) market.[xxiii]

The problem lies in the historical fact that such a fully realized market functioning without moral restraint was rendered largely impossible by the marginalist revolution by neo-classicist economists at the end of the nineteenth century. By locating value in marginal utility, the neo-classicists demonstrated the inevitability of scarce goods and the monopolies that would form around them, showing that some market players with rare abilities or control of scarce goods would be able to exercise at least some price control, and subsequently that rents were no different in principle from wages, interest or profits. Their discoveries would lead to the Keynesian destruction of Say's law and the supply side focus of economics. But the prime upshot for our discussion is the fact that they showed that not all market transactions could be morally neutral.

Gauthier's theory thus becomes stuck in a time warp. Contrary to standard criticisms of Gauthier that recognize that the conditions necessary for the contract formation he advocates are historically contingent but that the timing of this agreement is arbitrary,[xxiv] we contend that because Gauthier's moral free zone contradicts the facts of marginalist economics, its contract can only be struck at a time just preceding an industrial revolution when a labor theory of value required to make Smith's or Gauthier's market compatible with moral neutrality would be possible. Gauthier's contract may validly be struck between voluntary market participants at such an historical moment, but once the economy advanced into the rapid expansion of an industrial revolution, the contract would literally become an anachronism and would have to be voided on these grounds. There would simply be no way to extend its provisions to a globalized market where third world citizens could have their bare subsistence destroyed by the externalities of first world markets. Impoverished victims of flooding caused by global warming would have moral grounds to the justice provided by global institutions and the universal principles they embody. And it would be irrational for the first world administrators of this global system to abdicate their responsibilities. Therefore, the apparent justification given by Gauthier's theory to a global realist view such as Kaplan's not only fails, but its historical revisionism demonstrates the poverty of such views and their inability to provide viable and rational policy choices to nation states and global players.

The Idealist Response: Donaldson and Rawls

The solution, we believe, is to be found on the idealist side of globalization debates, and we will close this paper with a brief discussion of Thomas Donaldson's efforts to provide one aspect of a successful outline of a global ethic, one that finds ethical justification in John Rawls' *Theory of Justice*. As previously indicated, one reason why the apparent ethical justification of Kaplan's global realism by Gauthier's theory fails is its strategy of focusing on contributions by market participants to an initial contract while ignoring the risks that the externalities of such a contract imposes on those voluntary or involuntary stakeholders left out of it. In his essay, "The Ethics of Risk in a Global Economy,"[xxv] Donaldson uses the Bhopal disaster to argue on behalf of universal ethical standards that would provide a basis for determining distributive justice decisions in cases involving the apportioning of risks, particularly those entailed by dangerous manufacturing facilities in the third world. This approach stands in marked contrast to that advocated by Gauthier, which would license any allocation of high risk to Indian citizens in Bhopal, since they would not be directly involved in any contractual relationship with Union Carbide and would therefore merit no moral consideration whatsoever from corporate or governmental agents. (The host government would, of course, have a fiduciary responsibility to its own citizens, but these would have to be derived separately from subordinate claims of civic obligation, not from the contract itself.) Donaldson quite willingly makes allowances for host country standards that may legally permit higher levels of industrial risk for the sake of fast-tracking economic development, but he bluntly concludes that it would be morally unacceptable to permit a third world industrial practice that makes no provision for risk apportionment in that country if the same practice in the home country were subject to restrictions or to legal authorization by affected parties and/or compensatory provisions. To justify his stance, Donaldson draws on John Rawls' *Theory of Justice*, which makes explicit provision for standards of distributive justice.[xxvi] Although designed for a national culture, Rawls' theory can readily be adapted to international contexts, especially in cases of risk analysis, where universal principles are required that would protect third world citizens from being made worse off by a risk allocation designed to confer economic benefits on first world agents.

In conclusion, we have attempted to reinforce arguments advanced on behalf of idealist positions in international globalization debates and to show the nature of ethical justification that can be provided for realist positions, even when those arguing for them eschew such justification. By examining realist positions set forth by Robert Kaplan, we have attempted to show that apparent ethical justifications that can be provided for these positions from Gauthier's ethical theory not only lead to repulsive ethical conclusions, but also rationally undermine these realist positions through an historical revisionism that validates these positions only for historical periods that predate the industrial revolution. We have argued that such realist positions do not appropriately take account of global principles and institutions established after World War II that would compel the world's leading nations, the members of the UN Security Council, to take swift, effective action in the event of dystopic scenarios of civic breakdown of nation states as described by Kaplan. On the idealist side we have presented Thomas Donaldson's position on international risk analysis as directly addressing the shortcomings in the realist position through the provision of universal rights and principles, which in turn receive ethical justification from positions of distributive justice advanced by John Rawls. We believe that the idealist side of the ledger gives the strongest possible support for the authors' project of investigating and justifying global anti-corruption legislation, such as the Foreign Corrupt

Practices Act and the OECD convention. If, following the idealist agenda, such legislation could ever garner global recognition for intrinsic or inherent impartiality (an impartiality that has been entirely lacking during the years of realpolitik struggle against communism, a struggle characterized by U.S. support of corrupt regimes and self-perpetuating, realist cycles of economic crime and economic warfare that in Kaplan's view justify the continuation of realist policies by the U.S.), if, therefore, all nations could be persuaded to translate its "moral imperialism" into international law with full commitment to enforcement practices, then demand side problems of bribery and corruption would fall away of their own accord.[xxvii] It is crucial to the rhetorical strategies of Kaplan and the realists that the impending collapse of nation states be falsely blamed on idealist philosophy itself rather than on the failure of the world's nations to effectively apply and enforce that philosophy.

As a final comment, we would like to take note of important movements in international economics that grant strong support to the idealist position we have been upholding. Hernando de Soto has undertaken a global project for breaking the stranglehold on property ownership in third world nations by privileged elites and, following long established ethical principles of property ownership established in the seventeenth century by John Locke, vesting legal ownership in dispossessed peasants and workers who actually add value to property through the application of their labor. In nations such as Jamaica, it is now becoming recognized that a chief obstacle to protecting nation states from imminent collapse is the lack of an empowered civil society derived from a well-educated middle class and committed to establishing and preserving democratic institutions. Pace Kaplan and the realists, it is not necessarily tribalism and post-colonialist mishaps of poor boundary divisions between nation states that hinder the development of a civil society and multi-party democracy; rather, it is the artificial creation of "tribalist" divisions by criminal gangs capable, in cities like Kingston, Jamaica, of using violence and the threat of violence to divide a city into enclaves of support for two rival political parties that are both committed to subterfuges of morally suspect activities that create a spoils system for party hacks and community agents. Idealists recognize that the hard work of salvaging nation states will take years and entail a consistent commitment of time, money and effort. Realism can only succeed by casting aspersions on the "efficiency" and practicality of such efforts.

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[vii] U.S. foreign direct investment increased from $11 billion in 1950 to $213 billion in 1980.

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[xiii] The caveat must be added that this is an "in principle" claim, since all these international institutions have been subject to self-interested political manipulation. An account of U.S. efforts to influence the World Bank's third world development projects can be found in: Walden Bello, David Kinley and Elaine Elinson, *Development Debacle: The World Bank in the Philippines* (San Francisco: Institute for Food and Development Policy, 1982). An account of Soviet complaints of American interference in UN affairs to promote its foreign policy interests can be found in: Grigory Morozov and Evgeny Pchelintsev, *The United Nations: Twenty Years of Failures and Successes* (Moscow: Novosti Press Agency Publishing House, 1965). Among the Soviet charges are claims that the U.S. abused UN peacekeeping powers in the Congo and the Middle East, interfered in UN finances and made blatant efforts to appoint U.S. agents to key posts in the UN hierarchy.
[xiv] Preamble to UN Charter. Article 55 further commits the organization to developing high living standards, full employment and conditions of economic and social progress.
[xv] The U.S. and U.K. governments and their multinational corporations involved in the mining and energy fields have recently agreed to a set of voluntary principles on security and human rights that would establish corporate responsibility for the safeguarding of private citizens from the actions of the securities organizations these companies employ overseas.
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[xxii] David Gauthier, *op cit.,* 83.
[xxiii] Over forty years ago, Paul Samuelson demonstrated that in simple models of perfectly competitive markets pareto optimality (which Gauthier takes as a given attribute of PCM's) is not a necessary outcome, that such markets required fiat money (accepted in use on the basis of moral belief of each citizen in the integrity of all the others) or other forms of social contract (for example, an accepted obligation of the young to support the elderly) as moral preconditions. Cf., Paul Samuelson, "An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money," (467-482) *The Journal of Political Economy.* Volume LXVI, No. 6 (December 1958).
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Aspects of Multilateralism and Regionalism in South East Asia: The World Trading System, Economic Integration, Competitiveness and Development

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Abstract

The investigation reported here represents an attempt to work towards a policy decision framework to assist strategic planning in relation to trade liberalisation and the choice of the best options, from a universal perspective. Individual economies may exhibit particular circumstances, which render some of the potential choices redundant, including for example non-membership of the WTO, which would automatically mean the non-availability of that form of multilateralism .

The paper successively looks at: the background of the role of trade in the recovery process in the South East Asian region, then undertakes an assessment of current WTO liberalization efforts, followed by contrasting this with current regional liberalization efforts, considers the implications for long-term export competitiveness and concludes with an attempt to formulate a set of policy recommendations and consider their potential impact in specific South East Asian cases.

Introduction

The continuing problems with the delayed start of the next comprehensive round of negotiations under the WTO framework and the recent burgeoning development of regional and bilateral negotiations, force a refocusing on the issue of what is the best option for individual countries to pursue. This paper attempts to inject some structure into the policy debate and to work towards a better assessment of the anticipated benefits and impacts of the outcome of such agreements with particular attention to the needs of developing economies, through attempting to initiate a policy decision framework to assist strategic planning in relation to trade liberalisation and deciding on the best options, from a universal perspective and from the perspective of individual countries. Individual economies experience particular circumstances and difficulties, which mean that some of the potential choices are ineffective for them or are redundant, including such significant factors as non-membership of the WTO, so that multilateralism in its current form is not an option for them. There is no alternative currently on offer in terms of global liberalisation, so that for some, regional associations are the best choice available, assuming more liberal trade regimes to be beneficial.

The ranking of options as made here is not mutually exclusive, in the sense that some of those options may be complementary rather than competitive, with two options capable of adding to the sum total, even where one option generally appears to dominate another. Successful multilateral agreements are preferred, but their impact may be less in some sectors than is achieved through simultaneous regional agreements. Some indicative assessment of the anticipated worth of particular options in specific cases is made. Some general assessment of outcomes to date for specific South East Asian countries is conducted. The framework is intended to be informative rather than prescriptive. Desirable policy pathways may incorporate more than one option since they can be complementary rather than mutually exclusive. Particular institutional circumstances, constraints and time frames for any particular economy determine the range of possible options, leaving the theoretical ranking unaffected, but significantly influencing the actual possibilities. What is developed here is an ideal situation, which needs individual case information to be fitted around it for practical application.

It should be noted that the commonly used models for advance assessment tend to overstate the gains from agreements. This can be viewed as an extension of a general problem of apparent discrepancy between the prospects for gain from the agreements in principle, if fully taken up, and the outcome of poor or limited implementation. For proponents of trade liberalisation there is a danger in raising expectations, of producing a high level of disillusionment with the process, despite there being real gains to be realised.

After conducting a brief overview of the role of trade in the economic recovery process from the 1997-8 financial crisis underway in the ESCAP region, the paper continues with an assessment of the current WTO liberalization efforts, with particular reference to ongoing negotiations on agriculture and services and the launch of a comprehensive round of trade negotiations, including consideration of particular aspects of special and differential treatment as they relate to competitiveness. Section three contains an assessment of regional liberalisation efforts currently underway with particular reference to APEC, AFTA, ASEAN+3, and AFTA-CER bilateral initiatives. It demonstrates that regional developments are an important element for the ESCAP members and provides a particular background for section four's analysis of the implications for long-term export competitiveness that arise from the particular forms of regionalism and multilateralism as currently practised. In conclusion section five develops some policy recommendations for deepening the economic integration of developing countries and enhancing their export competitiveness.

Trade is a significant part of the process of opening economies to the outside world and enhancing their productivity and growth as well as allowing them to reap the direct benefits of gains from trade. Trade measures can be enhanced or negated by other factors, however. The role of the exchange rate, of non-tariff barriers to trade of international investment and the movement of people are also of importance. Trade liberalisation has been found to practically assist growth by encouraging investment [see Levine, & Renelt, 1992] and liberalisation is seen here as part of a process towards greater integration, both globally and regionally. It is based on the belief that the more open the economy the more likely it is to experience enhanced growth and competitiveness and the more growth and competitiveness the better for increased output. The outcome in terms of distribution and poverty alleviation are important matters not considered here. Economic research to date has concentrated on the link between the overall increased level of welfare from greater openness and less on matters such as poverty alleviation, competitiveness and development.

A recent study conducted for the WTO [Ben-David, Nordstrom & Winters, 1999, p. 3], whilst questioning how far income convergence has been achieved globally, suggests a superior outcome for East Asia. The region demonstrating that growth achieves poverty alleviation with that growth best achieved through a more open regional and global outlook. How to encourage growth as an optimal, sustainable and long-term process thus becomes a principal focus for the countries of the region.

Part One: Role of Trade in the economic recovery process underway in the region

After the initial speed wobbles created by the financial crisis, many of the countries in the region have returned to a growth path significantly above that of the world economy at large. Two questions are central to the relationship of trade liberalisation and expansion. The first is: to what extent does trade foster the process, the second: what extra strains are imposed in terms of volatility and distributional outcomes?

The World Bank report for last year was very optimistic in terms of liberalisation and growth relationships. They reported economic and financial conditions as having: "recovered sharply in 1999 from the trials of the prior two years. At an estimated 3.3%, world economic growth exceeded expectations, led by a strong United States economy and policy reforms in emerging market countries. Global trade recovered strongly, and commodity prices firmed. These elements will permit more "self-financing" of development by countries. This "… suggests those countries that rely more heavily on trade, are more diversified, attract more foreign direct investment, and have become more competitive, are the most likely to sustain growth." [World Bank, 2000].

Whilst the correlation is clear in this case, the causal links between these factors are more assumed than expounded and demonstrated. As with this paper, more integration is assumed to be positive for growth and development, at least in terms of maximising global welfare. The survey of studies of degrees of trade liberalisation/openness of economies and resultant growth rates, provided by Ben-David and his co-authors, [1999, Annex Table 1] produces results strongly supportive of this view, although it is worth noting that in at least one set of findings they reported on: [Edwards, 1997], initial GDP and human capital levels were seen as being even more important factors in determining the rate of growth than was openness itself. Even so, Edwards agrees that more openness is preferable to less for producing rapid growth. In his earlier [1992] study he reported along the lines that;

employing nine alternative indicators of trade orientation, investigation of the data suggests that more open economies tend to grow faster than less open economies.

Despite this weight of favourable evidence many developing countries have challenged the assumption that trade liberalization automatically leads to more rapid growth and development. Particular structural features of the economies of developing countries and distortions arising from historical trading relationships do influence particular outcomes. Impacts for individual economies on their terms of trade, their level of dependence upon primary commodity exports, balance of payments volatility and disequilibria can be, and have been, the subject of much concern. The growth of non-tariff barriers and the extension of the scope of international "trade" agreements to include services, investment access and other issues afford these concerns an even greater importance. Rent seeking in trade negotiations and their implementation is a constant phenomenon and one which may be more prevalent in global than in regional agreements [Francois, McDonald, & Nordstrom, 1999, p. 211].

The overriding question considered here concerns the particularities of the Asian economies. Both trade and GDP have shown remarkable rises in the past. Since 1997-8 the overall growth rate for East Asia has been a match for that of the leading countries in the world at large, averaging some 6.9% increase in GDP for 1999. Growth for East Asia is anticipated to have been nearly 7.2% in 2000, restoring the region to a pre-eminent position such as it held before the 1997-8 downturn. Whilst recovery from the crisis was more rapid and effective than some had expected, the continuing problem of non-performing loans remains a legacy many countries could well do without, affecting investment inflows as well as internal lending and business development. Some countries, notably Indonesia, have suffered instability and have not fared as well as others. In the longer run the region has done better than the World average by any measure including the impact of poverty alleviation. The percentage of the population in poverty has fallen as trade and growth have expanded, as has the absolute number of people in poverty [World Bank, 2000, table 1.10b].

Openness, as estimated by the World Bank, increased in East Asia by more than 20 percentage points over the 1990s, financial crisis notwithstanding. The access to, and transfer of, new technology, knowledge, and business practice facilitated the ability to meet the demands and increased competition brought about by greater openness. Things could be better still, however. Measures of Ecommerce, such as Internet and mobile phone access, in Indonesia, the Republic of Korea, Malaysia, the Philippines, and Thailand as a group lagged behind that of countries such as Brazil and Mexico in 1999. The latter exhibited greater reform of, and competition in, the telecommunications sector. The World Bank has also detected a possible weakening of Malaysia's commitment to regional free trade in their recent actions on automobile tariffs.

Trade has been an important component in the recovery process of the region. In the longer run the keenness to join regional and global groupings, by the likes of Vietnam, China and elsewhere, suggest they perceive this as a good route to development.

Part Two: Assessment of current WTO liberalization efforts with particular reference to agriculture and services trade and efforts to launch a new comprehensive round of trade negotiations

Three issues are considered here: the first covers the extent to which achieving a comprehensive agreement in the next round is likely or desirable, the second concerns liberalization in agriculture specifically and the third liberalization in services.

Choosing to put the comprehensive agreement issue first reflects the author's over-riding concern, lest this principle be lost and his view that regional, bi-lateral and more particularly sectoral agreements are conceptually a second-best approach and are more likely to exacerbate the relative disadvantage of those with the least bargaining power. Having waited nearly fifty years to get agriculture and textiles fully included in the negotiations, it is also deemed important from the region's perspective to not allow them to be marginalized once again. Including services in a broad agreement is best likely to achieve this, by allowing more room for manoeuvre.

Broadness can go too far. Adding more and more new areas can lead to little effective progress in terms of implementation. It would be better to concentrate on consolidating the implementation of existing agreements and improving on those emerging from the Uruguay Round, rather than further extending agreements, into ethical trade or other broader areas. Essentially this means concentrating on the so-called "built in agenda" and looking at particular areas of concern emerging from the last round, such as Anti-Dumping for example, rather than widening the scope of any new agreement. Comprehensive yes, but also constrained.

In many respects agriculture promised much in terms of payoffs from the Uruguay Round, but achieved less than expected. The 1994 estimates of what was likely to be gained, were too optimistic and largely omitted the downside for consumers in exporting areas with a competitive advantage, of raised domestic prices. Many people saw increased market access as the area where most gains had been made, whilst others felt that reducing domestic support levels, assisting the search for the Holy Grail of level playing fields, was the more important factor.

The current focus of developing countries in the negotiations on the agricultural agreement seems to reflect this, by focusing on extending their market access for processed goods and disciplining export subsidies. The processed agricultural goods question is important in their redressing the less satisfactory than anticipated outcome of the Uruguay round, due to implementation problems.

Non-tariff barriers have been a very significant factor in determining market access for agricultural trade. Under the Uruguay Round Agreement, with certain exceptions (including rubber, fish and forest products), these barriers are required to be converted into tariff equivalents with a subsequent phased reduction of the bound tariffs. Unfortunately some inflation occurred in estimating the base levels (using data from 1986-8) for setting the upper boundary for tariffs. The tariffication process has led to some very high levels of bound tariffs by traditionally protectionist economies, Japan's 388.1% for wheat products for example. Such high bound, tariff levels together with the exemptions, reduces the effective extent of the liberalisation process. Implementation could have been faster and more effective. Minimum Access Opportunity schemes and special safeguards provisions also give scope for reductions in effectiveness. Overall there are limits to the extent of liberalization in Market Access.

The second focus of the agriculture agreement, Domestic Support mechanisms, are measured and expressed in terms of an Aggregate Measure of Support or AMS, which again is based on 1986-88 levels. The calculation methods are complex and far from certain in their effectiveness, especially where no direct observation of support levels is possible. Implementation again could have been fuller.

The third area of commitment involves Export Subsidies. Essentially it is required of members that they will ensure that expenditure on budgetary outlays for export subsidies is reduced by 36% and the total quantity of exports covered by export subsidy be reduced by 21% (24% and 14% respectively for developing economies). The original base level of 1986-90, was adjusted in specified cases to 1991-2 in order to calculate the start point, really because several countries had increased export subsidies in the meantime. Thus some of the gain is more illusory than real.

The long-term objective of these developments has been stated as the achievement of substantial, progressive reductions in support and protection resulting in fundamental reform. Members agreed in the late 1990s that negotiations for the new round should take into account:

- the experience to date from implementing the reduction commitments;
- the effects of the reduction commitments on world trade in agriculture;
- non-trade concerns, special and differential treatment to developing country Members, and the objective to establish a fair and market-oriented agricultural trading system, and the other objectives and concerns mentioned in the preamble to the Agreement; and
- what further commitments are necessary to achieve the above mentioned long-term objectives.

A review of implementation of existing agreements needs to be given a high priority in looking at the built in agenda of the last round. Attitudes to current and future negotiations are constantly changing, although many of the apparent changes in stance are in essence cosmetic rather than fundamental. The EU position, for example, is such that it is somewhat difficult to distinguish at times between the rhetoric and real intent.

The talk currently emerging from Europe in early 2001 suggested that they are committed to achieving the negotiation of a "balanced" agreement and that mad cow disease problems exemplify the fact that the EU position on agriculture is right, in that it is more than just an industry. That European agriculture concerns the environment, consumers and food safety, amongst other issues. By specifying their own agriculture the EU appears to suggest that non-european agriculture is perhaps not so concerned with such issues, that the protection of a community's well being under the WTO multi-functionality proposals is not worth considering and that we need to wait at Europe's pleasure to find out what is meant by a "balanced" agreement. More substantive was the announcement that: "With the Agenda 2000 reforms we have proven our firm commitment to go down the road towards less trade-distorting, de-coupled farm support." [EU press release 5/2/01]. Subsidies and support mechanisms may be under some fire, not least for EU budgetary reasons, but liberalizing market access for agricultural exporters appears to face strong opposition within the EU from its farm lobbies. Similar difficulties for South East Asian exporters will be encountered from U.S. and Japanese interests.

Services trade issues may need to be considered in return for movement on the agricultural front. Legal migration of a permanent nature appears to be becoming more restricted over time, with temporary movement of natural persons for trade related reasons (GATS mode 4) continuing to be an issue in negotiations. Expanding numbers of "asylum seekers" and illegal migrants is a part of globalisation many economies are unwilling to fully address. This is a fast changing area, which is likely to see rapid development. Movement of capital and labour alter the standard rules of the trade analysis game, with its underlying assumptions that goods move because factors are relatively immobile. Restricting migration except under the services section and its movement of natural persons provisions, will also affect the level of remittances from migrants, a major source of income for many economies in South East Asia and elsewhere.

Negotiations on such matters continue, as required under Article XIX of the WTO-GATS agreement. Besides developing the movement of natural persons code, financial services and basic telecommunications agreements have been subject to refinement after further negotiation. Developing economies are allowed appropriate flexibility to open fewer sectors and liberalize fewer types of transactions than is generally the case (Article XIX). This flexibility appears advantageous and certainly is for the competitive advantage of producers within the country concerned. It reduces, however, the degree of integration and may delay the acquisition in the long term of true international competitiveness, a specific aspect of the costs and benefits of special and differential treatment.

In both agricultural and services negotiations special and differential treatment requirements for developing countries will be revisited. These currently include affording preferential market access, technical assistance in meeting WTO obligations and paying particular attention to implementing agreements in ways which at least do not harm developing economies, if not positively assisting them.

The developing economies receive a more lenient treatment under some of the disciplines of the WTO agreements. This leniency extends to binding tariffs on industrial products at higher than the applied level for example, having longer periods of time to complete transition to the new regime and more flexible treatment in the way in which protection for domestic industry is maintained. Implementation is much more within the control of the developing nations in this respect than in cases where the agreements and spirit of the agreements need to be implemented by the developed nations. The individual circumstances of the developing nations in terms of their needs, institutions and infrastructure is better known to them. The downside of claiming these "advantages" is that integration may be held back and the achievement of international competitiveness compromised. Preferential schemes have drawbacks as well advantages.

For the future issues of environmental and labour standards could constitute another ratchet in the increasing demands placed on the developing and transition economies. Ethical trade schemes use a wider canvas to paint possible "protectionist" use of existing WTO rules such as those relating to TBTs, as well as broadening the scope to include environmental and social standards in forestry and forest products for example [Tallantire & Blowfield, 2000].

Many developing nations have already seriously questioned whether developed countries have lived up to the spirit of existing WTO commitments such as those providing for special and differential treatment for developing countries, or whether they ever had serious intentions of doing so. The longstanding GATT attitude of non-inclusion of textiles in the liberalisation process may be gone in spirit, but has continued in practice, with little provision of the agreed preferential treatment for least developed countries and small exporters under the agreement on textiles. The number of developed countries establishing contact points to facilitate access of developing country service suppliers as required under the agreement has been very small, implementation again falling short of expectation. Effective implementation of existing agreements is needed before great store can be laid by pushes into new areas, especially if those new agreements offer only good intentions in return for more onerous responsibilities, such as imposing labour and environmental standards of an unrealistic and disguised protectionist nature.

Investigating or adopting alternative remedies to the imposition of anti-dumping duties on imports from developing countries is a particular area of concern. The relative frequency of antidumping investigations and the imposition of 'definitive' antidumping measures against developing countries have been estimated as far above those countries' share of world exports. There is also a tendency for developing nations, including from South East Asia, increasingly to go down the same route by extending their antidumping activities.

The lack of effective implementation ensures that the impact of globalisation is reduced, that the search for loopholes is extended and that nations in South East Asia and elsewhere, receive less benefit than they should from the process.

Part Three: Assessment of regional liberalization efforts underway, with particular reference to APEC, AFTA, ASEAN+3, AFTA-CER bilateral initiatives

Historically regional efforts to liberalize have been categorised as failing to achieve the aims set for them. As recently as 1994 David Henderson suggested that, outside the OECD nations, regionalism had only recently emerged as a significant factor [Henderson, 1994, p. 190].

In terms of ASEAN specifically, Schultz's 1996 assessment of the impact of ASEAN/AFTA efforts to establish a single market in the region categorised AFTA as likely to provide more of a safety net than an engine of growth [Schultz, 1996, p. 26]. Extra-regional trade was seen as the main engine of growth, not intra-regional trade. There are, however, some reasons to dispute this conclusion, even by using Schultz's own figures [p. 29] for the period to the early 1990s and more cause to dispute his findings in terms of events of the more recent past.

With larger regional groupings, intra-regional trade has now become a far more important factor. By 1997 Asian intra-regional trade accounted for over 50% of the total, up from 33.3% in 1980 [Yeung, Perdikis, & Kerr, 1999, p. 75]. Whatever the true relative importance, it is worth keeping in mind that both regional and global integration are, and will continue to be, important elements in fostering growth in the region.

APEC impacts offer the chance to extend beyond ASEAN and to make progress on implementation issues arising from the multilateral WTO type agreements. ASEAN+China has provided much of APEC's increasing levels of trade and openness in the recent past [Bora & Pangestu, 1998, pp. 22-23]. The real dynamism apparent in APEC figures can therefore largely be attributed to the wider East Asian region, albeit with a nod in the direction of some parts of Latin America.

APEC suffers somewhat from its voluntary nature. It cannot show the same route to success of the more assured outcomes of WTO agreements. Its lack of formalisation means progress is likely to be made only slowly, but this "drawback" is also an asset in the sense of allowing APEC to act as a facilitation mechanism and workshop for effective discussion of the multilateral agreements themselves. There is also the chance that an effective partial (regional) success can be achieved in terms of implementation of the global agreements where their full and timely implementation globally encounters subsequent difficulties.

Such extension work can also be progressed through the ASEAN+3 and AFTA-CER initiatives. The importance of the three outsiders added to ASEAN in its +3 format is significant, although suggestions for a common currency area for the region, presently emerging from Japan, may be viewed by many as rushing things a little. Estimates of the advantages to be gained from common currency areas are varied and less than exact. Work currently being done in the U.S. and reported to the American Social Science Association meeting earlier this year (2001) by Alesina and Barrow amongst others, suggests there is a limited scope for some countries, such as Cambodia, Hong Kong, Singapore, Thailand and South Korea adopting the US$. Trade expands significantly, but for most the welfare gains are small. National currencies, however, certainly can act as a border barrier, raising transaction and other costs of doing business, barriers not to be forgotten. Invoicing in an international currency can offer some gains in this respect.

The relatively small CER agreement between New Zealand and Australia appears to have progressed relatively rapidly and successfully in terms of its implementation on schedule and with only limited attempts to disrupt its implementation, by the use of delaying tactics or new forms of restriction. Apple imports into Australia, being one area where some recourse to arguments for delay on supposed bio-security grounds have been raised. Largely the agreement has progressed rapidly because of the relatively common background of the two parties and the fact that there are only two of them. Some of the adverse impacts have been on third parties such as the Pacific Island States and their trading arrangements with Australia and New Zealand. Bilateral initiatives thus become important for outsiders, including AFTA. An open and MFN type approach to such initiatives is of value rather than a closed one. New Zealand bilateral agreements with Singapore (in place) and Hong Kong (under discussion) are typical of efforts being made to move forward where economies can whilst multilateral efforts are somewhat stultified.

AFTA, being more heterogeneous and involving a larger number of parties has a problem in securing internal implementation, even where the principles are agreed to. The group may be clearer in terms of what it is seeking from outside than it is about what its internal objectives are.

A recent assessment of the advantages to all parties of a successful AFTA-CER agreement, demonstrates that it could be of benefit, not least through bringing forward the gains promised by APEC. If all of the Bogor goals were to be met then little would be gained by an AFTA-CER agreement. If the APEC goals are not met, then there is considerable scope for gains for all participants over and above those accruing from the Uruguay Round.

The major part of ASEAN (Thailand, Malaysia, Indonesia, Singapore and the Philippines) is predicted to gain from an AFTA-CER agreement, by something in the region of an additional one to two % above its otherwise growth in real welfare by 2005. Australia and New Zealand fare less well, but still gain one half of one% for Australia and one% for New Zealand by 2005, when the incidence of benefits peaks. These particular results rely on some borrowing occurring to increase consumption above production growth rates in the short run [Davis, McKibbin, & Stoekel, 2000, pp. 24-26]. Without borrowing there is a benefit, but one that appears more slowly and which is distributed differently as between the ASEAN members. Essentially Malaysia and Singapore do relatively better under the consumption (with borrowing) approach, whilst the output approach (without borrowing) relatively favours Indonesia and the Philippines. Significant beneficial increases in capital inflows following a raised rate of return on capital are also anticipated to result from an AFTA-CER agreement.

It is worth noting that a full and successful APEC agreement would provide a dominant result over AFTA-CER liberalisation, since the latter's trade volume is far less than that of APEC, which is more comprehensive and is more open, with MFN based tariff cuts being passed on to third parties. Davis and his co-authors describe APEC as "…a 'series of simultaneous unilateral MFN liberalisations' by a group of twenty-one countries" [p.27]. The net outcome of their analysis is that APEC is to be preferred, failing a full global liberalisation, but that there are significant benefits to gained for those involved in an AFTA-CER agreement should APEC not deliver. Similarly ASEAN+3 and other regional groupings could provide an alternative of benefit to those involved. The more open the grouping the better from a general perspective.

Part Four: An analysis of implications for long-term export competitiveness arising from regionalism and multilateralism

An integrated economy is far more than a trading economy, even a very open trading economy. Investment flows, service links and intra-industry trade all extend the degree of integration. Commonality of currencies and regional harmonisation of regulations and institutions further extend that integration. Much of economic activity is now becoming globally enmeshed. Competitiveness may rely on comparative advantage, but the perfect market conditions may be lacking for this to be the sole determinant. Differences in negotiating skills and bargaining power are also important. Hopefully in the long run, imperfections will tend to diminish and comparative advantage will emerge as the driving force.

Enhancing global competition would ensure the maximum development of competitiveness. Failing this ideal state, widespread open regional arrangements would be preferred, with closed and smaller regional agreements coming next and bi-lateral agreements last in line, as having an impact only on the competitiveness of a reduced range of producers.

Export competitiveness relies on the ability to compete with overseas producers in their own and/or in third country markets. This ability should be achieved with minimal or zero government assistance. Strictly speaking if ESCAP countries are competing only through such assistance or because of preferential trade provisions, whether generalised or particular, whilst this will achieve the short run target of boosting export returns, it does not address the long-term aim of true export competitiveness. The WTO philosophy of moving towards relying on the GSP system for any form of preferential treatment and towards the long-term minimisation and eventual removal of such preferences is consistent with an approach, based on global efficiency, free trade and welfare maximisation arguments. All this requires the existence of minimal imperfections in the system. That the WTO preamble talks of rules based (fair) trade rather than free trade, however, implicitly acknowledges the existence of such imperfections and introduces a note of caution. Under less than perfect conditions, regional agreements may be preferred as less likely to result in rent seeking behaviour through protection, as is likely with global arrangements. Those affected are less likely to oppose a regional agreement since they may have less to lose and be less certain of the likelihood of gaining support from their compatriots. Complaining about competitors from afar, is likely to be more popular than complaining about near neighbours.

Essentially the implications and outcomes of all liberalisation efforts are determined by the institutional, initial and background circumstances as they pertain to any particular economy. In the longer term the degree of multilateral involvement may be the more critical factor, whilst in the shorter run the emphasis may well be placed on the regional initiatives. The reasoning here is that for much of the region, the current pattern of trade is such that regional liberalisation efforts are the more important factor, as well as those most adversely affected being less likely to push for, or obtain, much in the way of protection from the competitive pressures resulting from a more open environment in this case. Intra-industry trade can be enhanced by regional developments, with existing technology. This means that resources can be more easily shifted, within the same industry and adjustment is more effectively accomplished. In the longer term it is likely that the technology will improve and greater acceptance of change be evident so that the full impact of multilateral liberalisation can be accommodated. [Hoekman & Kostecki, 1996, p. 213].

The amount of trade in basic, relatively unprocessed primary commodities continues to have a declining importance in the total mix, so that transport and other transaction costs will be reduced relative to the overall value of the delivered product. This should mean that distance is less of a barrier and that extra-regional trade can grow. The current extent of intra regional trade is clearly important. Based on a straight trade share approach, intra APEC trade is put at more than 70% for both exports and imports [Bora, & Pangestu, 1998, p. 32]. Intra-regional trade has been growing fast and looks set to continue to do so, regardless of any changes in stress between fostering it rather than pursuing a multilateral approach.

Part Five: Policy recommendations for deepening economic integration and enhancing export competitiveness

Bearing in mind the strict definition of long-run export competitiveness spelt out in the previous section, it must be emphasised that integration is not confined to trade issues alone. The extension of international agreements into investment and labour flows, common currency, competition law and other institutional and infra-structural issues are very important dimensions of what has happened at both the multilateral and regional levels in the recent past.
Integration is a current concern and not just at the multilateral and regional level. The search for an integrated framework approach to least-developed countries by six major agencies: the IMF, ITC, UNCTAD, UNDP, WTO and the World Bank, signifies their recognition of the need for greater integration on their part too.

The enormous expansion of scope of international agreements means that to be effective policy must be targeted. From what has been discussed, it is suggested that priority be accorded to:

- Concentrating on the implementation of current agreements rather than extending their scope further in principle
- Replacing “best efforts” approaches to Special and Differential treatment for developing economies to “agreed implementation” which is enforceable

- In the long term looking to remove the need for preferences
- Using regional agreements as an adjunct to global ones rather than as a substitute
- Stressing open regional agreements in preference to closed ones
- Being wary of sectoral agreements in place of comprehensive ones, at either the multilateral or regional level
- Minimising the use of bi-lateral agreements
- Achieving export competitiveness by actively pursuing a liberal regulatory regime and encouraging domestic competition wherever possible, especially where natural boundaries limit import competition
- Assisting the smooth transfer of resources from non-competitive to competitive areas of the economy

The basic thrust of these recommendations is designed to ensure, that the maximum is obtained from multilateral and regional agreements in terms of implementation, as well as extending their scope. It is also intended that these agreements are as wide as possible in their effects and that they result in the maximum increase in welfare through an effective encouragement of competition and competitiveness both internationally and domestically.

As outlined above, the economies of South East Asia have gained an above average return in a total welfare sense from openness, from trade and investment flows and consequent growth. There are significant distributional effects for their populations, particularly for those in the traditional agricultural sector. The Thai and Vietnamese economies are two regional examples where this is of relevance. Almost half of the employment is still generated in agriculture in Thailand and an estimated 70% in Vietnam. Employment opportunities and returns are sometimes under threat from international integration as it has developed so far.

Both countries are embracing a greater degree of openness in their economy, although Thailand has a longer history of this than does Vietnam. Implementation is a key factor in the effectiveness of globalisation for these two examples. Multilateralism in the form of the WTO is not an option at present for Vietnam, until membership can be acquired. Regional expansion important to Vietnam, is also important to Thailand, given its trade linkages and its pressing need to overcome the issues of non-performing debts.

The openness measures for Vietnam suggest that much of its recent expansion in economic output, averaging some 8% p.a. can be attributed to its growing involvement in the Globalisation process. Exports and Imports relative to GDP increased more than threefold between the mid 1980s and mid 1990s according to Asian Development Bank estimates. There are many problems with such measures, but the signing of the US Vietnam bilateral agreement on trade in 2000 is symptomatic of a move towards greater integration into the international economy. At present the second best opportunities associated with regional and bilateral agreements are all that is open to this and some other South East Asian transition economies. Internally Vietnam’s continuing dependence on state-owned operations can be accommodated within this process by ensuring that greater competitiveness and efficiency is achieved. The use of a hard budget approach, combined with greater competition through greater openness can achieve a sustainable continuation of expanding output. Recent FDI inflows have shown signs of strain, however.

Thailand is already more open than Vietnam in a general sense, being a member of the multilateral community but the improvements in competitiveness and expansion in output, particularly in agricultural trade, are still largely dependent upon regional rather than global agreements. Much of the primary trade such as rice exports is conducted within the region, with some opportunities for export outside, to Cuba for example, arising occasionally for special reasons. There remain some imperfections in the economic system and a substantial overhang of non-performing debt in the finance sector. More integration at the multilateral level is possible in this case and would assist in contributing to greater competitiveness. Better implementation of existing WTO agreements in agriculture and textiles would, however, probably be the best outcome from the Thai perspective.

In a general sense the ranking order given above can prevail, multilateralism is available to Thailand, but has drawbacks for some groups associated with agriculture as a means to gain basic sustenance and more generally in terms of implemetation of even existing agreements. Regionalism is an important adjunct for it especially in agriculture. For Vietnam some the same distributional and institutional problems apply especially for the agricultural sector, multilateralism is not available, but in prospect as an applicant to the WTO. Regional integration therefore becomes of prime importance, backed by bilateral agreements such as that with the US. The latter represents a second best outcome, but may assist in establishing credentials for full multilateralism as well as opening up some opportunities in its own right. Transition issues mark the dominant distinction from the Thai case.

For the free trade liberal, greater openness and integration is a welcome force, it contributes to greater competitiveness and higher levels of output, but as the ultimate reasoned advocate of free trade, Jagdish Bhagwati, so eloquently puts it, "…the most difficult policy act for a free trader is to be also a free immigrationist." [Bhagwati, 1998, p. xlviii]. Simple espousal of the latter policy is easy, policy enactment somewhat difficult, just as implementation of agreements has proved difficult. There is more to globalisation than mere free trade and problems with simply equating the rules-based WTO with 'Free Trade". However, as yet it remains the best game in town for those in this multilateral club.

Acronyms and Abbreviations used

AFTA	Asian Free Trade Area
APEC	Asia Pacific Economic Co-operation
ASEAN	Association of South East Asian Nations
ASEAN+3	includes Japan, Korea and China as well as ASEAN membership
CER (ANZCERTA)	Australia and New Zealand *Closer Economic Relations* Trade Agreement
ESCAP	Economic and Social Commission for Asia and the Pacific
EU	European Union
FDI	Foreign Direct Investment
GATT	General Agreement on Trade and Tariffs
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GSP	Generalised System of Preferences
IMF	International Monetary Fund
MFN	Most Favoured Nation
OECD	Organisation for Economic Co-operation and Development
TBTs	Technical Barriers to Trade
UNCTAD	United Nations Commission on Trade and Development
UNDP	United Nations Development Programme
US	United States
WTO	World Trade Organisation

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Change is inevitable progress is not

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Abstract

Globalization is the buzzword of the 21st century. Globalization is, of course, a real phenomenon. However, both the extent of interdependence and its impact are usually exaggerated and misunderstood. Because of the fundamentals and features of capitalism, trade tends to reinforce inequalities. Globalization generates an inequality in bargaining power in an economy and has the added defect of being conducted at the international level, where the absence of a supranational government eliminates the possibilities of redistributing the gains. It is fair to claim that the principal benefits of world trade have accrued disproportionately to rich nation. This should be construed as an indictment of the inherent nature of trade. It reflects the highly inegalitarian institutional, social and economic ordering of the global system. The awareness of the prosperity of the core zones and the degree of the North-South gap is far greater today. The feeling of rejection grows. The broader challenge for the 21st century is therefore not to take back globalization or scale down its main driving forces. The challenge is to engineer a new balance between the market and society.

Introduction

For friends and foes alike, globalization is the buzzword of the 21st century. This phenomenon has been coined as "globaloney". The term applies to the way many modern pundits ascribe everything that happens in the world to the vaguely defined impacts of the global economy. Globalization is, of course, a real phenomenon. International trade and investment have consistently grown faster than the world economy as a whole; national economies have become more interdependent. But both the extent of that interdependence and its impact are usually exaggerated and misunderstood.

The current forms of globalization - even if they are perceived inevitable and irreversible - do not imply that they are just processes, and therefore deserve our political, ethical and cultural approval. Some aspects and evolutions have to be questioned, and should cause major concerns vis-a-vis the problems and consequences they might lead to.

Dogmatism tends to define globalization. Even the smallest reservation by the blessing of the market is considered to be blasphemy. The point is not to argue that the changes involved in the operation and construction of markets are "bad" - though undoubtedly many people see these changes in social life as bad. The point is that the construction and reconstruction of markets bring huge changes that are not necessarily and/or inherently beneficial to all its participants.

The broader challenge for the 21st century is therefore not to take back globalization or scale down its main driving forces since this would only tackle and destroy the incarnation of a wider trend (esp. technological). The challenge is to engineer a new balance between the market and society; one that will continue to unleash its creative engines of private entrepreneurship, but also with a social basis of cooperation and solidarity that guarantees development for all. If anything, change is inevitable, progress is not!

Definition, concept and enzymes of economic globalization

Globalization refers to the multitude of relations and interdependence between nation-states and societies that define the current global order. It may be defined as «the intensification of economic, political, social and cultural relations across borders».[1] National economies are becoming more integrated in three fundamental ways: the increased trade and financial linkages, the sharp rise in foreign direct investment and the increased harmonization of economic institutions and policies. The economic side of globalization dominates the headlines. However, the causes and consequences of globalization extend beyond economics!

Globalization encloses two important phenomena: the range (width) and intensity (depth). The former defines the number of processes that comprise large parts of the globe or operate on a global level. The range relates to a geographical concept. The latter defines the level of interaction, interconnection or mutual dependence between nation-states and societies. Globalization is not occurring in a vacuum. It is part of a broader trend we may call marketization. Receding governments, deregulation and the shrinking of social obligations are the domestic counterparts of the intertwining of national economies. Globalization could not have advanced this far without these complementary forces at work.

Each of history's great empires marks a wave of globalization, a move towards a large and larger sphere of economic interaction. The principle distinctive features of the current globalization are qualitative. The current global economic integration is occurring in a world that is almost entirely capitalist. Because of the domination of the world economy by capitalism and the process of economic homogenization, the degree of competition is particularly intense.

In recent years, the overall level of international economic activity has escalated, spurred by a variety of factors ranging from innovations in information technology to efforts by national governments to liberalize, privatize and deregulate markets.[2]

The liberalization of capital has been the centerpiece that contributed to the shifting from a national oriented towards global capitalism. It accelerated and intensified the economic globalization. The opening up of national markets for free trade and free movement of goods, services, people and capital is one of the credos of capitalism. The liberal market theory states that the elimination of all sorts of tariff and non-tariff barriers can only promote international trade and, hence, fosters welfare for all participants. The process of liberalization functions not without problems and conflicts of interests. The strongest economy holds usually the strongest cards. Large and well-developed economies benefit most of an intensive liberalization of goods and services, capital and people.

The second engine of the economic globalization is privatization. Independent of the ideological battle against communism and other forms of economic socialism, we have witnessed the partial or full privatization of more and more industries within the so-called "mixed economies". The argument goes that the private sector within the market enables the best allocation of resources in the interest of both the producer and consumer.

To operate efficiently, privatization and liberalization of national markets need a third element, i.e. deregulation. State monopolies and economic interventions (including norms and guidelines) must be limited. It has partly been a healthy reaction against an excessive early faith in the power of governments to direct the economy, to manage businesses and to correct market failure. But unregulated markets can be both inefficient and cruel. After the Uruguay Round, it was estimated that the new trade agreements would lead to an increase in global income of some $ 212-500 billion, but a net loss of $ 600 million a year for the least developed countries and $ 1.2 billion a year for Sub-Saharan Africa.[3] There is no gain in replacing a regulated public sector monopoly by a deregulated private sector oligopoly. In the international economy, laissez-faire doctrines are fatal, for here sovereignty vanishes and aggressive transnational bodies pursue market strategies in the absence of any countervailing regulatory bodies whatsoever.

The recent pattern of economic activity points to a progressive move towards types of economic activity that are less labor intensive, but more knowledge intensive in both manufacturing and service sectors, with increasing emphasis on software and high-trade human capital rather than on large-scale fixed investment. The fourth, and perhaps most dramatic, enzyme of economic globalization is technological innovation. Technology is both cumulative and irreversible.[4] The impact of innovation has resulted in the "New Growth Theory" developed in the 1980s. It regards knowledge creation as endogenous, responding to market incentives such as improved profit opportunities or better education. There are two relevant categories of knowledge. One is the technical and economic knowledge that makes it possible to control sophisticated processes for producing goods and services and marketing them at a profit. The other category, to some extent still elusive, consists of political, social and cultural knowledge, that is, the capacity to manage increasingly complex social systems in a way that ensures coherence and synergy among a multitude of interacting elements.[5]

Globalization, an advanced form of capitalism

Fundamentals of the neo-liberal free market

The global economy is based on the neo-liberal fundamentals of free markets. The essence of the neo-liberal position on international commerce is the proposition that economic growth will be most rapid when the movement of goods services and capital is unimpeded by government regulations.

Within a capitalist economy, the market demand is considered to be the best and fairest democratic expression of the social needs, and the market as the most efficient mechanism to prioritize this multitude of demands and interests. The market mechanism is the best operational system since it is supposed to invoke nothing other than human selfishness, which accommodates the fundamental nature of human beings. Self-interest is an extremely important motive, and many works on economic and social organization and socio-political ideologies have suffered from not paying adequate attention to this basic motivation. The principal attraction of the market has been as a mechanism for creating wealth. This is a task it accomplishes by generating an unrelenting thirst for enterprise, innovation and growth, and by ensuring that resources are put to their most efficient use.

The global economy, as she is structured today, is a more advanced - wider and deeper - form of capitalism. The features - positive and negative alike - of a capitalist economy are brought into a higher - global - dimension. The many benefits not withstanding, there is also a brutal Darwinian logic to the markets: they are nervous and greedy and what they reward is not always our preferred form of ethical behavior. Markets are by nature unfair!

Evaluation of the features of free markets

We can identify five features of the capitalist market mechanism, i.e. growth imperative, short-termism, its inherent drive towards inequality and instability, and its lack of ethical motives. Within a global economy, these features have become more expressed and/or less manageable. Markets are subject to certain key "market failures" that are exacerbated, rather than limited, by globalization.

a) Growth imperative

Despite the economic models and rhetoric, economic growth is a very slow or even elusive process for the majority of countries. Out of 95 developing countries, 28 suffered a decline in GDP per capita between 1964 and 1999 and in an additional 46 countries GDP per capita increased less than 100% over this period Moreover, 39 of these 74 had a GDP per capita bellow $1,000 (in 1995 dollars) in 1999 and 38 of these 39 had been in the same situation in 1964. Thus, a large number of countries were poor and have remained poor.[6]

Prosperity is also a burden. The first burden is the pressure to maintain it. In the absence of growth, economic conflicts become "zero-sum": what I gain you lose, what you gain I lose. The demographic explosion in most developing countries has rendered this imperative even more urgent. In many developing countries the economic growth falls short of the population growth.

In his article *The place of development*[7], Bob Sutcliffe develops a twofold critique on this standard growth model. The polarization critique is a fundamental denial of the linearity and potential generality of the process of development. The process of development, when viewed globally, is not one of homogenization and universal attainment, but one of polarization and exclusion. The different and converging starting points of development and forms of travel have been special targets. It is not open to latecomers to take the same route to development since they are not starting from the same place and they face insuperable obstacles placed in their way by earlier travelers. The attainability critique of development argues that it is physically impossible for the whole world to reach the received destination. If all developed countries would attain the economic level of the industrial countries and the consumption associated with this economic output, the planet's resources would only be able to carry one fifth of its current population. This kind of development can not be ecologically sustained in the long term.

In addition, the link between economic growth and human development is neither automatic nor obvious.[8] Growth alone is not enough. It can be ruthless, leaving losers to abject poverty. Jobless, creating little employment. Voiceless, failing to ensure participation of people. Futureless, destroying the environment for future generations. And rootless, destroying cultural traditions and history.

b) Short-termism

We are observing a tendency to "short-termism" on the part of the corporate sector. Leading enterprises concentrate on obtaining a high rate of return on capital in the short run even at the expense of their long-term profitability, the sustainability of the economy and environment, and the socio-political impact of their policies. This tendency is understandable in a climate where corporate predators and speculators stand steady to take advantage of any development or management decision which may create an opportunity for short-term arbitrage (or a "quick killing").[9]

c) Inherently unequal

There are no equalizing feedback mechanisms in capitalism. Competitive markets do not guarantee that income and consumption go to the neediest or most deserving. Rather, the distribution of income and consumption in a market economy reflects initial endowments of inherited talents and wealth along with a variety of factors as race, gender, location, effort, health and luck. Markets do not necessarily produce a fair distribution of income. In fact, a market economy may produce unacceptably high levels of inequality of income and consumption.[10]

The neo-liberal position on the distribution of income rests on the argument that an unequal distribution of income serves as an incentive function to invest and work. The classical analysis of the origins and role of savings also serves as a justification. It follows that more income in the hands of the poor means more consumption and less savings, whereas more income in the hands of the rich means more savings. A more unequal distribution of income, then, leads to higher rate of economic growth. This concept is the basis for Simon Kuznet's hypothesis that the secular behavior in inequality follows an inverted U-shaped pattern, with relative income inequality first increasing and then decreasing in the course of development.[11] Combined with the arguments about incentives and savings, the Kuznets Curve rounds out the neo-liberal position nicely. On the one hand, the position asserts that nothing can be done directly about inequality. Direct efforts to reduce inequality will simply make the conditions of the poor worse by harming the economic growth. On the other hand, nothing needs to be done, because in the long run the conditions of inequality themselves will contribute to growth, and growth will both improve the absolute condition of the poor and reduce inequality.

In contrast, numerous studies published in the mid 1990s concluded that income inequality is negatively correlated with subsequent growth. According to these researches, the only relationship between income distribution and economic expansion that can be discerned after cross-country analyses is that countries with more equal income distributions have grown more rapidly. This would imply, there is no empirical basis for the neo-liberal claim that greater income inequality enhances economic growth.[12]

The dismantlement of trade barriers and restrictions on capital movements have resulted in an impressive increase of trade and national incomes. Global free trade is often described as a win/win situation for all participants. However, the theory can not be reconciled with the reality. The truth is that together with rising GNP statistics and exploding stock exchange values, the inequality has increased, the social and ecological situation worsened, and sovereign states and localities have lost their power to multinationals and anonymous international capital flows. This rising global inequality in an era of increasing international interdependence is especially disconcerting, suggesting globalization is generating forces that lead to the concentration instead of the dispersion of wealth.

Since capitalism is based on competition, it will lead inevitably to greater chasms between the have's and have-nots within each country. Capitalism is not a strategy that can work for the great majority of the world's poor. If left to take its own course, economic development is a process of circular and cumulative causation which tends to award its favors to those who are already well endowed and even to thwart the efforts of those who happen to live in regions that are lagging behind.

d) Inherently unstable

Financial markets have always been characterized by a tendency to experience boom-and-bust cycles. Globalized finance, with its access to large amounts of information, instant communications and the capacity to move large amounts of money across borders in short periods of time, has moved the boom-and-bust cycle into the international arena. As a result, the volatility of capital flows to countries through these markets has increased greatly in recent times. The experience of developing countries during the past several years has demonstrated that financial crises are highly contagious. After the Asian crisis, the World Bank recognized that, in absence of macroeconomic stability, international capital flows could be detrimental.[13] The source of the central problem of vulnerability and fragility lies in the growing importance of international movements of private capital, especially short-term flows. In recent years, 97.5% of international monetary transactions were of a speculative nature, that is, money was exchanged for money. Although the financial games are played virtually, the impact of a financial crisis is real and painful.

e) Amoral

At the heart of capitalism's inhumanity is the market - «an amoral and often cruelly capricious master».[14] Profit motive underlies the production and distribution of social output. This motive forms the internal dynamic of capitalist society independently of the will of its agents. The profit motive - and not public welfare - underlies the decision-making strategies of the major capitalist organizations. Markets advance individualistic rather than social goals. Within a global economy, the market's invisible hand is attached to a manipulative arm that is left to the contingencies of spontaneous greed. A major failing of the market is that there are economic circumstances to which it does not, or cannot, respond. «The market is efficient, but it has no heart nor brains,» Paul Samuelson states. Markets preclude "we" thinking and "we" action of any kind at all. Markets are contractual rather than communitarian.[15]

By rewarding selfishness and greed, the market creates atomized and isolated individuals, who have little incentive to fulfil their social and civic responsibilities. It should be clear that once social and political considerations are allowed to override the market, the whole neo-liberal position disintegrates.[16]

Evaluation of the assumptions of free markets

The neoclassical model - based on the concepts of comparative advantage, factor endowments and specialization - postulates that trade is an important stimulator of economic growth, and promotes greater international and domestic equality by equalizing factor prices, raising real incomes of trading countries and making efficient use of each nation's resource endowments. Although the theorem is sound, the conclusions of traditional international trade theory are derived from a number of explicit and implicit assumptions that in many ways are often contrary to the reality of contemporary international relations. This is not to deny the potential benefits of a world of free trade, but rather to recognize that free trade exists mostly in diagrams and models of economists, whereas the real world is beset by all sorts of national protection and international non-competitive pricing policies. Some basic assumptions of the neoclassical trade model must be scrutinized. They should be criticized in the context of the contemporary of developing countries in the international economic system.[17]

a) No equal resource and factor endowments

The neoclassical model assumes that all productive resources are fixed in quantity and constant in quality across nations. In reality, the world economy is characterized by rapid change, and factors of production are fixed neither in quantity and quality. Not only do capital accumulation and human resource development take place all the time, but trade has always been and will continue to be one of the main determinants of the unequal growth of productive resources in different nations. This is especially true with respect to resources most crucial to growth and development, such as physical capital, entrepreneurial abilities, scientific capacities, the ability to carry out technological research and development and the upgrading of technological skills in the labor force.

In the context of unequal trade between rich and poor nations, this means that any initial state of unequal resource endowments will tend to be reinforced and exacerbated by the very trade that these differing resource endowments were supposed to justify. This criticism has been crystallized in so-called North-South trade models. They focus specifically on trade relations between rich and poor countries, whereas the traditional model was assumed to apply to all nations. The typical North-South model argues that initial higher endowments of capital in the industrialized North generate external economies in manufacturing output and higher profit rates. This, in combination with the rise in monopoly power, stimulates higher Northern growth rates through further capital accumulation. As a result, the rapidly growing North develops a cumulative competitive advantage over the slower growing South. If we then add differential income elasticities of demand and capital mobility to the model, the basis for the Third World trade pessimism is further enhanced.

b) No perfect competition

The assumption of perfect competition is the most unrealistic of all premises of the classical and neoclassical trade theory. According to the model, trade is carried out among many atomistic and anonymous producers seeking to minimize costs and maximize profits. Hence, no firm or consumer is large enough to affect the market price. Perfect competition also assumes that all goods and services have a price and are traded on markets. International prices are set by the forces of supply and demand. In such a circumstance, it is argued, the "invisible hand" will produce an efficient allocation of resources. There are, however, many ways that markets can fall short of perfect competition. The three most important involve imperfect competition, externalities and public goods. In each case, market failure leads to inefficient production or consumption, and governments can - in fact, must - play a useful role in rectifying the inefficiencies.

Whereas under perfect competition no firm or consumer can affect prices, imperfect competition occurs when a buyer or sellers can affect a good's price. Imperfect competition leads to prices that rise above cost and to consumer purchases that are reduced below efficient levels. A second type of inefficiency arises when there are spillovers or externalities, which involve involuntary imposition of costs or benefits. This is because of the amoral conduct (to make sure: not necessarily immoral) of the market. When positive externalities exist for a particular activity, then the value of that activity to society will be greater than the private value. If investment decisions take place within a free market, there will be less investment in that activity that would be desirable from the perspective of society at large. When activities have negative externalities, unregulated market decisions will result in more of that activity taking place than is socially desirable. A third important market failure is imperfect information. The invisible-hand theory assumes that buyers and sellers have full information about the goods and services they buy and sell. Clearly, the reality is far from this idealized world.

The phenomenon of increasing return and monopolistic competition combined with the non-economic power of large multinational corporations and unequal access to information, means that those who were first to industrialize are able to take advantage of these economies of scale and differentiated products to perpetuate their dominant position in world markets.

c) Adjustment problems

The traditional theory of trade assumes that nations are readily able to adjust their economic structures to the changing dictates of world prices and markets. Movements along production possibilities frontiers involving the reallocation of resources from one industry to another may be easy to make on paper, but according to structuralist arguments, such reallocations are extremely difficult to achieve in practice. This is especially true in developing nations, where production structures are often very rigid. The more dependent nations are on few primary-product exports, the more inflexible their economic structures prove to be and the more vulnerable they are to the unpredictabilities of international markets.

Even if the problems of shifting labor from one set of activities to another were only matter of time, they would be significant. The income losses could outweigh the gains that might be obtained from the more "rational" allocation of resources forced upon a country by free trade. Yet, there is no assurance that, after these losses, a successful adjustment would ultimately be attained.[18] Moreover, the LDCs that can expand their capacities to produce low-cost, labor-intensive manufactured goods for export often find their exports blocked by tariffs and non-tariff barriers erected by developed countries to restrict the entry of such low-cost goods into their home market.

Any alternatives: in search of a capitalist feedback system

The defenders of neo-liberalism are not unaware of various criticisms. In response, free-trade proponents have developed some counter-arguments. The criticism is often accepted on a purely theoretical level, but it is maintained that they are relatively unimportant in practice. Moreover, it is argued that (government) interventions generally make the wrong selections and would cause more harm than the initial problem they try to rectify. There is also the argument that unilateral regulation of foreign commerce would be met with retaliation that would be more costly than any gains from regulation. When all other arguments in favor of free trade have failed, neo-liberal rhetoric falls on the there-is-no-alternative defense: because the world economy is already become so integrated and homogenized, any attempt to regulate the commerce would simply result in the relocation of the firms.

In the neo-classical tradition, GNP rises as result of the long-term effects of capital formation, labor force expansion and technological change, which are assumed to take place under conditions of competitive equilibrium. This dynamic is differentiated - but not challenged - by the so-called "structural analysis". Given the features, assumptions and dynamics of (global) capitalism described above, structural changes are most likely to occur under conditions of disequilibrium (this is particularly true in factor markets). These disequilibrium phenomena are shown to be more significant for the developing countries than the mature, industrial economies.[19]

Historically, the social-welfare state and social investment have been used to reconcile capitalism and democracy. The state took actions to equalize market outcomes and helped the individual develop marketable skills. The welfare state enlarges freedom by "empowering" individuals and freeing them from the social evils that blight their lives - unemployment, homelessness, poverty, ignorance, disease and so forth.

The postwar period has witnessed two apparently contradictory trends: the growth of trade and the growth of government. Prior to the Second World War, government expenditures averaged 20% of the GDP of today's advanced industrialized countries. By the mid-1990s, that figure had more than doubled to 47%. There is a surprisingly strong association across countries between the degree of exposure to international trade and the importance of the government in the economy. Work of Dani Rodrik unmistakable identifies a positive correlation between a nation's openness to trade and the amount of its spending on social programs.[20] This relationship is not confined to OECD economies: developing nations also exhibit this pattern. Rodrik concludes: «The social welfare state has been the flip side of the open economy.»

Whereas theories of social justice usually relate to how the whole cake of society's resources is distributed, the notion of welfare is more concerned with providing a minimum quality of life for all, accepting that much wealth and income is distributed through the market. It is clear that the welfare can never bring about absolute social equality. This is politically and economically not desirable and feasible. Its goal is rather to "humanize" capitalism by reducing distributive inequalities.

International economic integration thus poses a serious dilemma: globalization increases the demand for social insurance while simultaneously constraining the ability of governments to respond effectively to that demand. The process of international economic integration is taking place against a backdrop of retreating governments and diminished social obligations. Yet, the need for social insurance for the vast majority of the population that lacks international mobility has not diminished. If anything, this need has grown. The question, therefore, is how tension between globalization and the pressure to mitigate risk can be eased. If the vital role that social insurance played in enabling the postwar expansion of trade is neglected and social safety nets are allowed to dwindle, the domestic consensus in favor of open markets might erode seriously and protectionist pressures could soar.

Globalization, also a dynamic of exclusion

Having analyzed the inherent dynamics of capitalism, we can easily understand the current trends of polarization, triadization and delinking. Since globalization is an advanced form of capitalism, these trends are only further aggravated and brought to a higher, global, dimension. Although its benefits come to only a few, the excrescencies of the global economy affect many. Because of its own set-up, the contemporary inter- and transnational mechanisms fail to "guide" the dynamic of economic globalization.

Although the latest phase of globalization makes new promises for semi-peripheral regions that succeed in achieving high growth, it carries new dangers of severe economic marginalization and polarization for peripheral regions and unsuccessful semi-peripheral ones. Growing global income inequality reflects the fact that, in spite of a few important success stories, income has been growing more rapidly in rich countries than in poor ones.

Globalization, as the term itself suggests, is a worldwide phenomenon, but it has been uneven. The intensification of interdependence has been most pronounced among nations of the North and the emerging markets of East Asia, which have reaped its economic benefits. Although many claim a truly global economy, much trade remains regionalized between three growth poles. This dynamic is referred to as "triadization". Triadians are the people living in the economic triad, i.e. North-America, Western-Europe and Japan.[21] Because it is uneven, globalization also threatens to widen further the gulf between the world's rich and poor countries. While only 14.3% of the world's populations lives within the triad, the three growth poles produced 77.3% of the world's output and received 68.3% of all export in 1999.

Even worse is the process of delinking of certain countries and regions. This is particularly true for Latin America, Africa and some countries in Asia. They not only face economic problems, but are often torn apart by internal conflict and political turmoil. The real South of developing countries can not attract capital and investments except public donations and humanitarian aid.[22] Capital only flows to these countries out of humanitarian actions, not economic logic. They stay bereft from investment and trade. The *Trade and Development Report 1999* shows a combination of declines in terms of trade, losses of export purchasing power, and big-bang liberalization of trade and capital accounts have contributed significantly to this outcome.

The opening of international trade has changed - through various dynamics that are not limited to trade - the bargaining power of all economic actors. It is the power structure that indicates who will benefit most and, conversely, who will lose out. Globalization implies nothing less than a redistribution of global economic power which will increasingly translate into a redistribution of political power. Power in economic life means primarily an ability to shift more and more of the value produced by society into one's own hands. Power is largely a question of options. Social power is at the center of the market allocation process. Power - the ability to shape social situations to operate in your own favor - affects market allocation in two broad ways. There is the power to structure markets and the power to participate in the markets. But even to escape today's economic stranglehold is virtually impossible. The most important reason being that the developing countries are already too embedded in the global economic system.

The neo-liberal theory is simplistically narrow. It does not deal with host causal power relationships between the economic actors. Although we can talk about economic development in terms of expansion of total output in a country or in terms of the increase in per capita income, the broader character of economic development is intertwined with social power. In this way, neo-liberal globalization is a *de facto* formula for shifting income to the owner of capital and knowledge, that is, for increasing inequality in the distribution of income.[23]

People under siege

There are no rigid boundaries separating the interconnected dimensions of security, be they of a social, political, economic or ethical nature. Economy pervades every aspect of our existence. Globalization can not be confined to the realm of the economy. In fact, a socio-political backlash will be much more fundamental and dramatic (if not violent).

Globalization is seen by a growing number not as a friend of prosperity, but as its enemy; not as a vehicle for development, but as an ever-tightening vise increasing the demands on states to provide safety-nets while limiting their ability to do so. Whatever reality there is, the perception of a siege is unmistakable. As the masses of poor see their chances of escaping acute poverty diminish, they are likely to become increasingly resentful of those whose growing wealth is evident. If globalization is to succeed, it must succeed for poor and rich alike.

There are two dangers from complacency towards the social consequences of globalization. The first and most obvious one is the potential for a political backlash against trade. The second and more serious danger remains the creation of new set of class divisions between those who prosper in the globalized economy and those who do not. We can identify 4 broad socio-political reactions to a perceived failure of economic globalization.

Reaction against Westernization

Globalization promotes the overwhelming power of Western culture and lifestyle in undermining traditional modes of living and social mores. The sun does not set on the empire of Coca-Cola or MTV. As some of these changes appear to violate long-standing social bargains in many countries, the widespread populist reaction to globalization is perhaps understandable.

> In the early phases of change, Westernization promotes modernization. In the later phases, modernization promotes de-Westernization and the resurgence of indigenous culture in two ways. At the societal level, modernization enhances the economic, military and political power of the society as a whole to become culturally assertive. At the individual level, modernization generates feelings of alienation and anomie as traditional bonds and social relations are broken and leads to crisis of identity to which religion provides an answer.[24]

The pointer to any real conflict between the preservation of tradition and the advantages of modernity calls for a participatory resolution, not for a unilateral rejection of modernity in favor of tradition by political rulers, religious authorities or admirers of the legacy of the past. An attempt to choke off participatory freedom on grounds of traditional values simply misses the issue of legitimacy, and the need for the people affected to participate in deciding what they want and what they have reason to accept.

In search of a lost identity

The 1990s have seen the eruption of a global identity crisis. Almost everywhere one looks, people have been asking: "Who are we?" "Where do we belong?" and "Who is not us?". In a post-modern society, the search of a own identity becomes prominent. Because only by self-definition, a sense of direction, security and stability can develop. Self-knowledge is a central element of the human existence. However, many people are trapped in the logic of one against all to secure its own survival. We know who we are only when we know who we are not, and often only when we know whom we are against. As people define their identity, they are likely to see an "us" versus the "others" relation.[25] Almost unanimously and spontaneously, the "other" is suspected to be the enemy, a source of danger, or at least a threat to the own existence and identity.

If states or other identities of solidarity come to be seen as losing efficacy, to where will people turn for protection? The answer is already clear: to "groups". Groups can have many labels: ethnic, religious or linguistic; homo- or heterogeneous. This is nothing new. What is new is the degree to which such groups become exclusive and marked against other communities. As the post-Cold War world evolves, (civilizations) commonality is replacing political ideology and traditional balance of power considerations as the principle basis for cooperation and coalitions. This has been termed the "kin-country" syndrome.[26] As tension increases and especially when violence erupts, the initial issues at stake tend to get redefined more exclusively as "us" against "them", and group cohesion and commitment are enhanced. On the one hand, it is fueled by fear, by disintegration, and, above all, by fear of further disintegration. On the other hand it is fueled by the self-assertion of the oppressed, by their positive demands for a truly egalitarian world. It is useful to go back to Sigmund Freud's "narcissism of minor differences" to understand why people who seemingly have so much in common, hate each other with unrestrained passion.

The most dangerous spin-off of these dynamics has been the rise of nationalism and the proliferation of internal "ethnic" conflicts. An estimated 5 million people died in intrastate conflict in the 1990s. Three quarters of today’s refugees are caused by ethnic conflicts. Leaders in search of legitimacy are beginning to view globalization, and its down side, as a process that has weakened them vis-a-vis their rivals. Even more troubling, political leaders are increasingly seeking to sustain popular support amidst economic difficulties by exploiting historic enmities and fomenting trans-border conflict.

> The irony […] is that globalization's promise was based on the notion that trading partners become political partners, and that economic independence would eliminate the potential for political and military conflict.[27]

Without a background in constitutional liberalism, the introduction of democracy in divided societies has actually fomented nationalism, ethnic conflict and even war. In societies without strong tradition of multiethnic groups or assimilation, it is easiest to organize support along racial, ethnic or religious lines. Political competition that is so divisive can rapidly degenerate into violence. Without constitutional liberalism, democracy itself has no peace-inducing qualities. In countries not grounded in constitutional liberalism, the rise of democracy often brings with it hyper-nationalism and war mongering.[28]

Emergence of illiberal democracies

A third reaction to economic globalization has been the resort to illiberal solutions: the call for the man on the white horse, the strong leader. As central power disintegrates, democracy is falsely seen as a luxury and not a necessity; a blessing to be wished for, not a right to be fought for. Although we witnessed after the Cold War a swing towards democracy, the pendulum will move back towards the center: "between the ideal of Berlin and the reality of Hobbes".[29]

The argument that greater trade would naturally lead to greater prosperity, which in turn would sustain a broad middle class and hence foster democratic rule, proved to be overly optimistic. Fareed Zakaria observes the rise illiberal democracies.[30] He indicates a tendency of democratic governments who believe in absolute sovereignty (that is, power) through a centralization of authority, often by extra-constitutional and with grim results.

> Over the last decade, elected governments claiming to represent the people have steadily encroached on the powers and rights of other elements in society, a usurpation that is both horizontal (form other branches of national government) and vertical (from regional and local authority as well as private businesses and other non-governmental groups).[31]

Politics of populism

The fourth reaction against the forces of globalization has been a politics of populism. Embattled leaders may begin to propose forms of protectionism, isolationism and rejectionism as a way to offset losses supposedly incurred. «Globalization is made the scapegoat of ills which more often have domestic roots of a political nature. »[32] As people need new sources of identity, new forms of stable community, and new sets of moral precepts to provide them with a sense of meaning and purpose, populists offer them easy answers. The past decade, we have witnessed the birth of dozens of aggressive movements espousing varieties of nationalism, religious fundamentalism, fascism and apocalyptic millenarianism.

We have seen the rise of religious fundamentalism in recent years within all major religious movements. The revival of religion in some way attests to a broad unhappiness with the impersonality and spiritual vacuity of liberal consumerist societies. People, previously secular, are in need for a spiritual guideline. Religious people retreat in the more "fundamental" doctrine of their religion. The revival of religion, "*la revanche de Dieu*", provides a basis for identity and commitment that transcends national boundaries and unites civilizations. The trend to secularization and toward the accommodation of religion with secularism "went into reverse".[33] The renewal of religion throughout the world far transcends the activities of fundamentalist extremists. It is one thing to face population pressures, shortage of resources, educational/technological deficiencies and regional conflicts, which would challenge the wisest governments. But it is another when peoples themselves stand in angry resentment of global forces for change instead of selective responding to such trends.

The globalization paradox

Today, we can observe a globalization paradox: economically, we are looking outward towards a more integrated global economy - albeit unequally distributed; while socio-politically, we observe inward looking dynamics. The economic slogan of "The world, our village" is not met by a socio-political globalization. In fact, we can argue the reverse: "The village, our world". In the developed world, this dynamic can be labeled as an upsurge of demographic, political and military isolationism; while in many developing countries a similar inward looking reflex is driven by a rejection of Westernization. Ignacio Ramonet states that globalization is in fact a "reactionary" political evolution that challenges the democratic principles in the name of "adjustment" and "competitiveness".[34] Although we feel highly uncomfortable with the word "Jihad" to symbolize this trend, Benjamin Barber clearly illustrates this dynamic in his book *McWorld vs. Jihad*.

> Jihad and McWorld operate with equal strength in opposite directions, the one driven by parochial hatred, the other by universalizing markets; the one re-creating ancient sub-national and ethnic borders from within, the other making national borders porous from without.[35]

Barber portrays two simultaneous, but totally opposite dynamics. The first scenario holds out the grim prospect of a retribalization of large swaths of humankind by war and bloodshed. A Jihad in the name of a hundred narrowly conceived faiths against every kind of interdependence, every kind of artificial social cooperation and mutuality, against pop culture, against integrated markets, and against modernity itself as well as the future in which modernity issues. The second paints that future in shimmering pastels, a busy portrait of onrushing economic, technological and ecological forces that demand integration and uniformity.[36]

Neither McWorld nor Jihad is remotely democratic in impulse. Neither needs democracy; neither promotes democracy. On the contrary, the consequences of the dialectical interaction between them suggest new and startling forms of inadvertent tyranny that range from an invisibly constraining consumerism to an all to palpable barbarism.[37] Both McWorld and Jihad has turned out to be more of an anti-politics.

> For McWorld, it is the anti-politics of globalism: bureaucratic, technocratic and meritocratic […]. In its politico-economic imperatives, McWorld has been guided by laissez-faire market principles that privilege efficiency, productivity and beneficence at the expense of civic liberty and self-government.

> For Jihad, the anti-politics of tribalization has been explicitly anti-democratic: one-party dictatorship, government by military junta, theocratic fundamentalism. [38]

Although we behave globally in the economic sphere, socio-politically we remain within the same individualistic and egocentric framework, which is, in fact, the basis of economic globalization and made it successful. One might thing of these opposite dynamics as contradictory, but they clearly are not! In fact, both are supplementary to each other.

> [J]ihad stands not so much in stark opposition as in subtle counterpoint to McWorld; and is itself a dialectical response to modernity whose features both reflect and reinforce that modern world's virtue and vices - Jihad via McWorld rather than Jihad versus McWorld.[39]

In other words, Jihad not only revolts against, but also abets McWorld; while McWorld not only imperils, but re-creates and reinforces Jihad. McWorld cannot do without Jihad: it needs cultural parochialism to feed its endless appetites. Jihad is not only McWorld's adversary, it is its child.

The socio-political counterpart of individualism (if not: egoism), as the core value of our outward looking global economy, is parochialism that is, in turn, the driving force of the inward looking dynamics described above. We are stuck within the same individualistic and selfish ego. The globalization paradox is not a contradiction; it is a result of its own values.

Conclusions

At the beginning of the 21st century almost nobody believes that there is any good alternative to a market economy. At best we can hope to cushion people from the worst of the economy's brutalities. We can not alter the capitalistic structure since there is - unfortunately - no alternative that encompasses the selfish nature of mankind. However, reform is necessary! If anything, to avoid an economic and socio-political implosion of the system.

The new century, as the last, will have to face the problem of development, or rather, underdevelopment. We have clearly illustrated that free trade tend to equalize incomes is no more than a theoretical construct. Because of the fundamentals and features of capitalism, trade tends to reinforce inequalities. In addition, globalization generates an inequality in bargaining power. The real world transition to and intensification of globalization has made access to and control over meanings of technologies and resources more unequal than ever. It has the added defect of being conducted at the international level, where the absence of a supranational government eliminates the possibilities - which at least exist in theory at the national level - of redistributing the gains or investing them to promote development in disadvantaged regions or social groups.

It is fair to claim that the principal benefits of world trade have accrued disproportionately to rich nations and, within poor nations, disproportionately to foreign residents / organizations and wealthy nationals. This should be construed as an indictment of the inherent nature of capitalist trade.

> We are entering a bifurcated world. Part of the globe is inhabited by Hegel's and Fukuyama's Last Man, healthy, well fed and pampered by technology. The other, larger, part is inhabited by Hobbes's First Man, condemned to a life that is poor, nasty, brutish and short.[40]

The awareness of the prosperity of the core zones and the degree of the North-South gap is far greater today. The feeling of rejection grows: many poor feel the wealthy are rich *because* they are poor, and the poor are poor *because* the wealthy are rich. While economically we are supposed to behave globally, socio-politically we remain within the same individualistic and egocentric framework, which is the basis of economic globalization and made it successful. These opposite dynamics are supplementary to each other, rather than contradictory. The socio-political counterpart of individualism, as the core value of our outward looking global economy, is parochialism that is, in turn, the driving force of the inward looking dynamics. The globalization paradox is not a contradiction; it is a result of its own values.

Despite its major achievements and opportunities, there are grounds for doubting the durability of the existing world economic order. This is suggested not only by the symptoms of growing instability and widening social deprivation, but also by the general weakening of the authority of state and rising levels of feelings of resentment towards economic globalization. The great world disorder that looms is caused not by the struggles of the oppressed, but by the structure that oppresses them. Indeed, «the strong do what they can; the weak suffer what they must». So, who convinced you about change? Let alone progress.

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[21] It is worthwhile noting that for each growth pole there are fundamental doubts about its future. Although the most prosperous economy, recession looms in the US. The European economies never recovered from the recession in the beginning of the 1990s. Unemployment levels remain high and growth rates well below the US.

Japan still remains in an economic limbo with no prospect of recovery soon. The East-Asian Tigers have indeed recovered faster than initially was expected, but analysts question the sustainability of the recovery while restructuring programs are lagging behind. Moreover, a disastrous impact is feared when the US goes into recession.

[22] Even these funds are under increasing pressure since the end of the Cold War. Since 1992, the flow ODA to developing countries as a whole has declined significantly in real terms, and disbursements have also started to decrease in nominal terms. Each year the ratio of aggregate ODA of OECD member countries to their aggregate GNP reaches a new low. This ratio, which was 0.33% of donor's GNP in 1990, fell to 0.22% in 1997, a level that is less than one third the United Nations target for such flows.

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Corporate Social Responsibility And Sustainable Development In An Era Of Globalization: The Case for Latin America and the Caribbean

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Abstract

Many claim that industrial development through globalization is motivated strictly on the basis of an economic rationale particularly in developing countries, and that it occurs at the detriment of environmental management and social development. Globalization, like any revolutionary movement offers great potential, but like any powerful source, can be harmful if not carefully managed.

This paper will explore the issue of corporate social responsibility and sustainable development processes and programs in Latin American and the Caribbean (LAC). The challenge is to make the case why globalization and industrial development offer solutions to economic, social and political development in the LAC Region, rather than the often prevailing view that it is an oxymoron to such development. This can occur through numerous avenues, one being that of the approaches developed by socially responsible companies, associations and governments.

Background to Globalization

The powerful force driving the world towards a converging commonality is globalization or the Americanization of business and trade. The past 25 years have brought revolutionary changes in the international business environment that have resulted in important shifts in political, social, economic and technical forces driving organizations and their management. It is an environment where the nature of these forces of change is not clearly understood, yet they increasingly have significant implications for business practices in the developing countries. Historically, the concept of internationalization was considered an academic and research area traditionally linked to the universities, where it was often departmentalized and approached on the basis of the respective academic disciplines. Some scholars conducted historical and comparative studies internationally, others undertook cross-cultural studies and others undertook international case studies.

Globalization, on the other hand, has emerged in the 1990's as an integrative theme, the consequence of economic and trade policies in the 1980's and 1990's. The current focus on globalization is an example of where the realities of business practise are leading academic research. There is little doubt that the perception of the size of the world is shrinking. As new technologies and government policies are harmonized, the practise of enterprise has become universal. Modern advances in communication technologies, transportation, and global sourcing, have brought nations and their business operations much closer than every before. Globalization, like any powerful energy source, offers great potential, but like any powerful source, can be harmful if it is nor carefully handled. It challenges academic research to focus on new, integrative issues such as the concept of international values and ethics, the North America educational hegemony reflected in its' universal MBA, and global cooperate social responsibility for protecting the environment, attacking poverty and facilitating social and democratic development.

The question arises, however, what are the value components reflective of these global approaches, and how relevant are they to developing countries. This paper will address the issue of corporate social responsibility, particularly its emphasis on sustainable development as it impacts the developing countries of Latin America and the Caribbean (LAC) Region.

According to National Resources Canada, which adopted a Sustainable Development Strategy in 1999 and has taken the lead role in the Canadian government, in initiating a comprehensive and far-reaching dialogue designed to review the implementation of the department's sustainable development program.

> "Canadians have a role to play in sustainable development. Ultimately, sustainable development will result from our individual and collective efforts to find solutions to resource development challenges that are good for our communities, good for the economy and good for the environment…. The principles of

sustainable development enable Canada to build on its social, economic and environmental achievements to protect our nature heritage for the benefit of Canadians and our global neighbours." [11]

Corporate Social Responsibility (CSR)

In recent years, the concept of corporate social responsibility has become increasingly important and subject to considerable debate. It is based upon the premise that since the business firm is a creation of society, it has a responsibility to help in the accomplishment of societal goals. In a global society the issue becomes one of defining, which society the corporation represents and therefore which societal goals should it be held responsible for pursuing.

In the United States, corporate social responsibility evolved through four distinct phases: (1) profit maximization, (2) trusteeship management, (3) "quality of life," management, and (4) sustainable development.

Phase 1 – Profit Maximizing Management

This orientation to CSR is based upon the belief that business decision makers have only one objective – to maximize corporate profits. Profit maximization in order to optimize shareholder returns is the only justification for corporate decision-making. The drive for profits would result in greater wealth for the shareholders (and thus the nation), and as a result, everyone would be better off. In classic terms (e.g. [13]), the process becomes one of an "invisible hand" promoting the good of society. In Neo-liberal terms, corporate profit maximization will result in a" trickle down" of benefits to society at large.

Phase 2 – Trusteeship Management

Trusteeship management is based on the concept that the corporate managers and leaders are viewed as "trustees" of various contributing corporate stakeholders. Not only are they responsible for maximizing the stockholder's wealth, but also for maintaining an equitable balance among the often competing interests of the corporation's other stakeholders including customers, employees, management, creditors, suppliers and society in general. The concept of trusteeship management resulted from the increase in numbers of people who owned stock in the corporations and an increasingly pluralistic society. Trustee management is able to realize its own self-interest, while recognizing and playing off against each other, the competing interests of their company's stakeholders.

Phase III "Quality of Life" Management

Corporate social responsibility based upon a QWL view of management goes beyond mere trusteeship and accountability, to that of viewing the enterprise as a partner with government, education, and other social institutions in solving society's problems and creating a better quality of life for everyone. Attributed to an emergence of a more affluent society in the developed countries, corporations became instruments for enacting government social policy. Accordingly, education and training initiatives are supported, as are minimum wage laws, pollution prevention, opportunities for minorities and women, and codes of ethical conduct implemented. Corporate decision-making is based upon enlightened self-interests that are not simply justified on the basis of economic costs and revenues alone, but on the long-term interests of the firm.

Phase IV Sustainable Development

The current corporate social responsibility initiative that is receiving increasing amounts of attention is its responsibility for sustainable development. Historically, a major problem for deciding the social role of business has been the lack of any clear criteria for judging social performance. This leads to difficulties in allocating limited resources between economic and social programs. In an effort to address this challenge and establish meaningful criteria for evaluating the corporate social responsibility is to establish measurement criteria that can be incorporated in a company's balance sheet. If identified, measured and evaluated, then a firm's performance can be assessed, compared with others, singled out and rewarded as appropriate. Sustainable development has moved to establish audits to measure its social and environmental impacts and initiatives along with its economic successes. This evolution and its appropriateness for the developing countries of the Latin American and Caribbean Region will be assess subsequently in this paper.

Historical Arguments for Social Responsibility

There are several arguments that support the necessity of corporate social responsibility for the modern firm [2,7]

1. Business firms have the resources and should deal with social problems especially when other institutions have failed to solve them.
2. Since the business sector is seen as more efficient, it is better at resolving social problems.
3. Traditionally, the business sector is seen as innovative, and social issues require innovative solutions. Furthermore, it may be more effective in resolving those social issues that may generate some profit (e.g. health care, educations, prison management etc.).
4. Corporate social initiatives, when publicized, can improve the image of the business, which in turn can result in economic benefits. (e.g. increased name recognition in the market place, attract a greater number of talented employees, result in improved work culture and internal sense of pride).
5. Governments may provide incentives to support investments in socially responsible programs.
6. Investments in social programs will prevent unnecessary and costly government interference and regulation.
7. Corporate social responsibility is the moral obligation of business, which in turn is sanctioned and supported by society for the good of all.
8. Corporate social responsibility is good business; healthy communities provide a better climate for business.
9. Preventing social problems is better than attempting to cure them. A focus on social responsibility actions will reduce the threat of disintegrating communities and any crisis that will result.

Classic Arguments Against Corporate Social Responsibility

1. Many argue that the most socially responsible role of business is to make a profit, to use its resources efficiently and to obey the law.
2. Socially responsible decision makers are not authorized by the shareholders to use corporate funds to address social issues. If shareholders wanted to support social issues, they could do it themselves from the corporate profits they would receive.
3. There is no consensus as to which social issues should be addressed, or how to solve them, especially internationally.
4. There are apparent conflicts of interest in some of the social issues faced. Should it give priority to address local, domestic issues, or should it give priority to world issues of poverty, food, access to affordable energy, environmental protection etc.?
5. Business owners are not elected and have no mandate to act socially especially globally.
6. Business is already big enough, engaging in social programs increase its power and broadens its impact.
7. Corporate Social responsibility contradicts the traditional profit motivation, corporate efficiency and competitiveness.
8. Business lacks the skills and vision necessary to assume responsibility for the achievement of social goals.
9. There is no broad-based support or mandate for the involvement of business in corporate social responsibility initiatives.

Corporate Social Responsibility and Sustainable Development in a Global Context

According to a recent study of the Conference Board of Canada, Corporate Social Responsibility produces the following benefits for Canadian companies: [10].

1. establishes and supports beneficial government relationships
2. increases morale and productivity of employees
3. enhances corporate image
4. facilitates local community acceptance and value of the company in the eyes of the community
5. improves strategic marketing position by creating a positive market image and name recognition that can result in long-term sales potential and earnings
6. improves operational efficiency by expanding the corporate leadership skills
7. results in more sustainable presence (community. professional and national leadership – advisory committees etc.

The question that becomes very significant, however, is what is the contribution and nature of corporate social responsibility in an international context, especially among the developing countries. Many social and environmental issues transcend political boundaries, and when we combine this reality, coupled with the expanding nature of global trade, corporate social responsibility and especially its most current face, sustainable development must be analyzed in light of our 21st Century reality.

Conducting business on a global scale is far more complex than operating in a domestic setting. What works locally or benefits businesses locally in their domestic markets will not necessarily be appropriate and beneficial for the company or the international host country. With the growth of international trade and investment and the emergence of multinational corporations the utilization of resources has become more efficient. This in turn has led to economic progress and increasing prosperity for many nations, but created profound problems for their multinational companies. They have encountered cultural differences, different and often confusing trade policies, business practises and methods of operation that have challenged their strategy and questioned their vision. At the same time, as the economies of nations become tightly intertwined and interdependent, the economic health of developing countries becomes more dependent on external (foreign) forces.

Neo-liberal economic reforms in developing countries, deregulation, privatization and trade liberalization has led to increased international investment in developing countries. However international corporations are criticized for acting only in their self interests, and not being socially, economically or environmentally responsible in the developing countries where increasingly they operate. Their globalization agenda operates at the expense of local stakeholders. [5,6].

As discussed previously, Corporate Social Responsibility (CSR) refers to the ethical behavior of a company towards society, both shareholders and a wide range of stakeholders who have legitimate interests in the company. When corporations operate internationally, this responsibility becomes even more complicated and yet more compelling. In the case of the LAC region, it requires that we revise our definition of corporate social responsibility and sustainable development to reflect the specific needs and interests of the area. Reinhardt [12], offers four reasons today for businesses to proactively adopt corporate social responsibility initiatives in sustainable development particularly as they relate to the environment into their business strategies;

1. in order to better manage competition – pro-action by an enterprise will force rivals to match one's behavior
2. in order to reduce costs – e.g. knowledge and technology exist to cut costs and improve environmental performance simultaneously. (recycling and co-generation)
3. as a way of managing environmental risks- to avoid costs associated with environmental accidents or lawsuits.
4. by redefining their markets – a focus on "green power" can be very helpful in developing a market niche.

These same arguments proposed for corporate social responsibility and sustainable development can be applied to the LAC region. Latin American and Caribbean enterprises engaged in sustainable development can do so in order to secure a competitive advantage [1], either by the company's ability to create a first mover advantage and/or by their ability to establishing barriers to entry. This in particular makes sense for global energy companies operating the Latin American and Caribbean region. It becomes a less well understood rationale for companies from the region, or that operate exclusively in the region.

An Overview of Energy Energy and Economic Development In the LAC Region

Many would argue that industrial development reflective of modern globalization is motivated strictly on the basis of an economic rationale particularly in developing countries, and that it occurs at the detriment of environmental management and social development. According to this exploitation view the economic motive is the only compelling motivation for international as well as local private sector involvement in developing countries in Latin America and the Caribbean and that social development, education and health concerns are not significant factors in their decision making.

Energy development is critical to economic development in the region and is necessary to ensure economic, social and political stability in the region. Energy is required for industrialization and economic development, and it is only through industrialization and economic development that social and political development can occur. Whether or not one agrees with a neo-liberal development philosophy, it is the dominant economic philosophy today, supported by the industrialized countries, and reinforced by the financing policies of the international funding agencies such as the World Bank and the Inter-American Development Bank. The reality is that health, clean water, food, education and many of other aspects of social welfare cannot be improved unless modern energy is available to all people including the developing countries in the Latin American Region [17].

Energy resources are plentiful and do not represent a limiting factor in global economic growth. Unfortunately, these energy resources are neither equally shared nor capable for development regionally. Energy poverty results when there is a mismatch between energy demand, energy production and affordable energy availability.

Energy exploration and development can be very consistent with a corporate social responsible, sustainable development agenda, but whether or not it is, depends on the process uses to explore, extract, transport and market the energy. Discovering, developing and exploiting energy that will be necessary to sustain the current rates of global economic growth is no longer seen as an immediate challenge [18]. The challenge is one of ensuring that there is greater equity in these resources, and that their regional endowment and the pace at which they are developed and distributed are more reflective of the needs of the developing countries and this is particularly true for the countries in the LAC region.

There is a need for balance in access to energy development in order to reduce the political and social instability within the developing countries in the Americas. Providing them with greater accessibility to reliable and affordable energy is a critical challenge for the advocates of globalization and neo-liberal economic development strategies.

The relationship between energy development and sustainable development is poignantly demonstrated by the fact that most health damaging pollution occurs from an inappropriate use of energy, and with greater urbanization comes greater concentrations of pollution. This is clearly demonstrated in Lima, Mexico City, Sao Paulo and Santiago, who have to face the consequences of urban population growth, economic development, burgeoning transportation needs and energy produced environmental pollution. These critical urban field sites demonstrate the sustainability challenge of eradicating environmental pollution through cleaner technologies starting at the local level.

The World Energy Council (WEC), a global industry based organization with headquarters in London, believes that economic and social policies that focus solely on equitable income distribution are not the most effective way to help the poor [18]. What is advocated is the need for greater international cooperation between developing and industrialized countries through sustainable development principles as a more effective way of addressing poverty. According to the WEC, to make energy more affordable for the poor, governments should accept responsibility to absorb some of the costs required, development more effective policies and organizational mechanisms and focus on improved education and capacity development

Poverty, social development, health, education and environmental needs of the Latin America region depend upon equitable and affordable access to energy. In order to assure this access, sustainable energy must be reliable and based on a diverse energy profile. Sustainable energy development can easily become the vehicle for energy development in the region and in order to be acceptable, address the environmental concerns such as pollution and climate change that are directly related to energy development and use.

Sustainable Development In Latin America

There is not universal agreement on what sustainable development means or even what constitutes sustainability. Some view it as the achievement of a balance between Nature and Man, while others consider it as achieving a balance between Man today and Man tomorrow.

The starting point for any definition of sustainable development comes from the Brundtlands Commission's definition [16].

> "Sustainable Development is development that meets the needs of present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts:
>
> - The concept of 'needs', in particular the essential needs of the world's poor, to which overriding priority should be given: and
> - The idea of limitations imposed by the state of technology and social organization on the environment's ability to meet present and future needs.
>
> Thus the goals of economic and social development must be defined in terms of sustainability in all countries – developed or developing, market-oriented or centrally planned. Interpretations will vary, but must share certain general features and must flow from a consensus on the basic concept of sustainable development and on a broad strategic framework for achieving it.
>
> Development involves a progressive transformation of economy and society. A development path that is sustainable in a physical sense. …but cannot be secured unless development policies pay attention to such considerations as changes in access to resources and in the distribution of costs and benefits…implies a concern for social equity between generations, a concern that must be logically extended to equity within each generation."

Although this represents a generally agreed to definition, it does raise questions as to what constitutes equity to meet the needs of present generations, as well as what type of management of the environment will ensure that future generations will be able to meet their needs. It has also been accused as reflecting a developed country, northern hemisphere perspective, and not reflective of the needs and interests of developing countries particularly in the Americas.

The Development and Environment Commission of Latin America and the Caribbean, defines sustainable development as " a development that distributes more equitably the benefits of economic progress, protects the national and world environment for the benefit of future generations and generally improves the quality of life" [3]. The regional view of sustainable development is development that is more equitable, economically and socially, and redefines economic equity in terms of access to work as well as in income distribution.

At the UN sponsored conference on the environment and development in Santa Cruz de la Sierra, Bolivia in 1996 that followed up the previous 1991 conference in Rio, the concept of sustainable development was "Latin Americanized." According the declaration that came out of the conference, Latin American and the Caribbean need an action plan to deal with poverty, environmental issues, capacity building, as well as with their pressing social problems. The proposed action plan for sustainable development should include the promotion and support of cooperation and partnerships among countries, national and local institutions, the private sector, NGO.s and indigenous communities. Environmental and social conflicts between corporations and local stakeholders and NGO's can be very costly and embarrassing to international companies. From a corporate strategy perspective, especially as it relates to the development of resource based industries in the LAC region, the presence of strong, diverse and often conflicting stakeholders (i.e. political elites, bureaucrats, academics, Marxists, indigenous communities, labor unions, local and international NGO's, guerrilla groups etc.) can often be ameliorated through a sustainable development process and socially responsible initiatives.

The Declaration of Santa Cruz on sustainable development called on developing countries to pursue technology transfer and capacity building in order to achieve sustainable development in the region.

"We recognize the important role played by market-based mechanisms and will promote opportunities for technology transfer through training and cooperative work programs and through improved access to source information. In addition, we will strengthen national scientific and technological capabilities, complemented by international cooperation." [4].

According to the Latin American Energy Organization [9], people development should be the target and ultimate objective of development and therefore becomes the key component of sustainability. [9]. This concept of human development comes from the United Nations Development Programme [15], which views it as:

> "the process of enlarging the range of options of persons, providing them with greater opportunities for education, medical care, income and employment, and covering the full spectrum of human options, from good physical environmental conditions to economic and political freedom" [15, p. 18].

What the UNDP view proposes, reflective of its Latin American and Caribbean origin, is that sustainable development has four critical components:

- An economic focus on job creation as well as on building higher incomes.
- A social component reflective of the importance of improving education and health
- An environmental focus resulting form good physical environmental conditions,
- A political dimension based on democracy, political freedom and a civil society.

It is the later dimension that differentiates a Canadian or American perspective of sustainable development from that held in Latin America. We take democracy, political freedom and stability and a civil society as givens and focus sustainable development initiatives that are tri-dimensional (economically, socially and environmentally responsible). In Latin America, the State plays a much more active role in energy development. The State has historically controlled private sector involvement in the energy sector, and in spite of extensive privatization in the sector in the past ten years, continues to be actively involved. Neo-liberal reform has been adopted or imposed, depending on one's political agenda, throughout Latin America. Nevertheless, there is a legacy of economic exploitation and social abuse, by the private sector, often by international companies, that continue to influence State policy makers in Latin America.

A key component for energy companies operating in Latin America and the Caribbean is a committed to corporate social responsibility and sustainable development is their recognition of the important of process and the adoption of consultative processes for defining what they can do. Sustainable development implies consultation with stakeholders and their involvement in the sustainability decision-making.

Some other important components of an acceptable definition of sustainable development in the LAC Region, include that it is accompanied by development that is related to time – sustainable development has a long-term focus, and is not just immediate and short term oriented. A second requirement of sustainable development is that it has a global rather than local perspective reflective of a company's recognition of the wider impacts of their activities and the cumulative effects that they might produce. Decision-makers in sustainably focused operations develop proactive strategies to reduce future uncertainties in their energy development, rather than on reactive strategies that focus on compensatory actions (i.e. pay the fines that are levied, or take remedial action only when forced to do so). Finally, sustainable development adoption by globally oriented enterprises reflects their concern for their international image and reputation.

Sustainable development as a process, an approach to activity, rather than an end or result requires an integrative, systematic and system-wide view of the way an enterprise approaches its activities. It should not be a stand-alone action or activity, but prevail throughout the organization's planning and development strategies. It is a paradigm; a particular way of thinking and acting that requires policy and decision makers to incorporate social and environmental considerations along with their economic realities. It reflects' an organization's goal to succeed economically using technologies and processes that are compatible with the environment (environmentally friendly), and that are socially responsible. It also reflects a commitment to a consultative decision process in identifying sustainable development initiatives.

Industrial Development, Sustainable Development and Latin America (the Case of Energy Development)

Some basic features of industrial development and its relationship to economic development in Latin America are:

- Industrial development that produces an affordable, modern energy supply and more efficient end-use technologies are needed, but they are not yet accessible to the majority of people in Latin America.
- This lack of availability constrains the developing countries in Latin America opportunities for economic development and improved standards of living.
- There exist wide disparities in access to industrial development and the positive impacts it has on communities in the LAC region.
- Industrial development in the Region is inequitable and often runs counter to the concept of human development and threatens social stability in the region (growth in poverty in rural areas, increased urbanization, and the breaking up of families).
- Unreliable energy supply is a economic burden for a large portion of the region's population (e.g. the prevalence of power brown outs) and the dependence on imported fuels leave many Latin America countries vulnerable to disruptions in supply
- Human health is threatened by high levels of pollution resulting from industrial development that affects the local community and region.
- The environmental impact of a number of industrial-linked emissions including suspended fine particulates is precursors of acid deposition and contributes to air pollution and environmental degradation.
- Emissions of anthropogenic GHG mostly from the production and use of energy are altering the atmosphere in ways that may already be having a discernable influence on the global climate.

Finding ways to expand industrial development while addressing the environmental impacts associated with it represents a critical global challenge in the 21st Century, and especially in Latin America. In most low-income developing countries in Latin America, a small affluent minority uses various forms of commercial energy in much the same way as do most people in the industrialized world. However, most people in these countries rely on traditional, non-commercial sources of energy that use inefficient technologies (i.e. wood burning heat, bio mass and animal transportation).

Another challenge - the amount of additional energy required to provide energy in the future will depend on the efficiencies with which energy is produced, delivered and used, as industrialization proceeds and incomes rise so will energy consumption in Latin America. This will require sustainable development strategies that will include technology transfer and diffusion, and the establishment and support of energy efficiency improvements. Technology leapfrogging to the use of highly efficient appliances, machines and processes, vehicles and transportation systems in Latin America is a critical sustainability opportunity and challenge.

Energy price influences consumer choices and behaviours and can affect economic development and growth. High-energy prices increase the impact on energy costs with adverse consequences on business, employment and social welfare. On the other hand, high prices can stimulate exploration, energy development, and the use of more environmentally respectful alternative energy projects, innovation and energy efficiency. Capital investment is a prerequisite for energy development including the funding of plants, equipment and energy system's infrastructure. Difficulties in attracting capital for energy investment may impede economic development, especially in Latin America. Scarce public funds in developing countries are needed for many projects including rural development, education, health care and social service and usually get diverted from sustainable energy development.

The private sector is seen as the source of essential development funding (e.g. Ecuador's second pipeline and Mexico's gas development and transportation projects), yet private funding doesn't flow freely into developing countries due to a variety of reasons, but especially the risk to investors.

Energy, Sustainability and Social Development in Latin America

The discovery, development and use of energy are closely related to a range of social issues including poverty alleviation, population growth, employment, education and urbanization. Although these issues effect energy demand and availability, the relationship is two-way: the quality and quantity of energy services, and how they are discovered, exploited and transported, have an effect on social issues as well.

Poverty is an overriding social condition affecting the developing countries of Latin America. In the past ten years, the differences between the haves and have-nots in Latin America have deepened. The energy consumption patterns of the poor, especially their reliance on traditional fuels in rural areas, tend to keep them impoverished. The poor people in Latin America are without access to reliable, affordable energy, and continue to use unhealthy solid fuels for cooking.

Lack of electricity usually results in inadequate illumination and few labour-saving appliances in the home, as well as limited telecommunications and possibilities for commercial enterprise. In Brazil, a UN study found that the primary energy demand for various fuels was a function of income levels [14]. Convenient, affordable and reliable energy can contribute to a household's productivity and income generating potential and allow for breaking out of the cycle of poverty.

Although population growth tends to increase energy demand, the availability of adequate energy can lower birth rates. Adequate energy services can shift the relative benefits and costs of fertility and result in the lowering of family births. Low mortality and fertility rates can result from the availability of low-cost, reliable energy.

Urbanization is a critical social issue in the region. The two largest cities in the world are in Latin America. There is a progressive shift of the poor from rural to urban areas where energy supply and usage problems are totally different. Urban poor cannot rely on biomass and must depend on transformed biomass (charcoal), along with fossil fuels and electricity when available and affordable to meet their energy needs. Better energy availability in rural areas will potentially slow migration and reduce the pressure on rapidly growing cities in the region. Also, through improved land-use planning, infrastructures, construction standards and transportation systems, energy demand that results from rapid urbanization can be more effectively managed.

Eradicating poverty in Latin America is a long-term goal even under ideal economic and social scenarios, but providing the poor with affordable and reliable energy could dramatically improve living standards and offer more opportunities for employment and economic development. Satisfying the energy needs of the poor as an integral part of a sustainable development agenda including through the use of modern technologies has the potential to improve standards of living and health, and to create new jobs and business opportunities.

Making commercial energy more widely available to the region and thereby improving the economic and social environment of the poor, also has the important political aspects required of sustainable development in Latin America. The wave of democratization that swept across Latin America in the last 10 years placed political power in the hands of the economically disenfranchised. Societies with great inequities and disparities tend to be unstable, and large populations below the poverty line provide the breeding grounds for social upheavals.

Sustainable Development, Environment and Health

Industrial development creates pollution and directly affects public health. We increasingly recognize that this link is regional and global. Although industry's potential for improving the population's well being is obvious, conventional production and consumption are closely linked to environmental degradation. This degradation threatens human health and quality of life in the short term, and over the long term, effects our ecology and biodiversity as well as produce climate change through the production of green house gases. Poor air quality produced by the development and use of conventional energy is associated with increased sickness and premature death. Particulate matter (which is both emitted directly and formed in the air as a result of the emissions of sulphur dioxide and nitrous oxide) and hydrocarbons are global concerns, and particularly of concern in developing countries where dirtier fuels predominate with little emissions control.

Other sources of development also have significant environmental and health impacts. Large hydropower projects often produce significant detrimental environmental impacts related to flooding. Nuclear energy raises serious health questions and waste disposal issues.

By definition, sustainable development must support both human and ecosystem health over the long term, which requires that industrial development and production in Latin America be approached in the same way as it is done in the industrialized countries. As prosperity in the region increases, there will be greater public demand for health and environmental protection. Potential sustainable development initiatives could include the replacement of solid fuels for cooking with more environmentally friendly gaseous or liquid fuels, which have been discovered and produced with more environmentally responsible technology.

Are sustainable futures possible in Latin America?

There are obvious sustainable development realities associated with industrial development in Latin America. They include:

- Continuing the current path of industrial development is unlikely to result in sustainable development. Environmental degradation and social equity is not necessarily the price that developing economies have to pay en route to a developed economy. This case, however, needs to be more strongly presented and defended in Latin America.
- Achieving sustainable futures will require more reliance on industrial efficiencies, renewable energy resources and advanced technology. This will lead to increasing investments in research and development.
- New technologies and technology transfer as called for in the Declaration of Santa Cruz, creates opportunities for both local as well as global companies in the industrialized countries as well as the developing countries of Latin America.

The barriers to the application of sustainable development as part of a strategic industrial development strategy in Latin America include:

- Lack of adequate information, technical knowledge and training
- Lack of adequate investment capital
- Short term planning focus
- Ignorance of the value of sustainable development
- Political and social uncertainties in the region which in turn limits investment and raises expectations for more immediate and higher financial returns
- Uncertainties regarding the returns on investments in new and energy-efficient technologies
- High costs (both real and perceived) of more efficient technologies
- Traditional behavioural patterns that resist energy efficiency efforts or environmentally responsible initiatives

Sustainable development in Latin America will require the acceleration of research and development of new technologies and their faster transfer to the region. At the rural level, innovative approaches to sustainable development include decentralised solutions, appropriate, cost effective technologies, innovative financing and incentives, and local participation in decision-making and education.

What is Required?

The challenge of sustainable development for Latin America will require a concerted effort on the part of international organizations, national governments, the industrial sector, civil society, the international and local energy public and private sector, and their clients and customers in the region. It will require the establishment of a facilitating framework, including market reforms, consistent and effective regulations, and proactive policies that encourage competition in the global energy market, reduce costs to users and protect social, political and environmental development. Obstacles to development and sustainability must be eliminated in order to encourage investments, greater energy efficiency and the development and diffusion of new sustainable technologies.

Affordable industrial development must be provided, but subsidies must be eliminated so that prices reflect market and investment becomes less risky.

The demand for affordable, reliable, sustainable development will continue to grow in Latin America, but hopefully through increasing efficiency, alternative development sources, utilizing more effective sustainable technology. As a result of the technological advances and greater understanding of impacts, the developing countries of Latin America and Caribbean are in a better position to address local and regional environmental problems at an earlier stage of development than industrialized countries did. By addressing these negative externalities of development and use early on, countries in the region should find their economic and social prospects improve.

According to the United Nation's "World Energy Assessment 2000," [14], sustainable industrial strategies require:

- Making markets work better through competition and by reducing market distortions.
- Restructuring the industrial sector and establishing mechanisms that favour sustainable technologies.
- Implementing policies and practises that stimulate investments in sustainable development
- Supporting and facilitating technological innovations in the sector
- Encouraging leadership and capacity building in developing countries; and
- Encouraging greater international cooperation and the development of a global strategy to support sustainable development and use.

Sustainable development can provide the solution to the problems associated with traditional industrial development and use in Latin America. Industrial development can be a powerful tool for sustainable development. Poverty, environmental degradation, inadequate health and education, social disruption and political instability in Latin America require attention particularly from those countries that share the hemisphere. Unless they are addressed, many of the opportunities now available will be lost, the possibilities of future generations diminished and the goals of sustainable development lost. The challenge we face in our business schools is to challenge our students and our stakeholders to recognize that in a global society, companies operating internationally should act as world citizens, and we should lead in the development and support of sustainable development in the developing countries such as Latin America and the Caribbean.

Sustainable development partnerships between developing and developed countries will provide access to the latest technologies, considerable financial resources, project management experience and human resource expertise, all of which will assist them in obtaining a unique competitive advantage.

There are four basic arguments used by companies when they adopt sustainable development decisions and initiate sustainable actions:

1. <u>The fear of regulation</u>. Companies are more afraid of the consequences of possible regulations that may be enacted than with the costs of the anticipated sustainable development initiatives envisioned. Positive action in advance of compulsory regulations will lesson the pressure to enact stricter environmental regulations.
2. <u>As a co-optation strategy</u>. Better to act economically, social and environmentally responsible from the beginning and thus avoid the need by regulators to impose rules and regulations that stipulate required action.
3. <u>Because other organizations (either competitors or mentors) are following a sustainable development agenda</u>. In some cases, sustainable development results from companies wishing to be local suppliers to international companies with a commitment to sustainable development or because the international funding agencies stipulate sustainable development as a requirement for local, regional or international contractors.
4. <u>Because they understand the long-term consequences</u> of not having sustainable development practises and policies. They already have an established record of corporate social responsibility.

Sustainable development is a process, an approach to activity, rather than an end or result. It requires an integrative, systematic and system-wide view of the way an enterprise approaches its activities. It should not be a stand-alone action or activity, but prevail throughout the organization's planning and development strategies. It is a paradigm; a particular way of thinking and acting that requires policy and decision makers to incorporate social and environmental considerations along with their economic realities. It reflects' an organization's goal to succeed economically using technologies and processes that are compatible with the environment (environmentally friendly), and that are socially responsible. It also reflects a commitment to a consultative decision process in identifying sustainable development initiatives.

Industrial development produced and used in ways that support human development over the long term in all its social, economic and environmental dimensions, is what meant by the term sustainable development. Developing countries need to adopt sustainable development principles as well, but in order to do so, must see the economic advantage, especially in the long term, along with the more obvious social and political responsibilities they have. The value of clean water, affordable and reliable sources of energy, improved health care, education, affordable housing and environmental protection must be obvious, and valued and the case made in terms of the economic and political tradeoffs that would be required.

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Differences in Labor Costs between Estonia and Finland as a Determinant for Relocation of Economic Activities

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Abstract

Current paper is analyzing the role of labor costs between Finland and Estonia on the foreign penetration rate in Estonian manufacturing industry. On the bases of results of the survey carried out by the authors among foreign investors, the importance of labor costs in determining the decision to invest into Estonian manufacturing industry is growing rapidly and market seeking motives are loosing their importance. The difference in wages between Finland and Estonia differs according to the branch of manufacturing industry from 4.6 to 8 times. It was impossible to establish statistically significant relationship between wage differences and foreign penetration rate in Estonian manufacturing industry between branches. As there exists generally high wage difference in all branches of manufacturing industry, one may conclude that other specific factors like availability of skilled labor, low transportation costs or access to local raw materials are affecting foreign penetration rate between branches more intensively.

Introduction

At the beginning of the transition process most of the foreign direct investments (FDIs) to the Central and Eastern European transition countries were primarily interested in entering to the new markets. The situation is changing now and the share of efficiency oriented foreign investors is increasing in transition countries. These investors are mostly interested in relatively low-cost labor force that is available in the Central and Eastern European countries. It is expected that enlargement of the European Union will decrease the cost differences between present member countries and new members of the EU and this will cause relocation of economic activities. However, the fact that member countries of the European Union are trying to restrict free movement of labor for several years, increases the possibility of relocation of economic activities.

As compared to other Central and Eastern European countries, Estonia has been quite competitive in attracting foreign direct investments. Most of the investments in Estonia have been made by foreign investors from Sweden and Finland. Previous studies [for example, Reiljan 2000] have shown that servicing of the local market is the most important motive also in the Estonian market. However, the share of efficiency-seeking investors is increasing and the main determinant for those investors has been labor costs.

The main aim of this paper is to analyze differences in labor costs between Estonia and Finland and the role of labor costs in foreign direct investment inflows to Estonia. Taking into consideration this aim, paper is divided into four parts:

- At first, theoretical foundations of the foreign direct investment movements between countries are presented.
- After this, the role of labor costs in determining foreign direct investment inflows to Estonia is discussed.
- Finally, existence of wage differences in manufacturing industries between Estonia and Finland and possible impact of these differences on the foreign direct investment flows and relocation of economic activities is analyzed.

FDI Determinants

FDI determinants can be systemized by dividing them into three groups – economic, political and other determinants. At least one additional dimension – the objective of foreign investor – should also be taken into account. Sometimes the need of considering the type of foreign investment (greenfield, acquisition, merger or joint venture), sector of investment (agriculture, services or manufacturing) and/or the size of investment (small or medium sized enterprises or large MNC) is also stressed [see for example World Investment Report 1998, pp. 90-91]. Nevertheless, the analysis of FDI determinants in this paper concentrates only on the different objectives of foreign investments.

Four groups of foreign investors have been distinguished in the literature considering their different strategic objectives [Brewer 1993, p. 4; Chudnovsky, Lopez 1997, p. 2; Dunning 1994, p. 36; Foreign Direct Investment 1998, p. 21; Oxelheim 1993, p. 180]:

1. market-seeking foreign investors concentrate on servicing the host country's (and its neighboring countries') market(s);
2. efficiency-seeking investors are interested in low-cost host countries and the production is exported to the home country of foreign direct investment and/or other target markets;
3. natural-resources-seeking investments are motivated by desire to reduce costs and provide access to raw materials;
4. strategic-assets-seeking foreign direct investments are orientated toward acquiring resources and capabilities that the investing firm believes will sustain or advance its core competencies in regional or global markets.

Although some FDI projects include elements of more than one of these strategic objectives, most projects are focussed on only one. Table 1 gives a short overview of the most important host country determinants of FDIs, taking into account differences in the foreign investor's strategic objectives.

Table 1: MAIN HOST COUNTRY FDI DETERMINANTS CONSIDERING THE FOREIGN INVESTOR'S STRATEGIC OBJECTIVE

STRATEGIC OBJECTIVE	**ECONOMIC DETERMINANTS**	**POLITICAL DETERMINANTS**	**OTHER DETERMINANTS**
Market-seeking FDI	• nominal GDP • GDP *per capita* • GDP growth rate • previous FDI • real wage • production costs • transport costs • infrastructure • tariffs and other import restrictions	• ownership policies • price controls • convertibility of foreign exchange • performance requirements • market access constraints • sector-specific controls	• geographical locations • cultural differences • different languages • population • local content requirement • country-specific customer preferences
Efficiency-seeking FDI	• inflation • exchange rate • real wage • savings rate • domestic investments • production costs • infrastructure • transportation costs • previous FDI	• market access constraints • ownership constraints • taxes/subsidies • price controls • performance requirements • foreign investment's incentives • trade agreements • requirements of environmental protection	• geographical loca- • tion • availability of suitable workforce • existence of suppliers

Natural-resources-seeking FDI	• prices of raw materials compared to world markets • infrastructure • transportation costs • domestic investments	• foreign investment's incentives • foreign investment's restrictions • sector-specific controls	• existence and quality of raw materials
Strategic-assets-seeking FDI	• existence and quality of infrastructure • intensity of R&D activities	• protection of immaterial property • foreign investment's incentives or restrictions in using the host country's resources • risk level • innovation policy	• existence of patents, trade marks, etc.

Source: Reiljan 2001, p. 1225.

Lankes and Venables [1996], and Lankes and Stern [1998] have noted that previous studies have shown predominance of market-seeking investors in the Central and Eastern European countries and factor-cost considerations have appeared to be of less importance for the majority of investments. A survey that was carried out by the EBRD [Lankes, Venables 1996] also showed predominance of market-seeking investments in these countries. At the same time, the authors pointed out that the type of FDI varies significantly, depending on the host country's progress in the economic transition. They found that FDI projects in the transitionally more advanced countries were more likely to be export-oriented, more integrated into their foreign parent's multinational production process, and more likely to exploit the comparative advantage of the host economy. The results of a multinomial logistic regression analysis [Lankes, Stern 1998, p. 7] suggest that market-seeking investors are interested in making use of first mover advantage, while efficiency-seeking investors postpone their projects until the risk level is acceptable to them.

A study by Meyer [1995] affirms that at the beginning of the transition process the local market of the Central and Eastern European countries was the primary motive for making foreign direct investments whereas factor costs had only a secondary role in investing into those markets. Meyer suggests that efficiency-seeking FDIs emerge only if the host country additionally offers an attractive local market. Marinov and Marinova [1999] and Pye [1997] have reached similar results: they say that the local market is the primary driving motive for investing into the Central European transition countries.

Several authors have analyzed the impact of labor costs on foreign direct investment movements between countries. Some researchers have suggested that importance of labor costs in choosing foreign direct investments' host country has decreased recently. Instead of this, foreign investors are more interested in availability of skilled labor [Oxelheim 1993, p. 182]. However, the level of labor costs is not insignificant but in addition to this the effectiveness of labor force is also taken account [Thoman 1973, p. 73; Veugelers 1991, p. 368; World Investment ... 1998, p. 108]. Both possibility to decrease labor costs and availability of skilled labor are among most important FDI determinants for efficiency-seeking foreign investors in choosing host country. At the same time, the impact of these factors is not so important for market-seeking investors. Of course, if we take into account that average wage reflects also the level of earnings and thus has an impact on the size of the potential market, the wage rate could be a significant FDI determinants also in the case of market-seeking foreign investors.

Empirical studies about labor costs as a determinant of foreign direct investments have given somehow contradictory results. For example, Dasgupta, Mody, Sinha [1995], Holland, Pain [1998a, 1998b], Liu, Song, Wei, Romilly [1997], Tu, Schive [1995] and Wang, Swain [1995] have found out that labor costs are significant determinant of foreign direct investments in developing and Central and Eastern European transition countries. But analyses by Barrell, Pain [1999], Guimaraes, Rolfe, Doupnik, Woodward [1997], Loree, Guisinger [1995], Mariotti, Piscitello [1995], Moore [1993] and Veugelers [1991] have shown the insignificance of labour costs in determining foreign investment inflows. These differences in results may come from the fact that foreign investors have different motives in investing to different countries and in some cases other factors (for example, size of a market) are more important than the level of labour costs. Other explanation for insignificance of labour costs in several empirical studies is that data about the wage level is used instead of unit labour costs. Furthermore, in addition to the labour costs, the availability of suitable labour should be taken into account.

Determinants of Foreign Direct Investments in Estonia

In 1997-2000 the Estonian Investment Agency and the Faculty of Economics and Business Administration of the University of Tartu carried out four surveys of foreign investors. 80-100 responses were received each year and all the biggest investors have been included in the sample. Some of the firms replied yearly and thus the sample consists of 185 different firms. Considering the field of activities and export performance, the firms have been divided into four different groups – market-seeking investors (65%), efficiency-seeking investors (18%), natural-resources-seeking investors (10%), and strategic-assets-seeking investors (7%).

Table 2 presents an overview of the main factors that have influenced decision to invest into Estonia taking into account the strategic objectives of foreign investors. As expected, the most important determinants for market-seeking investors are entry to the Estonian market and possibilities of market growth. At the same time, for other types of foreign investors entry to the Estonian market has no influence at all or has only moderate influence. In the case of Estonia which is a small market, it has to be taken into account that many investors do not define the market as only Estonia but also the other Baltic States and/or Northwest Russia.

Table 2. FACTORS THAT HAVE INFLUENCED INITIAL DECISION TO INVEST TO ESTONIA
(1 – NO INFLUENCE AT ALL ... 5 – A VERY STRONG INFLUENCE)

	Market-seeking	**Efficiency-seeking**	**Natural-resources-seeking**	**Strategic-assets-seeking**
entry to Estonian market	4.15	2.74	2.45	2.88
market potential of CIS countries	2.94	2.89	2.25	2.25
market potential of CEE countries	2.57	2.46	2.50	2.33
prospects of Estonia joining the EU	2.17	2.26	2.15	1.88
possibilities for market growth	4.12	3.22	2.60	3.44
political stability	3.40	3.34	3.58	3.31
competitors' activities	2.89	2.32	2.16	2.56
production costs	2.68	3.79	4.11	3.00
rapid economic reforms	3.31	3.32	3.11	3.63
free movement of capital	3.38	3.89	3.37	3.63
convertibility of Estonian currency	3.45	3.47	3.83	3.79

Source: Reiljan 2000, p. 605.

Production costs have had strong influence on the investment decisions in the case of efficiency- and natural-resources-seeking investments. The importance of this indicator has increased significantly during the years – average score of the importance of production costs was 2.37 in 1997 and 3.36 in 2000. There are at least two possible explanations. At first, the share of efficiency-seeking investors could have been increased. Secondly, as the instability in most of the Central and Eastern European transition countries have decreased, the importance of production costs in locating affiliates could have been increased. Of course, there could be a simultaneous effect of both reasons.

Free movement of capital is the second important determinant for efficiency-seeking foreign investments. The importance of this factor could be explained by the need of repatriate profits earned in Estonia and free movement of capital has made investing into Estonia relatively less complicated than into several other Central and Eastern European transition countries.

Convertibility of the Estonian currency, political stability, free movement of capital and rapid economic reforms are significant foreign direct investment determinants for strategic-assets-seeking and natural-resources-seeking investors. Estonia has a currency board system and exchange rate policy have been stable during all the transition years. Both economic and political stability and exchange rate system have influence on credibility and convertibility of the currency. In addition to stability, fixed exchange rate has created relative advantage for those investors who are producing in Estonia and are exporting their production. Importance of convertibility of the Estonian currency, political stability, free movement of capital and rapid economic reforms show that foreign investors are interested in economic and political stability, favorable operating conditions and speed of transformation process. In combination with the interest of entering to the new growing markets, the relative success of Estonia in attracting foreign direct investment inflows could be explained – investors have looked for the countries which have relatively low risk level but have good geographical location for servicing several other markets.

The potential of CIS and CEE markets is quite insignificant in the case of market-seeking investors. Unimportance of this determinant in the case of efficiency-, natural resources and strategic-assets-seeking investors could be explained by the fact that these firms have targeted their production to the European and other developed countries. In the case of the CIS markets, the explanation comes from the fact that Russia has discriminative tariffs for Estonian production and because of this the Estonian production is not competitive in CIS markets. It is not easy to compete in the Central European markets either – the most important disadvantage of Estonian products in these markets tends to be high price, which comes from the high transportation costs.

Access to the EU is one of the least motivating factors for foreign investors in investing to Estonia. This result is not surprising if we take into account the fact that most of the foreign direct investments into Estonia have been made by the enterprises of member states of the European Union who have already their production facilities and sales representatives in those markets. Besides of that, export of some products to the EU market is complicated due to the non-tariff barriers. Finally, relatively low importance of future EU membership as a foreign direct investment determinant in Estonia could also be explained by reasoning that those investors interested in exploiting the locational advantage of Estonia have not yet invested.

Foreign investors were also asked to evaluate the importance of different resources in choosing Estonia for the investment host country (see Table 3). According to the results of the surveys, the availability of skilled labour is the most important resource in choosing foreign investments' host country. As 83% of respondents are interested in servicing local market or increasing the efficiency, this result was expected. There are some differences in the evaluations of foreign investors with different strategic objectives. As expected, the most important determinant for market-seeking and efficiency-seeking investors is labour. In the case of resource-seeking foreign investors influence of the availability of raw materials on investment decision was very strong. Local resources have had only moderate influence on strategic-assets-seeking investors.

One of the Estonia’s shortcomings is that the country’s natural resources are quite limited and because of this the importance of other factors – for instance, labour costs – is higher. Taking this into consideration, one can expect that most of the investments coming into Estonia use relatively skilled and cheap labor and rely heavily on the Estonian developed physical and economic infrastructure. Many foreign firms (mainly from Finland and Sweden) are relocating the part of their production process that requires skilled or semiskilled labor to Estonia and shipping semi-finished products back to the home production base for completion of the production process. However, the size of Estonia sets limits here – there is a lack of skilled labour in some professions and this comes from the small size of the local workforce.

As a conclusion from the previous analysis different groups of foreign investors in Estonia could be characterized by following characteristics:

1) Market-seeking investors are orientated in servicing Estonian and also Latvian, Lithuanian, Russian and Ukrainian markets. The share of export in turnover is relatively small or they do not export at all. Some of these investments have made into Estonia for decreasing economic and political risks in servicing East European markets. This type of investors usually does not relocate their production from their home country to Estonia. In

the contrary, their production at home market is increasing due to the opening of new markets. In the later phases of the market entry, this type of investors quite often develop production facilities in Estonia in order to use location advantages (being close to the Latvian, Lithuanian and Russian markets).

Table 3. RESOURCES THAT HAVE INFLUENCED INITIAL DECISION TO INVEST TO ESTONIA
(1 – NO INFLUENCE AT ALL ... 5 – A VERY STRONG INFLUENCE)

	Market-seeking	**Efficiency-seeking**	**Natural-resources-seeking**	**Strategic-assets-seeking**
labour	3.72	4.16	3.84	3.19
availability of the required raw materials	2.32	2.84	4.60	2.31
banking sector	3.28	3.05	3.16	3.19
system of communications	3.33	3.37	3.16	3.00
internal transport network	2.73	3.18	2.84	2.63
Estonian ports	2.85	3.35	3.55	2.88

Source: Reiljan 2000, p. 606.

2) The main aim of efficiency-seeking investors is to use comparatively low production costs and qualified labour for servicing home market of parent companies and/or other markets of industrialized countries. A small part of their production could be marketed in Estonia or in the markets of other Central and East European transition countries. These investors are often big multinationals, which use global sourcing and production strategies in order to achieve global efficiency inside the multinational. Relocation of production of some intermediary products from the EU member countries to Estonia is characteristic for this type of investors. Typical examples of efficiency-seeking foreign investors in Estonian are textile industry, leather production, office machinery, and metal products manufacturers.
3) There are only a few natural resources in Estonia and thus the share of natural-resources-seeking investors is quite small. Most of these investments are made to the enterprises related to buying up and processing of wood. Another group of investors is using Estonian oil shale as a production factor in chemical industry. Third group of natural resource seeking investors is active in construction material production. A great share of the production of these firms is exported to the developed European countries. In general, this type of investors are opening new production facilities or buying existing firms in Estonia with the aim to guarantee raw material or semi-final products for their major production facilities at home. Therefore, relocation as a strategy is not the main objective for the natural-resources-seeking investors.
4) There are also some firms, which could be classified as strategic-assets-seeking ones. These are foreign investors interested in acquiring knowledge base and networks of infrastructure enterprises and almost all of these investments are related to privatization. In Estonia investments into oil shale based energetic system, ports, railway between Russia and Estonia, which is oil transit gateway from Russia to West, could be classified as strategic-assets-seeking ones.

Labour Costs as a FDI Motivator in Estonia

There are two main source countries of foreign direct investments in Estonia – Finland and Sweden. FDIs from Sweden form 37.6% and from Finland 28.7% of the foreign direct investment stock in Estonia. The shares of other countries are below 6%. [Direct Investment … 2001] Due to the lack of comparable data about labour costs in Sweden, the data of labour costs in manufacturing industries in Estonia and Finland is used in the further analysis. Moreover, in favor of this kind of approach is that the labour costs both in Sweden and Finland are significantly higher than the ones in Estonia (see Fig 1) and the labour costs in Finland and Sweden are relatively similar. Table 4 presents an overview of the changes that have been taken place in the wages in manufacturing industry in the three countries during 1993-1999.

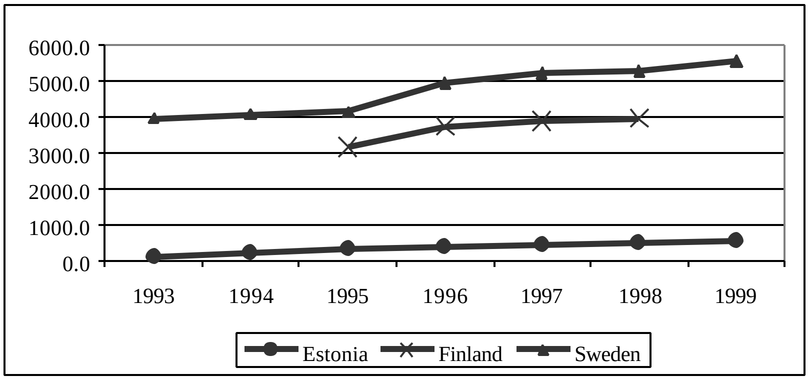

Fig 1: AVERAGE MONTHLY WAGE IN MANUFACTURING (DEM)
(the authors' calculations are based on the ILO Database 2001 and Average Monthly … 2001)

Table 4. CHANGES IN AVERAGE MONTHLY WAGE IN ESTONIA, FINLAND AND SWEDEN IN 1993-1999

	wage index (1993=100)							change as compared with last year (%)					
	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
Estonia	100	171.8	232.2	286.1	346.9	394.3	406.5	71.8	35.1	23.2	21.3	13.7	3.1
Finland										17.7	4.1	1.7	
Sweden	100	103.1	104.7	124.8	132	133.5	140.3	3.1	1.6	19.2	5.8	1.1	5.1

Source: The authors' calculations are based on the ILO Database 2001.

Estonia has chosen a very liberal wage policy in transition to a market economy. Above all it means that interference of government in wages of the business sector is negligible, limited to the establishment of minimum wages and adherence to the provisions of the wages law. The minimum wage established by government has increased from 450 kroons in 1995 up to 1250 kroons in 1999. Starting from 2001, the minimum wage is 1600 EEK (200 DEM). Remarkable is a very low starting level of wages in 1992, as the average wage 540 EEK was equal to 70 DEM only. During the following 8 years it has grown up to 4800 EEK in year 2000 (600 DEM). Over the period 1995-1998 the total rise in average pay was 78 per cent and CPI rise 48 percent. Therefore, increase in real wage was about 30 per cent during this period. As a result, labour has become more expensive, but it is still several times cheaper than in neighbouring high wage Scandinavian countries.

In comparing different production options, nominal wage has significant impact on foreign investors as it is indicating the actual costs of labour in target country. Therefore, comparative data about the nominal wages in branches of manufacturing industries in Finland and Estonia is presented in the Table 5. This table reveals that in 1998 the average wage of manufacturing industry in Finland was 7.5 times higher than in Estonia. There are significant wage differentials between the branches of manufacturing industry. The biggest difference between wages in Finland and Estonia in 1998 was in machinery and equipment (Finnish wages were 8.0 times higher than Estonian ones), followed by medical production (7.9 times), and radio, television and communication equipment (7.8 times). The smallest wage gap was in publishing (4.6 times), production of other non-metallic minerals (5.8 times) and leather production (6.1 times). Conclusion from the table is quite straightforward – wages in Estonian manufacturing industry are significantly lower than in Scandinavian countries and relocation of labour intensive stages of production processes has been an important strategic option in all branches of manufacturing industry. Foreign investors can easily pay higher wages in their Estonian affiliations and still achieve decrease in labour costs as compared with their home country.

Table 5: COMPARISON OF MONTHLY NOMINAL WAGES IN MANUFACTURING INDUSTRIES IN ESTONIA AND FINLAND*

ISIC Codes	Industries	Wage ratios (Finland/Estonia)			
		1995	1996	1997	1998
15	Food products, beverages	8.0	7.9	7.1	6.5
17	Textiles	10.3	10.1	8.2	7.6
18	Wearing apparel, dressing	8.4	8.4	7.0	6.7
19	Tanning and dressing of leather	8.2	8.1	6.5	6.1
20	Wood	10.5	9.5	8.2	7.2
21	Paper and paper products	10.0	8.4	7.7	7.2
22	Publishing, printing	7.8	7.2	6.1	4.6
23	Chemicals	12.7	10.9	9.6	9.8
25	Rubber and plastic	8.7	7.6	7.8	7.5
26	Other non-metallic minerals	9.8	9.0	7.2	5.8
28	Metal products	9.4	8.3	7.2	6.0
29	Machinery and equipment n.e.c.	11.5	10.9	9.7	8.0
30	Office, accounting and computing machinery	9.6	9.4	N/A	N/A
31	Electrical machinery and apparatus n.e.c.	9.5	8.8	7.4	6.4
32	Radio, television and communication equipment and apparatus	19.4	19.4	9.4	7.8
33	Medical, precision and optical instruments, watches and clocks	12.6	10.7	9.7	7.9
34,35	Motor vehicles and transport equipment	9.0	8.8	7.4	6.4
36	Furniture, manufacturing n.e.c.	9.3	9.1	7.4	6.6
37	Recycling	11.5	10.5	N/A	N/A
D	Manufacturing	10.2	9.7	8.4	7.5

Source: The authors' calculations are based on the ILO Database 2001.

* 16, 24, 27 – Estonia does not have these industries. In the case of sections 34-35, data of section 35 is used in the case of Finland.

Table 6 shows that foreign investors have actively used the possibility to relocate their activities to Estonia. In most of the industries, penetration rate have increased during the years 1995-1999. Only in the case of food products and textiles, a decrease in foreign investments' share has taken place. Correlation coefficient between wage ratios (Table 5) and FIEs' share in own capital of the enterprises (Table 6) is -0.0453 and this indicates that there is not significant relationship between indicators. One possible explanation for this result is that wage differences between Finland and Estonia are still very high and because of this direct relationships between FDI penetration rate and changes in wages does not exist. In the case of further decreases in wage differences in the future the relationship between these variables should become evident.

Table 6. FOREIGN DIRECT INVESTMENT'S PENETRATION RATE
IN ESTONIAN MANUFACTURING INDUSTRY (%)

ISIC Code	Industries	FIE-share in nominal capital				
		1995	**1996**	**1997**	**1998**	**1999**
15	Food products, beverages	39.7	30.3	27.8	26.4	26.7
17	Textiles	57.7	73.6	84.0	85.0	82.7
18	Wearing apparel, dressing	10.6	7.5	5.5	6.7	24.3
19	Tanning and dressing of leather	83.6	82.7	76.6	76.3	75.5
20	Wood	12.0	12.5	15.2	13.4	24.5
21	Paper and paper products	92.7	92.9	94.0	93.9	94.7
22	Publishing, printing	4.9	8.0	10.8	21.0	13.2
23	Chemicals and coke	61.9	61.2	50.8	51.5	67.7
25	Rubber and plastic	45.3	41.6	58.1	49.8	44.7
26	Other non-metallic minerals	82.4	79.4	76.4	78.4	87.3
28	Metals and products	11.0	27.4	20.2	11.9	14.0
29	Machinery and equipment n.e.c.	16.0	13.2	11.7	8.5	9.1
30-33	Office, electrical, radio and medical equipment	36.7	26.7	24.8	42.2	52.8
34, 35	Motor vehicles and transport equipment	5.7	13.1	29.3	29.5	33.0
36, 37	Furniture, others, recycling	11.5	20.3	15.2	8.4	22.6
D	Manufacturing	44.5	43.5	40.4	40.1	43.2

Source: The authors' calculations are based on the database of Estonian manufacturing enterprises.

* 16, 24, 27 – Estonia does not have these industries. In the case of sections 34-35, data of section 35 is used in the case of Finland.

Conclusion

Results of the analyses that were carried out in the paper suggested that the importance of labour is especially high in the case of efficiency-seeking foreign investors. During last years labour costs in manufacturing industries in Estonia have increased and therefore differences in labour costs between Estonia and Finland are smaller than at the beginning of the transformation period. However, differences in the labour costs are still high varying from 4.6 to 8 times between manufacturing industries. Thus, increase of the labour costs has not had significant impact on the relocation activities of Scandinavian industries. This was indicated by the fact that foreign direct investments' penetration rate in Estonia have increased during the whole period. Hereby, one may conclude that other specific factors like availability of skilled labour, low transportation costs or access to local raw materials are affecting foreign penetration rate between branches more intensively than labour costs.

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Eradication of Poverty and Economic Development Planning in Malaysia: Lessons to be Learnt

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Abstract

Poverty is a global problem irrespective of place and time. It exists whether in developed or developing countries. However the degree of seriousness may differ. Strategies and programs to tackle poverty produce diversified results. Nevertheless, poverty eradication in Malaysia is a rare case of successful story. This was possible only with the systematic management and economic development planning. Economic development planning in Malaysia started since 1956-1960 and 1961-1965 with First and Second Malaya Plan respectively. Since then, the five year period of economic planning continued with the First Malaysia Plan: 1966-1970 to the present Eight Malaysia Plan: 2001-2005. In addition, the first long-term economic development planning in Malaysia started with the launching of the First Outline Perspective Plan (OPP1): 1971-1990. It was later followed by the Second Outline Plan (OPP2): 1991-2000 and the Third Outline Perspective Plan (OPP3): 2001-2010.

Economic development planning within the period before 1970 has no direct policy with regards to poverty eradication. However, within the next two periods of OPP1 and OPP2 there was a clear and direct policy to eradicate poverty. Thus within the first two periods the incidence of poverty has changed remarkably. This is partly or probably due to the existence of the proper economic development planning. The success should not only be restricted to Malaysia but also possibly be extended to other developing countries.

This paper is divided into six sections. After the introduction the paper highlights the scenario of poverty in the world followed by poverty in Malaysia in third section. Section four evaluates poverty eradication in Malaysia which covers four phases based on time period, ranging from the period before 1970; OPP1: 1971-1990; OPP2: 1991-2000 and OPP3: 2001-2010. Before the paper is concluded section five discusses what can be learnt.

Introduction

The world, particularly developing countries have deep problem of poverty amid plenty, ever since the early history of mankind. However, the meanings and levels of poverty differ to different localities. Those who are considered as poor in developed countries may not be in the same category in developing countries. Instead the poor in developed countries may comparatively be better off compared to those who are considered as poor in developing countries.

To combat poverty, economic development planning, strategies and programs have been implemented. The results also differ. However, the successful results seem to be less than those unsuccessful ones. In this respect, Malaysia belongs to the former category in combating poverty. Nevertheless, given different background and environment, can Malaysian experience be shared by other developing countries? Rie Makita, 1998 writes “it is impossible for a country to achieve economic growth by copying an approach adopted by another country” (Rie Makita, 1998, p.247). However, Rie Makita 1998 in his study suggest that “trough examining the rural development administration of the Malaysian government, it is possible to draw lessons applicable to less developed countries for their implementation of anti-poverty programs”. This is, therefore something worth considering.

Scenario of Poverty in the World

Poverty is a socio-economic problem that exists irrespective of place and time, let it be developed or developing countries. In general the number of people living in poverty hardly changed within 1987 and 1988. World Bank, 2001 mentions that there are large regional variations in performance. East Asia and Middle East and North Africa have reduced their numbers in poverty – East Asia dramatically so. But in all other regions the number of people living in less than $1 a day has risen. In South Asia, for example, the number of poor people rose over the decade, from 474 million to 522 million, even though the share of people in poverty fell from 45 percent to 40 percent. In Latin America and the Caribbean the number of poor people rose by about 20 percent. Two regions fared particularly badly. In Europe and Central Asia the number in poverty soared from 1.1 million to 24 million. In Sub-Saharan Africa the number of poor people increased from an already 217 million to 291 million over the same period, leaving almost half the residents of that continent poor (World Bank, 2001, pp. 22-23).

Traditionally the problem of poverty is more severe in Developing Countries as indicated by table 1. In fact the problem of poverty is the problem of Developing Countries. However, South Korea, China and Malaysia recorded a lower rate of poverty of 16 percent, 9 percent and 5 percent respectively in 1995 lower than the rate of all Developing Countries of 31 percent.

Poverty Eradication in Malaysia

Since poverty is a multi-dimensional problem, therefore defining and thus eradicating poverty is not an easy task. Peter Townsend, 1985, defines poverty as "a lack of the resources required to participate in activities and to enjoy living standards that are customary or widely accepted in the society in which poverty is being measured". However, defining poverty is an unending process. This is because poverty is a socio-economic problem that can be seen from various perspectives, including social, politic, economic, as well as religious. There are at least two generally acceptable concept of poverty: absolute and relative poverty.

Absolute Poverty

According to Michael P. Todaro, 1998 "absolute poverty is meant to represent a specific minimum level of income needed to satisfy the basic physical needs of food, clothing, and shelter in order to ensure continued survival. A problem, however, arises when one recognizes that these minimum subsistence levels will vary from country to country and region-to-region, reflecting different physiological as well as social and economic requirements. Economists have therefore tended to make conservative estimates to world poverty in order to avoid unsubstantiated exaggeration of the problem. One common methodology has been to establish an international poverty line at, say a constant U.S. $370 (based, for example, on the value of the 1985 dollar) and then attempt to estimate the purchasing power equivalent of the sum of money in terms of a developing country's own currency" (Michael P. Todaro, 1998, p. 43). In Malaysia absolute poverty is measured using Poverty Line Income, which will be updated annually to reflect changes in the levels of prices by taking into account changes in the Consumer Price Indices. Malaysia, 1991 explains that: "Absolute Poverty in the country is measured on the basis of a poverty line income (PLI). The PLI takes into account the minimum requirements for food, clothing and shelter, and other regular expenditures that are necessary to maintain a household in decent standards of living. Using the PLI, the incidence of poverty is directly estimated by observing the number of households whose incomes are below the PLI. For 1990, the poverty line was $370.00 per month for a household size of 5.1 in Peninsular Malaysia, $544 for a household size of 5.4 in Sabah and $452 for a household size of 5.2 in Sarawak"(Malaysia, 1991, p.100). Table 2 shows the different levels of PLI applied in Malaysia.

Relative Poverty

Absolute poverty is normally referred to as subsistence concept. On the other hand the relative poverty is an inequality concept. Gini Coefficient and the percentage share of income by population groups are the two commonly used measurements to determine relative poverty as presented in table 3. However, it is not that easy to differentiate the two. This is because one is normally applied to explain the other. As mentioned earlier absolute poverty usually refers to a certain level of consumption necessary to maintain a descent minimum standard of living. In addition, other socio-economic indicators such as health, water supply, clothing, and income are considered to be the common denominator to decide whether an individual or household is poor or non-poor. Once a generally accepted standard of income is determined this is used for analysis. The analysis cannot be but a comparison between individuals, families or households, states or even other groupings at national or international levels. Thus it is only possible to analyze something in relation to something else. In this case, individuals, families or households or states or countries are said to be poorer or richer in relation to each other. The absolute concept of poverty is therefore used to explain the situation in a relative form i.e., relative poverty. However, Malaysia, 1986 suggests that the notion of relative poverty is a hybrid one as it captures some aspects of both absolute poverty and income inequality (Malaysia, 1986, p. 82).

An Evaluation of Poverty Eradication in Malaysia

Poverty eradication in Malaysia can be divided into four main phases, namely:

1. The Period Before 1970
2. The New Economic Policy: 1971-1990
3. The National Development Policy: 1991-2000
4. The National Vision Policy: 2001-2010

The Period Before 1970

The period before 1970 involved three five year development planning i.e. First Malaya Plan: 1956-1960; Second Malaya Plan: 1961-1965; and First Malaysia Plan: 1966-1970. Within the period before 1970s poverty was the way of life in Malaysia. This was attributed to the high rate of unemployment and underemployment, and the poor were normally engaged in low income and low productivity occupations in agriculture and services (Malaysia, 1973, p.5). The emphasis during the same period was on the primary products, rubber and tin. There was no direct policy towards poverty eradication. Instead there were Rural Economic Development Program and Integrated Rural Development Program with the sole objective to develop the rural areas. The former emphasizes on the development of infrastructure and the creation of institutions and organization for the smooth and efficient implementation of rural development projects. On the other hand the latter concentrates on a more integrated and comprehensive program including agricultural, socio-economic and institutional development. Through the implementation of various projects, economic and infrastructure such as drainage and irrigation, rural roads, community centers, hospitals, schools, water, electricity have been provided in a more coordinated and integrated manner by various government development agencies. Therefore, due to the serious efforts introduced by the government the number and rate of poverty have reduced.

The New Economic Policy: 1971-1990

The New Economic Policy was the First Outline Perspective Plan within a time span of 20 years from 1971 to 1990. The outbreak of bloody racial clashes on May 13th, 1969, gave the people and government of Malaysia a chance to pause, ponder, investigate and ultimately discover solutions to the socio-economic problems of the country. It is generally accepted that the main reasons for the incidence of May 13th, 1969, were linked to socio-economic imbalance (Chamhuri Siwar, 1988), (Mohd. Yusoff Kasim, 1988, p.8). However, some scholars believe that dissatisfaction with the government policies among the races led to the outbreak of the racial clashes (Zakaria, 1983). The Malays who are considered to be the *Bumiputra*[i] (son of the soil), were economically backward (Malaysia, 1971), whereas the Chinese who were the immigrants to help the colonial power, exploited the riches of tin ore in the country and became the masters of the economic activities of the country.

On the other hand, the Indians monopolized the estate sector of the rubber industry. Thus, there was created a multi-racial Malaysian society that can be identified in terms of various economic functions: the Chinese in commerce and industry; the Indians in the estate sector; and the Malays were left behind in the traditional agricultural sector. This is still a reality. This created jealousy and hatred among the Malays. At the same time, the immigrant Chinese and Indians felt superior to the Malays. Besides economic power the Chinese and Indians gained political strength, partly due to the political compromise amongst the Malays to gain independence from the British. This resulted in the emergence of a social disequilibrium. In order to correct the socio-economic imbalance and to guarantee economic justice, the New Economic Policy (NEP) 1971-1990 was introduced.

To address the above problems the NEP (1971 -1990), which was launched in 1970, has as its overriding objectives the promotion of National Unity through two-pronged strategies of :

> "(a) eradicating poverty by raising income levels and increasing employment opportunities for all Malaysians, irrespective of race. This is to be achieved by programs aimed at raising the productivity and income of those in low productivity occupations, the expansion of opportunities for inter-sector movements from low productivity to higher productivity activities and the provision of a wide range of social services especially designed to raise the living standards of the low-income groups.

(b) accelerating the process of restructuring Malaysian society to correct economic imbalance, so as to reduce and eventually eliminate the identification of race with economic function. Programs for this purpose include the modernization of rural life, the rapid and balanced development of urban activities, the establishment of new growth centers and the creation of a Malay commercial and industrial community in all categories and at all levels of operation. The objective is to ensure that the Malays and other indigenous people will become full partners in all aspects of the economic life of the nation" (Malaysia, 1973, p.1).

Malaysia (1971) provided further information concerning the policies and programs under the Plan, which bear more heavily on the objective of the eradication of poverty and were to be directed at:

"(i) Increasing the productivity and income of those in low productivity occupations through the adoption of modern techniques and better use of facilities. Measures for this purpose include programs for double cropping, off-season and inter-cropping, drainage and irrigation, improved marketing and credit, and financial and technical assistance to small-scale businesses and industries.

(ii) Increasing opportunities for inter-sector movements from low productivity to higher productivity activities in new land development schemes, modern fishing and forestry projects and in commerce, industry and modern services; also, the provision of financial and technical assistance, education and training opportunities and the necessary organizational arrangements to facilitate movements into these modern sectors.

(iii) Providing a wide range of free or subsidized social services especially designed to raise the living standards of the low-income groups. Such services include public housing products, subsidized rates for electricity, water and transportation, health and medical services, improved educational opportunities and increased recreational and community facilities" (Malaysia, 1971, p. 4).

The second prong of the New Economic Policy is aimed at accelerating the process of restructuring Malaysian society through reducing existing imbalances in income, employment and the ownership and management of productive assets in the economy.

The OPP1, known as NEP: 1971-1990 was first launched through the 2MP (1971-1975), which represented a new strategy in which national priorities were re-ordered and efforts intensified to deal with the economic and social problems confronting the country.

In addition, development planning in Malaysia proved to be indispensable from economic growth. The NEP was to be implemented in the context of rapid economic expansion (Malaysia, 1991, p. 3). It must further be emphasized that development planning in Malaysia is guided by the objectives of NEP which seek to promote rapid and sustained growth in an environment of social justice and stability (Malaysia, 1991, p. 63). It was evident that within the period of 1971–1990 the number and the rate of poverty in Malaysia have reduced tremendously. This can be deduced from table 4. In Peninsular Malaysia the poor has been reduced remarkably from 49.3 percent representing 791,8000 households in 1971 to 15 percent representing 448,900 households in 1990. As mentioned earlier, the NEP was the first Outline Perspective Plan: (1971-1990) for long term economic development planning in Malaysia. It was a unique experience since Malaysia, within a span of only 20 years, succeeded remarkably well not only in achieving growth, but also in addressing more effectively the problems of poverty and economic imbalance (Malaysia, 1991, p. 8).

World Bank, 1990 reports that: "In Malaysia investing in the poor contributed to rapid growth, with some improvement in a fairly unequal distribution of income and a decrease in poverty of 23 percentage points between 1973 and 1987. By investing in the human capital of the poor and providing an environment in which new skills could be productively used, Malaysia improved both the short-run welfare of the poor and the prospect for raising incomes in the medium term" (World Bank, 1990, p.50).

The National Development Policy: 1991-2000

The National Development Policy (NDP) was the Second Outline Perspective Plan covering 10 years. The incidence of poverty in Malaysia was further reduced from 16.5 per cent in 1990 to 7.5 percent in 1999 (Malaysia, 1999, p. 57). The rate of poverty in 1999 was higher than expected due to the adverse effect of economic recession in 1997. The traditional pattern of poverty in rural and urban sectors remains the same, where it was as high as 19.3 percent for the former and 7.3 percent for the latter in 1990. However, in 1999 it was reduced from 12.4 percent to 3.4 percent for the urban and rural sectors respectively. At the same time, the absolute number of poor households also decreased from 448,900 households in 1990 to 351,100 in 1999. The success of government policies and strategies to reduce poverty within the NEP has shifted the policy from the poor to the hardcore poor. During the second OPP or NDP special attention was given to this poverty group so as to provide them not only with income generating programs but also other basic utilities such as piped water, electricity supply, rural health centers, clinics and so on. With the commitment to development objectives, strategies, programs, as well as their implementation, the incidence of hard-core poverty was reduced to as low as 1.4 percent representing 64,100 households in 1999.

The National Vision Policy: 2001-2010

The Third Outline Perspective Plan: 2001-2010 is alternatively known as National Vision Plan. The first Five Year Plan of OPP3 is the Eight Malaysia Plan: 2001-2005. Malaysia 2001 reaffirms that "during the Eight Plan period, the thrust of poverty eradication will be to reorientate poverty eradication programs to reduce the incidence of poverty to 0.5 percent by 2005. Poverty eradication programs will be more target-specific by addressing pockets of poverty, particularly in remote areas. In addition, the respective programs will also address the issue of poverty between the *Orang Asli* and other Bumpier in Sabah and Sarawak. A study on the profile of the poor and hardcore poor will be undertaken to facilitate the implementation of target-specific anti-poverty programs (Malaysia, 2001, p. 73). During the Plan also, the key strategies to enable the achievement of the distributional objectives will be focused towards intensifying efforts to improve the quality of life, especially the rural areas by upgrading the quality of basic amenities, housing, health, recreation and educational facilities.

The Malaysian Prime Minister, Dato`Seri Dr. Mahadhir b. Mohammad, has declared in his speech `Malaysia - the way forward' that the ultimate objective that we should aim for is a Malaysia that is a fully developed country by the year 2020 (Malaysia, 1991, p. 21). This is now known as `The Vision of 2020'. Acknowledging that the present developed nations have their own strengths and weaknesses, to achieve the ultimate objective of being a fully developed nation by the year 2020, Malaysia should not duplicate any of them. Malaysia should be a developed country in her own mould. The fully developed country by the year 2020 is defined as:

> "a united nation, with a confident Malaysian society, infused by strong moral and ethical values, living in a society that is democratic, liberal and tolerant, caring, economically just and equitable, progressive and prosperous, and in full possession of an economy that is competitive, dynamic, robust and resilient." (Malaysia, 1991, p. 21-22).

A fully developed Malaysia will only be possible when the Malaysians finally manage to overcome nine central strategic challenges, one of which is the challenge of ensuring an economically just society. This is a society in which there is a fair and equitable distribution of wealth of the nation. Equity participation of the Bumiputera has improved from 1.5 percent in 1969 to 19.1 percent in 1999 as indicated in table 5.

There are many approaches towards eradication of poverty practiced around the world. The basic principle is to attack and improve the root problems that seed poverty, i.e. education and skills, technology, usage of resources especially land, mobilization of capital, infrastructure, and government policy and practice. Malaysia, 1973 stresses, "in the effort to eradicate poverty, the objective is not only to increase income but also to ensure that the poor have access to such basic needs as adequate nutrition, health, housing, education and transportation. More important, the Government seeks to cultivate the spirit of self-reliance and a positive attitude among the people to actively participate in the whole range of socio-economic development programs and improve their levels of living and that of generations to come."(Malaysia, 1973, p. 2). During the Third Outline Perspective Plan: 2001-2010 particularly within the period of Eight Malaysia Plan: 2001-2005 programs to eradicate poverty has become more integrated. Eight Malaysia plan: 2001-2005 states that: "during the Plan period, the thrust of poverty eradication will be directed towards reducing the incidence of absolute poverty to 0.5 per cent by 2005. The rapid economic growth that is anticipated during the plan period is expected to generate more opportunities for the poor to further increase their income and move out of poverty. In addition, the Development Program for the Hardcore Poor {*Program Pembangunan Rakyat Termiskin* (PPRT)} and other anti-poverty programs will be consolidated under the Scheme for the Development of the People's Well-being {*Skim Pembangunan Kesejahteraan Rakyat* (SPKR)}. The SPKR will be implemented as an integrated package encompassing economic, social and physical components, targeted towards eradicating poverty in areas and among groups with high incidence of poverty"(Malaysia, 2001, pp 9-10).

What Can Be Learnt

Michael P. Todaro, 1998 observes that " there are seven common economic characteristics of developing nations: Low standard of living, characterized by low incomes, high inequality, poor health, and inadequate education; low levels of productivity; high rates of population growth and dependency burdens, high and rising levels of unemployment and underemployment; substantial dependence on agricultural production and primary-product exports; prevalence of imperfect markets and limited information; and dominance, dependence and vulnerability in international relations" (Michael P. Todaro, 1998, p. 38). These characteristics were also true in Malaysia. But given committed political leadership and efficient economic management and planning Malaysia paves the way towards economic success.

Ataul Haq Pramanik, 1994 writes, "the achievement in growth has moved hand in hand with distributive justice. The incidence of poverty declined significantly as a result of high sustainable growth of 1970s and 1980s. Unlike many other countries particularly Latin America experiencing such a rapid growth, the inequality in income among the people classified either by income classes or racial groups instead of improving significantly worsened. The increasing higher standard of living enjoyed by the average Malaysian with one of the lowest inflationary rates in the world speaks in favor of prudent economic management as well as of committed political leadership"(Ataul Haq Pramanik, 1994, pp. 1-2). In addition Ataul haq Pramanik, 1994 continues that although the poverty eradication policy brought disaster for the poor in other developing countries, a determined effort in the difficult period of 1980s turned a faltering economy of Malaysia into a model of structural adjustment.

According to Ramon V. Navaratnam, 1997, Malaysia is a miracle because its success has been, to many observers and especially a lot of foreigners, unexpectedly outstanding. Today, Malaysia is regarded as a Newly Industrialized Country and one of the most successful developing countries. The success was attributed to among others the prudent economic management and planning.

Before 1970s there was no direct policy to combat poverty. However due to the intensive programs of rural development poverty has been reduced. Alternatively, during the second stage of economic development planning, policy towards poverty eradication was explicitly formulated. The success of the NEP to combat poverty has shifted the focus of anti poverty strategy towards eradication of hardcore poverty while at the same time reducing the relative poverty in the NDP. While incorporating the key strategies of NEP and NDP with respect of poverty and hardcore poverty eradication respectively, the NVP introduces the new dimension of addressing pockets of poverty in remote areas and among *Orang Asli* and Bumiputera minorities in Sabah and Sarawak as well as increasing the income and quality of life of those in the lowest 30 percent income category.

Economic development planning in any developing country could consider the following policy and strategies as practiced by Malaysia. They are:

1. There are two types of economic development planning in Malaysia i.e. a short-term five year plan followed by mid-term review and long-term plan of 10 to 20 years.
2. Taking into account the situational factors and the needs for economic development planning, any developing country can formulate her own mission, vision, objective, strategies and action plans to suit the country individually.
3. Poverty eradication needs to be integrated and multi-dimensional. The need to provide public utilities such as water, electricity, hospitals, schools and the like is as important as the need to encourage other economic activities so as to increase productivity and income levels. More attention needs to be given to industrial and services sectors as engine of growth without neglecting agricultural sector.
4. Ethical and environmental issues need to be given due attention to ensure sustainable development.
5. The establishments of marketing and financial institutions need to be facilitated by the government to ensure smooth process of economic activities.
6. The government needs to provide conducive environment to attract foreign investors.
7. Government needs to improve education system to produce, semi-skilled, skilled and professional workers to support other economic activities.
8. Objectives need to be more target-specific in order to combat poverty.

Conclusion

Taking into consideration that all countries in the world have their own distinct human as well as financial and natural resources no one country should duplicate any model from any country including Malaysia. Every developing country needs to combat poverty and thus achieve economic development in her own mould. However, in combating poverty all parties, individuals, organizations and government are jointly responsible. It should not be left to any one party in isolation without any effort to organize them. The government need to take responsibility to plan properly so that all parties can function effectively and efficiently to combat poverty. In addition, the success in combating poverty is more likely in an integrated approach involving ethical and material dimensions simultaneously.

Table 1:POPULATION BELOW THE POVERTY LINE IN SELECTED ASIAN COUNTRIES, 1995

Country	**Population 1995 (Millions)**	**Percentage of Population in Poverty**	**People in Poverty (Millions)**
Bangladesh	119.2	78	93.0
China	1,218.8	9	109.7
India	930.6	40	372.2
Indonesia	198.4	25	49.6
Malaysia	19.9	16	3.2
Nepal	22.6	60	13.6
Pakistan	129.7	28	36.3
Philippines	68.4	54	36.9
South Korea	44.9	5	2.2
Thailand	60.2	30	18.0
Asia (excluding Japan)	3,326.0	23	765.0
Latin America	481	39	187.6
Africa	720.0	54	388.8
All Developing Countries	4,533.0	31	1,405.2

Source: Michael P. Todaro, 1998, *Economic Development*, Table 5.6, p. 153.

Table 2:POVERTY LINE INCOME (PLI) 1970 TO 1999

	Peninsular Malaysia		**Sabah**		**Sarawak**	
	Household Size	**RM**	**Household Size**	**RM**	**Household Size**	**RM**
1970	5.4	180.00	-	-	-	-
1990	5.14	384.00	5.36	565.00	5.24	469.00
1999	4.6	510.00	4.9	685.00	4.8	584.00

Sources: Rie Makita, 1998, "Rural Development Administration for Poverty Eradication in Malaysia", in *OECF Journal of Development Assistance* Vol. 3, No. 2 (1998), Table 6, p. 253.

Malaysia, 2001, *Eight Malaysia Plan 2001-2005*, Table 3-2, p. 58.

Table 3: INCOME SHARE BY INCOME GROUP, 1970, 1990 AND1999

Income Share (%)	**1970**	**1990**	**1999**
Top 20 %	55.9	50.0	50.5
Middle 40 %	32.5	35.5	35.5
Bottom 40 %	11.6	14.5	14.0
Gini Coefficient	**0.5130**	**0.4421**	**0.4432**

Source: Jomo K.S., 1989, Beyond 1990: *Considerations for a New National Development Strategy*, University Malaya, Kuala Lumpur, Appendix Table 2.5, p. 41.

Malaysia, 1991, *The Second Outline Perspective Plan: 1991-2000*

Malaysia, 1993, *Mid-Term Review of the Sixth Malaysia Plan: 1991-1995*

Malaysia, 2001, *Eighth Malaysia Plan: 2001-2005*

Table 4: PENINSULAR MALAYSIA: INCIDENCE OF POVERTY BY STATE 1970, 1976, 1984, 1987 AND 1990.

	1970		**1976**		**1984**		**1987**		**1990**	
	1)	2)	1)	2)	1)	2)	1)	2)	1)	2)
States	000	%)	000	%)	000	%)	000	%)	000	%)
Johore	8.5	5.7	7.8	9.0	4.5	2.2	4.7	1.1	6.6	0.1
Kedah	15.0	3.2	31.9	1.0	3.0	6.6	2.1	1.3	3.9	0.0
Kelantan	16.3	6.1	12.7	7.1	1.0	9.2	0.4	1.6	9.3	9.9
Melaka	3.2.	4.9	7.8	2.4	5.1	5.8	12.1	1.7	13.6	2.4
N. Sembilan	3.9	4.8	5.0	3.0	7.3	3.0	0.1	1.5	3.0	.5
Pahang	0.3	3.2	4.9	8.9	0.0	5.7	3.8	2.3	3.1	0.3
P. Pinang	9.8	3.7	8.6	2.4	7.4	3.4	8.2	2.9	9.5	.9
Perak	39.2	8.6	46.4	3.0	1.1	0.3	9.7	9.9	9.5	9.3
Perlis	7.9	3.9	7.8	9.8	3.5	3.7	2.1	9.1	.5	7.2
Selangor	5.5	9.2	8.3	2.9	1.0	.6	0.8	.9	6.3	.8
Terengganu	2.2	8.9	0.7	0.3	7.6	8.9	9.6	6.1	6.8	1.2
W. Persekutuan			2.5	.0	1.8	.9	2.2	.2	.8	.8
P. Malaysia	91.8	9.3	64.4	9.6	83.3	8.4	85.8	7.3	48.9	5.0

Source: Chamsuri Siwar et al. 1992, Table 11-4;
Malaysia, 1991, *The Second Outline Perspective Plan: (1991-2000)*, Table 2-8;
Economic Planning, 1991, *Unit Briefing Notes* 30th August, JPM/PMD;
Malaysia, 1986, *Fifth Malaysia Plan: (1986-1990)*, Table 3-2.
Notes: (1) Number of poor households in (`000)
(2) Incidence of poverty in percent

Table 5: OWNERSHIP OF SHARE CAPITAL (AT PAR VALUE) OF LIMITED COMPANIES (1), 1969, 1990 AND 1999 (RM MILLION)

Ownership Group	*1969*	*%*	*1990*	*(%)*	*1999*	*(%)*
Bumiputra	**70.6**	**1.5**	**20,877.5**	**19.2**	**59,394.4**	**19.1**
Individuals and Institutions	49.3	1.0	15,322.0	14.1	54,046.0	17.4
Trust Agencies (2)	21.3	0.5	5,555.5	5.1	5,348.4	1.7
Non-Bumiputra	**1,576.6**	**34.8**	**50,754.0**	**46.8**	**125,013.3**	**40.3**
Chinese	1,064.8	22.8	49,296.5	45.5	117,372.4	37.9
Indians	40.9	0.9	1,068.0	1.0	4,752.9	1.5
Others	470.9	10.1	389.5	0.3	2,888.0	0.9
Foreigners	**2,909.8**	**62.1**	**27,525.5**	**25.4**	**101,279.2**	**32.7**
Nominee Companies	**98.9**	**2.1**	**9,220.4**	**8.5**	**24,389.5**	**7.9**
TOTAL	**4,726.5**	**100.0**	**108,377.4**	**100.0**	**310,076.4**	**100.0**

Notes: (1) Excludes Government holdings (except trust agencies).
(2) Refers to shares held by trust agencies, such as *Permodalan National Berhad* (PNB) and state Economic Development Corporations (SEDCs).

Sources: (1) Malaysia, 1993, MTR6MP: (1991-1995), Table 3-5.

Ethnic Group	**1970**	**1979**	**1984**	**990**	**1995**	**1999**
Bumiputera	172	492	852	940	1604	1984
Chinese	394	928	1502	1631	2890	3456
Indian	304	756	1094	1209	2140	2702
Others	813	-	-	955	1284	1371
Malaysia	**264**	**693**	**1095**	**1167**	**2070**	**2472**
Urban	428	975	1541	1617	2589	3103
Rural	200	550	824	951	1326	1718

Sources: Malaysia, 1976, Third Malaysia Plan: 1976-1980, Table 9-5, p. 179 Malaysia, 1986, Fifth Malaysia Plan: 1986-1990, Table 3-4, P. 99 Malaysia, 2001, Eighth Malaysia Plan: 2001-2005, Table 3-4, P. 61

Table 6:MEAN MONTHLY GROSS HOUSEHOLD INCOME BY INCOME AND ETHNIC GROUPS, 1995 AND 1999 (RM)

Ethnic Group	1995			1999		
	Top 20%	**Middle 40%**	**Bottom 40%**	**Top 20%**	**Middle 40%**	**Bottom 40%**
Bumiputera	3,986	1,461	572	4,855	1,810	742
Chinese	7,270	2,560	1,062	8,470	3,168	1,271
Indians	5,100	1,954	868	5,456	2,460	1,092
Others	3,106	1,131	539	3.242	1,204	616
Malaysia	5,202	1,777	693	6.268	2,204	865
Urban	6,474	2,323	942	7,580	2,844	1,155
Rural	3,153	1,235	515	4,124	1,577	670

Source: Malaysia, 2001, *Eight Malaysia Plan: 2001 – 2005*, Table 3 – 5, P. 62.

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[i]. The term used by the government to differentiate between the immigrants and the indigenous people. For policy purposes, the *bumiputra* are the indigenous people that include, among others, Malays, (who form the majority), Melanau, Iban, Bidayuh and other indigenous groups. For more information on the distribution of the population see Malaysia (various years): *Yearbook of Statistics*, Department of Statistics.

Internationalization of the Hong Kong Department Store Industry

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Abstract

This paper reviews the Hong Kong department store retail industry. The main scope traces the historical development of department stores in Hong Kong. The time frame studied is important, coinciding with a distinguished history as a British colony and an open economy. A narrative description of historical development is discussed. Understanding this evolutionary process provides insight into the emergence of the modern retail industry in Hong Kong.

This paper is structured into four sections. The first attempts to trace the conceptual framework of the department store, including the intellectual root of the department store in retailing literature, the conceptual framework in retailing literature, historical and economical development of the retail industry, and the relevance to internationalization retail literature. The second section concentrates on evaluation of empirical literature and research methods. The third section illustrates the process of internationalization of the department store industry, growth of department store retailers in Hong Kong, and investigates foreign inward investment and ownership. Expansion of individual companies will not be the focus for discussion; only overall trends are reported in the paper. The final section concludes the contribution of this study, and the implications for further research.

Introduction

Little work has been published regarding the development process of the Hong Kong retail industry. One may speculate that is not important, but in fact, tracing the development of the retail industry has been significant. It is important to understand the past development, and then the future directions can be assessed. By knowing the history of its industries, one can understand the dynamic developments of an economy. Previous literature has pointed out its value. Bluestone, Hanna, Kuhn, and Moore (1981, p.v) claimed that one "understand the dynamics of an economy by understanding the nature of its industries." They selected the department store industry for study because of its economic contributions in terms of employment generation, as well as its overall role in economic development. The Economic Development Administration of the U.S. Department of Commerce sponsored their project. Central to this work is the belief that the department store industry is important in the emergence of modern retailing.

Tracing the conceptual framework of the department store

Intellectual root of the department store in retailing literature

What is the definition of a department store? According to the Standard Industrial Classification (SIC) Manual in U.S., department stores are defined as:

> “Retail stores carrying a general line of apparel, such as suits, coats, dresses, accessories; home furnishings, such as table and kitchen appliances, dishes and utensils. These and other merchandise lines are normally arranged in separate sections or departments with the accounting on a departmentalized basis. The store's departments and functions are integrated under a single management. The stores usually provide their own charge accounts, deliver merchandise and maintain open stocks."

A department store is a departmentalized retail institution that offers a large variety of soft goods and hard goods. When did the department store industry begin? Diamond and Pintel (1996, p.4) described a brief retail history of America. At the end of the nineteenth and the beginning of the twentieth centuries the department store became popular. Bluestone, Hanna, Kuhn, and Moore (1981, p.10) stated that the New England region in the United States was the birthplace of most innovations in the industry. Bill Lancaster (1995) pointed out that the department stores first appeared in the cities of Northern Britain in the late 1830s. He stated, "the origins of the British department store are firmly rooted in the twin processes of industrialization and urbanization" (Lancaster, 1995, p.7). A legend of retailing occurred in Paris with the rise of Bon Mrache and Louvre (Miller, 1981). Other department stores, Printemps and Galeries Lafayette, also experienced high growth in the second half of the nineteenth century.

Only a few papers have been written about department store in Hong Kong. Philips, Sternquist and Mui (1992) wrote a paper about department store in the 1990s of Hong Kong. Chan (1996) did another paper about Sincere and Wing On department stores in Shanghai and Hong Kong from 1900 to 1941. Wong (1998) wrote a paper about joint venture of Wing On and Seiyu in retailing.

Review of the conceptual framework in retailing literature

What does the literature say about the evolution of the Hong Kong retail industry? There is a lack of study of in this field; no direct theoretical framework can be applied. References of retail evolution of other locations must be drawn for further analysis.

Trappey and Lai (1996) did a paper about retailing in Taiwan. They provided a narrative description of Taiwan's retail historical background from the 1600s to 1944, and outlined the development of modern retailing from the 1950s to 2000s. The paper explained the mix of the traditional market, modern retail structures, and discussed future retail opportunities. They indicated the key retail trends with reference to historical society type, and the retail sales of different retail sectors. They divided the analysis by different types of store - department stores, specialty clothing stores, convenience stores, supermarkets, hypermarkets, restaurants and food retailers. Another study by Feeny, Vongpatanasin, and Soonsatham (1996) was about retailing in Thailand. They used a narrative approach to trace the 40 years of historical development of the Thailand retail industry from traditional to modern market, outlined the differences between provincial Thailand and in Bangkok, and described different types of stores (department stores, convenience stores, discount stores, supermarkets, and specialty stores) being developed. They described retailing scene by illustrating 1993 statistics: GRP per capita at current market prices, population, number of major department stores, and number of outlets. They also reported location districts and future retail trends in Thailand.

What are the characteristics of the retail evolution in America? The general store as the first retail institution in America began to expand its operation in the mid-eighteenth century. During that time, retail stores began to operate on a cash basis instead of the barter system of the earlier retailers. In the middle of the nineteenth century, a great variety of goods were being produced in the United States, and therefore, the general stores were unable to carry unlimited manufactured products. The limited-line store as a specialty store that carried a wide variety of a single classification of merchandise became popular. At the end of the nineteenth and the beginning of the twentieth century the department store became popular. Mail-order retailers grew rapidly due to the development of distribution and mail services. Supermarkets became popular in the late 1930s. The 1950s became a time for retailing innovation, such as discount stores, off-price stores, warehouse clubs, and manufacturer-owned retail outlets (Diamond and Pintel, 1996).

Literature review of historical and economical development of retail industry

A brief historical review of the Hong Kong economy serves as a background for understanding. In doing this part, it is essential to establish the time period by distinguishing periods of history. Beginning in 1898, Hong Kong became a British colony, and major changes took place in Hong Kong before and after 1949. Hong Kong made a rapid economic growth from the 1970s to the 1990s. Economic development is an important background for the emergence of modern retailing. The internationalization process of foreign investment of the retail industry from the 1980s to the current market is also essential.

In retailing textbooks, there is always a chapter about the classification of retailers. Two major groups are store retailers and non-store retailers. The scope of study would be too big to include discussion of all types of retailers in this paper. In order to narrow down into a workable project, the department store is the main focus for this study.

This studies only concentrates on the modern retail industry, and excludes things in traditional retail market. Previous work from Sun (2000) adopts this same technique. Retailing develops alongside the uniqueness of the historical and economic development of a place.

Relevance to the retail internationalization literature

Globalization has been an important trend during the past twenty years. The impact of such a concept can be traced in societies and literature among various disciplines. From Pratt's (2001) review paper, the concept of globalization is clearly defined and discussed. Zou and Cavusil (1996) provide a comprehensive review of a global strategy and its integrated conceptual framework.

In retailing, globalization can be observed from the phenomena of the internationalization process of retailing. Hong Kong as a free trade and free-enterprise economy, has embraced internationalization. Phillips, Sternquist and Mui (1992) mentioned the changes of Hong Kong department stores in the 1990s. Davies and Jones (1993) studied the international activity of Japanese department stores worldwide. However, no work has been done in relation to the internationalization of Hong Kong department stores.

Evaluate the empirical research methods

Evaluate the empirical methods from literature

Bluestone, Hanna, Kuhn and Moore (1981) argued that the story telling approach can be used to study about industry evolution, by relating of how crucial industry case studies of the evolved institutions. They used this approach to examine department store history and the nature of the retail transformation, and to explore its consequences to the industry. The in-depth case study investigation is a widely accepted research method, but it is not applicable for this study.

The study by Trappey and Lai (1996) used secondary information to give a narrative historical description of retailing in Taiwan. The paper from Feeny, Vongpatanasin, and Soonsatham (1996) also used a narrative approach. Feeny’s paper has employed interview techniques to gather empirical data. Eight interviews were conducted to collect data from key persons of the retail industry, senior management from the retailers. Both papers have clear objectives, and research scope. Both papers do not have formulated research question or any defined hypothesis, only narrative descriptions. Due to the nature of study, the authors do not present any arguments or debate between these two papers.

Research method for reviewing department store industry

This study intends to understand the background and development of the department stores in Hong Kong. It is difficult to find a theoretical framework from similar studies. Modification of methods of previous work can be adopted.

This study gives a historical perspective of Hong Kong department stores. It will define the studied time period, and will describe the industry with reference to the historical, political and economic development. As a result, a narrative description of the history of department store retailing can be linked into the following themes:

1. Growth of department stores of the Hong Kong retailers,
2. Foreign inward investment of department store from both Japan and the West.

This study illustrates a brief trace of the growth of the historical evolution of department stores and investigates on foreign inward investment and market entry methods, and retail ownership.

The analysis is based on relevant data. Secondary data and empirical data can both be useful. In this paper, secondary data are used to map out the development of major department stores in Hong Kong. Gathering more empirical data for further analysis of this topic can also be useful. Interview can be a suitable method. However, the sample selection of interviews, analysis of empirical data result would be discussed in another paper, and not inside the scope of this paper.

Internationalization of Hong Kong department store industry

Growth of department store retailers in Hong Kong

Hong Kong was a traditional Chinese fishing village for years. The Commander of the British Forces first opened up Hong Kong as a free port in 1841. In 1898, Hong Kong was enlarged by lease, including Lantau Island and more than two hundreds other islands, from China to Britain.

At that time, there were only a few department stores in Hong Kong. Lane Crawford was established at 1850 with its first store on Queen's Road. Sincere and Wing On were the two early Chinese department stores. The Sincere Company was established in 1900, and the Wing On Company in 1907. Their store outlets were then built in Shanghai, and Guangzhou respectively during the 1910s (Chan, 1996).

1940s - 1950s

Ng (1992, p214) recorded major events of historical development of the Hong Kong clothing industry. In the 1940s, the garment industry started to grow. The Labor Department was also established in Hong Kong. Between 1945 to 1949, million of refugees poured into Hong Kong. After the Communist victory of China in 1949, many entrepreneurs who brought along capital and expertise came to Hong Kong from Mainland China. The industrialization of Hong Kong was only started in the late 1950s. Textile and garment manufacturing became important industries.

During that time, Hong Kong Chinese people were mostly workers, farmers and boat dwellers. Life was hard for most people in Hong Kong. Monthly wages remained under 200 Hong Kong dollars. But it took at least 50 dollars to get a tailor-made suit. Second-hand shops were commonplace (Ng, 1992, p6). Most of the retail businesses in those days were small-scale family-run operations. People operated their retail store in the front, and lived behind the stores (Sun, 2000).

1960s

Hong Kong industries developed rapidly. The financial situations of the families improved. The economy and living standards rose. The city was transformed into a high-rise profile. A better education system created a more educated workforce. Women began to work instead of staying at home.

With the fast-growing population including immigrants and the baby boom in Hong Kong, there were increased demands for consumer goods.

Retail businesses began to develop. Ready-to-wear businesses became popular, replacing the traditional tailor-made clothing (Sun, 2000). In 1960, Daimaru opened the first Japanese department store in Causeway Bay on Hong Kong Island (Veitch, 1990). Another local department store, Shui Hing stared its business in 1961.

1970s

During the 1970s, the economy of Hong Kong was further developed. Hong Kong became a modern and international city. Few trade restrictions and a stable legal system provided a good environment for business. A reliable banking and financial system was developed. Foreign investment came to Hong Kong. Towards the post-70s period, Hong Kong developed into a modern and economically diverse city.

The income and purchasing power of Hong Kong people increased considerably. The retail industry grew significantly. "Tailors were slowly replaced by clothing companies, boutiques and department stores" (Ng, 1992, p.8).

More Japanese department stores opened up. Isetan entered Hong Kong in 1973 with its first store in Tsim Sha Tsui; Matsuzakayz followed in 1974 with its first store in Causeway Bay (Veitch, 1990). The Ocean Terminal shopping center was built and attracted many shoppers. Supermarket retailers also began to develop.

1980s

The role of Hong Kong as a service and financial center grew. China adopted an open-door policy to attract foreign investment. Hong Kong industrialists moved production from Hong Kong to Mainland China for cheaper cost of production. Hong Kong became a major garment exporter to the US, Canada, and Western Europe. Earnings and living standards of Hong Kong people were greatly improved.

Local apparel manufacturers expanded and diversified their businesses, and set up their own retail specialty store chains with their own brands. These became local retail chains (Sun, 2000). "In the mid 80's, many large manufacturers started setting up their own brand names in the retail markets, such as Giordano, G2000, U2, Bossini, and Baleno. Companies set up vertical integration in order to reduce fluctuation. As a result, the profit margins were much more rewarding than just doing export manufacturing. Most of these chains became independent from their former manufacturers and became listed companies, such as Esprit, Bossini, Theme, Giordano, Crocodile, YGM, Goldlion, etc." (Wong, 1998). Ng, Newton, Tao and Kwok (2001) illustrated that Hong Kong fashion among the ordinary people had been overwhelmed by locally made Western style ready-to-wear fashions. The middle and upper-income people tend to purchase fashions imported from Europe and Japan. This was turning Hong Kong into one of the popular shopping centers for fashion.

More foreign investment come into the Hong Kong retail market. Retail ownership shifted from family run businesses to large-scale developed enterprises. By 1985, Causeway Bay was established as an important retail district. More Japanese department store retailers came into Hong Kong, such as Mitsukoshi, Sogo, UNY, Seibu, Jusco and Yaohan (Sun, 2000).

1990s

There was a trend towards investments in China. Although there was a slow down in 1989, most of the manufacturers continued to shift production into China in the 90s. In the 1990s, many local Hong Kong people immigrated to overseas countries. This trend slowed down domestic consumption. The Hong Kong economy picked up again from 1996 to 1997. Due to the Asian financial crisis in 1997, the Hong Kong economy slowed down from then to the present.

During the early 90s, general retail consumption fell for both tourists and locals. An overall fall in demand led to the softening of retail sales. Towards the end of the 90s, Hong Kong retailers faced keen competition. The department stores suffered with reduced sales turnover. Many Japanese department stores moved out of Hong Kong. (Isetan of Japan Ltd., Yaohan International Group, Daimaru Department Store Co. Ltd., Matsuzakaya Enterprises Co. Ltd., and Tokyu Department Store Co. Ltd.).

The world has become a global economy. Internationalization of retailing development in Hong Kong is an important trend-foreign investment into Hong Kong, local investment outside Hong Kong to other regions, such as China. Many local Hong Kong people traveled and shopped in nearby locations, such as the Lo Wu Commercial Center, and the Lo Wu audio-visual city in Shezhen because of cheaper retail prices.

Many retailers were forced to cut-throat sales tactics during the first and second quarters of 1999 (SUN, 2000). The French hypermarket Carrefour opened its store in 1997, and moved out the market in 2000. Retail sales continued to slow down until 2001. Expansion of supermarket outlets also took place.

Foreign inward investment of department stores from both Japan and the West.

The world has become a global economy. Internationalization of retailers is an important trend worldwide. One of the distinct trends of department store retailing is the internationalization process of the industry. Foreign investments from both Japan and the West have come into Hong Kong. The Japanese have developed many department stores. The investments from the West in retailing are mainly from the 80s to current year, particularly in developing specialty stores. A table follows summarizing international department store activity in Hong Kong. Data are adopted from papers, Phillips, Sternquist and Mui (1992), and Sun (2000).

Table 1:SUMMARY TABLE OF MAJOR DEPARTMENT STORE IN HONG KONG

Department store	Established	Ownership	Note / Market entry
Lane Crawford	1850	Chinese	public listed company
Sincere	1900	Chinese	public listed company
Wing On	1907	Chinese	public listed company
Daimaru	1960	Japanese	moved out HK, 1998
Shui Hing	1961	Chinese	department store closed, 1996
Isetan	1973	Japanese	moved out HK, 1996
Matsuzakaya	1973	Japanese	moved out HK, 1998
Yue Hwa	1973	Chinese	operated firstly during 50s direct investment for new store, 1973
Mitsukoski	1980	Japanese	foreign direct investment
Tokyu	1982	Japanese	moved out HK, 1998
Yaohan	1984	Japanese	closed at 1997
Sogo	1985	Japanese	financial difficulty, 2000 foreign direct investment
Jusco	1987	Japanese	foreign direct investment
Uny	1987	Japanese	foreign direct investment
Marks & Spencer	1988	British	from direct investment to franchise
Seibu	1990	Japanese	from direct investment to franchise
Seiyu	1991	Japanese	joint venture with Wing On Co

Market entry and retail ownership

Reviewing the historical establishment of department stores can help to understand the transformation of retailing. In table 1, all department stores in Hong Kong from 1850 to the current retail market are listed. Department stores require bigger investment compared to specialty outlets. Throughout the years, there are less than twenty department store chains as a total, and only eleven remain in the current market. Five Japanese department stores moved out Hong Kong market during economic recession after 1997. One can then draw a conclusion that department store developed rapidly in Hong Kong during 1970s to 1990s, and have a declining trend in the late 1990s.

Most of the department stores are direct foreign investments, mainly due to the low tax rate, a free market economy and the stable legal system in Hong Kong. Until recently, franchising becomes a popular retail format for investors who tried to minimize risk and maximize return. A problem for retailers in Hong Kong is the high rental and expensive overheads for shop retail space. Since the speedy development of shopping centers, the specialty stores have become competitors for department stores. Many department stores even rent out their space to specialty shops as concession space, instead of operating their own merchandise assortments to consumers.

Japanese retailers in the Hong Kong department store industry

Japanese retailers were aggressive investors from the 1970s to the 1980s, since the Japanese economy was blooming during that time. Many retailers expanded to the overseas market and operated their businesses under global strategies. The internationalization of Japanese retailing activities continued developing overseas as a major feature to many cities (Davies and Jones, 1993). However, the expansion reached its ceiling in the 1990s with shrinkage and recession in the Japanese economy. So far, there have been eleven Japanese department stores in Hong Kong; five have moved out Hong Kong, with remaining of six still operates among current market (Mitsukoski, Sogo, Uny, Seibu, Seiyu, and Jusco).

In Hong Kong, traditional department stores have pressure from Japanese competitors in the domestic market.

Conclusion

This study improves the understanding of background and structure of the current Hong Kong department store industry. Central to this work is the belief that the department store industry was important in Hong Kong's modern retailing. The topic area has been largely neglected and seldom studied. The contribution of this research is to add knowledge to the present retail literature.

By addressing the historical development of department stores, insights can be gained into the understanding of the industry. Further research can be done in many related topics; more research questions can be raised, such as: Why is the department store industry declining in Hong Kong? How do Japanese department stores come in Hong Kong? Why did they leave Hong Kong in the 1990s? Semi-structure oral interviews will be conducted with selected samples from the industries. It is then possible to further comment on the transformation of the retail industry of Hong Kong by future research.

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The Impact of Road Access on Spatial Economic Development in Klang-Langat River Basin, Malaysia

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Abstract

The purpose of this study is to determine the impact of road network on spatial economic development in Klang-Langat River Basin, Malaysia. The relationship between the causal factors and land use types was estimated using the multinominal logit regression method. These causal factors include a plot of land's distance to the nearest road (DIS2ROAD), distance to the nearest town (DIS2TOWN), index of suitability to agriculture (LANDCLASS), population density (DENSITY), share of agricultural employment (AGRIEMP) and forest reserve status (FOR_RES). Land use types, obtained using satellite remote sensing imageries, are used as indicators of spatial economic development. Results of the analysis show that DIS2ROAD, DENSITY, LANDCLASS, AGRIEMP and FOR_RES are statistically significant in influencing spatial economic development. The rest of the factors were found to be insignificant.

Introduction

This paper aims to model and explain spatial economic development in the Klang-Langat River Basin, Malaysia using land use type as a proxy for spatial economic development. Although land use change may be influenced by a multitude of causal factors [2; 4], this paper pays particular attention to the impact of road access on spatial economic change. An understanding of the causal factors of spatial economic development is essential in light of the general concern over unmitigated trend of land conversion (especially forest) to alternative uses, in the developing countries. To illustrate, deforestation in Borneo and parts of the Philippines are found to be largely the result of intensive timber extraction for export [3] while in Peninsular Malaysia, agricultural clearing is the main proximate source [1].

One determinant of change that has not received much attention in the literature is transport accessibility. This is despite the fact that the impact of transportation network, in particular roads, on economic development and the resulting increase in the utilization of land as an input to production is generally well understood [5; 6; 7]. Economic theory tells us that the construction of a new road network essentially reduces the price of land utilization (that was hitherto inaccessible) relative to other factors of production. Easier access thus causes reallocations of inputs in favour of greater utilization of land in the production of goods and services. Consequently, one would expect a systematic association between the degree of transport accessibility and spatial economic development.

Assuming that variations in land use/land cover and at least some of the causal factors (such as transport access) could be appropriately identified and quantified, it is possible in principle to empirically estimate a model that explains spatial economic development. Model building and estimation are useful for at least two reasons. First, they provide a framework for testing the significance of some of the factors that have been hypothesized to be responsible for change. Second, it also enables forecasting of future spatial development. Both are important inputs to policy analysis related to development.

This paper provides a description of the methodology adopted in modelling and estimating the impact of accessibility through road transport on spatial economic development in the Klang-Langat River Basin, Malaysia. It is organized as follows. The next section presents a simple economic model of spatial development. It is then followed by a section describing the methodology and data used in the study. Results are discussed in the penultimate section and the final section provides a summary.

An Economic Model of Spatial Development

Assume initially that there exist many firms currently operating close to a large tract of potential development (undeveloped) area with no road access. Each of these firms has the options of utilizing several types of inputs for the production of one output of price p. Let $x = (x_1, x_2 \ldots x_L \ldots x_n)$ represents the vector of inputs with the corresponding price vector $r = (r_1, r_2, \ldots r_L(A) \ldots r_n)$ where x_L refers to the amount of potential development area used in production with utilization price, $r_L(A)$. Accessibility, A, is an exogenous factor and is negatively related to utilization price i.e. $r_L'(A)<0$. Assume further that each firm faces a concave production function given by $f(x)$. Given these assumptions, the firm's problem reduces to maximizing $p\, f(x) - rx$. It is easy to show that the optimal amount of land to be used in production is chosen so that the condition $\partial f(\boldsymbol{x^*})/\partial x_L = r_L(A)/p$ is satisfied. This condition merely states that optimal land utilization is achieved when the value marginal product of land is equal to its utilization price. If the price for utilizing land is excessively high (say because of poor road access), a firm tends to use a relatively smaller amount of land. The opposite is true when utilization price is low. If this is true for a firm, it must also be true for all other firms that use land in their input mix. Thus, to the extent that road transport network lowers utilization price, spatial economic development is expected to be positively related to accessibility.

Methodology and Data

The empirical model is constructed with the basic assumption that the current land use pattern is in long run equilibrium. Any plot of land under study is assumed to be currently devoted to its most profitable use depending on several relevant attributes that were earlier termed "causal factors". This study adopts four-land uses categorization: urban, agriculture, forest and "other". In terms of economic development, the ranking of these land uses (in declining order) is urban, agriculture, "other" and forest. Since there are multiple land uses, this study requires a set of simultaneous probabilistic models for predicting spatial land use choice. A multinomial logit model is deemed appropriate for this purpose. A three-equation model is applied to describe the situation with three choices. The first equation, models the choice between forest and agricultural land; the second equation, models the choice between urban and agricultural land; and the third equation, models the choice between "other" and agricultural land. The three equations to be estimated are:

$$log\,(P_{forest}/P_{agr}) = a_0 + a_1X_1 + a_2X_2 + \ldots \qquad (1)$$

$$log(P_{urban}/P_{agr}) = b_0 + b_1X_1 + b_2X_2 + \ldots \qquad (2)$$

$$log(P_{others}/P_{agr}) = c_0 + c_1X_1 + c_2X_2 + \ldots \qquad (3)$$

where P_{forest}, $P_{urban,}$ P_{others} and P_{agr} are the probabilities of a plot of land being devoted to forest, urban, "other" and agricultural landuses. Independent variables are denoted as X_1, X_2, etc., and a_0, a_1, a_2, b_0, b_1, b_2, etc. are coefficients to be estimated.

In this study observations were made at the 'pixel' level. A pixel is a square plot of land measuring 30 meters on each side. Land use and land cover classification in this paper was carried out using satellite remote sensing imageries for the years 1989 to 1999. The methodology involved in the mapping of land use includes data preprocessing by applying the radiometric and geometric correction. The imageries were the geocoded to topographic map with the scale of 1:50,000. Unsupervised classification was carried out that was later verified using ground truth data. Selection of training sites was based on spectral and spatial characteristics as well as digitizing of land use map from the Department of Agriculture. Supervised classification was carried out and post classification procedures further ensure the accuracy of the map derived. Global Positioning System on many selected points was used for further field validation and accuracy of results.

Six explanatory variables, namely, the distance of selected pixels to the nearest road, distance of selected pixels to the nearest urban area, population density, a measure land suitability to agriculture, degree of dependence to agricultural employment and forest reserve status, were examined. Table 1 below provides the operational definitions of these variables.

Table 1: DEFINITIONS OF CAUSAL FACTORS

Factors	Definitions
DIS2ROAD	The distance measured in km from the middle of a pixel to the nearest road.
DIS2TOWN	The distance in km from the middle of a pixel to the boundary of the nearest urban center.
LANDCLASS	Classified according to the Geological Department set criteria. Value=1 if land not suitable for agriculture and 0 otherwise
DENSITY	Corresponding district population density (Population in thousand per square km).
AGRIEMP	Agricultural employment as a percentage of district total employment
FOR_RES	Value=1 if located outside reserve area and 0 otherwise

The variable of prime interest in this study is, of course, transport accessibility (DIS2ROAD) where it is measured by the shortest distance in km from a pixel to the nearest road. Measuring the distance requires overlaying a road network on a digitized satellite image of the area.

A measure of a pixel proximity to the nearest urban center (DIS2TOWN) is also included in order to capture the impact of access to product markets on land use. Boundaries of urban areas were drawn on digitized maps before measurements were made.

The LANDCLASS variable measures the suitability of land to agricultural production. The probability of a plot being cleared for agricultural activity should be positively related to its suitability for agricultural production. This was found to be particularly relevant for forest clearing in Peninsular Malaysia (Brookfield *et al*., 1990). Again, a digitized maps containing information on suitability of land for agriculture was overlaid on the satellite image.

Population density (DENSITY) is intended to capture the impact of population pressure on types of land use. It is measured by the number of persons (in thousand) per square kilometer. Agricultural employment (AGRIEMP) is also expected to influence land use type. Since agricultural activities tend to be relatively land intensive, variations in the percentage of agricultural employment to total employment across districts should explain differences in land use. Finally, a variable (FOR_RES) is also included to represent the impact of legal restriction on land use. This variable also allows for an assessment of the effectiveness of the law and the relevant enforcement agency in preserving administratively designated forest reserve.

The Klang-Langat River Basin was chosen as a study area. It is located between longitude 101° 17′ and 101°53′W and latitude 2° 40′ and 3°16′N. It spans the boundary of the states of Selangor and Negeri Sembilan and contains eight administrative districts. These districts are Gombak, Kuala Lumpur, Ulu Kelang, Sepang, Petaling, Kelang, Kuala Langat in the state of Selangor and Seremban in the state of Negeri Sembilan. In total, it covers an area of 3.809 million hectares. The river basin represents the most urbanized region in Malaysia. Kuala Lumpur, the capital city of about 1.37 million people in 1999, is located at the confluence of Klang and Gombak rivers. Combined with Kuala Lumpur, Klang-Langat region has a population of 4.18 million (1999), which accounts for 20% of the country’s total population. The importance of this region is reflected by its dominant position in the Malaysian economy contributing about 28% of the GDP with the area occupying only 1.3% of the total area of Peninsular Malaysia.

There are of course millions of pixels from which a random selection can be made for model estimation. However, in this study, 598 pixels at more or less equidistant from one another were manually selected. This selection method is adopted in order to maximize the distance between selected pixels to attenuate the problem associated with spatial auto-correlation.

Results

Results of the multinomial logit estimation are shown in Table 2. They are generally consistent with earlier expectations. Of greatest interest is, of course, the impact of road network on economic development.

Table 2: RESULTS OF MULTINOMIAL LOGIT MODEL

Variables	β	Std. Deviation	Wald	p-value	Exp (β)
Model 1 (Forest/Agriculture)					
DIS2ROAD	0.547	0.201	7.441	0.006	1.728
DIS2TOWN	0.019	0.057	0.105	0.746	1.019
AGRIEMP	-0.330	0.079	17.541	0.000	0.719
DENSITY	-0.130	0.216	0.361	0.548	0.878
LANDCLASS	-2.141	0.499	18.383	0.000	0.118
FOR_RES	4.332	0.467	85.951	0.000	76.086
CONSTANT	-0.559	0.689	0.659	0.417	
Model 2 (Urban/Agriculture)					
DIS2ROAD	-0.834	0.355	5.516	0.019	0.434
DIS2TOWN	-0.882	0.143	38.146	0.000	0.414
AGRIEMP	-1.171	0.073	5.528	0.019	0.843
DENSITY	0.044	0.110	0.157	0.692	1.045
LANDCLASS	-1.128	0.335	11.360	0.001	0.324
FOR_RES	0.030	0.827	0.001	0.971	1.030
CONSTANT	2.700	0.531	25.896	0.000	
Model 3 (“Other”/Agriculture)					
DIS2ROAD	-0.468	0.263	3.171	0.075	0.626
DIS2TOWN	0.080	0.049	2.898	0.089	1.087
AGRI	-	0.063	1.998	0.157	0.91

EMP	0.090				4
DENSITY	0.244	0.137	3.169	0.075	1.276
LANDCLASS	-0.735	0.339	4.707	0.030	0.479
FOR_RES	0.955	0.463	4.252	0.039	2.598
CONSTANT	-0.857	0.576	2.216	0.0137	

Table 2 shows that pixels are more likely to be in forest use relative to agriculture use as the distance to the nearest road increases. A kilometer increase in the distance of a pixel to the nearest road increases the odds of forest use as oppose to agriculture use by a factor of 1.728 (Model 1). Similarly, estimation results of Model 2 imply that proximity to road network increases the likelihood of urban use relative to agriculture use. A kilometer increase in the distance of a pixel to the nearest road reduces the odds of urban use relative to agriculture use by a factor of 0.434. The estimated coefficient for the DIS2ROAD variable in Model 3 is also consistent with this observation. Taken together, the three models generally confirm the hypothesis that the provision of a road network contributes positively towards spatial economic development. This is the case since road access exerts a positive influence on the odds of a plot of land being devoted to uses that are higher up in the development ranking i.e. agriculture instead of forest, urban instead of agriculture and “other’ instead of agriculture. This finding can be useful for development planning. It implies that a carefully drafted policy on road construction can be a potent tool in influencing economic development. It also implies that a poorly planned road provision may result in unintended consequences. For example, providing a road link that passes through a forest area is likely to result in eventual conversion of land into other uses. This is true despite the fact that it was originally intended only to facilitate travels between two points. Conversely, it could be argued that providing road access to a previously undeveloped forest area can be a very attractive development policy instrument.

Distance to town is not significant in influencing the choice between forest and agricultural uses (Model 1). However, it is highly significant when it comes to the choice between urban and agriculture (Model 2). A kilometer increase in distance to the nearest town reduces the odds of urban use relative to agriculture by a factor of 0.414. The general conclusion that can be made here is that the proximity to urban area tends to provide a positive influence on spatial development.

As expected, all models also show that a higher share of agricultural employment to total employment reduces the odds of a piece of land being utilized for forest, urban or “other” uses, although the coefficient for AGRIEMP is not significant in the case of Model 3. Qualitatively identical results are also found for the LANDCLASS variable. In fact, the coefficients of this variable that measures the suitability of land to agriculture are all negative (as expected) and statistically significant in all three models. The estimated coefficients for the LANDCLASS variable suggest that the physical characteristics of an area do influence the likelihood of development.

There is one rather surprising result: population density appears to have no significant impact on land use type. One would expect that population density should at least be significant in influencing the choice between urban and agricultural uses since increases in population tends to cause intensified use of land more likely.

Finally, the administrative designation of forest areas as reserves substantially reduces the likelihood of economic development. The odds of a pixel located in a forest reserve maintaining a forest status, instead of agriculture, are increased by a factor of 76. The estimated coefficients for this variable are, of course, irrelevant for Models 2 and 3.

Summary

This paper provides a description of the modelling and estimation method that have been adopted in estimating the impact of transport access on deforestation in the Klang-Langat river basin study. A simple production model was presented to provide a theoretical justification as to why transport accessibility is expected to influence spatial economic development. A multinomial logist regression model was estimated and it was found that transport access, along with four other variables, significantly affect the odds of spatial economic development. These variables are distance to urban area, share of agriculture employment as a percentage of total employment, the degree of land suitability to agriculture and forest reserve status.

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Section 2

Issues in Transition & Sustainable Development: States & Markets

A Conceptual Framework For Understanding And Guiding Action Research In Management Practice

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Abstract

Action research is regarded as the best way of conducting management research in practice. Through action research, researchers are able to intervene in practical situations with the intention of helping to solve client's problems while at the same time discovering/generating useful theoretical knowledge. However, many such situations may turn into consultancy or development projects and the development of knowledge into mere after event reports, case study or simple narrative accounts of practice instead of providing opportunities to abstract useful knowledge for management. These forms of activities do not capture the richness of the situations nor the use of useful knowledge for management. This paper discusses how a conceptual framework that was developed and used in the understanding of methodologies in practice is now being used for helping to understand and evaluate action research without turning potential research opportunities into simple reporting environments. The paper shows that evaluation needs to be critical and need to be conducted at three time periods on three dimensions in order to capture the richness of the knowledge.

Introduction

Management is a practical discipline. In a rapidly changing environment, the role of management has to be dynamic, leadership focused and control flexible and effective. Any research that is carried out into management should not only aim at informing them of good practice but more so on the intervention itself and the effectiveness of the use of relevant theory to guide the changes in management practice.

Action research is a genre of research, which is commonly associated or derived from the work of Lewin et al (1939) and Lewin (1947, 1951) whose field theory linked human behaviour to both personality and the social relationships. This pioneering work has been influential in developing knowledge for analysing and managing everyday human interactions and organisational behaviour. His extraction of the essences of action research (e.g. 'unfreezing', 'intervention' and 're-freezing') has become the common terminology used in the field of action research over the past several decades. Lewin's work has also helped to guide a wide range of research areas in the fields of social psychology, motivation theory and group management. In essence, action research is about intervention in practical situations guided by theory for the purpose of assisting the clients/practitioners and in that process extracting/abstracting knowledge that can assist future researchers and practitioners. In this sense, it is fundamentally different to survey or case study findings that attempt to extract knowledge from situations without influencing such situations or the perception of the respondents. See for example the definitions of Yin (1981, 1984).

The primary aim of action research is to help a client(s) or/and a group of stakeholders who are facing a particular set of problems or challenges in a particular context. In this context the role of the action researcher is first and foremost one of problem solving whether the deriving of solutions is individually based or through the facilitation of stakeholder interactions. In so doing the action researcher helps to transform that situation from 'current' to a 'desired' situation. The actions that an action researcher undertakes, either in direct intervention or in facilitation, helps to change the situation, which in turn presents considerable opportunity for abstraction of knowledge. However if such changes are to be effective, the process of intervention needs to be planned and well managed. It is this process of intervention that Lewin (1947) highlighted in essence to be one of unfreezing, intervention and re-freezing. Although the original work of Lewin did not recognise it, in action research the re-freezing can never leave the situation as it was, similar in the way one would fix a mechanical problem (e.g. breakdown of a lift, car or a production line).

Action research by the very nature of intervention has to address three essential perspectives. Their importance is critical in order to understand the discovery and the nature of the discovery of knowledge. They are (a) the situation, changes that take place in the situation, and the ultimate achievement (hopefully) of the 'desired' state for that situation; (b) the conscious selection, evaluation and use of concepts, models, theory, methodology, techniques, methods in the intervention and (c) the role, feelings, skills, motives of the researcher(s) who undertakes the intervention or/and facilitation. Most action research literature covers the first two dimensions but not the last one.

'Problem Situation' or the Research Context

This refers to the every day situations in which problem solving is carried out in practice. They are also the situations in which clients and others undertake or/and undergo changes. Such changes can be considered as social, cultural, political, technical, financial or emotional. In this sense they are 'real world' changes. However, the word 'real world' which is used to refer to many industrial/business contexts also creates a distinction between the academic (where most of activities carried out are of an abstract nature) and industrial (where most of the activities carried out are of a practical nature). We wish to clarify the terminology used in this paper. All of us live in the 'real world' in which we carry out different proportions of abstractions and practical action. Since action research is concerned with both we have chosen to replace the term 'real world' with the term 'action world' (Jayaratna, 1994). In this way we can separate the conceptual activities carried out in the abstraction – 'thinking world' and the activities carried out in practice – 'action world'. They both take place in the 'real world'. Checkland (1981), Checkland and Scholes (1990) and Checkland and Holwell (1998) discuss how both these aspects have helped them to solve practical organisational problems as well as help to capture the abstractions to formulate the 'Soft' Systems Methodology (SSM).

Methodology for action research

The early literature (Blum 1955; Susman & Evered 1978) on action research focused very little on methodological guidance although this is one of the most important aspects of action research. Unlike consultancy assignments or other development-based research, the differentiating factor in action research is the rigour in the thinking that has to be influenced and the actions that have to be structured before the intervention. The nature of action research as a valid instrument for abstracting useful learning was influenced by the work of Churchman (1968, 1979), Argyris and Schön (1978), and Checkland (1981) and in the case of the latter, over a period three decades – see Checkland (2000) for 30 years retrospective learning. Checkland's biggest contribution to management literature is the raising of consciousness of management to the concepts, models and methodology they need to use in 'action world'. In his later work he has raised the use of SSM in two modes – first in the sense of the use of the methodology for guiding action in a step by step mode and second as an experienced manager the use the set of ideas embedded in SSM as a framework to construct their own methodology for intervention.

The differentiating of espoused theory and theory-in-action was first brought to the attention of management by Argyris (1980) and Argyris and Schön (1978) and Argyris, Putman and Smith (1985). Jayaratna (1994) used these ideas to differentiate between the intended methodology (as a way of intervening in the situation) and the methodology-in-action. The latter goes through changes as a result of inter-actions in the situation but very few action research literature has recognised these changes or their relevance for research. In action research case studies (Jayaratna, 1991, 1995) we note that sometimes the change to methodology can make it unrecognisable and yet many research findings report the use of intended methodology and discard these potentially rich research findings. In non-interventionist type of management research the changes to the research instrument may be perceived as interference in the research thus making the research findings invalid (see Kumar, 1999) but in action research these changes contribute to the discovery of knowledge about the intervention process itself.

Problem Solver and Action Researcher

This is the third and one of the most important elements of any action research project and yet many research findings completely ignore the role of action researcher in the ‘action world’. Capturing knowledge about the roles and feelings of the researcher is as critical to the action research findings as those of the situational knowledge. This paper will expand on the discussions on the role of the action researcher within the context of the framework in the following section. See also Schön (1983), Argyris and Schön (1978) and Schein (1993).

NIMSAD Conceptual Framework

NIMSAD is an acronym for Normative Information Model-based Systems Analysis and Design. It was born from experience intervening in practical situations and a desire to make sense of the many different ‘methodologies’ being developed and used by both the academic and consulting communities, particularly in the domain of problem solving in the field of Information Systems. In that sense, its development during the late 1980's, was motivated by the need to provide a common conceptual framework to help understand and evaluate multiple methodologies, which had fundamentally different origins, authors, assumptions and characteristics. Most importantly, the creation of the framework was to develop the capability in the methodology user to evaluate the concepts, techniques, frameworks, methodologies etc. that they would apply in everyday situations.

The focus in NIMSAD on the *everyday* utilisation of methodologies (termed methodology-in-action) has been informed and influenced by action research and systemic thinking. According to the framework, problem solving, consists of four essential elements, namely, (i) the 'problem situation'; (ii) the 'problem solver'; (iii) the 'problem solving process', and (iv) evaluation of these in (at least) three time periods (t_0, $t_1..t_{n-1}$, t_n). (See figure 1).

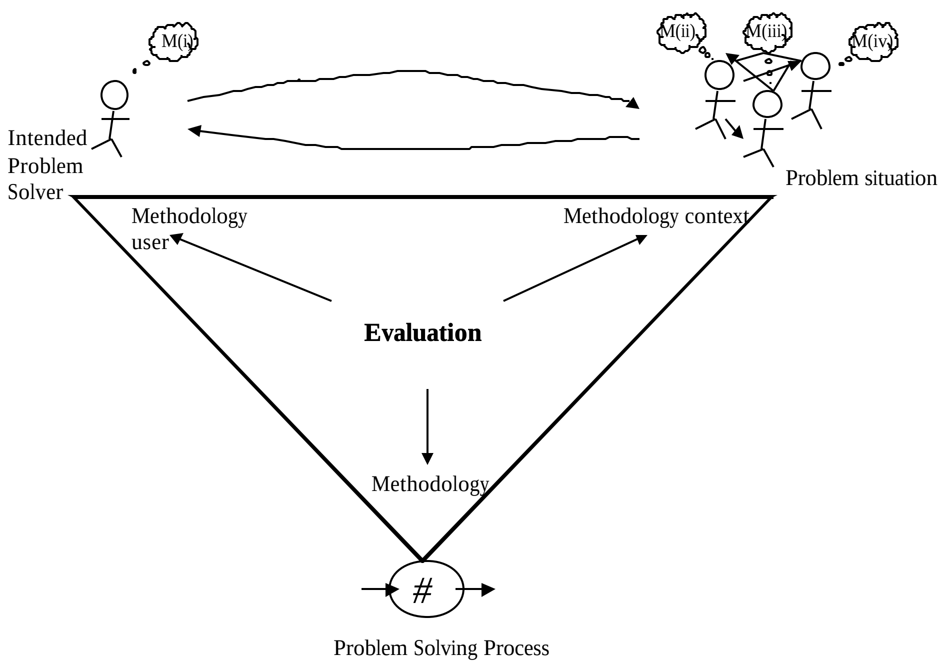

Fig.1: THE ESSENTIAL ELEMENTS OF NIMSAD FRAMEWORK

Action Research Context (the 'problem situation')

All action research activities occur within a social situation. Even in an action research process that is characterized by highly technical activity (e.g. installation of an IT network), there will be politics, interpersonal relationships, constraints, intellectual property right issues, client power and authority, issues of finance and facilities etc. Unlike other development based research, in action research the situations are usually complex and dynamic, and provide very rich environments for helping to abstract knowledge (see Schein 1993, 1993a).

Usually, the ‘problem situation’ is taken to be a situation in which 'action' is undertaken by the 'problem solver'. In action research, the ‘problem situation’ becomes the *research context* for the purposes of research. The term ‘problem situation’ is used within inverted commas focusing the mind of the problem-solver, that the ‘problem’ is a perception and that it needs to be justified. For this reason, the problem solver is seen as an ‘intended problem solver', as in practice the intervention by a ‘problem solver’ may not necessarily resolve the problem situation. Each action research arrangement is characterized by relationships between the clients and the action researchers as discussed in Schein (1987, 1988). This is because the roles influence the nature and the processes of action research (i.e. the role-relationship have significant effect on the outcome of the problem-solving process). For example, a client may assume that a problem can be solved by a particular task that the action researcher will be required to develop. However, the action researcher may recognize the flaws in this assumption (i.e. by becoming aware of the rationale based on the 'mental construct' of the client), and may seek to consider alternate interventions than those expected by the client and therefore may engage are action to influence the client. This may bring about tension between the client and the action researcher and therefore the role and relationships may have to be subjected to critical evaluation.

Action Researcher as the ‘Problem Solver’

In the context of NIMSAD, 'intended problem solvers' use their 'mental constructs' M(i) to select or construct a methodology that is appropriate to the situation. In a similar fashion, the action researcher seeks out appropriate method(s) and techniques for obtaining information about the problem situation. The 'mental construct' M(i) of the action researcher will determine and guide their action in the 'problem situation', and will be characterized by their experience, methods, values (see Jayaratna 1994). NIMSAD provides a number of named elements of the mental construct M(i), which may be subjected to change during the problem solving process: it is the changes in the ‘mental construct’ which will determine their actions. Therefore, the ‘mental construct’ elements will provide a structure for performing critical self-reflection. The evaluation to be carried out at time periods (t_0, t_1..t_{n-1}, t_n). Figure 2 shows the detailed elements that constitute the ‘mental constructs’ of the action researcher.

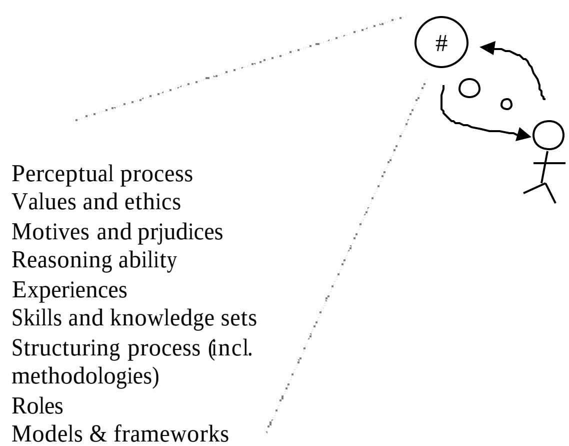

Fig. 2: THE ELEMENTS OF THE MENTAL CONSTRUCT OF THE INTENDED PROBLEM SOLVER

Since every action researcher is unique, their critical self-reflection on how their 'mental constructs' influence their actions is a key aspect of the problem solving process. It is the uniqueness of action researcher's 'mental construct' that influences their choice of methodology and continuous reflection. In NIMSAD, the methodology user is encouraged to engage in continuous critical self-reflection (Schön 1983) and yet in action research literature, this is a neglected aspect of research activity. Since the 'methodology-in-action' often involves dealing with complex human situations (power, roles, and inter-personal aspects), the exploration of the 'mental construct' is of critical importance in the framework.

Action Research process aligned to Problem Solving Process

In NIMSAD, the problem solving process consists of several conceptual stages that are undertaken in formulating problems, designing solutions and implementing designs. There are eight conceptual stages that one may go through in problem solving and they may be undertaken in any order implicitly or explicitly using methods, techniques and methodologies in practice. There is also a significant difference between the use of the terms 'research method' and a problem solving methodology. A 'methodology' is defined by Jayaratna (1994) as simply a way of structuring one's thinking and/or action. If a methodology is to undertake problem solving, then it needs to offer steps, an order in which to carry out the steps (e.g. sequential, cyclical, parallel but not random - this is the methodology structure). A methodology must offer ways of performing the steps. These are the various methods and techniques. Above all, a methodology must provide a rationale as to why a potential user should follow the steps, in the order suggested, using those methods/ techniques. In action research, where a complete transformation covering all the stages of a problem solving process are involved, a way of structuring the whole process can be termed as a methodology - as for example in 'Soft' Systems Methodology (Checkland 1981, Checkland & Scholes 1990, Checkland & Holwell 1998).

Since the models, methods, techniques, methodologies and the 'mental construct' of the 'problem solver(s)' are incapable of addressing the complexity of a particular problem situation, there is a need to evaluate all three elements in order to make the learning more holistic. In addition this learning has to be carried out before (t_0), during ($t_1..t_{n-1}$) and after (t_n) intervention on all the three essential elements (problem situation, problem solving process and action researcher) contained within the framework. Since these are conceptual stages in the problem solving process of the NIMSAD framework, evaluation has to be applied as a source of critical analysis (see for example the evaluation studies (Jayaratna 1995, Jayaratna 1994, Lye 1996)). Since all action research involve problem solving, the problem solving process in action research can be analyzed using these stages. Some action research assignments may not involve all these conceptual stages explicitly because they may built into the 'craft' skill of the action researcher. Whether they take place explicitly or implicitly, they will be important elements in the evaluation of the processes involved action research and therefore need to be explored.

The stages of NIMSAD should not to be confused with the stages in a project or methodology. Rather, they are conceptual stages in the problem solving process of any action research setting. The conceptual stages can guide the action researcher in a number of ways. They can help identify missing elements in the intervention during action research project and in this way they can help to guide the critical evaluation of the actions, in order to enhance the learning of the action researcher M(i). Secondly, the critical evaluation of the 'mental construct' M(i), can inform the process of action research thus altering the project stages, developing new lines of enquiry and helping the action researcher to recognize the assumptions of their colleagues, clients or other stakeholders. In this sense, the conceptual stages can be used to guide the thinking of the 'methodology-in-action' of the action researcher. In all cases, an action researcher will be required to engage explicitly, in all of the stages, else they will not be able to discover the gaps in the intervention. The conceptual stages are discussed in the following sections.

Understanding the 'situation'

In any action research, one of the major activities of an action researcher, is to ascertain the vews of the clients' perceptions and then formulate an understanding of the situation. Since this involves some boundary definition, the area thus selected for investigation is defined as the 'situation of concern' (D'Arcy and Jayaratna 1985). The analysis of the situation is itself a process of analysis using information gathered by engagement of discourse with the stakeholders using their own mental constructs - M(ii)..M(n), and from critical reflection using M(i).

Since a description is derived from a perceptual process, it must be justified (i.e. it is not an abstraction that can be taken 'as given'). The analysis of the situation therefore, involves highly developed conceptual skills, critical reflective reasoning processes and effective skills in information gathering (e.g. interviewing). Systemic thinking can help to develop the 'holistic' understanding of the situation, and develop conceptual boundaries around specific situations of concern.

Performing the diagnosis

The diagnosis is the expression of the understanding gained from the previous stage and includes the nature and characteristics of the situation. In this sense, the diagnosis is where researchers make explicit their understanding of the situation. It is simply an expression, and includes justification for that expression i.e. why that situation exists the way it is and why that expression should be considered as valid. This process may make use of a variety of techniques (e.g. flow diagrams as suggested by some methodologies for instance). It also helps the action researcher to express their assessment of situation in terms of physical criteria (e.g. who does what, when and how; social, political issues), or/and in logical terms, (e.g. roles, functions, hierarchy etc). The analysis of the physical and the logical models help to clarify their thinking processes. Diagnosis is essential in the process of action research as: (i) it can reveal gaps in the action researcher's knowledge about the situation; (ii) it can help to develop an explicit expression of the situation, and therefore enhance understanding between the action researcher and client(s), through interactions between M (i)..M (n); (iii) the diagnosis serves as a basis for further activities to be undertaken in problem solving.

Developing a prognosis outline

The prognosis is the process through which one expresses the 'desired' situation. The prognosis is a process of making explicit, a desired situation, and involves investigating the desired states as expressed through M (ii)..M (n). The process of critical thinking that is involved in the development of a prognosis is crucial because if the client or action researcher cannot be explicit about or are unsure, or are unclear of the prognosis outline as directed by M (i)..M (n), then it is likely that the 'desired states' that will be generated may undergo radical changes during problem solving. In action research, unlike in every day problem solving the validity of the diagnosis and the prognosis, have to be tested thoroughly in order to justify those states. Like the diagnosis, the prognosis can be expressed in physical and logical terms, which can help to clarify the thinking processes. Most methodologies tend to take the client's prognosis or the processes involved in its construction without critical examination. If the diagnosis and prognosis processes are not rigorous then they can result in considerable development or changes to the situation which may be irrelevant and expensive. The importance of the diagnosis and prognosis require equally rigorous and specific techniques, concepts or methods. It is here that SSM has made its biggest impact on the action research processes. SSM (Checkland, 1981) which originated as a way of improving situations and rigour of thinking has now firmly established itself as a practical methodology in the industry/business domains thus illustrating the benefits of action research as a practical research approach.

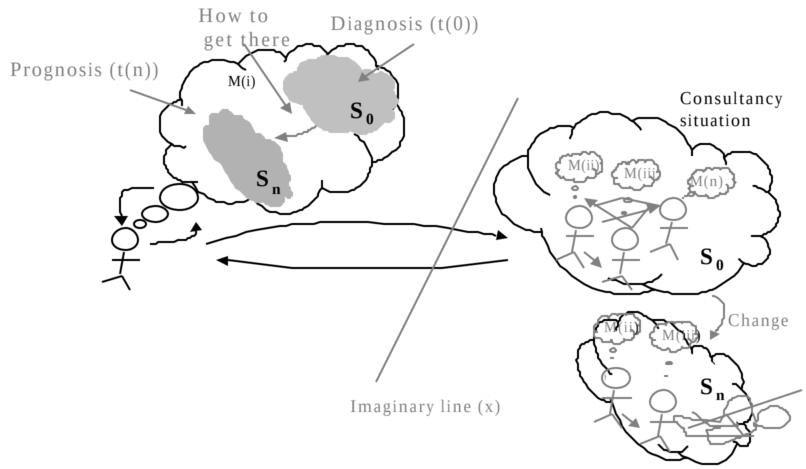

Fig. 3: THE IMPORTANCE OF THE DIAGNOSIS AND THE PROGNOSIS

The constructions of the diagnosis and the prognosis are essential stages of NIMSAD, because they inform the rational basis for the intervention and all activities that are associated with it. Figure 3 depicts the two situations (S_0 and S_n). S_0 represents a perception of a situation before intervention (at time $t_{0)}$ and Sn to denote the perception of a situation after intervention at time t_n. The imaginary line (x) divides the 'action world' to the right and the 'thinking world' to the left to show the relevance of the representation of the situations as states S_0 and $S_{n,}$ results of the 'mental construct', and to help understand the need for intervention to achieve the desired state.

Identifying problems

The diagnoses are expressions resulting from the analysis of the situations while the prognosis outline is the desired state for that situation of concern. A problem is defined by Jayaratna (1991), as "*…the difference between perceived 'reality' and perceived 'expectation' for that 'reality', together with a desire to make the perceived 'expectation' become 'reality'*." Action research will involve a process of identification of problems, though sometimes this may take place implicitly in every day situations. 'Systemic' ideas are important to this process of thinking. Specific problem areas can be defined by mapping the diagnosis on prognosis. This can point to missing or non-functioning of existing elements in the current situation that are preventing the achievement of the prognosis. The gaps may point to a variety of elements (e.g. roles, organization structures, quality control mechanisms, group dynamics, information processing, attitudes, markets etc), but it is the justification process that will help to uncover of generic issues that form knowledge.

Deriving notional systems

Notional systems are those 'systems' that need to be developed if the situation is to be transformed from the 'current state' to the 'desired state'. They are simply the output of a rigorous thinking process. This process is the engagement of explicit mental exercises which may be undertaken by both clients and action researchers M(i)...M(n). For example, a problem may require the creation of an information system; or a programme of group experiential learning etc. There may be a number of notional systems that are derived during this process. Each notional system, represents changes or additions to existing situational components. For example, notional systems often lead to formal documentation which detail certain features of the notional system (e.g. an IT requirement document, a document outlining the requirements for a programme of learning for individuals etc). In SSM, these notional systems are known as 'root' definitions. Many methodologies do not address this process and rely on their users to either accept the client's notional system 'as given' thus denying the opportunity to learn about the process or for ensuring the validity of the notional systems. However, notional systems must also display the ways that they are to be linked to other unchanged elements in the problem situation. The simple construction of notional systems in practice may not change the current state to the desired state unless their relevance are critically examined at this stage.

Logical design

The systemic analysis phases discussed above have the central objective of deriving notional systems, and ensuring their relevance to the situation in which the 'problems' are perceived. Systemic design is the process of deriving design models using ‘systemic’ ideas to achieve the notional system behaviour. The logical design activity set is considered to be the process of justifying the essential elements of each notional system that is perceived to be necessary for the functioning of the notional systems in practice. This process by its very nature has to be a creative activity.

Physical design

The physical design is mapping of the logical model to the practical reality. It is concerned with the application of specific tools, techniques, and products, people that are essential for the operation of the system. For example, if the logical design defines the roles and skills needed to achieve the notional systems the physical design is where the choice is made as to who should perform these e.g. the actual person. The process of physical design will consider issues such as the social, political, technical, elements of the situation. In NIMSAD, these are cross-referenced to the physical elements that were identified during the diagnosis. Typical characteristics of the physical design will include consideration of the issues of security, reliability, safety, enhanceability, availability of resources, legal issues etc.

Implementation

The implementation is the stage during which realisation of the previous models take place. The test of the relevance and thoroughness of all the thinking, and analysis & design activities undertaken in the previous stages of action research, take place during this stage. It is essential that close collaboration between action researchers, clients, and other stakeholders take place to help achieve success. No matter how detailed the diagnosis and prognosis, they can never capture the richness of the situation of concern therefore unforseen issues may arise during this stage to challenge the success of the model implementation. This stage involves considerable planning (e.g. timing and scheduling of events, resource considerations etc), and effective management and control actions.

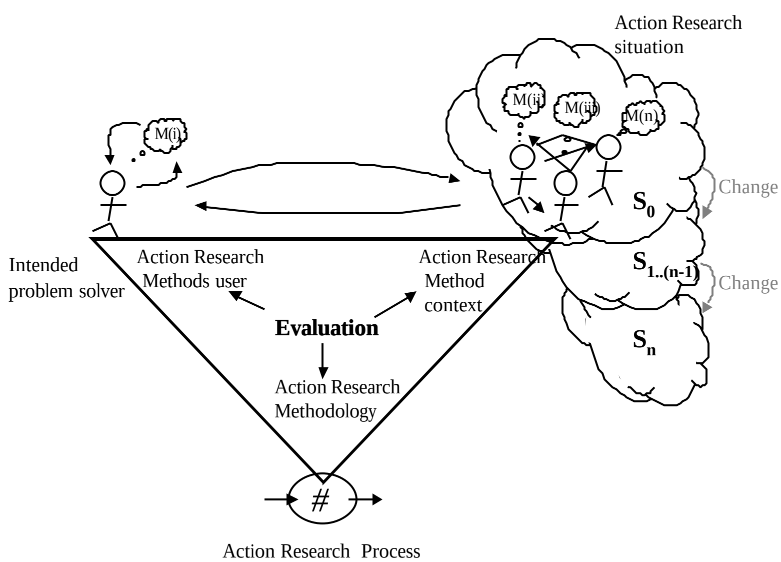

Fig. 4: THE NIMSAD FRAMEWORK AMENDED TO THE SHOW THE DIMENSIONS OF ACTION RESEARCH

Evaluation of action research

One of the most important features of the NIMSAD framework is not simply its use in the understanding of the problem solving, but more so its evaluation process to generate learning. Since the primary purpose of action research is problem solving, the implementable designs should resolve the 'problem situation'. However, knowledge generation is of crucial importance for the researcher, the action research process also need to engage the researcher in the evaluation of their thinking and action. In the NIMSAD framework this is carried out on three elements (research context, research methodology and researcher) and at three time periods (t_0, $t_1..t_{n-1}$, t_n). before, during and after intervention. Because there are changes that occur in each of these three elements throughout the period of action research, the conduct of evaluation at three time periods is critical not only to understand the final changes but also uncover the principles underpinning the process of change. The evaluation and time element is shown in figure 4, as applied to the situation and denoted by $S_0..S_{1..(n-1)}$, S_n. It is the evaluation of three dimensions, (i) 'situation', (ii) 'problem solving process', and (iii) the problem solver's 'mental construct' at three time periods before (t_0), during ($t_1..t_{n-1}$) and after (t_n) intervention, that gives NIMSAD its uniqueness as a research instrument for the abstraction of knowledge. It also provides the basis for a holistic understanding of the process of action research and its key elements.

Additional considerations of the use of NIMSAD framework in action research

NIMSAD when applied to guide the thinking and activities of the action researcher should include a number of additional elements. These are discussed below.

Primary and non-primary clients

The primary beneficiaries of the process of action research will be one or more individuals or groups of clients. Following Churchman (1979), the clients are those "…*whom should be served*". The clients may become the beneficiaries or victims of the intervention of the action researcher. If the client groups are defined in these terms, then there is the requirement to consider the effect that the process of action research will have on specific individuals or groups. The ethical concerns, and the resolution of conflicts of interest, will be components of the process of action research, and these are undertaken by critical reflective reasoning processes undertaken using the elements of the mental construct M (i). This reflective process should not only cover the clients but also others.

The client report R (i)

Action research will involve one or more documents, reports, services or products for the client(s). For example, in industry, business, service and government based activity, the output may take the form of reports (market research, analysis, recommendations), whilst in engineering, and this may take the form of a prototype product. This is denoted by R(i) in figure 5. In these cases the clients will expect the output to match their expectations and in return for the facilities, information provided or rewards e.g. payment of a fee/grant. Like in everyday commercial activity, clients may not ask for the justification or the process used in arriving at R (i) because of their trust in the competence of the action researcher.

The purpose of the report is to satisfy the perceived needs of the client(s) M (ii)..M (n) at the point in time in which it is delivered (at $t_1..t_{n-1}$, t_n). R (i) is the outcome of the process of action research, and it is this process that will be guided using methodology. In some situations where the client requires the justification of the outcome, the researcher may have to discuss the process through which they arrived at the outcome. For example, if R(i) contains unexpected, unpalatable or unpleasant results or information, then the process of action research (i) may need to be demonstrated and justified to the client; (ii) may need to be questioned in terms of the attention given to the changes in the expectations of the client(s), as reflected in M(ii)..M (n).

Integrating sources of 'knowledge' S (i)...S (n)

A further requirement of action research is the need to reference to existing published knowledge, ideas, concepts, and techniques within their undertaking. Since all knowledge constructed is for specific purposes by humans (scientists, researchers, practitioners), in specific contexts and with in-built assumptions, then using external sources of 'knowledge' must be subjected to a process of critical appraisal. The use or rejection of the 'external knowledge' within the process of action research will be to influence the ‘mental construct’ of the action researcher M (i), and to provide a reference point for the evaluation of ongoing discovery of knowledge. This can only be achieved if the reference literature is subjected to the same critical evaluation as those of the situation elements.

Conclusion

NIMSAD framework provides a conceptual framework for examining action research. Originally developed as a framework for understanding methodologies, the framework now serves as a basis for guiding action research and evaluation of the outcomes and the processes before, during and after intervention. One of the most important elements for evaluation in the framework is the ‘mental construct’ of the action researcher during the process.

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Administrative Reform: Strategies For Promoting Efficiency, Effectiveness, Productivity In The Malaysian Public Sector

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Abstract

The success of Malaysian development in the first thirty years after independence depended greatly on the predominant role of the State. The public sector is a necessary ingredient in the country's drive towards modernization and development as an industrialized nation. The importance of the public sector in developing economy of the nation is undoubted in the sense that no matter how sound is the economic policy; it cannot be run effectively without a strong public sector involvement. In order to carry out its role effectively and make an impact on economic growth, the public bureaucracy's role have been restructured to support the private sector as the engine of growth, This role involves administrative reform efforts covering three broad strategies of reform namely structural, procedural and behavioural dimensions. These holistic approaches of reforms were dictated by the need to increase efficiency, effectiveness and productivity in order to speed up the implementation of development policies and deliver goods to the people. Therefore, this paper is aimed at examining these three variables of strategies is the main factors. which contribute to the success of reform in the Malaysian public sector and further the economic development.

The paper will discuss various programmes of reform under these three strategies. Just to mention a few examples, under the procedural strategy, the paper will bring into focus on various new management styles introduced in- the public bureaucracy. Under the behavioural strategy, it will discuss the role of political leaders in affecting the administrative reform. While under the structural strategy of reform, the paper will discuss the privatisation policy adopted by the Malaysian government and its impact to the bureaucracy, the people and the economy of the nation. Finally, the paper also brings some new challenges and issues encountered by the Malaysian public bureaucracy in the wake of new millennium and globalisation, especially how the public administration responds to the economic downturn, which occurred in the country in 1997. The paper concludes that though, more effort is still needed, especially in determining how close programmes and policies have come to achieving their target, administrative reform carried out between 1981 and 2000 have generally been successful in changing attitudes of civil servants towards the goal of efficiency, effectiveness and productivity. And finally, the success of administrative reforms can, perhaps, be seen in the country's economic stability and achievement even though in the wake of economic recession, which occurred in 1997.

Introduction

The concept of administrative reform means different things 'to different people. Caiden (1969) uses it to refer "... to all improvements in administration;... to general administrative overhauls in difficult circumstances;... to specific remedies for maladministration;... to any suggestion for better government;... and to intentions of self-styled administrative reformers..."In this paper, administrative reform is defined as "a systematic and integrated effort to bring about fundamental changes in public administration to enhance public administrative capability to achieve national development goals (Hanh 1970). This definition is designed to accommodate: (1) organizational improvements (both structural and procedural), and (2) improvements in the behaviour of civil servants.

Justification (Reasons) for Administrative Reform in Malaysia

When the newly independent Malaysia realized that the administrative system that it had inherited from the former master was unfit for the development challenge, a central priority was assigned to expedite the restructuring of administrative system. The political leaders of Malaysia began to realize that national administrative capabilities (of a standard relevant in terms of the magnitude of problems involved) for national development were grossly inadequate. Therefore, they pushed for administrative reform. The general public, dissatisfied with the service rendered by the government agencies, demanded rectification of their grievance and changes in official conduct. Even public officials called for better terms and service conditions, higher professional capabilities and greater autonomy. The result of previous administrative efforts were the whole disappointing, and the government agencies continued to have shortage of managerial personnel capable of guiding development programmes and projects to effective completion. The need to introduce changes into the government machinery is obvious, although he challenges are enormous. Since independence, the Malaysian government had formulated various administrative reform techniques in order to improve efficiency and effectiveness in the public sector. In the earl 1980, the Mahathir administration has continued undertaking reform efforts in the public sector in a very formidable way in light of technological revolution and globalisation movement. Thus, it is the main focus of this paper.

The Background of Administrative Reform Efforts: 1957-1966

The success of Malaysian development in the first thirty years after independence depended greatly on the predominant role of the State. The public sector is a necessary ingredient in the country's drive towards modernization and development as an industrialized nation. The importance of the public sector in developing its economy undoubted, and it cannot be run effectively without a strong public sector involvement. In his case, Malaysia has been able to respond to such a notion that in order to carry out its role effectively and make an impact on economic growth, its public bureaucracy's role has to be restructured to support the private sector as the engine of growth.

In Malaysia, administrative reform was first initiated during the colonial period. At that time it was carried out in response to political changes in Malaya as a result of the British forward movement. When Malaya was formed in 1957, the country, (Malaya and later Malaysia) inherited the British colonial administration. However, the organizational structure of the colonial government machinery was considered unsuitable for the aspirations of the newlv independent state. Therefore, immediate action was taken by the Malayan government to reorganize its government machinery. Various measures were introduced, including the Malayanization process, reorganization of the administrative machinery, restructuring of work in central agencies and ministries, and the establishment of the Public Service Commission. The reforms carried out in the early 1960s were mainly structural and procedural in nature. Furthermore, they also met with limited success, as the pace of development was so slow due to the limited resources available to the government then.

Administrative Reform Efforts: 1966-1980

The period of restructuring extended from 1966 to 1981. The administrative reform based on the proposals of Montgemory-Esman of the United States then held the central role in the restructuring exercise. The creation of the Development Administration Unit (DAU) in 1966 represented a very important structural reform in administrative development in Malaysia. The main thrust of reform during the 1966-1981 period was towards increasing efficiency, productivity and development orientation, especially in land and district administrations. Rural development planning is another area, which was heavily emphasized. In this way, reform became politicised. During the six-year period of 1976-1981, there were important administrative reform efforts, particularly in institution building such as the formation of MAMPU and the introduction of a code of ethics for civil servants. At the end of 1980, there was an expansion of the civil service, but this was subsequently aborted at the beginning of the Mahathir era to reduce the public sector. The period of extensive modernization began in the earlv 1980s with the prime ministership of Dr Mahathir Mohamad. This was also a period when the "technological revolution-“ was causing drastic changes in the world (Mattoo 1985; de Guzman *et aL* 1985). These changes were especially significant in the industrially advanced countries like the United States and Japan. This technological revolution had an important bearing on the far-reaching reforms introduced in the Malaysian administration. Various new tools, methods, management styles and technologies from the industrially advanced countries were gradually introduced into Malaysia.

Administrative Reform Efforts: 1981-2000

A holistic approach has been adopted in the administrative reform efforts during the period of 1981 to 2000. Various programmes have been introduced since then in order to upgrade leadership quality, efficiency and productivity among civil servants. Among the programmes are those designed to: (i) improve work system and procedures; (2) improve service to the public; (3) change attitudes of civil servants; (4) inculcate work ethics; (5) privatize government bodies; (6) utilize automation and technology; (7) reform the budget and improve the financial management system. In addition, the government has provided training opportunities for all levels of civil servants, better terms of service, promotion prospects, and other fringe benefits such as opportunities for postgraduate studies and sabbatical leave; job rotation, in order to give civil servants wider exposure to the operations of various departments. Another major reform initiated in 1983 was trimming the size of the public sector to keep the number of employees at an appropriate and optimum level**.** This unprecedented move was also aimed at both improving the capability of the public service and as a cost-saving measure to reduce the operating expenditure of the government.

Reform efforts carried out since 1981 confirms that structural and behavioural strategies were heavily emphasized in an effort to reform the bureaucracy and increase efficiency and effectiveness of civil servants. However, not all the reforms introduced have met success. Generally, there is an overall improvement in the efficiency effectiveness and productivity among civil servants as a result of various administrative reforms. There is evidence to show that the public are generally satisfied about the reduced time it now takes to apply for or renew passports, road tax discs and driving licences. In government hospitals, waiting time for patients seeking treatment has also been generally reduced.

As mentioned earlier, there are three main strategies or approaches for the government to undertake administrative reform especially after Dr. Mahathir Mohamad took office as the Prime Minister of Malaysia in 1981. Those are: procedural, behavioural and structural approaches. The epitome of the approaches are as follows:

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Procedural Approach – Improving Work Systems and Procedure

Amongst the work systems and procedures that were first introduced are punch card and clock-in system, name tag identification, quality control circle (QCC), open-Space & office layout, work procedure manual and desk file system, postal correspondence, management thru meeting and productivity measurement programme.

The use of punch card and clock-in system and also name tags by civil servants was designed by MAMPU so that requiring all civil servants to clock-in by 8.00 a.m. and to clock-out at 4.15 p.m. The new officer thereby facilitating not only closer supervision, but close communication and practice of recording time of entry and exit in interaction among and between employees and an attendance register. the public. This system was imposed to improve work identification is a practical idea and is clearly the Mahathir's objective in changing the public service. It was also a device to identify corrupt officers. It is believed that the punch card system has given rise to efficiency among civil servants, as gaining civil servants' rapport. most civil servants are in their office by 8.00 o'clock and leave after 4.15 p.m. The introduction of the name tag is also positively seen as a way of promoting efficiency.

The effectiveness of the quality control circle as a mean of increasing efficiency in the public service is also of interest. Quality control circles (QCC) are another technique, which was introduced under the Mahathir administration on 14th March 1983 as a technique for increasing efficiency. QCC encourages lower level employees to analyse problems and recommend solutions to management. This could contribute to higher productivity, as employees know best how operations can be improved.. Many agencies are encouraged to adopt the programme.

The open space concept was introduced in 1977 by MAMPU, first on a small scale in the MAMPU. The flow of information and processes are the prime elements in the planning of an open space office. Its arrangement has to be such that it facilitates smooth flow of work. The number of formal memos are greatly reduced and communication within the office becomes virtually instantaneous. It further assists in facilitating decision-making and implementation. Its objective is to provide a more hygienic and suitable work environment. To this effect, plants and foliage are used to beautify the office. Good colour schemes are imperative so that they blend with the greenery, the drapery and the paintings.

In 1981, Dr Mahathir extended the introduction of the open office concept to government offices nationwide. Government General Circular 14 outlined several means to implement the concept. The concept has not only saved space and money, but has also facilitated closer supervision, communication and interaction among employees and employers. To derive full benefit from the open space concept, there must be a proper office layout. All departments planning new offices or renovating existing ones were encouraged to adopt the open office concept. It is quite obvious that this technique has been perceived as an effective means of increasing efficiency, in the public service. Perhaps the open space concept is more appropriate for agencies where speedier interaction and workflow between staff is important rather than departments involved in research work.

The work procedure manual is another new procedure implemented through a directive from the Prime Minister on 6th April 1983.Its main objective was to serve as a reference on procedures and regulations. Its application and usefulness can be best seen in departments, which place emphasis on the use of these documents, especially among new staff. Work procedure manuals and desk files were introduced in government agencies and departments to help avoid mistakes and shortcomings.

Up to the end of 1998 all agencies are required to prepare work procedure manuals and to assign one officer as coordinator. By April 1987, the work procedure manual had been fully implemented in 30 federal agencies. So far, MAMPU has been able to design several work procedure manuals to be adopted in district offices: those on the issuance of licences for sale of food and drink, revenue collection and its accounting procedures, preparation and delivery of bills and due bills for assessment, approval for setting up building, chart for processing, the programme has been very successful.

The desk file system is another work system introduced to improve office management. Its aim is to assist the speedy processing of services by government agencies. MAMPU issued a guideline on the file system in June 1986. Most agencies have already updated their file system based on the guidelines produced by MAMPU.

Guidelines for postal correspondence were aimed at ensuring all correspondence is managed efficiently and speedily. These reforms were considered necessary to counter the numerous delays in correspondence at various stages of preparation, delivery, receipt and posting. For instance, mail within the Kuala Lumpur area takes about four to six days to arrive, while mail posted to Kuala Lumpur from other areas takes about five to seven days. The Prime Minister, Mahathir Mohamad, directed MAMPU on 22nd May 1984 to prepare guidelines. Each agency is required to assign a senior officer to co-ordinate the implementation of these guidelines and to prepare a checklist for implementing them.

As most government agencies did not follow a proper method for organizing meetings and reporting minutes and decisions taken, in 1983 the government directed all agencies to adopt the management through meeting concept. MAMPU has designed a special meeting format to be followed by agencies when reporting implementation progress on programmes under the detection and evaluation system for improving public service system.

In conjunction with the meeting format, the government also issued an administrative circular outlining proper ways of recording minutes. The circular prepared by INTAN and MAMPU contains several formats for recording minutes and decisions taken at meetings. Another important aspect is the follow-ups and follow-through on decisions taken. It is of communiques and press releases for international meetings and conferences. The new procedure has attained considerable success. Though the English language is not important compared with the other reform techniques, a senior officer suggested in the questionnaire that English should be emphasized. It was argued that mastering English would help increase efficiency, in conducting meetings and conferences, particularly those dealing with international affairs.

The productivity measurement programme (PMP) was introduced on 20th September 1986 following a directive from the Prime Minister. Its objective was to upgrade output (quantity) and increase the quality of service. Quality is obviously poor when unnecessary, cost is incurred. Therefore, good quality service means prompt, courteous and trouble-free service incurring minimum cost. Generally, productivity is seen as the ratio of output to input. However, productivity is also a measure of how well resources are utilized to accomplish specific desirable results. Thus, productivity is defined as the ratio of the effectiveness with which organizational goals are achieved to the efficiency with which resources are consumed in the course of achievement (Drucker 1967).

Improving Service to the Public

The Mahathir administration emphasized that departments dealing with the public need to improve the quality of their services in order to upgrade the image of the government. One of the steps taken was to improve the counter 1982, the one-stop counter service was introduced, allowing payments of various licence fees and public utility bills (previously made at different departments) to be made at one centre Until 1989, about 880 such centres were established throughout the country. Since the introduction of the system in 1982, it has resulted in a substantial increase in workload in the post office, thereby leading to an increase in operating expenditure. Thus, the government has authorized post offices to collect commission or impose service charge for any services rendered.

One-stop service centres were introduced in November 1982. Because of the substantial increase in workload and congestion in certain service departments such as RIMV (Road Inspection and Motor vehicles Department) and Stamp Duty offices, the new system was aimed at decentralizing the responsibility of the respective departments so that efficiency and effectiveness of services to the public would be enhanced. Since then, certain agencies have been selected, to manage services of departments such as the Stamp Duty office, RIMV and judicial Office. Through the one-stop service centre, the public is able to obtain services such as stamp duty, commissioner of oaths and renewal of driving licence at one place. Up to 1990, there were at least 140 service centres throughout the country.

The one-stop licence centre was launched on 24th March 1984. Since then, the Agencies involved are required to facilitate the application process, shorten the period for processing or issuing approval of licences and permits, and improve the format of application forms. Two agencies offered to provide one-stop licence centres, Kuala Lumpur Cit), Hall and MIDA (Malaysian Industrial Development Authority),). The Kuala Lumpur City Hall is in charge of granting entertainment licences to foreign artistes, While MIDA is in charge of the issuance of manufacturing licences.

The concept of one-stop licence centres was expanded. The Kuala Lumpur City Hall started its drive-through centre on 18th January 1988. MIDA established a one-stop investment centre, aimed at providing speedier services relating to business opportunities and other investment information. The same facility is provided at the state level by the respective State Economic Development Corporations (SEDC). With the introduction of the service, people from outside Kuala Lumpur City need no longer come to the city to get services relating to investment opportunities or to get business and manufacturing licences. .

Efficient and courteous counter service is a concept introduced by the Mahathir administration in an effort io boost the morale and image of the civil service. Dr Mahathir wanted to change the behaviour of the civil servants to give more people-oriented service.

The suggestion box is another technique adopted in an effort to take public views, suggestions and grievances into consideration in reforming the administration, particularly in matters concerned with the implementation of the new concept of one-stop counter service.

The GIRO System is another reform effort, which deals with the improvement of service to the public. Its objective is to enable the public to pay their utility bills such as water, electricity telephone, insurance and income tax without having to queue. This system is expected to bring about rapid changes in revenue collection and billing and a substantial increase in productivity of employees. Dr Mahathir indicated the possibility of establishing the GIRO system in 1984 when delivering his speech at the opening ceremony of the Daya Bumi building. As a result, on 27th February 1987, the National Giro system was launched for the Klang Valley area. In November 1987 until to date, the system was extended nationwide.

In February 1988, the number of GIRO account holders was about 165,508. Up to 1989, about 140 outlets were established throughout the country- providing the facility for the public to settle their utility, bills through the system (MAMPU 1988: 36). .

Improvement in System Budget Reform

One of the important techniques, which deal with the executive budget process, is programme, performance, and budgeting system (PPBS). It was first introduced as a result of the recommendations of the Montgomery-Esman report. It was introduced in stages beginning from the 1969 financial year and was adopted by all government agencies by the 1972 financial year (Gorham 1967; Doh 1981). However, the PPBS has not been successful. The reasons for the failure are as follows: (i) Lack of knowledge and expertise at the Financial Management SN-stem Unit, Budget Division, ministry and d apartment developing the system; (ii) Lack of commitment towards the PPBS among top management; (iii) Generally, the ministries were not confident of the system because it has also failed in other countries, especially in United States; (iv) There was no special training programme provided for officials to support the implementation of the PPBS (MAMPU 1988: 1 I12); and (v) there was an implicit view that the lack of response from the agency chiefs toward

PPBS stemmed from the fact that the new system revoked their privilege of being the authoritative persons in the budget process. The situation gradually changed when Dr. Mahathir took office in 1981. The PPBS was revitalized to suit the new administration. Consequently, PPBS succeeded in forcing the agencies to review their goals and objectives and generating a lot of useful information for the purpose of budgeting and the decision-making process. This reform effort has improved the financial system based on the amendment to the Audit Act 1957. Performance audit directly attempts to evaluate the performance of government agencies in terms of economy efficiency and effectiveness.

In 1995, the government improved the PPBS by introducing a new technique, which was call MBS – Modified Budgeting System. With a combination between PPBS and MBS, it is expected that some issues in the budgeting process would be addressed. The new MBS is not a substitute for PPBS, but rather to give more authority to the agency head to make their own decision according to the local and situational environment.

Improvement in Financial Management Control

Financial management control has also been undertaken under the package of budgetary reforms. One of the factors that led to the adoption of the privatization policy was the rampant management in the financial administration. The central issue in financial management is accountability. The reasons for the decline in accountability are inefficiency in financial management, failure to follow proper procedures and regulations, delay in the preparation of the annual report, and poor financial planning. In addition, unbecoming attitudes of comptrollers towards reform efforts in their respective organizations, weakness in cost control, and finally economic and financial issues encountered by the country occurring from 1981 until 1986 and also in 1997.

In an effort to keep pace with public accountability in the financial management and to maintain a certain level of integrity, various strategies have been undertaken by the Mahathir administration. These include: (i) establishing a committee to monitor financial management and consolidating the role of the Public Accounts Committee (PAC) meeting system of the Treasury, comment and management report of the auditor, evaluation and audit system and inspectorate teams; (ii) providing assistance to the comptrollers in upgrading their knowledge of financial management, for example, training (iii) providing organized systems to be followed by the comptrollers such as existing procedures and systems including Treasury Instruction, Audit Act (1957), Financial Procedures Act (1957), Federal Constitution, Accounting Act 240, and several Treasury Circulars issued from time to time; and (iN,) combating malpractices and corruption in the public service. Though efforts to improve financial management are still in progress, it is expected that considerable improvement will be achieved.

Behavioural Approach

Changing Attitudes of Civil Servants

Changing the attitudes of civil servants is one of the behavioural dimensions of Mahathir's administrative reforms in pursuit of efficiency among civil servants. The behavioural techniques in increasing efficiency in the public service such as the 'clean, efficient and trustworthy concept is considered to be an effective concept in bringing about a change in attitude among civil servants. In fact, this concept is indeed considered to be a key part of the Mahathir administrative reform programmes, The slogan is the most important aspect of ethics to be cultivated among civil servants.

Leadership-by-example is aimed at increasing efficiency and productivity in the public service, and the concept to be an effective tool in improving attitudes of civil servants. The civil servants have gradually been convinced of the concept's worth since its introduction 18 years ago.

Excellent service award was introduced by the Mahathir administration to reward and recognize those in the public service who have shown excellent performance. There is a positive evaluation of the award as to be an effective mean's of increasing efficiency. This also will help increase efficiency and enthusiasm of the civil servants in the public service.

The Malaysia Incorporated concept was introduced in 1983 and from the beginning, it was said to have limited success because bureaucrats have not been able to incorporate it into their respective agency's priorities, and they need time to become acquainted with it. The Malaysia- Incorporated concept was gradually accepted since 1990 up to the year of 2000, where privatization concept was adopted together with the concept of Malaysia-Incorporated.

Inculcating Work Ethics

There are seventeen positive values by which the government has given priority and which stressed that efficiency improvement in the civil service that must take into consideration. Amongst the important components inculcated are "thrift" and 'enterprise" 'values. The 'thrift" value aims to encourage civil servants to manage government property as well as government expenditure with prudence and thrift. Other values include accountability, co-operation, team spirit, diligence and client-orientedness, integrity, self-discipline, positive attitude, professionalism, self-management, creativity and innovativeness, high performance-oriented, intellectual honesty and self-development, which were accepted for improving attitudes of civil servants.

The positive acceptance of almost all work ethics values inculcated among civil servants is attributed to a more comprehensive behavioural strategy, and commitment on the part of the Mahathir administration to adopt such work ethics towards cultivating positive attitudes among civil servants. The values the government is attempting to inculcate need more time to be institutionalized. We should bear in mind that a whole host of cultural and social factors have been responsible for the development of the values, which in turn support the existence of a set of work ethics or positive values in the public service.

Personnel Improvement

The program of personnel improvement in organizational management during the Mahathir administration is unique. Tremendous efforts have been undertaken to improve leadership quality in the public service. Amongst the reform efforts that have been introduced are improvement of career development, new recruitment process, job specialization, location and job rotation, new promotion system based on merit and competency, post graduate study program, special training for middle and supervisor management and timing the size of public service. Amongst the very important reform in the personnel improvement is the New Remuneration System (SSB). It consists of several reforms such as a new salary scheme and other intrinsic and extrinsic values for the civil servants. One of the important bearing in the NRS is the promotion – based performance of the civil servants. All of these reforms efforts are mainly aimed at improving the leadership quality of the civil servants.

Structural Approach - the Privatization Policy

Privatization is one of the issues confronting the bureaucracy and which leads to administrative reform. Although privatization is not the main concern in administrative reform measures, it evokes various answers of different weight and value and effects public administration as well as the society at large.

The Reasons for the Privatization Policy: The realities of economic and public enterprise inefficiencies of the early 1980s justified the government concern over the privatization implementation. Amongst the factors included the rising public sector budget deficit that had resulted in government effort to relieve financial and administrative burdens on government. As for example, the operating expenditure increased substantially from RM13 billions in 1977 to RM38 billions in 1986.Taking three indicative years, total public expenditure jumped from 28.7 per cent of GNP at market price in 1970, to 40 per cent in 1979, and 61.2 percent in 1982. A prime factor causing the mounting financial trends was the increase in budgetary resource flows to the public enterprises, quasi-government bodies and government companies. In 1987, the external debt of about 525 "government companies/enterprises amounted to more RM15 billions; 74 per cent of these debts was guaranteed by the federal government. Clearly, relieving the financial burden by reducing the size of the public sector are mutually reinforcing objectives in the privatization strategy. But the Malaysian government is interested in promoting private sector growth and introducing competitive forces in the economy as well. There are, of course many reasons for poor performance of public enterprises. Firstly, the objectives of certain public enterprises were not always clear, resulting in overlapping and duplication. Secondly, there was ambiguity in the criteria (commercial versus social goals). Thirdly, many of the officers of the public enterprises were short of experience. Fourthly, there was a weak coordination, regulation and control, especially financial control, compounded by the inadequacy of the database on each public enterprise.

Effectiveness of the Privatization Policy

Since the privatization policy was undertaken since 1984, it has confirmed that it spurred economic growth, relieved the financial and administrative burden of the government, promoted competition, efficiency and productivity, stimulated entrepreneurship, reduced the size of the public sector and has met the objectives of the NEP (even though beyond the target of 30 percent).

Although the impact of the privatization is always observed at the financial and economic of public service, it can also be looked into other aspects such as effectiveness, productivity and efficiency of civil servants. Thus, privatization appears to have produced behavioural changes in the public organization. For example, the privatization also has led to improvements in the service delivery and courtesy towards clients. Its movement has made their organization more conscious about public accountability, has generated consciousness about productivity, and quality of service. This indicates that since its adoption in 1983, the civil servants have been convinced of the objectives of privatization in Malaysia in bringing about greater quality, and productivity in public services.

Privatization movement has not led to job insecurity among civil servants.. This is a quite different view from the one on the privatization constraints, such as job insecurity or the fear of loss of bumiputra control and the resentment of public servants over the reduction of prestige and power. That they do not fear the job insecurity is not surprising because the privatization programmes in Malaysia did not follow the full privatization philosophy. The government still retains its power and authority over privatized agencies. To a greater or lesser degree, civil servants continue to hold the view that public enterprises serve other than commercial purposes.

Another reason they do not fear the privatization exercise is because the government has pledged to take care of their well being if their agency is to be fully privatized. This provision is contained in the government's guidelines for privatization. Firstly, no personnel can be retrenched within the first five veers of privatization, except on valid grounds. Staff redundancy, if any, is to be overcome through the normal attrition, redeployment and expansion of activities. Secondly, upon privatization, affected personnel shall be offered a package of no-less-favourable terms and conditions of service than they have enjoyed while working for the government. Affected employees will be given the options of joining or leaving the privatized agency,. Those who choose to leave have the option of early retirement; in this case they are given retirement benefits accordingly and immediately. Those who wish to stay on in the privatized agency are offered two schemes of service, one, which replicates the government scheme of service and another, a commercial oriented one. Under the latter scheme, the employees are entitled among other things, to purchase the privatized entity's shares and to enjoy whatever bonuses are declared. It should be emphasized that the above policy decisions apply to affected personnel of government departments and statutory bodies only, and do not cover personnel of government companies.

Privatization Programme Achievement

Since the implementation of the privatization programme in 1983, a total of 434 projects had been privatized, of which 68 were privatized during in the review period (1996-2000) with a total cost of RM66, 699 million. These included both Federal Government and state government projects. During the review period, a total of RM5,900 million which constituted government support in the form of advances for land and loans was provided especially for major infrastructure projects.

Out of the 68 projects privatized during the review period, 47 have started implementation, while 21 have yet to commence. In addition, several major privatized projects approved during the previous Plans were completed during the review period (1996-2000), such as the Second Link to Singapore, the National Sports Complex, the upgrading of the KL-Karak Highway and the Light Rail Transit (LRT) System I and System 11 projects. In terms of sectoral distribution, infrastructure including the utilities sector accounted for 54.4 per cent followed by government services sector at 19.1 per cent, while finance, real estate and business services sector accounted for 10.3 per cent of the total.

Notes:

SOE = Sale of Equity	BT = Build-Transfer
BOT = Build-Operate-Transfer	MBO = Management- Buy- Out
SOA = Sale of Asset	LOA = Lease of Asset
BOO = Build-Operate-Own	MC = Management Contract
COR = Corporatization	

Source: Mid-Term Review of The Seventh Malaysia Plan 1996-2000, Percetakan Nasional BHD., Kuala Lumpur 1999, p. 145.

Most of the new and major projects privatized since implementation of the programme was through the build-operate-transfer (BOT) method. This method of privatization involves the private sector constructing, operating and maintaining the facility using its own funds as well as collecting revenue from the users during the concession period. The facilities will be transferred at no cost to the government at the end of the period. Some major projects privatized through this mode were the North-South Highway, Second Link to Singapore and the various Independent Power Producers (IPPs). Major projects privatized through other modes of privatization, such as the sale and lease of assets, include the Johor Port, Government Security Printing and Medical Stores while the Light Rail Transit Systems were privatized by the build-operate-own (BOO) method

Gains From Privatization

The privatization programme demonstrated that the transfer of activities and functions that were traditionally with the Government to the private sector had brought about positive changes to the organization, management and performance of the entities. Since its implementation, it had achieved the objectives of relieving the financial and administrative burden of the Government; improved efficiency and productivity; facilitated economic growth; reduced the size and presence of the public sector in the economy; and helped meet the National Development Policy (NDP) targets.

In term of growth and efficiency: Privatization continued to provide opportunities for the private sector to conceptualize and develop new projects as well as to expand existing projects, thus enhancing economic growth. Since the implementation of the programme, major privatized projects such as the 847 kilometer North-South Expressway not only reduced travelling time from 15 to 7.5 hours, but also the number of accidents and loss of lives. Even though users of privatized highways had to pay toll, they benefited from the comfort of travelling due to the high standard of services provided as well as savings in the vehicle operating cost as a result of better road design and maintenance. Likewise, privatized highways within the urban and sub-urban areas improved traffic dispersal and reduced bottlenecks on existing roads.

During the review period, the completion of the LRT System I Phase 11 provided direct rail service between Kuala Lumpur city centres to the National Sports Complex at Bukit Jalil, the venue of the Kuala Lumpur 98 - XVI Commonwealth Games. At the same time, the Second Link to Singapore project reduced travel time and traffic congestion at the causeway, thus benefiting commuters. Growth was also generated from privatized projects through efficiency gains with better utilization of assets and the generation of multiplier effects to the economy. The resultant savings and proceeds enabled the government to channel these funds for the growth of other critical sectors.

There were marked improvements in the management of several privatized entities leading to increased efficiency and productivity, as shown in *Table 1*. This was achieved through improvements in the quality of service and management systems, changes in work culture, expansion of capacity and service networks as well as acquisition of modern equipment and technology. Various privatized entities embarked on expansion programmes such as the expansion of generation systems by the IPPs and extension of rail services by *Sistem Transit Aliran Ringan Sendirian Berhad* (STAR). Privatization led to faster project implementation especially in the construction of highways, as evidenced by the KL-Karak Highway that was completed eight months ahead of schedule. The construction of highways through privatization also led to the development of new growth centres along highways, such as Bukit Beruntung and Sungai Buaya in Selangor and Bukit Merah Laketown in Perak.

Various new services were introduced by *Pos Malaysia Berhad, such* as the Express Post Pilgrim Baggage Service and Post 2020. The performance *of Pos Malaysia Berhad* improved, as reflected by an increase in its revenue from RM300 million in 1992 when it was corporatized, to RM497 million in 1996 and RM544 million in 1997. Improvements were also carried out in the provision of services and distribution by Telekom. As they became self-financing entities, the management of privatized entities also improved in terms of administrative flexibility.

Table 1: EFFICIENCY AND PRODUCTIVITY INDICATON OF SELECTED PRIVATIZED ENTITIES

Indicator	**Before Corporatization Privatization**	**After Corporatization l Privatization (1997)**
Johor Port Berhad'		
Return on Assets (%)	6.6	8.6
Operation Cost Per Tonne-Freight Weight (RM)	8.3	7.3
Gross Profit Yearly (RM million)	29.1	65.8
Operating Revenue Per Employee (RM)	110,000	260,000 (8)
Average Container Throughput (TEUS)	128,556	429,448
Average Number of TEUs Per Vessel	110	170
Average Handling Rate Per Ship Hour	28	52
Crane Handling Rate Per Hour (TEUS)	28	26 (5)

Telekom Malaysia Berhad'		
Return on Assets (%)	4.0	7.6
Revenue Per Subscriber (RM)	1227	1,609
Production Per Employee (RM)	34,372	219,641
Direct Exchange Lines Per Employee	36	154
Response to Complaints within 24 Hours	80	91.5
Tenaga Nasional Berhad (3)		
Revenue Generated (RM billion)	3.3	10.3
Cost Per Unit Per Output (cent/kWh)	16.6	23.1 (6)
Access to The Public (number of service centres)	100	142
Cost to Public Per Unit Per Output (cent/kWh)	18	22.2 (6)
Penang Port Sdn. Bhd (4)		
Return on Assets (%)	11	12
Operation Cost Per Tonne-Freight Weight (RM)	6.9	7.0 (7)
Gross Profit Yearly (RM million)	30.7	45.2
Operating Revenue Per Employee (RM)	58,253	82,548 (8)
Average Container Throughput (TEUS)	330,922	506,863
Average Number of TEUs Per Vessel	271	384
Average Handling Rate Per Ship Hour	23.4	24.6
Crane Handling Rate Per Hour (TEUS)	21.5	24.6

Notes:

1. Privatized in 1995.
2. Privatized in 1990.
3. Privatized in 1991.
4. Corporatized in 1994
5. Reduction due to changes in criteria used as denominator for calculation of average crane handling rate per hour.
6. Due to energy purchase from Independent Power Producers (IPPS)
7. Due to increases in operation and management costs.
8. Total operating revenue divided by total number of staff.

Source: Mid-Term Review of Seventh Malaysia Plan 1996-2000 PM' Department, Percetakan Nasional Bhd., Kuala Lumpur. April 1999.p.148.

In term of Savings and Reduction in Administrative Burden: The privatization programme implemented during the review period relieved the financial and administrative burden of the government, as shown in Table 2 Savings in capital expenditure from privatized projects amounted to RM53,130 million, representing 41.1 per cent of the total savings of RM129,130 million since 1983. This capital expenditure, however, would extend throughout the construction period of the privatized projects. In addition, privatization also led to savings on operating expenditure amounting to RM663 million annually. The sale of assets and equity under the privatization programme generated proceeds of RM2,510 million to the Government. The financial performance of privatized entities was enhanced, benefiting the country through increased revenue from corporate taxes. Major entities such as Telekom and TNB contributed a total of RM4,737 million in the form of corporate taxes, since their privatization.

The administrative burden of the government in terms of recruitment, promotion and training of personnel was further reduced as a result of the privatization programme. During the review period, a total of 9,781 employees was transferred to the private sector, representing 9.2 per cent of the total 105,825 employees transferred since 1983. This number, however, excluded personnel of government-owned companies that were privatized. Examples of privatized projects, which resulted in the transfer of employees to the private sector, were the privatization of hospital services and port services.

Table 2: PROCEEDS, SAVINGS AND REDUCTION IN PUBLIC SECTOR EMPLOYEES

Item	1996-1998	1983-1998
Proceeds (RM million)	2,510	21,520
Sale of Equity	660	19,130
Sale of Assets	1,850	2,390
Savings (RM million)		
Capital Expenditure'	53,130	129,130
Number of Public Sector Employees Transferred	9,781	105,825

Note: Based on project cost spent during construction period, which may exceed the Plan period.
Source: Mid-Term Review of Seventh Malaysia Plan 1996-2000 PM' Department, Percetakan Nasional Bhd., Kuala Lumpur. April 1999.p.149

Bumiputera Participation

Equity Ownership: During the review period, privatization continued to be an effective mechanism in meeting the objectives of the NDP (New Development Plan), especially in pursuing growth with equity. It continued to be one of the major vehicles to enhance Bumiputera participation in the corporate sector. Although the privatization policy stipulated that at least 30 per cent equity should be taken up by Bumiputera, of the 68 projects privatized during the review period, a significant number had majority Bumiputera ownership. The overall equity structure of 230 selected entities privatized since 1983 is shown in Table 3. At the point of privatization of these entities, Government equity was 58.3 per cent due to its holding in major entities such as Telekom, TNB and Heavy Industries Corporation of Malaysia. Subsequently, the Government divested some of its holdings in these companies.

Table 3:EQUITY OWNERSHIP OF SELECTED PRIVATIZED ENTITIES

Equity Ownership	Upon Privatization	December 1998
Government	58.3	43.3
Bumiputera	24.3	28.5
Non-Bumiputera	11.4	17.2
Foreign	6.1	12.

Source: Mid-Term Review of Seventh Malaysia Plan 1996-2000 PM' Department, Percetakan Nasional Bhd., Kuala Lumpur. April 1999.p.150

Table 4: NUMBER OF PRIVATIZED COMPANIES OWNED BUMIPUTRA AND NON-BUMIPUTRA UP TO APRIL 2000

Privatized Companies	Number	Values o Equity
Government	43	RM 16.5 billion
Bumiputera	109	RM 8.1 billion
Non-Bumiputera	28	RM 5.3 billion

Source: Utusan Malaysia, p.23, 4.4.2001

Table 4 shows that, up o April 2000, the number of privatised company owned by Bumiputra was about 109 with RM8.1 billion in equity values, while the non-Bumipuitra owned about 28 companies with RM5.3 billion. The remaining number was left to the government of about 43 companies valued at RM16.5 billion or 56.4 percent of the total number of the privatized companies.

Wider Distribution of Benefits: Grater efforts were undertaken to ensure that privitization benefited more Bumiputera entrepreneurs. However, due to the size and nature of privatised projects, which required substantial capital investment, the companies selected to undertake the projects should possess not only sufficient technical expertise but also financial capabilities. Some privatised companies were required to shoulder administrative and financial burden, especially those involving the transfer of public sector personnel. As a matter of policy, the employees who opted to joint the privatised entity was offered terms and conditions of service, which were no less favourable than, those received previously.

The existing policy of reserving 30 per cent of contract works to Bumiputera continued to be enforced. To enable wider distribution of benefits to Bumiputera contractors, one of the conditions imposed on concession companies was that they should not award contract to contractors, which were directly or indirectly owned by them or their shareholders. These contractors were also required to be registered with the Centre for Contractor Services, Ministry of Finance and the Construction Industry Development Board (CIDB). Apart from being a vehicle to enhance Bumiputera participation, privatization also benefited other Malaysians, especially through joint-venture projects between Bumiputera and non-Bumiputera as well as contracting and sub-contracting to non-Bumiputera. The listing of privatized entities at the KLSE likewise, provided an avenue for all Malaysians to become shareholders. In conjunction to that, up to April 2000, there were about 40 privatised companies which had been already listed in the KLSE, and this number accounted for 5.2 per cent of the total number of the listed companies. These companies had contributed about RM156.6 billion or 24.7 per cent of the total number of capital investments listed in the KLSE. The Bumiputra owned about 21 per cent of privatised equities listed, while non Bumiputra owned about 27 percent, the foreigners accounted for 27 per cent, while the government accounted for 41.8 per cent.

Impact of Reform

Given that there is some degree of political control over the civil service, pressures may be put on the bureaucracy to reform their rigid procedures and attitude so that the are able to perform more efficiently in the complex tasks of development planning. Hence, the bureaucracy has been able to implement the government's policy development by introducing various administrative reforms.

Effect on Bureaucracy

Although administrative reforms during the 1980s and up the year 2000 seem to have been fairly successful, there are also some negative impacts on the Malaysian bureaucracy. One of these is the ideal of neutrality of civil servants, which is now being challenged as a result of certain reform programmes.

During the Mahathir administration, it is observed that the neutrality of civil service is less certain than in Tun Razak's or Tun Hussein Onn's period. This popular conventional theory of public administration is becoming increasingly out of touch with the prevailing realities during the Mahathir administration. Since the adoption of various reform programmes such as the privatization policy and the Malaysia Incorporated concept, the civil servants have to play their important part hand in hand with the private sector in an effort to boost the economy of the nation. This is contrary to the 1970's era where the civil servants were cast in their role as implementers of the development plan with a clear-cut or dichotomistic role between civil servants and politicians as well as businessmen. Under the conventional theory of public administration, the civil servant independently carries out the policy implementation without political interference. However, this concept has now been challenged by several practices adopted by the government under the Mahathir administration.

Subsequent reappointments of retired top strata civil servants in the public sector are another example, which has eroded the neutrality concept. In comparison with Tun Razak's period, when such reappointments rarely occurred, during the Mahathir period it has become a normal practice, which has affected the neutrality, concept. Amongst the objectives of such a policy are to create former boss-subordinate relationships, exert their experiential knowledge in order to facilitate the implementation of development projects and carry out them faster. Hence, the neutrality. as an ideal stated concept is being challenged because there are two criteria for the appointment of civil servants into the public service, one based on merit and qualifications, the other one based on political appointments.

The appointment of top strata civil servants in the private sector after their retirement is another example, which appears to go against the neutrality concept. This is because such appointments would lead to unhealthy elements in terms of pursuing business opportunities, such as favouritism and nepotism. This deprives those who do not have access to officials inside the public agencies though they do have the same criteria for any business application.

To effect the Malaysia Incorporated concept, the government has encouraged top civil servants to co-operate with the private sector such as corporate groups, businessmen and both local and foreign investors in an effort to boost the economy of the country. For example, the top are encouraged to have informal recreational activities such as placing --the private sector community. This social interaction is encouraged to the government-business relationship.

Economic Achievement

In conjunction to the above statement, the success of administrative reforms in Malaysia can, perhaps be seen in the country's economic achievement thus far as a result of the active public sector engagement in economic activities mainly through public sector investment in a large number of public enterprises. Since 1970 and 1980, Malaysia has achieved significant progress in economic growth as well as meeting its social objectives. This success is partly because of the well-equipped civil servants and sound economic policy plus political stability in the country resulting in economic improvement. For example, the poverty rate in Malaysia declined from a high rate of 49.3 per cent in 1970 to a relatively low of 15 per cent in 1990, 9.6 per cent in 1995, 6.8 percent in 1997 and 6.0 percent in 2000. Per capita income in Malaysia substantially increased from M$1,937 in 1970 to M$4,268 (based on 1970 prices or M$6,180 at 1990 prices) in 1990 and RM$9,786 in 1995 and nearly RM$13,000 in 2000. Average monthly household income in Peninsular Malaysia substantially increased from M$264 in 1970 to about M$1,163 in 1990.

Unemployment rate declined from 7.4 per cent in 1970 to 3.6 per cent in 1990, and 2.8 in 1995, 3.9 in 1998 and 3.5 in 2000 such increase is due the economic downturn occurred from 1997 to 1999. Malaysia's GNP substantially increased from M$21,548 million in 1970 to MS79,103 million (at 1970 prices) in 1990; and RM113,704 in 1995, RM$124,476 in 1998. In 1970-90 the rate of growth averaged about 6.7 per cent, while in 1996 was 8.2 percent, and in 1998 was about –6.7. Such negative growth is due to the severe economic downturn occurred in 1997. In the last three years, between 1988-90, robust growth rate at 9 per cent was recorded. Estimates for 1990s put the growth rate at 10 per cent, which was among the highest recorded in the world for this decade.

The period of New Economic Policy (NEP) witnessed rapid shifts in the structure towards modern sector and high value-added manufacturing. The rapid growth of the manufacturing sector resulted in the sector becoming the largest in the economy in 1987, far surpassing that of agriculture. By 1990, manufacturing accounted for 27 per cent of the GDP while agriculture accounted for 18.8 per cent. In 1995, manufacturing accounted for 33.1 per cent, 34.4 per cent in 1998 and 34.7 per cent in 2000. In manufacturing alone, total approved projects increased from M$9,100 million in 1988 to M$28,200 million in 1990, and RM$39,790 million in 1995, RM$45,155 in 1998 and RM$48,247 in 2000.

The New Role of Civil Servants/Public Managers

As Malaysia prepares to enter the 21st century,. greater challenges lie ahead. In all certainty, the panel set up by the government to monitor the civil service is well aware of these challenges. Although the period of the New Economic Policy, (1971-1990) ended ten years ago, Malaysia will continue to experience dynamic changes in all aspects, as the nation prepares herself for development as embodied in Vision 2020. A new economic policy, the National Development Plan, has been introduced and it contains some of the basic principles of the previous NEP, with a new emphasis to suit the new environment in line with new goals set in Vision 2020. For sure greater challenges lie ahead. These include globalizatiom, liberalization, economic recession, technological revolution and advancement of ICT. Administrative reform has to keep abreast with those challenges. In the paper, it is sufficiently to state that the Malaysian government under the leadership of Dr. Mahathir Mohamad has been able to resolve many issues and problems arising from the economic downturn, which occurred in 1997.

One of the factors contributing to the success in relieving the such downturn is the role of public management or public bureaucracy to assist the government in designing some economic policies which have been able to address a host of economic issues in the crisis. With well-equipped government servants in terms of their efficiency, effectiveness and quality (which had already been undertaken before the crisis) and with strong cooperation from the corporate members in the corporate sectors, only can the government resolve such the economic upheavals, which nearly deteriorated the country. Should the government have not reformed the public service since 15 years ago, we contend that the Mahathir administration would not have been able to manage the massive economic upheavals.

The role of public managers or civil servants in Malaysia is expected to continue in the new millennium in terms of becoming more proactive role in accelerating the development process and to help the private sectors as engine of growth. They also are expected to become a very affective facilitator for the private sector to move forward in their development of their business activities. In addition, the public sector is expected to provide infrastructures and social amenities, to continue to play their traditional role of maintaining law and order, regulate policy and to help the political masters to ensure peace and harmony and to provide healthy environment for the economic activity.

The effects of globalisation, economic liberalisation, advances in information and communication technology (ICT) and growing expectation for a efficient and effective civil servants have made Malaysia recognise the need to transform its economy from a production-based economy to a knowledge-based economy which is also known as k- knowledge. Successful transformation into k-economy requires the government to strengthen its administrative mechanism through management practices adopted by the government like TQM, ISO 9000, QCC, productivity, excellent performance and so forth.

The Malaysian government has responded positively to the challenges arising from the globalisation and economic liberalisation by establishing and implementing policies and programmes of Electronic Government (e-government) in effort to assist businesses and citizens in meeting their needs in k-economy. The development of the k- economy has demanded the civil servants to play not only the roles as maintainer of law and order and as service provider but also as facilitator, pacesetter, regulator, negotiator and strategic integrator.

As facilitator, the government, on one hand has to ensure that it is efficient in facilitating business and industry to retain Malaysia as attractive place for foreign investment by instituting favourable policies, improving systems and procedures, disseminating information and providing adequate manpower. On the other hand, it also plays the role as pacesetter for venturing into new frontiers as illustrated by the establishment of MSC (Malaysian Super Corridor), Putrajaya and Cyberjaya.

In the public-private partnership approach in he provision of public service, the government plays the role of regulator where it monitors the activities of the privatised agencies to ensure that the interests of the customers are not sacrificed by fulfilling their obligations. The government will also have to function as negotiator and strategic integrator, for example, with WTO, APEC and ASEAN at the international level and with the private sector and NGO’s at the national level to reach consensus and decisions that can secure the national interest.

Conclusion

In Malaysia, reforms have been carried out using an integrated approach in order to overcome shortfalls of any particular model when applied individuals. Three major reform models have been emphasized. These are: (i) structural-functional; (ii) procedural; and (iii) behavioural. Various reform programmes implemented have adopted a combination of two of these reform approaches. While the structural-behavioural approach has been closely adopted in the case of privatization, the Mahathir administration has not neglected the need for institution building, an approach which was strongly emphasized in the 1960s and 1970s. In fact, structural, procedural, behavioural and institutional approaches have complimented one another in many reform developments.

One of the important elements in the reform effort is political leadership. Thus, the era of Dr. Mahathir Mohamad is the most crucial and dynamic one. The 1980s and 1997 saw saw not only massive economic upheavals, but also witnessed a concurrent growth of the size and complexity of the Malaysian bureaucracy, the globalisation and the development of ICT.In order to counter or to meet such challenges, fast and efficient means had to be found to improve the output capacity of the bureaucracy. This could only be don3e through intensifying administrative reforms via his direct political influence. As Marvis Puthucheary argued "…political and administrative developments must take place side by side if there is to be reform necessary to achieve administrative efficiency and public accountability… "(Marvis,78'.119)."…Without political intervention, the bureaucracy is unlikely to bring about a change by itself…" (Ibid) Here, Dr. Mahathir has been able to gain control over the implementation of his policy development by exerting various reform measures to speed up his development policy as discussed above.

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Can Third Party Access Facilitate Sustainable Development of the Water Industry?

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Abstract

The water sector in many countries is in a state of flux. In many countries this valuable resource is either over exploited or not sufficiently funded to undertake the necessary investment to ensure the long-term sustainability of the sector. Increasingly governments are involving the private sector to provide financial and other resources to the sector. Recent initiatives include introduction of competition, privatisation and development of third party access regimes. This paper assesses the introduction of third party access regimes within the water sector and in particular the implications of the introduction of these regimes for the long-term sustainability of the water industry.

Introduction

The water sector in many countries is in a state of flux. In many countries this valuable resource is over exploited with no sufficient funds available to undertake necessary capital works. Developing new, or replacement of existing infrastructure, is very costly and many local and even national governments do not have the financial resources to adequately service the needs of the population. Governments around the world are seeking new and better means of ensuring the ongoing management and sustainability of the sector. In many cases, this has included the increasing involvement of the private sector as well as the introduction of mechanisms to increase competition in the sector.

A recent mechanism introduced to increase competition in the industry is the so called "third party access regime" which allows non-owners of assets, or third parties, to access assets to provide water and water services. Much has been said, particularly by its government proselytisers, of the potential benefits of third party access to the water industry, but little comment has been made with regards to its effect on the sustainability of the water industry. This paper attempts to redress this issue by furthering the debate on the potential impacts of third party access regimes on sustainability. It also provides a framework for developing third party access regimes, which would maximise the long-term sustainability of the industry.

Section 2 of this paper reviews some of the more pertinent trends in the water sector while in section 3 the concept of third party access is explained. Section 4 reviews briefly how access has been successful in other industries and in section 5 recent developments in third party access are discussed. The sustainable implementation of third party access is discussed in section 6 and some brief conclusions are provided in section 7.

Some Recent Trends in the International Water Industry

In many parts of the world the water sector has been characterised by public sector ownership and management. Traditionally, this has been undertaken in vertically integrated manner with one entity responsible for the extraction, treatment, transmission, distribution and retailing of potable water as well as the treatment and disposal of wastewater. However, in many parts of the world this is changing. Some of the more pertinent trends in the water industry can be summarised as follows:[1]

Increasing focus on water allocation

Due to increasing awareness of the resource constraints, water managers are moving away from new resource *development* to water resource *management*. This requires a different institutional framework to traditional centralised structures, and not all jurisdictions are proceeding towards this with equal speed.

Increasing dependability on the private sector

Increasingly the private sector is becoming involved in the provision of water services. This is mainly due to the limited resources available in the private sector. In particular urban water supply has substantially been privatised especially in the UK and France. Irrigation is less frequently privatised, although there are some notable exceptions, particularly in Australia and New Zealand. Privatisation is limited to the portions of the water sector able to earn a profit, and aspects such as flood control and drainage have consequently necessarily remained in public hands.

For larger privatisation programs there are also limited competition. Two French multi-nationals (Vivendi and Suez-Lyonnaise) dominate the private portion of the industry with some recent competition from Thames Water, Anglian Water and International Water, UK private water providers. In some cases, private concessions have been offered without any competitive tendering process. This occurred for all private concessions in the Czech Republic, Hungary and Poland up to 1997.[2]

Privatisation is often viewed with some hostility, particularly given the fact that private sector players are predominantly the large, multi-national firms of the UK and France. Critics of privatisation of water services often refer to a number of difficulties, which include:[3]

- Lack of competition in the private sector
- Concessions can deliver a monopoly right for extended periods of time
- Incomplete contracts
- Inappropriate management
- Neglect of social obligations

Towards integrated resource management

Water resource constraints increasingly necessitate more sophisticated resource management practices. Over abstraction in one area of a catchment impacts on water availability in other areas. This requires the development of integrated water plans to overlay local resource management, on a national, and sometimes even an international scale.

Financial viability and physical sustainability

In many countries, physical assets have been severely degraded, often through a lack of public investment, and there is a growing realisation of the need to recover sufficient costs to ensure industry sustainability in the longer term. In many cases, this has involved the political unpalatability of water price rises as traditionally water has not been priced to include asset replacement. However there is general agreement that phased implementation of full cost recovery is an important step to salvage the water sector from both financial crisis and physical degeneration.

Third Party Access in the Water Industry

Third party access enables a potential market entrant to access an incumbent's infrastructure, where this infrastructure is a 'natural monopoly' and as such, cannot be duplicated at an economically feasible cost. Unlike the voluntary sharing of facilities between two firms, third party access is usually imposed on the incumbent firm in industries where the prohibitive expense of building natural monopoly infrastructure acts as a barrier to market entry. These high entry costs confer an advantage on the incumbent firm. This is unlikely to be conceded in the absence of an enforced access order. Hence, third party access is an effective policy where competition is reliant upon access to natural monopoly infrastructure.

A natural monopoly occurs where at all scales of production it is more efficient to have output supplied by a sole producer rather than a group of producers operating in a competitive market. This often happens where there is a substantial barrier to entry into a market. A monopoly producer tends to produce less output than a producer in a more competitive market and to charge more for its products and services. This delivers a monopoly profit or 'monopoly rent' to the producer. Elimination of these monopoly rents is an important goal of competition regulators.

A key component in the regulation of a monopolist is the development of access regimes for third parties to the components of a business, which represent a natural monopoly. In the water industry, these are parts of the infrastructure, such as pipeline and sewerage networks, which are expensive and economically wasteful to duplicate.

The regulation of third party access is essentially a 'set of rules' determined by government regulators to provide access for a number of users to facilities owned by a service provider. Once the access arrangement has been set in place, potential users negotiate with the monopolistic infrastructure owner to access the infrastructure based on the parameters determined by the access arrangement.

Typically an access arrangement would indicate a maximum price, which can be charged for a specific service, and the potential user negotiates an acceptable price with the service provider.

This formal access arrangement should be distinguished from general commercial arrangements between a facility owner and a potential user, which is not governed by a third party access regime.

In order to appreciate how third party access operates within the water sector, it is important to examine the sector from a different framework from the traditional vertically integrated monopolist.

The water industry is characterised by natural monopoly market structures arising from:

- the magnitude of capital investment required in the industry;
- geographical constraints to trade; and
- environmental constraints on the use of water resources.

These factors do not affect all aspects of the water industry uniformly. Rather, as is the case with other infrastructure distribution networks such as gas, electricity and telecommunications, there are strong natural monopoly features in relation to infrastructure used in certain stages of the production process.

Table 1 below outlines a possible classification of the production process for both water supply and sewerage services.

Table 1: THE WATER INDUSTRY BY STAGE OF PRODUCTION

Production Stage	**Water Supply**	**Sewerage**
Generation Stage	Harvesting or collecting of water, water treatment and water pumping.	Treatment of wastewater.
Bulk Transmission Stage	Bulk supply of raw and treated water using large transmission pipes. Usually this involves transmission of water from its source , via pumping stations and other headworks to a local storage reservoir.	Bulk wastewater transmission refers to the transfer of sewerage through trunk sewers.
Distribution Stage	Reticulation of water from bulk sources to users via a network of small to medium pipelines.	Small to medium pipelines that transport sewerage from customers to large trunk sewers.
Retail Stage	Customer service, metering and billing.	Customer service, metering and billing.

Source: Tasman Asia Pacific (1997).

Often, all stages of production are undertaken by a single monopoly provider in a given geographical area.

The natural monopoly elements of businesses in both the water supply and sewerage industries can be best demonstrated by examining each of the categories separately.

The generation stage of production, involving the procurement of raw water supplies, is potentially competitive with different companies being able to access water reserves.

In the sewerage treatment sector, the generation stage of production includes the treatment of wastewater. While wastewater facilities are capital intensive and costly, private wastewater facilities are often constructed by large industrial customers to service their own demand. This would indicate that a suitable regulatory regime allowing such facilities to access bulk transmission and sewerage networks provide the basis for a competitive wastewater treatment market.

In very large markets, it is possible that pipeline infrastructure in the transmission stage of production will be economic to duplicate. However, in smaller markets potentially competitive suppliers of water services may be deterred from entering a local market because the duplication of an existing transmission facility cannot be justified. In this instance, a third party access can be implemented to foster competition in the supply sector.

The distribution networks for both water supply and sewerage industries are facilities, which typically source a large number of small customers. Hence, they are not likely to be duplicated at a reasonable economic cost in most cases. As such, they are normally considered to represent the strongest natural monopoly component in the water industry.

Generation and retailing represent the most substantial scope for potential competition in the market. However, some means of accessing the transport infrastructure is necessary if potential generators or retailers are to be viable. Take for example a new entrant in the generation stage. The only way it can physically supply its water to final consumers (short of building its own infrastructure or using a truck) is through the pipelines of the transmission and distribution infrastructure owner(s). Some mechanism is required to ensure that the transmission and distribution pipelines are available to the new supplier and this is normally undertaken through formal third party access regimes.

The Impact of Access on Other Industries

Access regimes have been operational for some time in a number of sectors in countries such as Australia and the UK. The benefits of the introduction of competition in general and third party access in particular have been substantial. For example, in Australia:

- Over $1 billion in efficiency gains to the New South Wales electricity industry through the National Electricity Market.[4]
- Reductions in electricity bills in Victoria of 23.2 percent and in New South Wales of 30.6 percent,[5] with reductions in Queensland of 23 percent.[6]
- In Victoria, service levels in the electricity industry have improved to the point that reported incidences of blackouts have fallen by 50 percent since the introduction of the National Electricity Market.[7]
- Gas prices in the Pilbara region of Western Australia have fallen by 50% since deregulation began in 1995.[8]
- In Victoria in 1999, the state's main gas production plant at Longford was damaged in an explosion and could not produce gas for a number of months. However, gas for emergency purposes was available through a recently constructed interconnecting pipeline from New South Wales, which was constructed largely in response to incentives created by the access regime.[9]
- In Western Australia, the main gas pipeline, the Dampier to Bunbury Natural Gas Pipeline has phased in tariff reductions of 26% between 1997 and 2000.[10] For the state's second largest pipeline, the Goldfields Gas Pipeline, reductions have exceeded 25 percent.[11]

In the UK, with larger and better-developed markets, the impacts have been larger. For example:

- An increase to 26 suppliers in the gas market and 17 in the electricity market, with 13 gas suppliers offering "dual fuel" (electricity and gas).[12]
- In electricity, 12 percent of small business and domestic customers have changed suppliers and realised savings of up to 10 percent.[13] By May 1999, 1.3 million customers, or 5 percent of the total, had switched suppliers.[14]

- In gas, 5.2 million customers have changed supplier, 77 percent of these from British Gas with savings of up to 20 percent depending upon the type of tariff they have chosen.[15]
- In both electricity and gas, the market has been segmented with a number of different tariffs developed for different types of customers, again highlighting market innovation. Independent, web-based firms have developed to assist consumers choose an appropriate plan.[16]

Recent Developments in Third Party Access

To date there has been only limited international experience in the implementation of third party access in water markets overseas. Some examples are the following:

The Proposed Introduction of 'Common Carriage' in the UK

The water industry in the UK, along with other major infrastructure utilities, has been subject to significant restructuring in recent decades. Currently in the UK there is an ongoing debate regarding the application of the Competition Act 1998 to the water industry. The Competition Act, which became effective from 1 March 2000, addresses issues of anti-competitive behaviour, abuse of a dominant market position and thereby addresses issues of common carriage – the UK equivalent of third party access. The provisions of the Act, therefore, do not distinguish between denying access to essential facilities and other anti-competitive behaviour such as predatory pricing and similar abuses of a dominant market position.

While theoretically, the legislative framework could accommodate the development of common carriage provisions prior to the introduction of the Competition Act, there have been few examples where this has occurred. Given the recent implementation date of the Competition Act, it is too early to determine whether it has had any impact on the development of common carriage provisions in the industry. There is no specific statutory framework for common carriage beyond these provisions.

Common carriage is being considered to increase competition in the water industry. Unlike access regimes in Australia, common carriage has no specific statutory framework but is rather dependent on the Director of the Office or Water Services' (Ofwat) interpretation of the Competition Act 1998.

Common carriage has usually been discussed in terms of the water supply distribution network, with access issues in the sewerage area only now coming into consideration.

Common Carriage – The Policy Framework

While the legislative framework underpinning common carriage provisions may not be specific, an extensive range of policy provisions relating to this issue have been developed by both the Office of Fair Trading (OFT) and Ofwat.

These policies are summarised in a report outlining the application of the *Competition Act* to the water and sewerage sectors (see Office of Fair Trading, 2000).

The report identifies a number of issues, which need to be addressed in common carriage arrangements, including:

- The protection of water quality standards;
- Establishing liability in the event of supply failures or quality incidents;
- Responsibility for leakage and maintenance; and
- Reasonable terms of access (including price).

Common carriage provisions are based on the premise that owners of essential infrastructure should accommodate access through the negotiation of provisions recognising the requirements of the water industry and in a manner that does not restrict competition. It is an approach based on the application of the 'essential facilities doctrine'. This requires that the onus of proving that the denial of access is justifiable lies with the owner of the essential facilities, who must show that they are not abusing their market position in order to restrict competition.

California

California is projected to have significant water shortfalls over the next two decades. California's water supplies are managed at all three levels of government - Local, State and Federal. Most of the State's water supplies are obtained from local surface and groundwater resources, with Federal Government managed resources such as the Central Valley Project (CVP), the State Water Project (SWP) and the Colorado River also being important. These supplies are presently able to accommodate California's total demand for water which is in excess of 80 million acre feet per annum.[17]

Given its vast water requirements, the state of California has implemented a series of reforms on water pricing and trading, environmental management in the water industry and the management of the industry's infrastructure. On this latter issue, California has some experience in implementing third party access through the existence of 'wheeling' contracts that allow private negotiation for access. Wheeling contracts are contracts for the use of an incumbent's water conveyance (i.e. transmission) facilities by a third party seeking to transfer water. The original wheeling statute – *Assembly Bill No. 2746* was enacted in 1986, whereby under Section 1810:

> *'Notwithstanding any other provision of law, neither state, nor any regional or local public agency may deny a bona fide transferor of water the use of a water conveyance facility which has unused capacity, for the period of time which that capacity is available, if fair compensation is paid for that use.'*

Section 1810 also outlines the conditions under which access can be granted. Briefly these are:

- Parties with existing contracts involving the transmission facility have rights to unused capacity prior to any bona fide transferor (third party);
- The introduction of transferred water does not interfere with the quality of water currently being transported through the facility, except where this diminution in quality is compensated for by the third party transferor;
- Water uses with existing contracts involving the transmission facility, may have first access to unused capacity for the duration of the emergency; and
- Use of the facility does not endanger fish, wildlife or in stream beneficial users and does not unreasonably affect the overall economy or environment of the country from which the water is being transferred.

Under wheeling legislation, third parties seeking to transport water in an incumbent's facility must pay 'fair compensation', where this is defined as any reasonable charges incurred by the owner of the transmission infrastructure, including capital, operational, maintenance and replacement costs.

The potential for widespread implementation of such contracts has seen the issues surrounding third party access being more closely scrutinised, especially in the context of the State's water policy management and environmental/public health regimes.

Water transfers under a permit system are utilised as a viable water resource management option. Water rights in California are managed by the State Water Resources Control Board (SWRCB). Users can also negotiate with a water supplier holding a water permit. Relatively few long-term transfers have taken place over the past two decades, due to the current low cost of water in California.

Water transfers require third party access to transmission and distribution infrastructure. Current regulations on wheeling contracts define the conditions under which access can be enforced. Given the increasing focus on the potential to create water markets in California, it is likely that an access regime for the water industry may emerge which is not dissimilar to that already in existence, and managed by the Californian Public Utilities Commission (CPUC) for the gas and electricity industries.

California provides a particularly good example of the complex issues involved in instituting some form of access regime:

- Environmental Limits on Sources: The United States Government recently limited the amount of water that could be transferred from the Delta region to Southern California because a threatened species, the Delta Smelt was getting caught in pumping infrastructure associated with these transfers. This action significantly reduced the amount of water which could be transferred from the Delta;

- Capacity Limits: The capacity of California's infrastructure limits transfers between regions. Significant water trading will require the expansion of the State's transmission infrastructure; Access Prices: Under the so called 'wheeling statute', a state or local agency may not deny access to a 'conveyance facility' if the facility has unused capacity and if 'fair compensation' is paid for its use. However, the legislation does not clearly define 'fair compensation' nor does it compel infrastructure owners to disclose information on capacity and cost constraints;
- Regulation responsibilities: In California, there exists no single regulator of water transfers. The SWRCB can review a transfer, as it involves a change in the ownership of water rights. The Department of Water Resources also has the right of review, as most transfers involve local water agencies. At the federal level, the US Bureau of Reclamation has responsibility for water transfers from the Central Valley Project; and
- Public Concerns Regarding Water Transfers: Water transfers in California have met with public resistance on two grounds. The first group of concerns relate to water quality and security, and the rights of consumers to expect constant levels of quality water supplies. Initial transfers of water to Southern California were met with resistance because water users near the source felt that transfers of 'cheaper' water would stimulate development and further demands in this region in the foreseeable future. This could limit available supplies to local users, raising prices paid for water. The second group of concerns refer to the natural and built environment. For instance, in Los Angeles, water rights to the Mono Lake were revised to protect fish and wildlife habitats.

Chile

Chile is an example of informal arrangements under which water is traded using centrally owned facilities, managed by cooperatives, which potential users can buy into. These provide some indication of the issues involved in allocating capacity in infrastructure.

Rural Chile, particularly the Limari Valley, provides an example of the establishment of a 'water market' in which water rights are actively traded. It is the availability of infrastructure, which allows the trading, and distribution of water between registered water users that facilitate the operation of this market.

There is an active trade in these water rights, with some water users purchasing the rights to use additional water from other users.

The Limari Valley Canal Infrastructure: Informal Third Party Access

A critical feature of the Limari Scheme, is that trade in water is facilitated by the existence of canal systems owned by market participants, organised into Water Users Associations (WUAs). In a typical WUA, the canals are owned and operated by their members, with fees charged on the basis of member's capital and operating costs. In addition, federations of WUAs located along a common stream or river are formed to administer water use, including storage and canal intakes.

While this is not strictly third party access, it is similar in the sense that users are purchasing capacity in the system.

Members of a WUA have access to its infrastructure, that is, the canal system that has been developed to distribute water in that area. Irrigation systems are not normally designed to facilitate market transfers. However, the flexibility of access arrangements in the WUAs reduces the costs of water in the Limari Valley. The use of reservoir storage and gated canals allows water to be delivered efficiently to users. Water transfers are relatively easy due to the availability of suitable infrastructure, which can be accessed by market participants where the frequency of transfer is high and the market for water-use rights is active. Individuals easily separate water from land and farmers make marginal water-use decisions.

The experience of infrastructure sharing in the Limari Valley indicates that there exist substantial benefits from access to water infrastructure in the water industry, in terms of the correct functioning of water markets. The regime in the Limari Valley provides an example of the significance of access to such infrastructure in the effective development of a water market.

Sustainable Implementation of Third Party Access

Evidence from other sectors is clear that third party access can benefit the water sector. However the sustainable implementation of third party access in the water sector requires a range of conditions and policy responses. These vary from the facilitation of appropriate market conditions, development of legislative and regulatory regimes and the formulation of resource management plans. Together these measures should facilitate the introduction of third party access and aid in the long-term sustainability of the water sector. Some of the more important measures are discussed below:

Alternative Suppliers Must Exist and be Competitive

Unless there are alternative suppliers of water, then an access regime will not be successful, as there will be no alternative suppliers seeking access to the incumbent's infrastructure. Competitors must also have some form of competitive advantage. If competitors are similar in cost structure and pricing to the incumbent, then consumers will be indifferent between suppliers. Alternate suppliers could develop a competitive advantage in a number of ways:

- Through access to different technology, supplying water or sewerage services at a lower price.
- Through locational advantages allowing charging of different prices to consumers in certain areas.
- Through temporal advantages, such as an ability to harvest floodwaters, and provide these at a lower price when water is scarce.
- Through offering improved value adding services to the water they supply.
- Through economies of scale, where infrastructure owners with spare capacity can seek access to a distribution network to provide services to the broader market. For instance, an industrial operator with a private sewerage treatment facility could seek access to the local wastewater distribution grid in order to compete in the local wastewater market.

Water and Sewerage Infrastructure Must Have Spare Capacity Available

The availability of spare capacity is an important issue in third party access to infrastructure in both water supply and sewerage systems.

In practice it is likely that the operational limits of bulk water pipeline or sewerage networks depend not only on measured available capacity but also on how the network can be configured to accommodate the increased utilisation of existing capacity. For instance, in both water supply and sewerage networks, capacity is determined by both the pipeline size and the number of pumping stations along a given pipeline. In some instances, additions to infrastructure, which could be paid for by the third party, could easily accommodate their access requirements.

There must be Limitations to Local Alternative Supply

At present, in many areas, if a consumer considers the prices offered by the incumbent water services provider to be too expensive, they often source their own supply.

Given that the major components of the cost of water are transmission and distribution cost, clearly alternate suppliers will have difficulties in competing in areas where consumers can source their own water supplies relatively cheaply through groundwater supplies or, as technology develops and energy costs decrease, desalination.

Thus, demand for access is likely to occur from alternate suppliers near localised areas, which have reached their sustainable capacity, or where water is simply not available. As the tradeable water rights market develops, a more comprehensive overview of these localised areas of constraint is likely to occur.

Comprehensive Water Resource Management Plans

An access regime may create or exacerbate the so-called "tragedy of the commons" through the over exploitation of the primary resource. As such, it is critical that an access regime not be introduced until an appropriate resource management regime is put in place.

Energy must be Relatively Inexpensive

Apart from capital costs, energy is the most expensive component of water supply. The high cost of transmission is partially due to the energy component of these costs. As energy costs decrease, the cost of transmission relative to production is likely to decrease[18]. With a lower proportion of the final price being determined by the cost of transmission, efficiencies in water production begin to have a greater impact on the final price of water to consumers[19]. Thus, consumers are more likely to show interest in alternate suppliers of water and hence the demand for access is likely to develop.

The Natural Monopoly Component of the Business Must be Isolated

The natural monopoly components of an industry are the critical components, which must be isolated and regulated in order for third party access to be successful. In the water industry, these are the distribution and transmission networks. If a vertically integrated incumbent has control of these networks, in addition to upstream and downstream activities, then the ability of alternate service providers to compete is impaired. Without legislative controls, the vertically integrated owner of the natural monopoly component of the industry is likely to charge high prices for access to its infrastructure and may use its knowledge of which alternate suppliers are offering water services to specific customers to undercut the prices of alternate suppliers. To prevent such an outcome the water industry can be separated into different business entities or appropriate ring fencing procedures can be put in place.

There must be Appropriate Regulation

A key component in the success of access is appropriate regulation. In particular the regulation should not favour either the asset owner or a third party. This allows the regulator to make decisions unencumbered by the interests of service providers. The regulator also has to have access to legal, technical and economic expertise to assist in formulating appropriate responses to proposed access regimes.

Regulation Independent From the Political Process

The access price will generally be the product of a bargaining exercise between the incumbent, new entrants and the regulator. If the regulator is part of the political process, then there is a substantial danger that the bargaining exercise will become politicised, rather than focussing on delivering an access price, which represents a sustainable industry. The process of bargaining is essentially un-related to industry sustainability and reflects only the competing interests of the new entrants and incumbents. The regulator will be the only party to negotiations who can represent the view of industry sustainability. As such, it must be independent of the political process, for sustainability as well as competition reasons.

Access Arrangements Must be Workable, Flexible and Transparent

In order for an access regime to succeed, the process by which access is attained needs to be well defined. This allows both consumers and potential alternative suppliers to easily understand how the whole system operates and to appreciate the benefits, which could eventuate. Essentially, it facilitates the provision of information to the market about the access regime.

An effective regime would include the process whereby access arrangements are proposed by infrastructure owners, but their content is substantially prescribed by legislation in such a manner that the resulting document is transparent and equitable for consumers and alternate service providers seeking access. The resulting document is approved by an independent regulator, which ensures that the principles of the overarching legislation are incorporated into access arrangements. This provides confidence in the market that such arrangements will be equitable.

Some issues, which can be included in an access regime, include:

- *A Services Policy:* This explains the services to be offered under the access arrangement.
- *A Reference Tariff:* This explains the prices for these services. Importantly, the derivation of the tariff must be transparent and included with the access arrangement to all interested parties. Also, the Reference Tariff is negotiable downwards.
- *Terms and Conditions:* Describing the general terms under which access will be offered. They must be reasonable in the opinion of the regulator.
- *A Queuing Policy:* This describes the way prospective users queue for capacity when the pipeline capacity has been reached.
- *An Extensions/Expansions Policy***:** This explains the procedure by which any expansions to existing infrastructure, including those funded by consumers, takes place.
- *A Review Date:* This outlines when an access arrangement will commence, when it will be reviewed and when it will cease. Commonly, access arrangements are for five years, which facilitates reasonably frequent reviews as markets change.

Conclusion

Third party access is a relatively new concept in the water sector. Given the widespread application of access regimes in similar industries and concomitant competitive pressure it can be expected that third party access regimes will increase be implemented in the water sector. Inappropriate application of access regimes has the potential to severely impact on the long-term sustainability of the sector. Implementing access regimes based on some of the guidelines provided in this paper should minimise the potential negative impacts of such regimes.

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[17] An 'acre foot' is the volume of water which can cover an acre to the height of one foot.

[18] Note: depending on how the water is produced, decreasing energy costs may reduce the cost of production as well. However, transmission is generally more energy intensive than production.

[19] Note: if transmission costs are 90% of the total costs of supplying water, then a 50% reduction in production costs will lead to a decrease in the final price of only 5%. However, if the transmission costs are only 60% of the final cost, then a 50% decrease in production costs will lead to a 20% reduction in the final price of water.

Environment-Friendly Sustainable Development
– Energy Efficiency Alternatives from the Malaysian Experience

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ABSTRACT

A country's actions in the name of development and prosperity can become a controversial concern of the global community, particularly if those actions ignore the importance of preserving the environment altogether. Environmental issues become sensitive when they are seemingly in conflict with a country's goal of achieving a certain level of development. Especially in emerging economies, environment activists are often not a welcomed group, perhaps due to their adamancy in upholding their principles. But need we shy away from discussing initiatives that could protect the environment altogether? Like it or not, environmental issues lurk outside the door of any government planning to push a country into prosperous development. Pressure from the global community has made it almost compulsory for the development of a country to go hand-in-hand with environmental considerations. Discussions on development and environment preservation often relate to the need for energy and power to fuel that development. Energy related activities are thought to be one of the major contributors to environment deterioration. This paper shall share the experiences of the government and the private sector in Malaysia in planning and promoting energy efficiency efforts as a way to pursue sustainable development whilst promoting environment preservation. Could this collaboration work? Who benefits besides the public? What were the "carrots" for the private sector to be seriously involved in such efforts? These and related questions will be further explored in the main paper.

Introduction

In the wake of environmental concerns, the global community is putting pressure on governments of countries, developed or otherwise, to ensure environmental preservation efforts were taken into consideration in the pursuit of economic growth and prosperity. The scientific community had begun addressing concerns over global warming caused by Green House Gas (GHG) emissions ever since the International Geophysical Year in 1957 [1]. More recently in 1992, the global community adopted the United Nations Framework Convention on Climate change (UNFCCC). However, little progress was made until the adoption of Kyoto Protocol in 1997. The Conference of Parties to the UNFCCC agreed that the protocol would be binding for the 37 Annex 1 countries (OECD countries, and Central and Eastern European states with economies in transition).

The Kyoto Protocol original targets for Annex 1 countries include ensuring aggregate carbon dioxide equivalent emissions do not exceed assigned amounts and by the year 2005. Three types of mechanisms were introduced to serve as tools to ensure the targets were met. They are: Joint Implementation (JI) – whereby parties undertaking GHG emissions reduction efforts would be given credit, Emissions Trading (ET) – involving tradable permits and Clean Development Mechanism (CDM) – specifically intended for those countries not included in Annex 1 to actively contribute their efforts with Annex 1 countries in terms of burden sharing and mutual assistance [2].

Even so, developed countries shy away from making any serious commitments until there is a global effort (from both developed and developing countries) on curbing GHG emissions. More recently, President Bush of the United States announced that the Kyoto Protocol had set unrealistic targets and could actually damage the US economy. On the other end, the developing countries were using the need for economic development as a ticket to avoid any full commitment towards controlling GHG emissions. From this historical flow, it is evident that most countries are waiting for others to start before anyone would start anything; thus, the slow progress in addressing environmental concerns. Moreover, some scientists as well as one recently featured in an international magazine believed (and tried to prove) that global warming and climate change are part of a normal phenomena and have nothing to do with environmental deterioration [3].

A global concerted effort would be ideal and powerful if it could work well. However, it is only human nature to protect one's own self-interest. Thus, it is not to say that any global concerted effort on protecting the environment will not work but it is not surprising to see the slow progress. There need to be other measures taken by the countries themselves that would serve both in protecting the environment as well as promoting economic growth and activities.

Whenever one talks about environmental deterioration, one cannot run away from including the energy sector into the picture. Undoubtedly, the energy sector contributes to a large portion of carbon emission and always seen as the culprit to natural habitat destruction. Whenever a dam somewhere would be built, environment activists would be fast to react by checking the environmental impact on the area if the dam comes into reality.

However, energy is an important part of any country's development and growth. When Malaysians work towards Vision 2020, energy sources and infrastructure became even more crucial. Malaysia's Vision 2020 one key objective is to achieve the status of a developed nation by the year 2020. In parallel to this vision, one could see rapid growth in energy consumption as well as great improvement in energy infrastructure so as to ensure economic activities are not interrupted by unreliable or unstable supply of energy.

Overview of Malaysia Energy Sector

Malaysia Energy Policy

To ensure stable and secure supply of energy in powering the nation's growth, Malaysia has formulated and adhered to several energy policies. These policies serve as a guideline to any energy-related activities undertaken including physical energy assets in Malaysia. Historically, the idea for these policies fruited in reaction to the world oil price crisis and started with the Petroleum Development Act in 1974. Five years later, three principal energy policy objectives were formulated:

- *Supply Objective*: to ensure adequate, secure and cost-effective energy supply through developing and utilizing alternative energy sources (both renewable and non-renewable) either from within or outside the country.
- *Utilization Objective*: to promote efficient utilization of energy and to discourage wasteful and non-productive patterns of energy consumption.
- *Environment Objective*: to minimize the negative environmental impacts of the energy supply chain, i.e., energy production, transportation, conversion and utilization [4].

These policies later served as a guideline to the four-fuel diversification strategy adopted by the Government of Malaysia in 1980, which complemented the national depletion policy. The four-fuel strategy stressed a national energy mix based on the utilization of oil, natural gas, hydropower and coal. Renewable as a fifth fuel is now being highly recognized as an option of being added to the diversification strategy. It should be noted that Malaysia has never been and is not planning to include nuclear power as a source of energy. Even though nuclear power is acknowledged to be a clean source of energy, nuclear power is only used in other fields. Malaysia Institute of Nuclear Technology (MINT) housed a 1-megawatt (MW) thermal research reactor operated only for research purposes.

Malaysia Energy Supply and Consumption

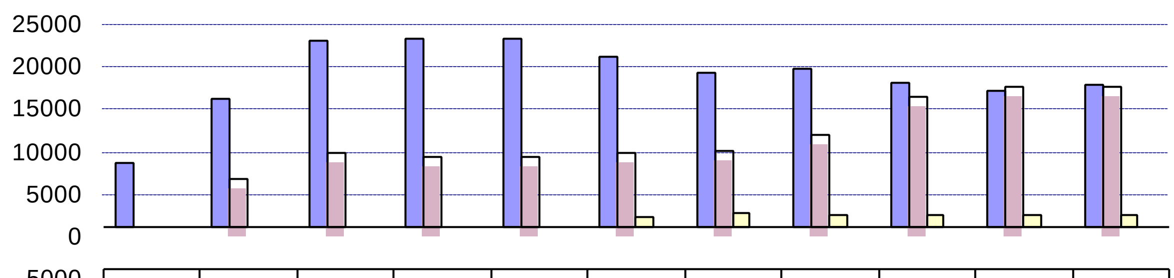
Malaysia's energy requirement in 1998 touched 25,588 kilotonnes of oil equivalent (ktoe) while electricity demanded was 4,577 ktoe, which is 18% of the total energy requirement. Due to economic development despite the slowdown experienced currently, energy requirement is expected to increase, albeit at a slower pace during the economic slowdown that affects the US and most Asian countries. Malaysia's primary source of energy is oil but the recoverable reserves in Malaysia is depleting. The 1998 oil reserves stands at 3.6 billion barrels. Other sources of energy is also depleting with gas reserves at 85.8 trillion standard cubic feet (tscf) and coal reserves at 1,024.5 million tones [5]. Malaysia's hydropower potential is large at 123,000 Gigawatt Hours (GWh) (see Table 1 below). However, it is hard to tap into the coal and hydropower reserves due to the remoteness of the areas offering those potentials. Most of those areas are buried inside the heart of Sarawak's (a state in northern part of Borneo) thick rainforest.

Table 1: SOURCES AND RESERVES

Sources	**Reserves**
Oil (in billion barrels)	3.6
Gas (in trillion standard cubic feet)	85.8
Coal Reserves (in million tones)	1,024.5
Hydroelectric Power Potential (in Gigawatt Hours)	123,000

With the depletion of oil reserves and without major new discoveries, Malaysia would become a net oil importer in 2008 as specifically stated in Malaysia's third Outline Perspective Plan (OPP3) [6] report.. Fig. 1 shows the trend of Malaysia's oil trade with the international community.

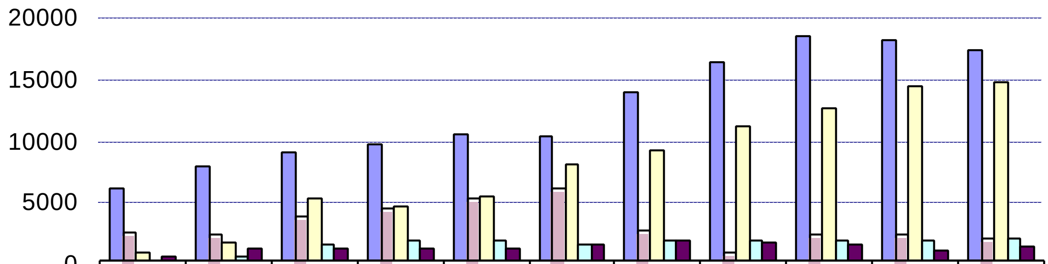
Fig.1: Net Export of Crude Oil, Natural Gas & Electricity (ktoe)



	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998
Crude Oil	7585	15036	21902	22200	22215	20049	18160	18518	16859	16022	16626
LNG	0	5658	8686	8278	8262	8654	8938	10790	15251	16396	16429
Natural Gas	0	0	0	0	0	1258	1589	1474	1474	1340	1444
Electricity	-7	-5	5	2	2	-2	-4	2	1	-1	-1

To avoid heavy dependence on only one primary source of energy, Malaysia is now turning towards other types of fuel such as natural gas and alternative fuels, which can be considered to be efforts that promote environmental preservation. Fig. 2 demonstrates the declining trend in oil utilization. From the figure, one can see that oil dependence has started a declining trend since the year 1996.

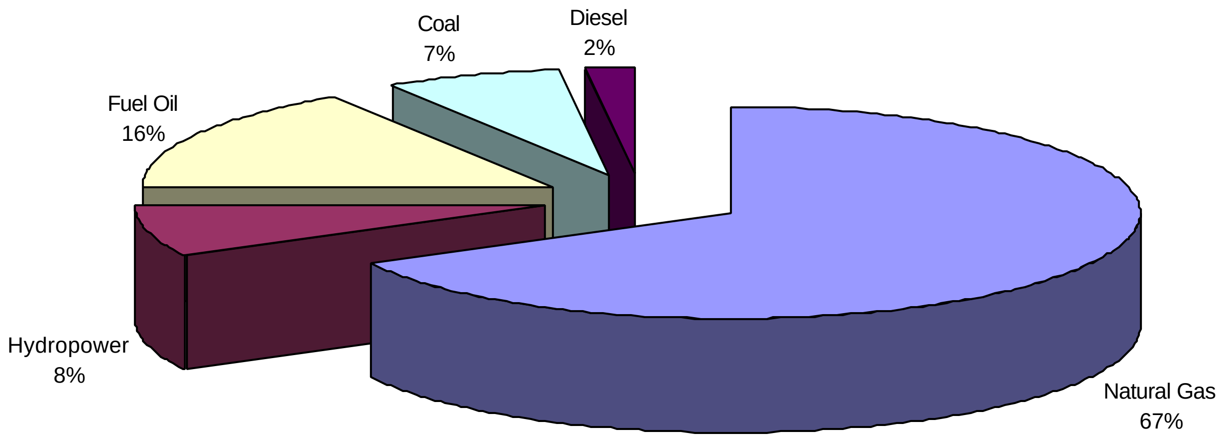
Fig.2: Commercial Energy Supply (ktoe)



	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997	1998
Crude Oil	5901	7579	8783	9443	10175	10135	13605	16159	18255	17916	17132
Petroleum Prod	2323	2131	3651	4165	5100	5814	2446	610	2099	2113	1763
Natural Gas	697	1487	4991	4390	5142	7729	8977	10974	12339	14108	14549
Coal and Coke	53	362	1326	1562	1647	1352	1563	1612	1677	1622	1731
Hydropower	383	1019	915	1053	997	1262	1652	1540	1243	790	1113

Natural gas consumption has been steadily increasing replacing oil utilization. Extraction is currently controlled at 2000 million standard cubic feet per day (mmscfd) and is believed to last another 40 years [4]. In 1998, natural gas is the biggest input to power stations in Malaysia with 67% followed by fuel oil (16%), hydropower (8%), coal (7%) and diesel oil (2%) (see Fig. 3 [5]).

Fig. 3: Energy Input in Power Stations, 1998 (ktoe)



More recently, co-generation and renewable energy has become more important as a source of energy. Although the cumulated contribution towards energy supply is small currently, with proper technology and research & development, it is believed that these more environment friendly efforts could prove to be a more important source of energy in the future. Table 2 shows the current and future (in planning) capacity for major co-generation, renewable and waste heat generation [4].

Table 2: TOTAL CAPACITY OF MAJOR CO-GENERATION, RENEWABLE AND WASTE HEAT GENERATION LICENSEES IN MW (AS AT 31ST DECEMBER 1998)

Status	**Natural Gas**	**Non-Natural Gas***	**Biomass****
In Operation	247.0	119.1	71.8
In Planning	457.5	92.3	5.2

Notes: *including waste heat and gas from industrial/refinery process, diesel and hydro.
*or agricultural waste

Source: Department of Electricity Supply and Gas, Malaysia

Malaysia has long established five-year planning cycle periods and is now in its 8th Malaysia Plan for the period 2001 to 2005. In the newly published 8h Malaysia Plan, it was stated that "concerted efforts will be undertaken to ensure the sustainable development of energy resources, both depletable and renewable, in meeting the energy demand of the economy" [7]. This was hoped to make the nation more competitive and resilience. The main focus would be to concentrate on adequate, secure, quality and cost-effective supply of energy, promoting efficient utilization of energy and minimizing the negative impact it could impose on the environment. Below is an excerpt from the plan regarding strategies for the 8th Malaysia Plan period [7]:

- ensuring adequacy and security of fuel supply as well as promoting the utilization of gas and renewable energy;
- ensuring adequacy of electricity supply as well as improving productivity and efficiency;
- developing the energy-related industries and services as well as increasing local content;
- promoting Malaysia as a regional center for energy-related engineering services; and

- encouraging efficient utilization of energy, particularly in the industrial and commercial sectors.

It is worth noting that demand for petroleum products is projected to grow at 7.2 % per annum, mainly from transport and manufacturing sectors. However, the share of petroleum products to the total commercial energy demand is expected to decrease to only 67% in the year 2005. The big consumers of petroleum products would still be the industrial and transport sector. These two parties are the primary targets for energy efficiency efforts due to the large overall impact they will have if their consumption of energy decrease.

Establishment of a center called the Malaysia Energy Center or Pusat Tenaga Malaysia (PTM) is also in line with the nation's effort to ensure energy projects adhere to the policies and guidelines set by the government as well as to minimize costs of monitoring those projects. Pusat Tenaga Malaysia coordinates many energy efficiency projects including those that will be discussed later in this paper. It is also the home of many energy-related data that used to be scattered in various organizations in such a way that planning on energy development for Malaysia was not very integrative at that time.

Malaysia's Efforts on Achieving Development through Environment Friendly Activities

As a party to the UNFCCC, Malaysia has made its own initiative in achieving sustainable development through energy efficiency programs and other environment friendly activities. As stated before, the major consumers of energy in Malaysia is the industrial sector followed by the transport sector. The discussions that follow will put into perspective actions taken by Malaysia in ensuring an environment friendly development of the nation.

Industrial Energy Efficiency Improvement Project in Malaysia (IEEIP) [8]

This project was developed in the context of Global Environment Fund (GEF) Operational Program No. 5: Removing Barriers to Energy Efficiency and Energy Conservation". IEEIP was initiated in the middle of 1997 and approved by GEF Council in June of 1999. It was officially launched by the Minister of Energy, Communications and Multimedia, Malaysia on 30th July 1999 in the nation's capital city. The project commences in August of 1999.

In line with GEF Operational Program No. 5, the IEEIP project is aimed at improving energy efficiency in Malaysia's industrial sector by removing barriers to efficient industrial energy consumption, creating sustainable institutional capacity to provide energy efficiency sources and a conducive policy, planning and research framework. The IEEIP focused on eight energy-intensive manufacturing sub-sectors in order to maximize gains and attain set targets. The set targets are as stated below:

- Reduce industrial sector energy usage by 10% (with reference to "business as usual" scenario) by the year 2004.
- Reduce energy intensity by 10% in the year 2004
- Reduce GHG emissions from the industrial sector by 10% in the year 2004.

There are eight sub sectors targeted for this project: wood, food, glass, cement, rubber, pulp & paper, iron & steel and ceramics. Key party to move this project into action is the project National Steering Committee (NSC) chaired by the Economic Planning Unit (EPU) of the Prime Minister's Department of Malaysia, and co-chaired by the Ministry of Energy, Communications and Multimedia. Members of the project include representative from the public and the private sectors. PTM played the role of its implementing agent. Several key activities of the IEEIP project are:

- Energy Technology Application Programs:
  - Energy Use Benchmarking Program
  - Energy Auditing Program
  - Energy Rating Program
  - Energy Efficiency Promotion Program
- Energy Efficiency Support Programs:
  - ESCO Support Program
  - Energy Technology Demonstration Program

- Local Energy Efficient Equipment Manufacturing Support Program
- Financial Institutional Participation Program

Energy Use Benchmarking Program

This program addresses the lack of "benchmark" information regarding the performance of various processes in different industrial sub-sectors. Project team will develop a database to support the storage and processing of information from various industry reports and energy audits. The benchmarks will be based upon best international industrial practices.

Energy Audit Program

This program aims to achieve practice of energy auditing in industry to become common and part of the industry's energy management efforts. The team members was responsible for developing a standardized energy audit procedures and tools. The Energy Audit Program was to develop sectoral (industry group) audit teams for the eight industrial sub sectors. Another task of the program's team is to develop "energy efficiency features" assessment mechanisms for new industrial facilities.

Energy Rating Program

The third program addressed the barrier concerning the lack of information on energy use performance of equipment and machinery used. Those in-charge of this program have the responsibility to provide information on energy-efficient equipment and energy rating programs to increase awareness. This program aimed at encouraging the use of energy efficient equipment in the industry and to set up industrial equipment testing facility as well as to establish energy ratings (including labeling of appliances and motor).

Energy Efficiency Promotion Program

This program addressed the information barriers that hinder the implementation of energy efficiency and conservation (EE&EC) efforts in industries. It aimed at disseminating information on energy efficient practices and EE&EC technology applications in industries. The program will establish an association of accredited energy specialists, consultants and technology developers and providers.

Energy Service Companies (ESCOs) Support Program

Due to the ever-high capital needed for smaller companies to enter the energy industry, this program is aimed at stimulating the establishment of credible and proactive ESCOs. It will develop a sustainable institutional and legal framework for ESCOs that would assist local ESCOs to prepare bankable project proposals, business plans and to secure financing arrangements. The program would be key in advising ESCOs in defining feasible products and services that they could offer and evaluate the risks associated with performance contracting.

Energy Technology Demonstration Program

This program aimed at replicating the demonstrated energy efficiency technologies in other industrial facilities (including those abroad) to prove the applicability and feasibility (technical and economical) of those technologies in local setting. Results of operations would be documented and disseminated for the benefits of the relevant local industry. This program would be responsible for the provision of technical and financial advice to industrial energy users.

Local Energy Efficient Equipment Manufacturing Support Program

This program addressed the barriers concerning expensive imported energy efficient equipment and the lack of locally manufactured cheaper energy efficient equipment. Under this program, local manufacturers would be trained on high efficiency equipment designs. Funds and technical assistance would be provided to eligible equipment design and manufacturing improvement projects.

Financial Institutional Participation Program

This program is aimed at setting up financing arrangements to provide loans to eligible companies (like ESCOs and equipment manufacturers). The program would also arrange for local banking and financial institutions training on financing EE&EC projects in industries.

Efforts Taken in Curbing GHG Emissions in the Transport Sector

One common effort taken by the government that is often done by other countries as well is to promote car-pooling. However, this effort is admittedly not showing much of its intended results, as was the case in most other countries. Another effort was to promote the use of natural gas as a fuel alternative for vehicles. In promoting the Natural Gas for Vehicles (NGV), the government has fixed the retail price of NGV at half the price of petrol. NGV is a clean and lead-free fuel. Additionally, "import duty and sales tax exemption were also given to the imported component of the conversion kits and NGV refueling equipments" [9]. NGV is mainly targeted towards the public transport industry. A mandatory ruling of a 25% requirement on new taxis running on NGV was made to ensure the effort would show positive results. Although the effort is currently concentrated in the Klang Valley area, the targeted group is expected to include bus fleets, vehicles owned by large corporations and government agencies.

Another suggestion underway was the use of "biofuel" or biodiesel, which is actually methyl or ethyl esters, derived from vegetables. Malaysia could formulate its biodiesel from palm oil, which would then be considered as a renewable energy. The Malaysian Palm Oil Board claimed that the fuel properties between palm oil and diesel are similar. However, this effort needs to be preceded by thorough research and PETRONAS (Malaysia's oil company) has biodiesel research collaboration with MPOB [9]. Other potential alternative cleaner fuels for the transport sector are electricity and solar power, which have not reached a commercial stage yet.

Malaysia has upgraded its public transport facilities to include commuter trains that emphasized environment-friendly features. The Light Rail Transit System I (LRT STAR) had commenced commercial operation at the end of 1996. The ridership count of passengers-per-day (ppd) for LRT STAR has increased by about 66% from 1997 to 2000. Another LRT system called the LRT PUTRA increased its ppd growth count by about 291% per annum since its operations in 1998 till the end of 2000 [9]. Quality improvement of bus transportation is also underway. Highways connecting major cities and towns have been constructed and excellently maintained while road expansion activities have been undertaken to decrease road traffic congestion and improve traffic flow.

Other Energy Efficiency Initiatives and "Green" Contributions

Malaysia has undertaken several other projects, which are geared towards a more efficient utilization of energy. This includes collaboration with Japan External Trade Organization (JETRO) and Japan International Cooperation Agency (JICA) that carried out energy audits of several companies in Malaysia. Malaysia also took advantage of the funding from Japan Green Aid Plan, New Energy and Industrial Technology Development Organization (NEDO) to perform a feasibility study for Energy Conservation Model Project (ECMP) in three energy-intensive industrial sectors [1]. On-going efforts and collaborations with organizations like those aforementioned, GEF and Danish cooperation for Environment and Development (DANCED) are in place to ensure transfer of technology and knowledge to Malaysia on environment-friendly approaches in energy utilization.

Malaysia is also successful in its four-fuel diversification policy with the addition of renewable energy as the fifth-fuel option as was discussed previously. Malaysia has turned towards natural gas as a source of energy reducing its dependency on fuel oil. Moreover, Malaysia is rich with high quality fossil fuels and has been exporting its Tapis crude oil with sulphur percentage weight only less than 1% [1].

Conclusion

Although many energy efficiency initiatives above are started by the Malaysian government, the operations and success of those initiatives largely depends on the collaborative effort of both the public and the private sectors. For example, the IEEIP project overall objectives could not be achieved without cooperation from the private sectors. In actuality, the government only provides the assistance, international networking with other organizations and advice to the local industries to improve on energy efficiency. These initiatives are opening up business opportunities for smaller organizations or companies like ESCOs to get its share of one of the largest industries in Malaysia.

Curbing GHG emissions is a larger community effort that includes governments, businesses and the public. The catch for businesses to get involved seriously in energy efficiency efforts is if the efforts would bring positive impact on their bottom line. In fact, energy efficiency could increase productivity via producing goods with lower energy input. Incentives should be given by governments to encourage the use of more efficient energy sources in such a way that businesses would find it profitable to change industrial facilities or make other necessary changes in order to use the more energy efficient technologies or fuels. Lastly, although a global effort in curbing GHG emissions a needed cooperation, each country has its own responsibility to respond to environmental protection and preservation issues.

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Forging Partnerships and Information Sharing for Sustainable Business Development

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Abstract

Businesses have always had a Love-Hate relationship with channels and channel partners. So it has naturally been tempting for companies to look at various opportunities that could essentially strengthen the relationships with the existing partners and also get newer ones. In this paper, the authors have tried to focus on the following critical issues to forge partnership and information sharing to have sustainable business development in global perspective:

- **Partnership Relationship Management,**
- **Trust as a catalyst to develop relationship with the partners,**
- **Sharing of information and risks to forge partnerships, and**
- **Total Partnership Relationship Management.**

The endeavor of the authors is to develop a *'Symbiosis Model'* to make partnership effective for sustainable business development. This model would cover all the aspects mentioned above. The focus is on the management of relationships with the partners and the significance of long-term relationship with them in creating value and mutual growth. The model also focuses upon the trusting mechanism that the organisations should build to strengthen their relationships with their partners. Hence the Model is developed to make the organisations compatible to absorb the shocks of the turbulent competitive environment.

Introduction

Today technology drives the businesses. Technology is benefiting the customers to its fullest, which in turn has created a cutthroat competition among the businesses globally. Doing business in the high tech world is all about whom you are doing business with, and these days channel partnerships are more important than ever. Every player in the market is making its corporate and business strategies with a view of a global player. To have a business at a global level, it has to have partnerships in the business environment, which in reality act as a lubricant in all business process; absence of which creates a wearing and tearing in business flow. So its no surprise that many vendors want to keep close track of their relationships with resellers, alliance partners, and the like to strengthen relationships, shore up any faltering partnerships and maximize the 'partnerships value' for everyone involved. Partnership relationship comes about through **partnering,** *which is a process where a customer firm and supplier firm form strong and extensive social, economic, service, and technical ties over time, with the intent of lowering total costs and /or increasing value, thereby achieving mutual benefit [3].*

The authors have proposed a 'Symbiosis Model of co-learning' based on the views of the respondents in the survey conducted by the research team. In this survey respondents were asked open questions about the need of information and to what extent it should be shared with their partners, if at all it has to be.

To develop high level of trust among your partners in every sphere of business the organisations need to have a trusting mechanism for sharing of information. Such type of business environment is created, when an enterprise extends from the suppliers from any part of the world to the customers from any part of the world.

Though companies have gone into partnerships earlier also, but their significance was not realized in the value chain. Customers remained at the 'Numero-Uno' in the priority list until today, when timing is everything. Traditional sales-side value chains have been fairly linear and sequential: There is a manufacturer that sells to a distributor, and on the other side is the reseller community, and on the other side of the reseller is the end-user [Fig. 1]. In the race to have an edge companies have tried to alter their value chains and the advent of e-commerce has further necessitated this alteration and has changed it into more networked value chain.

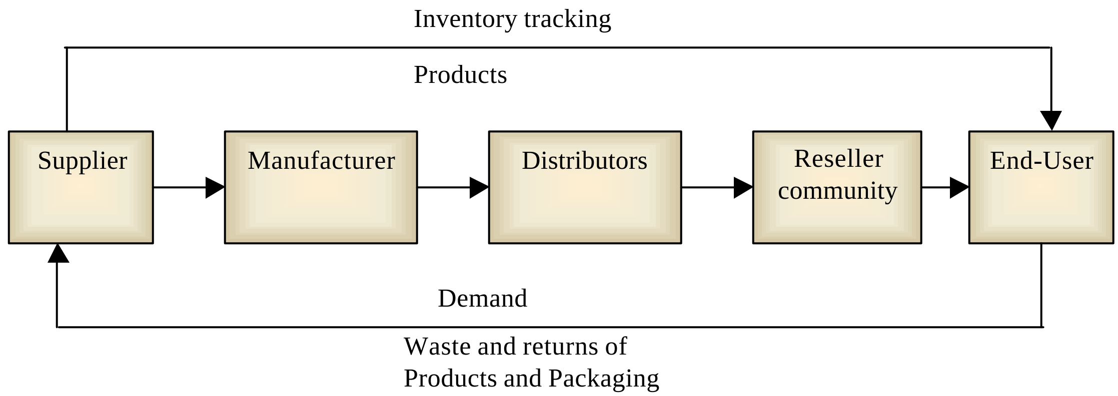

Fig. 1 TRADITIONAL VALUE CHAIN

The networked value chain has put the partners in the relationship management loop [Fig 2]. When the number of these partners increases, there management needs special attention in terms of their involvement with the company, the costs incurred and the return that they get from it. With all of these partners, generally the companies have no idea, which one is actually producing to the levels they should be. When the partners are managed separately, one can make sure they are up to speed. Then more time is spent with that partner, and incentives are created and rewards are given to those who are producing.

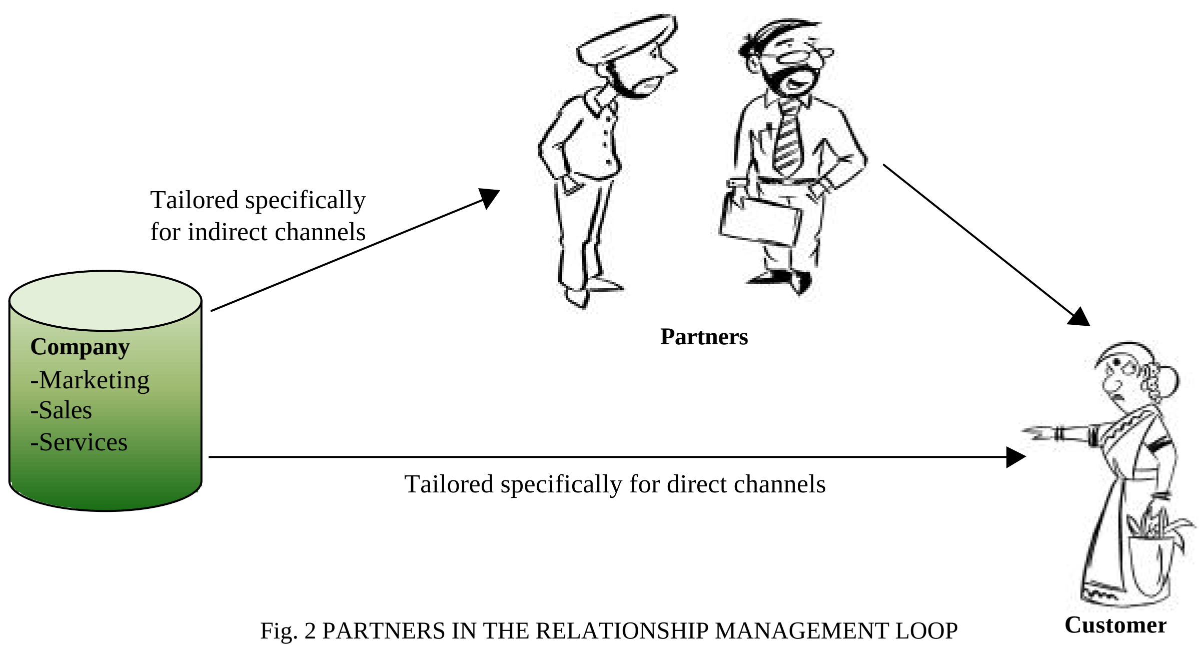

Fig. 2 PARTNERS IN THE RELATIONSHIP MANAGEMENT LOOP

Information Sharing for effective Partnership Relationship Management

Partnership is all about creating a broadly connected world, from suppliers to producers to customers to the customer's customers that can react more quickly to changes in supply and demand. Companies need to partner with suppliers and customers to develop the right products, find the right markets, and deliver the goods on time without stockpiling huge inventories. ERP and CRM tools have helped many businesses lay a foundation to make all this happen; now, these companies are looking for the next edge by building close partnerships with the suppliers and the customers.

Partnership may sound like one of those irresistible business ideas that everyone supports, but the reality is that very few companies are at the forefront of this flow. Many companies remain suspicious of opening up too much. Only 30% of the companies surveyed share their monthly or quarterly sales data with their suppliers and only 20% make collaborating with customers part of early product development. Those who have shared their data with more than one partner find this strategy excellent and those who have shared with just one feel that way.

Most businesses aren't built to take full advantage of collaborative networks, they haven't yet approached that state in which suppliers and customers interact unconsciously in an illimitable manner, where customer feedback ripples back on its own through the supply chain. Only a rare few companies have set their sites on something approaching that. It calls for decentralized decision-making structures that let knowledge workers act on the information that IT tools place before them and this requires a revolution in the thought processes and operating structures of a business. It's a basis for loop connecting employees, customers, and suppliers i.e., it is a kind of broad effort at collaborative business that draws from traditional technology disciplines from Knowledge Management (KM) to ERP to SCM to CRM [Fig. 3].

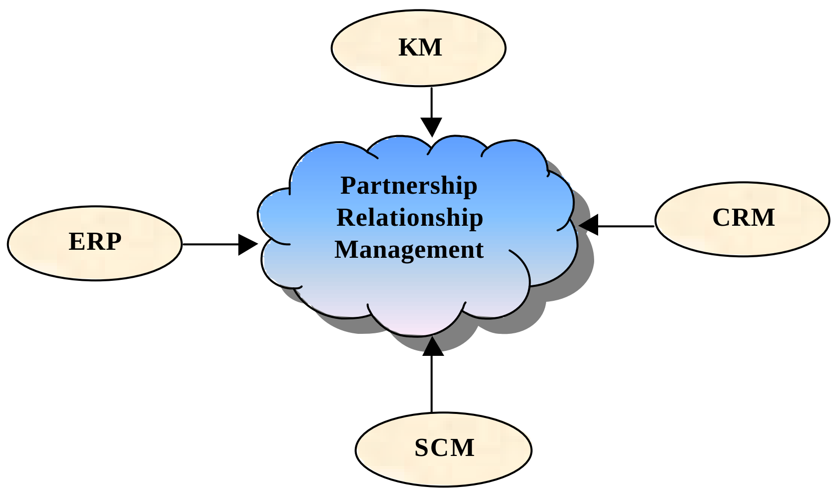

Fig. 3 PARTERSHIP RELATIONSHIP MANAGEMENT CONTRIBUTORS

This helps in developing a fully collaborative networks internally and across its supply chain and customer base and ultimately link them all together. If the loop can be connected from the suppliers to customers, the entire process can be made more efficient. The thing that matters the most, is that, the correct inforamtion has to be pushed into the development chain in right time and in right figures. Even the distributors can set up a web site to highlight information of particular interest to their customers as the cost of getting information out is greatly reduced. The consumers/end-users are the most benefitted ones in this way, as the distributors have the most up-to-date information.

Though increasing sales is the most common goal for collaboration, companies are also collaborating to cut costs. About 45% of the respondents to the survey view collaboration as a means to squeeze expenses out of their supply chain and target other pockets of inefficiency. The focus has to be on the problem areas and the companies have to make sure that they supply the accurate information to their customers and have to make sure that their peronnels have thorough knowlegde of what data was going out to the customers, so that they are prepared to deal with new, sometimes tougher questions that are ignited by the supply of better data. Customers can access reports and analyze personal account information, this enables them to identify potential sabings. Therefore they are willing to pay for the information.

Bottlenecks in Information Sharing

True business collaboration is being adopted only gradually by large corporate, despite the fact that it has enormous potential. According to the survey, apart from some notable success stories, most businesses don't routinely collaborate with customers and suppliers. Only half of the respondents say that they routinely share information with the customers and just 40% routinely share information with suppliers.

Technology itself forms a part of the problem. Most of the times, the incompatibility in the platforms used by the manufacturer and the distributors and other successors in the chain poses problem for information sharing. The exchange of critical business information is limited to the fact that some have advanced systems and some have systems with limited functionality.

Companies are reluctant to share their information with their suppliers

About 70% of the respondents in the survey don't regularly share any business information with suppliers. The most common area for companies to share data with their suppliers is in the early product development phase, where 40% of the respondents say they routinely engage in partnerships. The recent slowdown and the fact that the high tech industry was caught off guard by it has left some doubts over the promise of supply-chain partnerships. Networking company Cisco Systems, heralded as a master of supply-chain collaboration for its outsourced manufacturing network, had to write off $2.5 billion in excess inventory in 2001. Even though Intel extensively shares product and sales information with manufacturers, the chipmaker's first quarter profits went down drastically because of an unexpected rise in inventories.

Some find information sharing a costly affair. Some small players usually don't have technological platform to do so, and it would be too difficult and costly for them to build one. For this, one could always wait for a broader industry solution.

Security risks in partnerships

Nearly one fifth of the companies surveyed report security problem as one of the downsides to increased collaboration. Business partners thinking about liking applications or networks to share information must first sort out the security issues based on the kind of relationship they will have, how closely their networks will be tied, and who will be responsible for security. This problem has nothing to do with the technology but has everything to do with the nature of relationship between the companies.

When a partnership involves tight integration of two companies' business process, and the companies have established permanent, joint management of their endeavor, security management should be handled the same way, with just one person responsible for both companies' collaboration security so that, you have at least one person solely in charge. To deal with the security problem, companies should avoid connecting their networks directly. Instead, they should connect only a few applications. The information that the companies are willing to share with their partners are given below in the sequence of their importance as given by the respondents of the survey:

- Order Management
- Collaborative Planning
- Marketing Data
- Monthly or Quarterly Sales Data

- Aggregated Customer-Sales Data
- Sales Forecast
- Inventory
- Product Design or Engineering
- Individual Customer-Sales Data
- Segmented Customer –Sales Data
- Aggregated Customer Demographics
- Financial Data
- Cost Structures by Product or service line

How do we reap the crop of success?

One has to overcome the hurdles in the way of collaboration. One of the most critical hurdles is that companies are reluctant to share information. There are two reasons for this, one is that they are not sure about the security of the information they are supplying and secondly they feel that once they impart the knowledge they have, then they will not be required anymore and hence would loose the power. They must realize that if knowledge is power, sharing it can build even more business muscle. That's the idea behind collaboration. This concept is proving to be a tough sell in a business culture raised on the belief that sharing knowledge is surrendering power. Companies can always go on to sharing knowledge, but they need to strike a balance on what information has to be shared and what should not be shared. This could be very well understood with the help of 'Symbiosis Model of co-learning' [Fig. 4], which is based on mutual trust. This model has laid trust as the basic foundation for building partnerships. The model has been developed with the help of the responses gathered in the survey. The respondents were asked about the information they are willing to share and the information they are not willing to share at all. The model extends from the collaboration with the suppliers and various alliances up to the collaboration with customers, and is enriched with the seven key ingredients for healthy partnership [Perlmutter Howard, 2001], hence takes care of total relationships in a partnership.

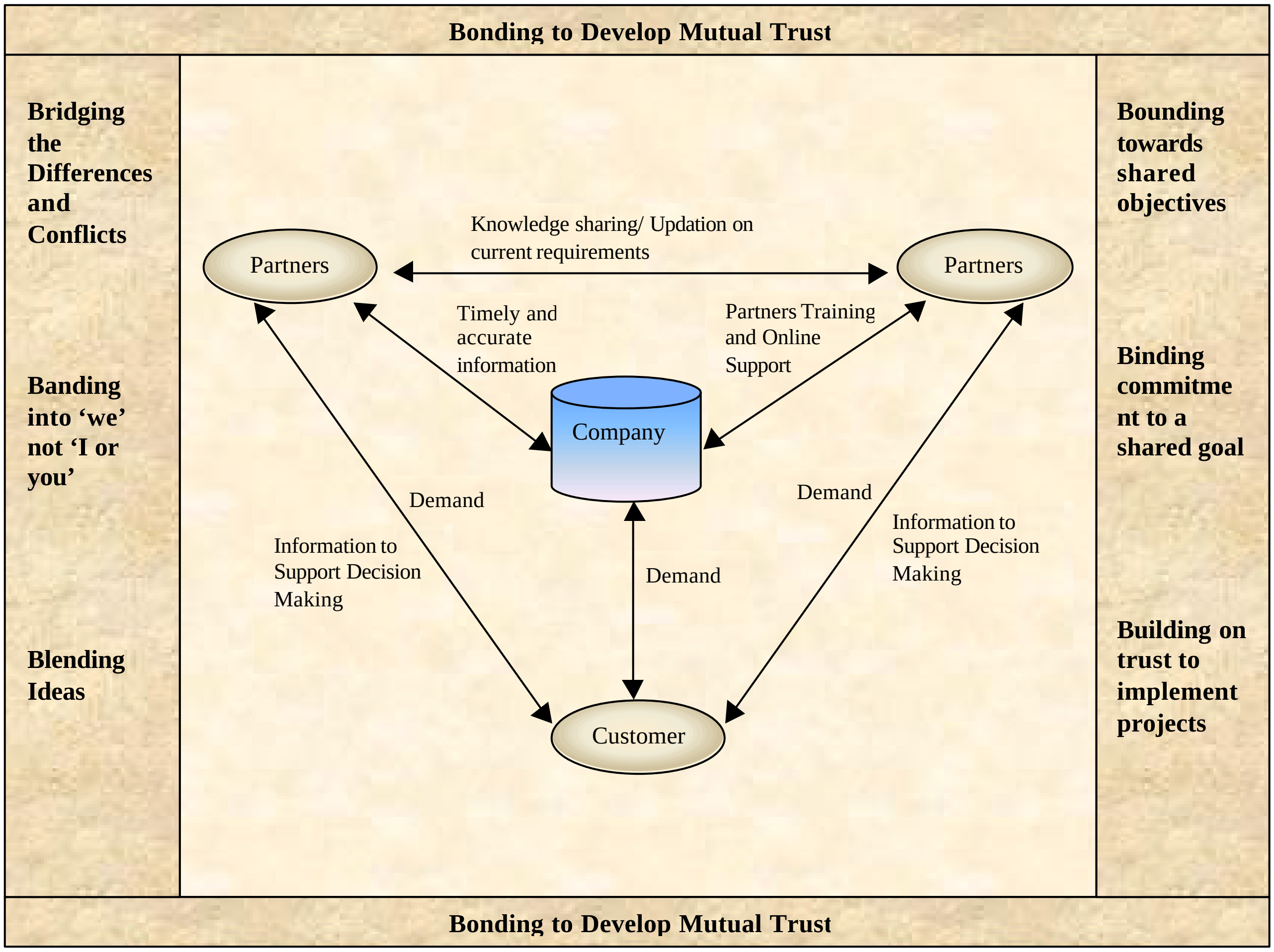

Fig. 4. SYMBIOSIS MODEL OF CO-LEARNING

This model depicts that all the participating entity is an active member in the learning process. They are mutually dependent on each other for information and hence learn from each other. Suppliers are dependent on the firms for the sales and inventory information and they need it periodically, just at the right time for continuous supply of the materials. Here partners are directly interacting with each other. This type of interaction keeps them updated about the current demands and requirements. Like wise, customers directly exchange information with the suppliers, they are mutually benefited with this, as suppliers get a feel of the market demand and preferences and the customers get valuable information about the product or the services that helps them in decision making. There is no stopping at any point, then the ideas are developed that one entity could not have developed on its own. It deals with the quality of the information sharing among the partners and the trust building aspects, discussed later in the paper. This model is quite effective for collaboration when five trouble signs [Perlmutter Howard, 2001] are avoided:

- Fallow: Active avoidance to starting conversation
- Feeble: Lots of worthless information-sharing
- Frozen: Two sides stalemated over an issue
- Failing: Trust and communication decreasing
- Failed : With no attempt at communicating

Building trust among partners

Building trust as an aspect of managing the relationship deserves particular attention. For a partnership to be formed, there must be some initial trust between the companies involved. As time passes, trust may be enhanced or destroyed [Gill and Butler, 1996]. In the early stages, the idea of trust seems related to the reliability. It takes time and interactions to build confidence in the partner's good faith and develop loyalty. Its like a chain reaction which triggers with satisfaction [Fig.5] which leads to trust and then finally to loyalty.

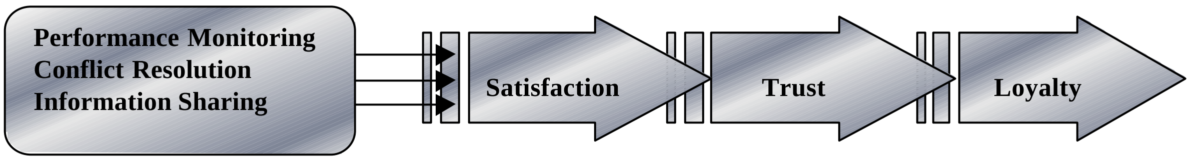

Fig. 5 LOYALTY CHAIN

The survey reveals that legal contracts play no significant role in the process of trust building. While it is necessary to move prudently and to have a good, tight contract, still this is not sufficient to develop healthy partnership. The contract can be the basis on which partnership is developed. The challenge is to make it alive, but nobody will enforce it. Direct contacts are very important in developing trust-based relationships. Over time, the interactions between the partners help shape a deeper trust or else they destroy it. This process of trust building is influenced by how decision-making is carried out, and by the companies' attitude toward conflict resolution. Decision making by consensus involves lengthy discussions, but it brings the partners' attitudes closer one to the other. Interpersonal relationships become the cornerstone of trust building and interpersonal relationships develop over time.

Do we Gain or Loose with Partnerships or Collaborations?

The respondents of the survey have given their experiences of positive results [Table1] and negative results [Table2] of their collaboration with partners, suppliers, or customers. These results are mentioned in their priority sequence.

Positive Results of Collaboration
- Increases sales and marketing opportunities
- Improves Collaboration
- Promotes Innovation
- Establishes more efficient processes
- New Customers
- Increases Customer Satisfaction
- Encourages Closer ties
- Better Business Decisions
- Gain Competitive advantage
- Increases revenue
- New Business Partners
- Reduce Costs
- New Suppliers
- Higher Profit Margins
- Improves Quality

Table 1.

Negative Results of Collaboration
- Increased Competitive Challenges
- Complex or Confusing Processes
- Increased Costs
- Missed Opportunities
- Data Corruption
- Business Downtime
- Lower Profits Margins
- Secrets Compromised or Security Problems
- Lost Customers
- Decreased Customer Satisfaction
- Lost Business Partners
- Close Ties Discouraged
- Lost Suppliers
- Decreased Revenue

Table 2.

Strengthening Business Partnership

There are various issues of partnership and ownership that arise frequently, creating significant trouble spots at the developmental stages of collaboration. These issues might include questions of stock distribution, investment of key resources, growth, leadership style, contributions and fairness in benefits, buyouts, strategic direction, performance accountability, roles and responsibilities, and management philosophies. These issues if left unresolved may hinder a venture in its growth and evolution; at worst can kill it. Partners must collaborate to resolve these issues. One can go step-by-step to strengthen partnership [Kerns D. Charles, 2000].

Determining common ground and valuing the relationship

Recognizing Contributions

Acknowledging each party's benefits

Clarifying functional roles vs. equity ownership positions

Indexing the desire for success.

Conclusion

Collaborative efforts to succeed at growing businesses through partnerships or other business alliances can have tremendous benefits for the participants. Partnership is like motherhood concept. Who can be against it? We all should collaborate but one should look at the consequences first before collaborating and sharing information. The study sheds some light on the management at the initial stages in the partnerships between companies and suppliers, customers and other alliances. Partnership has to be based on the foundation of trust. The partners should be managed by focusing on building partner loyalty and getting partners trained and prepared to adequately sell your product. They should be treated as the true extensions of the company and give them the tools that they need. To develop healthy partnership companies have to go for sharing of information. Before getting into partnership they must first assess the trustworthiness of their partners and then only should they indulge into it.

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Management Challenge in Transitional Economy: From Stability to Instable Environment - Indonesian Case Study

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Abstract

For more than three decades, Indonesian Economy has been growing steady and stable. Business, trade and foreign investment amazingly growth in Indonesia. It was named to be the next Asian's Tigers after Singapore, South Korea and Taiwan. However, a great currency shock at 1997 that wiped all over Asia had become a turning point for South East Asia's economy, and so did Indonesia. A stable growth in economy and friendly investment environment had been shifted to be a drastic declining in economic growth and volatile social-economy condition.

Such volatile condition had made Indonesian economy in transitional period whether it will become more capitalist or socialist. Uncertainty is what management should face as a consequence of the condition. Under those conditions, management were facing a certain environment makes them easier to make a business decision and forecasting. What management should do is (1) Avoid any important decision and waiting for the new political economy equilibrium, (2) Focus on niche-small market which is the business expertise, (3) Communicate company's product to the market continuously, (4) Moderate Budget and management planning, (5) Shorten performance evaluation. Within a period of uncertainty, those four action will help management to make a balance and safe decision. An example from success story of management in transitional economy is represented by 50 small and medium enterprises (SMEs) listed in a research by Andersen Consulting (which now called Accenture) and SWAsembada (Indonesian Business magazine).

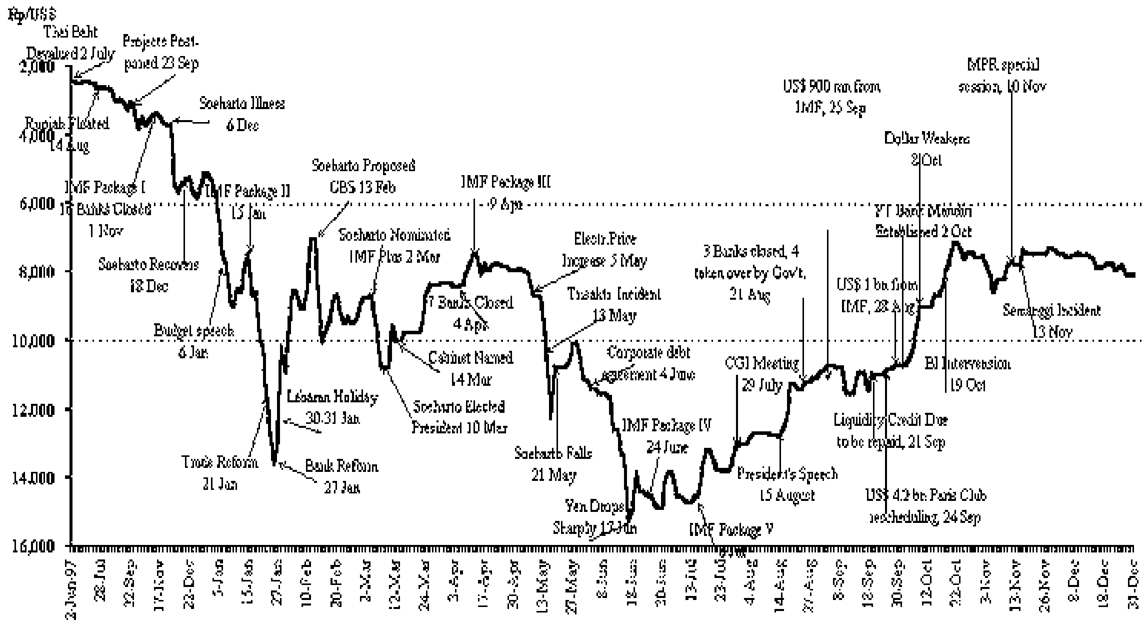
Introduction

At present, Indonesian Business and Industrial environment is under transitional era, from the era of autocratic-highly controlled government that lead them into stable economy to the new economy order, which still under construction. Forming the new economy order brought Indonesia to many serious consequences, such as unstable growth, trade deficit, and also social instability. In the other hand, the next economy system is still unsure, whether it will become more capitalistic or socialist. This serious consequence rises as an effect of decades of false governmental policy of Soeharto which Dutch people used to say "*heij denkt allen zo ver voor uit net als neus lang is*". They hide every bad result and published a pretty looking report for the public.

As we can see at **Figure 1** on 19 months currency movement within June 1997 till December 1998, Rupiah was fallen into a deep position to US$. From position at Rp 2,300/US$, Rupiah had dropped to Rp 15,600/US$ before it recovered to Rp 8,500/US$ at Habibie's Presidential period. This unstable condition had not over yet. When Abdurrahman Wahid selected as President replacing Habibie for his accountability report refused by the parliament, Rupiah shown a negative trend toward US$ and continue dropping to Rp 12,000/US$. In the time Megawati Soekarnoputri replacing Abdurrahman Wahid as President August 2001, Rupiah showed a positive trend (again) toward US$ to Rp 8,500/US$. This up and down movement really did make business and industry into a great volatile and uncertainty period.

Fig.1:INDONESIAN CURRENCY MOVEMENT AND POLITICAL ISSUES

Source: Indonesia NET Exchange, www.indoexchange.com



Six presidential periods within six years followed by different public and economic policy is what Indonesian business and economy faced in making management plan or policy. Abdurrahman Wahid, which ruled for almost two years, also made a significant contribution into this uncertainty period. His controversial comment and easy-change policy really made market and business become more volatile then ever. Hereby **Table 2**, we can see an unpredictable currency that changed obviously followed by the ruling president. What the ruling president did was really affect the market as well as the social and economy stability.

Table 2: PRESIDENTIAL CHANGE AND UNSTABLE CURRENCY

Presidential	Year	Currency (Rp/US$)
Soeharto		
7th presidential period	August 1996	2,300
Soeharto's falling	May 1998	15,000
Habibie		
Succeeded as President of Indonesia	May 1998	15,000
Ended the Presidential period	August 1999	7,500
Abdurrahman Wahid		
Elected as President of Indonesia	August 1999	7,500
Overwhelmed by the Parliament	August 2001	11,500
Megawati Soekarnoputri		
Succeeded as President of Indonesia	August 2001	11,500
At present	September 2001	9,000

Source: Various media in 1997-2001

Transitional Economy: Lesson from The People's Republic of China

The political and Indonesian economy has been changing from steady and stable political and economy condition, into a period of uncertainty. As a matter of fact, we are now in the midst of transitional economy. The best guru from transitional economy is China. For the last 20 years, Beijing's leader has developed China from a highly socialist system into a free market competition. The face of China (in several places) has been changing so fast from the time we saw it. There were thousand of miles highways in one province since China decided to change their economy system. Three top Beijing policies over economic changes are

1. Beijing since 1996 has started implementing the new strategy adopted in 1995 under which the central government focuses its support and supervision on 1,000 of the largest state enterprises while granting local government greater leeway to pursue ownership reforms in smaller states firms. A substantial proportion of new bank lending in 1996, for example, went to 300 large state enterprises selected as the best performance among the 1,000 "backbone" enterprises.
2. Central authorities also gradually reduced subsidized lending to smaller state's firms and endorsed locally initiated reforms for smaller state's firms including sale, lease, merger, and transformation into shareholding companies as well. A dominant theme of Beijing's enterprise reform plan in 1997 has been preparing for more "bankruptcies, mergers, and reemployment."
3. In addition, Beijing has continued to implement reforms intended to gradually transform the state banks into commercially viable operation. In August 1996, for example, Beijing issued new loan regulation tightening loan criteria, and this year authorities have taken a series of measures to prevent bank funds from flowing into stock markets, with the aim of reducing risk in the financial system.

Right after those three economic strategies, The Government of China implementing political strategy that reduce and minimize social shock problems. To be frank, we have to admit that China hasn't leaves their socialist government style as well. Strong military government is still being practiced in China. What wonderful is, that strong government in the other hand had made the transitional economy succeed. China changed their economy, social, and political structure gradually, not all at a time. This reason makes China to become one of the raising important economy and political power at present.

A bit different from Indonesia, the changes didn't come from the government. It comes directly from the Indonesian's grass root people. On May 2001, Soeharto who military cooped soekarno bowed before this pressure and resigned. This fast changing had ruined the wall, which built for the last 32 years by Soeharto's military pressure. Social revolution comes afterward the fall of Soeharto presidential, and had made anarchy and et cetera.

Business environment in Indonesia

As broadly known, Indonesian economy was engineered by military, almost 65% of wealth properties were under military power and its alliance, direct and indirectly. Below in Table 2 we can understand that the strong power that moves Indonesian economy was direct or indirectly owned by States and/or military power. In Indonesia, it is a common thing for retired and some active generals to control a company and seated in bureaucracy. We called things like this as ABG (ABRI-Birokrat-Golkar, Military-bureaucracy-Golkar, the ruling party) or can be read as Soeharto's click.

Above fact indicate that Indonesian economy is centrally controlled by those military click. Since Soeharto was fall on his president chair, then this established business system had change significantly. As every business need uncertainty, the period of searching a new economy form had brought business peoples into jeopardy era in their business. Different president, different approach.

There are too many alternatives for Indonesian economy. IMF pressure will take Indonesian economy to be more open and liberal, in the other hand, some power inside the country still insists to built their own economy without IMF intervention.

Table 2: MILITARY-BEREAUCRACY-RULING PARTY ECONOMIC RELATIONSHIP BETWEEN 1970-2000

Name	Bureaucratic Position	Company Name
Ibnu Sutowo (Major General, Retired)	President Director of Pertamina, a State Owned Oil Company	Indobuildco group, Nugra\Sentana
Sumitro (General, Retired)	Commander for National Defence	Rigunas Group
Tjokropranolo (Liutenant General, Retired)	Soeharto's Secretary of Military	Inico, Panarfina Kniting Industry
Department of Cultural and Education		Balai Pustaka
Department of Labor		Asuransi Sosial Tenaga Kerja
Department of Transportation		Djakarta Loyd
Department of Tourism, Post and Telecommunication		Telkom
Department of Tourism, Post and Telecommunication		Hotel Indonesia International
Department of Energy and Mining		Pertamina
Department of Energy and Mining		Tambang Timah
Department of Agriculture		PTP IX
Dharmais Foundation, Supersemar Foundation (Soeharto's Foundation)		Bank Pacific
Department of National Defenses		Tri Usaha Bakti
Military's Special Operation		Pan Group, Berkat Group, Pakarti Group, Propelat
Company Chain from Kartika Eka Paksi Foundation-Military		Aerokarto Indonesia, Asuransi Cigna Indonesia, Cilegon Fabrication, Kayan River INdah Timber Plywood, Meranti Sakti Indah Plywood, Truba Jurong Engineering, Sakai Sakti, Kayan River, International Timber Corporation Indonesia, Sempati Air, Arta Graha Bank, Danayasa Artha,
Company Chain from Bhumyamca Foundation- Marine Force, Military		Bhumyamca Sekawan, Admiral Line, Yala Trada, Yala Ladang Kurnia, KGA, ATMI, Halmahera Kay, Yala Gadam Yala Gitatama
Company Chain from Adi Upaya Foundation- Air Force , Military		Chandra Dirgantara, UPaya Guna Dirgantara, Kresna Putri Dirgantara, Dirgantara Husada, Cargo Dirgantara, Green Delta, Jasa Anka Semesta, Dirgantara Air Srvice
Company Chain from Brata Bhakti Foundation- Police Force,		Sapta Prisa Mandiri, Asuransi Bhakti Bhayangkara, Bhara

Military		Union, Bhara Induk, Tasna Trisna

Source: Info Bank 1992, Rochard Robinson, 1990 15, PDBI 1990

Managing in Transitional Economy

At present, the military economy power has been replaced with the professional private sector. But since Soeharto, backbone of the system has been unpowered, and then the economy becomes a game between new players in new political economy system. The players have their own interest and want to take control on Indonesian Political and Economy System.

Under the conditions, corporate should have a very strong and prudent management in order to survive in transitional economy era. Hence, managers should understand how to react with social and political issues that will affect their business. One of the simplest ways to deal with instable conditions is not to take any long terms decision. Strategically, managing under transitional condition is likely to be very short terms and surviving, using minimal resources and hold any important decision until conditions going better. To be frank, that action will sound closely to be opportunistic, yet, in order to survive in terms of business, corporate have to take that wait and see action.

In case of Indonesia's transitional economy, corporate also should take a distance between any political and vested interest from the ruling and the opposition party. Any connection with political interest might lead business to disadvantage position in the future, as if the party were beat by their opposition. Briefly, it might be uneasy to take a distance from any political interest for huge and giant business but at least for Small and Medium Enterprise's (SME's) that action could have worked, and big business can minimize their relationship to a neutral position.

A prudent planning in corporate resources is also an important concern in transitional economy. To hold any strategic action is the conservative way a business could do under transitional economy. Indonesian economy is still in the midst of cross way between opened to be capitalistic economy system, closed to be controlled economy system or continue floating between both of them. Thus, a short terms oriented management action will be the most appropriate posture under transitional economy.

In operational level, management that focused to maintain their market and their traditional stakeholders is likely to be more success then the one aggressively penetrates the market. Collapsed business is no longer odd news it was happened in big and small business nor good or bad corporate management. Creating a strong defined value to the customer will also works best in transitional economy. Corporate should dropped some product branch and focusing on one or two product that have the highest value to the customer. Yes it will bring lay off and downsizing, but still the corporate can allocate their best human capital to the others line of business.

Conservative actions in term of business focus and maintain a distance in political issues is considerably the best action in order to survive in transitional economy. Indonesia is definitely have a large potential to play a strong economy power in South East Asia due to the geographical site and also the natural and mineral resources, hence it will be a great advantages for the business if they could passed the transitional economy, for they will have a fundamental competence in the future when the new economy form had been established.

The Proper action dealing with transitional economy *in order to survive* Indonesia which is fully corrupted with vested interest is (1) Avoid any important decision and waiting for the new political economy equilibrium, (2) Focus on niche-small market which is the business expertise, (3) Communicate company's product to the market continuously, (4) Moderate Budget and management planning, (5) Shorten performance evaluation.

1. Avoiding any important decision should be very easy for SME's, but it could be difficult and dilemmatic for big business. The moderate action is to take a neutral position against the ruling party or political vested interest in the business. Political power in Indonesia used to use big corporation to raise their fund, since politic needs a lot of money. This practice will brought a serious problems in established country, but in Indonesia where all regulation haven't been straight and haven't been established, it will not be matter.
2. The management should focus on the niche-small market in order to save their resource and using it effectively. They would rather to get survive in something they know they were expert rather than spending money in something that is not sure. A focused market will also increase business competency and awareness to the market.

3. Communication between corporate and its market is a must for a business. It is not something business can save or avoid. Corporate customer could switch to another product or service in just a flash.
4. Moderate budget and management planning will help management to control the business over expansion. In transitional economy, it will be much safer and survive to take a moderate planning rather than expand the business.
5. Shorten performance evaluation will also help the business to take more control. The control could be done into fastening the distance between one control time to another. As of there was something happened on the plan or there are big changes on the business environment, management can take a proper action vastly. As well as taking shorten time between time control, management could also take more sample covering all are of the company during the uncertainty time. This will also help management to take control and react dynamically toward the transitional economy.

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Polska Pipe Works: Managing an IJV in the Transitional Economy of Poland

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Abstract

William Zukowski, an American expatriate of Polish ancestry was given the opportunity by his company, Stewer Technologies, to head a small joint venture in Poland. Zukowski experiences a number of difficulties in attempting to institute American management practices such as pay-for-performance, quality management, participative management, and lean manufacturing. The case also address a number of cross-cultural management issues. This case is useful for exploring the difficulties of starting an entrepreneurial venture in transitional economies of Central Europe.

Introduction

With the fall of communism in the former Soviet Union and its Eastern European neighbors in the early 1990's market opportunities opened for Western companies, which had not previously been available. The American pipe manufacturer, Stewer Technologies had previously exported in small quantities high-density polyethylene pipes to Poland. These pipes were used in Poland's major cities for sewer and drainage. With the end of communism and the dawn of a free market economy in Poland, Stewer Technologies took steps to expand its market opportunities in Poland and other Central and East European countries. With the liberalization of foreign joint venture law and its existing business associations, Stewer was able to find a Polish partner to begin the manufacturer of polyethylene pipes in the Polish city of Krakow.

The market for sewer and drainage pipes was rather limited during the previous fifteen years due to the lack of resources of the Polish government. Recently the federal government of Poland began an ambitious program of infrastructure improvement in an effort to bring Poland's major cities up to the standards of Western Europe. Very little high-density polyethylene sewer pipe was manufactured domestically, and the Polish pipe that was produced domestically was considered to of inferior quality. Most polyethylene pipe used in Poland was imported from the United States and Western Europe. Stewer saw this situation to be an excellent opportunity to produce quality pipe in Poland with lower labor and transportation costs, and the possibility of exporting to neighboring countries such as the Czech Republic, Slovakia, Belarus, Lithuania, and Hungary.

Poland

With a population of 38 million, Poland is the largest country in Eastern Europe. Poland is a very homogeneous country with ninety eight percent of its population being Polish. Poles are a Slavic people, proud of their heritage and ability to endure the ravages of many invaders and two world wars. Poland had been under the control of the former Soviet Union since the end of World War II, however, the Polish people did not embrace Soviet ideals, and in the late 1970's with a Polish Pope providing encouragement, the Polish people began a campaign for freedom. In the early 1980's Poland's labor movement flexed its muscles and gained concession from the government. During the decade political tensions ran high with the Polish labor movement, Solidarity making some gains and receiving some setbacks. By the end of the decade free elections were held and Solidarity leader Lech Walesa gained the presidency of the nation.

Poland's post-communist government began an ambitious movement towards free market reform. Privatization of state-owned industry began, and laws were enacted to improve the business climate of the country. The Foreign Investment Act of 1991 encouraged foreign investment, and in most cases allowed up to 100 percent foreign ownership of businesses. Certain restrictions on foreign direct investment remain, however, including restrictions on investment in steel, mining, energy, banking, telecommunications, and broadcasting. Poland has been very successful in attracting foreign investment, with FDI in excess of $8 billion in 1999 and $12 billion in 2000.

While the 1991 Act encourages FDI, foreign owned firms are placed at a competitive disadvantage in bidding on government contracts. If the foreign firm establishes a joint venture with a Polish company, however, the company can qualify as a domestic company and avoid the restrictions. This aspect of the law has made international joint ventures popular in Poland.

Stewer Technologies

In 1958 Fred Stewer started a small company to supply water and sewer pipes to the city of Chicago. The company grew over the years and in the 1980's the company began to receive orders for its products from abroad. International sales were not considered important to the company until the middle of the 1990's when this segment began to increase significantly and domestic sales began to drop. The company realized that the international market was not only more lucrative in most cases, but also that it may be necessary to cultivate it in order for the company to survive. Stewer established an international division in 1995 and began to promote its products through international trade shows and with the help of federal government agencies.

Stewer Technologies had been exporting small quantities of polyethylene pipe to Poland since 1989; however, the sales figures were too low for much attention to be paid to the country. All that changed in 1998 when the company was approached by a Polish contractor who proposed that a joint venture be established to supply the Polish government with sewer and water pipes for its large-scale infrastructure renewal program. The idea seemed like a good one in that Polish labor costs were quite low compared to the United States, and the company could avoid transportation costs and tariffs. The potential for export to other Central and East European countries also made the proposal appealing.

Polska Pipe Works and William Zukowski

The city of Krakow was chosen from three competing cities in Poland and construction of the plant began in 1999 and was completed in 2000. The joint venture was named Polska Pipe Works. It was decided that an American manager from Stewer Technologies would be chosen as plant manager or Managing Director, but that almost all other employees would be Polish. With a relatively high unemployment rate in Poland it was easy to find workers for the plant. The Polish partner recruited and selected the Polish workforce. The Polish partner also established the organizational structure, created job descriptions, and helped determine compensation and benefits. Most Poles were very happy to be able to work for an American company in that they perceived that the American company would be able to provide job security and higher wages. The wages which were low by American standards were much higher than that offered by similar domestic companies in Poland. American workers at Stewer Technologies were not unionized and the company hoped to keep its Polish operation non-union as well. It was believed that if compensation were set significantly above the standard domestic rate employees would see no advantage to unionization. To supplement the Polish workforce, a temporary team of experienced American workers was selected to work in Krakow in order to help train the Polish workers.

William Zukowski, a 19-year veteran of Stewer Technologies was selected to head the Polish operation. Trained in engineering and management, Zukowski had held a number of positions in the company, but this position would be his first opportunity to head an entire facility. Zukowski was considered to be a good candidate for the position in that he had an excellent track record at Stewer, and that he had some understanding of Polish culture. Zukowski's grandparents had immigrated to Chicago from Poland and he maintained ties with the Polish community of Chicago. Although not fluent in Polish, he did speak some of the language and had visited the country while on vacation in 1996. Zukowski eagerly accepted the assignment for two reasons. Most importantly, he felt that the position offered an excellent opportunity for advancement, and he did have an emotional attachment to the Polish people and felt that it would be important to teach them American methods of management. Zukowski moved to Poland with his wife Sandy and their three children, Stefan, age 14, Elizabeth, age 12, and John, age 8. The family was excited, yet somewhat anxious about the move. It was never very clear how long the family would be living in Poland.

Early Difficulties

After the Zukowski family arrived and settled in Krakow, William began to assume his duties at Polska. William felt that employee development was a top priority and that he should spend much of his time in the supervision of employee training programs. Zukowski also decided that he would train some key managers himself. His initial contacts with Polska employees seemed to indicate to him that the employees were very receptive to learning Western business practices.

One of the first areas in which Zukowski sought to train workers was in the area of quality management. Zukowski had instructed managers at Stewer in TQM, and he lead a special projects team, which helped the company, achieve ISO 9000 certification. He had attended one of the seminars conducted by the late quality guru Edwards Deming and was fascinated by his approach to management. Zukowski hoped to quickly implement a quality management program and gain ISO 9000 certification for Polska.

At first it appeared that the managers who had been selected for the training were motivated to learn. Over time, however, it seemed that the managers kept asking questions unrelated to the training. More and more the managers were asking about compensation and benefits and fewer and fewer questions about the training material. For example, it became very clear that the Polish managers had determined that the American workers who came to Krakow on temporary assignment were being paid much more. The Polish managers were also comparing company benefits and found out that the Americans were receiving more benefits than the Poles. Zukowski tried to answer the questions and respond to the objections as quickly as possible and then to resume his training efforts. Not everyone was satisfied with his answers.

One of the more vocal Polish managers, Michal Gorzko was often difficult to silence during the training sessions. He often complained that the American company showed preferential treatment to the Americans. He also expressed his dissatisfaction with the fact that many of the Americans were younger than most of the Polish managers and that they treated the Polish managers as if “they were their children.” Gorzko felt that the older Americans were skilled and experienced workers but that they should not be perceived as being more valuable to the company. Gorzko, a graduate of Warsaw University also seemed to resent the fact that people without a college education would be making more money. Zukowski tried to explain how the Americans were only going to be in Poland temporarily and that they had to be compensated by American cost-of-living standards. Over time it became clear that Gorzko was acting as a spokesperson for the entire group of Polish managers. After this initial training effort Zukowski decided that he should delegate the training function to others.

There were also personal difficulties in the early days for William Zukowski. His family was not adjusting well to their new environment. At first the experience seemed exciting for Sandy. Living in a foreign country was always something she had wanted to do and she felt that the experience would be good for the children. Although the children were unhappy from the start, with their mother’s encouragement and understanding, she was able to make the experience less traumatic. The children missed their friends back in Chicago and they were not happy with their new America style school. The children also missed the comforts and recreational activities they had become accustomed to back in the United States. William was very busy at work and was seldom available even on weekends to be with the family. At first Sandy accepted the hardships, but over time she began increasingly to complain about her life in Poland including the lack of friendship, the poor telephone service and roads, and the difficulty of communicating with people who did not speak English. Life was much harder in Poland than she had expected.

Proposed Changes

At work, having finally completed the quality training sessions, Jukowski moved on to other areas. He decided to change some of the operational policies, which the Polish partner had established for the joint venture. In particular he wanted to reduce the level of bureaucracy, change compensation to a more performance-based system, and institute a participative, teamwork approach to management. Zukowski felt the present system created by Stewer's Polish partner was too much like old Eastern Bloc management.

With the help of a young Polish manager named Tomasz Fusinski, Zukowski began an assessment of the organizational structure of Polska. The two worked out a plan to reduce many administrative positions and save the joint venture considerably on salary expense. However, Fusinski, feeling uneasy about the changes did speak up, providing a prophetic warning. "Mister Director, enjoyment in the summer can come at the expense of comfort in the winter." Zukowski wasn't quite sure what the young manager was trying to tell him and he dismissed the advice as some unimportant old Polish lore. The changes were implemented as directed by Zukowski with considerable unhappiness among the entire workforce. The changes meant that not only would positions be eliminated among the office staff, but that production positions would also be cut as well. Outsourcing of some supplies and a reduction in many support positions would make the manufacturing process leaner, and more productive. Ultimately this would allow for more compensation for the remaining employees. Zukowski felt that some employees would resent the layoffs but that most would find the thought of making more money "music to their ears."

Zukowski felt that the workers of Polska were either not motivated, or that they simply didn't understand modern management practices. He felt that an improved system of financial rewards would give them an incentive to work harder. Zukowski was concerned by the fact that workers routinely left for home at around 4PM, even if the plant had an urgent need for production. Consistent with company policy in Chicago, and previously agreed upon between the partners, all employees at Polska were paid a salary. There were no hourly employees in either company. Although this compensation system seemed to work in the United States, Zukowski wondered if it was appropriate in Poland, given the recent experience with the communist system. He worried that such a plan may be abused by the Polish workers. In response he met with some of the higher-level Polish managers and ask for their advice. The managers who were always very formal, and respectful, failed to give him much guidance. Zukowski, therefore, created a new compensation plan himself and gained its approval from Chicago. The new plan was called "ZlotyShare" using the name of the Polish currency the zloty, and indicating that it was a form of the American practice of gain sharing. The new plan was complex but basically meant that compensation would be tied to worker productivity and cost reductions.

Immediately upon announcement of the new compensation program the Polish employees rebelled, including most of Polska's managers. Although Zukowski explained that the new program was an attempt to allow workers to make more money, few accepted the idea. Zukowski could not understand why the workers would not want the opportunity to earn additional money and all his attempts to explain the program seemed to fall on deaf ears. It occurred to him that the reason that he was receiving such resistance to his change effort was that it was too autocratic, and so he began to develop a more participative approach to decision making. Zukowski created a series of committees and appointed several high level Polish managers to head those committees. The purpose of the committees was to force authority down to lower levels of the organizational structure. Because of his past difficulties with Michal Gorzko, Zukowski did not appoint him to any of the committees. Although it appeared that the Polish managers liked the idea of the committees, Zukowski was disappointed in their progress. It appeared that they were only recommending superficial changes, and that they were mainly concerned with holding on to, or increasing, their own power. Frustrated with their success Zukowski disbanded the committees.

After consulting some friends back in Chicago and discussing the ideas with his now trusted Polish advisor Tomasz Fusinski, Zukowski announced a new organizational structure, once again. Productivity and quality had been steadily dropping since the introduction of the ZlotyShare plan and the downsizing effort. Zukowski needed something to work, and work quickly. He announced that young Fusinski was being promoted to the position of Assistant Director and Manager of Special Teams. Fusinski would be supervising the introduction of a production team structure, similar to the one used by Stewer in the United States. It was announced that team leaders would be selected based on interviewers by Zukowski and Fusinski and that the team leaders would receive sizable increases in salary. The positions would be open to all production employees. Present managers could apply, but they would not be assured a team leader position.

Triad of Despair

William Zukowski was aware of the anxiety, which his changes had produced for the employees of Polska. He did not want to make their work environment difficult, however, he was convinced that some pain was necessary in order to change the Polish mindset, which had developed over the many years of Soviet domination. He was prepared to endure some pain himself; however, he was not prepared for the events, which would occur on the Monday morning following the week he proposed his latest changes.

After a stressful weekend with the family it was decided that Sandy and the children would return to the United States by Christmas, and that William would stay in Krakow for the duration of his assignment. It was a difficult decision, but all family members agreed that it would be best. William would fly home every month to visit and Sandy and the children would resume their life as usual back in Chicago.

On the way to work that morning William began to lament his decision to accept the Polish assignment. He was still confident in his ability to make improvements in the operation and to advance his career, however, he did not like the toll it was taking on his family. He also lamented the missed opportunities he had planned to tour Poland with his family and enjoy its rich history. As he continued to work he vowed that he would quickly improve the operating results of Polska and then ask to be returned to Chicago.

When Zukowski arrived at the office he was met with very disturbing information. He first noticed that a letter of resignation was on his desk from Tomasz. The letter was very brief and apologetic and offered no reason for the resignation. Zukowski was very surprised and personally hurt by the sudden departure of his trusted young advisor. Not having much time to absorb the resignation, Zukowski was hit again with bad news. His assistant informed him that many of the workers had refused to come to work today and that Michal Gorzko was leading a drive to unionize all plant personnel. Thinking of his family, the loss of his Polish advisor, and the threat of unionization, Zukowski looked out the window of his office and realized that the coming Polish winter may in fact be very uncomfortable.

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State Intervention in Transition Markets: liberalization, lemons and learning.

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Abstract

Using a theoretical model that allows firm level brand quality choices to be analyzed in the context of industrial organization (IO) structures, this paper shows that transition markets require State intervention in setting quality standards. The role of the state eventually disappears when customers learn to accurately perceive brand quality. Thus, quality standards and learning processes are necessary to prevent the "lemons" problem in liberalizing markets. Recent experience from India in the airlines and Internet markets is found to support these propositions.

Introduction

Many countries the world over are transitioning from monopolistic marketplaces to open competition. This paper investigates with a theoretical model the impact of quality regulation by the state (or the absence of quality regulation) on the provision of quality in markets transitioning from monopolistic to oligopolistic competition. The issue of quality trajectories in transitioning markets is gaining in scope. The WTO nations have lifted quantity restrictions recently and are leveling the tariff structures for international competitors in a variety of sectors where often one large public sector undertaking was hitherto dominant. Since quantity and price restrictions will be lifted, the scope for quality as a strategic dimension ought to rise in importance. A key perspective in this scenario of globalization and deregulation, usually accompanied by privatization and growth in competition, therefore, is the impact on customer value. In this paper, we address this issue with a theoretical model and apply the results to an analysis of India's transitioning markets.

The main propositions identify the free-rider problem when quality perceptions of newly "liberated" customers are weak, and conformance or manufactured quality of competing brands cannot be distinguished. Then the State should intervene until learning allows customers to develop accurate quality perceptions. Once quality competition is restored, the specific interventions should evolve or be eliminated. I explore examples that reflect this dynamic in recent experience of liberalizing markets in India.

Transition Markets

For the purposes of our paper, a transition market is one that is moving from monopolistic to oligopolistic competition. This transition is occurring in many countries and in many industry sectors. Markets were being supplied with an entire product line under different brand names by a single firm (monopolist), which often was the original Public Sector undertaking. Examples are available from diverse sectors such as telecommunications, and domestic air travel. The Indian insurance industry, where General Insurance Corporation (GIC), a public sector undertaking (PSU) owned by the government, was the holding company for four other insurance brands, supplying an entire set of insurance product lines. Under the new oligopolistic scenario, several new domestic brands in collaboration with well-established international brands will compete. In education markets, often State owned Universities and Institutes were the only option for the student with higher education aspirations. With deregulation of education, several professional institutes and private universities have mushroomed. Even Internet universities are making a debut. In the business-to-business (B2B) e-marketplace, cross-border brand competition will become more frequent since formal market entry need not be a pre-requisite for sales. Industrial manufacturers could procure raw materials, components and sub-assemblies over the web from remote suppliers. Steel industry products were originally produced by a few dominant firms (SAIL, TISCO), but the development of vertical portals in steel allow procurement of sheet steels, rods, pipes and other products from anywhere in the world.

Transition Markets, Industry Associations and Regulation

As markets mature and the number of firms competing with the sector grows, they begin to develop a coherent set of concerns that are unique to the value propositions they represent. This process of maturation is evident in the Indian software export industry in recent years.[1] While many issues are resolved by self-regulation, some need a process of dialogue between the set of industries and the state. The special interests often have to do with financial and tax levies and burdens, import and export restriction on quantities and tariffs, and investment regulations across borders. For the Software sector additional issues of importance are value and benefits for rural sector, and of "crossing the digital divide." [1] Social choice in quality of goods and services is often invoked as a framework for State intervention in Markets. Other interventions with implications for international business are IPR, investments, public procurement, and environment.

The issue of quality in social choice is interpreted in different ways. Instruments for State intervention in asserting quality through social choice are regulation through certification and differential tariffs and taxes for different quality products. Thus, luxury taxes are imposed on hotels, and higher tariffs on higher quality cars. In extreme cases, selective licensing is resorted to when production processes require quality controls, such as in the production of pharmaceuticals or for franchise services such as telecommunications infrastructure. Another quality issue is related to product differentiation for high and low priced (and quality) models that will cross-subsidize in order to allow access to less affluent segments.

In general, when monopolistic markets liberalize customers do not accurately perceive brand quality. We then find that the dynamics that follow benefit from State intervention in various ways. Due to absence of relevant external quality reference standards, customers form standards endogenously based on some average brand quality provided. Imprecise perceptions of quality occur when customers are unable to distinguish qualities. These imprecise perceptions give firms the incentive to offer lower quality products, when reference standards are endogenous. The State often should and does intervene to create reference standards that are exogenously imposed on markets. Along with these standards, some effort at public education and information dissemination might be attempted. Over time the need for external reference standards withers away as customers begin to develop better perceptions. Eventually, perceptions are precise, quality can be distinguished, and endogenous quality standards will allow the firm offering better brand quality to benefit. Overall quality provision then improves above the monopoly situation without the need for State intervention.

Research Questions

The advent of international quality competition in protected markets raises interesting research issues. A key one is: What is the impact of transition from a monopolistic market to oligopolistic competition on the equilibrium quality choices of firms? We investigate with a theoretical model the profit maximizing quality choices, when perceptions of quality by customers and reference standards play a role. What are the implications for State agencies in intervention in such transition markets, in order to assure higher brand quality choices in equilibrium? The validity of our propositions is demonstrated by examining recent de-regulating industries, in particular the domestic air travel and the internet service markets, in the light of our propositions. We challenge the widely held view that oligopoly (competition) with brand proliferation always leads to immediate value and quality improvements. The next section briefly reviews the literature; and we propose the theoretical model in #3 and state our results and propositions; #4 and #5 examine the airlines and the Internet markets in India the light of our propositions; and #6 concludes with indications for future work.

Literature Review

The strategy literature view of quality in markets owes its origin to Akerlof (1970). His paper noted the tendency of markets to collapse with low quality products ("lemons") when uninformed customers are unable to distinguish qualities prior to purchase. Among various ways to deal with the lemons problem, third-party intervention is a plausible solution (Leland 1979). While the question "what is quality?" is a complicated one, most approaches address quality as a set of attributes that may be captured by an index of sorts, accounting for the relative importance of the key attributes. More recently, management and marketing scholars have studied customer perceptions of quality (for example, Parasuraman *et al* 1985; Tellis and Wernerfelt, 1987). The findings consistently indicate that customers do form less than accurate perceptions of quality, that reference standards are a part of the perception formation process, and that information flows, or learning, leading to more accurate perceptions by customers will induce firms to improve average quality. [2]

In a different context, Spence (1979) introduced a market utility function that allowed model-based analyses of marketing mix activities at the firm level to be included in industrial organization (IO) analyses. Karnani (1983) adopted a modification of the utility function to analyze market share structures in industries. He demonstrates the equivalence of the utility function to standard models in marketing, and characterizes constructs such as price elasticities and product differentiation in terms of the utility function's parameters. Ali and Seshadri (1993) employ a further modification of the function to include perceived brand quality. Their analysis contrasts quality choices in alternate industry structures such as monopoly and oligopoly, under varying levels of perception accuracy.

This paper builds on the perceived quality, reference standard (PQRS) market utility model. It extends the comparative analysis to transition markets where monopoly has given way to oligopoly. Numbers of products in monopoly and oligopoly markets differ, and key ratios will be affected. We determine the relative impact of quality improvements on revenues in transition markets. In turn, we derive theoretical propositions relating State intervention on both reference standards and perceptions on quality improvements. These propositions are explored for their validity in the context of Indian liberalization measures. The next section describes the model.

Model and Propositions

Theoretical PQRS Mode

The model I use has three aspects: (i) a market utility function; (ii) quality perceptions based on a reference standard; and (iii) multiple models or brands. Consider a market consisting of n+1 products with utility function $U = (U_1 + \text{--} + U_n)^{?} = (S\ Ui\ )^{?}$. Here Ui denotes the utility of each product to the consumers, with $Ui = a_i\ Qi^{ß}\ yi^{a}$. Here, a_i, a, and ß are market parameters, Qi is perceived quality, and yi is sales in units of the ith brand. ? (between 0 and 1) denotes the parameter for elasticities (see Spence 1979; Karnani 1983, for a discussion of this utility function). Denote a specific product by i, and the remaining products by k (k=1,…,n; not equal to i). There are n other products (models or brands) in the marketplace. For monopolistic markets there are m product models of a single brand; for ologopolistic markets there are o brands. Thus, n+1=m for monopolistic markets and n+1=o for oligopolistic markets. For this specific product i, the firm that produces it chooses the manufactured quality qi, and seeks to maximize its profit with that product. The demand for the product depends on its price and the customer perceived quality, among other differentiating factors. The perception of quality can vary from precise to imprecise (see Parasuraman et al 1985 for a discussion of perceived quality). Therefore, perceived quality is Qi = f(perception, qi). If precise, the manufactured and perceived qualities are identical. If imprecise, quality cannot be distinguished by consumers, and the manufactured quality is perceived as some reference quality, common across all products in the market. Intermediate levels of perception (between precise and imprecise) would normally be the case. This reference quality is either exogenous or set by some statutory authority, or endogenous as some function of the manufactured qualities of all products in that market. Here, we assume it is a share weighted average of all brand qualities.

The number of monopoly product models m may be as low as one. In a transition situation the private sector entrants offer a competing brand for each product offering of the monopolist. Therefore, m < o, and S Uk (k=1,..,m) < S Uk (k=1,..,o).

The exponent ? is a market specific parameter, between zero and one, common for all firms, rather than specific to a single brand. A higher ? corresponds to lower price elasticities -- both own and cross elasticities among the brands (see Karnani 1983 for the derivation of elasticities).

The revenue and cost assumptions are captured in Fig. 1. The usual assumptions of increasing costs and returns to quality, and decreasing marginal returns with increasing marginal cost apply. While market revenues may double or triple after liberalization, the entry of new brands will reduce the revenues for each. For instance, if market revenue doubles and six new brands enter, each brand will average one-third of the monopoly revenues, as shown in Fig. 1. With these simple assumptions we can derive the following propositions (all derivations are available from the author).

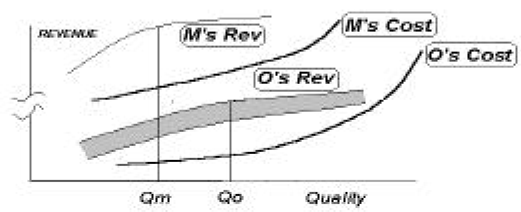

Fig.1: REVENUE AND COST CURVES.

Proposition 1

Oligopolists provide lower quality than does a monopolist for corresponding products when perceptions are sufficiently weak and the reference standard is endogenous. In this case the relative revenues are given by the following equation.

$$\frac{Oligopolist \quad Marginal \quad Revenue}{Monopolist \quad Marginal \quad Revenue} = \left[\frac{\Sigma_o Uk}{\Sigma_m Uk}\right]^{q-1}\left[\frac{s_{io}}{s_{im}}\right]\left[\frac{Ui}{\Sigma_m Uk}\right]\left[\frac{Qm}{Qo}\right]$$

Discussion

This overall ratio of OMR (oligopoly marginal revenue) to MMR (monopoly marginal revenue) is less than unity. Let us look at the four ratios comprising this individually.

1. The market utilities of oligopoly to monopoly markets exceeds unity, since o>m. Then since ? <1, the first ratio is less than unity.
2. The second ratio is the relative shares of the ith brand in the oligopoly (s_{io}) and monopoly (s_{im}) markets. Since many more brands will exist in oligopoly relative to the corresponding model in the monopoly market, this ratio is less than unity.
3. Next, the ratio of brand utility to the total monopoly models' utility will be less than unity, since total market utility will always exceed that of a single brand, Ui.
4. Finally, the ratio of the quality standards of monopoly markets to oligopoly markets counteracts the other ratios. Whenever the net result is a lower marginal revenue curve for the oligopolist relative to the monopolist, the ratio of their quality standards will follow suit.

The relative marginal revenues are depicted graphically in Fig. 2. The MMR curve lies above the OMR curve. The OMR curve is actually a band representing the various brands from competing firms. Since the marginal costs are similar, we can clearly see that the equilibrium quality choice is lower in the oligopoly case. The endogeneity of reference standard and inaccurate perception drives this result. Firms have incentives to free ride on weak customer perceptions and provide lower quality than otherwise.

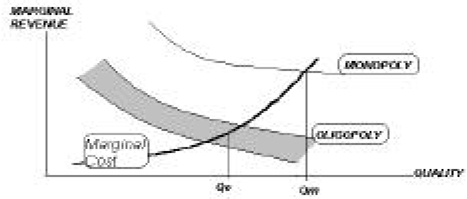

Fig. 2: REFERENCE STANDARD IS ENDOGENOUS, PERCEPTION IS IMPRECISE

Lower cross price elasticities and demand elasticities (inversely related to the magnitude of ?) decrease the intensity of these effects. The oligopolist would be better off when ? is higher. Then brands have lower elasticities and are less substitutable. The oligopolist with a higher product quality does not enjoy higher demand, since perceptions are imprecise. Improving quality will not draw customers from competing brands. The oligopolist can only hope for an overall lowered price sensitivity for the entire market in order to improve their marginal revenue curves. The marginal revenue of this brand will be higher than otherwise. I now examine the situation when the State intervenes and sets a reference standard that is exogenous, or when there is rapid learning and newly "liberalized" customers are able to distinguish quality standards.

Proposition 2

Oligopolists provide better qualities than does a monopolist for corresponding products when the reference standard is exogenously fixed. This is also the case when the reference standard is endogenous and when the perceptions are precise. In both cases the relative revenues are given by the following equation:

$$\frac{Oligopolist \quad Marginal \quad Revenue}{Monopolist \quad Marginal \quad Revenue} = \left[\frac{\Sigma_o Uk}{\Sigma_m Uk}\right]^{q-2} \left[\frac{Uio}{Uim}\right]\left[\frac{Qim}{Qio}\right]\left[\frac{\Sigma_o Uk + (q-1)Uio}{q\,\Sigma_m Uk}\right]$$

Discussion

This ratio of marginal revenues, OMR to MMR, is greater than unity for given quality; Again, let us look at the four ratios individually.

1. If ?=1, corresponding to low elasticities, then the first and the last ratio involving market utilities drop out. The ratio of OMR to MMR then depends only on the relative brand utility and quality. But with ? <<1 as is usually the case, corresponding to higher elasticities, the relative market utilities in the last ratio will exceed unity, and more than compensate for the other effects.
2. With o >m, the single brand will not contribute much utility even though the perceived quality will be high. Then the relative marginal revenue will be less than unity. When elasticities are high, a brand with better quality and demand will benefit more from quality improvements, drawing more customers from the competition. The relative marginal revenues will therefore be much higher than unity.
3. The monopoly quality is lower than the oligopoly quality in this case, since free riding is not a problem in the oligopoly situation.
4. The last term drives the result, since high elasticity (? <<1) implies that customers are able to reward firms that offer high quality with much more revenues.

Fig. 3 depicts this graphically. As can be seen from the figure, the qualities provided under an oligopolistic market are higher than under a monopolistic market.

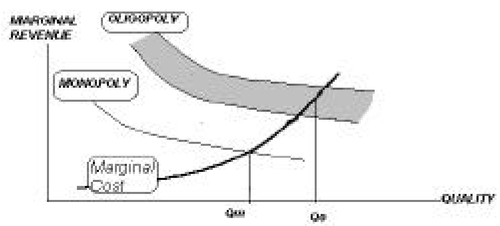

Fig. 3: REFERENCE STANDARD IS (A) EXOGENOUS; OR (B) ENDOGENOUS, PERCEPTION IS PRECISE.

The reference standard is set exogenously when the State through its committee or body applies standards that must be passed. The review of the process or testing of the product will determine whether the product quality is superior, but it will not be necessary to actually apply this review or test in every case. Firms would voluntarily exceed the standard since the penalties are usually high if they do not. The relative marginal utilities correspond to the exogenous quality standard case; only the marginal revenues themselves increase with perception accuracy. Therefore, Fig. 3 applies to this case as well.

Lower cross price elasticities and own price elasticities of demand (inversely related to the magnitude of ?) increase the intensity of these effects. This may be observed directly from the above equation. Since ? captures the elasticity magnitudes (higher ? implies lower elasticities), it will directly impact the relative revenues The closer ? is to zero (higher elasticities) the higher the ratio of the marginal revenues. This implies oligopoly markets would seek to improve their marginal revenues by increasing the substitutability of their brands. A brand that improves quality will find greater draw from other competing brands.

In the sequel I examine the dynamics of two recently liberalized sectors in the Indian economy: airlines and telecommunications. In the light of the propositions above, I trace the dynamics of products and qualities, of reference standards, of perceptions and their interactions.

Domestic Airlines: Pie in the Sky

Products and Qualities

The period immediately after 1996 saw emergence of several private airlines. The domestic air travel monopoly of Indian Airlines had created a initial level of performance expectation as a consumer experience. The dimensions of product and quality decisions were capacity, frequency, fares, and service levels. The major service quality dimensions were in-flight service and on-time departure and arrival record. Clearly, there were limited flights servicing trunk routes and regional routes. The new private airlines operated on either trunk routes (Damania) or on regional routes (Skyline) or on both (ModiLuft, Jet, Sahara), depending on the portfolio of plane sizes and capacities.

Standards

Initially there was the 1996 Airlines Act that ushered in deregulation. The uneven distribution of flights over trunk and regional routes introduced a modification about a year later, requiring an airline to offer a mix of routes. This prompted a (hostile) takeover of an airline. IATA rules for domestic flights were applied. The Directorate General of Civil Aviation (DGCA) is the statutory authority that watched over the airline industry. It evolved a seven-point maintenance norm and informed that "any laxity in observing the norms will entail stern action."

Perceptions

The service offering varied widely among airlines, with in-flight offerings that bordered on luxury to cramped seat arrangements. The perceptions of on-time record of airlines were unformed. Some airlines set very high standards of passenger reporting and check-in, while others delayed flights for VIPs at will. The perceptions gradually turned more precise over a period of two years.

Dynamics

The initial euphoric experience of multiple flights, and special service gave way to poor on-time departure and arrival record. Other quality slips to do with ground engineering, maintenance, and in-flight catering emerged. Some airlines faced bankruptcy, since demand was lower than projected. The recession in 1997 -98 led to a folding three airlines, and a near failure of the fourth. It appears that the number of competitors has stabilized at three by 2000. The quality of service is stabilized and perceptions are far more accurate of the differences between the three brands of air travel services.

Telecommunications: Not Just Talk

Products and qualities

This section applies the propositions stated and discussed above to India's converging mobile cellular telecommunications, and Internet sectors. In 1991, the Government opened manufacturing to private industries. The 1994 National Telecom Policy (NTP 94) liberalized private value added services such as e-mail, 64 Kbps data interchange over very small aperture terminals (VSAT) and videotext. This opened the route to privatization (with foreign participation) of basic telecom services. A duopoly market structure was planned in both basic telecom and cellular services. However, NTP94 was considered a failure. The market offerings were radically new. In the light of Propositions 3 and 4 above, the endogenous nature of quality standards and the highly imprecise perception of product/service quality by customers unused to the technology not surprisingly led to an unacceptable market equilibrium of degenerate quality and stagnant markets. In the second quarter of 2001, a government body called group on telecom and IT (GoT-IT) has formed. It has ruled on "limited" mobility, or the policy that allows wireless operators to enter local markets that hitherto were monopolized by fixed line operators. A dual policy is inevitable, since long distance subsidizes local calls especially on fixed lines. Unless long distance calling is available to mobile operators the level of subsidy cannot be replicated. Therefore, spectrum fees are not likely to be as much for mobile operators, leading to discontent in the fixed line operator’s camp.

Standards

Historically, the Government seriously faced the need for quality standards in the late '90s, and initiated efforts to improve the customer's ability to perceive accurately the quality of internet-telecom service provision. A national IT Task Force in September '99, a National Informatics Infrastructure initiative, and a NTP 99 ensued, preceding the full liberalization of the domestic market for ISPs. The features of NTP 99 included detailed technical standards on interconnectivity, performance, tariffs structures, and penetration targets among other things.

Perceptions

Customer perceptions have been rapidly improving in accuracy. Experience with value-added services such as e-mail and web hosting is a major factor. The GUI interface even in email is almost universal. Dimensions of ISP performance such as (i) time to connect (ii) bandwidth or speed of transmission at router (iii) percentage of service up-time (iv) user friendly features (v) customer service satisfaction, etc., are understood much better by consumers today. These enhanced perceptions are finding their counterpart in mobile communications, and other yet to be liberalized marketplaces.

Dynamics

The first round of biding for duopoly licenses allowed a ten year period to pay the fee. Most operators defaulted when bids had escalated, and their business plans went haywire. Some segments of the market were being under-served by the private operators; several value-added services such as voice mail were not included and retail franchises often indulged in misrepresenting service package costs and fraudulent billing. Penetration, growth and revenues were far lower than expected. In the transition to the fourth license bid scenario today, quality reference standards are far better known. The scenario corresponded to a transition from Fig. 2 to Fig. 3. The existing mobile cellular operators were bailed out from a fixed license fee system, now payable up to mid-1999 only, to a revenue sharing mode. Clearly, the revenue sharing mode would not be worse for the Government if the oligopoly market's marginal revenue curve for the firm would shift upwards. At the present time, leading cellular phone companies, and ISPs are engaging in branding exercises, and value-added services such as short messaging service (SMS) are available. The growth of Internet is projected at 1.3 million subscribers (10.7 million users) by the end of 2002. Several other products / services in the telecom sector are slated to move from monopoly to oligopoly markets in the near future. Some of these are Domestic Long Distance, International Voice Telephony, Call Termination, and Infrastructure Providers.

Conclusions

Summary

The main research question we addressed was whether the State should have a role in setting quality standards after liberalizing in transition markets. We find that the improvement in quality expected from oligopolistic competition is not automatic. The market realities of inaccurate quality perception due to unfamiliarity with the products and brands as well as the endogenous nature of reference quality standards when brands compete lead to lowered quality incentives (lemons). The way around this is to appoint State agencies that propagate quality standards through legislation and statutes. Moreover, advertising and promotion of these standards as well as brand information on quality must be encouraged in order to increase the customer's learning and ability to recognize quality differentials. These measures, of exogenous standards and improved perceptions will remove the incentive to offer lower brand quality. Over time the oligopolists will raise quality above the monopoly situation and the need for external quality standards set by the State will vanish. It would then be preferable to allow endogenous standards to emerge based on perception by customers of brand quality. The experience of civil aviation as well as Internet service bears out these findings.

Further research

The theoretical model will be enriched by including other elements of the marketing mix and branding activities that modern firms are likely to practice. Product differentiation by oligopolists, where a single brand may include widely different versions on price and quality, would be a natural extension of the theoretical model. The qualitative results will not be altered, but the incentive to proliferate offering within a brand could lead to additional insights. A valuable direction is to seek other recent experiences around the world where transition markets can be analyzed in the light of these propositions.

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[1] Equity in income distribution is also a concern, when indications are that a small segment of the professional workforce (.05%) will produce 20 % of the GDP (McKinsey-Nasscom 2000).

[2] Quality ratings surveys show that problems in the first 90 days per 100 vehicles have improved dramatically from 88 to 20 between 1980 and 2000 in the USA (Consumer Reports magazine). Quality over a long-term has greater impact on satisfaction than in the initial period, but long-term quality is more prone to imprecise perceptions. Interestingly, surveys of durability or problems with vehicles that are 4 to 5 years old had not improved much (JD Power & Associates).

Strategic Technology Alliances, Economic Growth and the Developing Countries

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Abstract

The proposed paper conducts an in-depth review of the previous research on international strategic alliances and its relation with economic growth. The key purpose of the paper is to consolidate and integrate previous research for identifying the necessity of strategic alliance as a mode of acquiring technology. The study will have significance for the economic planners, corporate planners, and economic and management disciplines. The paper has been divided into three parts. First part will focus on the various aspects of economic growth and the lessons for the developing countries. The Second part will concentrate on the role of strategic alliance for acquiring knowledge and technology for the economic growth of the developing countries. The Third part will conclude the study with comments for strategic alliance as a tool of acquiring technology for the developing countries for economic growth.

I

Of all the issues facing development economists, none is quite compelling as the question of economic growth. Economic growth is often seen as solution to problems such as poverty or unemployment. Hence, achieving high growth is an issue that is high on the agenda of many policy makers. While in developing countries the main emphasis has been on capital accumulation as the main source of growth, for developed countries it is on technological change. In the context of continuous and rapid technological changes in the international markets, how accumulated capital is utilized to generate technological change and higher labor productivity is as important as capital accumulation in developing economies.

Growth theory offers two explanations for growth. One stresses the supply of productive ideas and says that the growth of living standards depends on the growth of science. The other explanation invokes incentives : growth could begin only when hard work and business enterprises were free of interference by authority. While the classical economists – Marx in particular – were much concerned with growth, its modern revival started with a remarkable paper by Roy Harrod published in 1939. Interest in growth revived at first slowly and then by leaps and bounds. This was to a considerable extent the result of an immense practical concern with growth after the Second World War. The war-damaged economies were trying hard to reconstruct fast, the developing countries were attempting to initiate economic development, the advanced capitalist countries being relatively free from periodic slumps were trying to concentrate on raising the long-run rate of growth, and the socialist countries were determined to overtake the richer capitalist economies by fast economic expansion. Growth was everybody’s concern and it is no wonder that in such a milieu growth theory was pampered by the attention of the social scientists.

Recent developments on new growth theory have conveyed two important conclusions for the subject. The first is that technical progress is a major engineering of growth and has its determinants on endogenous features of an economy. The second crucial conclusion is that there are several market restraints, which play major roles in the speed of technical progress. These two assertions lead to the conclusion that one of the targets of public policies aiming to promote economic development should be to foster technical progress. As a consequence of such ideas, which precede the developments on new growth theory, public authorities have developed sophisticated policies to promote technical progress, which goes from research and labs financing to special fiscal incentives for investments in technology. There are two types of models on new growth theory. Those, which emphasize the existence of constant, return to scale on the production of some factors of production, which normally are some kind of capital, such as physical capital (Rebelo, 1991), human capital (Lucas, 1988) or physical public infrastructure (Barro, 1990). There are also those models, which rely heavily on the existence of positive externalities associated with the production of some factor of production, such as technology (Romer, 1990) or human capital (Lucas, 1988). In these last models, the reliance on market constraints to determining growth in the form of externalities is obvious. In the first group of models, market constraints play some role determining growth only if there are no incentives to produce the factor of production whose production function has constant returns to scale.

A new theoretical literature based on the new growth theories has emerged on the subject of innovation driven growth in an open economy context. This has emphasized the importance of domestic R & D efforts and of international technological knowledge spillovers for helping to explain country's productivity growth. In a world characterized by increasing, but still incomplete economic integration, it can be expected that individual countries' productivity depend both on their own and on foreign R & D efforts. This literature stresses the importance of innovation efforts for explaining countries' economic growth. A characteristic feature of these innovation-driven growth models is that the production function for new designs, or the knowledge function, is characterized by increasing returns to scale because of the existence of knowledge spillover effects. These increasing returns help to offset the upward influence of wage increases on the relative cost of human capital intensive R & D, so that the R & D cost remains constant in terms of goods. A given level of R & D effort will in this case be sufficient to generate a sustained growth of total factor productivity. In others words, a thoroughly endogenous growth process becomes possible whereby the steady-state growth rate depends on variables that help to determine the level of R & D effort. A logical consequence of these models is that, given the level of R & D effort, a process of opening up and integration of formerly closed economies will tend to raise their rates of growth.

In advanced countries, technological capability is accumulated largely through “Learning by research,” which expands the technological frontier. In developing countries, in contrast, technological capability is built primarily in the process of imitative “learning by doing.” A few newly industrializing economies (NIEs) have made a rapid transition from “learning by doing” to “learning by research.”

Technology has received increasing attention in economic literature in the past few decades. The two central assumptions of the neo-classical growth theory, that technological change is exogenous and that the same technological opportunities are available to all countries in the world, have been shed. In neoclassical theory, the emphasis was on capital accumulation, and also on labor adjustment for quality, with technological change treated exogenously. Technological change has been incorporated endogenously in the new growth theories (Romer, 1990; Lucas, 1988; Grossman, 1991). By specifying technology endogenously, the new theories recognize knowledge or technology as a factor of production in its own right, alongside capital and labor. That helps to rectify the inability of the neo-classical theory to explain the failure of poorer countries to catch up with the high-income countries and in providing a possibility of non-diminishing returns to capital as the capital stock grows. With the global economy becoming more and more open and interdependent with liberalization of international trade and other economic exchanges, international competitiveness and hence technology are currently receiving increasing attention in the growth and trade literatures as well as in policy making. The new growth industries are knowledge based. They depend on the continuous generation of new technological innovations and the rapid transformation of these innovations into commercial products the world wants to buy.

The neo-classical growth theory dose not provide an accurate representation of the complex processes through which technological knowledge is being generated, adapted, diffused and used within any given society. It fails to take into account the fact that no blueprint or engineering manual is always completely written and specified, or that its adaptation to any given environment strongly depends upon the accumulated knowledge its user has of the underlying mechanical and organizational principles embodied in such technique. Although modern growth theory has successfully modeled in recent times endogenous forms of learning, creative destruction processes, externalities, increasing returns to scale, and imperfect competition, it is still true that neoclassical thinking does not, as yet, provide a useful characterization of the institutional environment underlying innovative and technological behavior, which evolutionary economists have been struggling all along to describe. Progress in this direction has been attained under the form of appreciative theorizing that is well ahead of what modern neoclassical growth theory has managed to incorporate formally. This is particularly so in relation to the behavior of institutions, to the complex nature of learning processes at the level of the firm, and to the mechanisms through which any given society develops its own technological capabilities through time. Along with neoclassical thinking, contemporary literature offers us alternative ways of describing what economic growth is all about. Rather than starting from the ‘representative firm’, this literature think of firms and individuals as possessing imperfect information regarding the technical options they face as well as incomplete understanding as to the costs and benefits associated with each one of them. They also assume that firms are operating with “bounded rationality” in the sense that they respond to profit signals. Business firms learn by trial and error; they carry out search experiments and develop new routines that bring about improvements in relation to what they did before. They gain experience as they move along their learning curve, a process in which time, history and accumulated R&D efforts play a vital role. There are increasing returns to scale, externalities and imperfect appropriability of the benefits of R & D expenditure. On account of the above, the price mechanism does not necessarily ensure a socially optimal allocation of resources in the field of knowledge generation and diffusion. For evolutionary economists, the creation of new institutions and the development of domestic technological capabilities appear as a hallmark of the economic growth process. The important point of evolutionary argument is that growth is a process that takes place in historical time. This implies that economic growth interacts with, and is influenced by many factors that are more or less outside the economic domain. It also means that an important part of evolutionary economic theory consists of ex post explanation of events and developments, rather than strict ex ante prediction of growth paths. Evolutionary economics is to a large extent a branch of theory that rely on methods that go beyond the standard toolkit of economic modeling, and this leads to a situation in which many different approaches flourish.

Pasinetti (1981) also describes trade between developed and developing countries in terms of international learning, or developing countries’ constant efforts to learn developed countries’ technology. According to him, the wealth of modern nations depends on the will and ability to master new technology rather than on the relative or absolute abundance of natural resources. Kuznet characterized the ‘modern economic growth’ of Western economies since the Industrial Revolution as predominantly dependent on sustained improvements in technology rather than capital accumulation, due to the ‘extended application of science to the problems of economic production’. It is reasonable to expect that, with rapid technical progress, decreasing returns to increased application of capital were overcome, resulting in decreases in the capital-output ratio. Kuznets considered modern economic growth since the Industrial Revolution as one of the major epochs in human history. The epochal innovation that distinguishes the modern economic growth epoch is the extended application of science to problems of economic production. There is little doubt that the major factor underlying the shift in the growth pattern was acceleration in technological progress as measured by growth in total productivity. Similarly, the extended-technology gap model constructed by Dosi, Pavitt and Soete (1990) provides a comprehensive and appropriate basis for assessing the related policy belief that achievement of technology intensive trade success will boost national economic performance. It contains an overall depiction of most of the conceivable relationships and processes, between technology, trade and growth, which tend to form the basis of the technology intensive trade success-economic performance link. While their model is intended to be focused primarily at the sectoral level, the existence of pervasive spillover effects suggests that this mechanism also applies at a national, macroeconomic level. A central feature of model is the identification of circular processes of positive feedback whereby technological investment and resulting advantages flow through to productivity, trade and income gains which, fuelled by dynamic economies of scale and demand-side incentives, stimulate further productivity-enhancing investment. These cumulative causation processes can generate both ‘virtuous’circles of growth and decline respectively. Dosi, Pavitt and Soete (1990) highlighted the role of trade surpluses which fuel growth in demand for national output and growth in income. In combination with the technological advances and productivity gains, which contributed to trade competitiveness (and provide an additional stimulus to economic growth), these developments act to augment factor supplies and remove factor-scarcity constraints. Vital levels of economic activity, growing levels of income and a positive investment climate, facilitate further investment in productivity growth and complete a positive feedback mechanism leading to further economic benefits.

Theoretical developments since Romer’s (1990) seminal work on human capital-driven growth have generated several classes of models in which long-run growth of per capita income can be affected by a variety of permanent policy changes. Proponents of the new growth theory have concluded that, unlike the neoclassical model, the new theory may actually explain growth. One of the primary objectives of new growth theories is to build models that can generate sustained long-run growth in per capita income. The second objective is to endogenize that growth rate. A number of authors dig into the history of economic thought to suggest that such characteristics of growth had featured prominently in the earlier literature of development. Heinz Kurtz and Neri Salvadori classify the extant new growth theory models (linear models, models of accumulation of human capital, and endogenous technological change models) into two categories; those that generate sustainable and endogenous growth by setting aside all non-accumulable factors of production, and those that recognize non-accumulable factors but postulate their efficiency is increased within the economic system so that the tendency of diminishing returns to the accumulation of capital is offset exactly. They make the astute observation that the first variant is featured in Frank Knight's 'Crusonia plant model', while the second is Ricardo's 'corn model' where the system ends up in a stationary state, not because of diminishing returns to capital, but because land is the postulated non-accumulable factor of production so that no additions to cultivable land can offset the effects of capital.

Thus, economic growth is due to growth in inputs, such as labor and capital, and to improvements in technology. There have been two periods of intense work on growth theory, the first in the late 1950s and the 1960s and the second 30 years later, in the late 1980s and early 1990s. Research in the first period created neoclassical growth theory. Neoclassical growth theory focuses on capital accumulation and its link to savings decisions and the like. The best-known contributor is Robert Solow. Endogenous growth theory focuses on the determinants of technological progress. The conclusions that can be drawn from the previous diverse analysis of economic growth are:

1. Economic growth is a process of transformation, not of convergence to a steady state growth path.
2. Technology is a key factor shaping economic growth, and the changes in growth rates.
3. Technology cannot be fully be appropriated by the firm that develops an innovation. In time, technological knowledge spillover to other firms and other nations.
4. The process of economic growth through imported technology depends on domestic absorptive capacity.

It is now well understood that economic growth results either from accumulation of factors of production or from improvements in technology or both. To encourage the generation of new knowledge, industrialized countries have elaborate systems of intellectual property rights in place and conduct majority of the world's research and development. Technologies resulting from such R & D spread throughout the world through a multitude of channels.

The developing countries' economic prospects have long been heavily dependent on the developed countries. But the share of world output, trade and capital flows that can be attributed to developing countries has been increasing over the past two decades. As a result, "reverse linkages" - the impacts of developing countries on developed countries – are becoming more significant. Growth of the developing countries' output and trade –and of their share of world output and trade – has accelerated over the past five years. If this trend continues, over the next 10-15 years, developing countries can be expected to play a much greater role in the world economy and have a much larger impact on the developed countries. Although the rising importance of developing countries in the international economy has so far been due to a relatively small number of countries, the recent acceleration of growth in the developing world has been broadly based, and this trend is expected to continue.

II

As the millennium dawns, the role of knowledge and technology has become increasingly salient in the structure, growth and organization of economic activity all round the world. The rapid pace of scientific and technological development is a major factor behind the fairly dramatic restructuring occurring globally. It is widely recognized that the creation, diffusion, adaptation and effective use of knowledge is critical to sustained development and poverty reduction in developing countries. Economic policies all over the world and especially in the developing world, are being liberalized. This has resulted in an increase in competitive pressures, both in the domestic and international markets. The long-term efficacy of these liberal policies for the developing countries will largely be determined by the impact these policies have on the development of technological capabilities among firms in these countries. The policy-makers will have to gradually evolve instruments most conducive to technological dynamism and the enterprises will have to explore various methods of technology acquisition /management to face the competitive challenge. The literature in the late 1980s and 1990s has clearly shown that development of technological capabilities is a very complex process and there are no ready-made policy recipes, which developing countries can follow to facilitate this process.

The concept of catch up economic growth has been in the development literature for many years. A strong version of this proposition is that the scope for catch up growth is proportional to the difference in technological capabilities between a follower and the leaders. This version predicts an inverse relationship between technological capabilities at any point in time and subsequent productivity as well as economic growth. The mechanism generally specified as underlying this process can be described as technology transfer. Followers, with appropriate policies and investments, are expected to learn about the leaders', choose the best techniques for particular purposes, and then implement them. The policies required for transfer are usually not seen to differ from those required for achieving economic efficiency. The investments entailed are usually thought to be investments in education, physical capital, and general management capability. In particular, R & D and related activities that are considered essential to the maintenance of technological leadership are often not deemed to be important for success by follower countries.

Developing countries differ from developed countries not only because they have less capital but because they have less knowledge. There are three critical steps that developing countries must take to narrow knowledge gaps:

- Acquiring knowledge involves tapping and adapting knowledge available elsewhere in the world as well as creating knowledge locally through research and development, and building on indigenous knowledge.
- Absorbing knowledge involves ensuring universal basic education, with special emphasis on extending education to girls and other traditionally disadvantaged groups, creating opportunities for lifelong learning and supporting tertiary education, especially science and engineering.
- Communicating knowledge involves taking advantage of new information an communications technology – through increased competition, private sector provision and appropriate regulation.

A main challenge of public policy in the era of globalization is the seizing of the opportunities it opens while at the same time managing the tensions and problems it poses, particularly, for developing countries. The economic order of early 21st century certainly offers opportunities to developing countries and other actors in the global economy. In the current era of liberalization of international trade regimes worldwide and increasing emphasis attached to international competitiveness, the importance of technology as a factor determining the growth prospects of nations has gone up even further. A considerable proportion of technological inputs are sourced from abroad especially in the early stages of a country's development. Technology is perceived as an intangible assets and is traded internationally either in embodied or disembodied form. The former includes transfer of knowledge incorporated in the designs of machinery or that embodied in the skills of migrating experts. The disembodied knowledge is transferred under contracts under which process know-how, product designs, rights to use patented knowledge or copyrighted designs or drawings are transferred by their owner to another party for a fee. For developing countries, acquiring knowledge involves two complementary steps: obtaining knowledge by opening up to knowledge from abroad, and creating knowledge not readily available elsewhere. The main route of facilitating the acquisition of knowledge from abroad is strategic technology alliance.

In the current scenario of globalization of business, strategic technology alliance is emerging as a powerful management tool in business management. Strategic technology alliances are becoming one of the main drivers of globalization. Business firms around the world have engaged in cross-national alliances to achieve certain competitive advantage in domestic as well as in international markets and resources dependency in various industries have also stimulated strategic technology alliances to response to increased competition, changing market conditions and rapid technological change. Strategic technology alliances are being regarded as the latest phase in the search for innovation, entrepreneurial spirit and globalization among organizations. The attention for the role of strategic technology alliances as a mixture of both internal and external learning tools is found in a growing number of contributions (Gomes-Casseres, 1996; Hagedoorn, 1993; Mytelka, 1991; Teece, 1992). Although differences do exist, all these contributions highlight the relationship between the increasing complexity of technological developments, that goes beyond the capabilities of most individual companies, and the use of external sources of technology through strategic technology alliances. In that context external resources for innovative renewal can complement endogenous capabilities and enable companies to cope with complex technologies through shared resources for increased learning capacity and improved innovative skills (Teece, 1992).

During the last several decades, there has been a significant change in the attitudes of governments, especially those in developing countries, towards FDI. Rather than viewed as evil exploiters, foreign investors are now welcomed as a source of new technologies, better management and marketing techniques and creators of skilled jobs. Not all types of foreign investment, however, are perceived as equally beneficial to host countries. Governments tend to favor joint ventures (JVs) over other forms of FDI, since they believe that active participation of local firms facilitates the absorption of new technologies and marketing skills. Regardless of the channel through which technology spillovers occur, the fact that FDI often involves capital inflows along with technology transfer implies that one would expect a positive impact of FDI on growth in the host country.

Strategic technology alliances have emerged as a popular strategy in an environment in which fast access to up-to-date technology and emerging markets is more critical than ever. Technological alliances are a particular case of inter-firm cooperation. In a spectrum ranging from informal knowledge sharing to mergers and acquisitions (and thus to a total consolidation of the firms technological assets), alliances stand somewhere in the middle. They constitute a median solution between soft and hard technological interaction among business enterprises. More precisely, technological alliances are a long-term contractual agreements between two or more enterprises, aiming at the development of new or improved product or process technologies. Sometimes, research universities and government laboratories are associated with these partnerships. During these alliances, each of the cooperative firms contributes various kinds of resources (technological, financial, capital, equipment) for achieving a common goal, and then share the results. Technological alliances may be organized either through joint ventures or, more often, through written agreement between the partners.

Many factors have been mentioned in the managerial literature to explain technological alliances and cooperation among independent firms The following are the most frequent:

1. In the pursuit of a common technological goal, companies and other research unites may cooperate either to reduce the R&D costs for each partner or to attain critical masses of resources permitting them to conduct large-scale projects that would be beyond the reach of any particular firm.
2. To accelerate innovation.
3. Capturing the knowledge of users.
4. Reducing risk and uncertainty.
5. Shortening life cycles of products.
6. Capturing other complementary assets.
7. New methods of management
8. Governments have been sharing the costs of collaborative R&D in order to increase the competitiveness of domestic companies, accelerate technological diffusion, nurture the development of new industries, reduce duplication of efforts and foster interactive learning.

Technology policy is now clearly a central factor in the theoretical and empirical analysis of international trade and growth. Its ascendancy among the various traditional influences stems from many sources. However, major reasons for the greater role attributed to the technology would include the shift in global production towards the use or embodiment of sophisticated technology, the limited explanatory power of empirical growth models focused on labor and capital (treated as homogeneous and largely fixed entities in most growth and trade analysis), and growing evidence of the existence of powerful linkages between national technological capability, trade competitiveness and economic performance. As the driving force behind productivity and economic growth, international differences in technological capability can be conceived to configure structural competitiveness and absolute trade advantage processes. They are heralded as the key to engineering substantial and persistent economic gains – mainly by the intentional restructuring away from a low-return ‘natural’ comparative advantage to more promising, dynamic sectors of production.

Technology is driving the formation of strategic alliances at the international level in several different but intertwined ways, reflecting the growing ease of communication, cost of research, and need for international standards. The emergence of new communication tools such as the Internet, electronic mail and electronic data interchange (EDI) make cross-border collaborations far easier and more practical than ever before, even compared to five years ago. These information technologies have changed the manner of doing business in many sectors and have enabled firms to share know-how, information, distribution networks and other assets in different locations simultaneously. The knowledge assets of one firm such as new product designs and ideas can be enhanced and adopted by firms in a distant country without delay. Rapid advances in information and communication technology have provided a more conducive business environment for partnerships and spurred growth in international strategic alliances and in phenomena such as cross-border patenting. At the same time, alliances are being driven by multiplying research costs accompanied by shortening product life cycles, which prompt the need to share resources and risks. Technology-related alliances among firms are generally aimed at gaining economies of scale and scope in research and development. This is in contrast to alliances for production, marketing and distribution whose major objective is to gain access to new markets through sharing facilities and networks. R&D alliances are also effective in developing global product and system standards with potential competitors and steering the path of technological change. In high-technology sectors, such as electronics and information technology, studies show that the rate of alliances tends to have a cyclical dimension. The early formative periods of new technological systems, during which no dominant design or standards exist, are characterized by high technological uncertainty and a large number of strategic alliances among firms. In later periods when a dominant design emerges and economies of scale and standardization become more evident, co-operative ventures diminish. Creating a new global product standard and being one of the original patent-holders enhances the long-term prosperity of firms in high-technology sectors. Co-operation is particularly sought with leading multinationals due to their global brand name recognition and marketing power. Once a breakthrough product or system (and possible candidate for a new global standard) is developed, an allied company can exploit its partners' assets including sales and marketing networks.

Recent trends in international strategic technology alliances points out that private (firm-level) as well as social (economy-wide and consumer) benefits can be raised by raising efficiency and innovativeness. A fundamental question for policy makers is whether economic benefits and efficiency derive from a higher level of co-operation among firms or from a greater degree of competition or a combination of the two. In the current era, characterized by fast-paced technical change and higher levels of globalization, traditional theories and measurement approaches concerning market concentration and efficiency is being called into question. The nexus of technological innovation, internationalization of industry, greater networking, global standards and intellectual property are fostering new debates about the benefits and costs of various forms of international coupling. Co-operation among firms in international strategic technology alliances does not necessarily mean less competition. This is true even though international alliances as well as cross-border mergers and acquisitions are breaking all records in terms of pace and size in the 1990s and transforming entire industries. In order to reach scale economies in technology, production and marketing, enterprises are choosing among a number of paths to globalization, *e.g.* foreign direct investment, mergers and take-overs and strategic alliances.

Most studies point to the positive efficiency effects of strategic technology alliances rather than to negative competitive impacts. In general, these alliances can provide private (firm-level) benefits as well as social (economy-wide) benefits by raising efficiency, innovativeness and ultimately consumer welfare. Strategic technology alliances are typically intended to bring together complementary inputs and stimulate innovative activities to introduce new technologies and products, and hence economic growth.

III

The process of economic growth and development is characterized by a transformation of the technologies used in production. Technological change in the developing countries has often been seen as a process through which techniques of production invented and first used in the developed countries are imported and adapted for local use. Experimentation and learning have only a minor role to play in this process of technology transfer, production technologies are chosen 'off the shelf' and are often embodied in capital goods imported from developed countries. However, technological change in the developing countries is more complex than a simple transfer of blueprints from developed countries. Technology is mostly tacit, and as such is not easily transmitted. The tacitness and circumstantial sensitivity limit the value of international spillovers, and require local investments in technology. It is locally produced and adapted knowledge that provides a source of growth. To overcome the tacitness or circumstantial sensitivity of a newly developed or imported technology, there must be local investment in learning. Developing countries cannot take advantage of the vast stock of global knowledge unless they develop the competence to search for appropriate technologies and to select, absorb, and adapt what they find. There is a strong complementarity between local technological efforts and technology imports. To take best advantage of the technology that comes in, and to spread successful practices through the economy, developing countries have to adapt that technology to local conditions.

There are strong indications of future divergence in the world economy. In this technology-dominated economy, convergence (or, catching-up) based on the assimilation of foreign-technology is becoming a more and more active process. Research and Development (R&D), now, seems to be a crucial part of the catching-up strategy. This implies that undertaking R&D is no longer an activity that is unequivocally associated with moving the world technological frontier. Again, the differences between countries in terms of ‘pure’ technological competencies become more and more important for explaining growth rate differentials. In other words, assimilating foreign technology requires more and more active efforts, which increases the danger for countries to fall behind to the world technological frontier, and technological differences between countries translate more easily into growth rate differentials. These tendencies increase the profitability of divergence in the world economy.

Although strategic technology alliances are an attractive option for companies and countries that deal with convergence, development and growth, there are at least three difficulties:

1. the first problem is associated with information distortion and opportunism, which may mislead the acquiring company,
2. the second problem is that creative and innovative companies which are incorporated in a large and bureaucratic structure often lose their flexibility and therefore lose much of their original creativity and innovativeness, and
3. the third problem is related to the externalities, which are connected to the acquisition of a company.

The ability to exploit external knowledge is a critical component of innovative capabilities. The ability to evaluate and utilize outside knowledge is largely a function of the level of prior related knowledge. At the most elemental level, this prior knowledge includes basic skills or even a shared language but may also include knowledge of the most recent scientific or technological developments in a given field. Thus, prior related knowledge confers an ability to recognize the value of new information, assimilate it, and apply it to commercial ends. These abilities collectively constitute what is called ‘absorptive capacity’. At the level of the firm, absorptive capacity is generated in a variety of ways. Research shows that firms that conduct their own R & D are better able to use externally available information. This implies that absorptive capacity may be created as a byproduct of a firm’s R & D investment. This strategy of importing technology through contractual modes, however, can succeed only in countries having high absorptive capacity. Furthermore, the right kind of technology may not be available on a contractual basis in the absence of adequate local technological capability.

However, the new order of international trade under the World Trade Organization (WTO) will make it difficult for developing countries to protect the domestic market for infant industry learning. Furthermore, because of new pressure under the WTO regime to liberalize the domestic market for products, services, and investments, becoming independent of multinationals will be more difficult for developing countries. Finally, intellectual property rights protection will pre-empt duplicative imitation of foreign technologies. Reverse engineering of foreign products for duplicative imitation will be more difficult and costly for developing countries.

Higher levels of product and/or process technology have been the key for national competitiveness. The use of foreign direct investment can be a very efficient tool under appropriate conditions and it can help in the improvement of local skill level and competition. A passive reliance may lead to stagnation of the domestic technological capability. Therefore, the best way is to develop an active domestic technology development program and supplement it with selective foreign technology. Thus, countries undergoing economic restructuring that are currently focusing on the opening up of the economy, and privatization to improving domestic competition would have to take another serious look at their strategies.

It is clear that their improved access to modern technology alone does not guarantee that low-income countries will realize productivity increases. They need the human capital required to absorb and efficiently use modern technology. The introduction of new technology can stimulate skill accumulation in two ways. First, the technology can be of a more recent vintage without affecting the sectoral composition of production (within-industry effects). Second, assuming the existence of a technology ladder in the production of goods ordered by increasing technical sophistication, the introduction of new technology can stimulate skill accumulation also – and perhaps most importantly – when it leads to a change in the sectoral composition of production by relating to activities which are one rung up on the technology ladder compared to those which already exist in an economy (between-industry effects). Hence, the full impact of technology adoption on skill accumulation depends on the amount of new technology that is introduced and on the degree of change in the structure of production up the technology ladder, which the new technology entails.

Country after country is choosing the free market economic structure and privatizing state controlled organizations as fast as they can. Various countries are instituting policies to restructure their economies. Countries acted as if all problems would be solved if their border were opened to international competition, and the government withdrew its controls, including controls on the exchange rate, to let the free market prevail. It was hoped that multinational organizations would bring advanced technologies with them to the countries. It was argued in theory that infrastructure should be improved along with the domestic competitiveness. However, in practice, privatization and opening of borders to outside companies was emphasized. Some companies entered the developing countries and some technology transfer also took place. However, the overall result of such policies was the flooding of these markets with foreign goods, decline of domestic industry, heavy unemployment and the resulting increased criminal activity. Policies have to be developed by the government to develop trust in the economy and provide incentives for technology transfer. It is the government, which has to develop the infrastructure to make it profitable for multinationals to enter, and to facilitate the flow of needed information for the domestic market. In other words, technology transfer has to be supplemented with economic restructuring.

The globalization of trade and an increasingly borderless market economy will entail integration and convergence of policy making in many sectors such as trade, investment, environment, and technology policy. This will certainly bring about increasing conflicts between national interests and global welfare as the pace of convergence and integration among these areas accelerates. Such conflicts can only be resolved by adopting appropriate policy measures, backed by sound and objective analytical work. One of the critical issues that has emerged as a result of recent globalization trends is the trade-environment competitiveness issue. It is generally believed, based on classical economic thought, that free trade will open the flood gates for the migration of highly polluting industries to countries with lax environmental standards generally assumed here as developing countries. However, there are already moves to incorporate restrictive trade practices in negotiations at various multilateral trade, investment and environmental initiatives. But, many analysts acknowledge that this will further damage global environmental welfare, apart from polarizing trade and investment patterns. Such restrictive trade practices may also hinder the flow of foreign direct investment, which many developing countries rely upon increasingly for technology acquisition and upgrading, and thus may adversely affect national technology development initiatives. Thus any developing country could be part of this production system and attract investments in high technology industries, irrespective of its level of technological capability, if it adopts open and conducive investment, economic and fiscal policy measures. Thus, the key to catching up in the technology hierarchy is to promote a liberal investment climate to attract high technology industries.

A review of the available evidence suggests that the current state of understanding about the causes of economic growth is fairly poor. Clearly, there have been development successes just as there have been development failures. What we are arguing is that we are in a weak position to explain why some countries have experienced economic growth and others not. The practice of development has relied upon theories, which all purported to explain why developing countries had not experienced economic growth, and purported to be able to offer cogent advice on what should be done to overcome this. Yet the available evidence suggests that none of these theories has so far been able to do this very well. On the theoretical side, more energy should be directed toward understanding the complex and varied inner workings of actual economies rather trying to assimilate them into abstract universal models. Over 100 years ago, Thorstein Veblen said substantially the same thing. He argued then that economists needed to abandon their animistic bent, and instead turn to a study of the complex causal processes of economic development (Veblen, 1948).

Thus, national prosperity is created, not inherited. It does not grow out of a country's natural endowments, its labor pool, its interest rates, or its currency's values, as classical economists insist. A nation's competitiveness depends on the capacity of its industry to innovate and upgrade. Companies gain advantage against the world's best competitors because of pressure and challenge. They benefit from having strong domestic rivals, aggressive home-based suppliers, and demanding local customers. In a world of increasingly global competition, nations have become more, not less, important. As the basis of competition has shifted more and more to the creation and assimilation of knowledge, the role of the nation has grown.

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Sustainable Business Development – A Three-dimensional Approach

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Abstract

Although there are several initiatives that companies can implement towards more sustainable business development, many companies still restrict their actions to improving their financial performance only. While this is an important strategy to remain viable, alone it will not achieve sustainable business development in the longer term.

Increasingly, companies accept that their strategic planning must incorporate the financial, social and environmental dimensions if they wish to remain competitive in the future. As a consequence they embrace a wider philosophy.

The paper discusses the management philosophy underlying sustainable business development and introduces companies that have already taken up the challenge of environmental, social or triple bottom line reporting as one outcome. Associated tools and principles are discussed and The Natural Step concept (TNS) is introduced as a framework that companies can apply towards achieving sustainable business development and towards improving their triple bottom line.

A Changing Paradigm

Only 49 of the world's 100 largest economies are countries; 51 are corporations. Traditionally, the primary accountability of big corporations has been to financial markets, with a commitment to the financial bottom line only. The world is now experiencing the consequences of this blinkered approach, such as the destruction of the natural environment (the source of raw materials and life supporting eco-services) and communities, the transfer of wealth upward, and the marginalisation of individuals, communities, and cultures and their inherent values. [15]

A new management culture is emerging that expresses a growing concern about the environment, human health and the currently wasteful and unsustainable patterns of production and consumption. Globally, there are demands on businesses and governments to move beyond environmental protection to restoration to make good the excesses of the past. Consumer awareness is also growing and often dictates environmentally and socially responsible production methods. Growing private investment in developing countries and increasing competition in many business sectors, driven by globalisation, have provided opportunities for managers with long-term goals in mind.

The emerging management philosophy is moving away from the traditional view of the world, where the natural and social environments are auxiliaries of the economy. The new picture of the world places the economy inside environmental and social networks by recognising the prevailing interdependencies. Figure 1 illustrates this shift.

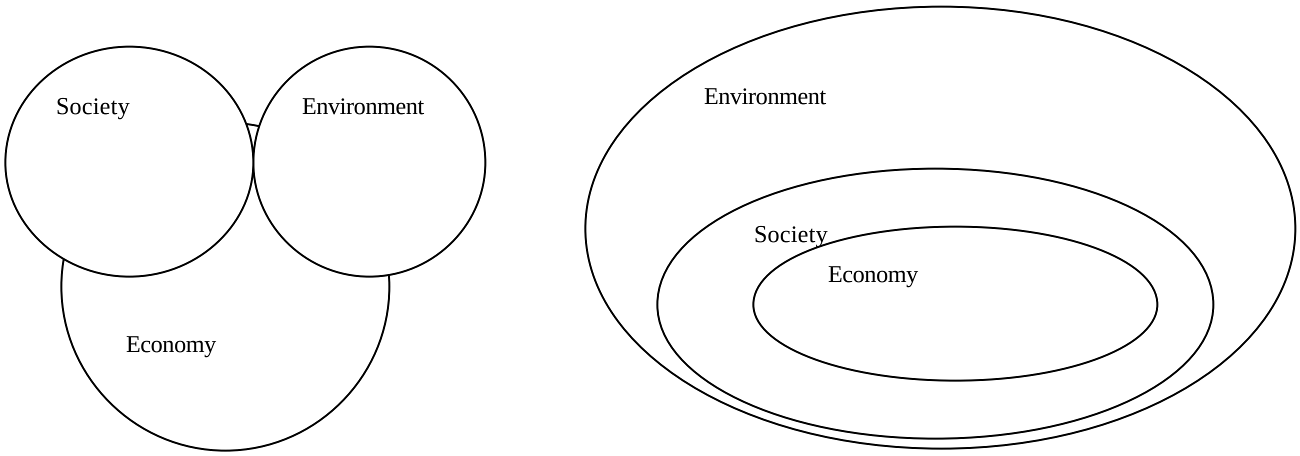

Fig.1: THE ECONOMY CAN NO LONGER BE SEEN IN ISOLATION FROM THE NATURAL AND SOCIAL ENVIRONMENTS. [19]

In current production systems, on-the-spot and short-term thinking and more readily available information are required more than ever, along with technological sophistication to deal with their implications, for example just-in-time production. It is, however, long-term strategic thinking, which discounts the consequences of current actions, that is the key to sustainable business development. [1]

Increasingly, companies recognise the need to move towards long-term management decisions. Some developments act as a further catalyst. [25] Companies will, for example, increasingly be required to repair environmental damage they cause, and they will be required to make financial provision for any environmental liabilities they might incur. The cost of environmental remedies is also set to increase in light of the realisation that current damage control is only superficial. Already the public is demanding wider disclosure of the social and environmental effects of business operations. Many effects were in the past unearthed only during mergers, acquisitions or other financially driven changes.

Emerging management trends are going beyond compliance, and companies are increasingly being measured by a combination of their social, environmental and financial management performances. Bigger corporations have started to set the trend by disclosing their impact in public reports. Half of the world's biggest companies (G100) reported on their environmental performance in the year 2000. Fifty-three per cent of the G100 companies reported on social issues that affected their corporate performance. [18]

However, this balance of social and environmental reporting is not evident beyond the G100 companies. While historically there have been debates on social justice issues such as working conditions, slavery, and child labour, attention to environmental issues and reports have recently outweighed attention to social issues.

As a consequence, many companies decide on either environmental **or** social reports to accompany their report on financial performance. Reports on all three aspects are still the exception. Where financial, environmental and social performance form equal parts of the management structure, companies reflect a concern for long-term company sustainability and the triple bottom line.

Managing Business for Sustainable Development

Non-governmental organisations (NGOs), governments and companies are expected to lead the change to achieve sustainable development. Currently 35 per cent of experts in a global survey believe that companies will provide the most significant leadership in the move towards sustainable development over the next ten years. [11]

For a company, managing for sustainable development requires decisions based on three questions:

1. Does this product/service/decision have a financial benefit?
2. Does this product/service/decision have a benefit for the natural environment that the company relies on?
3. Does this product/service/decision have a benefit for the community and society in which the company operates? [21]

Not only company managers are picking up the signals of change. Investors, for example, are diversifying their portfolios by consciously selecting companies that show commitment to sustainability. They realise that sustainable business management allows for better risk management, while also creating better long-term shareholder value.

The Dow Jones Sustainability Group has recently developed an index whereby sustainable business leaders can be identified. Identification is based on five corporate performance principles: company innovation, governance, shareholders, leadership, and society. Each principle is tested in regard to the company's commitment to making a positive difference to the natural and social environment in which it operates. [7] With the full integration of the index with the Global Dow Jones Index, sustainable investment becomes mainstream and sets a precedent for rising social and green shareholder value. A bibliography of leading companies is already established and listed by Dow Jones, according to their sustainability opportunities and risks. [8]

Sustainability indices like the Dow Jones also give rise to standards, for example for socially responsible investment (SRI) [23] and for social and ethical accounting. [1]

The term 'Corporate Citizenship' or 'Corporate Social Responsibility" (CSR) has also emerged as one that reflects the commitment of a company to link management decisions to ethical values, compliance with legal requirements, and respect for people, communities and the environment. [10] Increasingly, companies are adopting corporate citizenship as their flagship by becoming member of business groups that subscribe to sustainable business development. One group that has in the past set trends in corporate citizenship is the World Business Council for Sustainable Development (WBCSD). The WBCSD is a coalition of 150 international business leaders who share a commitment to sustainable development. Multi-national companies like Du Pont, Sony and Procter & Gamble are associated with the council. The latest publication of the WBSCD sets a new trend for business by calling on companies to look beyond the effects of their production methods to feeding into market-driven sustainable development that integrates consumption and production. [14]

As mentioned above, one way to demonstrate a company's commitment to sustainable development is to produce environmental and/or social performance reports. Many reports do not yet link financial, environmental and social reporting as indicators of sustainable development. Rather, companies produce three separate reports or reports on any two of the three dimensions. Triple bottom line reporting attempts to produce a single, integrated document. Very few companies have yet risen to the challenge of producing such an integrated report. However, there is a trend towards it, and guidelines are now being established.

The Global Reporting Initiative (GRI) has recently published globally applicable sustainability reporting guidelines (a synonym for triple bottom line reporting) together with an extensive set of indicators for all three areas. [24] While the GRI recognises that it may not suit some companies to produce a report that covers the financial, environmental and social dimensions straightaway, it provides pathways that allow companies to take an incremental approach towards full adoption and integration over time. All guidelines were developed for organisations of any size, sector, location, or sophistication, including governmental and non-governmental organisations.

To date, however, many companies have developed their own individual set of indicators. Unfortunately, the resulting variety does not provide a sound basis for benchmarking and identification of best practice. There is a degree of freedom regarding the selection and application of indicators at every level. No doubt, as the practice of triple bottom line reporting becomes more established over the years, reports will become more prescriptive. Verification procedures of triple bottom line reports are currently also under development and will add to their credibility in future.

Companies that Accept the Challenge

The move towards sustainable development is due to a change of attitude towards company management to meet new market signals. Accepted business theory maintained for decades that only things that were measurable could be managed. Hence, leaders were not trained in matters that went beyond financial business management. As a result, they did not worry about Corporate Citizenship issues and thus were most of the time not even aware of social and environmental values or interdependencies. This is changing now, as internationally far-sighted business leaders play a major role in the attempt to bring Corporate Citizenship into everyday business operations. By moving away from financial benefit-driven thinking towards looking after the triple bottom line of business operations, they have learned that they are able to 'do good while doing well'. In other words, including the environmental and social dimension in business decisions is bound to improve the financial bottom line; it makes good business sense. Some obvious reasons to take this three-dimensional approach are as follows:

- A company will be more competitive in the global market place by being innovative.
- 'Going green' and being a 'fair' employer is likely to result in increased market share.
- The financial bottom line of a company will be improved through more efficient resource use, generated, for example, by reducing the discharge of emissions, recycling, and using raw materials and energy more efficiently. Interface Carpets, for example, estimate that they can run the entire factory energy for two years with the energy saved by reducing the face weight (in effect reducing the density) of a carpet by approximately thirty-four grams per square meter. [2]
- The conversion of sustainable development ideas into business operations is likely to prompt a shift to a more holistic view, thus changing the thinking from linear to systems thinking. This, in turn, will generate resource efficiencies and opportunities for system improvements.

Examples of new business leaders of the Western World are Ed Wollard, who was instrumental in adopting Du Pont's environmental stewardship strategies in the early 90s, and Stephan Schmidheiny, the visionary founder of the Business Council for Sustainable Development, who brought multinational companies like 3M, Shell and Volkswagen to the table. Ray Anderson is another business leader who corrected the course of environmental and social neglect of his carpet manufacturing empire, Interface. [22][3] Business leaders who are leaving their mark in Australasia are Stephen Tindall of New Zealand, who is working towards making his empire of The Warehouse more waste-and energy-efficient and Dick Hubbard, who has established a successful breakfast food empire and who chairs the New Zealand arm of the Business for Social Responsibility organisation.[2] [13] Graham Duff, Managing Director of the Australian company Fletcher Construction, has adopted a philosophy to reduce waste wherever possible. The increased recycling of steel, concrete, timber cardboard and plaster has already reduced waste removal costs by 55 per cent. [6]

Overall, however, Australasian companies have a longer way to go than their counterparts in Europe and North America. This is probably due to only moderate market pressures and little government intervention in Australia and New Zealand.[3] A culture of minimum compliance still outweighs voluntary environmental enhancements, and few companies currently consider social improvements. [9]

We have established before that a way to publicly claim being a forward-thinking and long-term-oriented company is to produce annual reports that reflect a company's environmental or social performance.

While there are an increasing number of companies that are currently reporting on their environmental performance in addition to their financial performance, the number of companies already providing integrated triple bottom line reports is small. Where integrated triple bottom line reports are being used, they serve a different purpose in Australasia from the purpose they serve internationally. They are being used internationally as an external communication tool, but they are used as an internal management tool for business change in New Zealand. [17] Triple bottom line reporting in New Zealand is also very new. The first New Zealand report on sustainable development was published in the year 2000 by Landcare Research, an independent Crown research institute. [16] The first cluster of triple bottom line reports is expected in June 2002. A number of companies are currently establishing individual key performance drivers, from which indicators will be developed.

On a global scale, few companies currently reflect the trend towards sustainability reporting by integrating their financial, social and environmental reports. Interestingly, companies who are ranked highly in terms of their social responsibility are often companies who also report on their environmental performance. Internationally, highly ranked companies that fulfil their responsibility to society are Shell, the Body Shop, BP Amoco, Du Pont, Interface and Novo Nordisk. [11]

3M is also regarded as an international company that has shown an ongoing concern for the social and natural environment. In New Zealand their Pollution Prevention Pays (3Ps) programme led to water conservation of almost 65 per cent and power reduction of 50 per cent in the head office. Dow Chemicals, another international company, adopted an ethic of responsibility and accountability when they introduced the ‘Responsible Care Code of Management Practices’ in 1997. They have also established twenty-two advisory panels worldwide, with the aim to improve communication with the community. In Australia, this has resulted in an environmental improvement programme that was developed and prioritised jointly with the community of Altona, where a chemical plant is located. [6]

Overall, more companies chose to report on either their environmental or their social performance. Seventy per cent of the non-financial G100 companies produced a full environmental report for the year 2000. This included companies belonging to the oil and chemical sectors. While the automotive and utilities and telecommunications sectors have adopted environmental reporting as a norm, only 5 per cent of the financial companies produced a full environmental report. Many of them have, however, developed ethical and socially responsible investment portfolios. [18]

The environmental and social responsibilities of companies have evolved in parallel, with a number of companies opting to report on the aspect that is more affected by their operations. Many publications continue to look at both areas in isolation, suggesting to business leaders that they pursue one path or the other.

Tools and Principles for Change

So far, we have established that recent business management trends reflect a concern regarding company long-term sustainability in the market place, the natural environment, and the community in which each company operates. A number of companies are starting to integrate their reporting to disclose, and indeed improve, environmental and social effects over time.

These reports are, however, merely an annual snapshot. It is also unlikely that a company will be held accountable for their environmental and social performance in the absence of an associated framework for sustainable development.

If they are serious, there are two factors a company has to consider in the quest for sustainability:

1. a commitment to engage in a long-term process, where a system of continuous improvements evolves over time from a linear statement of commitment into a complex web of regularly verified data and information
2. a commitment to active stakeholder dialogue and regular disclosure of information.

Over the last ten years, a number of tools to assist companies to pursue sustainability strategies have been developed. Some emphasise the need to lessen companies’ environmental impact and some include measures to develop social responsibility.

Tools include environmental management systems, cleaner production, waste minimisation initiatives, environmental labelling, environmental, social and ethical accounting, life cycle assessment or risk assessment tools, audits, eco balances and design for the environment. Quite often the tools are already standardised by bodies such as the International Organisation for Standardisation (ISO) or the Global Resource Institute (GRI), to name only two.

In addition to tools for change, principles for change have emerged. Amongst the plethora of principles, two have gained recognition for challenging the prevailing mindset: ‘Factor Four’ [26] and Natural Capitalism: [12]

While Factor Four discusses the need for, and gives examples of, natural resource efficiency, backed by a number of examples, Natural Capitalism describes four principles of sustainable business practice. In fact, the idea of Natural Capitalism goes beyond the improvement of resource efficiency by promoting a shift in business practice towards restoration. Let us look briefly at the four principles that form the basis of Natural Capitalism:

1. A dramatic increase in resource productivity is needed by slowing depletion and lowering pollution, and thereby also providing the base for increased employment. Current management thinking does not give consideration to the fact that 99 per cent of the energy used to move a car is lost to heat and combustion for example. Only 1 per cent moves the driver.
2. Eco-efficiencies can be gained through redesigning industrial systems as biosphere-inspired production systems. Where nature is used as a model, high temperature extruders and boiling sulphuric acid in the production of polymers can be replaced, for example, by using spiders for silk production. The end-product is even stronger and tougher than the synthetic version.
3. The notion of affluence measured by acquisition must be replaced by putting value on services. This can be achieved by paying for the service, rather than for the product itself.
4. Business must be conducted in a way that is restorative to ecosystems. This includes moving from income-based taxation, to resource use- and waste-based taxation.

While similar principles were ridiculed until recently, there has been a change in company management practice that acknowledges at least two of these principles. Companies like Du Pont, for example, are increasingly investigating, and investing in, production methods that are inspired by natural systems, while companies such as Xerox and Electrolux have led the way towards manufacturers becoming deliverers of service. Governmental policy has already changed in Europe, where personal tax rates are decreasing, while CO2, vehicle and waste taxes are rising.

The Natural Step – A Framework for Change

While environmental management systems, cleaner production and waste minimisation are tools for the achievement of company sustainability, the notion of Natural Capitalism provides principles that can be adopted by companies shifting from traditional production and consumption patterns.

However, a ‘living’ framework is required to encourage the mind shift and ongoing commitment to improvement of the triple bottom line of a company. The Natural Step (TNS) acts as an overarching framework and can be used by companies to integrate environmental and social considerations into long-term planning.

The Natural Step Framework is based on the perception of a cyclic economy, whereas most traditional frameworks place business in a linear, throughput economy. In a cyclic economy it is acknowledged that waste occurs during the manufacture of goods, during their useful life, and after disposal. With this in mind, to reduce waste an improvement of production processes has to replace the prevailing notion of waste minimisation.

TNS is built on first-order principles that must be followed to achieve a sustainable society. They are described as the four system conditions and require that, for a society to be sustainable, nature’s functions are not systematically

1. subject to increasing concentrations of substances extracted from the earth’s crust
2. subject to increasing concentrations of substances produced by society

or

1. impoverished by over-harvesting or other forms of ecosystem manipulation

and

2. resources are used fairly and efficiently in order to meet basic human needs worldwide. [20]

TNS assists in the facilitation of a process towards three-dimensional sustainability, by providing a compass or direction towards a desired endpoint, rather than prescribing specific pathways and actions. It does this following the recognition that globally increasing demand will meet decreasing resources, which, in turn, will induce a correction of business behaviour sooner or later. With TNS, the emphasis is being shifted from re-active company behaviour to pro-active company management. ‘To work towards sustainability…the company needs to understand what is required for society to be sustainable and what constitutes an ecologically sustainable and integrated human/nature system.’ [20] Applying the system conditions, which are based on non-negotiable scientific principles, to business operations assists companies to achieve this understanding.

In summary, TNS does not ‘tell people what to do’ it rather works towards a culture shift or philosophy adjustment, by prompting people to question their actions in light of the system conditions.

Originally founded in Sweden in 1989, TNS is now validated by a number of scientists and engineers of international reputation and applied today in England, Scandinavia, North America, Australia, New Zealand and South Africa.

International companies that have introduced TNS to their operations include IKEA Furniture, Scandic Hotels, Interface Carpet, Electrolux and the Collins Pine Company. All companies have also experienced an increase in their long-term profitability, while following environmentally and socially sustainable principles.

A group of TNS Pathfinder organisations was established in New Zealand in the year 2000, following the successful example of the United Kingdom. Having a group of companies moving through the process at the same time allows for communication, interaction and sharing of ideas. All Pathfinder companies have, for example, investigated transport issues relevant to their operations while drawing from the experience of international companies involved with TNS. Although every company will find their own best way of addressing unsustainable transport matters, the overarching framework will have prompted them to check their operations against the same four system conditions, which will thus ensure that they work towards the same goal.

Conclusion

Increasingly business leaders are realising that commitment to environmental justice and human rights is crucial for long-term sustainable business development and to maintain a competitive company advantage. With growing public support and stakeholder pressure, the sustainability agenda has moved from the public relations area, where it was handled by legal advisors some decades ago, into the boardroom, where it now forms part of strategic development for the new environmentally aware, consumer driven, market place.

Many multinational companies are now reporting on their social or environmental performance in addition to providing a financial report. A transition towards sustainability has begun. Soon more companies will have to extend their attention beyond financial bottom line thinking, even beyond ‘greening’ their operations, to the effect of their operations on the triple bottom line. These developments are driven by a number of factors, including the increasing realisation that social systems and ecosystems are being affected adversely by many business operations and the challenges that stakeholders and consumers put to companies.

The knowledge revolution, which is currently under way, will accelerate the shift to a demand for disclosure of company information beyond financial disclosure. While global knowledge is currently doubling every seven years, estimates suggest that it will double every seven days by the year 2020. [5] This increase in knowledge will also assist us to devise new systems of company operation and management that are beyond our current imagination and comprehension. For example, it is estimated, that 80 per cent of the goods and services that will be used in 10 years are yet to be invented. This estimate is also based on the realisation that the technological evolution is currently taking place at a rate that is 10 million times faster that the speed of natural evolution. [4]

Future strategies for a sustainable world will have to include company development that reaches beyond current practices. At this time, a commitment to long-term sustainable company development, in the form of regular, externally verified triple bottom line data is still the exception.

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Endnotes

[1] Sustainable development shall be defined here as '…meeting the needs of the present without compromising the ability of future generations to meet their own needs. (This is a widely accepted definition provided by the World Commission on Environment and Development, 1988.)

[2] Asian business philosophies are also shifting beyond financial dimensions, with car-manufacturing and electronic companies leading the way. Discussion of the Asian market, however, is outside the scope of this paper.

[3] Most moves to address social and environmental issues in Australasia are still in response to international market pressures. ZESPRI, the governing and export-dependant body of the New Zealand Kiwi fruit industry are, for example, in the process of introducing a 'customer gateway programme' that addresses environmental and ethical concerns in response to international market trends and customer demands.

Sustainable Development, Strategic Alliances and National System of Innovation: A Malaysian Outlook

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Abstract

The essential idea behind sustainable development is that current modes of behaviour – especially in the developed countries – are unsustainable and therefore threaten current and future ways of life. It should not be defined strictly to planetary environmental issues; it is also essentially a social concept.

With this in mind, the goals of social and economic development of all countries must then be defined in terms of sustainability – developed or developing, market-oriented or centrally planned. Interpretations will vary, but must share certain general features and must flow from a consensus on the basic concept of sustainable development and on a broad strategic framework for achieving it.

These past few years have seen the increasing attention given to knowledge and its pivotal role in economic development. Economic growth and development has lately become largely dependent on knowledge investments and these investments are played out in the form of research and development, education and training and innovative work means. If the ability to measure these investments can be perfected, then perhaps, a country might just be able to leverage its position regionally and, subsequently, globally to enhance innovative performance and competitiveness towards ensured positive economic growth.

Sustainable development requires, among other things, an economic system that is able to generate surpluses and technical knowledge on a self-reliant and sustained basis. Through our case study on the Malaysian concept, we aim to highlight that, while strategic alliance among industry, academia and government is an inevitable component of a NSI, it can synchronously play a catalytic role in achieving sustainable development and a scale economy in its efforts to nourish originality and diversity towards evolutionary but sustainable innovations for the better of a country.

Introduction

These past few years have seen the increasing attention given to knowledge and its pivotal role in economic development. Economic growth and development has lately become largely dependent on knowledge investments and these investments are played out in the form of research and development, education and training and innovative work means. *The present state of the nations is the result of the accumulation of all discoveries, inventions, improvements, perfections and exertions of all generations which have lived before us: they form the intellectual capital of the present human race, and every separate nation is productive only in the proportion in which it has known how to appropriate those attainments of former generations and to increase them by its own acquirements* [Friedrich List, 1841].

International trade and capital flows contribute to long-term economic growth and development. Concern for the interests of future generations will, for many people, be reason enough to look beyond economic growth as an indicator of welfare. But long-term sustainability of economic growth itself depends on other reasons, including cohesive societies. Hence, the importance of taking a broader view of what welfare entails, a longer-term view about the consequences of today’s activities, and of greater emphasis on international co-operation to reach viable solutions. Ten years after the Rio Conference on the Environment and Development, the concept of sustainable development is firmly rooted in standard economic analysis. But for all the work at the conceptual level, its implementation in practice seems to remain muted and uneven. Given the urgency with which the case for sustainability is often made, it is imperative that concrete actions take place.

Sustainable Development

Sustainable Development can be defined as a system of development which "…. meets the needs of the present generation without compromising the ability of future generations to meet their own needs" [Brundtland Report, UNWCED 1987].

The essential idea behind sustainable development is that current modes of behaviour – especially in the developed countries – are unsustainable and therefore threaten current and future ways of life. It should not be defined strictly to planetary environmental issues; it is also essentially a social concept.

Sustainable development can be interpreted in economic terms as "development that lasts" [Pearce and Barbier, 2000] – i.e. a path along which the maximisation of human well being for today's generations does not lead to declines in future well-being. Human well being here is interpreted as including not only the satisfaction of economic needs, but also preferences in terms in social development.

This naturally means that economic and social developments are strongly linked, and are equally important for the well being of both current and future generations. But social dimensions often lose out to shorter-term economic considerations, while social policies are sometimes formulated without due regard for their economic consequences. Given the increase in the world's population, and since consumption in developing countries will grow and attain a level comparable to that of developed countries, sustainable economic development will be inevitable from now on [Doucet, 2000].

A National System of Innovation

As the world steps into the era of a new economy where geographical boundaries are blurred by the wave of globalisation, this paper highlights the importance of a National System of Innovation (NSI). According to Freeman (1987), NSI is defined as "… the network of institutions in the public and private sectors whose activities and interactions initiate, import, modify and diffuse new technologies." The building blocks of a nation's NSI should at least comprise of a national education system, industrial relations, technical and scientific institutions, government policies, cultural traditions, together with numerous other national institutions [Freeman, 1995].

The study of national innovation systems focuses on flows of knowledge. The flow of knowledge is basically engineered to measure knowledge investments. If the ability to measure these investments can be perfected, then perhaps, a country might just be able to leverage its position regionally and, subsequently, globally to enhance innovative performance and competitiveness towards ensured positive economic growth.

Hence, attention should be directed to the bonds of interchange within the overall technology development process. Policy makers can then accost possibilities on ways to embellish innovative exploits in the knowledge-based economies of today by understanding these systems [OECD, 1997]. Interaction and communication is the essence of knowledge economy; an economy built mainly upon thriving flow of knowledge exchange and sharing, which by definition are forms of interaction and communication.

Strategic Alliances

Of recent, an increased level of perceptivity has been engaged by the national innovation system approach in the field of technology. Summarising, it involves (1) the recognition of the economic importance of knowledge; (2) the increasing use of systems approaches; and (3) the growing number of institutions involved in knowledge generation [OECD, 1997].

It is important that information technology be seen as the powerful tool that naturally assists in identifying knowledge flows. An intricate appraisal and analogy of the knowledge flows at the domestic level will consequently identify the clots and suggest policies and approaches to refine their fluidity [OECD, 1997]. Hence, there is a need to ascertain the links and relationships among industry, government and academia in the evolvement of science and technology. Such analysis may ultimately lead to the ability to measure the knowledge distribution power of a national innovation system, which is considered one determinant of growth and competitiveness.

Strategic alliances can be understood to be associations important to alliance partners and formed to further their common interests. It can mean to be the foundation for inter-organisation collaboration in business and industry. Whereas large organisations in the past maintained in-house research and development laboratories in order to retain dominance in their core technologies, organisations increasingly have externalised this function through co-operative agreements with other organisations, research laboratories and universities [Fountain, 1998]. But there is an underlying risk. That when the knowledge base of an industry is hard to comprehend, not complete, and highly dispersed across organisations, then collaboration among organisations, universities and national laboratories can inadvertently reflect a strong and fundamental interest in access to knowledge rather than simply with strategic calculation, resource sharing, or transaction cost reduction.

The paradox of innovation is that while it is driven by competition, it cannot flourish without co-operation, sometimes even between competing organisations [Guinet, 1999]. The costs, complexity and risks of innovation are high and no organisation, no matter how large, can find all the knowledge and information it needs in-house or even within the boundaries of its own country. To share risks and costs, to access new knowledge, and to ensure that innovation responds to consumer needs, organisations join in networks, alliances and clusters. They work with universities and research institutes, with clients and regulatory agencies, and even with competitors. Many of these networks and alliances, in areas such as cars, airlines, telecommunications and retailing, now have a global character.

Government/Industry Relations

As the pace of technological change intensifies, as economic resources become more scarce, and as information technologies produce linkages among geographically dispersed actors, the predominant form of economic organisation changes [Fountain, 1998]. There is a clear change in the relationship of organisations with their national governments in matters of regulation, research and development funding, standards setting, procurement, and other functions that shape the capacity of organisations to innovate.

A significant effort must be made to reduce the extent of mandatory regulations enforced by primitive sanctions and to replace them with a growing array of incentives and disincentives intended to induce organisational behaviour that satisfies public needs while allowing organisations to optimise their economic performance [Fountain, 1998]. If government-industry relationships also contribute to the formation of an environment necessary to innovation in science and technology, then governments must continue to modernise their management, rules, and behaviour to contribute. The criticality of innovation to economic performance and competitiveness is one powerful reason to move away from a market economy bounded by hard walls of government regulation.

Meanwhile, a significant and growing number of institutions with various fields of expertise are now involved in the generation and dissemination of knowledge, as conveyed by the fact that economic activities are becoming more knowledge-intensive. Enterprises, and national economies as a whole, need to scrutinise on their methods of effectiveness in gathering and employing knowledge from institutions in order to succeed. This act becomes distinctively intricate when each country has its own institutional profile depending on the governance regime for enterprises, the organisation of the university sector and the level and orientation of government-funded research [OECD, 1997].

In all sectors of the economy, organisations need innovation to grow and to stay ahead in the market [Guinet, 1999]. It helps producers to satisfy diverse and fast changing consumer demands, and enables improvements in health, communications and the quality of life generally. In other words, innovation is the driving force of progress.

Liberalisation of international trade and investment helps developing countries like Malaysia enhance their economic growth and has the potential to lift large numbers of people out of poverty. However, globalisation will not deliver its full potential benefits if new technologies, capital and export markets only benefit those countries when the conditions to effectively exploit these opportunities are present, while marginalising those countries where these conditions do not yet exist [OECD, 2001].

Social considerations are equally important in the pursuit of sustainable development. The social policy of a country should be motivated by concerns about equity and the social externalities of poverty, unemployment, inadequate skills and ill-health. Hence, with a healthy level of wealth, institutional infrastructure and social safety nets, the goal of sustainability can be more attainable. However, even with altruistic goals in mind, most experiences have demonstrated that the required changes in policies and behaviour may be difficult to achieve in the face of ignorance, inertia and vested interests [OECD, 2001].

The thing is, the roots of the problem – explosive population growth and rapid economic development in the emerging economies – are political and social issues that exceed the mandate and the capabilities of any corporation. At the same time, corporations are the only organisations with the resources, the technology, the global reach and ultimately, the motivation to achieve sustainability. Hence, the idea of moving towards inter-organisational linkages in the form of partnerships and consortia as an effort of achieving sustainability can contribute to a country's economy. Organisations can form productive collaborative relationships with a variety of other organisations, laboratories, universities and governments in order to leverage the benefits of co-operation. These benefits include shared resources, shared staff and expertise, group problem solving, multiple sources of learning, collaborative development, and diffusion of innovation [Hart, 1997].

Sustainable development requires, among other things, an economic system that is able to generate surpluses and technical knowledge on a self-reliant and sustained basis. In the face of technology, it may seem difficult to attain sustainable development when much focus is placed on achieving economic progress. However, it may be worth looking into the idea of using knowledge as one of the ways to achieve sustainability. A closed system like the earth's cannot withstand a systematic increase of material things, but it can support exponential increases of information and technology [Magretta, 1997]. Information technology is a very powerful tool. It miniaturises things, avoids waste, and produces more value than one can ever realise. Although any powerful new technology is liable to create ethical problems – privacy issues, fairness, ethics, power, control etc – society can still solve these inherent issues with a change in the technological substrate.

Developing economies can grow if leading companies transfer their knowledge and help those countries avoid the mistakes of the past [Fountain, 1998]. The multinational corporation is an impressive invention for dealing with the dilemma between the application of broadly interesting ideas on one hand and economic and cultural differences on the other. As more countries enter the world economy, they will have to accept – with greater or lesser enthusiasm – the fundamental rules that apply. Sustainability is definitely one of those rules.

We aim to highlight that strategic alliances - an inevitable NSI component - among industry, academia and government can synchronously play a catalytic role in achieving sustainable development and a scale economy in the effort to nourish originality and diversity towards evolutionary but sustainable innovations. With this in mind, this paper aims to highlight a phenomenal Malaysian effort, the Multimedia Super Corridor (MSC), which began formulating in late 1996. It gives an idea as to how to identify leverage points to further appreciate sustainable innovative performance and competitiveness in general.

Being a developing country, it is absolutely imperative that Malaysia shines in her quest to comprehend the fruits of the NSI towards achieving sustainable technological and innovative development. As a result, better understanding of this concept can lead to sound government policies, sustainable economic performance and outstanding innovations. Thus, by analysing the MSC through the foundations of the Malaysian System of Innovation framework, this paper hopes to show an exemplar network underlying national advantage. The players within MSC – government, industry and institution – become mutually reinforcing, with beneficial interaction flowing in all directions.

Overview Of A Tiger Nation

Being in a strategic position, at the heart of East Asia, Malaysia is one of the "tiger" nations to have had experienced phenomenal economic growth in the 1990s. Although hard hit during the Asian economic crisis in 1997-98, the country is fast bouncing back onto its feet. Propelled by massive capital investments, substantial productivity gains, and a business-focused "can-do" government, the per-capita GDP of Malaysia's 22 million inhabitants has skyrocketed in the last two decades.

This success story is largely due to the country's determined effort in transforming herself from an agricultural economy focused on rubber, palm oil, and petroleum to a manufacturing economy with a significant focus on electrical, electronic, IT and multimedia technology products and components.

Continued growth is secured through the Government's efforts in maintaining political stability. After gaining its independence peacefully from the British in 1957, Malaysia has demonstrated the benefits of political prudence and regard for good neighbourliness in her governance and international relations. The country is managed by a ruling coalition which harmonises the political needs of the different ethnic communities, and which has provided political stability under a pragmatic leadership for the past 40 years. The Government, believing itself to be a facilitator for private enterprise under the "Malaysia Incorporated" concept, works diligently to lay the groundwork for industrial growth.

The multi-racial population consists of Malays, Chinese and Indians as the majority ethnic groups. They speak a variety of languages, including English, Bahasa Malaysia, and various Chinese and Indian dialects. However, a stroll around the nation's capital, Kuala Lumpur, proves that Malaysia is emerging as one of the global melting pots with an increasingly international society. Hence, ensuring strong cultural links to neighbouring and regional markets. Interestingly, Malaysia's population is relatively young, with 42 per cent falling within the 15-39 age group, thereby promising the country a large pool of knowledge workers to sustain the country's growth in the new economy.

The Malaysian National System Of Innovation

Innovation and technical progress are manifested in a perplexing set of relationships among players creating, disseminating and employing various kinds of knowledge. The innovative performance of a country depends to a large extent on how these players relate to each other as elements of a consolidated assemble of knowledge creation and use as well as the technologies they use. These players are primarily private enterprises, universities and public research institutes and the people within them. The linkages can take form of joint research, personnel exchanges, cross patenting, purchase of equipment and a variety of other channels.

Without denouncing the importance of other institutions, we have anticipated governmental activities, financial institutions, the education system, research organisations and NGOs, private enterprises and MNCs, and the cultural traditions of a multi-racial society, to be the key components of the Malaysian System of Innovation (See *Figure 1*).

Malaysia is a multi-racial society with each race having their own distinctive culture and numerous traditions. Anything that takes place in a country, affected albeit by the Government, the education system, financial institutions, industries, or research organisations and NGOs, is within the societal sphere. Thus, the aspects of its multi-racial society influence these building blocks of the Malaysian NSI in one-way or another.

The Multimedia Super Corridor (Msc)

The vision is to create an integrated environment with elements and attributes of a global multimedia climate - an environment that encourages innovation, helps companies (both Malaysian and international) reach new technological frontiers, partners global IT players, and provides opportunities for mutual enrichment and success. A world where information, ideas, people, goods and services move across borders effortlessly in the most sustainable and liberal ways.

It is a piece of land, 15 kilometres wide by 50 kilometres long, that starts from the Kuala Lumpur City Centre (KLCC), which houses the world's tallest buildings, the Petronas Twin Towers. This Greenfield "corridor" stretches from the centre of the nation's capital, moving down south to the site of the region's largest international airport, the Kuala Lumpur International Airport (KLIA). The corridor has the backbone of a high capacity (2.5 to 10 gigabit per second) digital fibre optic network. It also houses the townships of Cyberjaya and Putrajaya as the world's first intelligent cities. Cyberjaya, some 40 kilometres south of Kuala Lumpur, provides the nerve centre for the infrastructure and facilities to support the multimedia industry. Putrajaya is the new seat of Government and

Administration, a garden city catering for 250,000 people. Designed as a paperless environment in a bold experiment at electronic government, Putrajaya also houses the office of the Prime Minister of Malaysia.

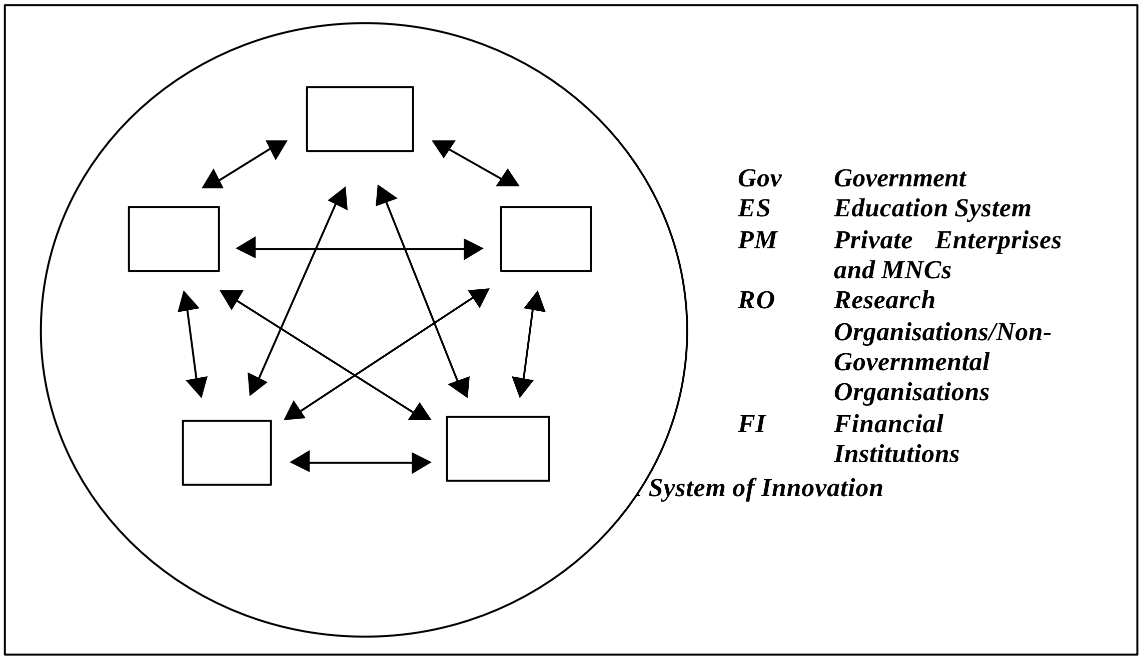

Fig.1: THE MALAYSIAN NATIONAL SYSTEM OF INNOVATION

In the effort to realise the vision, seven “Flagship Applications” have been perceived to be principal. They are identified primary areas of multimedia applications. Driving their development are government ministries and agencies that report directly to the MSC Implementation Council, chaired by the Prime Minister of Malaysia and his Deputy. The *Multimedia Development Corporation* (MDC), a government-appointed, government-backed corporation, monitors the development, and is responsible for managing the MSC.

Through the Flagship Applications, the Government of Malaysia extends an open invitation to the multimedia community in Malaysia and throughout the world to participate in the MSC. They contain an unprecedented and attractive opportunity for local and international business - in their variety and scope, and in the manner in which they are being offered to the global community. Companies taking up the offer will be able to create value for themselves and their shareholders in an environment uniquely suited to their needs, and at the same time have the opportunity to help transform Malaysia and the region.

MSC, the Malaysian NSI and Sustainable Development

The MSC project consists of both infrastructure and info structure development activities, with a strong emphasis on forming an environment conducive for R&D efforts, and having strategic collaborations/alliances play a significant role throughout the project. Simply put, the MSC can be seen as a sustainable system of interactions.

The vision and concept of the MSC project was the invention of the Malaysian Government and its presence made visible through the Multimedia Development Corporation (MDC). MDC is a unique, performance-oriented, client-focused corporation possessing all the necessary implementation powers to ensure the necessary conditions are in place to meet the needs of each company interested in joining the MSC. It plays the role of champion, facilitator, and partner of companies choosing to operate in the MSC. It markets the MSC globally; shape

MSC-specific laws and policies by advising the Malaysian Government, and set standards for the MSC's information infrastructure and urban development. The cyber laws are the Government's legislative activity specifically targeted for the MSC.

The Government's role as a financier is also apparent in the MSC project. Substantial financial incentives are made available to those companies given MSC status, including exemption from customs for up to 10 years or a 100 per cent investment tax allowance, and no duties on multimedia equipment. All companies that create, distribute, integrate, or use multimedia products and services can apply for MSC Status. This includes numerous MNCs and private enterprises. Once given the status, they do not only enjoy the above-mentioned financial incentives but they also get exclusive rights to bid for flagship applications' implementation tenders.

This, in effect, has made MSC an area with a high concentration of high technology usage and development. In order to facilitate the companies, MDC cuts through red tape to expedite permit and license approvals, to provide information and advice on the MSC, and to introduce companies to potential local partners and financiers. As of the end of July 2001, Malaysia proudly records 518 registered MSC-status companies.

Venture capital organisations also play a significant role. In September 2000, it was announced that Malaysia would lead the formulation of a RM570 million (US$150 million) venture capital company together with investors in the US, Saudi Arabia, and Bahrain with the stated purpose of investing in the IT sector in Silicon Valley. The firm, American Pacific Venture Capital Inc. (AMPVC) would invest in to conduct research and development activities in Silicon Valley. Meanwhile, manufacturing activities would take place in the MSC. This provides opportunities for the local industries to bridge the technological gap with those of the Silicon Valley citizens.

Another venture capital company, MSC Venture Corporation Sdn Bhd (MSCVC) - the venture capital arm of MDC – aggressively identifies innovative, potential high-growth SMEs in this sector for investment. MSCVC is a wholly owned subsidiary of MDC. It was established to provide venture capital financing to innovative and emerging IT and multimedia companies at the start-up, growth and pre-IPO stages. The company manages the RM120 million MSC Venture One Sdn. Bhd. (MV1) fund, which was established through investments by MDC and Khazanah Nasional Berhad, which is the investment arm of the Malaysian Government.

The MSC's Smart School initiative, one of its seven flagship applications, responds to the need for Malaysia to make the critical transition from an industrial economy to a knowledge-based one. The objective is to produce a technologically literate and thinking workforce, which is well able to perform in a global environment and use information-age tools and technology to improve productivity.

In addition, at least six of the nation's public and private universities are located within or near the vicinity of the "greenfield" corridor. These institutions provide skilled workforce for the development of MSC and for the companies operating in the MSC. The institutions are also research hubs with high levels of knowledge creation and sharing activities further enhancing the innovative environment of the MSC. The universities are also natural collaborative counterparts for the companies in MSC. This is made evident with the Multimedia University. With one of its campuses located in Cyberjaya, its joint ventures in research and development with the MSC-status organisations is an example of the type of co-operation that the Government hopes will enable Malaysia to benefit economically from its transformation into a high-tech society [Andaya, B W et al, 2000].

It is worth noting that, with an impressive collage of MSC-status companies, the MSC stands to enhance long-term growth prospects by especially focusing on human capital; it offers a splendid way of drawing people into employment – thereby improving overall efficiency in using capital and labour. Specifically, it results in greater labour utilisation i.e. lower unemployment rates and improved labour productivity. With the MSC, there can be visible improvements in the quality of labour, through the creation of knowledge workers. It offers a new environment that demands for new skills, competences and ways of organising work. In addition, focus is also given to the importance of information and communication technology (ICT) to highlight the need to understand and bridge the "digital divide". ICT hardware and software are useless without the competence to exploit them. It is through the national education system, of which among its components are the MSC Smart School and the Multimedia University, that this competence is nurtured with the foundations of lifelong learning and technological literacy. The two townships of Cyberjaya and Putrajaya have residential precincts built with advanced telecommunications infrastructure to support the learning process that should take place throughout life in homes and communities.

In addition to the research activities done by the industries and the higher education institutions, there are also other research organisations practising in the MSC. One example is the Malaysian Agricultural Research and Development Institute (MARDI), of which their pioneering work in the agricultural sector and, more recently, in biotechnology has further enriched the technological mix in the MSC.

Conclusion

The technology revolution begins at home – yet no country will reap the benefits of the work age by waiting for them to fall out of the sky. Today's technological transformations hinge on each country's ability to unleash the creativity of its people, enabling them to understand and master technology, to innovate and to adapt technology to their own needs and opportunities. Nurturing creativity requires flexible, competitive, dynamic economic environments. For most developing countries, this means building on reforms that emphasise openness – to new ideas, new products and new investments [UNDP Human Development Report 2001, 2001]. The key is to create an environment that mobilises people's creative potential to use and develop technological innovations. For Malaysia, the key lies with the MSC.

It is with earnest hope that this paper has successfully endeavoured to enlighten readers on Malaysia and her idealistic vision. Summarising, it is clear that knowledge plays a very prominent role in sustainable development. Malaysia's MSC aims to provide a world where information, ideas, people, goods and services move across borders effortlessly in the most sustainable and liberal ways. It aims to provide an environment that hopes to generate surpluses and technical knowledge on a self-reliant and sustained basis. Conclusively, MSC aims to be the place for strategic alliances among industry, academia and government to synchronously play a catalytic role in achieving sustainable development and a scale economy in an effort to nourish originality and diversity towards evolutionary but sustainable innovations for Malaysia.

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[v] These are sometimes sunk in political, economic and social problems of purely national order that they did not know how to exceed by the putting on of processes of harmonization that their links(coming& together) let nevertheless hope (For European Union)

[vi] desolation by the Countries of Central and Oriental Europe of collectivist politico-economic systems of management considered as non effective and obsolete and passage to an a-typical kind of market economy by the involvement of "shock therapies" or of "progressive therapies".

[vii] AFTA : Asean Free Trade Area; since January, 1992 10 countries, members of the ASEAN decided on the progressive application of a Free trade area for the countries of the Association, including, according to a fitted out calendar for the future members (1995 : Vietnam, 1997 : Laos and Myanmar, 1999 : Cambodia). By 2003, the members of the Association should return in a fork from 0% to 5% the group of tariffs concerning products coming from the ASEAN-area. Vietnam, which integrated the Association on July 28, 1995, sees giving a grace period of 3 years.

[viii] " In the world, but not of it "; Karel van WOLFEREN, " the enigma of the Japanese power ", Robert Laffont, Paris 1990.

[ix] The third Interministerial Conference of the OMC took place in Seattle (USA) from November 30 till December 3, 1999 and ended in a due loud failure, partially , in the lack of time which had the representatives of the various member countries to get ready for new questioning aroused by the acceleration of the economic and commercial events of the period 1995-1999.

[x] At the UNO, 1 State = 1 vote ; in the NATO, the action of the partners decides on the embargo against some, and on the help for others. The end of Cold war made obsolete the concept of "not alignement" which had been mostly included as a disalignement towards some, followed by a fast realignment on the others.

[xi] Financial Community of Africa ; The parity of the CFA franc, 50 for 1 with the French franc remained unchanging until January 11, 1994 for the African countries of the U.E.M.O.A. (Economic and monetary Union of West –African Countries : Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal, Togo) and of the U.D.E.A.C. (Customs and Economic Union of the States of central Africa : Cameroon, Congo, Gabon, Equatorial Guinea, Central African Republic, Chad). In this date intervened a devaluation of 50 % which fixed the value from 100 CFA to 1 FF.

[xii] The theory of the *"wild goose flight",* elaborated by the Japanese economist AKAMATSU in the 30s, describes an international cycle of production by virtue of which the goose of head passes on its model of production to those that follow on the way of the development as increases the productivity and the technological capacity, and as capacities and payment for the labor forces improve. This evolution is strikingly regular in Asia of the East and the Southeast. This progress was facilitated by a modification of the international division of the work and, during the last decade, by a vertiginous development of the intra-regional business and a large-scale transfer of industrial resources of Japan and four "tigers" (Hong-Kong, China, Singapore, South Korea, Singapore and Taiwan) to their poor neighbours.

[xiii] Advised by Sir Keith Joseph, Margaret Thatcher conforms to Friedrich von Hayek's monetarist theories. She directs the action, first and foremost to the defence of the pound and the fight against the inflation. She advocates a real financial orthodoxy disputing so Keynesian rules.

[xiv] But also methods, rhythms, safety standards, even standards of eligibility of products on the world markets

[xv] the USA (8.860); Japan (4.500); Germany (1.930); France (1.530); Great Britain (1.360); Italy (1.080); China of which Hong-Kong (1.160); Canada (600); Brazil (360); Spain (530).

[xvi] The population accumulated by the first five countries quoted in previous note is crossed(spent) from 1.892 million inhabitants in 1988 to 2.186 millions in 1999; the accumulated GDPS evolved from 10.476 to 21.910 billion dollars during the same period.

[xvii] Including GDR in 1987

[xviii] We retained 1) Far East to market economy, 2) China and Indochina, 3) Indian Subcontinent

[xix] Helms-Burton Law (in March, 1996) against Cuba which had seized the possessions of the Cubans of the opposition, Amato-Kennedy's law (in August, 1996) forbidding foreign investments in Iran and in Libya, suspected of sheltering and of developing international terrorism etc...

[xx] The presidency of the European Union, is confided symbolically to Member-States, alternately , for a period of six months. It is a question there, an administrative reality which would not know how to, on any account, be analyzed as a delegation of sovereign power.

[xxi] It matters for the subject which retains us, well to operate distinction between culture and civilization : the first being a group of spiritual and artistic phenomena, second recovering from circumstances bound to the development of techniques and sciences.

The process of fit between the contingency factors of the environment and the structural design parameters: an empirical study

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Abstract

This paper, using a sample of 150 Spanish companies of large size, aim to corroborate the postulates determined by the contingency models regarding the relationships between the organisational environment and structural design parameters. Our basic aim is to establish the different relative importance of each of the elements characterising the environment to the design parameters. The results obtained show that the first relation to be clearly observed is that between level of complexity of the environment and the degree of organicity of the structure. However, such an evident relationship is not observed between the degree of dynamism of the environment and the level of organicity. As for the relation between degree of hostility of the environment and the design parameters analysed, the contingent hypotheses that predict that the degree of centralisation of the structure increases with the hostility of the environment are confirmed.

Introduction

Strategic analysis has traditionally centred its attention on external adjustment or fit, i.e. that which must necessarily exist between the contingency factors that condition the organisation and the strategies it adopts. Organisational design, on the other hand, has centred its attention on two different but overlapping processes of adjustment: the internal fit among the variables of organisational design and the fit between the strategy selected and the different variables of organisational design (Chandler, 1962; Miles and Snow, 1984; Galbraith, 1993). In this study we will try to test empirically the theoretical connection between the external fit and the strategy-structure fit, to verify whether what the theoretical models predict actually occurs. We will establish hypotheses, based mainly on the contingent approach, that predict relationships between the contingency factors and the structural design parameters, attempting to test them against a wide range of large firms based in Spain.

The contingency factor chosen for analysis was the competitive environment, as it is one of those that present greatest homogeneity in its fit with the structure. The literature gives as fundamental defining characteristics of the environment its degree of dynamism-stability, complexity-simplicity, and hostility-non-hostility (Ansoff, 1979; Aldrich, 1979; Scott, 1981), but says little about establishing the relative importance of these characteristics dynamism-stability, complexity-simplicity, and hostility-non-hostility to design parameters. Our fundamental aim is to verify, in the sample of firms selected, which of these characteristics of the environment has greatest influence on structural design parameters, and to see whether the one traditionally considered to be fundamental, the dynamism-stability of the environment, is in fact so outstanding.

The rest of the paper is structured as follows. Section two reviews the fundamental fit models that can be found in the literature on the subject, justifying the contingent approach as the study's framework of analysis. Next we put forward the hypotheses to be tested and thirdly we set out the technical characteristics of the empirical study, giving the results obtained and testing the hypotheses. The final section discuss conclusions and implications, and suggest some avenues for further research.

Theoretical framework of the study

To speak of organisations is always a delicate and controversial task, in which it is difficult to arrive at a consensus and a unifying paradigm. It has been compared to finding one's way in a jungle (Koontz, 1961) or walking through a thicket (Pfeffer, 1993). It is therefore a priority to establish the analytical framework of the study, which is none other than that of the contingent school, and fundamentally the view of it held by Mintzberg (1979). According to Donaldson (1996) this approach has dominated the study of organisational design for the last twenty years. Other models have complemented or rebutted its principles; such is the case of population ecology (Hannan and Freeman, 1977; Aldrich, 1979), the resources dependency model (Pfeffer and Salancik, 1978), institutionalism (Meyer and Rowan, 1977; DiMaggio and Powell, 1983), or, within the economics of organisation, the theory of transaction costs (Williamson, 1975) and the theory of agency

(Eisenhardt, 1989). We prefer to concentrate on the contingency model as it is the clearest representative of normal science within the study of organisational structures (Donaldson, 1996). It is clearly prescriptive or normative, i.e. it provides consistent responses on how to design the internal structure of organisations, giving an active role to the organisations and attributing to them a capacity for reaction; it is therefore far from the explanatory approaches of little practical value. Although our basic standpoint for analysing the process of organisational design is contingent, we feel it should be complemented by others. We will therefore make a brief review of the basic fit models that can be found in the literature on this subject.

Conceptual models, of a heuristic or interpretative nature, aiming to identify the necessary processes of fit, have a strong tradition in the theory and design of organisations. Possibly the most popular is that of Mintzberg (1979) which can be clearly situated within the frame of the contingent approach. This contingent school fundamental characteristic since its most classical formulations (Pugh, 1973; Van de Ven and Ferry, 1980; Van de Ven and Astley, 1983; Donaldson, 1996) is the deterministic view of the contingency factors on the organisation, centring its efforts on demonstrating empirically how these factors condition structural design (Woodward, 1965; Lawrence and Lorsch, 1967a and 1967b; Pugh, Hickson, Hinings and Turner, 1968; Pugh, Hickson, Hinings, and Turner, 1969; Pugh, Hickson and Hinings,1969).

The determinist positions of the contingent school, despite their enormous popularity due mainly to their practical orientation, have one fundamental problem. In the process of fit between structure and contingency factors they seem to forget the intermediate element presided over by strategic choice. Indeed, as shown by the fit models by Miles and Snow (1978; 1984) and by Child (1972; 1997), the firm chooses the sector in which it offers its products or services, and within it chooses the environment when it establishes how and in what way it competes. Thus, in the context of these models, we consider strategy to be the filter through which the contextual variables are incorporated into the organisation by means of strategic system (Grant, 1995). The level of uncertainty and ambiguity, depending ultimately on uncontrollable exogenous variables, is incorporated and defined in the organisation through a controllable endogenous process, strategy, i.e. they are the result of an explicit or implicit choice that determines their type and intensity. Various authors have put forward similar arguments, among them March (1978), McCaskey (1982) and Martin and Meyerson (1988).

The model by Nadler and Tushman (1988; 1997), of a macro-organisational nature, bears great similarities to that of Miles and Snow (1984). Like the latter, they posit strategic choice as the controllable filter of contingent factors. Its fundamental contribution to the processes of fit lies in introducing and giving importance to the informal variables of organisational design. Seeking the socialisation of the individual through a human resources policy based on leadership, norms and values, informal as well as formal relationships, influence, etc., is considered fundamental both in internal fit and in strategic-structural fit.

Later studies on the subject of structure from the same viewpoint have concluded that for a work unit to operate efficiently it must reduce uncertainty, understood as variety, and ambiguity, understood as possibility of error, with suitable organisational capacities. (Tushman, 1978; Daft and Macintosh, 1981). Studies on this subject have understood organisational design as the path of isolation to achieve lower levels of uncertainty and ambiguity, considering that design parameters, whether structural or of process and socialisation, are fundamental for this objective (Galbraith, 1973; Tushman and Nadler, 1986; Daft and Lengel, 1986; Larson and Gobely, 1988). This importance lies in the fact that they are responsible for the quantity, richness and timing of the transfer of information between all types of units to reduce the levels of uncertainty and ambiguity (Tushman, 1978; Zmud, 1978; Daft and Macintosh, 1981; Daft and Lengel, 1986; Gales, Porter, and Mansour-Cole, 1992).

Objectives of the study and hypotheses

On the basis of the models of fit discussed above, and accepting that in general they are not contradictory but complementary, and are based fundamentally on contingent premises, this study will consider some of the mainly determinist relations that they predict. These relations establish which structural design parameters respond to certain contingency factors or certain strategies selected by the organisation. The study will centre on the fit necessary between the contingency factor "environment" and the design parameters used by the organisation, a fit dealt with in depth by authors like Miles and Snow (1984) or Galbraith (1993). Based fundamentally on the now classical studies by Thompson (1967), Burns (1967), Lawrence and Lorsch (1967 a and b), Duncan (1970) or Ansoff (1974), among many others, Mintzberg (1979) synthesises in a series of hypotheses the relations that should occur between the environment in which the organisation operates and the design parameters that it implements. The general objective of this study is therefore to test empirically three of these hypotheses, specifically those that refer to the effect on design parameters of the qualities of the environment dynamism-stability, complexity-simplicity, and hostility-non-hostility. Furthermore, we aim to clarify the different relative importance of these variables in the design parameters. In this respect, Mintzberg (1979) puts forward three hypotheses. The first hypothesis is:

Hypothesis 1. The more dynamic the environment, the more organic the structure

An Organic structure is a term coined by Burns and Stalker (1961), in opposition to the bureaucratic model, but worked upon by many contingent authors, with this name or others. Thus we have Ciborra (1996) with his *platform organisation*, Ostroff and Smith (1992) and their *horizontal organisation*, or Galbraith (1994) and his *distributed organisations.* Perhaps the description of the organic model that has achieved greatest popularity is the *adhocratic organisation* (Mintzberg, 1979). A review of the contingent literature offers a detailed description of an organic organisational structure, which is basically characterised by its great capacity for adaptation. The low level of formalisation is one of the fundamental characteristics of organic structures. The initial studies by Woodward (1965) later confirmed by those of the Aston group (Pugh, Hickson, Hinings and Turner, 1968; Pugh, Hickson, Hinings, and Turner, 1969; Pugh, Hickson and Hinings, 1969), clarify this relationship at a very early stage. A low level of centralisation is another characteristic of organic models, as reflected in the studies of the Aston group. The greater autonomy of workers close to the operative work enables decisions to be taken more rapidly (Galbraith, 1973). The high levels of socialisation, or of standardization of norms in Mintzberg (1983) terminology, is another typical characteristic of organic structures which allows them higher degrees of decentralisation while at the same time maintaining the integrity of the organisation. This is reflected in the studies by Edstrom and Galbraith (1977), Ouchi (1979), Prahalad and Doz (1986) or Hennart (1993). Another feature of organic structures is the higher level of training of the operating core staff, as shown in numerous studies (Hall, 1968; Perrow, 1972; Spencer, 1978). This higher level allows standardisation of skills and greater autonomy in the operating core. Another characteristic of organic models is the high flexibility of their technical systems, allowing swift low-cost readjustments to new types or volumes of production. This is shown in the early work of Woodward (1965) and Perrow (1967), and is confirmed by studies such as Pine (1993) or Kotha (1995). Simplicity, understood as the flattening of structures and the reduction to a minimum of organisational units that do not clearly incorporate added value is another typical organic characteristic, aiming at the maximum reduction of hierarchical levels between top managers and core workers (Kanter, 1990). A great diversity of production, which in the continuum that goes from standardised mass production to production to order totally individualised and adapted to each customer lies closer to the latter is also typical of organic models (Burns and Stalker, 1961). A final typical characteristic of these structures is the intense flows of communication, vertical and horizontal, formal and informal, facilitating mutual adaptation and socialisation as fundamental mechanisms of co-ordination (Galbraith, 1973, 1977, 1993; Knight, 1976; Handy, 1989).

Let us, therefore, detail and subdivide the hypothesis of Mintzberg (1979) for greater precision in the empirical testing:

Hypothesis 1.a. The more dynamic the environment, the less formal the structure.
Hypothesis 1.b. The more dynamic the environment, the less centralised the structure
Hypothesis 1.c. The more dynamic the environment, the more socialisation there will be in the structure
Hypothesis 1.d. The more dynamic the environment, the more training in the structure
Hypothesis 1.e. The more dynamic the environment, the more technical flexibility in the structure
Hypothesis 1.f. The more dynamic the environment, the simpler the structure
Hypothesis 1.g. The more dynamic the environment, the greater the diversity of production provided by the structure
Hypothesis 1.h The more dynamic the environment, the more communication flows there will be in the structure

The second hypothesis that it is intended to test, also formulated by Mintzberg (1979) is:

Hypothesis 2. The more complex the environment, the more decentralised the structure

From the point of view of organisation theory centralisation is understood to be inversely related to the levels of uncertainty and ambiguity faced by the organisation (Hage and Aiken, 1967; Thompson, 1967; Lawrence and

Lorsch, 1967 a and b). As the complexity of the tasks to be undertaken increases, the adaptation to the environment and the swifter reactions of a decentralised model are preferred to the extreme congruency in decision making of a more centralised structure (Mintzberg, 1979).

And finally, the third hypothesis considered in this study, also formulated by Mintzberg (1979), is:

Hypothesis 3. Extreme hostility in its environments drives any organisation to centralise its structure temporarily

The more centralised communication networks organised themselves more quickly and required less communication to make decisions. When an organisation faces extreme hostility its very survival is threatened. Since it must respond quickly and in an integrated fashion, it turns to its leader for direction (Mintzberg, 1979).

Research Methodology

Information was gathered by means of a structured questionnaire containing aspects relating to the main variables to be analysed: structural design parameters and environmental contingency factors. Structural design parameters, specifically aspects relating to the degree of formalisation, decentralisation, socialisation, training, flexibility of technical system, structural simplicity, diversity of production and intensity of communication flows, were measured on a scale created for the purpose, consisting initially of 48 items [i]. After refining to increase its reliability [ii] it was reduced to 40 items with a Cronbach alpha coefficient of 0.9550 [iii]. The responses to the items of the questionnaire were registered on a Likert-type scale of five points.

The other scale used in the questionnaire was intended to measure the characteristics of the environment in which the firm operates, considering its degree of dynamism-stability, of complexity-simplicity, and of any hostility that it may present [iv] (Mintzberg, 1979). This scale is formed by a total of ten items with a Cronbach alpha coefficient of 0.8224.

The first seven items of this second scale refer to questions on the complexity of the environment: number of competitors in the industry, diversity of competitors, diversity of consumers in buying habits, diversity of suppliers, degree of presence of differentiated products in the industry, interconnection of the firm with other organisations of the industry whose actions influence it, and degree of relationship with other organisations whose actions are co-ordinated. These responses are measured with a score from 1 ("very low") to 5 ("very high"). The last item referring to the complexity of the environment asks about existing technological diversity, also measured on a scale from 1 ("none") to 5 ("very high"). Of the two remaining items, one refers directly to the degree of hostility presented by the environment, measured from 1 ("very low") to 5 ("very high"), the other to the degree of dynamism/change or turbulence of the environment in which the firm operates, asking whether the challenges it presents are 1 “habitual”, 2 “extrapolatable”, 3 “irregular”, 4 “novelty”, or 5 “unpredictable”.

To obtain the data, a group of 250 large firms, with more than 250 employees, belonging to the services sector and based in Spain, were selected through the Dunn & Bradstreet database (Dunn's 30,000 Principal Spanish Firms). A questionnaire was sent by post to the general managers of each of these firms, all privately owned and representing various activities. A total of 150 valid responses were received, or 14 per cent of the total number of questionnaires sent. This can be considered acceptable, as percentages of response are habitually around 15% and in many cases lower (Punnett and Shenkar, 1996).

Testing of hypotheses and results

Firstly, to test the first block of hypotheses, referring to the relation between the dynamism of the environment and the level of organicity of the organisational structure, we undertook a Pearson bivariate correlation analysis among the variables being studied. The results indicate the existence of four significant relations among the design parameters that reflect the degree of organicity and the dynamism of the environment. As can be seen from Table 1 [v], the correlations of dynamism of the environment with degree of centralisation, with degree of structural simplicity, and with intensity of communication flows, are positive and statistically significant. The results obtained in these four structural variables allow us to affirm that hypotheses H.1.b, H.1.c, H.1.f, H.1.h are fulfilled.

The strongest correlation found is that between dynamism and decentralisation, with $p \leq 0.01$, followed by other variables closely related to the latter, such as structural simplicity and the intensity of communication flows.

It can thus be affirmed that the firms in the sample do take into account to some extent the degree of dynamism of the environment in which they operate when determining their degree of decentralisation, socialisation, structural simplicity and intensity of communication flows.

Table 1: BIVARIATE CORRELATIONS BETWEEN ENVIRONMENTAL DYNAMISM AND DESIGN PARAMETERS

	FORMAL	DECENT	SOCIAL	TRAING	FLEXI	SIMPLI	DIVER	COMMU
DINAMIS	-0.128	0.243***	0.167**	0.090	0.058	0.192***	-0.044	0.195***

*** Significance level $p \leq 0.01$
** Significance level $p \leq 0.05$

However, no significant relation was found between environmental dynamism and degree of formalisation, level of training, technical flexibility, or diversity of production. Hypotheses H.1.a., H.1.d., H.1.e. and H.1.g. cannot therefore be corroborated. Following the above reasoning, the firms of the sample decide their degree of formalisation, level of training, technical flexibility, and diversity of production independently of the degree of dynamism of their environment.

Secondly, in order to verify the fulfilment or otherwise of hypothesis 2, which relates the complexity of the environment positively to the degree of structural decentralisation, the correlations of these variables were analysed, obtaining a very satisfactory result which prevents us from rejecting this hypothesis. The results obtained show a strong correlation between the variables studied at a very high level of significance ($p \leq 0.01$). That is to say, the firms in the sample consciously or unconsciously take very much into account the complexity of the environment when they determine the degree of decentralisation of their organisation.

To test the third and last hypothesis a variance analysis, ANOVA, was applied. For this it was necessary to classify the firms in terms of the hostility of their environment, which we did by applying the analysis of conglomerates, enabling us to group the firms of the sample according to the distribution of the values of the variables in such a way that each group is as homogeneous as possible and as distinct as possible from all the others. In our case, we used the k-means method, introducing as solution the finding of three conglomerates. The resulting sub-groups were as follows: 29 firms operate in low-hostility environments, 52 at average hostility levels, and 69 in very hostile environments. As the sub-groups differ in the number of firms they contain, the Scheffe test was used to interpret the results. These indicate that there are no significant differences in the degrees of decentralisation taking into account the different levels of hostility in the environment (Table 2).

Table 2: ANOVA BETWEEN DEGREE OF DECENTRALISATION AND LEVEL OF HOSTILITY OF ENVIRONMENT

Level of hostility of environment	Number of firms (N=150)	Means	Test F	Sig.
Low	29	3.32		
Medium	52	3.39	0.707	0.495
High	69	3.49		

We therefore reject hypothesis 3, as it can be considered that in the sample analysed the firms do not consider the degree of hostility of their environment when deciding their levels of decentralisation.

After making the above analyses and testing all the hypotheses, in order to confirm the results obtained and expand them if possible we carried out a multiple regression analysis, using as dependent variables those that measure the organicity of the structure, and all the variables relating to the environment as independent variables.

With this analysis we have tried to verify the relationships that may be established between the different variables defining the environment, and those that characterise the organicity of the structure. As shown in Table 3, the environmental factor most taken into account by firms when deciding the level of organicity of their structures is the complexity of the environment, this relation being positive and highly significant ($p \leq 0.01$) for all the structural variables except formalisation, where the relation is negative and significant ($p \leq 0.05$), since, as could be expected, firms tend to reduce their levels of formalisation as the complexity of the environment increases.

The relations between the dynamism of the environment and the degree of organic structure are more ambiguous, as could be foreseen after our initial analysis of correlations. The positive and significant relations between dynamism and decentralisation ($p \leq 0.05$), socialisation ($p \leq 0.1$) and intensity of communication flows ($p \leq 0.05$), are confirmed, though that between dynamism and simplicity is not confirmed.

These results allow us to affirm that for the sample of firms taken, there is a stronger relation between complexity and organicity than between dynamism and organicity. We can therefore conclude that the more complex the environment the more organic the structure will be.

As to the relation between the degree of hostility of the environment and the structural variables, significant relations are found at different levels between hostility and decentralisation, socialisation, training, technical flexibility and intensity of communication flows.

It must be highlighted that the relation between the degree of hostility and the degree of decentralisation is negative, i.e. the greater the hostility of the environment the higher the level of structural centralisation, as in hypothesis 3, though it should be pointed out that the coefficient of regression obtained is not very big and has a significance level of 90% ($p \leq 0.1$).

The remaining significant relations are coherent, since if we accept that greater hostility brings a higher degree of centralisation, the latter in turn implies a lower degree of socialisation, as well as lower degree of training, less flexibility of technical system and lower intensity of communication flows.

Table 3: MULTIPLE REGRESSION ANALYSIS

	FORMAL	DECENT	SOCIAL	TRAING	FLEXI	SIMPLI	DIVER	COMMU
Hostility	0.091	-0.133*	-0.140*	-0.211**	-0.218**	0.028	-0.135	-0.161*
Complexity	-0.203**	0.457***	0.243***	0.297***	0.325***	0.373***	0.236***	0.230***
Dynamism	-0.093	0.147**	0.133*	0.059	0.020	0.079	-0.077	0.170**

***Level of significance $p \leq 0.01$
** Level of significance $p \leq 0.05$
* Level of significance $p \leq 0.1$

Conclusions and future lines of research

This study has aimed to verify the fulfilment or otherwise of the relations established formally by Mintzberg (1979) based on contingency studies, according to which there exists a positive relation between dynamism of the environment and organicity of structure, between complexity of the environment and level of decentralisation of the organisation, and between hostility of the environment and level of decentralisation of the organisation. Following the empirical study, the most important conclusions can be highlighted as follows:

The first relation to be clearly observed is that between level of complexity of the environment and the degree of organicity of the structure. Indeed, it has been verified that for the sample of firms analysed there is a strong significant relation between the degree of complexity of the environment and all the design parameters used to measure organicity (formalisation, decentralisation, socialisation, training, technical flexibility, structural simplicity, productive diversity and intensity of communication flows).

However, such an evident relationship is not observed between the degree of dynamism of the environment and the level of organicity, as it has not been shown that all the parameters that determine organicity are related to the degree of dynamism of the environment. Significant relations have only been found with the parameters decentralisation, socialisation, and intensity of communication flows. That is to say that the firms studied decide their levels of formalisation, training, flexibility, structural simplicity and diversity of production independently of the degree of dynamism existing in their environments.

As for the relation between degree of hostility of the environment and the design parameters analysed, the contingent hypotheses that predict that the degree of centralisation of the structure increases with the hostility of the environment are confirmed. In coherence with this, when the hostility of the environment increases, and the firm reacts by increasing its centralisation, the organisation's levels of socialisation, training, structural flexibility and intensity of communication flows decrease.

It can therefore be affirmed that the traditionally accepted relationship, i.e. the greater the dynamism of the environment the more organic the structure, can be only partly corroborated by this study. However, its results indicate that this relationship can be totally accepted when the complexity of the environment is considered instead of its dynamism.

To conclude, a specially interesting line of future research seems to be to carry out further studies in the same line as this one, but using different samples of firms, e.g. from the industrial sector, so that results obtained from different sectors of activity can be compared. The authors recognises that some of the issues analysed are too complex to be studied only through questionnaires. Cases studies could add to this study a more in-depth evidence and analysis of the variables analysed. Ideally, a combined method would be useful in deciphering some findings. Moreover, our results are based on the opinions of a single respondent in each firm when it is assumed that the decisions are usually made by a group of people.

However, despite this limitations, the study provides an extension of the research done in other contexts. Our basic aim was to establish the different relative importance of each of the elements characterising the environment to the design parameters. The paper offer a fairly realistic view of firms' reactions to changes in their environments, which can be an interesting starting point for the necessary analysis by management of their organisations.

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Endnotes

[i] The measurement of design parameters is based on the semantic constructs adapted from the work of Ghoshal and Nohria (1989) and of Veiga, Lubatkin,Calori and Very (2000).

[ii] The reliability of a scale is the degree to which it will give consistent results is repeated measurements are made. In other words, it is the proportion of variance attributable to the real score of the variable, and is a good indicator of the amount of measurement error inherent to a model. This is equivalent to considering that the structure of the scales created is correctly designed. Hayes (1992: 50) defines reliability as "the degree to which measurements are free of the deviations produced by causal errors". It is fairly usual to conceive reliability as the degree of internal consistency of the scale, and the most usual way to estimate it is on the basis of the calculation of the Cronbach α (Cronbach, 1951). The main advantage of its use is that it allows reliability to be determined when the scale has been applied to only one group of individuals.

[iii] It has to be pointed out that the value proposed by Nunnally (1978) of 0.7 is the most widely accepted in studies in this area of research, but other authors consider that a scale is reliable if the Cronbach α is over 0.80 (Carmines and Zeller, 1979).

[iv] The environmental variables dynamism-stability, complexity and hostility were measured by means of constructs based respectively on the work of Hinnings, Hickson,Pennings and Schenck (1974); Heydebrand (1973) and Porter (1980); and Ansoff (1979).

[v] The variables that measure the design parameters were calculated as averages of the items making up each variable in the scale used, and to express them in the table we have used abbreviations: FORMAL for formalisation, DECEN for degree of decentralization, SOCIAL for degree of socialization, TRAING for level of training, FLEXI for degree of technical flexibility, SIMPLI for structural simplicity, DIVER for diversity of production and COMMU for intensity of communication flows.

The Role of Risk in the Choice of Optimal State-Market Relations

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Abstract

Optimal roles of the public and private sectors to achieve sustainable economic growth depend on the level and distribution of risk across agents. In this paper, we build on the framework of general equilibrium to incorporate the role of risk in the determination of relative prices. Where risk is abnormally distributed by level across agents in time and space, market prices will deviate from a Pareto-optimal allocation. Whether this justifies public sector intervention depend not just on the specification of the level and distribution of risk, but also on the transactions costs of correction. We provide some preliminary evidence on the role of risk as it relates to property rights and economic growth to support the notion of growth as dependent on property rights and economic flexibility. In turn, we find that property rights depend on the level of judicial independence and the underlying degree of confiscation and contract repudiation risk. Economic reform in developing and emerging market economies thus depends ultimately on establishing civil society institutions that provide a consistent framework for the allocation of property rights. Where risk is explicitly considered in the formation of property rights, market prices will be closer to a Pareto-equivalent allocation of resources.

Introduction

For some time, underlying perceptions of risk and uncertainty have shaped public attitudes toward the role of the state in economic decisions. Interestingly, explicit measures of risk often are absent in such discussions. Consequently, public policy choices often are framed in some larger ideological context in which neither markets nor the public sector could be held consistently accountable for outcomes[1]. Such is the debate that has taken place regarding structural adjustment in developing and in emerging market economies[2]. In this paper, we propose a framework that incorporates risk in the evaluation of traditional economic functions of the public sector. We contend that it is not risk *per se* that determines the roles of states and markets, but rather the abnormality of the underlying probability distributions associated with the allocation of resources. With this framework in mind, we provide some empirical evidence regarding the direction of optimal state-market relations. In so doing, we seek to clarify the choice of optimal public and private sector partnerships for sustainable economic development.

Competitive General Equilibrium

With due allowance for distributive justice, Pareto optimality traditionally serves as the first best standard for economic efficiency.[3] For a given distribution of assets, economic efficiency is achieved in an environment by an institutional structure of prices that produces the maximum level of production at the lowest social cost. In turn, dynamic sustainability embodies the selection of a set of economically efficient prices such that growth occurs as a weighted function of the prevailing rate of interest and technical change.

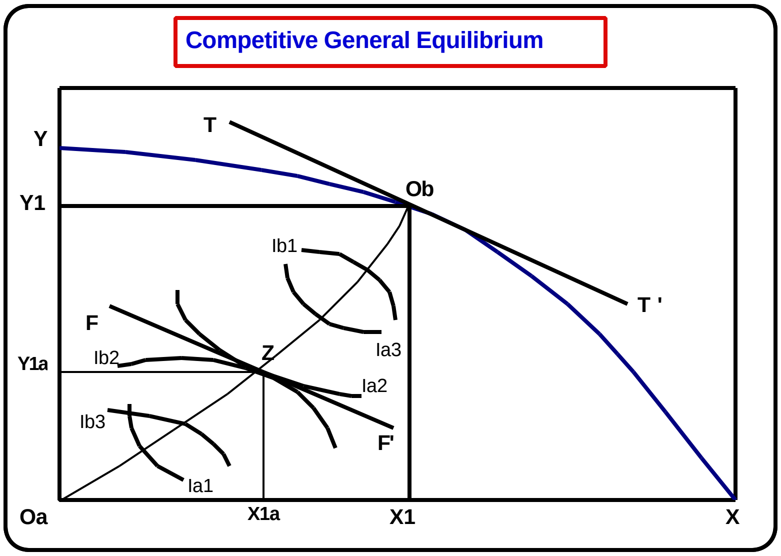

Fig. 1

Figure 1 illustrates static economic efficiency within a competitive general equilibrium framework[4]. In a world of perfect information and in which there are neither externalities nor economies of scale or scope, all possible outcomes are known at the outset, including those over time. Society's production possibilities frontier YX defines the range of output choices under a given technology and degree of input specialization. Selection of a particular output combination such as at Ob determines Y1 and X1 levels of goods Y and X. In turn, individuals a and b arrive at a particular distribution of income through an established social contract, which in turn determines the maximum level of social welfare, shown here at point Z, the tangency of the respective highest indifference curves for the respective goods for the respective individuals[5]. All other combinations are inefficient in that they are either non-intersecting or do not intersect on the social contract curve. The line FF' defines the equality of the marginal rates of substitution for the respective goods for the respective individuals. This marginal rate of substitution is equal in turn to the opportunity cost of production, or marginal rate of transformation, at point Ob, and is defined by the line TT'.

Competitive general equilibrium also requires equality of the respective marginal products to their corresponding input prices across producing units, as well as the distribution of input utilization across producers. To do so, one could replicate figure 1, but in the box OaY1ObX1 specify the respective isoquants of the respective producers where the rays OaYa and OaXa specify the corresponding inputs used in production, which for purposes of geometric simplicity, are limited to two. The slopes of these respective isoquants portray the marginal rates of technical substitution in the use of inputs for a given level of output. Taken together, competitive general equilibrium produces for a given income distribution and distribution of inputs across producers an equality of the respective marginal rates of substitution, the respective marginal rates of technical substitution, and the marginal rate of transformation.

In a dynamic world of certainty, the above conditions are modified through the use of discounted present values of utility in consumption and with discounted net benefits of investment equated at the opportunity cost of capital and other inputs in production. In turn, the economy's expansion path is determined by the rate of capital accumulation at the current rate of discount and by the rate of technical change in production[6].

Risk in the Context of General Equilibrium

Risk arises in both a static and dynamic context when a probability distribution of alternative possible events replaces the certain outcome of a decision in space and time. In the framework of Arrow-Debreu-MeKenzie, or

ADM, a Pareto-equivalent allocation of resources can be achieved through use of contingent spot and forward markets that reflect relevant events of various underlying probability distributions. Although the same physical good delivered in different states of nature or time is treated as a different commodity, as long as the number of markets corresponds to the number of contingent outcomes, and as long as the level of information on the underlying probability distributions is known in equal degree among all agents, the ADM framework suggests that there is no *a priori* basis for public sector intervention.

Adoption of a continuous-time environment, as illustrated, for example, in the option price models of Merton (1973), and Black and Scholes (1973), does little to alter the basic propositions of the ADM framework. In continuous-time, effectively complete markets are achieved by trading extensively and continually in space and time. As long as the number of markets corresponds approximately to the number of contingent events, a Pareto equivalent, or constrained, equilibrium will be achieved on a continuous basis.

As appealing as the contingent continuous-time framework may be, it does not follow that it automatically will produce a Pareto constrained competitive general equilibrium. The basic context for such failure is the presence of incomplete markets, a notion dating back to Bator (1958).[7] In its more recent formulation (Magill and Quinzii, 1996), incomplete markets exist as long as there are incomplete contracts to cover all commodities in time-contingent space.[8] Incomplete contracts produce deviations from the standard Pareto requirement of equality of respective marginal rates of substitution, marginal rates of technical substitution, and marginal rates of transformation. As such, they result in a lower level of output that could be achieved with a more efficient set of prices. At the same time, even in the presence of incomplete markets, it does not follow that public sector intervention automatically can restore conditions to a Pareto constrained competitive general equilibrium, for reasons which we will set out subsequently[9].

Why do incomplete markets exist? The simplest explanation is the presence of significant transaction costs. If transaction costs exceed the perceived benefit of creating contracts that cover all possible contingencies, then markets will be incomplete. Contracts thus contain both explicit and implicit commitments since the marginal cost of perfect information may approach infinity. Coase (1937, 1960) and Williamson (1975) emphasize the role of transaction costs in determining not only the shape and structure of market institutions, but also the extent to which they determine whether public sector intervention may be warranted.[10] Even in the presence of externalities, Coase (1960) argued that as long as transaction costs are not relatively high, agents might find a way to arrive at an efficient allocation of resources without public sector intervention. The question is what determines the level of relatively high transaction costs and under what conditions is public sector intervention warranted.

Transaction costs depend partly on the institutional efficiency of contracting and partly on the level and distribution of risk. In turn, the institutional efficiency of contracting depends on the degree of transparency and consistency in the specification and allocation of property rights. At the same time, transparency and consistency in property rights depend on the actual and perceived level and distribution of risk. Pareto optimality thus depends on a sequential hierarchy of institutions and decisions. Simply stated, efficient prices are a function of both production and transaction costs. In turn, transaction costs are a function of the degree of transparency and consistency in the specification of property rights. Transparency and consistency in the specification of property rights are a function of the perceived level and distribution of risk. In our view, the challenge of defining Pareto efficient prices turns ultimately on the measurement of risk and uncertainty in a dynamic setting through the above-defined sequence of causality. How well risk is measured and incorporated into prices thus determines the appropriate boundaries of public and private sector roles in the allocation of resources.

What do we know about risk and do market prices incorporate risk sufficiently to achieve a Pareto allocation of resources? Most risk management models are based on the assumption of standard Gaussian normal distributions. Whether for spot, forward, or contingent markets, asset prices typically contain a risk premium that reflects understanding and assumptions regarding the underlying probability distribution of alternative events. Insurance markets exist to hedge against risk, while risk premia compensate agents for taking additional risk. However, if the true probability distribution of an event is non-standard, or idiosyncratic, and agents hold heterogeneous perceptions, then the resulting structure of prices is likely to be inefficient. Skewness and kurtosis typify non-standard distributions, and can exist in the presence of insufficient sample size, relatively unique events such as economic innovation, and under conditions of asymmetric information across agents. In turn, for both standard and non-standard distributions, where perceptions of the underlying form differ across agents, then the resulting Pareto inefficient prices will produce a misallocation of resources.

We add further that consumer preferences may not be consistent over time, thus presenting an aggregation problem. Prospect theory, which Kahnemann and Tversky (1979) propose as an alternative to the standard expected utility model, draws on insights developed by Friedman and Savage (1948)[11]. Non-expected utility theory suggests that we may not be able to draw on classical statistical models to explain human behavior, which suggests that markets may not follow the standard rationality assumption. This becomes particularly difficult in the context of heterogeneous expectations across agents, and provides a basis of why markets may fail in the presence of asymmetric information.

Failure to achieve homogeneous perceptions of a probability distribution across agents arises in the case of adverse selection and moral hazard. Both cases illustrate the principal-agent problem when incentive compatible contracts may be difficult to conclude. Under such circumstances, agents face the problem of Simon's (1957) bounded rationality, leading to second-order satisficing choices rather than first-order Pareto-maximizing conditions.[12] As such, satisficing behavior does not constitute evidence of market failure.

Bounded rationality involves three types of limitations: 1. Limits on the knowledge that an agent has regarding the environment; 2. Limits on an agent's ability to envision what the future may hold; 3. Limits on an agent's ability to calculate optimal strategies to respond to a complex decision environment. Asymmetric information is embodied in the first. Incomplete contracts define the second and the third. All contracts embody both explicit and implicit elements. Because no agent has perfect foresight and because the marginal transactions cost of perfect foresight approach infinity, effective execution and monitoring of contracts relies in the last instance on implicit rules. For this reason, most agents prefer to rely on contracts with limited commitment about the future, and to execute complex decisions through sequential actions, relying on the outcome of one stage to redefine the level of knowledge for the next, much as is suggested in Bayesian rather than in classical distribution theory.

The above framework holds true not just in a static decision environment. It holds as well for asset price fluctuations. If information is limited and agents are information bound in sequential decision-time, then asset price fluctuations can be considered rational (Garber, Woodward).[13]

As long as risk is symmetric, there is no a priori reason for public sector intervention in the allocation of resources to achieve a Pareto efficient allocation of resources. The problem is that imperfect information rarely is symmetric, and it is at this level that the case for public sector intervention becomes relevant. Moreover, we can use asymmetric information to evaluate standard arguments involving the extent of market versus government failure.

The Role of Risk in Public Sector Economic Functions

Standard arguments for public sector intervention can be grouped under five basic functions[14]. They are: 1. Rules for an orderly operation of markets; 2. Intervention in support of an efficient allocation of resources; 3. Intervention in support of an equitable distribution of income; 4. Fiscal and monetary policies to achieve macroeconomic stabilization and economic growth; and 5. Taxes and subsidies to promote an efficient composition of production in the presence of externalities. We contend that each function depends on the nature of risk and on the institutions for its efficient pricing. Historical arguments invoking these functions typically have not provided explicit measures of risk, which have made problematic the question of accountability and efficiency.

The first function relies on public sector rules that define the level and allocation of property rights. It includes the economics of contracts in general (Salanié, 1997), and in particular the assignment of rights and responsibilities for issues such as patent protection and product liability under different economic structures such as corporations, partnerships, and proprietorships[15]. The literature on this function is extensive, and covers the limits of contracts in the presence of asymmetric information, notably the presence of adverse selection and moral hazard[16]. The literature shows generally that where search costs are significant, asymmetric information is likely to lead to market failure. Regulation regarding disclosure may result in achieving Pareto-equivalent economic efficiency, but rarely are the costs of regulation measured against the perceived level of benefits. Moreover, as transaction costs fall, regulatory standards often fail to take into account the reputational consequences of mis-priced resources[17].

Even where risk assessments are undertaken to assess the role of regulation, little distinction is given to the normality or abnormality of the underlying probability distributions.

One difficulty with regulatory standards is that the level and distribution of information can change over time, thus leading to regulatory inefficiency. Where transaction costs are falling (and transparency is increasing), there is a reduced need for regulation. Regulatory processes often are slow to adapt to new information, in which case, continued regulation causes deviations from a Pareto-equivalent outcome.[18]. Finally, there is a trade-off between transparency that would lead to a reduction in information asymmetry and economic efficiency (Bordignon and Minelli, 2000)[19]. Simply put, the relationship between transparency and efficiency may be quadratic rather than inversely linear. Up to a point, regulation may provide Pareto-increasing equilibria, after which increasing deviations will occur.

Promoting competition, the second public sector function, focuses on the extent of imperfect competition in the presence or absence of economies of scale and/or scope[20]. While the tools put forth to promote competition, e.g. antitrust, regulation, taxes and subsidies, and public ownership, are extensive, they evolved in an environment in which transactions costs and the role of risk were not taken into consideration. Building on the framework of transaction costs developed by Coase (1937) and Williamson (1975), Tirole (1988) offers a more contemporary synthesis[21]. The modern theory characterizes firms as institutions that pursue the efficient allocation of resources under the constraint of incomplete contracts. This literature on market structure uses the foundation of transaction costs and demand to determine the number of firms, implying that quasi-economic efficiency will be achieved under a variety of market structures, depending on the internal and external transactions costs.

One basic finding of the literature is that government intervention built on principles of antitrust, regulation, taxes and subsidies, and/or public ownership will be inefficient in that it fails to take into account the role of transactions costs. Since risk is a transaction cost, as long as it is symmetrically distributed, the presence of imperfect competition *per se*, as measured by traditional indices of market power, does not constitute economic inefficiency. Moreover, the presence of imperfect information also may be a key characteristic to the innovation of firms and for which economic rates of return are justifiable, as Schumpeter (1912) long ago argued[22]. However, where information is imperfect and asymmetrically distributed and where transaction costs are relatively high, then the case for public sector intervention may be more compelling. Equally important, it may not depend on a given degree of market concentration, a conclusion at odds with conventional notions of monopoly[23].

The question of the optimal distribution of income illustrates more directly attitudes toward risk. At any given moment, the prevailing distribution of income (and wealth) is a function of some combination of skill and chance, and which may be reinforced or undermined by prevailing public policy as it applies to taxation and re-distributive spending. Absent a compelling case that imperfect competition is the principal cause of income inequality, a useful way of looking at the role of government in affecting the distribution of income is that in the aggregate, individuals display a higher degree of risk aversion than they do on an individual basis. Whether the distribution of income and wealth can be fairly characterized as a public good (Thurow, 1971), or whether it simply reflects differences in individual versus aggregate preferences is a question that economics may not be capable of resolving, as Bergson (1938) and Samuelson (1938) long ago pointed out[24]. What is known is that extremes of economic equality and economic inequality may impose social costs such as reduced rates of economic growth.

One approach to the question of optimal income distribution is to derive a model that explicitly incorporates the social aversion to risk. Drawing on the work of Pratt (1964), Atkinson (1970) proposed a model of income distribution in which society's rate of inequality preference could be modeled explicitly as a function of underlying attitudes toward risk[25]. Atkinson's formulation leaves open the question of the optimal degree of income inequality, though others, notably Rawls (1971) and Sen (1973) have offered philosophic reasons for reducing existing levels [26]. As we have noted, a Pareto optimal allocation of resources can be achieved under a variety of distributions. The question thus becomes one of individual and social degrees of aversion toward risk and the conditions that give rise to it. It also depends on the underlying social structure and sense of community interdependence. If an individual's utility depends directly not just on the own-consumption of goods but also directly on the consumption of other individuals, whether public sector intervention may be needed to achieve a socially optimal distribution may be problematic.

The fourth function, public sector intervention to achieve stabilization and economic growth, embodies again underlying attitudes toward risk. Until recently, most discussions of economic stabilization focused on the respective roles of fiscal and monetary policy (Keynes, 1936; Friedman, 1956)[27]. However, once risk is taken into consideration, one can apply the notion of rational expectations (Muth, 1961; Lucas, 1972; Sargent, 1975), to formulate quasi-efficient outcomes[28]. Whether public sector intervention is efficient depends on the dynamic problem of measuring the benefits of reductions in fluctuations against the costs of public sector monetary and/or fiscal policy intervention through reduced levels of output over time.

At this macroeconomic level, the search has been for transparent rules that over time minimize instabilities of inflation and unemployment consistent with an economy's underlying potential rate of growth. Some (Friedman, 1960; Brunner, 1968; Lucas, 1980) have suggested a simple long-term money supply growth rule, compensating where necessary, for the offsetting effects of fiscal policy, to minimize the inflation-unemployment rate instability pattern. Where the debate between monetary versus fiscal policy was once highly joined, in more recent years, the trend has been to shift toward a greater reliance on monetary policy to achieve economic stability, leaving fiscal policy with greater emphasis on the questions of income distribution and externalities.

Even as most countries settle on some form of monetary growth rules to achieve economic stabilization, this leaves open is the extent to which public sector intervention is warranted in terms of an economy's rate of innovation. Here the question is whether market-driven investment, which by definition embodies a degree of risk about the future, can be efficient. Dixit and Pindyck (1994) suggest that as long as financial option contracts are available, firm's can shape investment decisions at least as efficiently as any degree of government intervention[29]. At a more macroeconomic level, Aghion and Howitt (1998) develop models of growth in which Schumpeterian uncertainty plays a role in the determination of rates of investment and growth[30]. What often is missing is how to establish suitable market institutions such as financial options contracts that can more efficiently fulfill the allocation of resources over time in comparison to traditional tools such as price controls or targeted and non-targeted subsidies. Unless one can make a credible case that state agents have more information than market agents do, then fluctuations in output and asset values may still be Pareto-superior to public sector intervention.

The fifth and final function, the use of taxes and subsidies to promote an efficient composition of markets, reflects the classic problem of externalities and public goods. Here, markets may be incomplete in that the costs and benefits are not fully embodied in market prices such that there will be a socially optimal under or over-supply. Negative externalities in the form of environmental pollution and congestion typically have been addressed with both regulation and taxes. However, growing awareness of the stochastic nature of these externalities has given rise to the use of market tradable pollution permits, which provides decentralized flexible arrangements to evaluate and re-allocate them to achieve a socially efficient outcome.

On the opposite side is the question of positive externalities in the form of quasi-public and pure public goods. Here again, we can invoke the role of risk. For quasi-public goods such as health and education, the standard argument is that only through public sector intervention can the external benefits be internalized. In our view, how individuals perceive the level of risk shapes the response to the production of quasi-public goods. If agents are highly risk averse, then they will be less likely to engage in the production of public goods through market institutions, and prefer instead that they be provided by public sector intervention. In contrast, if agents are less risk averse, then they are willing to take on the risk of loss through positive externalities in exchange for the expected positive direct benefits that they expect to receive. While we do not claim that risk assumes away the problem of externalities, we contend that it governs it to a larger degree than is commonly assumed.

International Comparisons on Public-Private Sector Dynamics

Thus far, few studies examine the role of risk in the determination of optimal state-market relations. In practice, international financial markets regularly are forced to incorporate some measure of risk in the determination of contingent and future claims, but decomposition of the underlying probability distributions typically has not been undertaken and the question of aggregation is problematic. With these limitations in mind, we seek here to provide some indication of the various linkages thus far identified, and what this implies for state-market relations.

At the aggregate level, we first use a country composite risk index developed by Morgan Stanley to examine cross-section evidence on risk, using the World Bank database. A country composite risk index represents a weighted average of political, economic, and financial risk for each country. Unfortunately, weighting is not consistent across countries, and so this index is at best a proxy for some of the relationships we seek to examine.

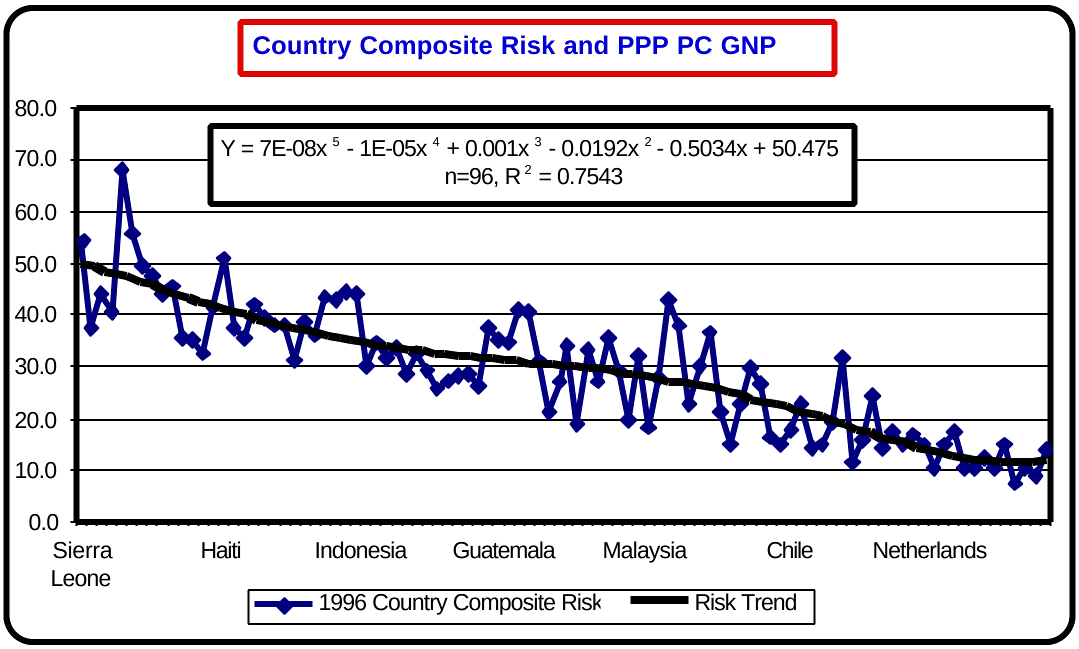

Fig.2

Figure 2 illustrates the basic inverse relationship between country composite risk and per capita income for a sample of 96 countries[31]. The question is why are some countries above or below the estimated relationship and does government intervention have anything to do with reductions in the level and distribution of risk as it affects transaction costs and efficient prices. In our view, for a given level of income, risk will be less the greater is the degree of flexibility in the formation of prices and the stronger is an economy's property rights regime.

Using the Heritage Foundation Index of Economic Freedom, we draw on a series of variables to explain country composite risk adjusted for a country's PPP per capita GNP. Basic correlations are summarized in Table 1.

Table 1:DETERMINANTS OF COUNTRY COMPOSITE RISK

	1998 PPP Per Capita GNP	1996 Country Composite Risk Index	Government Regulation Index	Property Rights Index	Currency Convertibility Index	Price Control Index	Contract Risk Index	Confiscation Risk Index	Judicial Independence Index	Capital Freedom Index	Trade Share of GDP
1998 PPP PC GNP	1.0000										
1996 Composite Risk	-0.8113	1.0000									
Govt.Regulation Index	-0.4723	0.4475	1.0000								
Property Rights Index	0.6949	-0.8626	-0.3726	1.0000							
Currency Convertibility	0.5910	-0.6047	-0.6654	0.4981	1.0000						
Price Control Index	-0.5799	0.5036	0.7995	-0.4606	-0.5713	1.0000					
Contract Risk Index	-0.6319	0.8091	0.3510	-0.9316	-0.5012	0.4179	1.0000				
Confiscation Risk Index	-0.5048	0.7216	0.3255	-0.8610	-0.4182	0.3778	0.8373	1.0000			
Judicial Independence	0.6029	-0.6505	-0.2461	0.7374	0.3307	-0.3615	-0.5504	-0.3705	1.0000		
Capital Freedom Index	0.6479	-0.6623	-0.7405	0.5003	0.7523	-0.6275	-0.4899	-0.3995	0.3621	1.0000	
Trade Share of GDP	0.2818	-0.3133	-0.1902	0.1779	0.1927	-0.0919	-0.1609	-0.1356	0.1629	0.2768	1.0000

Source: The World Bank, *World Development Report 2000*; The Heritage Foundation, *2000 Report on Economic Freedom.*

Granger causality tests were used to test for exogeneity of variables. Single equation estimates were done separately for country risk and property rights, where property rights serves as an independent variable in the country risk equation. Three variables, the government regulation index, the price control index, and the capital freedom index, explained little of the variation in either a country risk or the property rights equation, and were dropped from the final estimates. As each represents a synthetic rather than an observed variable, there may be errors in specification aggregation, or multicollinearity across variables. Equation A uses the predicted value of property rights from equation B to estimate overall country risk. When risk is explicitly taken into account, equations A and B confirm the underlying relationships we have examined and underscore the need for proper sequencing of institutional reforms in transition and developing economies

Table 2: REGRESSION RESULTS FOR COUNTRY RISK AND PROPERTY RIGHTS

	A.		B.
	Country Risk		**Property Rights**
Intercept	**65.6985**	Intercept	**6.5932**
Property Rights	**-3.6850**	Judicial Independence	**0.3480**
	(13.1812)		(22.0700)
Currency Convertibility	**-1.0419**	Confiscation Risk	**-0.3211**
	(4.1033)		(14.8931)
Trade Dependency	**-0.0699**	Contract Repudiation Risk	**-0.3313**
	(2.9129)		(14.1854)
n	96	n	96
Adjusted R^2	0.7943	Adjusted R^2	0.9819
F	118.431	F	1722.5228
DW	1.8324	DW	2.0836

Implications and Conclusion

With the collapse of the Soviet Union in 1991, economic reform in developing and emerging market economies placed growing emphasis on a shift away from public sector intervention to greater emphasis on markets. The tools of this shift included a deregulation of output and input prices, capital market liberalization, foreign exchange convertibility, lower marginal tax rates, along with substantial efforts to privatize state-owned enterprises. While market liberalization did bring about success in some countries, it fell short in others. We find that the shift to market prices succeeds where civil society institutions can help in the formation of economically efficient prices that reflect the underlying degree of risk. Where property rights are weak, prices will fail to capture the underlying level and distribution of risk, which in turn leads to a mis-allocation of resources that reduces the rate of economic growth. While developed economies already have put into place effective institutions for the specification and allocation of property rights, until developing and emerging economies can institute similar reforms, the shift to market-driven reforms is likely to fall short of expectations.

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[1] Stiglitz (1998) illustrates this problem in the context of World Bank structural adjustment programs. See Stiglitz, J. (1998), "The Private Uses of Public Interest: Incentives and Institutions," *Journal of Economic Perspectives* 12:2 (Spring), 3-22. For a descriptive review of World Bank privatization initiatives, see Gabriel Roth (1987), *The Private Provision of Public Services in Developing Countries* (New York: Oxford University Press for the World Bank). For a more general treatment in the context of imperfect information, see Jean-Jacques Laffont and Jean Tirole (1993), *A Theory of Incentives in Procurement and Regulation* (Cambridge, Mass.: MIT Press).

[2] A good example is the contrasting behavior in China and Russia following the collapse of the Soviet Union. China has moved toward market liberalization, but with an explicit emphasis on controlled evolution associated with political stability, while Russia underwent a headlong process of liberalization that resulted in economic contraction and widespread corruption, leaving many skeptical about the virtues of a market-based economy. Institutions matter, but more importantly, they matter in terms of how various types of risk can be assessed in which economic agents can make rational decisions.

[3] A Pareto allocation in one in which any re-allocation that benefits at least one individual does so only by a reduction in the social welfare of another individual. It is a first order welfare criterion that seeks to avoid interpersonal comparisons of utility, and for which less restrictive criteria have since been proposed, e.g., Kaldor (1939), Scitovsky (1941), Bergson (1938), and Rawls (1971), among others. V. Pareto (1927), *Manuel d'économie politique*, deuxième édition (Paris: M. Giard).

[4] Bator, FM (1957), "The Simple Analytics of Welfare Maximization," *American Economic Review*, 47, 1, pp. 22-59. Bator's exposition builds on Walras' original formulations of general equilibrium in 1874 and provides the complementary geometry that has since become standard in most expositions of general equilibrium.

[5] Appendix A provides a formal statement of the standard model of competitive general equilibrium. As long as the respective marginal rates of substitutions across agents in a given equilibrium are equal, a Pareto-efficient allocation can be achieved under alternative patterns of income distribution. What this does not resolve is the social welfare ranking of various distributions of income, where interpersonal comparisons of utility become central to the discussion.

[6] Growth models in the 1950s and 1960s generally relied on an underlying assumption of economic certainty in which the expansion path could be derived through closed form solutions.

[7] Bator, F.M. (1958), "The Anatomy of Market Failure", *Quarterly Journal of Economics*, 72, 351-79.

[8] Magill, M. and Quinzii, M. (1996). *Theory of Incomplete Markets*, vol. I. (Cambridge, Mass.: MIT Press).

[9] We set aside for the moment of motivation. The literature on public choice provides substantial evidence that the behavior of agents in the public sector differs significantly from those in the private sector. Our concern remains with the underlying question of why public sector intervention may be necessary independent of individual public agent motivation.

[10] Coase, R.M. (1937), "The Nature of the Firm", *Economica*, n.s., 385-405. Coase's argument forms the basis of Williamson (1975), *Markets and Hierarchies* (New York: The Free Press).

[11] Kahnemann, Daniel and Amos Tversky (1979), "Prospect Theory", *Econometrica*, 47, 263-91; Milton Friedman and Leonard J. Savage (1948), "The Utility Analysis of Choices Involving Risk," *Journal of Political Economy*, 56 (August), 279-304. Friedman and Savage put forth the theory that at some levels of income individuals may be risk loving while at others risk averse. This is the core of the prospect theory argument which Kahnemann and Tversky report in "Prospect Theory".

[12] Herbert Simon (1957). *Models of Man*. (New York: John Wiley and Sons). Simon's notion of satisficing behavior under bounded rationality is linked to Ronald Coase's 1937 observations about the role of transactions costs in determining what actions are best made internally by a firm and which are best left to external market solutions. All of this is presented more systematically in Oliver Williamson's (1975) framework put forth in *Markets and Hierarchies.* (New York: The Free Press).

[13] Garber, Peter (2000), Famous First Bubbles: The Fundamentals of Early Manias, (Cambridge, Mass.: MIT Press); Manuel S. Santos and Michael Woodward, (1997), "Rational Asset Bubbles", *Econometrica*, 65:1 (January), 19-58).

[14] This taxonomy is as much a product of historical observations and comparisons as it is of economic theory. We seek here to link the historical context to economic theory.

[15] Bernard Salanié (1997), *The Economics of Contracts* (Cambridge, Mass.: MIT Press).

[16] Akerlof, G. (1970), "The Market for Lemons: Quality Uncertainty and the Market Mechanism," *Quarterly Journal of Economics* 84, 488-500. See also Diamond, P., and M. Rothschild (1989), *Uncertainty in Economics* (San Diego: Academic press); J-J Laffont, *The Economics of Uncertainty and Information* (Cambridge, Mass.: MIT Press), and J-J Laffont and J. Tirole (1993), *A Theory of Incentives in Procurement and Regulation* (Cambridge, Mass.: MIT Press).

[17] A classic example is the asymmetric information environment portrayed in Upton Sinclair's 1906 book, *The Jungle,* (New York: New American library Signet edition published in 1960), which led to the creation of the Food and Drug Administration in 1908. In contrast, the relatively transparent information in the mid-1980s Tylenol poisoning case produced corrections with no government intervention.

[18] Michael Spence (1973), "Job Market Signaling," *Quarterly Journal of Economics* 87, 355-74. Spence notes the importance of signals in conveying information, thus reducing some of the apparent imbalance in markets with incomplete information.

[19] Massimo Bordignon and Enrico Minelli (2001), "Rules Transparency and Political Accountability," *Journal of Public Economics* 80, 73-98. Bordignon and Minelli offer a model in which transparent, or flat, rules, can increase political accountability more easily than contingent rules of allocation and redistribution. The cost of doing so is some loss in economic efficiency where contingent rules are designed to correct for given levels of market failure.

[20] Ironically, any argument for public sector intervention to promote competition implies that competition is an un-natural and unsustainable market structure, a position first put forth by Karl Marx.

[21] Jean Tirole (1988) *The Theory of Industrial Organization* (Cambridge, Mass.: MIT Press), p. 29; Ronald Coase (1937), "The Nature of the Firm," *Economica*, n.s. 4, 386-405; Oliver Williamson (1975), *Markets and Hierarchies: Analysis and Antitrust Implications*. (New York: The Free Press).

[22] Joseph A. Schumpeter (1934, 1912). *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*. (Cambridge, Mass.: Harvard University Press 1934 translation from the original 1912 German publication, *Theorie der wirtschaftlichen Entwicklung*). Schumpeter's theory of evolutionary economics is analogous to the theory of imperfect markets in which agents engaged in sequential trading with limited commitments, reflecting a given level of risk aversion at a given moment in time.

[23] No where is this perhaps clearer than in the U.S. government's antitrust case against Microsoft, in which Microsoft is charged with predatory behavior in operating systems and applications software. Because the rate of change in computer technology is so rapid, it may be impossible to predict the direction, let alone the number of firms as some new innovation may rapidly displace existing ones unless otherwise anticipated by existing firms.

[24] Lester Thurow (1971), "The Income Distribution as a Pure Public Good," *Quarterly Journal of Economics* 85, 327-336; Abram Bergson (Burk) (1938), "A Reformulation of Certain Aspects of Welfare Economics," *Quarterly Journal of Economics* 52 (February), 310-334; Paul A. Samuelson (1938), "A Note on the Pure Theory of Consumer's Behavior," *Economica* (February), 61-71. One solution suggested by Nicholas Kaldor (1939), "Welfare Propositions of Economics and Interpersonal Comparisons of Utility: A Comment," *Economic Journal* 49 (September), 549-552, is that if the gains of the gainers exceed the losses of the losers, then there will be a net gain

in social welfare. The problem remains on how to make such comparisons in a non-dictatorial way and in which some compensatory mechanism is established.

[25] J.W. Pratt (1964), "Risk Aversion in the Small and the Large," *Econometrica*. 31, 122-136; A.B. Atkinson (1970), "On the Measurement of Inequality," *Journal of Economic Theory* 2, 244-63.

[26] John Rawls (1971), *A Theory of Justice* (Cambridge, Mass.: Harvard University Press); Amartya K. Sen (1992), *Inequality Re-Examined* (New York: Oxford University Press). For a review of measures of income distribution, see, for example, Nanak C. Kakwani (1980), *Income Inequality and Poverty: Methods of Estimation and Policy Applications*. (New York: Oxford University Press for the World Bank)

[27] John Maynard Keynes (1936), *The General Theory of Employment, Interest, and Money* (New York: Harcourt Brace); Milton Friedman (1956), "The Quantity Theory of Money – A Restatement," in *Studies in the Quantity Theory of Money*, (Chicago: University of Chicago Press). These two works provide foundation arguments regarding the role of fiscal and monetary policy to achieve economic stabilization, and on which most traditional macroeconomic theory has been pursued. Neither work gave primary emphasis to the theory of risk bearing, though Keynes did develop a theory of risk as a basis for using discretionary fiscal policy to achieve a full-employment equilibrium.

[28] John F. Muth (1961), "Rational Expectations and the Theory of Price Movements," *Econometrica* 29 (July), 315-335; Robert E. Lucas (1972), "Expectations and the Neutrality of Money," *Journal of Economic Theory*, 4, 103-124; T. J. Sargent and N. Wallace (1975), "Rational Expectations, the Optimal Monetary Instrument, and the Optimal Money Supply Rule," *Journal of Political Economy*, 83, 241-254.

[29] Avinash K. Dixit and Robert S. Pindyck (1994). *Investment Under Uncertainty* (Princeton: Princeton University Press).

[30] Philippe Aghion and Peter Howitt (1998). *Endogenous Growth Theory*. (Cambridge, Mass.: MIT Press).

[31] The country composite risk index is for 1996. Per Capita Income is the 1998 PPP Per Capita GNP. Both series are from the World Bank database.

Appendix 1
Conditions for a Competitive General Equilibrium

Given two inputs, two firms, and two individuals, achievement of a competitive general equilibrium in the absence of transactions costs, economies of scale or scope, and complete contracts, we specify the following for the production of two goods, X and Y:

(1.) $X = f(K_x, L_x)$, the production function of good X

(2.) $Y = f(K_y, L_y)$, the production function of good Y

(3.) $\bar{L} = L_x + L_y$, the allocation constraint of resource L

(4.) $\bar{K} = L_x + L_y$, the allocation constraint of resource K

Given the above, the object is to maximize total output subject to the respective production functions and resource constraints. The corresponding Lagrangean expression is:

(5.) $Z = f(K_x, L_x) + \lambda\left[\bar{Y} - f\left(\bar{L} - L_x, \bar{K} - K_x\right)\right]$. The respective first-order conditions are:

(6.) $\dfrac{\partial Z}{\partial K_x} = \dfrac{\partial X}{\partial K_x} + \lambda \dfrac{\partial Y}{\partial K_x} = 0$,

(7.) $\dfrac{\partial Z}{\partial L_x} = \dfrac{\partial X}{\partial L_x} + \lambda \dfrac{\partial Y}{\partial L_x} = 0$. In turn, these expressions can be further reduced to:

(8.) $\dfrac{\partial K/\partial K_x}{\partial Y/\partial K_x} = -\lambda = \dfrac{\partial X/\partial L_x}{\partial Y/\partial L_x}$, And which in turn, is equal to:

(9.) $MRTS^{Y}_{kl} = \dfrac{MP^{Y}_{l}}{MP^{Y}_{k}} = \dfrac{\partial Y/\partial L_x}{\partial Y/\partial K_x} = \dfrac{\partial X/\partial L_x}{\partial X/\partial K_y} = \dfrac{MP^{X}_{l}}{MP^{X}_{k}} = MRTS^{X}_{kl}$, Where MP is the respective marginal product.

Beyond production, the equilibrium of consumers is defined by:

(10.) $U^A = f(X, Y)$

(11.) $U^B = f(X, Y)$, where X and Y are outputs as above. The corresponding Lagrangean function is:

(12.) $L = f\left(X^A, Y^A\right) + \lambda\left[\bar{U}^B - f\left(X^B, Y^B\right)\right]$. The corresponding first-order conditions are:

(13.) $\dfrac{\partial L}{\partial X} = \dfrac{\partial U^A}{\partial X^A} - \lambda \dfrac{\partial U^B}{\partial X^B} = 0$

(14.) $\dfrac{\partial L}{\partial Y} = \dfrac{\partial U^A}{\partial Y^A} - \lambda \dfrac{\partial U^B}{\partial Y^B} = 0$, which reduces to:

(15.) $\dfrac{MU^A_X}{MU^B_X} = \dfrac{\partial U^A/\partial X^A}{\partial U^A/\partial Y^A} = \lambda = \dfrac{\partial U^B/\partial X^B}{\partial U^B/\partial Y^B} = \dfrac{MU^B_X}{MU^B_Y} = MRS^{B}_{xy}$, where MU is the corresponding marginal utility.

In terms of the production possibilities frontier, selection of any point on the frontier requires that:

(16.) $Q = f(X, Y) = f\left(X^A + X^B, Y^A + Y^B\right) = 0$, such that:

(17.) $\dfrac{\partial T}{\partial X}\,dX + \dfrac{\partial T}{\partial Y}\,dY = 0$, and

(18.) $\dfrac{dY}{dX} = -\dfrac{\partial T/\partial X}{\partial T/\partial Y} = MRT_{xy}$. This is now added to equation (12.) to yield:

(19.) $L = f\left(X^A, Y^A\right) + \lambda\left[\overline{U}^B - f\left(X^B, Y^B\right)\right] + u[0 - f(X, Y)]$. The corresponding first-order conditions are:

(20.) $\dfrac{\partial L}{\partial X^A} = \dfrac{\partial U^A}{\partial X^A} - u\,\dfrac{\partial T}{\partial X} = 0$,

(21.) $\dfrac{\partial L}{\partial Y^A} = \dfrac{\partial U^A}{\partial Y^A} - u\,\dfrac{\partial T}{\partial Y} = 0$

(22.) $\dfrac{\partial L}{\partial X^B} = -\lambda\,\dfrac{\partial U^B}{\partial X^B} - u\,\dfrac{\partial T}{\partial X} = 0$

(23.) $\dfrac{\partial L}{\partial Y^B} = -\lambda\,\dfrac{\partial U^B}{\partial Y^B} - u\,\dfrac{\partial T}{\partial Y} = 0$. Re-arranging,

(24.) $MRS^A_{xy} = \dfrac{\partial U^A/\partial X^A}{\partial U^A/\partial Y^A} = \dfrac{\partial T/\partial X}{\partial T/\partial Y}$

(25.) $MRS^B_{xy} = \dfrac{\partial U^B/\partial X^B}{\partial U^B/\partial Y^B} = \dfrac{\partial T/\partial X}{\partial T/\partial Y}$. Re-arranging further, we have

(26.) $MRS^A_{xy} = MRS^B_{xy} = MRT_{xy}$.

Further, we specify the utility maximization conditions of the two consumers in terms of the following Lagrangean:

(27.) $L = f(X, Y) + \lambda\left(I - p_x X - p_y Y\right)$. Differentiating, we have:

(28.) $\dfrac{\partial L}{\partial X} = \dfrac{\partial U}{\partial X} - \lambda p_x = 0$,

(29.) $\dfrac{\partial L}{\partial Y} = \dfrac{\partial U}{\partial Y} - \lambda p_y = 0$. This further reduces to the standard optimization conditions:

(30.) $\dfrac{MU_x}{p_x} = \dfrac{\partial U/\partial X}{p_x} = \lambda = \dfrac{\partial U/\partial Y}{p_y} = \dfrac{MU_y}{p_y}$, and

(31.) $MRS_{xy} = \dfrac{MU_x}{MU_y} = \dfrac{\partial U/\partial X}{\partial U/\partial Y} = -\dfrac{p_x}{p_y}$.

Finally, efficiency requires that the relative factor price ratio also be equal to the marginal rate of substitution in consumption, to the marginal rate of transformation, and to the marginal rate of technical substitution. This condition can be expressed as:

(32.) $\dfrac{MU_x}{MU_y} = MRS_{xy} = \dfrac{p_x}{p_y} = \dfrac{MC_x}{MC_y} = MRT_{xy}$

Appendix 2
Alternative Probability Distributions and Economic Efficiency

Consider two individuals, A and B, within the framework of general equilibrium, and in which there are no joint probability distributions. In a world of perfect certainty, each individual makes choices within a universe of perfect certainty. This is equivalent to the distributions portrayed in Figure 1, with the expected value of an asset identical to all agents, and in which the probability is 1 with a standard deviation of zero.

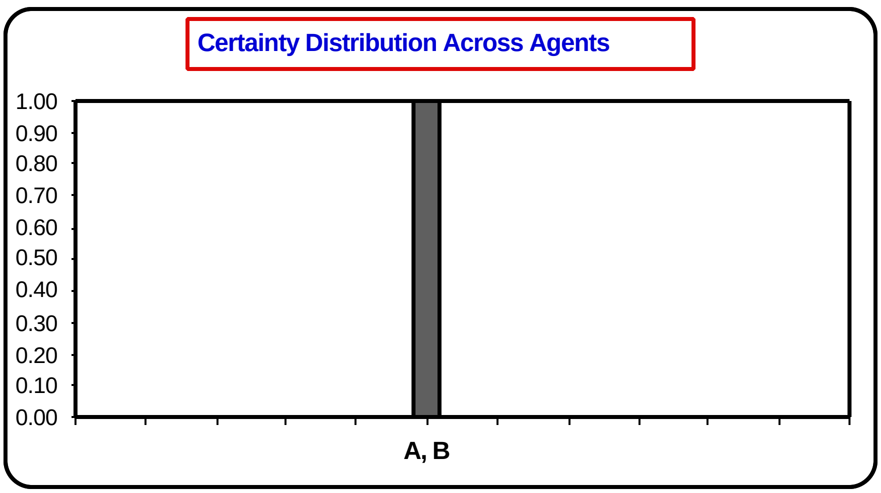

Fig. 1

This is the framework implied for the framework outlined in Appendix 1. All agents face certainty outcomes and Pareto-efficient prices. No public intervention is warranted.

Now consider a universe in which risk is present. As long as the distribution of risk is normal and homogeneous across agents, relative prices will again be Pareto efficient. This is the case of competitive general equilibrium in the presence of risk as portrayed in the Arrow-Debreu-MacKenzie framework. Continuous normal distributions are homogeneous across agents and prices, as shown in Figure 2. As long as the distribution of risk across agents is homogeneous and the number of contracts equals the number of contingent events in space and time, no public intervention is warranted.

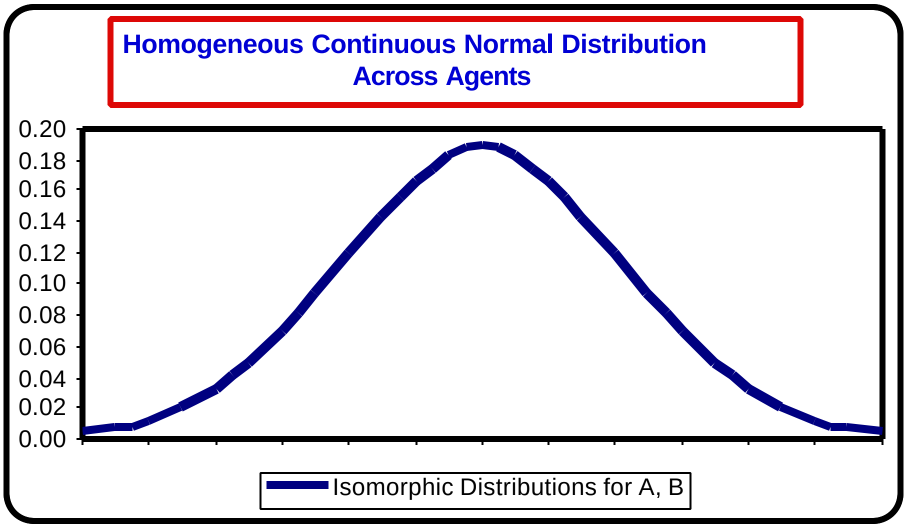

Fig. 2

Now consider a universe in which there is certainty at the level of each agent, but that the distribution of information across agents is asymmetric, as is shown in Figure 3. In this case, the higher valuation in distribution B relative to distribution A will lead to an inefficient allocation of resources.

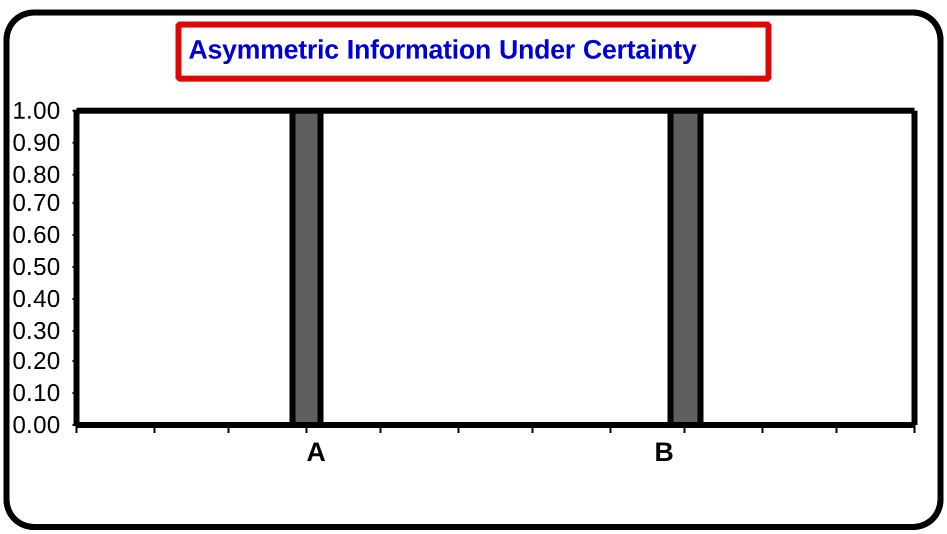

Fig. 3

While asymmetric information across agents with individual certainty is possible, it is more likely that there will be an uncertain probability distribution for each agent, A and B, as is shown in Figure 4. Here the expected value for agent B exceeds that of agent A, in which case the resulting market price will be inefficient. This can be thought of in the context of Akerlof's (1970) market for lemons problem of imperfect information, in which agent B places a higher value on an asset than agent A.

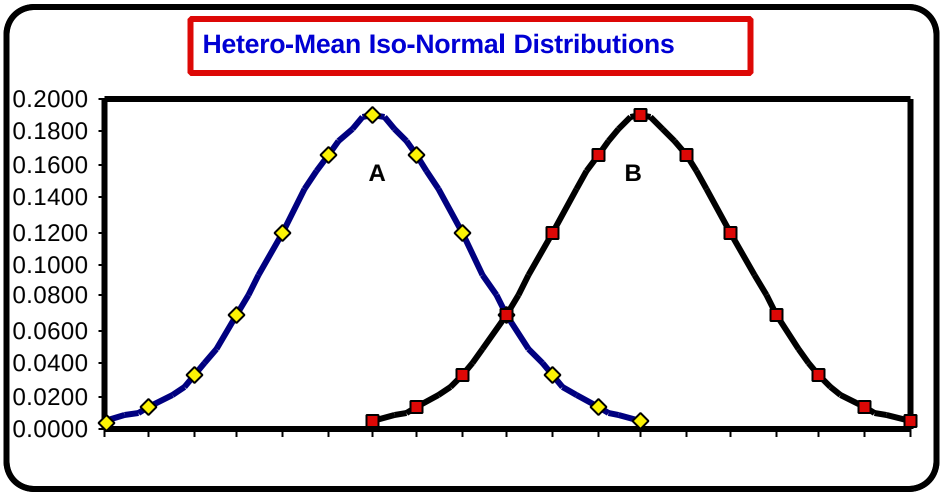

Fig. 4

Asymmetry of information across agents is the most likely reason for market prices to be inefficient. However, there is an additional problem. In figure 5, two agents may assign different values to an asset based on different perceptions of the underlying probability distribution. Distribution A corresponds to a normal distribution, while distribution B is leptokurtotic. If zero probability values are excluded, then distribution B clearly is less risky than distribution A. In most risk management models, the assumption of normality in the underlying probability distribution rules out kurtosis although this may lead to a mis-allocation of resources. An example is the case of the dynamic hedging option pricing model of Merton and Scholes that led to the collapse of Long Term Capital Management in 1998. The underlying probability distribution was assumed to be normally distributed, when in fact the tails of the distribution contained higher probabilities than were allowed in their model.

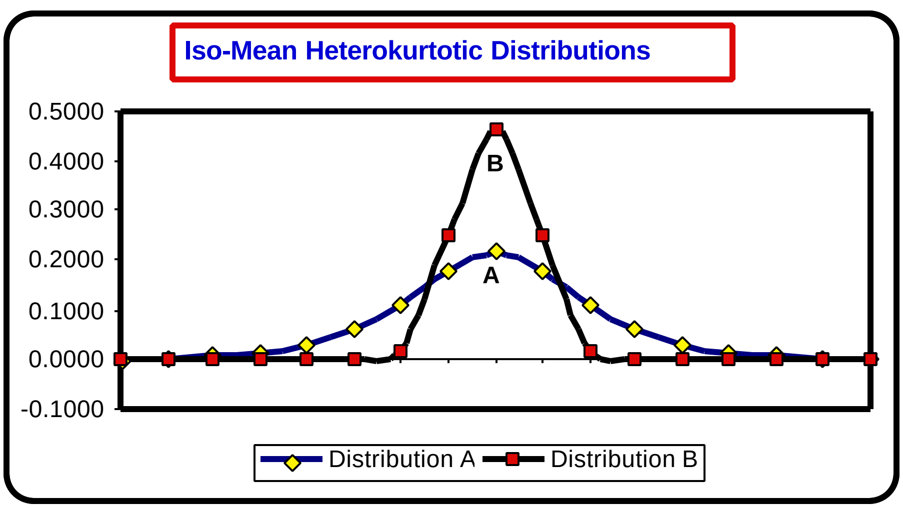

Fig. 5

Market prices can be further distorted in the presence of both kurtosis and differences in the expected values of the underlying probability distributions, as is shown in Figure 6. This extends the asymmetric framework illustrated in Figure 4.

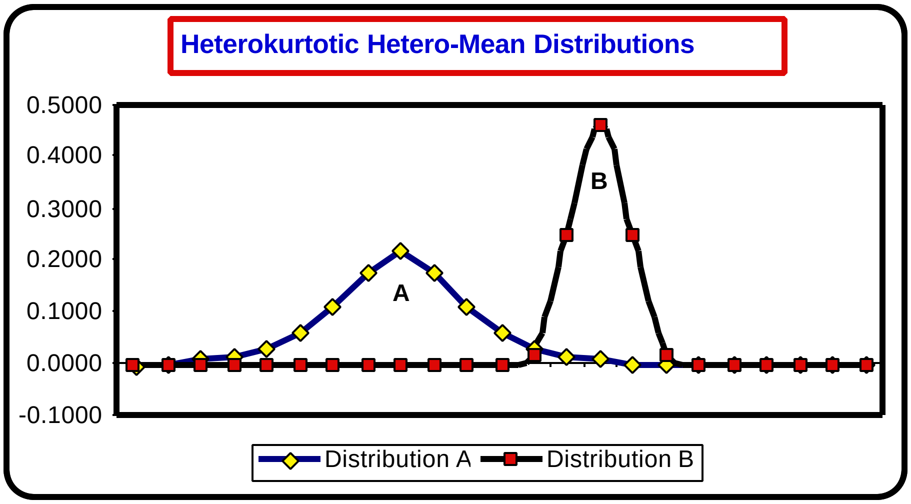

Fig. 6

Finally, we come to the cases of right and left skews in the underlying distributions of individual agents, as is shown in Figure 7 and 8. When we combine skewness, kurtosis, and asymmetric information, prices will deviate substantially from the Pareto-efficient level.

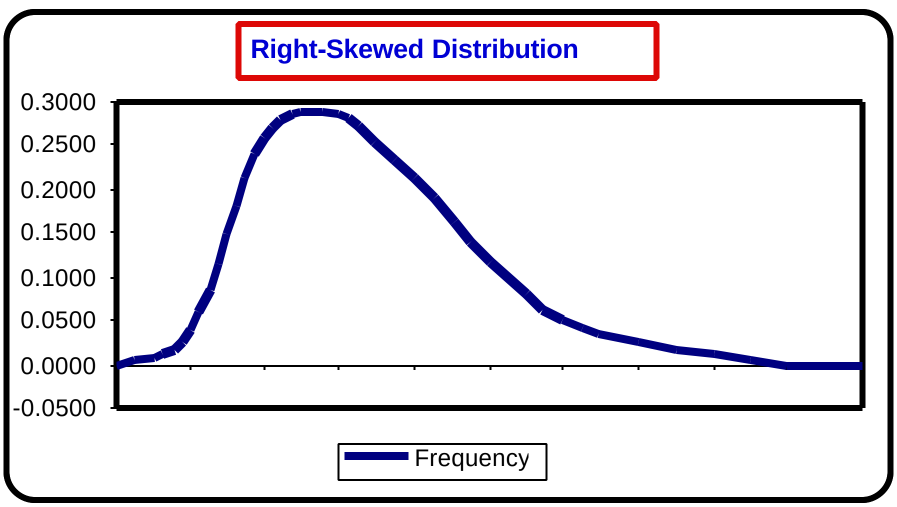

Fig. 7

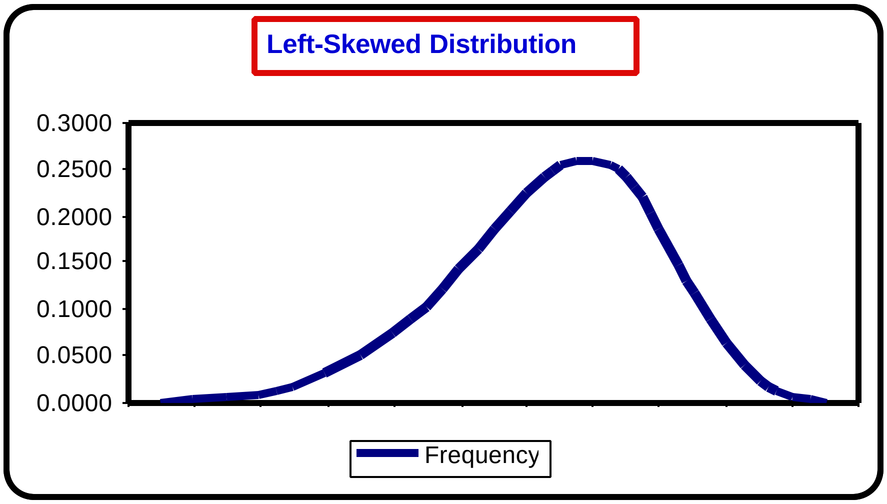

Fig. 8

Whether public sector intervention is warranted depends on the costs of correcting for deviations in the underlying probability distributions, and on the consistency of preferences across agents over time.

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The Evolution of Economic Interpretation between The EU and Maghreb and between The EU and Central and Eastern European countries

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Introduction

The Maghreb countries were for a long time the privileged trading partners of the European union, benefiting from generalized preference agreements. Indeed, Tunisia and Morocco signed partnership agreements with the EU since July 1995 and February 1996 respectively.

One of the key aspects of these euro-Mediterranean agreements is the development of an economic and financial cooperation pushing the instalment of a free trade area.

To the term of these agreements, the Maghreb countries were in the top of the scale of the European's preferences, with a free access to the European market for the industrial products and a preferential regime for the agricultural domain.

However, with the fall of the wall of Berlin and generally of the socialist economic regime, the countries of the Central and Eastern Europe became, as well, important political and trading partners to such point that the Maghreb countries see in them a threat to their trades with Europe.

Thus, during the nineties the European union, had to face a widened periphery, composed to the East and to the South, of countries with comparable trading orientation and income levels.

The risk of marginalization of the Maghreb countries during the process of widening of the European union to the CEEC is underlined in this article through the comparison of the different European agreements signed by the two areas with the EU on the one hand, and a calculation of the trade integration indicator on the other hand.

A gravity model will be estimated in order to confirm the findings of the first part.

State of the relations between the European union and its neighbours of the East and the South.

We will try to value the relations of the European union with the countries of the Maghreb and the CEEC through the European partnership agreements signed in 1991 with Hungary & Poland and in 1995 & 1996 with Tunisia and Morocco.

In a second part, we will calculate the coefficient of integration to value the evolution of the integration of the Maghreb countries in the European union after 1991, date of the signature of the European agreements with the CEEC.

Comparison between the different preferential trade agreements signed by the two areas with the European union

The Maghreb countries established some privileged trading relations with the European union thanks to the historic ties that unite them. Indeed a preferential treatment has been granted to the former colonies of Africa by the signature of cooperation agreements during the sixties and seventies.

These ties were strengthened in 1995 thanks to Barcelona Declaration were it was decided to set up a Euro-Mediterranean free trade area by the year 2010. This decision led to the signature of bilateral agreements with Tunisia and Morocco.

On the other hand, the economic relations between the European union and the countries of Central and Eastern Europe and notably Poland and Hungary soon turned out to be important, fact crowned by the German unification and by the signature of preferential trade agreements with Hungary in 1988 and with Poland in 1989.

Based on the Maghreb's agreements of 1995 and the European agreements signed between the European union and Poland & Hungary in 1991, we will try to compare the advantages of each area on the European market.

In a first table we will represent the different generations of agreements signed between the EU and the Maghreb countries then the EU with Hungary and Poland.

Table 1: HISTORIC OF THE TRADE RELATIONS OF THE EUROPEAN UNION WITH MOROCCO, TUNISIA, POLAND AND HUNGARY.

Country	***Dates of the signature of the agreements***	***Objective***
Morocco, Tunisia	1976	**Agreements of cooperation** that have for goal the economic and financial cooperation and which trading regime is founded on the non-reciprocity. Morocco and Tunisia are placed under the regime of privileged nation.
Hungary Poland	1988 1989	***Agreements on trade and economic & trade cooperation*** (agreements of first generation)
Hungary, Poland	1991	***European's Agreements*** establishing a partnership between the European union and the two countries for a real rapprochement of their economic system.
Maroc, Tunisie	1992	**Beginning *of the negotiations in order to reach partnership agreements*** aiming to create a free trade area for the industrial products and a mutual liberalization of agriculture and services.
Tunisie Maroc	1995 1996	Signature of ***The partnership agreement*** that foresees a tariff dismantling in consumer goods. It will be effective four years after the entry into force of the agreement (mars 1998) and will be spread over eight years.

The partnership agreements signed between the European union and the CEEC were probably one of the elements at the origin of the trade expansion between the two areas since 1990. Hungary and Poland were the first two countries to beneficiate of partnership agreements with the European union; indeed Hungary signed this agreement in 1991.

The agreement's main goal is the reinforcement of the relations previously established mainly through the agreement relating to trade and economic cooperation signed in September 26th 1988.

Being convinced that a partnership agreement will create a new climate for its economic relations with the European union, notably for the development of trade and investments, Hungary undertook since then an economic restructuring and a technological modernization to become member of the European union.

The article 7 of this agreement[i] stipulates that the European union and Hungary progressively establish a free trade area during a transition period of ten years at the latest, divided in two successive stages of five years each. A progressive tariff reduction is applied starting from the entry into force of the agreement on imports of Hungary's industrial products to the European union.

The economic cooperation between the European union and Hungary aims to assure the respect of all arrangements to be fixed in the commercial domain and to bring closer the customs regime of Hungary to that of the European union. This should contribute to facilitate the progressive liberalization considered within the framework of the present agreement.

Poland signed, on its turn, on September 19th 1989, the agreement of trade and economic cooperation followed by the signature of the European agreement in 1991, which at the origin of Poland fast transition towards a new market economy system.

This agreement stipulates, in its article 8, that custom duties applied to imports in the European union of some Polish industrial products are suppressed since the entry into force of the agreement. Custom duties imposed on all other industrial products, are suppressed progressively according to a calendar that spreads over four years following the entry into force of the agreement[ii].

Any quantitative restriction on imports to the European union and any measure of equivalent effect is suppressed since the date of entry into force of the present agreement with regard to the products coming from Poland.

No new customs duties on imports and exports, nor tax of equivalent effect will be introduced in trade relations between the European union and Poland, and those that are already applied won't be increased after the date of entry into force of this agreement based on article 25 concerning agriculture products.

A financial assistance from the European union is valued in light of the needs and the level of development of Poland and considering the priorities that have been fixed, the capacity of absorption of the Polish economy, the capacity of loan repayment, the setting up of an economy of market and the restructuring of Poland.

Therefore partnership agreements had an important impact on the bilateral relations between the European union and the CEEC.

The fast progression of trade relations between the European union and the countries of the East can make the Maghreb countries fear a receding on the European markets and a loss of the advantages of which they beneficiated.

In fact, Tunisia was the first country to sign a partnership agreement with the European union on July 17, 1995.

On the commercial plan, Tunisia undertook anticipated steps to dismantle its customs duties starting from 1996, way ahead the scheduled date of entry into force of the agreement, March 1st 1998. It permitted to accelerate its commercial integration in the European market.

The European union is the main trading partner of the Maghreb countries; it absorbs 78% of Tunisia's exports and provides 72% of the Tunisia imports.

In the agricultural field, Tunisia bears an increasing interest to the conditions of access of its olive oil to the European market. In November 2000, the negotiations permitted the initials of an agreement, precisely a bill of exchanges, which was approved by the council in year 2000.

According to this agreement, the preferential tariff contingent on olive oil becomes permanent and is subject to an increase of 10.000 tons. In exchange, Tunisia will offer concessions to the community, notably with regard to exports of soft wheat and oleaginous.

Tunisia benefited between 1977 and 1996 from four financial protocols, of 742 million Euros for the funding of projects and cooperation programs out of which 98% of the total have been already engaged.

Within this agreement[iii] framework, Tunisia and the European union are engaged to progressively create a free trade area by 2010.

The euro-Mediterranean partnership agreement signed between the European union and Morocco came into force on March 1st 2000. This agreement includes a progressive liberalization of trades over a period of twelve years to end up with a free trade area.

A calendar for the dismantlement of custom tariffs on industrial products entering Morocco is foreseen in this agreement. More than half of Morocco's trading relationships are done with the European union. In 1998, the imports of the European union from Morocco amounted to 5,323 millions Euro and exports towards Morocco of 6,548 millions Euro. The Moroccan commercial balance has always been positive with the European union.

Entry requirement for Moroccan industrial products are already admitted in franchise to the European union market. Some agriculture products are subject to quotas within which limits custom duties are nil.

Morocco also, benefited from a financial aid estimated at 1,091 millions Euro, out of which 438 millions Euros are a non-repayable aid.

The Generalised Preference System (Système de Préférence Généralisé - SPG) granted to economies in phase of transition during the years1990 and 1991 within the framework of PHARE program, and the signature of partnership agreements between the European union and the CEEC, rose questions about the advantages and the privileges given to Maghreb countries.

Calculation of the integration indicator for the countries of the two areas in the European union

In order to know if the generalisation of the preferences granted to the countries of the East doesn't entail a deterioration of the Euro-Mediterranean relations, we will calculate an economic integration indicator based on Chelem database of the CEPII.

$$I=[(Xij +Mij)/(2*PIBj)] *100$$

Xij = total Exports of country i toward country j.

Mij = total Imports of country i from partner country j.

GDP = gross domestic product in current dollar.

i, j = countries.

I = indicator of trade integration of country i with country j.

This coefficient is sometimes called opening coefficient. The higher the coefficient the more important are trades of the European union with country j.

	1989	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Tunisia	***24,5***	**26,8**	**25,7**	**24,9**	**25,2**	**26**	**26,7**	**25,3**	**27,4**	**31,7**
Morocco	**14,3**	**16,1**	**15**	**15,7**	**16**	**15,9**	**16,9**	**15**	**16,5**	**15,3**
Poland	**6**	**11,8**	**12,7**	**13**	**13,3**	**14,2**	**14,9**	**15**	**16,2**	**16,4**
Hungary	**12**	**13,1**	**16,7**	**17,6**	**17,1**	**17**	**23**	**26,1**	**30,9**	**36,5**
Bulgaria	**8**	**7**	**17,6**	**16,3**	**13,5**	**18,8**	**18,9**	**21,5**	**21,2**	**23,5**
Romania	**3**	**4**	**9,3**	**11,2**	**9,3**	**10,4**	**12,8**	**14,2**	**18,2**	**14,3**

Source: Calculation of the author from Chelem database of the CEPII

The integration of Poland in the European union was reinforced between 1989 and 1995, the coefficient shows a progression of about 9 points, it reached 16,4% in 1998.

However, Tunisia maintained the highest level of integration during the period of 1989 and 1997.

It is important to note that starting from 1996, the level of integration of Poland came closer to that of Morocco and even exceeded it starting from 1997, whereas the indicator of Hungary exceeded those of the Maghreb countries.

The level of integration of Bulgaria was higher than that of Morocco in 1998, it increased by 3 points in ten years, but it remained weak compared to that of Tunisia.

The trade integration of Romania seems quite difficult; the indicator of integration lost 4 points between 1997 and 1998.

The very strong progression of the Eastern countries from 1992, and the decrease recorded by Tunisia in 1998 can reveal a diversion of the trades of the European union toward the countries of the East considering their geographical, historic and cultural proximity.

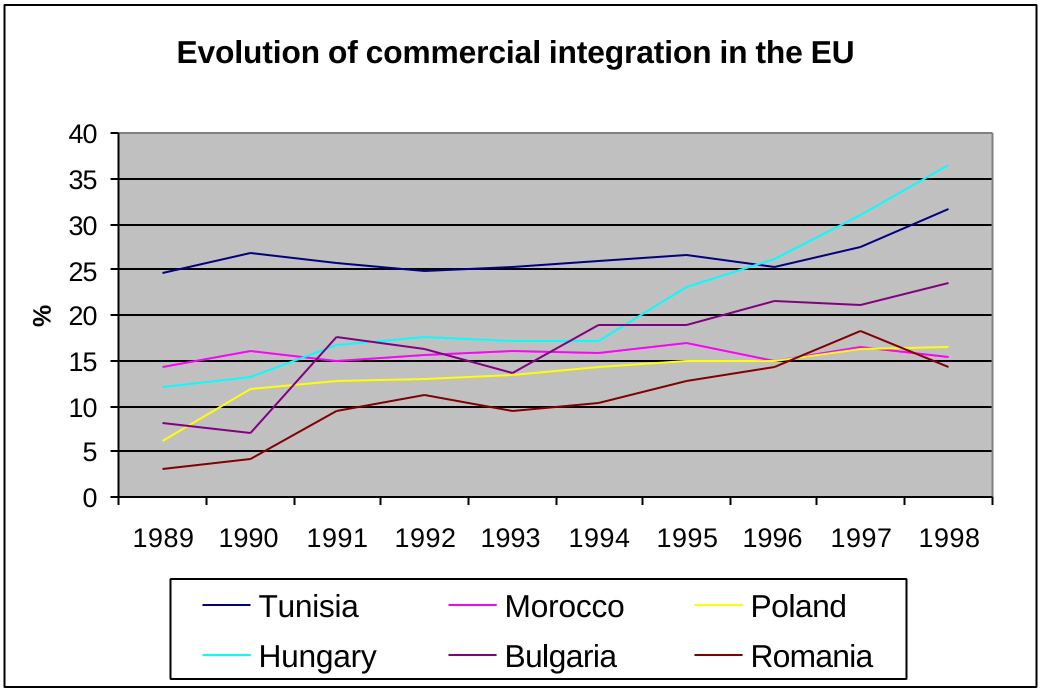

Fig.1: INDICATOR OF TRADE INTEGRATION

Despite the reduction of the gap between the coefficient of the CEEC and that of the Maghreb countries, the fast progression of the economic integration of eastern countries in the European union didn't result in a receding of the trades between the EU and Tunisia and Morocco. During all this period the Maghreb countries maintained a quite high integration level.

Nevertheless, It is necessary to note that for reasons of geographical, historic and cultural proximity Poland and Hungary have developed strong ties with Germany, whereas Tunisia and Morocco developed their trades mainly with France.

Modelling of the impact of the integration of Poland and Hungary in the European union on Morocco and Tunisia

The Gravity Model

The well-known gravity model (Aitken, 1973) relates the import flow of country i to country j (Mij) with their respective GDPs (GDPi, GDPj) and populations (POPi, POPj), as well as with a number of additional variables (Zhij; h=1,2,….., H) either aiding or resisting trade between both countries (Bergstrand, 1985). Its logarithmic version takes the form:

$$LogMij = \alpha + \beta_1 \text{ logGDPi} + \beta_2 \text{ logGDPj} + \beta_3 \text{ logPOPi} + \beta_4 \text{ logPOPj} + \Sigma\gamma_h Z_{hij} + u_{ij}$$

Where u_{ij} are disturbances, and α, β .., and γ are the parameters of the model.

Following Aitken (1973), GDPi determines the economic capacity of country i and POPi determines its domestic market/ foreign market production ratio.

The most straightforward example of a variable representing trade resistance is the distance between both countries (the further they are from each other, the more difficult trade is, due to higher transport costs).

On the other hand, neighbourhood (sharing common borders) is an immediate example of factor lowering trade resistance. Other typical factors reducing trade resistance are any kind of preferential trade agreements, while the fact that region A establishes preferential trade agreements with region B may lead to trade diversion from region C, thereby inducing trade resistance in the trade between A(B) and C.

The relatively privileged position of Maghreb countries until early 1990's, would have been challenged by the collapse of the communism and the EU-CEEC agreements, which would have triggered Maghreb countries demands for agreements with the EU comparable to the EU-CEEC ones.

The previous section has presented descriptive empirical evidence suggesting that trade has been enhanced between the EU and CEEC, while rather opposite effects are found regarding trade flows between the EU and Maghreb countries.

In this section we try to test with the gravity model if higher integration between the EU and the CEEC has reduced trade between Maghreb countries and the EU.

To that end, we consider the bilateral trade flows of 22 countries between 1990 and 1996: The current EU 15[iv] ; 2 Maghreb countries (Morocco, Tunisia); 5 CEEC (Poland, Hungary, Romania, Bulgaria and Czech Republic).

We consider the following trade resistance variables:

EUCE= 1 if i is in the EU 15 and j is CEEC or j is in the EU 15 and i is CEEC,
= 0 otherwise

EUMAG= 1 if i is in the EU 15 and j is Maghreb or j is in the EU 15 and i is Maghreb,
= 0 otherwise

Results of the modelling

We are particularly interested in the evolution of the coefficient of EUMagh. Eventually, the coefficient of EUCE should decrease in absolute value if it is negative, when preferential trade agreements between the EU and the CEEC are actually damaging trade between the EU and Maghreb countries.

On the other hand the coefficient of EUMagh should be negative and increase in absolute value.

If trade resistance has been significantly reduced between the EU and the CEEC, while it has remained stable or decreased less between EU and Maghreb countries, the latter may still have the perception that their trade conditions have worsened with relation to their CEEc competitors in EU markets.

Econometric Findings

Econometric estimations of this model for 1990, 1991, 1992, 1993, 1994, 1995 and 1996 are represented in six tables.

It also includes the R^2, the adjusted R^2 as well as the number of observation.

First estimation in 1990

Number of obs = 260
F (7, 253) = 335.06

Model	1130.04874	7	161.435534	Prob > F = 0.0000
Residual	121.898319	253	.481811538	R-squared = 0.9026
				Adj R-squared = 0.8999
Total	1251.94706	260	4.815181	Root MSE = .69413

xij	Coef.	Std. Err.	t	P>|t|	[95% Conf. Interval]	
pibi	.8050832	.1211752	6.644	0.000	.5664426	1.043724
popi	-.0338216	.1248769	-0.271	0.787	-.2797522	.212109
dij	-1.133897	.0824538	-13.752	0.000	-1.29628	-.9715139
pibj	.8823325	.0592231	14.898	0.000	.7656994	.9989656
popj	-.0341234	.059364	-0.575	0.566	-.1510339	.0827872
eumag	-.6334174	.3360056	-1.885	0.061	-1.295142	.0283068
euce	-1.258168	.2675784	-4.702	0.000	-1.785133	-.7312034
_cons	-4.693714	1.18462	-3.962	0.000	-7.026686	-2.360742

Second estimation in 1991

Number of obs = 260
F (7, 251) = 345.38

Model	1129.20141	7	161.314487	Prob > F = 0.0000
Residual	117.232987	251	.467063692	R-squared = 0.9059

Adj R-squared = 0.9033

Total | 1246.4344 258 4.83114107 Root MSE = .68342

Xij |	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
pibi |	.8502558	.1104012	7.702	0.000	.632825	1.067687
popi |	-.103175	.1193076	-0.865	0.388	-.3381464	.1317965
dij |	-1.143095	.0810333	-14.106	0.000	-1.302687	-.9835031
pibj |	.8967517	.0586277	15.296	0.000	.7812867	1.012217
popj |	-.0396601	.0592884	-0.669	0.504	-.1564263	.0771061
eumag |	-.5130082	.3122874	-1.643	0.102	-1.128046	.1020294
euce |	-.9239959	.2654967	-3.480	0.001	-1.446881	-.4011108
_cons |	-4.756297	1.126326	-4.223	0.000	-6.974552	-2.538042

Estimation of 1992

Number of obs = 260

F (7, 252) = 343.92

Model | 1115.43979 7 159.348541 Prob > F = 0.0000

Residual | 116.759756 252 .463332365 R-squared = 0.9052

Adj R-squared = 0.9026

Total | 1232.19954 259 4.7575272 Root MSE = .68069

Xij |	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
pibi |	.904851	.1122628	8.060	0.000	.6837581	1.125944
popi |	-.1878384	.1205996	-1.558	0.121	-.4253499	.049673
dij |	-1.09665	.0809372	-13.549	0.000	-1.256049	-.9372504
pibj |	.9182333	.0585252	15.690	0.000	.8029724	1.033494
popj |	-.0432925	.0587023	-0.737	0.462	-.1589022	.0723172
eumag |	-.3517687	.3152969	-1.116	0.266	-.9727214	.269184
euce |	-.7376041	.2718746	-2.713	0.007	-1.27304	-.2021682
_cons |	-5.264167	1.141494	-4.612	0.000	-7.512251	-3.016083

Estimation of 1993

Number of obs = 260

F (7, 252) = 342.26

Model | 1136.25331 7 162.321902 Prob > F = 0.0000

Residual | 119.514697 252 .47426467 R-squared = 0.9048

Adj R-squared = 0.9022

Total | 1255.76801 259 4.84852514 Root MSE = .68867

xij |	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
pibi |	.9688563	.1195604	8.103	0.000	.7333914	1.204321
popi |	-.2276213	.1257239	-1.810	0.071	-.4752246	.0199821
dij |	-1.092629	.0822508	-13.284	0.000	-1.254615	-.9306423
pibj |	.9553243	.0611709	15.617	0.000	.8348529	1.075796
popj |	-.0634714	.0614175	-1.033	0.302	-.1844285	.0574857
eumag |	-.2445541	.3323167	-0.736	0.462	-.899026	.4099178
euce |	-.7164553	.2716033	-2.638	0.009	-1.251357	-.1815536
_cons |	-5.93734	1.18089	-5.028	0.000	-8.263011	-3.61167

Estimation of 1994

Number of obs = 260
F (7, 252) = 328.98
Model | 1062.30317 7 151.757596 Prob > F = 0.0000
Residual | 116.247245 252 .461298592 R-squared = 0.9014
Adj R-squared = 0.8986
Total | 1178.55041 259 4.5503877 Root MSE = .67919

xij	Coef.	Std. Err.	t	P>|t|	[95% Conf. Interval]	
pibi	.9178146	.1188367	7.723	0.000	.6837749	1.151854
popi	-.2016291	.1262666	-1.597	0.112	-.4503015	.0470432
dij	-1.091737	.0823181	-13.262	0.000	-1.253856	-.929618
pibj	.9317494	.059759	15.592	0.000	.8140588	1.04944
popj	-.056797	.058969	-0.963	0.336	-.1729318	.0593378
eumag	-.3098824	.324146	-0.956	0.340	-.9482628	.328498
euce	-.6116909	.2711914	-2.256	0.025	-1.145781	-.0776005
_cons	-5.296092	1.175277	-4.506	0.000	-7.610709	-2.981474

Estimation of 1995

Number of obs = 260
F (7, 252) = 273.08
Model | 1043.56207 7 149.080295 Prob > F = 0.0000
Residual | 137.572747 252 .545923599 R-squared = 0.8835
Adj R-squared = 0.8803
Total | 1181.13481 259 4.56036607 Root MSE = .73887

xij	Coef.	Std. Err.	t	P>|t|	[95% Conf. Interval]	
pibi	.8791588	.1357983	6.474	0.000	.6117145	1.146603
popi	-.1808038	.1427254	-1.267	0.206	-.4618904	.1002827
dij	-1.079615	.0892161	-12.101	0.000	-1.255319	-.903911
pibj	.9174202	.0639719	14.341	0.000	.7914326	1.043408
popj	-.0175491	.0607298	-0.289	0.773	-.1371517	.1020535
eumag	-.5981654	.3730875	-1.603	0.110	-1.332932	.1366013
euce	-.5625846	.3107445	-1.810	0.071	-1.174572	.0494025
_cons	-5.350116	1.306839	-4.094	0.000	-7.923834	-2.776399

Estimation of 1996

Number of obs = 260
F (7, 252) = 303.19
Model | 1031.44228 7 147.348897 Prob > F = 0.0000
Residual | 122.472007 252 .486000029 R-squared = 0.8939
Adj R-squared = 0.8909
Total | 1153.91429 259 4.45526752 Root MSE = .69714

xij	Coef.	Std. Err.	t	P>|t|	[95% Conf. Interval]	
pibi	.8788859	.1242063	7.076	0.000	.6342713	1.1235
popi	-.1807889	.1327035	-1.362	0.174	-.4421381	.0805603
dij	-1.110471	.083025	-13.375	0.000	-1.273982	-.9469595
pibj	.9284826	.0608939	15.248	0.000	.8085568	1.048408

popj	-.0436512	.0573689	-0.761	0.447	-.1566347	.0693324
eumag	-.493681	.3429399	-4.440	0.151	-1.169074	.1817124
euce	-.5378794	.2921347	-1.841	0.067	-1.113216	.0374573
_cons	-5.018647	1.208902	-4.151	0.000	-7.399486	-2.637807

The coefficient of EUCE has been decreasing in absolute value since 1990 (from -1.25 to almost 0). Statistically significant trade resistance decreased until 1994, to become statistically insignificant (at 5% or higher) for both year 1995 and 1996.

On the other hand, trade resistance between EU and Maghreb has been significant only in 1996. Furthermore, over the whole period the coefficient of EUMag has been greater in absolute value than of EUCE. Therefore, there is preliminary evidence, at least, that Maghreb countries might have the perception that their relative position in trading with the EU has worsened. However, it should be noted that since trade resistance has been decreasing between the EU and Maghreb countries, it is difficult to conclude that preferential trade agreements between EU and CEEC are actually harming Maghreb countries' trade.

Conclusion

Our survey is based on a comparison between the different agreements signed between the European union and the Maghreb countries on the one hand, and the CEEC on the other hand. From this comparison, we show that the fast progression of the financial and trade relationships established starting from 1991 between the countries of the European union and the countries of the East didn't result in an eviction of the Maghreb countries, since the Euro-Mediterranean agreements signed in 1995 and 1996 preserved the advantages granted to Maghreb countries.

The calculation of the economic integration coefficient could show that in 1995, Poland caught up Morocco, which means that the access to the European market of Maghreb's and Eastern Europe's products became the same.

Tunisia was, in the beginning of the nineties, the most integrated within the European union. Then it started recording a deterioration of the value of its integration coefficient to reach in 1998 the same level of integration as that of Poland.

The geographical closeness of the two areas to the European union has always privileged the relations between these regions. In fact, the evaluation of the gravity model shows a negative coefficient. This means that closer the countries, the more prosperous trades are.

It is important to note that trades of the two areas within the European union are asymmetric; indeed trades of eastern countries are focused on Germany, their primary trading partner. Germany by it self represents more than half of the trades between the EU and the countries of the East. On the other hand trade relations between the CEEC and France are not enough developed?

France reaction was a little late in relation to the opening to the CEEC. Since the beginning, it considered this new area as a market only. That is why it preserves strong trade relations with the Maghreb countries.

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[i] European Agreement signed on September 26,1988 between European union and Hungary.
[ii] European Agreement signed on September 19,1989 between European union and Poland.
[iii] Euro-Mediterranean partnership agreement signed between Tunisia and European union on July 17, 1995 http://europa.eu.int/comm/trade/index_en.htm
[iv] Note that this gives 14 countries, since regarding trade flows Belgium and Luxembourg are a single trade partner.

Section 3

Education & E-learning

Adapting Traditional Courses to Fully Asynchronous E-Learning Models

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Abstract

We have been working with various models of e-learning since 1994. The original model was pure video conferencing using one-way video with two-way audio. We have progressed thru non-interactive use of web pages to enhance classroom work, the hybrid model which is 40%-70% online, to two-way online interactive asynchronous e-learning which starts at 70% and works its way to 90-100% as the developer determines. We have also experimented with on-site classroom enhanced e-learning.

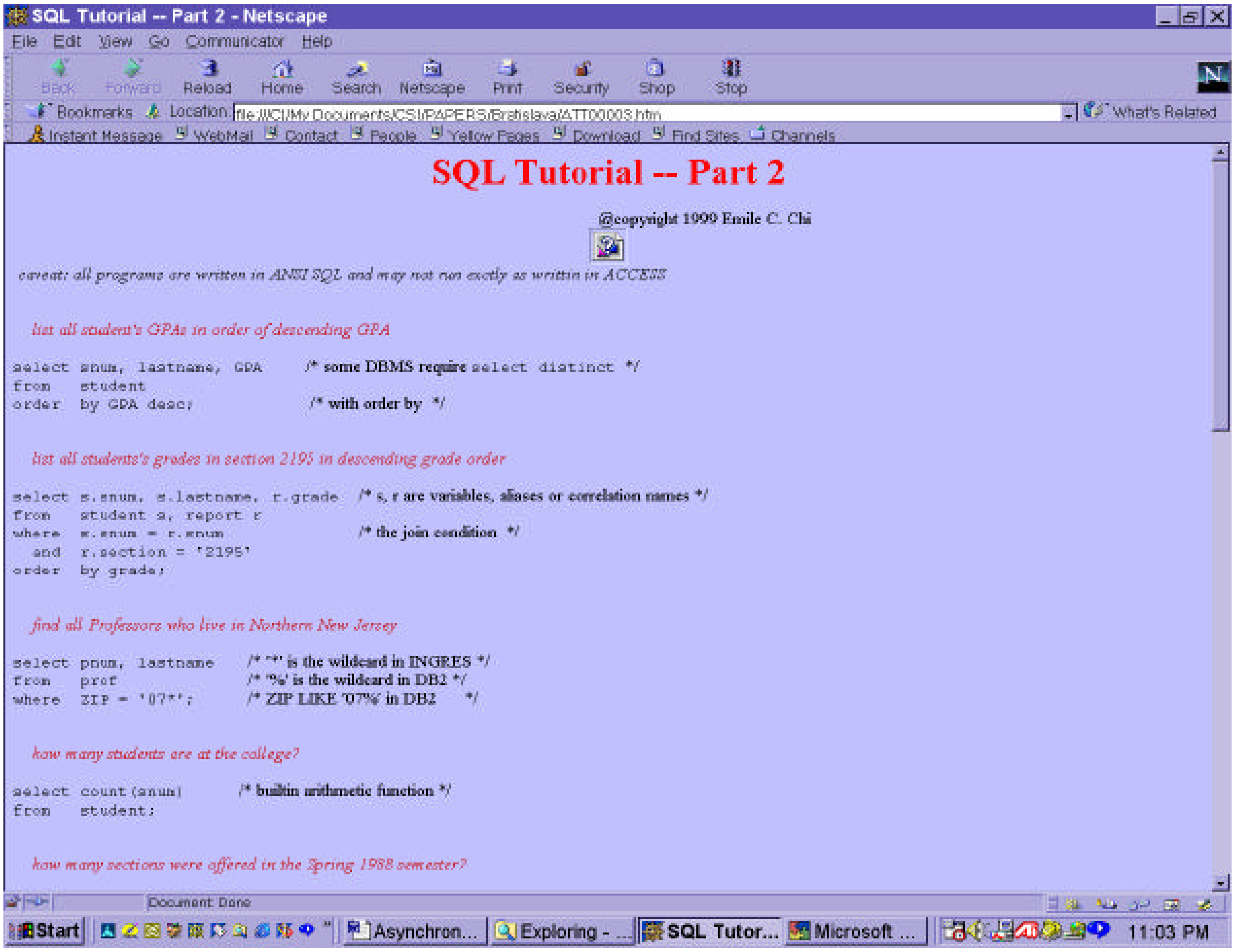
Introduction

Distance learning is not new, but using a Web site for interactive delivery is. E-learning using commercial software or homegrown web pages has grown to over 2 million students in 2000-2001. The driving force in the rapid growth of e-learning can be traced to the following factors:

- Technology has evolved so that distance learning can be delivered efficiently at a minimal cost.
- Delivery systems such as *Blackboard*, *WebCT*, *FrontPage*, and other packages are available on multiple platforms and provide an easy framework for organizing and putting course material online. These packages also simplify the navigation process for the student.
- Faster computers, improved compression algorithms and high-speed internet connections allow instructors to use integrated audio, data and video technology features that were not practical previously.
- E-learning is delivered anywhere, at anytime, to anyone – providing flexibility to students who cannot come to campus on a regular scheduled basis.
- Web based courses bring learning to the student instead of bringing students to learning.

Currently City University of New York (CUNY) has a Sloan Foundation grant to implement e-learning using both the hybrid and asynchronous models. As this project proceeds, we will gain the experience to study and compare these models more fully. The authors have been teaching hybrid courses for more than 3 years and are currently converting them to asynchronous.

Our traditional classroom course in Database theory and practice has been offered for more than 20 years. Since 1994, we have adapted the course material for the web. This started as a web enhanced course with a few web pages, used to supplement the textbook, and written in very simple html. Fig. 1 is a tutorial from the web-enhanced course. Over time this course developed into a hybrid mode, meeting half the time only online. The course is now available through CUNY Online in a fully asynchronous version. Fig. 2 shows the course map.


SQL Tutorial -- Part 2 - Netscape
File Edit View Go Communicator Help
Back Forward Reload Home Search Netscape Print Security Shop Stop
Bookmarks Location: file:///C|/My Documents/CSI/PAPERS/Bratislava/ATT00003.htm
What's Related
Instant Message WebMail Contact People Yellow Pages Download Find Sites Channels
SQL Tutorial -- Part 2
@copyright 1999 Emile C. Chi
caveat: all programs are written in ANSI SQL and may not run exctly as written in ACCESS
list all student's GPAs in order of descending GPA
select snum, lastname, GPA /* some DBMS require select distinct */
from student
order by GPA desc; /* with order by */
list all students's grades in section 2195 in descending grade order
select s.snum, s.lastname, r.grade /* s, r are variables, aliases or correlation names */
from student s, report r
where s.snum = r.snum /* the join condition */
and r.section = '2195'
order by grade;
find all Professors who live in Northern New Jersey
select pnum, lastname /* '*' is the wildcard in INGRES */
from prof /* '%' is the wildcard in DB2 */
where ZIP = '07*'; /* ZIP LIKE '07%' in DB2 */
how many students are at the college?
select count(snum) /* builtin arithmetic function */
from student;
how many sections were offered in the Spring 1988 semester?
Document: Done
Start Asynchron... Exploring - ... SQL Tutor... Microsoft ...
11:03 PM
Fig. 1

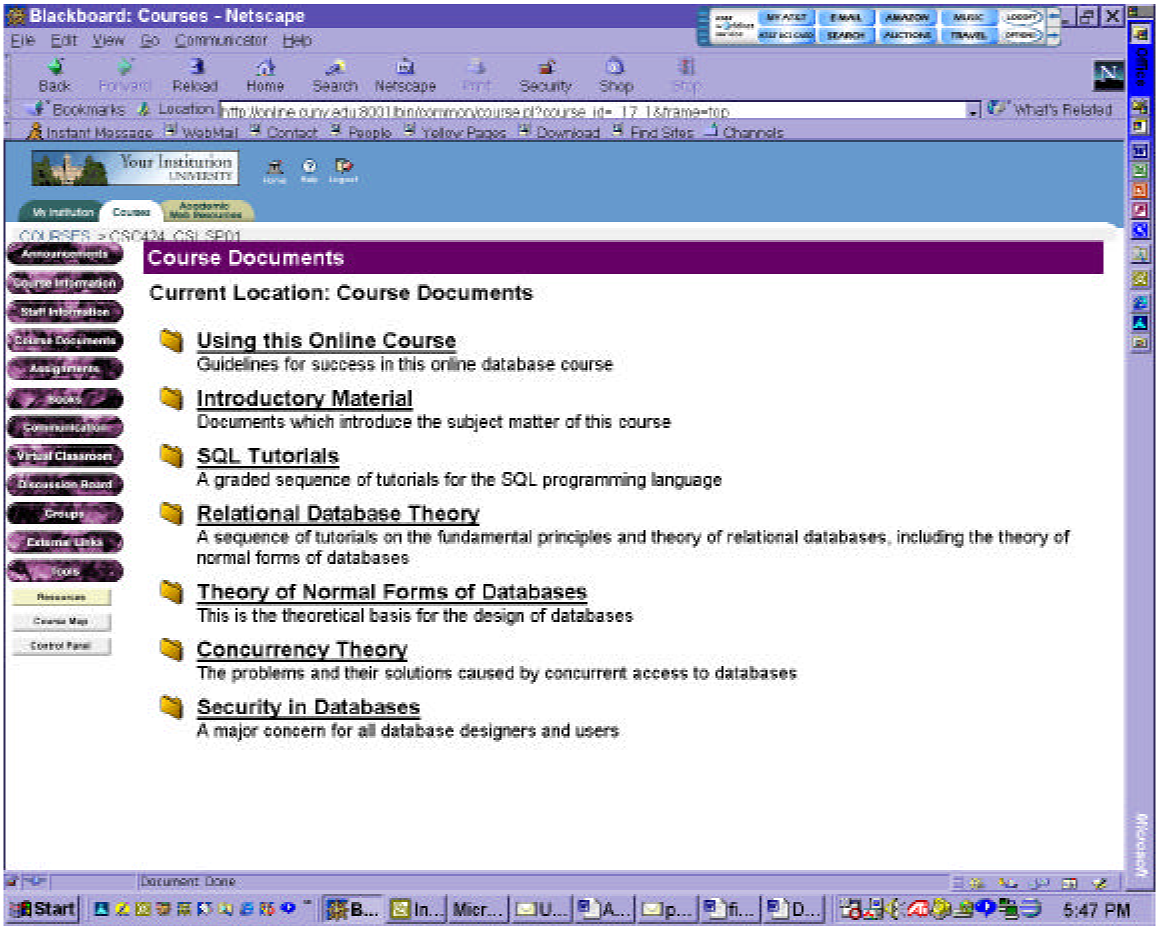


Fig. 2

When designing asynchronous courses the following issues must be addressed:

Recreate the classroom experience online

Higher education started with scholars expounding verbally (lectures) to groups of students at their feet. Lectures were gradually supplemented with blackboard illustration and textbooks. Lecture enhancements have already been largely replaced: first by overhead projectors and more recently by PowerPoint presentations. The next step, namely the transition to Web pages is easy, in fact many e-learning software systems permit incorporation of entire PowerPoint presentations. The conversion to fully asynchronous e-learning continues and increases this development away from lecture presentation of course content to written and illustrated presentation. Seen from this point of view asynchronous e-learning is just another step in the development of educational technology which started with the invention of the printing press and chalk.

Adapting traditional course material for the web

Once your students are interested in the new material, are focused, and are motivated to learn, the class is ready for you to present the new information. Presentation, also called development of courses for e-learning, is a step-by-step process of introducing the new material to your students. Teaching step-by-step is key in development. The proof that learning has taken place must be demonstrated via application. Learning does not truly occur until it has been practiced. Thus, it is essential when planning a lesson to include time for students to practice new concepts and skills. Careful consideration must be given to the placement of the practice within the lesson. The student must practice new material after each step, not just at the end. But practice cannot end with incremental application. It is equally important to practice at integrated and culminating skill levels. In essence, putting multiple new skills together is a new skill that needs to be modeled and practiced. While the foregoing applies to all teaching, it is especially required for asynchronous e-learning, where the instructor is not physically present to "hold the student's hand while walking him thru the steps".

New paradigms for communication and interaction must be developed for e-learning

Fully asynchronous courses require students to be motivated to work in a different mode. They must log on regularly. Students taking self-paced courses have no one looking over their shoulders. These courses require self-discipline and a pestering instructor who follows up with email and/or phone calls when students do not log on and participate in the discussion forums by commenting on and questioning the assigned readings. Students use the course Web site to:

- obtain the syllabus
- review the assignments and deadlines
- study the course tutorials
- create a course *community*
- access aids for enhancing the learning process
- submit the course work and receive comments
- communicate with both the instructor and other class members by email, discussion boards and chat sessions
- take tests and surveys
- review grades and check all announcements.

Online learning resources must address the many facets of mastering subject matter or application skills. To encourage student inquiry and research supplemental course material must be made available via links to additional web resource centers and tutorials.

Build an online community

In fully asynchronous classes, students have no face-to-face time, yet they are expected to develop a sense of camaraderie and collaboration in order to participate in group projects and communications. The initial introductions can be conducted via student homepages, where each student builds her homepage as a window into her thoughts and aspirations. In some sense online courses give students an opportunity to be more forthcoming in their relationships with their fellow students. This is especially true with students who feel freer online than in face-to-face interactions. A problem with this is that, at times, a student may be too revealing and discuss personal matters and opinions, which are not relevant to, nor appropriate for the course.

Encourage teamwork but NOT collaboration among students

In the database course students are not permitted to work in teams on the initial assignments, so that they may learn the skills required to develop algorithms. After the introductory lessons, 3-4 person student groups are encouraged to work together on the development of the complex algorithms, which are sometimes required to solve queries to the database. Once the team develops the algorithms, they are required to be implemented individually. However, the line between teamwork and collaboration is quite fine.

The digital divide: Access to technology and adaptive technology become critical issues

For the student without home internet access, e-learning is a convenience mostly for the university. Nonetheless, e-learning is very popular in countries, such as China, where Shanghai Television University has more than 500,000 students. Most of them take courses by one-way broadcast TV or non-interactive video or CD-ROMs. They take the exams by coming to one of the university testing centers. In this country, students without home Internet access may use the resources of the local public library or make arrangements with their employers to access a course after work and on their lunch hour.

Internet access and acceptable response time are requisites for successful participation in interactive Web based courses. Conversion to an asynchronous mode from the traditional face-to-face lecture and chalkboard course is improved by the addition of interactivity, enhanced audio and video presentations and multiple external links to supplementary course material. These may cause download speed problems with 56K modems or difficulty viewing large high-resolution images on computers with low-resolution video cards and older monitors. Depending on how many others are accessing the Internet from the student's geographic area or network, the speed of the telecommunication service, and the hardware components (e.g. modem, DSL or cable speed) available to the student, delivery of the course may be slow.

Appropriateness to the current student population; mature working students vs. traditional full-time student

Experience has shown that mature working students tend to be more motivated and committed to e-learning than traditional full-time students. You cannot spoon feed motivation to your students, but you must create a situation in which they will want to learn. Motivation must be continually rethought and reassessed throughout the instructional session. It is also important to remember that all students are not motivated by the same activities.

In online courses, the course interface is the students' sole connection to the instructor, peers and the course content. The interface heavily influences the students' satisfaction, learning, and retention in online courses. It must facilitate interactions between students and teachers and among students. As the semester progresses new and interesting material must be continually added to the course. Instructors must interact frequently and constructively with students, and discussions must be valuable and dynamic.

E-learning requires that students develop writing skills not needed for success in traditional technical courses

Without face-to-face meetings there is no oral communication. Student and faculty collaboration and interactivity takes place via home pages, chat sessions and e-mail. Therefore, writing skills must be developed and enhanced for clear communication and participation. CUNY has recognized this problem and developed the CUNY Writesite URL: http://writesite.cuny.edu, to assist students in developing this essential skill. This web-based resource for CUNY writers is a highly interactive online writing lab (OWL) designed to serve the needs of writers from basic to professional. The Writing Projects Section is of particular interest to online faculty and students, with very specific examples and exercises for discipline-based writing assignments. A complete Grammar and Composition section allows students to troubleshoot grammatical problems and, through the Hot Spots features, to gain practice in correct usage.

Another advantage of developing writing skills is that, whereas writing ability may not be required for success in many science courses, it is essential for success at most careers to which college graduates aspire.

Testing

Testing in fully asynchronous courses remains one of the biggest hurdles. With a diverse and disperse student population exams can be given in college testing offices or arrangements can be made with private learning and testing centers for students to take exams by appointment. Fully asynchronous online testing has yet to be perfected. Some colleges use the honor system, where students sign a pledge not to cheat. But who is kidding whom?

In California, drivers convicted of speeding can avoid the points on their license by passing a driver education course, which is offered either face-to-face or asynchronously online. The final exam of the asynchronous class is taken online. The authors know a student who did not do any of the course work. She simply took the final exam online on one computer while a friend sitting next to her at home was logged onto the course site on another computer looking up the answers. Another friend refined this technique. Alone, he logged on to both the course and the exam simultaneously and rapidly completed the exam by looking from one screen to the other.

Experience using Blackboard Inc.'s Blackboard for E-Learning

The CUNY On-line project made a decision to use *Blackboard* for all its e-learning courses.

Advantages are:

- All courses present a common interface to the student
- Easy to learn to navigate
- Small student teams are easy to create
- Discussion forums are easy to create and use
- A digital drop box has been incorporated into the system making it easy for students to submit their work and instructors to grade and return student work
- Easy to incorporate any digital media into the product
- Statistics are easily available to the instructor covering such areas as the number of hits to the course and the number of hours each student has spent online
- Each student has easy access to his own grades online, anytime, anywhere
- A simple gradebook with weighting factors is available to the instructor for computing final grades
- Easy to send email to individuals, the entire class or select groups

Disadvantages are:

- All courses look the same, stifling creativity on the part of the course developer
- A large portion of the screen real estate is devoted to *Blackboard* administrative and navigation buttons
- The navigation buttons are preset preventing the course developer from adding new topics or deleting irrelevant ones
- Cumbersome and time consuming to jump between areas of the course site
- Logging off the course requires shutting down the web browser

Conclusion

Fully asynchronous courses require a firm commitment from the faculty to log on, communicate and monitor each student on a regular basis. A class of 35 students, who each send only 2 emails a week for a 15-week semester means more than 1,000 personal responses, which must be sent promptly. A truly excellent asynchronous course requires an enormous time commitment in reading and responding to all posted forum material, as well as active participation in the live chat rooms for ‘office hours’. Because asynchronous courses are in session anywhere, anytime, students expect access to the professor 24/7. Asynchronous e-learning means more work for the professor!

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Learning and Education in the Post Industrial Era: Implications for Teachers And Universities In Developing Countries

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ABSTRACT

Western thinkers have viewed learning in a more mechanistic way as a process of instilling cognitive and/or behavioral changes in individuals. The industrial age encouraged learning of standard skills and conforming behavior as required by the industrial organizations. The post-industrial era needs people who are independent thinkers and creative problem solvers. This is where the West meets the East. The East always-viewed education and learning as a process leading to emancipation of the individual. The holistic and integrated approach of the East is once again gaining currency in the West.

Educational institutions, such as the traditional universities - the citadels of learning, appear to be caught up in a time warp. The article highlights the changing face of education, with reference to management education, due to the entry of broadcasting companies, IT companies, Big Corporate houses in the field of education resulting in the blurring of boundaries between the traditional Universities, virtual Universities and open Universities. Some strategies for the traditional universities and the teachers on how to cope with these new developments are also discussed in this article.

Introduction

The world is constantly changing, with every change bringing opportunities for personal and professional growth. Skills need to be updated or refreshed continually, to reflect changes in technology, legislation or practices. Consequently, the importance of learning is being increasingly recognized. Terms such as 'the learning organization' and 'lifelong learning' are frequently used, at present.

However, learning has meant different things to different people at different points of time. Learning is generally understood as acquiring of new skills. At a deeper level, it is also seen as enhancing one’s intellectual capabilities. Western thinkers have looked at learning in a more mechanistic way as a process of instilling cognitive and/or behavioral changes in individuals. However, the East views education and learning as a process leading to emancipation of the individual. The difference is not only in the goals but also in the process that is advocated.

Basically, the industrial age encouraged learning of standard skills and conforming behavior as required by the industrial organizations. Our present educational system, which follows fixed curricula, has been designed to meet the needs of the old economy institutions. It killed the spirit of enquiry in the individuals and reduced people to the status of human robots that can carry out tasks as instructed. However, the new economy needs people who retain their individuality and originality and also have the ability to come up with radically new approaches to organizational problems.

This first part of the article attempts to give a flavor of western and eastern thinking on learning and highlights the need for a shift towards a holistic approach of the east for greater success in the post-industrial era. By no means is it possible to cover the entire gamut of theories of learning propounded by scholars from the east and west. Theories have been quoted only to the extent needed to highlight the need for a new approach to learning,

The second part highlights the changing face of education, with reference to management education, due to the entry of broadcasting companies, IT companies, Big Corporate houses in the field of education resulting in the blurring of boundaries between the Traditional Universities, Virtual Universities and Open Universities. Some strategies for the traditional universities and the teachers on how to cope with these new developments are discussed at the end.

PART - I

Western Thoughts On Learning

The popular theories on learning by western thinkers include Operant Conditioning by B.F. Skinner [1], Experiential learning by Rogers [2], Gestalt theory by Kohler and Koffka along with Max Wertheimer [See Ellis -3], Double loop learning by Argyris [4], Lateral thinking by Edward de Bono [5], Social Learning Theory by Bandura [6] and the Double-loop learning by Kolb[7]. These theories can be broadly grouped under the following three models.

The response-strengthening model, which influenced the first half of this century, lays emphasis on the role of feedback to enhance learning. Knowledge is considered to be the associations people make between stimuli and responses. Drill and practice was the instructional method of choice by the proponents of this theory.

The information-processing model proposes that knowledge is a definite entity that can be transferred from one person to another. This assumption gave rise to didactic instruction and classical instructional design with lecturing as the prevalent instructional technique.

Constructivism is a philosophy of learning founded on the premise that, by reflecting on our experiences, we construct our own understanding of the world we live in. Each of us generates our own "rules" and "mental models," which we use to make sense of our experiences. Learning, therefore, is simply the process of adjusting our mental models to accommodate new experiences.

Eastern View of Learning

The western model of learning came in for strong criticism from the spiritual leader, J. Krishnamurti [8]:

In our search for knowledge, in our acquisitive desires, we are losing life, we are blunting the feeling for beauty, the sensitivity to cruelty; we are becoming more and more specialized and less and less integrated. Wisdom cannot be replaced by knowledge, and no amount of explanation, no accumulation of facts, will free man from suffering. Knowledge is necessary, science has its place; but if the mind and heart are suffocated by knowledge, and if the cause of suffering is explained away, life becomes vain and meaningless. And is this not what is happening to most of us? Our education is making us more and more shallow; it is not helping us to uncover the deeper layers of our being, and our lives are increasingly disharmonious and empty. Information, the knowledge of facts, though ever increasing, is by its nature very limited. Wisdom is infinite, it includes knowledge and the way of action; but we take hold of a branch and think it is the whole tree. Through the knowledge of the part, we can never realize the joy of the whole. Intellect can never lead to the whole, for it is only a segment, a part.

Fundamentally, J Krishnamurthy questions the wisdom of de-linking life and learning; the separation of mind and the heart. When we talk of `continuous learning' or a `learning organization' we basically talk about imparting of knowledge and skills for survival and growth of the individual and the organization. There is a clear demarcation between work and personal life. There is no concern for making the personal life more enjoyable or making the person a better person. All that the modern rhetoric tries to do is cultivate the intellect without any concern for the heart and soul of the individual.

Of course, the western model does deserve due recognition for the material benefits it has brought to the masses. The concept of dividing any phenomenon into its components and studying deeply the sub-components has helped the development of modern science. It has also resulted in too many specializations and we have reached a situation where one specialist does not understand what the other says. The western model of `more and more about less and less' has been exploited to the hilt and we need to reintegrate things and learn to study `more and more about more and more'.

If one looks back at the pre-industrial days there was a harmonious existence with the body, mind and the soul integrated into a whole in every activity undertaken by people. While sowing the seeds, the village community organized poojas to invoke the blessings of the Almighty. Similarly in the Gurukula system of education, the emphasis was on a holistic development of the person and not mere skill development.

The holistic approach is becoming a lot more important in the post-industrial era as we need people who can invent the future rather than those who simply create the future that the founder or the owner manager has envisioned for the organization. In the present day situation, the CEO himself is at a loss to understand how the future will unfold itself. What companies need are not conforming slaves but independent partners.

Having understood the need for a holistic approach to learning, let us now turn our attention to the traits of an effective learner. In order to become an effective learner (read as, an emancipated individual) one should follow the instructions given below:

1. Free oneself from conditioning
2. Be aware
3. Become Child-like
4. Have love and compassion
5. Meditate

We shall now see each one in detail.

Freeing from Conditioning

To some extent, western thinkers too have talked about the need for getting out of the conditioning of the mind. However, it is easier said than done. The modern education system is built around the skills needed for the industrial society. For example, when we train someone to become a mechanical engineer, the emphasis is on imparting the necessary knowledge and skills for the job as defined by the industry. This basically kills the spirit of inquiry and instils a scientific orthodoxy in the minds of students. This kind of conditioning starts right from our elementary school curriculum that they eventually lose the power of independent thinking.

The story about a Zen master who asked his disciple to pour water into a cup that was already full must be familiar to many readers. The Zen master did that to show to the disciple that it would not be possible for him to teach the disciple anything until he emptied his cup (mind). The fundamental problem with many of us is that we think that we know everything. Learning starts the day we manage to get out of this conditioning. J Krishnamurthy [9] has the following points about freeing oneself from conditioning.

"How does one free oneself from this conditioning? ...When you observe a tree, between you and the tree there is time and space, isn't there? And there is also the botanical knowledge about it, the distance between you and the tree - which is time - and the separation, which comes through knowledge of the tree. To look at that tree without knowledge, without the time-quality, does not mean identifying yourself with the tree, but to observe the tree so attentively that the boundaries of time don't come into it at all; the boundaries of time come in only when you have knowledge about the tree. Can you look at your wife, or your friend, or whatever it is, without the image? The image is the past, which has been put together by thought, as nagging, bullying, dominating, as pleasure, companionship, and all that. It is the image that separates; it is the image that creates distance and time. Look at that tree, or the flower, the cloud, or the wife or the husband, without the image!".

Now, to look without the observer! You do this when you are completely attentive. Do you know what it means to be attentive? Don't go to school to learn to be attentive! To be attentive means to listen without any interpretation, without any judgment - just to listen. When you are so listening there is no boundary, there is no 'you' listening: there is only a state of listening. So, when you observe your conditioning, the conditioning exists only in the observer, not in the observed. When you look without the observer, without the 'me' - his fears, his anxieties, and all the rest of it - then you will see, you enter into a totally different dimension."

What is conveyed by Krishnamurthy is much more than getting out of the biases. He advocates intent listening and keen observation without ever passing any judgement. This should enable one to transcend the obvious and get the vision of the unknown.

Be Aware

Different people have talked about being aware in different forms. For example, Buddha calls it right mindfulness. According to Osho [10], `Examination is the first step: becoming alert to what passes through your mind. And there is constant traffic--so many thoughts, so many desires, so many dreams are passing by. You have to be watchful; you have to examine each and everything that passes through the mind. Not a single thought should pass unawares, because that means you were asleep. Become more and more observant'.

"When man becomes aware of the movement of his own thoughts, he will see the division between the thinker and thought, the observer and the observed, the experiencer and the experience. He will discover that this division is an illusion. Then only is there pure observation, which is insight without any shadow of the past or of time. This timeless insight brings about a deep, radical mutation in the mind. Total negation is the essence of the positive. When there is negation of all those things that thought has brought about psychologically, only then is there love, which is compassion and intelligence." J Krishnamurthy [11].

It is only when one is totally aware and learns to look inward, a whole new insight unfolds, which incidentally leads to new discoveries too. Additionally the negation of what is known and the obvious that leads to the deeper insight of the new and unknown. In practical terms, a person pursuing studies in a specialized subject, on reaching a certain level of distinction in the chosen field, sometimes gets a feeling that what has been achieved amounts to nothing. It is this negation that launches him/her into a higher orbit and the pursuit of broader and nobler goals. By digging deep into the greater consciousness attained through vigilant awareness, one manages to get a greater vision.

For the mind trained in the traditional scientific methods, it may be difficult to understand the true meaning of what is being conveyed here. In some sense it may appear contrary to the commonsense view of learning. Most readers should be familiar with the famous quotation by Edison that discoveries are 90 percent perspiration and 10 percent inspiration. The arguments so far put forward are not against the 90 percent perspiration; but the emphasis is on the 10 percent inspiration. By digging deep into the inner consciousness one gets that special intuition for which one needs to be fully aware and accept that one is a shunya (zero). For example, Kekkule apparently got the idea for the Benzene Ring in his dreams.

Socrates once said that `learning is only a process of reminding'. When his disciples challenged his assertion, he called his maidservant and made her prove Pythagoras' theorem by just asking her a series of questions. The idea here is not to discount the value of traditional learning but to prove the point that there is a lot of merit in looking inwards.

However the looking inward cannot start up until an individual exhausts all that is externally available in his field of study. A person studying marketing may reach the level of an authority in the field of marketing. However, his knowledge should not make him feel arrogant. If s/he goes deep into the subject, s/he will realize that s/he is shunya (nothing) as business is much more than just marketing. This should launch him into the greater orbit of business strategies. It is this negation and the look inward that helps a person come up with unique and innovative ideas in his/her field of study.

Become child-like

When someone becomes childlike, he/she has no inhibitions; there is no fear of failure and the person becomes inquisitive. Only when someone gives up his/her ego, the real learning begins. What comes in between our learning and us is the highly bloated ego about ourselves. We fail to see many possibilities when our mind is cluttered with our own notion of what is right and wrong. The basic idea expressed here is that learning is possible only when one empties his/her mind.

However it should not be misconstrued that experience is denounced here. Past experiences and knowledge are quite valuable as long as one has an open mind to learn from each new experience. Often times, the past successes turn out to be the root cause for the failure of a person. The reason is that we tend to do more of what brought success to us in the past, until we fail miserably. If one has an open mind, he/she will be able to learn and adapt to the changing circumstances.

Osho [12] defines intelligence as follows: 'Intelligence is just an openness of being - capacity to see without prejudice, to listen without interference, capacity to be with things without any prior ideas about them - that is what intelligence is... All experts are blind. Expertise means you become blind to everything else. You know more and more about less and less, and one day you arrive at the ultimate goal of knowing all about nothing. Then you are completely closed and not even a window is open; then you have become windowless.'

Basically, all of us have our cups filled to some extent. Those who manage to get off the weight of prior knowledge and learn to look at every moment with the inquisitiveness of a child will truly become learned persons. `Fear of failure' and `what others will think' are the two major ills that hinder learning; but do not afflict children.

Another trait of children that could be learnt by adults is their playfulness. Basically one should enjoy what he/she is doing. The joy of doing something in itself leads to a great amount of learning.

Have love and compassion

Most readers must be wondering as to how love and compassion can enhance learning. Interestingly love is the fundamental aspect of learning and life itself. For effective learning, there has to be love between the teacher and the taught and there has to be love for the subject too.

Successful teachers are those who love their students. They go beyond the subject that is being taught and help the students in their holistic personality development. Each one of us can recollect one or two such great souls to whom we feel indebted for life, for giving us the guidance and direction at some crucial juncture. Children tend to like the subjects that are taught by teachers who are lovable.

Many teachers tend to slight the students when they ask questions. Some brush aside the same as silly questions. In reality, there are no silly questions at all. Every question is an important question if the teacher has the patience to understand the full meaning of the question. If there is love, every question will be viewed with compassion and care.

The other major problem is that the present day students tend to have knowledge on wide ranging subjects, thanks to the exposure to TV, Internet etc. This has made life miserable for the traditional teachers as they view teaching as a one-way process. If there is love, then there is a possibility of making it a two-way learning.

Meditate

Apart from concentration and contemplation, Eastern philosophy advocates meditation for greater insights into any subject. Meditation helps one to get out of the routine ways of looking at a problem and unleashes a great amount of creative energies hidden inside an individual.

Often, information is considered as knowledge. People fail to understand that information should be digested by the individual and internalized before it becomes knowledge. That is when one can rediscover the concepts and apply the same to solve problems and exploit opportunities. The matter does not end here. The next step is to critique the acquired knowledge and create new knowledge. Meditation is one of the approaches that greatly aid this knowledge creation process.

Convergence of approaches

The West has developed education as a means for acquiring skills for stipulated jobs. However with rapid changes in the environment, the skill set required for survival are constantly changing. This has led to a debate on the need for continuous learning and also the critical evaluation of the present system of education. Western thinkers like Peter Senge, Chris Argyris and others emphasize the need for adaptive and creative problem solving skills for survival. This is where the West meets the East which has always looked at education as something that makes one a better person rather than simply a means for acquiring skills for making a livelihood. This holistic approach advocates continuous seeking of knowledge and wisdom until death without any prejudice or ego. Apart from knowledge acquisition, one needs to also become a knowledge creator. Every individual is capable of this creative process; all that one needs to do is look inward through some process like meditation. Having understood the ideal type of learning, let us now turn our attention to the current trends in the field of education.

PART - II

The Inertia in Traditional Universities

While there is so much happening in the field of learning, the traditional universities appear to be caught up in a time warp and they are reluctant to change according to the changing times. They continue to believe that the primary purpose of education is to feed their pupils with information. Those who could memorize the concepts and vomit in their examinations are awarded the highest academic honors. They fail to recognize that information by itself is of no use unless it is digested and made into knowledge; knowledge by itself is not of much value unless it is applied to various situations, internalized and used to synthesize new wisdom. Additionally, learning is a continuous process and cannot end with the highest University degrees. The meaning of the black belt given by a master sensei shown in the box aptly illustrates this point. A black belt is not a reward for hard work, nor the highest achievement in the field of martial arts and does not represent the end; but the beginning, the start of a never-ending journey of discipline, work and the pursuit of an ever-higher standard.

The Meaning of Black Belt

A martial art student knelt before a master sensei in a ceremony to receive the hard-earned Black Belt after years of relentless training.
"Before granting you the belt, you must pass one more test," the sensei solemnly told the young man.
"I'm ready," responded the student, expecting perhaps one more round of sparring.
"You must answer the essential question, 'What is the true meaning of the Black Belt?'"
"Why, the end of my journey," said the student. "A well-deserved reward for all of my hard work."
The master waited for more. Clearly, he was not satisfied. The sensei finally spoke: "You are not ready for the Black Belt. Return in one year."
As the student knelt before his master a year later, he was again asked the question, "What is the true meaning of the Black Belt?"
"A symbol of distinction and the highest achievement in our art," the young man responded.
Again the master waited for more. Still unsatisfied, he said once more: "You are not ready for the Black Belt. Return in one year."
A year later the student knelt before his sensei and heard the question, "What is the true meaning of the Black Belt?"
This time he answered, "The Black Belt represents not the end, but the beginning, the start of a never-ending journey of discipline, work and the pursuit of an ever-higher standard."
"Yes," said the master. "You are now ready to receive the Black Belt and begin your work."

The skill set needed for survival in the post-industrial era (information and knowledge era), are dramatically different from that of the Industrial age. The axiom `Information is power' is coming under attack due to the free and instant availability of information, thanks to the internet and other communication devices. What is needed is constant up gradation of skills and the ability to think outside the box and come up with new solutions to old as well as new problems. To fill this void left open by the traditional universities, we see the emergence of virtual universities, corporate universities and a whole host of new institutions.

Current Trends in the field of Education

Distance education is one of the fastest-growing -- and most controversial -- parts of higher education. Indeed, some experts believe that education - much of it delivered via the Web - is set to become the biggest industry in the world. It is estimated that the worldwide spend on education is currently $1.5 trillion and will double in the next five years [13]. Throughout the world, universities are banding together to develop e-learning programmes. Fears have been expressed that online programmes offered by big name institutions could mean that smaller, less prestigious universities, will be wiped out.

To make matters worse, MIT President Charles M. Vest has announced that the Massachusetts Institute of Technology will make the materials for nearly all its courses freely available on the Internet over the next ten years. He made the announcement about the new program, known as MIT OpenCourseWare (MITOCW), at a press conference at MIT on Wednesday, April 4, 2001.

A number of people in the field of education are wondering as to how the concept of Open Course Ware will help MIT. The following are some of the benefits envisaged by MIT.

1. Usage of course material by diverse audience groups will lead to cross fertilization of ideas and development of new concepts. A market researcher as well as a scientist may take up a course on statistical data analysis that in turn will help the course writer to enrich the course with diverse examples.
2. Ideal for interdisciplinary courses - Courses like `Neural Networks for data Mining' will benefit from students from different disciplines in terms of new applications and development of new concepts through cross-fertilization of ideas.
3. By doing it first, a large university like MIT can become the de facto syllabus setter for the whole world. This can be exploited through various ways like franchising education, certifying programmes around the globe and so on
4. Free knowledge will raise the quality of learning - and ultimately, the quality of life - around the globe.

As regards the revenue model, one can think of several revenue streams once they get students enrolled for their open courses. Apart from selling items like books, videos and teaching aids, the ad revenues from makers of related and supporting products, such as computers, stationery suppliers etc. will add to their booty. The large community of learners across the globe, can be formed into different interest groups and in turn can be exploited for other paid programmes of MIT and its partners. MIT can also partner with several franchisees to deliver education around the globe.

In an interesting development, Harvard and Stanford Universities - separated by ideology, distance, and a rivalry that has them competing for students, faculty, and corporate customers- have chalked out plans to combine their executive education into a separate entity that will design and deliver face-to-face and online programmes to companies around the globe. [14].

Apart from these, the following trends are worth considering:

1. Several virtual universities have sprung up over the Internet.
2. With the domination of West in scientific and management education, every university in the West is going global by partnering with institutions around the world and making available the courses online.
3. Some of the universities use satellites to deliver education to remote parts of the world. Media companies themselves are entering education.
4. Several corporate houses are also eyeing the education market. For example, APTEC has tied up with an Institute in Manipal to offer MBA through the net and Satyam has set up a separate division to tap the online education market.

Convergence and Blurring of Boundaries

All these point to the fact that education is big business and is going through a process of consolidation. With IT companies, media companies, large corporate houses and venture capitalists converging in the field of education, we can expect major changes in the structure and functioning of education. Most traditional universities have started offering distance learning programmes, aided by Internet and satellite broadcasting resulting in the blurring of boundaries between traditional universities, open universities and virtual universities as shown in figure 1.

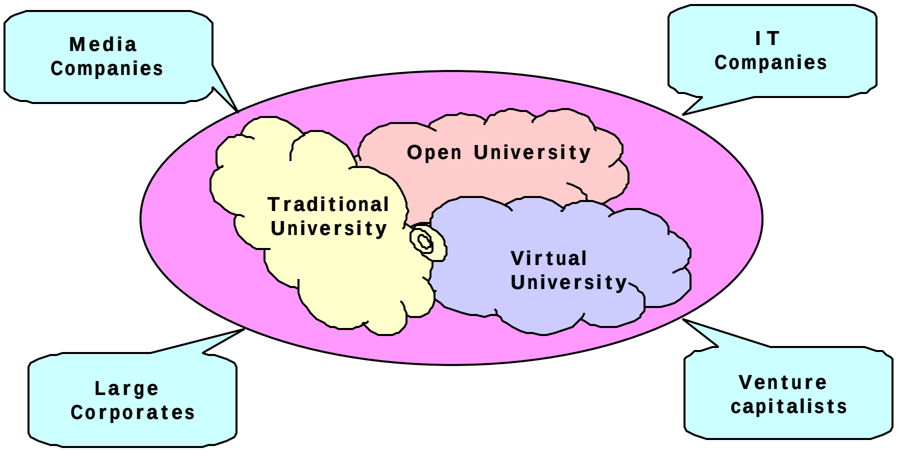

Figure 1: CONVERGENCE AND BLURRING OF BOUNDARIES

Blurring of boundaries can be seen between subjects and specializations. For example, Georgetown University in the U.S. offers a master's programme in physics and management. Stanford University offers projects that involve engineering and MBA students. BITs Pilani has been offering several dual degrees for a number of years.

Additionally, the blurring of boundaries between education, technology and business and the emergence of global universities are likely to render the tradition-bound education systems obsolete. For example, when the Harvard MBA is made available at a reasonable price in India, the question is whether there will be a demand for the local ones.

One of the major problems faced by educational institutions in developing countries, such as India, is the apathy for attracting and retaining good teachers. Any institution is as good as the quality of its teachers or gurus. Harvard Business School is considered the Mecca of management education mainly on account of its ability to attract and retain gurus. How many gurus do we find in India? Unfortunately, the institutions in India have an uncanny knack of ejecting out people with potential. Another way of looking at the same issue is that western universities snatch the potential gurus-notable examples being C.K. Prahalad and Sumantra Ghoshal.

Another reason for the poor quality of education in developing countries is due to the excessive importance given to knowledge dissemination as opposed to knowledge creation. Very few institutions realize that knowledge creation is as important as knowledge dissemination. What new theories in management that academics from developing countries like India have developed? How much importance do we give to research and writing? It is a different matter that evaluation of research output is much more difficult than assessing the quality of teaching. That does not mean that we should not attempt to measure research output. This has led to the creation of a new breed of teachers who are good at repeating western theories.

What will happen to a number of teachers who simply read the western books/materials and vomit the same in the classroom? This question has to be understood in the context where a student has direct access to the same courseware prepared by the guru himself? Consider the situation where a student has the option of choosing between Philip Kotler and a local Professor for a course in marketing. The choice is obvious. When you have direct access to the God, why go through the priests - middlemen? Are we witnessing disintermediation in education too?

In order to understand the underlying reason for these changes we need to go to the concept of learning itself. As discussed in Part - I, the industrial age encouraged learning of uniform skills and conforming behavior as required by the industrial organizations. Our present educational system, which follows fixed curricula, has been designed to meet the needs of the old economy institutions.

With the advent of the information age, the skill mix required has undergone a drastic change. The new economy needs people who retain their individuality and originality and also have the ability to come up with radically new approaches to organizational problems. There is a greater demand for people who are independent thinkers and creative problem solvers. In sum, these are continuous learners who can cope with constant change.

In order to prepare people to face these new challenges, education has to elevate itself from the basic role of providing information and skill building to enhancing one's intellectual capabilities. With the information (knowledge?) made abundantly and freely available on the Internet and self-learning made possible, the role of teachers should be to enable students to rediscover the concepts for themselves.

Given this background, what are the strategic options left for the traditional universities? Fundamentally, only those that offer value to learners will survive. In their current form, they are bound to perish. However there are two ways in which they can offer value. (1) With education getting global, it may be a mutually beneficial approach to tie up with large western universities and become their delivery agents in the local market. (2) Design and offer curricula for the niche markets. While it is going to be difficult to compete with Harvard University for an MBA programme, it should be possible to develop a Management programme for IT professionals or managers from auto industry etc. that reflect the local culture and needs. One can even design management programmes for housewives.

Six I's of Management Education

As far as management education is concerned, the 6I's model of Xavier [15] may be of help in designing a curriculum to meet the local needs.

6 I's of Management Education.

1. Internationalization
2. Interpersonal Skills
3. Integrated Perspective
4. ICT Integration
5. Integrity
6. Individualization

With businesses getting globalized, it is essential that the international perspective get built into the curriculum. Even with automation and computerization, interpersonal skills continue to occupy the center stage in management education. However, many schools tend to neglect this very important aspect. The third major aspect is the need for giving an integrated perspective to students. Business schools continue to teach finance, marketing, personnel and production as separate functions, while in reality the walls between functions are collapsing fast, thanks to the developments in Information and Communication Technologies (ICT). That logically leads us to the importance of integrating ICT in management. Techies who do not understand management and managers who do not speak the IT language will soon perish. The fifth major aspect emphasizes the need for teaching ethical behavior and integrity in business dealings to business students. Individualization, the last I, is discussed in the next section.

Individualization

The order of the day is customization. Cosmetics companies offer customized products to suit individual faces and body complexion. Readymade garments, such as jeans, are custom tailored. Bikinis and brassieres get mass customized by taking into account the asymmetries in individual bodies. Even medicines are custom made. While we advocate customization as a key strategy to business houses, why not introduce the same in business schools?

Individualization of curriculum should go beyond offering few electives to suit individual needs. One possible approach will be to split every course into several sub-modules and allow the students to assemble modules in a fashion most suited to individual needs.

Ideally we should go to the gurukula method where the guru decided on the right course of study and the syllabus for each student. We need to devise expert systems that would assess individual aptitudes and capabilities and advise students on modules ideally suited to each. This is akin to the Lakme Kiosk, which gives make up advice to individuals.

Additionally, Internet offers alternate delivery methods for education and the scope for one-to-one interaction with gurus wherever they may be. More over a single guru can offer instruction to thousands of students. As discussed earlier we can have Philip Kotler offer marketing management to students all over the world or Porter offer the course on Competitive Strategies. Individual students can drop out at different stages depending on their interest and requirement. The advantage of this system of education is that it can extend into the working life too. Someone who is very keen to go deep into competitive strategies may go as deep as he or she wants, subject to the guru's acceptance of the person as a disciple.

Curriculum for the Post-Industrial Era

Basically, all these point to the fact that we are on the verge of rediscovering education for the post-industrial era. All these years the emphasis was on mass-producing management graduates of uniform quality to man the industrial organizations. The post-industrial world (information age) would need managers who think and act differently. They need to be more of right brain people who are creative and find innovative solutions to common problems. Consequently, curriculum for business education should take into account individual capabilities apart from institutional capabilities and industry requirements as shown in Figure 2.

This clearly brings out the fact that enforcement of a uniform syllabus across the world or a country will only be counter-productive. Institutes should take into account the needs of the industries in the region and also the capabilities of their teachers, while developing their curricula.

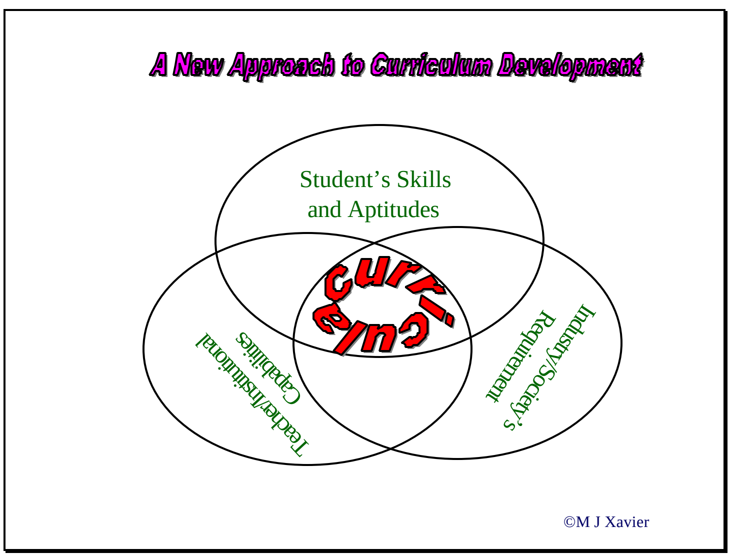

Figure 2: A NEW APPROACH TO CURRICULUM DEVELOPMENT

In this kind of approach, developing countries do stand a chance in the field of management education if they can customize curriculum to the local needs. However the question of building competent faculty still needs to be addressed.

Strategies for traditional teachers

What should the traditional teachers do? Only those who have some insight of their own to offer to the learner, will be in demand. All these days, knowledge creation got relegated to the sidelines with most Indian Universities concentrating on dissemination of knowledge created in the West. With knowledge (information) abundantly available on the Internet, once again knowledge creation is placed at a premium. It is going to be the age of gurus. With people learning to learn on their own, they would approach the gurus with specific problems on hand. Those who have some stuff will get invited to write lessons for the online education portals while others will be left in the lurch.

If a traditional teacher has nothing of her own to offer, the only option left for her will be to become a facilitator in delivering western education. With the rising bandwidth, full motion videos of western gurus will be delivered through the Internet with the local facilitators interpreting them using local examples and anecdotes.

In sum, the field of education is undergoing a major metamorphosis. As education gets into the hands of Broadcasting companies, IT companies, Large Corporate Houses, Virtual Universities, and Open Universities, traditional forms of education will be rendered obsolete. The moot question is, are we ready to face the challenge?

Conclusion

The ever-changing environment throws up opportunities and challenges to individuals and corporates in measures unheard of in the past. The future will be inherited by those who have rapid learning skills coupled with fast forgetting capabilities. Basically, those practices and strategies that gave success in the past also turn out to be the undoing of an individual, as he/she tends to use the same indiscriminately. The story of a man who refused to leave the raft that helped him cross a river aptly illustrates this point. While he is justified in feeling grateful to the raft for helping him to cross the river, there is no need for him to carry it along with him, which turns out to be a burden when he is climbing a mountain. It is the ability of the individual to approach any problem with an open mind and a fresh outlook that will carry him to greater heights.

Educational institutions unfortunately are filled with teachers who leave much to be desired. In the old Guru kula system of education, the guru was seen standing on a pedestal and revered for his wisdom. The gurus themselves strived to produce disciples who would move a step above the gurus themselves. The curriculum was custom designed by the guru for the individual disciple and offered on a one to one basis. The umbilical cord connecting the disciple with the guru lasted for ever. May be there is a lot to learn from those old systems and operationalize those principles and values through the use of technology.

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The influence of the Demographic Characteristics on Adult Education – A Market Segmentation Approach

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Abstract

Many developmental programmes are resource specific and custom-designed to exploit the resource base. Such customization is not even attempted in areas like education. One possible reason is that customization of these programmes depends on the socio-economic and cultural factors and it is difficult to quantify their impact. Hence, the developmental strategies are uniformly applied to different categories of the target population. A market segmentation approach can be used to take these factors into account, in strategizing and customizing the developmental programmes. Such an approach is illustrated using the data from Dharmapuri District in Tamilnadu, which has one of the lowest literacy rates and was selected for the Post Literacy Campaign in 1997. There are significant differences in demographic characteristics of participants in each of the blocks and these differences influence the achievement levels. Many of these characteristics are qualitative in nature and amicable to market segmentation approach.

Introduction

Many developmental programmes initiated by the government are resource specific and usually custom designed to exploit the resource base of the concerned geographical region. For example, all the agricultural programmes are specific to the agro-climatic conditions of the region. Similarly, the irrigation development is based on the surface as well as ground water availability and the industrial strategies are designed to leverage the resource availability as well as the infrastructure facilities. While the government policies are alive to the need to customize the developmental programmes to the resource base in many such cases, such customization is not even attempted in certain areas of development, such as education. Even though it is generally known that the effectiveness of such educational programmes is dependent on the socio-economic and cultural factors of the target population, the operational strategies are rarely customized to suit the characteristics of the target population. One possible reason for the lack of such approach is that the socio-economic and cultural factors are qualitative in nature and it is not easy to quantify their impact on the programme. As a result, the developmental strategies are uniformly applied to different categories of the target population. The influence of such socio-economic and cultural factors can be taken into account in strategizing the developmental programmes through the application of market segmentation approach. This paper attempts to use market segmentation approach to identify the influence of the demographic characteristics on the effectiveness of adult education programme. The adult education programme in Dharmapuri district of Tamilnadu in India is used to illustrate this market segmentation approach.

Profile of Dharmapuri District

Dharmapuri is one of the biggest and most backward districts in Tamilnadu. Majority of the people speak Tamil language. A large number of Telugu, Kannada and Urdu speaking people also live in this District. According to the 1991 census, the district has a population of 24.28 lakhs - 12.51 lakhs Male and 11.78 lakhs Female [4]. As per the 1991 census, total literates are 9.41 lakh persons. Of these 63.7 per cent are Males and 36.3 per cent are Female. More than 45% of the people are agricultural workers. Half of the geographical area of the district is being utilized for crops. Over 65% of the farmers are small and marginal farmers. The district has been set up in 3 revenue divisions namely Dharmapuri, Krishnagiri and Hosur. These divisions are further are divided into 18 Blocks. Figure 1 presents the district map of Dharmapuri district.

Educational Status

Dharmapuri district is lagging far behind in all the fields including literacy. According to 1991 census, the literacy rate in urban areas is 46.2% where as it is only 31% among rural population. As per the records 93% of target learners were enrolled in Total Literacy Campaign out of which 3.55 lakhs were women. About 94% of scheduled caste target learners were also enrolled. The proposal for Post Literacy programme of Dharmapuri District was approved by the National Literacy Mission in January 1997 for a period of two years from February 1997 to January 1999. The programme was completed on 31.1.1999. The budget approved was Rs. 3,67,31,950. Out of this approved budget, the total amount actually received was only Rs. 91,83,000. This amount included the Central share of Rs. 61,22,000 and the State share was Rs. 30,61,000. As per the details of expenditure incurred in the district from February 1997 to January 1999 provided by the District Office, the expenditure incurred was Rs. 1,24,33,546. As per the District Project Office, the excess expenditure was due to the fact that the balance amount from Total Literacy Campaign and the interest accrued from the deposits, have been utilized for Post Literacy Campaign. On the whole, since the District did not receive the entire allocated finances from the Center, the programme suffered from insufficient funds. On account of this, many components of the programme could not be taken up and books and newspapers could not be to be supplied to Libraries.

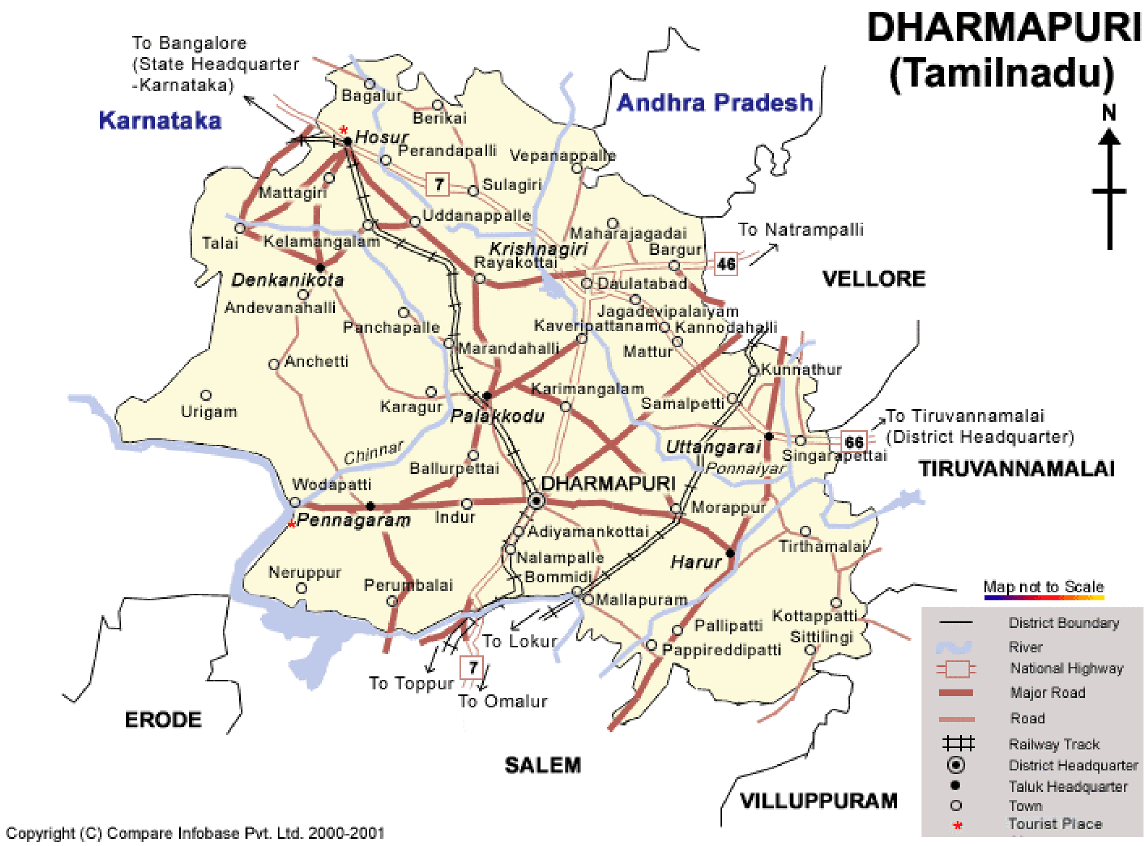

Fig.1: DHARMAPURI DISTRICT

Post Literacy Campaign (PLC) Programme Implementation

The Primers prepared in Tamil and Telugu languages were used in the programme. A two-page weekly supplement, exclusively prepared for the neo-literates, were published in three Tamil Dailies and one Telugu Daily. Special emphasis was given to the women since their literacy levels and empowerment are very important to the society [2,3]. Neo-literate women were organized into groups called "Arivoli Magalir Sangams". Many women self-help groups have been given DWCRA assistance. Many other programmes have been organized like T.B. Detection Camps, dental camps, eye camps, etc, with the active involvement of neo-literates. The small-savings programme of the women's groups has been very successful in this district. Primers 1- 3 were supplied to all learners in the 18 Blocks.

After the implementation of Post Literacy Campaign, the External Evaluation of Dharmapuri District was taken up with the following objectives:

1. Measure the effectiveness of the programme and recommend appropriate policy changes for improving the effectiveness.
2. Measure the learning outcomes vis-à-vis 3 R's of literacy, functionality and awareness components.
3. Identify the impact by gender, age, social group, income level and occupation.

The following methodology was adopted to evaluate the effectiveness of the programme. There were a total of 400 thousand neo-literates included for the post-literacy programme. A two per cent sample of neo-literates was drawn for the purpose of the evaluation. To start with, all the 18 Blocks were included in selecting the sample. The villages within the Blocks were selected based on Simple Random Sampling technique. A simple random sample of neo-literates was drawn, including those who were included at the mopping-up stage and dropouts.

A test was designed to measure the achievement levels of the neo-literates. The test had three areas namely, Writing (with a weightage of 30 per cent); Reading (with a weightage of 40 per cent) and Mathematics (with a weightage of 30 per cent). The testing materials were prepared strictly in accordance with National Literacy Machine [5] Guidelines. The question papers were discussed with the coordinators of the programme to check whether the difficulty level and the language were appropriate. The test materials took into account, the Primers used in the PLC programme. The testing of neo-literates was done in 68 centers spread over the 18 Blocks.

Profile of the sample

The total sample drawn for purposes of conducting the examination was 7000. Out of which the final sample after deleting proxy learners and those absent for the examination was 5986. This sample included 1852 females (30.93%) and 4135 males (69.07%). The age profile indicates a range between 15 years and 46 years. A majority of the sample was in the age group of 16-35 years. A majority of the neo-literates comprising the sample belonged to Other Castes (66.91%) followed by Scheduled Caste (31.69%). The predominant Mother Tongue happens to be Tamil (83.36%). The predominant Religion is Hindu.

The main occupation appears to be laborer (75.48%) and Agriculture (22.55%). The Income ranged from Rs.2000 to Rs.10,000. A majority of the sample falls in the range of Rs.4000-Rs.6000 (32.77%) per annum, followed by Rs.2000 - 4000(27.23%) and Rs.6000-8000 (18.81%).

Achievement levels

The average of the test scores obtained by the students of the adult education programme in each of the blocks of Dharmapuri district are presented in Table 1. The sample size varied from a minimum of 236 in Shoolagiri block to 485 in Bargur. It can be observed from Table 1 that the performance as measured by the total score varied across the 18 blocks with the lowest being 47.84 in Pennagaram to 67.11 in Uthangarai. Pennagaram Block is situated in the Southwestern corner of the district where as Uthangarai is located in the western region of the district, bordering Vellore district. Obviously, there are regional differences in the achievement levels across the 18 blocks.

Table 1: BLOCK WISE AVERAGE TEST SCORES OBTAINED

Sl. No.	Block	Number	Average Score
1	Dharmapuri	419	57.11
2	Nallampalli	374	53.78
3	Morappur	356	51.86
4	Harur	337	57.76
5	Pappireddipatti	287	49.98
6	Pennagaram	356	47.84
7	Karimangalam	354	57.10
8	Palakode	325	53.36
9	Krishnagiri	279	53.91
10	Uthangarai	288	67.11
11	Mathur	277	52.32
12	Veppanapalli	266	55.61
13	Bargur	485	60.05
14	Kaveripattinam	390	62.42
15	Hosur	287	49.50
16	Kelamangalam	317	57.58
17	Thaly	353	60.32
18	Shoolagiri	236	60.86
	Total	5986	56.15

In order to confirm, statistically, that there are significant differences in test scores across different blocks, a comparison between the means was done using ANOVA. The results of the ANOVA are presented in Table 2.

Table 2: ANOVA WITH TEST SCORES AS THE DEPENDENT VARIABLE AND BLOCK AS THE TREATMENT

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	135777.370	17	7986.904	37.784	.000
Within Groups	1261536.188	5968	211.383		
Total	1397313.558	5985			

It is evident from Table 2 that there are very significant differences in achievement levels, as indicated by the test scores, across the blocks, as measured by the test scores as indicated by the large F value. Given that there are such significant differences, which could be attributable to regional differences, it will be interesting to explain these differences through various demographic characteristics (variables) that inherently define the nature of the regional differences. It should be mentioned here that the demographic characteristics that are being discussed are based on the sample data only and not based on either the total population or the census data.

In order to explain the differences in achievement levels across different blocks, the following methodology is adopted. Firstly, all the blocks with similar characteristics as measured by different variables (excluding the test scores) are grouped together to form different clusters. These clusters are formed in such a way that the blocks are homogenous within the cluster, but there are significant differences across clusters. Each cluster can be characterized by a set of features specific to the blocks contained within the cluster. Then, the test scores are included as an additional variable and the entire process of clustering is repeated. If the clustering of the blocks based on different characteristics before and after the inclusion of the test scores remains the same, then it could be concluded that the achievement levels (as measured by the test scores) are not only influenced by these characteristics, but also the level of achievement can be related to the levels of these characteristics.

Clustering of Blocks

The sample drawn from the eighteen blocks that are covered under the study exhibited different demographic characteristics such as the age distribution, income levels, type of occupation, gender and caste differences. Tables 3 and 4 provide the details of these characteristics, Block-wise, which are presented in the following pages:

Table 3: BLOCK WISE CHARACTERISTICS OF THE SAMPLE DATA

TALUK	Average Income (Rs)	Other Caste %	Scheduled Caste %	Scheduled Tribe%	Male %	Female %
Dharmapuri	5102.00	80.34	19.42	.24	34.84	65.16
Nallampalli	3708.10	71.93	28.07	.00	16.58	83.42
Morappur	6024.30	63.20	35.39	1.40	12.08	87.92
Harur	4530.20	43.62	54.01	2.37	39.17	60.83
Pappireddipatti	5430.70	9.76	85.71	4.53	32.06	67.94
Pennagaram	7076.10	80.34	19.66	.00	28.37	71.63
Karimangalam	7019.40	83.29	16.71	.00	22.32	77.68
Palakode	6297.00	83.69	8.92	7.38	21.85	78.15
Krishnagiri	4358.80	65.23	34.77	.00	18.28	81.72
Uthangarai	6468.10	61.81	38.19	.00	31.25	68.75
Mathur	6732.70	71.48	26.35	2.17	20.22	79.78
Veppanapalli	4494.00	69.81	30.19	.00	54.89	45.11
Bargur	7110.10	70.52	28.04	1.44	19.18	80.82
Kaveripattinam	5446.60	83.59	16.41	.00	30.26	69.74
Hosur	6170.20	47.04	52.26	.70	43.21	56.79
Kelamangalam	7442.30	59.62	40.38	.00	47.63	52.37
Thaly	4457.50	62.89	33.43	3.68	48.44	51.56
Shoolagiri	6915.30	81.78	18.22	.00	53.39	46.61

Table 4: BLOCK WISE CHARACTERISTICS OF THE SAMPLE DATA (ALL VALUES IN PERCENTAGES)

	Age Group (Years)					Occupation		Mother Tongue	
TALUK	Less Than 15	16 to 25	26 to 35	36 to 45	More Than 46	Agriculture	Other	Tamil	Other
Dharmapuri	15.98	50.85	25.67	6.78	.73	79.47	20.53	95.23	4.77
Nallampalli	1.87	37.70	46.26	12.57	1.60	100.00	.00	100.00	.00
Morappur	.28	23.38	46.20	27.32	2.82	94.38	5.62	100.00	.00
Harur	2.67	36.20	48.07	10.98	2.08	96.14	3.86	98.22	1.78
Pappireddipatti	2.10	31.82	44.41	19.23	2.45	94.43	5.57	100.00	.00
Pennagaram	5.06	45.22	38.20	9.27	2.25	84.83	15.17	93.26	6.74
Karimangalam	.00	42.66	38.70	14.41	4.24	81.07	18.93	99.44	.56
Palakode	3.38	34.46	45.23	12.92	4.00	68.31	31.69	99.69	.31
Krishnagiri	7.61	41.30	35.87	14.49	.72	69.18	30.82	89.96	10.04
Uthangarai	5.90	53.47	28.13	9.38	3.13	71.53	28.47	96.88	3.13
Mathur	.00	20.22	61.37	14.44	3.97	92.42	7.58	98.19	1.81

	Age Group (Years)					Occupation		Mother Tongue	
TALUK	Less Than 15	16 to 25	26 to 35	36 to 45	More Than 46	Agriculture	Other	Tamil	Other
Veppanapalli	11.70	62.26	22.26	3.77	.00	59.40	40.60	64.29	35.71
Bargur	1.86	28.93	49.79	17.77	1.65	79.38	20.62	88.04	11.96
Kaveripattinam	3.85	45.38	33.33	16.15	1.28	65.13	34.87	97.69	2.31
Hosur	13.24	36.24	37.28	9.06	4.18	69.34	30.66	25.44	74.56
Kelamangalam	1.26	54.26	33.75	8.83	1.89	34.07	65.93	38.80	61.20
Thaly	7.67	47.73	32.67	11.36	.57	55.24	44.76	43.34	56.66
Shoolagiri	12.71	57.20	20.76	8.05	1.27	49.15	50.85	44.92	55.08

Cluster analysis is carried out to group these eighteen blocks into different clusters based on the similarities as well as dissimilarities in terms of different characteristics across blocks. The Squared Euclidian Distances (SED) are used to measure the similarities and dissimilarities [1,6]. If the two blocks namely Nallampalli and Morappur are compared with respect to the age group between 26 to 35 years, as well as the mother tongue, these two blocks are very similar. On the other hand, the same two blocks are not very similar with respect to other age groups and average incomes. The Euclidian Distances are used to measure the similarities or other wise across different characteristics. The difference between each pair of blocks with respect to each characteristic is first calculated and then squared. These squared differences are summed across all characteristics and the number so arrived at, is used as the measure (Squared Euclidian Distance) for similarities or other wise between each and every pair of blocks. All the variables (Characteristics) are standardized before calculating SED in order to eliminate scale and measurement differences. The procedure used for forming the clusters is as follows:

The pair of blocks with minimum value of the SED is grouped together as one cluster. Then this cluster is treated as a single block for further comparison purpose. Other blocks are progressively formed into new clusters or added to the existing clusters. This procedure is followed till all blocks are grouped into one single cluster. In other words, there are 18 clusters (each block is a cluster in itself) to start with and these are progressively reduced to one single cluster by combining each block with another block, or with an existing cluster or by combining existing clusters. The actual process is shown in the following Figure 2. The actual clustering is done using SPSS V10 software provided by SPSS South Asia Pvt. Ltd.

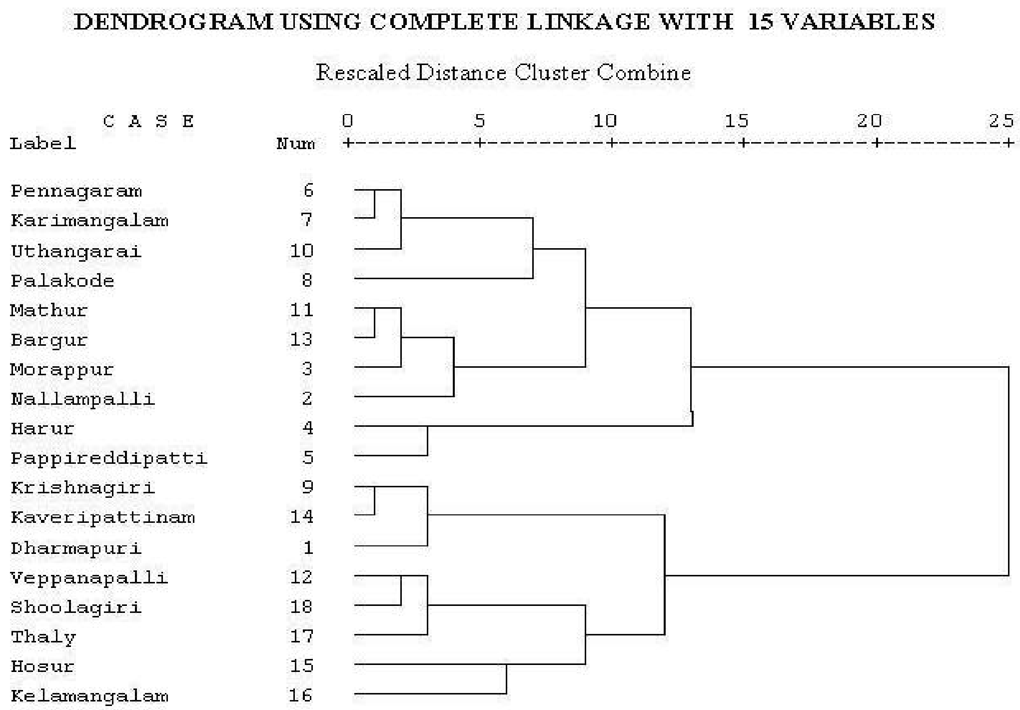

Fig. 2: DENDROGRAM WITH ALL VARIABLES EXCEPT TEST SCORES

It can be seen from Figure 2 that initially, each block is considered as a cluster in itself, thereby forming 18 clusters. Then, as a first step, the two blocks, Pennagaram and Karimangalam are the first ones to be formed to a cluster. In the next step, Krishnagiri and Kaveripattinam are formed into another cluster. The process is repeated till all the blocks are finally formed into one single cluster in the last step. Unfortunately, neither the first step with 18 clusters nor the last step with one single cluster can throw any light on the similarities or dissimilarities of the blocks. For any meaningful analysis it is necessary to have 4-5 clusters. Again, Figure 2 above provides enough information to enable the selection of the required number of clusters. In Figure 2, the scale given on the top is an index of the sum of the SEDs used in clustering. It is evident from the figure that the distances are very small in the initial stages of the clustering process and the distances become larger as the process reaches the final step. The 18 blocks have been reduced to 4 clusters within rescaled distance of about 9 and the distances beyond this point are very large. This indicates that the number of clusters can be around 4. Accordingly, the following 4 clusters have been identified as shown in Table 5.

Table 5: CLUSTERS IDENTIFIED AND THE CORRESPONDING BLOCKS

Cluster No.	Block
1	Dharmapuri, Krishnagiri and Kaveripattinam
2	Nallampalli, Morappur, Pennagaram, Karimangalam, Palakode, Uthangarai, Mathur, Bargur
3	Harur, Pappireddipatti
4	Veppanapalli, Hosur, Kelamangalam, Thaly, Shoolagiri

As mentioned earlier, the clustering of the 18 blocks was done based on the sample data and not based on the population characteristics or by the census data. Nevertheless, it is interesting to note that there is a geographical pattern in the formation of the clusters. All the northern blocks of the district formed into cluster no.4 while the two blocks in the south formed into cluster no. 3. Cluster no.1 primarily consists of the blocks in the center of the district with all the remaining blocks forming into cluster no.2. In order to identify the differentiating features of these clusters, Table 6 presents the average values of different variables corresponding to each of the clusters.

It can be seen from Table 6 that Cluster no. 3 is predominantly characterized by high concentration of scheduled caste and scheduled tribe population and agriculture as the main occupation. Also, it has the highest percentage of people with Tamil as the mother tongue. On the other hand, Cluster no. 4 is characterized by almost an even distribution of male and female population. In addition, it has the lowest percentage of people with Tamil as the mother tongue. The main occupation is divided almost evenly between agriculture and other.

Cluster No. 2 has the highest average income among all the clusters. Also it has the highest proportion of female learners. Cluster No. 1 predominantly consisted of younger group (more than 50 per cent of the people are below 25 years) and also the highest concentration of other castes (consequently, the lowest concentration of scheduled caste and scheduled tribe).

Table 6: AVERAGE VALUES OF DIFFERENT VARIABLES, CLUSTER-WISE

Variable	**Cluster Number**			
	1	2	3	4
Income (Rs.)	4969	6304	4980	5895
Other Caste (%)	76.39	73.28	26.69	64.23
Scheduled Caste (%)	23.53	25.17	69.86	34.90
Scheduled Tribe (%)	0.08	1.55	3.45	.88
Male (%)	27.79	21.48	35.61	49.51
Female%	72.21	78.52	64.39	50.49
Age (Less than 15 Years) %	9.15	2.29	2.38	9.32
Age (16 to 25 Years) %	45.85	35.75	34.01	51.54
Age (26 to 35 Years) %	31.62	44.23	46.24	29.35
Age (36 to 45 Years) %	12.48	14.76	15.10	8.22
Age (More than 46 years) %	.91	2.96	2.26	1.58
Occupation - Agriculture (%)	71.26	83.99	95.28	53.44
Occupation – Non-Agriculture (%)	28.74	16.01	4.72	46.56
Mother Tongue - Tamil (%)	94.29	96.94	99.11	43.36
Mother Tongue - Other (%)	5.71	3.06	.89	56.64

It can be observed from Table 6 that there are certain characteristics unique to each of the clusters. This feature is the very essence of cluster analysis. It identifies the similarities and dissimilarities across different blocks, using as many variables that may appear completely different at the first instance. The blocks with large amount of similarities as measured by the square of the Euclidian distances are grouped into a single cluster and those with large amount of dissimilarities become members of different clusters. Using this property of the cluster analysis, it can, now be tested whether the present clusters remain the same even after adding a new variable namely the achievement score, in addition to the existing variable. If the clusters remain the same, it provides enough evidence that differences in achievement scores are integral part of the characteristics that govern the formation of the clusters of similar blocks.

New Clustering of the Blocks

The clustering process is repeated with the sixteen variables (the same fifteen variables as before and achievement scores as the sixteenth variable). The dendrogram resulting from this clustering process is presented in Figure 3.

DENDROGRAM USING COMPLETE LINKAGE WITH 16 VARIABLES

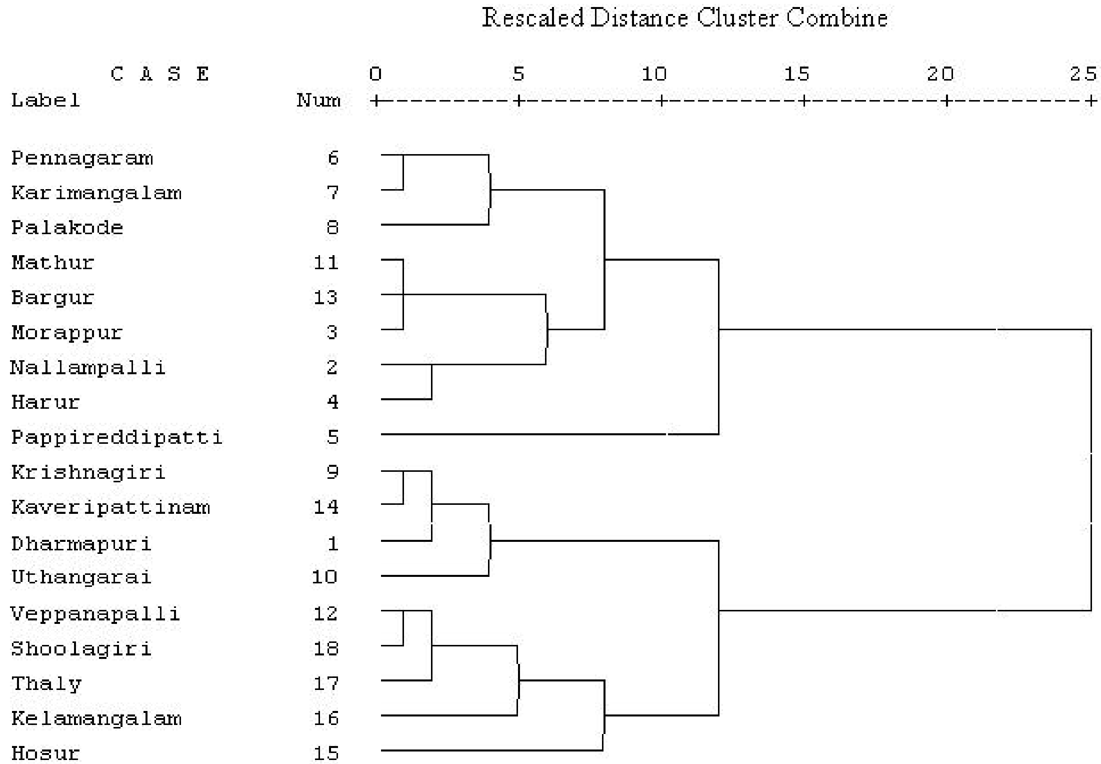

Fig. 3: DENDROGRAM WITH ALL VARIABLES INCLUDING TEST SCORES

It can be seen from Figure 3 that four clusters can be identified within a rescaled distance of 9. It can also be seen that the distances between clusters beyond this point are very large. Again, it is obvious that 4 clusters are indicated. Accordingly, the following 4 clusters as shown in Table 7 are identified. An examination of Figures 2 and 3 reveals that the clustering process was exactly same. In addition, the four clusters formed with all the sixteen variables are same as those formed earlier, except two changes. The Pappireddipatti Block alone formed a cluster in the new set of clusters where as it was combined with Harur in the earlier set of clusters. Harur Block became a part of the second cluster that was formed earlier along with other 7 blocks. At the same time, Uthangarai Block became part of the first cluster, where as it was part of the second cluster in the earlier case.

Table 7: CLUSTERS IDENTIFIED AND THE CORRESPONDING BLOCKS AFTER THE INCLUSION OF ACHIEVEMENT SCORES

Cluster No. (with Achievement Score)	**Block**
1	Dharmapuri, Krishnagiri, Kaveripattinam, Uthangarai
2	Nallampalli, Morappur, Pennagaram, Karimangalam, Palakode, Mathur, Bargur, Harur
3	Pappireddipatti
4	Veppanapalli, Hosur, Kelamangalam, Thaly, Shoolagiri

The fact that the composition of the four clusters remained more or less the same, before and after the inclusion of the test scores among the variables used for clustering process indicates that there is a strong linkage between the test scores and the other demographic characteristics of the blocks. An analysis of the test scores along with the other characteristics will help in identifying the variables that promote or inhibit the success of adult education programmes and help in formulating appropriate strategies to suit different segments of the target population.

Table 8 presents the average values of all the variables used for clustering the blocks. These values are presented cluster-wise based on the clusters presented in the following Table 7.

Table 8: AVERAGE VALUES OF DIFFERENT VARIABLES, CLUSTER WISE

Variable	**Cluster Number**			
	1	2	3	4
Income (Rs.)	5343	6062	5430	5895
Other Caste (%)	72.74	71.01	9.76	64.23
Scheduled Caste (%)	27.20	27.15	85.71	34.90
Scheduled Tribe (%)	.06	1.85	4.53	.88
Male (%)	28.66	22.47	32.06	49.51
Female%	71.34	77.53	67.94	50.49
Age (Less than 15 Years) %	8.33	1.89	2.10	9.32
Age (16 to 25 Years) %	47.75	33.60	31.82	51.54
Age (26 to 35 Years) %	30.75	46.73	44.41	29.35
Age (36 to 45 Years) %	11.70	14.96	19.23	8.22
Age (More than 46 years) %	1.46	2.83	2.45	1.58
Occupation - Agriculture (%)	71.33	87.07	94.43	53.44
Occupation – Non-Agriculture (%)	28.67	12.93	5.57	46.56
Mother Tongue - Tamil (%)	94.94	97.11	100.00	43.36
Mother Tongue - Other (%)	5.06	2.89	.00	56.64
Test Score	60.14	54.26	49.98	56.77

It can be seen from the above table that the average test scores varied across the clusters with a minimum of 49.98 in Cluster 3 to a maximum of 60.14 in Cluster 1. In order to confirm whether the test scores are significantly different across clusters, comparison of means is carried out using ANOVA. The results of the ANOVA are presented in the following Table 9.

Table 9: ANOVA WITH ACHIEVEMENT SCORE AS THE DEPENDENT VARIABLE AND CLUSTER AS THE TREATMENT

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	8978.005	3	2992.668	12.895	.000
Within Groups	1388335.554	5982	232.086		
Total	1397313.558	5985			

The ANOVA table shows that the average test scores are significantly different across the clusters. Cluster 1 has the highest average test score among all the clusters. The next highest score is with respect to cluster 4. One of distinguishing characteristics of these two clusters is the predominance of younger age group of the students. Also, the percentage of people with agriculture as the primary occupation is lower in these two clusters. On the other hand, cluster 3 (which consists of only one block, namely Pappireddipatti is predominantly agriculture oriented with 100 percent of the sample engaged in agriculture and the age distribution is slightly towards the older group. A possible conclusion is that the effectiveness of the adult education programme can be improved if the people are enrolled at a younger age. Similarly, blocks with agriculture as a predominant occupation appear to perform lower on the test scores. It is possible that people with agriculture as the main occupation do not readily see the importance of adult education and hence may not be concentrating on the learning activities. Obviously, there is a need to evolve a different strategy for this group of learners.

Cluster 3 has the second highest average test score and the distinguishing features of this cluster are high percentage of female learners, even distribution of agriculture and non-agriculture as the primary occupation and lowest percentage of people having Tamil as the mother tongue. Considering that the medium of instruction was Tamil and that the test was also conducted in Tamil, one possible conclusion is that these people are highly motivated to learn Tamil, especially it being the official language of the state. It could be more so because occupation of non-agricultural nature requires higher levels of functional literacy in the official language.

It is worthwhile mentioning again here that the Uthangarai block shifted from Cluster 2 to Cluster 1, when the test scores are included in the variables for clustering. In the process, the average income level of cluster 1 has increased as also the percentage of other castes. Noting that Cluster 1 has the highest average test score, it could be possible that income and the caste variables do play a role in the effectiveness of adult education programmes. This can be further corroborated by the fact that Harur block shifted fro Cluster 3 to Cluster 2. The percentage of other castes is very high in Harur block as compared to Pappireddipatti block (which alone remained in Cluster 3, after the shift).

In conclusion, it can be seen that the demographic characteristics such as age, income, occupation, mother tongue and the caste composition do play a role in the effectiveness of adult education programmes. It is also evident that the inter play of these characteristics is as important in the effectiveness.

Summary and Conclusions

The government programmes such as adult education and complete literacy programmes need to be specific to the socio-economic and cultural characteristics of the target population, just like any other developmental projects designed to suit the specific resource endowment. Even though there appears to be clear awareness of this requirement, the programmes do follow a general uniform approach across different segments of the target population. This probably owes to the fact that the qualitative nature of these characteristics is not amicable to quantitative measurement of their effects on the achievement levels of the programme. Under such circumstances, a different approach borrowed from marketing literature can be effectively used to segment the target population based on their socio-economic and cultural characteristics and the resultant impact on the effectiveness of the developmental programmes. This will enable the policy makers to design specific strategies to leverage the socio-economic and cultural characteristics and derive maximum possible benefit from these programmes.

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Section 4

MNCs, Mrgers & Acquisitions, Financial Markets & Entrepreneurship

A Sustainable Entrepreneur Creation Model: A Case Study Of A Regional Development Program

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Abstract

This paper begins by describing the model for entrepreneurship development, which has been developed by consultants/trainers from the Universiti Utara Malaysia (UUM). The components of the model were then discussed. As this model has been tested over a period of 2 ½ years, a substantial amount of data have been collected, analyzed and presented. A number of implementation issues have also been identified and discussed. The paper concludes by highlighting the significance of this model for entrepreneurship development.

The Model

This paper discusses a case study of an entrepreneurship development programme designed for a regional development agency (The Agency) involved in socio-economic development in one of the states in Malaysia. The Agency's functions include developing, fostering, planning and initiating efforts and activities in property development, agricultural, industrial and commercial sectors in its area. It is also responsible for the overall monitoring and coordinating the implementation of development efforts in the area.

The main development theme lies in improving the livelihood of residents in the area; to eradicate poverty and for the residents to become self-sustaining without continued assistance from the government or other external sources.

The main objective of this approach to entrepreneur development is to create successful entrepreneurs who possess the capability for sustained growth. They in turn may be able to create job opportunities, generate income for the local community, contribute towards the eradication of poverty and a balanced economic growth, overall area development, encourage immigration into and discouraging emigration from the Agency's region. Furthermore, one of the expected results of this program is to improve the standard of living of the local community.

The Approach To Entrepreneurship Development

This is a continuous approach, which is implemented through a comprehensive concept involving a number of phases, which are progressive in nature.

The phases are divided into four distinct levels, which are designated as KS1, KS2, KS3 and KS4. A comprehensive and continuous action plan was designed to identify, guide and ultimately create successful entrepreneurs. The definitions of the term entrepreneurs varies according to the specified levels in the entrepreneur cycle.

Definition Of Entrepreneurs

A dynamic, and not static definition for the term "entrepreneur" has been specifically adopted for the implementation of this program. This approach in definition has been taken, as the process of developing entrepreneurs is a progressive in nature. As such, it is a more programmatic approach that allows participants in the program be given guidance and support at the appropriate levels in the entrepreneurship life cycle.

The definition for entrepreneurs in The Agency's region is as follows:

"At the start up stage, an entrepreneur is defined as one who has succeeded in starting a new business venture.

At this level, the entrepreneur is a person who is able to realize a new product, a new idea or a new innovation using various business vehicles. At the growth stage, the entrepreneur is defined as one who has successfully harnessed resources, evaluated the risks and exploited existing opportunities while avoiding threats in order to develop a business venture. This person would possess qualities such being motivated, disciplined, committed, trustworthy, and confident and forward looking. This entrepreneur would be driven to deepen his knowledge in areas related to entrepreneurship, management and technical skills.

During the mature or developed stage, the entrepreneur is defined as one who has succeeded in creating jobs, provided services and generated income, creating spin-offs and increasing the socio-economic standing of his community.

The Action Plan Model

Basically, this model consists of five main elements that make up the process. These elements are entrepreneurial vision, starting up, creation of a sustainable venture, which is also a way of life, entrepreneurship strategy and the tools, skills and entrepreneurship ability. All these elements function within the socio-economic environment (please refer to Figure 1).

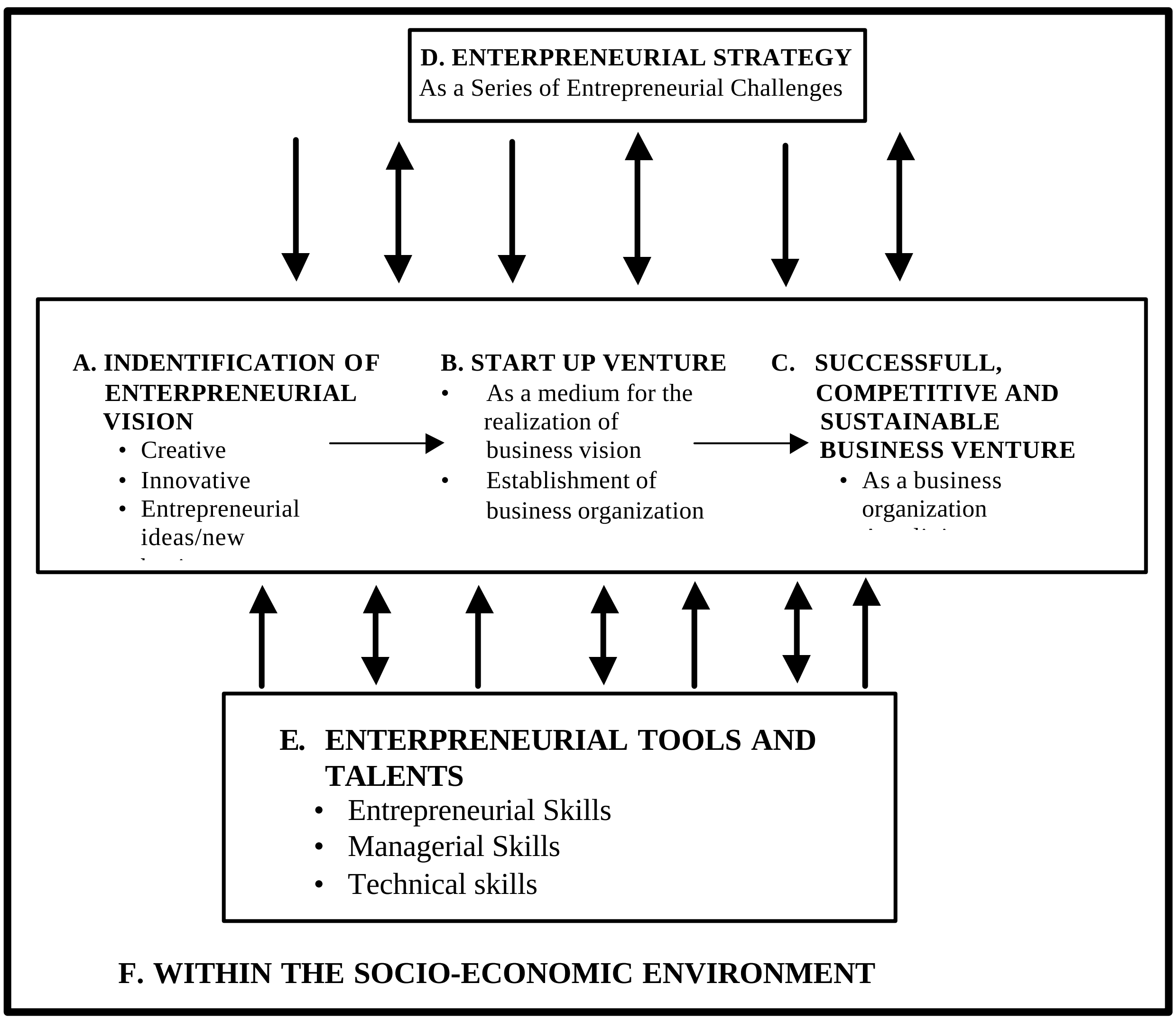


Fig.1 ENTERPRENEURIAL DEVELOPMENT ACTION PLAN FOR THE AGENCY

Entrepreneurial vision in the entrepreneur development process includes creativity and innovative ideas for new products, new services or new processes.

This vision can be translated into a new industrial or commercial activity through a creation of a venture as a vehicle for realizing the vision. With the establishment of this venture, the entrepreneur can commence operation. This is the start-up or take-off stage. From start up, the entrepreneur would advance towards the growth stage of the entrepreneurship cycle and then on to the maturity stage.

At this point, entrepreneur's business operation will be regarded as a system whose existence requires continuing attention, support, and provision of knowledge, tools and skills at each level of development.

As such, The Agency needs to devise policies and strategies while acting as a supporting agency to facilitate the development of entrepreneurs under this program. This can be achieved through making available the infrastructure, technological resources as well as training and consultation. The Agency, through their officers, need to develop training capabilities to function as trainers of entrepreneurs under this program. The entrepreneurs, too, need to prepare themselves with the appropriate knowledge, tools and skills especially those pertaining to entrepreneurship, management and technical skills.

Model Building

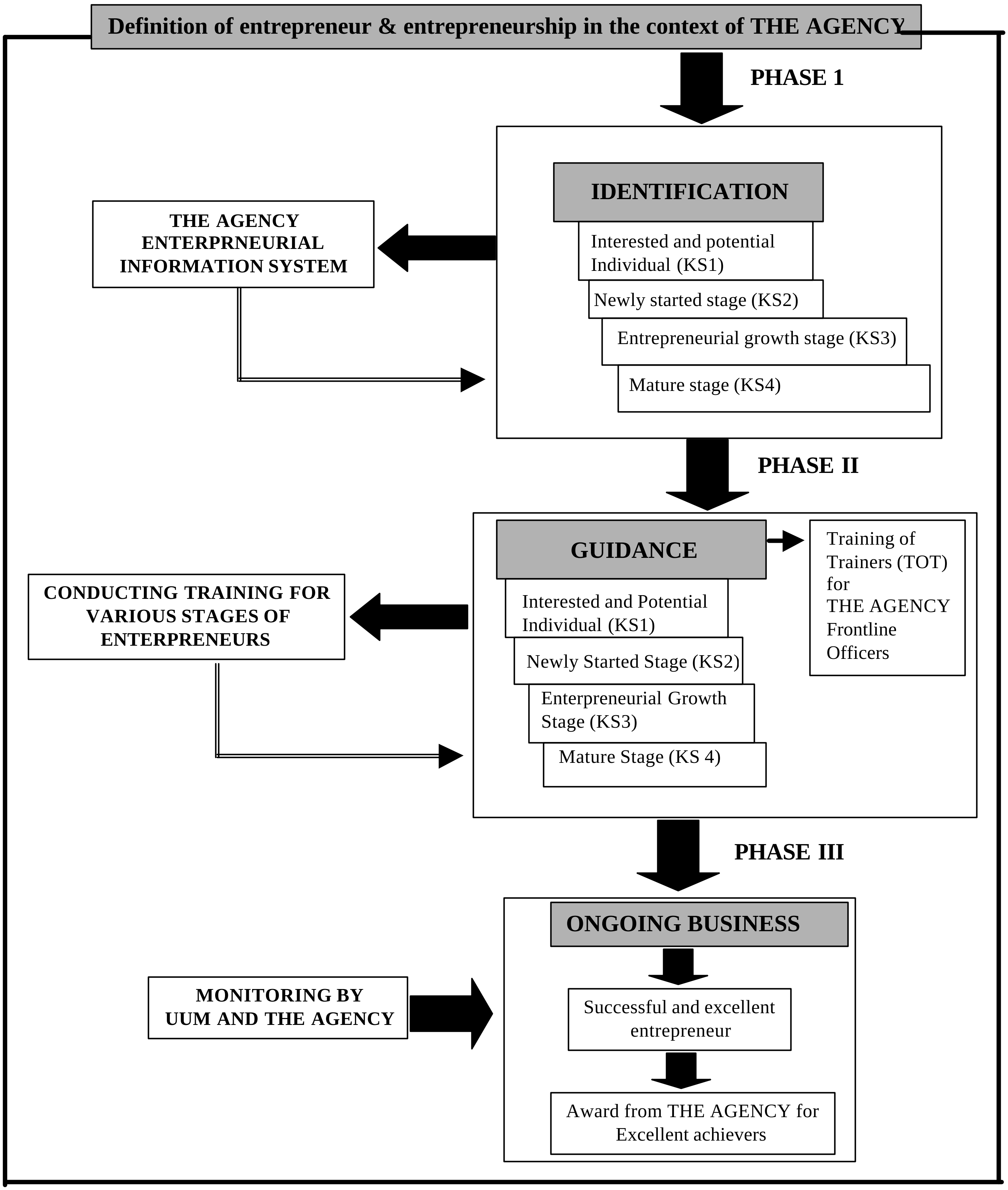
To strengthen the entrepreneurship development efforts, an expert group has been formed comprising of UUM consultants and The Agency's officers. This group will conduct short-term and long-term research/consultancy. Their task lies in identifying specific programs, the participants and the impact of those programs. Other tasks include evaluation and monitoring of entrepreneurship programs and to enhance their impact. The researcher/consultant will collect and analyze data from which forecasts can be made and proposals forwarded to the program technical committee, which is chaired by the Chief Executive Officer of The Agency. The other major responsibility of the consultants involves making on-going assessments on the performance of each entrepreneur who participates in the program.

The consultants have set up the criteria for the selection of entrepreneurs who could qualify for the Annual Successful Entrepreneurs Award by The Agency. This award is designed to inculcate an entrepreneurship culture amongst the local community.

As it was designed by taking into consideration the entrepreneurship life cycle and its stages, the program is divided into three distinct phases: identification, guidance and venture creation (please refer to Figure 2).

These phases involve the development of an entrepreneur development information system and the entrepreneurship-training program. The consultants will make specific proposals for each phase based on the available data and analysis.

Fig.2 FLOWCHART FOR THE PLAN OF ACTIONS THE AGENCY
ENTERPRENEURIAL DEVELOPMENT PROGRAM



The Identification Phase And The Agency Entrepreneur Information System (The Smu)

This phase involves identifying individuals with the potential to succeed as entrepreneurs. The individuals who have never been in business but have the interest, vision and creativity or with ideas capable of further development.

Another group of candidates, who can and has been identified by the SMU, would be those who have been in business or own their businesses and have the potential for further development.

For these purposes, a databased information system named "Sistem Maklumat Usahawan (SMU)" or the Entrepreneur Information System has been developed. The characteristics of the SMU are as follows:

1. Contains the types of information to be incorporated based existing reports and research findings.
2. A "smart" which is able to filter and select candidates based on pre-determined criteria. It can also perform analysis on the data and prepare regular statistical reports.
3. With these characteristics, the SMU is able to perform the following functions:
   - 3.1 To maintain a database and information on Entrepreneurs in the Agency's region.
   - 3.2 To retain progress reports on entrepreneur candidates for future reference and assistance to the entrepreneur.
   - 3.3 Keeping track of the investment by each entrepreneur.
   - 3.4 To conduct regular analysis on the performance of the program itself.
   - 3.5 To select potential winners of the Agency Successful Entrepreneur Award to be implemented in the final phases.
   - 3.6 To prepare performance reports and statistics for use by The Agency's and others.
   - 3.7 To link the Agency's SMU through the internet with other systems relating to entrepreneurship such as those its sister agencies at the Ministry for Rural Development, Ministry for Entrepreneur Development and other government agencies, suppliers, customers, funding institutions and related industries.

The consultants jointly with the Agency's officers designed and developed the questionnaire for the data collection undertaking. Data collection commenced in March 1999 and is an on-going activity. Data collection is undertaken by the Agency's officers. To date about 1000 questionnaires have been returned and of this number 970 have be successfully incorporated as data into the SMU. A small number were incomplete and needed to be reviewed. The SMU is now capable of recording, sorting and reporting information relating to the Agency's entrepreneur candidates based on the data captured in the questionnaire.

A user's named was constructed to facilitate the use of the SMU. A series of training sessions were conducted to train four of the Agency's staff on the use of the SMU.

The Guidance Phase And The Entrepreneur Training Program

The program was launched with an entrepreneur/business appreciation seminar (the KSH series) where there were 37 participants. Please refer to Table 1, which lists the stage of development, the number of participants, new gender, education and the business sector in which they are operating.

Table 1: PROFILE OF PARTICIPANTS IN THE KETENGAH ENTREPRENEURS DEVELOPMENT PROGRAM

Stage of Development	**Number of Participants**	**Gender**		**Education**		**Business sector**	
KSH	37	Male	31	Primary school =	3	Retail	6
				Secondary school =	26	Manufacturing	6
				Other =	3	Food	3
						Service	17
					32		32
		Female	6	Primary school	1	Retail	
				Secondary school	4	Manufacturing	
				Other		Food	2
						Service	1
					5	Other	3
KS 1	84	Male	59	Primary school =	19	Retail	4
				Secondary school =	12	Manufacturing	3
				Other =	6	Food	5
						Service	8
					38		30
		Female	25	Primary school =	2	Retail	3
				Secondary school =	3	Manufacturing	
				Other =	2	Food	1
						Service	2
					7		6
KS 2	47	Male	33	Primary school =	1	Retail	17
				Secondary school =	14	Manufacturing	7
				Other =	2	Food	1
						Service	6
					17		31
		Female	14	Primary school =	1	Retail	2
				Secondary school =	2	Manufacturing	
				Other		Food	1
						Service	
					3		3
KS 3	16	Male	13	Primary school =	1	Retail	2
				Secondary school =	7	Manufacturing	
				Other =	1	Food	1
						Service	
					9		3
		Female	3	Primary school		Retail	2
				Secondary school =	1	Manufacturing	
				Other		Food	1
						Service	
					1		3

KSH = General Target Group
KS 1 = Those who are interested in business, have new product, or those who are in innovative and creative
KS 2 = Those who are at the business start up stage
KS 3 = Those who, re in the growth and development stage for their business

A number of entrepreneurs have been identified for the program. They have been given guidance through a series of formal theory-based training in accordance to the levels within the entrepreneurship cycle the candidates are in followed by visits to their business premises by the consultants.

The levels are divided into four sections according to designated target groups (please refer to Figure 2).

KSH consists of who are interested an alternative occupation.

KS1 consists of those who are interested to venture into a business, have new ideas, have new products or those who are innovative and creative.

KS2 consists of those who are at the business start up stage.

KS3 consists of those whose are in the growth and development stage.

KS4 consists those whose businesses are at the mature or advanced stage.

It is anticipated that amongst the candidates selected there will be those who are already able to proceed directly to the more advanced levels of training (i.e. KS3 or KS4) based on their previous experience or current involvement in business. Candidates for higher-level training can also be chosen subsequent to their participation and satisfactory performance in the lower levels of training provided (i.e. KS1 and KS2).

The Entrepreneur Development Institute, UUM has developed and provided a number of suitable programs and training modules. These programs and modules may also be designed from feedback received at each level. For instance, at the KS1 level, training modules would include motivation, basic management, business decision-making, identification of business opportunities and exposure and assessing business support systems. At the KS2 and KS3 levels the candidates have been given training to enhance their management skills in areas such as human resource management, financial management, accounting, inventory management, operations management and marketing management.

The KSH series is a one-off preliminary/introductory program. The KS1 series has been conducted three (3) times. 84 participants were involved together with a number of the Agency's officers as understudies. The third KS1 program was conducted by the Agency's officers under the supervision of the consultants. The KS2 series were conducted twice with a total of 47 participants. The second program was conducted jointly with The Agency's officers. The KS3 series, which targets the group at the growth phase, has been conducted once with 16 participants. There were 184 participants for the all series conducted so far including those from the lower levels (KS1) moving to more advanced level (KS3), The Agency's trainers, and those who join at the higher level without having to go through the lower levels. The Table 2 describes the courses, the years in which they were conducted and the participants.

Table 2: THE KS SERIES OF DEVELOPMENT

Series	Number of participants			Total
	1998	1999	2000	
KSH	37	-	-	37
KS 1	-	54	30	84
KS 2	-	-	47	47
KS 3	-	-	16	16
				184

Technical training was also provided when needed, especially for those who are involved in manufacturing and processing activities. Training in other areas such as in franchising, vendor development or sub-contracting is also being planned

Training modules have also been tailored towards business sectors in which the entrepreneur is active. The retailing, services, manufacturing, the agro based especially those with higher value added such as packaging, distribution, warehousing and processing, franchising and manufacturing sectors are some of the business sectors identified.

During this phase, visits are made to the business premises to observe their operations and application of theory such as in keeping accounts, marketing and inventory management. The consultants then provide feedback on their performance especially on the areas in which they could improve on. A total of 21 business premises were visited. These businesses were run by participants from the KS2 and KS3 levels. They are in the food, services, retailing and manufacturing sectors please refers to Table 3.

Table 3: BUSINESS MONITORING ACTIVITIES

Series of Development	**Number of Participants**	**Business Sector**	**Total**
KS 2	10	Retail Manufacturing Food Service	3 1 2 4 10
KS 3	11	Retail Manufacturing Food Service	2 1 3 5 11
Total	21		

The Venture Creation Phase

The participants in this phase are those entrepreneurs who have been able to operate their businesses successfully. They can now be nominated for the Agency's Successful Entrepreneur Award.

The criteria for winners are based on their venture performance and their contribution to the economic development to the region. Venture performance measure is based on change sales volume which represents overall growth of the business (Acklesberg and Arlow, 1985, Miller and Toulouse, 1986, Venkatram and Ramanujam, 1985, and Desai, 1990, 1991); gross margin which represents management control over pricing and cost of goods sold (Boyle and Desai, 1990, 1991); profits which represent the ultimate outcome measure (Acklesberg and Arlow, 1985, Miller and Toulouse, 1986, Venkatram and Ramanujam, 1985, and Desai, 1990, 1991); and cash flow which collectively represents management of revenue and expenditures (Acklesberg and Arlow, 1985, Boyle and Desai, 1990, 1991). The number of entrepreneurs and criteria for the Award will be determined from data on the target groups.

The Training Of Trainers (Tot) Program

This program is intended run under the supervision of UUM trainers for three years only. After that period, the Agency's own training officers themselves will conduct the training program to ensure continuity of this program for entrepreneur development. The trainers will themselves require training to prepare them to perform the role which is presently undertaken by the UUM trainers. A training of trainers (TOT) program has been designed and implemented. Suitable officers from amongst the Agency's staff have been selected for training as trainers and program supervisors for the target groups mentioned earlier.

The aims of the TOT program are to:

1. Create an awareness of the level of knowledge that need to be acquired for those who want to become effective trainers;
2. Expose trainers to new approaches in training and supervision;
3. Enhance their problem solving and counseling skills.
4. Transfer to The Agency's essential training/mentoring skills to ensure the continuity of the program.
5. The trainers who participated in the TOT program will be required to attend all the courses at the guidance phase. They were required to sit for a psychometric profile test to ensure their suitability as trainers.

Three workshops have been conducted for the Agency's Trainers. The first workshop (held over 3 days) seek to expose them to the concept of work groups and to prepare themselves as trainers. There were 26 participants (please refer to Table 4).

Table 4 : PROFILE OF TRAINING OF TRAINERS PARTICIPANTS FOR THE FIRST WORKSHOP

	Gender		Position held	Total
	Male	22	Assistant Director	11
	Female	4	Admin officer	5
			Assistant Admin officer	10
		26		26

During the second workshop (held over 2 days), 15 trainers were given detailed briefing on the concept and operation of the SMU. While the third workshop (held over 2 days) was on business counseling where the 15 participants were introduced to the various techniques on counseling for entrepreneurs. Their academic qualification ranges from high school diplomas to diplomas and basic degrees from universities. Their positions in The Agency ranges from Assistant Administrative Officer to Administrative Officer and Assistant Director.

Some Implementation Issues

1) The definition of entrepreneurs has to be placed in the context of the Agency's region where business are at the micro level and the market and purchasing power is rather weak.
2) The entrepreneurs lacked specialized skills.
3) Those who have the potential to be developed as successful entrepreneurs often lack financial resources.
4) Many of these entrepreneurs who are potentially successful are able to assimilate the knowledge given during the training especially in IT and accounting.
5) Many of the Agency's trainers lacked basic skills and experience in entrepreneurship/business development. They are also burdened by other duties in The Agency.
6) Although the SMU has been installed, its utilization needs to be enhanced.

The Agency's Entrepreneur Development Program is a comprehensive and continuous process. It is intended for this program to generate a number of entrepreneurs through sustainable ventures. The underlying principle here is that "entrepreneurs can be developed and are not born naturally".

Concluding Remarks

A number of benefits can be derived by the Agency's communities as a consequence of the creation of sustainable entrepreneurs and entrepreneurial culture. These benefits include:

1. Increased job opportunities
2. Income generation
3. A significant step towards eradication of poverty
4. A balanced economic development
5. Contribution to overall regional development
6. Improved living conditions
7. Positive multipliers effect or spin-off effect for related business activities.

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Case Analysis of Indian Mergers and Acquisitions

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Abstract

It is consolidation time in India Inc. Mergers and acquisitions (M&A) are getting more frequent and bigger by the day. Driven by the desire for enhanced values (which may accrue from one of three sources - cost synergy, value synergy or growth synergy), companies are looking at M&A as one sure way to attain corporate nirvana.
The Paper analyzes 6 major deals in the Indian industry based on their mode of finance. These deals have been analyzed on 4 Parameters: Target Characteristics of the acquired company, Buyer's Financial Position, Structure of the deal, Market Reaction to the deal.

Based on the study, a framework for choosing the mode of finance has been developed. A model (Grand Strategy Matrix based on the market growth in which a company operates and its competitive position) has been developed as to decide which strategy to implement to maximize gain from M&A activity.

The deals

1. Acquisition funded by leveraging (*Gujarat Ambuja Cement Ltd. acquiring stake in ACC)*
2. All cash deal *(Acquisition of Indal by Hindalco)*
3. Merger with share swap *(Times Bank and HDFC Bank)*
4. Leveraged buyout *(Tata Tea's acquisition of Tetley)*
5. Acquisition funded by issue of GDRs/ADRs *(Satyam Infoway's acquisition of IndiaWorld)*
6. Acquisition funded by various means *(India Cement's acquisition of Raasi Cement)*

Case 1: Acquisition funded by leveraging

The deal

Gujarat Ambuja Cement Ltd. took a 7.2% stake in ACC for Rs. 455 crore (Jan 2000). GACL took an additional 4.1 % in ACC for Rs 259 crore (May 2000).

This deal followed GACL's acquisition of 75% in DLF Cements (including a 20% open offer) for Rs 350 crore. GACL's new status as co-promoter of ACC has given the combined force immediate control of around 20 million tons of cement capacity, out of the country's around 100 million tons. The combined output will rise further following the completion of ACC's ongoing expansion program

Advisor

JM Morgan Stanley advised Ambuja on both deals. The financial adviser for ACC was Bank of America.

Target characteristics

ACC has been in the cement business for many years. Over the years, it has built up a really strong brand, distribution network, and manufacturing facilities.

Buyer's financial position

GACL had a D/E ratio of 1:1 and it had a PAT of Rs 150 crore on sales worth Rs 1060 crore in '98-'99. Of this, the cash profits were Rs 273 crore. The company recently doubled its equity base to Rs 147.16 crore following its 1:1 bonus issue.

Structure of the deal

GACL bought out the 11.3 % stake in ACC at a price of Rs 370, a premium of 49 % over the ruling price of Rs 248.25.

Being unable to dilute equity, the company was forced to take an innovative route. The stake in ACC was transferred to a wholly owned subsidiary - Ambuja Cement India Ltd. (ACIL) and so was the debt raised to fund the acquisition. For the debt, corporate guarantee was given by the holding company - Gujarat Ambuja.

After this, Gujarat Ambuja's entire stake in the 93 per cent owned subsidiary was transferred at Rs 25 per share to the wholly owned subsidiary-ACIL. Thus, Ambuja booked the pre-tax profit of Rs 249 crore by transferring the stake to a wholly owned subsidiary. Also transferred to the subsidiary was the 2 mtpa cement unit being set up in Andhra Pradesh.

After that, 40 per cent stake in the subsidiary was offered to FIIs for a consideration of Rs 372 crore. GACL has the option of raising up to $200 million (Rs 870 crore) through issue of Global Depository Receipts (GDR) or American Depositary Receipts (ADR) to part-fund the buyouts.

In case GACL decides to raise its full quota of $200 million through equity dilution, the company's earnings per share will dip by around 15-16 per cent. But given the company's track record and the fact that investors in its Euro convertible bond offering have reaped significant gains upon converting into equity, GACL should be in a position to raise equity at close to the market price.

The other option was to fund the deal by debt. Post-DLF Cements buyout, the debt equity ratio of GACL currently stood at around 0.9. Even if the entire Rs 455 crore deal is funded by debt, the company's debt-equity ratio will increase to a manageable level of around 1.4.

Given the current networth of over Rs. 1,100 crore, a debt equity ratio of 0.40 and the likely internal generation of around Rs. 500-600 crore in the current fiscal, GACL has considerable financial leeway to raise additional resources to put through an open offer. This situation might arise if SEBI interprets the inclusion of Mr. N.S. Sekhsaria, MD of GACL, into the board of directors of ACC as a change in control

Since it has not raised equity in the last few years and its track record in the Euro market is good, it may not have any problem in raising a part of the finance through the equity route.

Market reaction

The market has given a very clear signal that the acquisitions might be beneficial in the long-term by keeping out a competitor, but unless the acquirer has the funds to manage buy-out and earn return on the assets acquired higher than the cost of capital, the stock will be hammered. Ambuja-ACC deal fits in this category.

While GACL's share prices have fallen from Rs 231 (on 10th April 2000) to Rs 167 (on 30th Aug 2001), that of ACC has also fallen from Rs 166 to Rs 136 during the same period.

Case 2: All cash deal

The deal

Hindalco acquired Indal in an all-cash deal worth Rs 1008 crore (April 2000).

This deal is forward integration for Hindalco because Indal is primarily in the production of Foils and industry and utensil grade aluminum. The combined capacities of Hindalco and Indal would be 50% of the industry capacity in primary metal and about 56-59% in the rolled products sector.

Advisor

DSP Merrill Lynch for Hindalco and JM Morgan Stanley for Indal

Target characteristics

Indal was a subsidiary of Alcan. Alcan was interested in selling out its stake in Indal because of its global merger with Pechiney of France and another smaller European major.

Buyer's financial position

Hindalco has a low D/E ratio of 0.2:1 and in March '99 had reserves of over Rs 4700 crore. Its cash and bank balances alone were worth Rs 108 crore. Hindalco had a healthy EPS of 76.1.

Structure of the deal

The deal is funded through internal accruals only. The proposed expansion of Hindalco will be funded without disturbing the debt: equity ratio of 0.2:1.

In addition to the amount to be paid for Indal, Hindalco has also taken over the Rs 400 crore debt of Indal. If Hindalco picks up the remaining stake at Rs 190 per share, the whole deal will be worth Rs 1700 crore.

Market reaction

The successful acquisition and positive market reaction shows that if the acquirer can manage to raise the funds internally and if the balance-sheet size post-acquisition is within manageable proportions, the deal will be appreciated by the market.

Case 3: Merger with share swap

The deal

There was an elegant, first-of-its-kind all-stock deal in the banking sector with Times Bank and HDFC entering into an equity swap merger to create the country's largest private bank. (Dec'99). The deal helped the merged entity gain critical mass overnight. It now has 107 branches in 34 cities.

Advisor

JM Morgan represented Times Bank, whilst KPMG Peat Marwick was HDFC Bank's advisor

COMPARISON OF THE TWO BANKS

Characteristics	**HDFC BANK**	**TIMES BANK**
Spreads	3.38 per cent	1.66 per cent
Business per employee	Rs 5.2crore	Rs 7.22 crore
Profit per employee	Rs 10 lakh	Rs 5 lakh
Return on average assets	1.89	0.95

Buyer's financial position

HDFC has reserves of Rs 139 crore and has a net worth of Rs 339 crore. Its EPS has increased consistently over the past 4 years and is now 4.1. Its RONW was 26% in 1998-99.

Structure of the deal

The deal consisted of a share swap of 5.75 shares of Times Bank for 1 share of HDFC Bank. No money changed hands in this deal.

Market reaction

The Times Bank-HDFC Bank merger has found immense favor with the markets. After the deal, the market cap of HDFC Bank overtook that of its parent HDFC.

Case 4: Leveraged buyout

The deal

Tata Tea's acquisition of Tetley for Rs 2135 crore or 305 million pounds. This deal is the largest corporate takeover by an Indian firm abroad.

Advisor

Rabo India Finance

Target characteristics

Tetley is the largest branded tea company in the world.

Buyer's financial position

Tata Tea is in a sound financial condition with reserves of Rs 367 crore, a liquidity ratio of 2:1 and a D/E ratio of 0.5. It has a ROCE of 24.8%. In 1998-99, it had a PAT of Rs 128.7 crore on net sales worth Rs 846 crore.

Structure of the deal

The deal was structured using the Earnout Model.

1. Tata Tea set up a 100% owned subsidiary called Tata Tea (GB). The Rs 490 crore equity (70 million pounds) of the company was funded as follows:
   a. Rs 105 crore from Tata Tea's reserves of Rs.367.32 crore
   b. Rs 315 crore from Tata Tea's GDR issue (75.98 lakh GDRs issued at $9.87 each)
   c. Rs 70 crore from Tata Tea Inc.
2. Tata Tea leveraged this equity 3.36 times to raise Rs 1645 crore (235 million pounds) as follows
   a. 10 million pounds (Rs 70 crore) from Prudential Mezzanine Capital
   b. 10 million pounds (Rs 70 crore) from Schroders
   c. 30 million pounds (Rs 210 crore) from Intermediate Capital Group
   d. 185 million pounds (Rs 1295 crore) from Rabo Bank
3. Tata Tea is to repay the debt over a nine-year term at an average rate of 11%.

Market reaction

The market capitalization of Tata Tea fell from Rs 2858 crore in March 2000 to Rs 2158.85 crore in April 2000 and presently stands at Rs 760 crore as of 30^{th} August 31, 2001.

Case 5: Acquisition funded by various means

The deal

India Cement's acquisition of Raasi Cement

Advisor

N.A.

Target characteristics

In 97-98, Raasi had a D/E ratio of 1.1, total fixed assets of Rs 113 crore and a ROCE of 14.3 %.

Buyer's financial position

India Cement was on major acquisition spree when it took over Raasi cement in order to gain a foothold in southern India. It was in a healthy situation with a D/E ratio of 2:1, a ROCE of 11.5 % and reserves of Rs 560 crore. The net worth of the company was Rs 685 crore

Structure of the deal

The whole deal will be worth Rs 445 crore. Funding for the acquisition would be through

1. A rights issue for Rs 160.85 crore
2. Sale of ships worth Rs 25 crore
3. Issue of preference shares worth Rs 25 crore
4. Borrowings worth Rs 180 crore
5. Private placement of equity worth Rs 54 crore

Market reaction

The market capitalization of India Cement has decreased by almost 50% in last 18 months.

Case 6: Acquisition funded by issue of GDRs/ADRs

The deal

Satyam Infoway's acquisition of IndiaWorld for Rs 499 crore.

Advisor

DSP Merrill Lynch for Satyam Infoway and Ernst & Young for IndiaWorld.

Target characteristics

IndiaWorld had a turnover of Rs 1.3 crore and a profit after tax of Rs 25 lakh.

Buyer's financial position

Revenues of Rs 10.33 crore in 1999, and by the first quarter of fiscal 2000 Rs 42.39 crore. Currently, the company has paid-up equity capital of Rs 22.6 crore and an authorized capital outlay of Rs 25 crore.

Structure of the deal

Satyam bought over 22 portals of India World for $115 million in cash in November 1999. The payment of cash was done in two stages.

In Phase I, Satyam paid Rs 122.2 crore or $28m in cash to acquire 24.5 per cent of IndiaWorld and a non-refundable deposit of $12m (Rs 51.3 crore) to acquire the balance 75.5 per cent. Satyam acquired an option to purchase the remaining shares any time before June 30, 2000, for $87m or Rs 376.5 crore. The non-refundable deposit of $12m or Rs 51.3 crore will be adjusted against the final price when it exercises the option.

SIFY must pay the balance before June 30, 2000, failing which the purchase price will rise at a rate of 16 per cent per annum. The deadline for full payment is September 30, 2000, unless Indiaworld and SIFY agree otherwise.

According to the ISP policy, Satyam Computer Services cannot let its holding in Satyam Infoway slip below 51 per cent. Its stake is currently around 60 per cent. As a result, Satyam Infoway may have to opt for a mix of equity and debt.

Satyam had a $85m war chest, built through its initial issue of American Depository Shares (ADS). The company has also announced a 4 for 1 split in its existing American Depository Shares (ADS). In mid Feb it sold ADRs worth $130 million to finance the acquisition

Market reaction

Since SIFY is not a traded company in India, the market reaction can be judged only by the wide publicity given for this deal. This deal marked the turning point in the fledgling Indian Internet industry and encouraged a number of companies into jumping onto the dot com bandwagon so as to make a fast buck. Over a longer period the deal proved highly overvalued for Satyam Infoway.

Choosing A Mode of Finance

The following framework can be used for choosing between the modes of financing:

1. Value the target by using an appropriate valuation method.
2. Get management's ideas about the future plans for the acquiring company. If a company has further expansion plans after the acquisition, the peak negative cash outflows are predicted in the future and financing is arranged for accordingly.
3. Compare the acquirer's financial strength and performance with that of the industry.
4. Get an idea about the management's desired capital structure and compare with industry to check feasibility.
5. List down all the possible choices of the mode of financing available to the firm.
6. Analyze whether it has the required flexibility to choose between different options e.g. if the company's D/E ratio is 3:1, then the company is not in a position to borrow more. Issuing more equity may be the only way out
7. Estimate the cost involved in servicing each kind of mode e.g. interest rates on debt, dividend on equity etc. over the time period of repayment, keeping in mind the dividend policy of the company
8. Estimate the total cost of the deal, in terms of payment to the shareholders plus the charges to the investment banker's etc.
9. Forecast the company's future cash flows in order to check the ability to pay for the deal i.e. in terms of interest payments or dividend payout.
10. Develop the optimum combination of equity/debt etc to finance the deal so as to maximize shareholder value.

Choosing Between Cash and Stock

Issues faced by the acquirer

The management of the acquiring company should address three questions before deciding on the mode of payment

1. Are their firm's shares overvalued, fairly valued or undervalued?

If the acquirer believes that the market has undervalued the shares – The firm should not issue additional shares to finance the deal. Research has shown that if a firm issues additional shares to finance a transaction, the market believes that the shares are over valued and hence there is a fall in the stock price. Shareholders also believe that a company would offer equity only if it were unable to raise debt funds. Now, a company may be unable to raise debt only if the market perceives it to be highly risky.

2. What is the risk that the expected synergies needed to pay for the acquisition premium will not materialize?

Generally, confident acquirers prefer to pay for the acquisition in cash so that their shareholders would not have to give any of the expected gains to the target company shareholders. But if the management thinks that there is a substantial risk in the deal, they may try to hedge the risk by offering stock and diluting their holdings thus limiting the losses they incur, if any.

3. How likely is that the value of the acquiring company's shares will fall before closing the deal?

Research has shown that the market responds more favorably when the acquirers demonstrate their confidence in the value of their own shares through their willingness to bear more preclosing market risk.

Issue of equity in order to fund investments/acquisitions is made mostly by software companies - a highly profitable industry with substantial internal accruals and a few in other industry groups, which are doing well.

Guidelines for Choice of Strategy

Forward Integration

- When an organization's present distributors are especially expensive or unreliable or incapable of meeting the firm's distribution needs.
- When the availability of quality distributors is so limited as to offer a competitive advantage to those companies which integrate forward
- When an organization has both the capital and the human skills needed to manage the new business of distributing its own products
- When an organization competes in an industry that is growing and is expected to grow rapidly (because forward integration reduces a firm's ability to diversify)
- When the advantages of stable production are particularly high (because the Company can increase the predictability of its demand through forward integration)
- When present distributors or retailers have high profit margins; the Company could profitably distribute its own products and price them more competitively by forward integration

Backward Integration

- When an organization's present suppliers are especially expensive, unreliable, or incapable of meeting the firm's needs for parts, components, assemblies or raw materials.
- When the number of suppliers is few and competitors are many
- When an organization competes in an industry that is growing and is expected to grow rapidly (because backward integration reduces a firm's ability to diversify)

- When an organization has both the capital and the human skills needed to manage the new business of supplying its own products
- When the advantages of stable prices are particularly important, because a firm can stabilize the cost of its raw material and that of its finished product through backward integration
- When present suppliers have high profit margins; the Company could profitably supply its own raw materials
- When an organization needs to acquire a given resource quickly

Horizontal Integration

- When an organization can achieve near monopoly status in an industry without violating any legal regulations
- When an organization competes in a growing industry
- When increased economies of scale and scope provide major competitive advantages
- When an organization has the capital and the required human skills required to manage the expanded organization
- When competitors are faltering due to lack of managerial expertise or a need for a particular resource that the acquirer firm has; Horizontal integration is not appropriate if the competitors are doing poorly because the overall industry sales are declining

Concentric Diversification

- When an organization competes in a no growth or a slow growth industry
- When adding new but related products would significantly enhance the sales of the current products
- When new but related products could be offered at highly competitive prices
- When new but related products have high seasonal sales levels that counterbalance an organization's peaks & valleys
- When an organization's products are currently in the decline stage of the product life cycle
- When the organization has a strong management team

Conglomerate Diversification

- When an organization's basic industry is experiencing declining annual sales and profits
- When the organization has the capital and the managerial talent to compete successfully in the new industry
- When an organization has the opportunity to purchase an unrelated business that is an attractive investment opportunity
- When there exists financial synergy between the acquired and the acquiring firm based on profit considerations
- When the existing markets for the organization's present products are saturated
- When monopoly charge could be made against a Company that has historically concentrated on a single industry

Horizontal Diversification

- When revenues derived from an organization's current products or services would significantly increase by adding the new, unrelated products
- When an organization competes in a highly competitive and /or a no-growth industry as indicated by low industry profit margins and returns

- When the organization’s current distribution channels can be used to market the new products to the current customers
- When the new products have a counter cyclical sales pattern compared to the organization’s current products

THE GRAND STRATEGY MATRIX

Market Growth ¯	**Competitive Position ¯**	
	Strong	**Weak**
Rapid	Forward integration Backward integration Horizontal integration Concentric diversification Market development Market penetration Product development	Horizontal integration Divestiture Market development Market penetration Product development Liquidation
Slow	Concentric diversification Horizontal diversification Conglomerate diversification Joint Ventures	Concentric diversification Horizontal diversification Conglomerate diversification Divestiture Liquidation Retrenchment

Evaluation of the strategies needs to be done taking into account the management aspects, the financial angle, the tax implications, the operational feasibility, the human factors involved, the impact on the Company’s future, the role of suppliers, the legal obligations, the regulatory restrictions, the reaction of the competitors, the impact on stock prices etc.

Conclusion

The future for Indian industries looks bright. They have now realized that they need to compete with global competitors in order to survive. They are now not afraid of competing with MNCs in their home turf. With further relaxation in regulations and support from financial institutions, Indian companies have the potential to be world beaters and make brand names like Tata, Reliance, Infosys, Polaris etc., household names all over the world.

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Eastern Europe's Emerging Securities Market

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Abstract

The increasing integration of the world's economies provides an opportunity to examine the role of securities markets in financial development. The trend towards globalization of financial markets has resulted in a substantial increase in net private capital flows to developing economies. Current flows have been directed primarily at emerging economies of Asia, Eastern Europe and Latin American. The development of securities market infrastructure is a critical dimension of economic infrastructure development. This article examines the comparative development of Eastern Europe's securities markets and the implications for global investors.

This article examines the region's trading systems and arrangements and the rules and procedures. The lack of standardization presents investors with a challenge when investing in the region's securities. Without understanding the market's structure, trading systems, and regulations international investors will not provide Eastern European projects with the equity capital required for further development. The region offers investors significant growth opportunities as new securities products are developed and market regulations are adopted to address regional concerns for cross listing companies and members. Harmonization of the rules of listing, trading, clearing and settlement of trades, the reporting requirements and standards, surveillance and technical compatibility will serve to make the region more attractive to investors. The increased efficiency afford by these market developments will provide corporations with an incentive to raise capital through the domestic financial markets, at reduced costs.

Introduction

The development of securities market infrastructure is a critical component in the development of an economic infrastructure. This research examines the comparative development of Eastern Europe's securities markets and the implications for global investors. The increasing integration of the world's economies provides an interesting opportunity to examine the role securities markets in financial market development. The trend towards globalization of financial markets has resulted in increases in net private capital flows to developing economies. Current flows have been directed primarily at emerging economies of Asia, Eastern Europe and Latin American. This research examines the continual evolution of Eastern Europe's emerging securities markets and their role in regional economic development. The Federation of European Stock Exchanges (FESE) notes that,

> "European securities exchanges play a vital role in these markets by providing companies with the opportunity to raise capital and by giving both private and institutional investors the opportunity to invest. The increasing globalization of economic activity, driven by advances in technology and telecommunications, is leading to a growing number of companies wishing to raise capital in more than one country. Investors too are looking at integrated, or interconnected, international markets in order to maximize their return and spread their capital risk."[i]

Without understanding the market's structure and custodial arrangements, international investors will not provide Eastern European projects with the equity capital required for further development. Section one provides selective descriptions of Eastern European securities markets' regulations, procedures and development. Section two examines the current status of securities market integration in Eastern Europe. Section three describes the region's technological infrastructure and trading platforms. Section four discusses securities product development and market innovations. Section five discusses the challenges for future market development.

Markets Overview

The opening or reopening of Eastern European exchanges in the early 1990s has been essential to the region's privatization process. The exchanges provide an important market dimension to the governments' plans to transition their formerly command controlled economies. As Divecha, Drach and Stefek (1992) and Speidell and Sappenfield (1992) note emerging securities markets provide an important degree of portfolio diversification. Table 1 presents a brief overview of the region's exchanges. The market hours reflect the individual characteristics of the region's exchanges and illustrate one of the challenges in the development of regional exchange links.

At the end of 1999 the markets listed 8,262 firms with a total US dollar capitalization of $68,074 million. In contrast the total market capitalization at the end of 1995 was $24,928 million. This four year, 173 percent increase illustrates the dramatic growth of the region and the results of continued privatization of state owned enterprises. The region's largest exchange is the Warsaw Stock Exchange with $29.6 billion in market capitalization. The smallest market is in Latvia with a market capitalization of $391 million. This indicates the significant range of value represented by the Eastern European markets. In addition, the low market capitalization of markets presents a challenge for attracting market participants due to low liquidity levels.

As noted in Table 1 Eastern European exchanges in general meet internationally accepted clearing and settlement standards of the G-30 and ISSA of T + 3 (Transaction day + 3 business days). The Riga Stock Exchange offers customers the opportunity to choose direct transaction settlement terms – either on the date the deal was struck (T+0) or at any date up to 40 days later. Other exchanges present challenges to the traditional settlement period. In Croatia, despite a settlement period of seven days, outdated procedures and decentralized clearing mean that few trades can be successfully completed within this time.[ii]

Market Turnover reflects the liquidity of the securities markets. As reported in Table 1 the Hungarian market has the highest regional turnover ratio. The 95.8 turnover ratio is comparable to that of many developed exchanges. However, the other exchanges' have ratios that reflect a lack of liquidity. Exchanges are active in developing linkages and make the exchanges the preferred locations for trading the region's securities.

Table 1: EASTERN EUROPEAN SECURITIES MARKETS – 1999

	Hours*	**Settlement**	**Market Capitalization Million US $**	**Turnover Ratio**	**Number Listed Firms**
Bulgaria	09:30 – 12:00[iii]	T + 3	706	6.0	860
Croatia	10:00 – 16:00	T + 7[iv]	2,584	2.7	59
Czech	09:30 - 16:00[v]	T + 3[vi]	11,796	36.7	164
Estonia	10:00 – 14:00	T + 3	1,789	24.1	25
Hungary	10:00 - 16:30[vii]	T + 5[viii]	16,317	95.8	66
Latvia	10:00 – 14:00[ix]	T + 1 to 40	391	11.9	70
Lithuania	10:00 – 14:00	T + 3[x]	1,138	26.2	54
Poland	10:00 – 16:00[xi]	T + 3	29,577	45.8	221
Romania	10:15 – 14:15[xii]	T + 3	873	36.2	5,825
Slovakia	10:30 – 14:00	T + 3	723	59.7	845
Slovenia	09:30 – 13:00	T + 2	2,180	32.4	73

*All Exchanges are open Monday – Friday, unless otherwise noted, with the exception of national holidays.

Table 2 presents a summary overview of important market characteristics. The exchanges list a number of securities with government bonds and privatized corporate equity the main listings. All of the region's exchanges permit the repatriation of foreign investment funds. The exchanges have developed guarantee funds to ensure the safety of exchange transactions. The operation of a Guarantee Fund is connected with the financial settlement of Stock Exchange trades and is primarily funded by the member firms as a portion of their transactions. The

Guarantee Fund is a market confidence builder as it ensures that investors who are selling securities get financial compensation even in the event that the counter-party is not able to fulfill its financial liability in time.

Table 2: MARKET CHARACTERISTICS

	Guarantee	**Internet**	**Listed Securities**
Bulgaria	Guarantee Fund – 1% of Turnover Value	www.bse-sofia.bg	-Government Bonds -Corporate Bonds -Bulgarian Depository Receipts -Equity Shares
Croatia	The Central Depository Agency maintains a guarantee fund	www.zse.hr	-Government Bonds -Equity Shares
Czech	Exchange Guarantee Fund	www.pse.cz	-Government Bonds -Corporate Bonds -Equity Shares -Derivatives (second half of 2001)
Estonia	Member firms must submit a Bank Guarantee letter to the exchange	www.tse.ee	-Government Bonds -Corporate Bonds -Equity Shares -Closed-end funds
Hungary	Exchange Settlement Fund and Government Securities Exchange Settlement Fund)	www.bse.hu	-Government Bonds -Corporate Bonds -Equity Shares -Derivatives (Futures and Options)
Latvia	Members must participate in the Guaranty Fund	www.rfb.lv	-Government Bonds -Corporate Bonds -Equity Shares -Closed-end funds
Lithuania	Exchange Guarantee Fund	www.nse.lt	-Government Bonds -Corporate Bonds -Equity Shares -Closed-end funds
Poland	Settlement Guarantee Fund	www.wse.com.pl	-Government Bonds -Corporate Bonds -Equity Shares -Derivatives (warrants/futures contracts)
Romania	Exchange Guarantee Fund	www.bvb.ro	-Financial Investment Funds -Equity Shares
Slovakia	Guarantee Fund	www.bsse.sk	-Government Bonds -Corporate Bonds -Equity Shares
Slovenia	Guaranty Fund	www.ljse.si	-Government Bonds

			-Corporate Bonds -Equity Shares -Investment Funds

The region's significant growth opportunities and challenges were confirmed for foreign investors with the Polish market's US dollar total return of +740 percent in 1993. However, the region could not sustain the high return levels as the challenges of economic transition became evident. Table 3 reports the total returns in US dollars for the region's markets from 1995 – 1999. The 1998 and 1999 returns reflect the particular challenges to the region from the collapse of the Russian markets in 1998. Eastern European securities markets present international investors with unique opportunities for diversification with risk return profiles consistent with emerging markets. The range of returns is large, i.e. the 1994 – 1999 average annualized mean total return ranges from Hungary's 26.64 percent to Slovakia's –33.48 percent U.S. dollar returns. This highlights the need to be selective in evaluating Eastern European markets.

Table 3: TOTAL RETURNS – PERCENT US DOLLARS

	1995	**1996**	**1997**	**1998**	**1999**
Bulgaria		-83.0	-70.5	-30.1	-23.4
Croatia				-31.4	-16.6
Czech	-24.9	16.9	-21.8	-7.0	6.5
Estonia				-64.8	43.4
Hungary	-33.6	102.6	61.8	-9.9	16.9
Latvia				-66.3	-7.7
Lithuania		86.5	9.7	-39.2	11.2
Poland	-6.9	74.7	-17.0	-10.8	23.6
Romania				-67.4	-35.3
Slovakia				-54.9	-23.7
Slovenia		7.0	12.1	19.4	-2.6

Source: Emerging Stock Markets Factbook 2000

Development

The evolution of securities markets is an important factor in determining economic progress. Equity market development may be categorized by four phases. The initial phase occurs after a country has achieved a degree of economic and political stability. Markets beginning to gain the confidence of domestic investors and become more widely accepted as an investment alternative to traditional bank deposits and short-term government bonds characterize this first phase of development. In the second phase, there is pressure from abroad for greater accessibility and at home for cheaper capital funding which leads to a loosening of regulations in domestic capital markets. International investors begin to recognize the diversification benefits of investing in such markets. In the third, or expansion phase, the market offers the prospect of higher, less volatile returns, and investors easily absorb new issues of stocks and corporate bonds. The volume of issuance increases rapidly as firms strive to pay down debt and private or newly privatized companies market their initial public offerings. During this phase equity and currency-hedging instruments such as derivatives and index products evolve. In the final, or mature phase, as equity market risk premiums fall to internationally competitive levels relative to government treasury bill rates or equivalent short-term money market rates, the equity market begins to achieve the stable growth that marks a mature or developed state.

Based upon the Eastern European markets' current state of evolution the markets can be characterized as follows

Initial Phase:	Bulgaria, Romania, Croatia
Phase Two:	Slovakia, Estonia, Latvia, Lithuania
Phase Three:	Hungary, Slovenia, Czech Republic, Poland
Phase Four:	

There is no specific timetable for development and evolution to the next phase, but periods of global economic expansion tend to accelerate the development of capital markets--emerging equity markets in particular. The global economic slowdown, starting with the Russian financial crisis in 1998, has slowed Eastern European market development. Clark (1999) examines market characteristics to determine the implications for securities market returns. The findings indicate that there are no particular market characteristics that segment markets into higher and lower returns.

Memberships[xiii]

Eastern European markets acceptance into international organizations is important to their continued development and ability to attract investment capital. The Federation of European Stock Exchanges (FESE) has two basic levels of membership to assist exchanges in their development. Associated membership may be granted to a country's stock exchange when official negotiations about the entry into EU have begun. The country's legal framework in the field of capital market is in compliance with EU directives, and the capital market itself is regulated by an independent supervisory institution that has the needed competence and resources to monitor the market and to penalize violations.

Correspondent membership may be granted to a country's stock exchange, which has been preparing for entry into EU, though it has not yet harmonized its legislation with EU directives or it does not meet some of the other requirements such as the existence of an independent supervisory institution.[xiv]

The Federation of European Stock Exchanges (FESE) has the following Eastern European Associate Members Budapest Stock Exchange, Ljubljana Stock Exchange, Prague Stock Exchange and Warsaw Stock Exchange. Corresponding exchanges are Bratislava Stock Exchange, Riga Stock Exchange, Tallinn Stock Exchange and The National Stock Exchange of Lithuania. The status of associated member was granted to the Warsaw, Budapest and Ljubljana stock exchanges in the year 1999.

In addition, regional exchanges participate in The International Federation of Stock Exchanges, FIBV, which is the global trade association for the exchange industry.[xv] Ljubljana and Warsaw's exchanges are full members; Budapest is an affiliate member; and Bucharest, Prague, Bratislava, Bulgarian, National Stock Exchange of Lithuania, Riga and Zagreb stock exchanges are all correspondent members.

Securities Market Integration

The trend toward regional integration is an important one to recognize, clearly indicating the need for regulatory standardization and harmonization of reporting standards. Eastern European exchanges are no exceptions. Representatives of stock exchanges in Prague, Bratislava, Budapest, Ljubljana and Warsaw have agreed on closer cooperation among their respective markets. Some Central European bourses are currently working in teams on projects of joint approaches to listing, member registration on the so-called new markets, settling deals, and publicizing information on key issues and issuers on the Internet.

Integration examples include the July 1999 agreement between the London Stock Exchange and the Warsaw Stock Exchange (WSE) to exchange information on companies and regulatory issues. In addition, the WSE has entered an agreement with the Paris Bourse SBF SA to expand cooperation between the exchanges and to assist in regulations. The agreement between both stock exchanges creates opportunities for electronic connection between both floors.

International Links

The co-operation initiated in 1998 between Baltic and Scandinavian Stock exchanges was of great significance. This is aimed at helping the Latvian market integrate into Nordic financial markets as well as to encourage closer ties between the Baltic Stock exchanges. Riga and Tallinn Stock Exchanges made the first step towards co-operation when they signed a contract on April 6, 1998 regarding exchange of information concerning cross-listed companies and cross-members.

In late spring 1999 a memorandum of understanding was signed in Vilnius between the Riga Stock Exchange, the Tallinn Stock Exchange and the National Stock Exchange of Lithuania. It provides for close co-operation between the exchanges in setting up a joint Baltic market. Baltic co-operation is based on the following principles: single point of liquidity, cross membership, a common trading system via NOREX synchronized trading hours. The agreement also created the Baltic list of securities that can be traded across national boundaries. The Riga Stock Exchange trading platform is not linked to any other platforms. However, the members of the Riga SE, Tallinn SE and National SE of Lithuania have reciprocal access to each others trading systems as view only screens. The aim is to harmonize the three markets into a single investment area, which would be a liquid, attractive and easily understandable market for the international investor community.

The Warsaw Stock Exchange and the National Stock Exchange of Lithuania signed a Memorandum of Co-operation (MoC) on August 9, 2001. The co-operation will cover not only sharing of information and experience on the functioning and promotion of the two markets, but also sharing of technology. Both Exchanges will work to bring their capital markets closer and to allow investors from both countries to trade securities listed on their markets. The co-operation between the Exchanges is expected to facilitate and stimulate cross-border trading in the future. [xvi]

Further integration of Europe's financial markets will come about through technological partnerships between national stock exchanges, as opposed to full-blown mergers, which have been attempted but proved unworkable.[xvii] "We fear losing blue chip trading to large bourses," said Wieslaw Rozlucki, President of the Warsaw Stock Exchange, who plans to link up with a larger network of European bourses in the next 1-2 years. Before developing technological alliances for trading, however, bourse officials were unanimous in calling for the simplification of clearing and settlement operations, which remain fragmented and closely linked to individual exchanges.[xviii]

International Securities Market Correlation

As the securities markets of Eastern Europe evolve their integration with other global economies and exchanges will increase. This also indicates that as the markets' correlation coefficients increase the markets will provide less potential diversification benefit to investors. Bekaert and Urias (1996) note the importance of diversification and integration in dealing with emerging markets. As noted in Table 4 the Slovakian market's negative correlation coefficient with both the U.S. S&P and the FT European Index indicates that the market provides the greatest potential portfolio diversification benefits. Despite global integration Diermeier and Solnik (2001) find that investors retain a pronounced home bias in their investments. They note, "this practice is sometimes justified by the increase correlations between national stock markets, which reduces the benefits of international risk diversification."[xix]

Table 4: S&P/IFCG TOTAL RETURN INDEX CORRELATION COEFFICIENTS 1994-1999

U.S.	**1.00**						
Europe	**0.65**	**1.00**					
Czech	**0.15**	**0.25**	**1.00**				
Hungary	**0.48**	**0.40**	**0.53**	**1.00**			
Poland	**0.42**	**0.41**	**0.53**	**0.66**	**1.00**		
Russia	**0.33**	**0.44**	**0.32**	**0.59**	**0.42**	**1.00**	
Slovakia	**-0.21**	**-0.11**	**0.10**	**0.10**	**0.21**	**0.00**	**1.00**
	U.S.	**Eur**	**Czech**	**Hungary**	**Poland**	**Russia**	**Slovakia**

Source: Emerging Stock Markets Factbook 2000

Clark and Ramagopal (1998) examine the level of market correlation in Asian markets as they increase their regional integration and find that the markets provide less diversification value to investors as the region's integration increases. This factor may indicate that the attractions of Eastern European markets may decrease as the level of correlation with western markets increases. As Soydemir (2000) indicates stock market movements are transmitted from one market to another especially as the links between markets are increased.

As the markets in Eastern Europe mature and their economies are more integrated with other global economies the country effect of a portfolio investment in the region may dissipate. Researchers have examined Western European equity markets to determine whether the country effect is disappearing after the EMU. However, Rouwenhorst (1999) finds that the country effects in stock returns still dominate the industry effects despite the convergence in the markets after Maastricht.

Technology

Technological advances are a constant challenge in exchange development. Access to the latest in exchange trading system technology is critical to the continued evolution of Eastern European exchanges. In addition, the compatibility of software and platforms is a major consideration as the region works towards greater market integration. The following are a few highlight notes concerning technological issues for the region's exchanges.

The software of the Bucharest Stock Exchange was developed with Canadian assistance. The HORIZON TM system was purchased by the Bucharest Stock Exchange and implemented in 1999. A system for the open, safe, and parameter-geared management of the market represents a means of bolstering the interest of foreign investors. The open and secure communication channels optimize the transaction accessibility. Apart from the acceptance of remote orders or from the stock exchange ring, it is possible to make connections to other systems for the management of the stock exchange orders.[xx]

The Budapest Stock Exchange's significant growth in trading volume required it to develop new technology for its trading systems. A goal of the system was to fully automate the trading system, recognizing the important needs for the system to build in scalability and high reliability. The exchange notes that

> "There are several advantages of fully electronic trading coupled with remote trading: It expands borders and allows trading outside Budapest, as exchange members can connect to the system from country towns and it also facilitated significant lengthening of the trading hours. MMTS promotes higher transparency and more orderly market operations and in terms of risk management it operates as a high security trading technology."[xxi]

Phase one of the exchange's trading system development included electronic trading that permitted brokers to access the system from remote locations, which eliminated the need for a centralized trading floor. The Budapest Stock Exchange started up its new derivatives trading system known as Multi Market Trading System II (MMTS 2) on October 25, 2000. The system upgrades provide for the ability to handle 50 – 450 incoming transactions a second.

In October 2000, the Bulgarian Stock Exchange's RTS Plaza trading system, based on the NASDAQ quotation system was launched with the assistance of American and Russian experts. It is an order and/or dealer driven trading system with multiple market-makers. The response time from the moment the transaction is input until it is displayed on all terminals is not more than one second.[xxii] Trading of securities runs on Bratislava Stock Exchange days in the SPOTOS, a subsystem of the Electronic Stock Exchange Operating System (EBOS). The Stock workstations are located in member offices and have on-line connections to the central computer of the Stock Exchange. It means that Stock Exchange trade is executed directly between the members - the parties to the trade.

The Warsaw Stock Exchange introduced a new IT trading system, WARSET in November 2000. The system connects an extensive network connecting several dozen capital markets institutions: the Exchange, the National Depository for Securities, and the Polish Securities and Exchange Commission and some 32 data vendors both those operating domestically and internationally. The Zagreb Stock Exchange introduced a new Windows-based trading system (MOST ®) on May 31, 1999. MOST® is an anonymous, order-driven electronic system, with real time information and immediate dissemination of trading data. It allows the members (brokerage houses) to drive their orders through their office workstations connected to the central server on the ZSE.

Product Development

In order to attract order flow Eastern European exchanges are exploring ways to make trading easier, and the addition of new exchange traded products. An example of making trading easier is the Riga Stock Exchange's Internet-based technological solutions; a major step was taken in Internet service providing. The RSE started offering the investors a direct access to the stock exchange trading system and invited to try their own trading without using the broker as an intermediary. The Budapest Stock Exchange (BSE) allows brokers to connect their IT systems to the bourse's trading system and thus allows real-time Internet trading to customers. Several brokers offer Internet trading, but previously they had to enter clients' bids into the BSE trading system manually causing investors delays. Although with the new regulations, investors will be able to make real-time trades, the bourse will implement a system of filters to ensure fair and safe trading.[xxiii] Similarly the Warsaw Stock Exchange's new trading platform makes the potential of Internet trading possible.

Web Site Information

As reflected in Table 5 the region's exchanges provide a significant level of information to the public. The exchange web sites have increased both in depth of information provided and accessibility since the mid 1990s. Exchanges are working to develop their web presence as an opportunity to extend online trading to exchange members and the general investing public. In general Sites are navigable with appropriate hyper links. The search function is only present in three sites in September 2001 and this is an area where the exchanges could improve content.

Table 5: OFFICIAL EASTERN EUROPEAN MARKET WEB SITES (ENGLISH LANGUAGE)

Exchange	Current Trading Info	Stock Quotes	Company Information	Exchange Regulations	Search	Contact Information
Bulgaria	X	X		X		X
Croatia	X	X		X		X
Czech	X	X	X	X	X	X
Estonia	X	X	X	X		X
Hungary	X	X	X	X		X
Latvia	X	X	X	X	X	X
Lithuania	X	X	X	X		X
Poland	X	X	X	X		X

Romania	X	X	*	X		X
Slovakia	INDEX			X		X
Slovenia	X	X	X	X	X	X

*Basic Company Information – Co. Web Site not accessible

In addition to increased market transparency and information distribution through electronic means the exchanges are exploring the addition of exchange-based products. The exchanges currently offer only limited products to provide investors risk management tools, i.e. derivative products. As noted in Table 2 only two exchanges currently offer a full array of derivative products, with the Czech markets planning to add these products in the second half of 2001.

Derivative Products

In addition to identifying structural and regulatory issues in development markets seek to provide appropriate products. A typical product development path is the trading of government bonds, then adding equity investments, and in a final state of continuous product development add derivative instruments. As securities markets evolve the exchanges turn to developing new investment instruments to enhance investment options. Derivative instruments provide a value risk management role and their exchange-traded liquidity is an important milestone in the development of the securities markets.

Typical of the region's development is the introduction of derivatives on the Warsaw Stock Exchange. On January 16, 1998, the Warsaw Stock Exchange started trading futures contracts on WIG20 index in the continuous trading system. On August 1, 2000, the Warsaw Stock Exchange will start trading futures contracts on TechWIG index in the continuous trading system. On January 22, 2001, the Warsaw Stock Exchange started trading new derivative product - individual stock futures on stocks of the following three companies: TPSA, PKNORLEN and ELEKTRIM in the continuous trading system. An example of product introductions is the Polish exchange's EURO futures contract. Exhibit 1 provides the basic contract design information. The Euro exchange rate futures contract started continuous trading on May 31, 1999.

Exhibit 1: EURO EXCHANGE RATE FUTURES CONTRACTS

Contract size:	EURO 10 000
Price quote:	PLN per 100 EURO
Minimum price fluctuation:	PLN 0.01 per 100 EURO
Contracts months:	Three nearest calendar months plus two subsequent months from the March quarterly cycle
Last trading day:	Trading day directly preceding the expiry date.
Expiry date:	Fourth Friday of the contract month; in the event of the fourth Friday not being a business day, the expiry date shall normally be the last business day preceding the fourth Friday
Final settlement price:	The average exchange rate determined by the National Bank of Poland at the fixing on the contract expiry date multiplied by 100
Settlement:	cash in zloty

Source: www.pse.com.pl

In September 2000 the Budapest Stock Exchange amended its regulation to allow for the introduction of warrants to the bourse. In addition, the BSE Council decided at their meeting on May 3, 2001 to expand the exchange's range of futures products by introducing deliveries of all listed "A" shares, with the exception of OTP preference shares. In Prague new securities regulations effective January 1, 2001 provided the basis for developing derivative products that are expected to be introduced to the market in the second half of 2001.[xxiv]

Conclusion

If securities markets do not develop they will not be able to fulfill their important roles in accelerating structural reform and in the efficient allocation of resources. To maximize their impact the region's exchanges must work towards harmonization of regulations and technical cooperation. Lack of harmonization of market regulations and the use of diverse technologies limits the role of securities markets in the region's economic development. In addition, difficult economic conditions cause investors, particularly foreigners to limit their use of the financial instruments listed on the Eastern European exchanges. The EBRD estimates that in the first half of 2001 only a few hundred million euro have been raised for central and eastern European private equity investment, far short of last year's estimated record total of Euros 2.5bn.

The harmonization of the region will increase liquidity and international interest, however the future of global exchanges is evolving. Dan Karpisek of Komercni Banka sees another possible scenario as a fully electronic bourse, which would operate 24 hours a day as the currency market does. However, this option is still far off and dependent on the development of telecoms, Internet access, access to information, harmonization of legislation and other similar factors, he added. Unification would also bring some disadvantages, however, particularly for brokerage firms, points out Jiri Smehlik of Atlantik FT, because investors would have access to all markets through a single dealer. "I think that many companies are trying to resist it, but unification is only a matter of time and it will minimize client fees," he said.[xxv]

The region offers investors significant growth opportunities as new products are developed and market regulations are adopted to address regional concerns for cross listing companies and members. Harmonization of the rules of listing, trading, clearing and settlement of trades, the reporting requirements and standards, surveillance and technical compatibility will serve to make the region more attractive to investors. The increased efficiency afford by these market developments will provide corporations with an incentive to raise capital through the domestic financial markets, at reduced costs.

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[ii] Quest Economics Database World of Information Country Report, 11 October 1999 Retrieved September 3, 2001 from LEXIS/NEXIS Academic Universe database (Business News) on the World Wide Web: http://web.lexis-nexis.com/universe.

[iii] The Bulgarian Stock Exchange also is open for Block Trading from 12:00 – 13:00; Parallel trading in Bulgarian Depository Receipts and Government Securities is from 9:30 – 14:00.

[iv] Quest Economics Database World of Information Country Report, 11 October 1999 Retrieved September 3, 2001 from LEXIS/NEXIS Academic Universe database (Business News) on the World Wide Web: http://web.lexis-nexis.com/universe.

[v] The Prague Stock Exchange also has 17:00 – 20:00 auction receipt of orders for closed auction phase for all securities and Block Trades. SPAD (MM involved) trades are also available for the closed phase from 17:00 – 20:00 and 07:30 – 09:30.

[vi] The Prague Stock Exchange settlement for trades involving market makers (SPAD) is T + 5, unless other agreements of T + 1 is agreed to by the participants.

[vii] The Budapest Stock Exchange has free trading for bonds from 9:00 – 16:30. The period 10:00 – 10:05 is set for opening match for all equities.

[viii] Budapest Stock Exchange settlement period for securities in the government securities section is T + 2.

[ix] The Riga Stock Exchange permits trading at a fixed rate after the continuous trading hours.

[x] The settlement period for T-bills traded on the Lithuanian exchange is T + 1.

[xi] The Warsaw Stock Exchange Pre-opening trading session lasts from 8:30 – 10:00.

[xii] The Bucharest Stock Exchange has pre-open and pre-close trading 15 minutes before and after the continuous trading hours.

[xiii] Source: Federation of European Stock Exchanges (FESE) web site: www. Fese.be/members.htm. Retrieved 29 August 2001.

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Effect of Partner Relationships on International Joint Venture Performance: The Moderating Role of Strategic Motives on Venture Formation

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Abstract

Although some researchers asserted that partner-related factors are more influential than joint-venture-related factors in accounting for IJV performance outcomes, to data, empirical evidence has been lacking. To further complicate the search for key success factors of IJVs, there is little knowledge concerning the way in which partner-related factors *interact* with joint-venture-related factor to affect the performance of IJVs. In order to address these voids in the literature, this empirical study investigates the effect of partner relationship characteristics and partner motives on IJV performance. With regard to the main effect, three partner relationship characteristics namely: partners' mutual trust, two-way communications, and previous quanxi showed significant, positive effect on performance indicators under examination. With regard to the effect of the interaction between partner motives and partner relationship on IJV performance, the results supported the notion that partner relationship characteristics becomes particularly important in explaining IJV performance when venture partners attached a high level of importance to strategic positioning motives on venture formation.

Introduction

International joint venturing activities between partners from Triad countries started in the mid 1970s (Anderson, 1990; Glaister and Buckley, 1999), and joint venturing in Asia between partners from Triad countries and various Asian partners has accelerated since 1980s. The proliferation of international joint ventures has attracted research effort on joint venture formation, operation and evolution of venturing activities over time (Lasserre, 1999). In particular, international joint venture performance, one of the distinctive research streams, looked at the sources of success, or failure of joint ventures (Beamish, 1988; Osland and Cavusgil, 1996; Sarkar, Cavusgil, and Evirgen, 1997). It examined effect of such economic, management, and strategic factors as partner selection criteria (Beamish, 1987; Luo, 1998), economic ownership structure (Pan and Chi, 1999), management control systems (Ding, 1997; Schaan, 1983), and entry mode strategies (Isobe, Makino, and Montgomery, 2000) on international joint venture performance. Recent research has shifted to on-going partner relationship characteristic variables, such as trust (Aulakh et al., 1996; Saxton, 1997), relationship commitment and relational norms (Lin and Germain, 1999) in explaining joint venture success. According to Glaister and Buckley (1999), *both* ex ante variables (i.e. predictors of success at the time of joint venture formation) and ex post variables (i.e. predictors of success that emerge during the operation of joint venture) are required to account for successful performance outcomes in international joint ventures.

Nevertheless, little research effort was spent on identifying the success factors in international joint ventures in developing countries like China. Hu and Chen (1996) made the pioneering effort in identifying the success factors in Sino-foreign joint ventures and revealed that performance of Sino-foreign joint ventures is more dependent upon partner-related factors than joint venture-related factors or environment-related factors. Luo (1997) also reported that whereas strategic and organizational traits of local partners in the forms of local partner's market position, absorptive capabilities, and organizational experience have very significant effect on Sino-foreign joint venture performance, organizational form and size have insignificant effect. Recent research has shifted to examining the role of strategic choices on Sino-foreign joint venture performance. Pan, Li and Tse (1999) found that in China, joint ventures pursuing an early entry strategy have significantly higher market shares and profitability than joint ventures pursuing late follower strategy. Li, Qian, Lam and Wang (2000) also showed that Sino-foreign joint ventures pursuing a capital- and technology- intensive strategy have significantly better performance than those pursuing a labor-intensive strategy. Further, based on their findings, Isobe, Makino, and Montgomery (2000) concluded that both aspects of entry strategy: early entry and high resource commitment to technology transfer have positive impacts on performance of international joint ventures in China. In spite of notable research effort that has spent to identify the predictors of success, little has been designed to examine the interrelationships between strategic-choices variables and partner-related variables, and their interaction effect on IJV performance.

Since the strategic characteristics of local partners influence the degree of resource complementarity, and the extent of strategic fit between local and foreign partners (Buckley and Casson, 1988; Luo, 1996; Zeira and Shenkar, 1990), strategic alignment is expected to influence joint venture performance outcomes (Lasserre, 1999). For example, "the degree of congruence in strategic motivations of IJV formation, and the degree of complementarity in rent-generating skills (such as relationship building skills) between foreign and local partners are areas well worth investigating" (Luo, 1997). In order to ascertain the extent to which partner behavior and partner motives influence IJV performance, this study aims to examine the following major research questions:

1) What is the nature of local partners' relationship building behavior?
2) What is the level of importance of local partners' motives on venture formation?
3) What is the influence of local partners' relationship building behavior on IJV performance?
4) What is the influence of the interaction between relationship-building behavior and venture-formation motives on IJV performance?

This study uses international joint ventures in China for investigation. China clearly represents an important country context for any IJV performance study as she is the second largest but fastest-growing foreign direct investment recipient in the world (MOFTEC Bulletin, 1997). Besides, China has a transitional market structure, to the extent that the Chinese settings are analogous to other developing countries, the findings could have important implications for international firms entering these emerging markets (Luo, 1998). Furthermore, as the whole business system in China can be seen as a complex web of networks (quanxiwang), the relational approach to doing business is particularly relevant in the country (Ambler et al., 1999). China hence provides the business context for the investigation of the effect of local partners' relationship building skills on IJV performance.

Theoretical Foundation Linking Partner Relationships to IJV Performance

The partner relationship model of international venture performance used in this study is described in figure 1. The proposed model rests on the major premise that interfirm collaborations represent a form of social exchange. According to the social exchange perspective (Hakansson and Johanson, 1988), firms carry out various economic activities through a matrix of exchange relationships with other firms. Explicit collaborative arrangements, through which "access to people, facilities, documents, and other forms of knowledge is traded between partners" formalize this matrix of relational exchange (Hamel, 1991). As a form of social exchange, the performance of IVJ can be attributed to the *economic* value of resources that partners provided, as much as the *behavioral* value of relationship nourishment that partners maintained (Saxton, 1997). This study examines the effect of four, distinct relationship characteristics of international venture partners on IJV performance. Specifically, venture partners' mutual trust, shared norms over planning, and two-way communication were included in the present model since they have been proposed by the relationship marketing literature (Morgan and Hunt, 1994; Sarkar, Cavusgil and Evigen, 1997) as potentially powerful predictors of venture performance. Finally, venture partners' prior quanxi/affiliation was included in the current model as it has been reported by recent empirical studies (Ambler et al., 1999; Glasiter and Buckley, 1999; Saxton, 1997) as a significant determinant of venture performance.

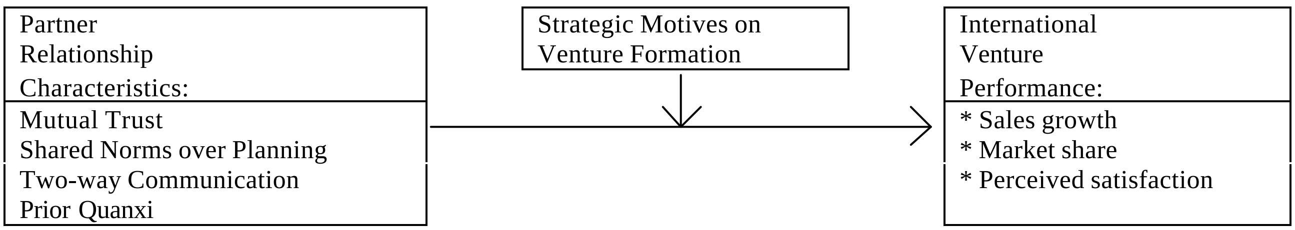

Fig.1: PARTNER RELATIONSHIP MODEL OF INTERNATIONAL VENTURE PERFORMANCE

Trust refers to "a party's confidence in an exchange partner's reliability and integrity" (Morgan and Hunt, 1994). The extant literature identified three important roles of trust in inter-organizational exchanges (Aulakh, Kotabe and Sahay, 1996) including: trust as a behavioral deterrent of opportunistic behavior (Bradach and Eccles, 1989; Hill, 1990), as an alternative to ownership control (Dwyer, Schurr and Oh, 1987), and as a contributor to cost reduction and value enhancement of projects involved (Madhok, 1995; Sarkar, Cavusgil and Evirgen, 1997). Previous empirical studies (Achrol, 1991; Doz, 1988; Sarkar et al., 1997) have substantiated the link between trust and commitment to project. The relationship between trust and collaborative performance has also been found (Ring and Van de Ven, 1992; Sarkar et al., 1997; Wallace, 1993). Thus, it is hypothesized that:

H1: High level of mutual trust between international venture partners will have a positive impact on IJV performance.

Shared Norms over Planning refers to congruency in organizational values and compatibility in organizational procedures (Sarkar et al., 1997) towards the crafting and implementation of business plans from which venture partners learn to respond to environmental changes. In line with organizational learning theory (Hedlund, 1994) that suggests that firms seek to establish and maintain competitive advantage through acquiring tacit as well as articulated knowledge, IVJ is one mechanism firms use to learn (Lyles, 1988; Pennings et al., 1994). Saxton (1997) noted that shared decision-making would enhance the appropriability of knowledge and affect alliance performance outcomes. Empirically, Saxton (1997) reported that shared decision making could increase the likelihood of successful alliance performance. It is therefore hypothesized here that:

H2: High level of shared norms over planning between international venture partners will have a positive impact on IJV performance.

Two-way communication refers to the formal and informal sharing of meaningful and timely information between firms (Anderson and Narus, 1991). Frequent communication helps the firms to realize mutual benefits by reducing dysfunctional misunderstandings (Dwyer, Schurr, and Oh, 1987), enhance trust (Sarkar et al., 1997) and relationship quality (Crosby et al., 1990), and finally contributes to successful ventures (Badaracco, 1991; Lewis, 1990). Past studies (Aulakh et al., 1996; Sarkar et al., 1997) found that two-way communication enhances trust between partners. This study hypothesized that:

H3: High level of two-way communication between international venture partners will have a positive impact on IJV performance.

Prior Quanxi refers to previous relationships (Glaister and Buckley, 1999) or prior affiliations between partners (Saxton, 1997) that were developed before formation of international joint ventures. Saxton (1997) suggested that prior market contact could bring several benefits since it allows partner firms to know each other better, thus facilitating a greater understanding of the likely behavior of the partner and the respective capabilities and resources that they are seeking to access. Moreover, Glaister and Buckley (1999) added that repeated alliance among firms engender inter-firm trust among partners that in turn limit transaction costs associated with future alliance. In particular, prior quanxi can constitute strategic asset for IJVs in China where the notion of impartial justice was underdeveloped and where foreign firms were challenged by weak market structure, poorly specified property rights and institutional uncertainty (Luo, 1997). Previous quanxi brings in advantages to IJVs in China when a local partner's quanxi network helps foreign companies obtain scarce production factors, facilitate value chain contributions, promotion relationships with various governmental institutions, and increase effectiveness of market penetration (Luo, 1998). Saxton (1997) empirically found that prior affiliations had a positive effect on a firm's initial satisfaction with a venture. Thus, it is hypothesized that:

H4: High level of previous quanxi developed between international venture partners will have a positive impact on IJV performance.

Moderating Effect of Strategic Motives on Venture Formation on the Relationship between Partners Relationship and IJV Performance

Strategic Positioning Motives on Venture Formation refers to a major set of motives of venture formation (Glaister and Buckley, 1996) that put emphasis on the desire of using alliances as "reactive responses to competitive pressure" and as "competitive weapons in the battle for global market share". These motives are underpinned by the theory of strategic positioning (Kogut, 1988) that views alliances in the context of competitive rivalry and collusive agreements to enhance market power. For example, many IJVs are motivated to conform to host government policy (Beamish, 1988; Tatoglu and Glaister, 2000), to facilitate international expansion (Contractor and Lorange, 1988; Gannon, 1993), to shape competition (Porter and Fuller, 1986), and to consolidate market position (Harrigan, 1985). Notably, Glaister and Buckley (1996) reported that foreign-based alliances have placed greater emphasis on strategic positioning motives to venture formation than for alliances based at home. In short, a strategic positioning motivation that emphasizes the use of local partners to develop market quickly would encourage the further nourishment of relationships with local partners (Beamish, 1988) so as to bring about superior IVJ performance.

This study used "strategic motives on venture formation" as the contingency variable and developed hypotheses about how strategic motives on venture formation moderate the effect of partner relationship characteristics on IJV performance. In line with prior research (Geringer, 1991; Luo, 1995) that partner composition is an important variable affecting IJV performance, the study proposed that local partners that put emphasis on strategic positioning motives may rely on prior quanxi more heavily, communicate more frequently, cooperate over shared planning more commonly, and develop mutual trust more extensively with foreign partners to enhance overall IJV performance than local partners denied such an emphasis.

In contrast to traditional perspective (Buckley and Casson, 1988; Lewis, 1990) that suggests that relationship commitment be a key predictor of relational exchanges and have a direct effect on performance outcomes of IJVs (Morgan and Hung, 1994; Sakar, Cavusgil, and Evigen, 1997), the contingency perspective proposes that relationship commitment has both a direct and an indirect effect on IJV performance (Lin and Germain, 1999). Whereas the traditional perspective implies that relationship commitment has a direct influence over venture performance irrespective of partners' motives on venture formation, this study upholds the contingency perspective that commitment to relationship improves venture performance only when venture partners attach enough importance to strategic positioning motives. One major kind of strategic motives on venture formation has been characterized as market/competitive positioning (Glaister and Buckley, 1996). When local partners involved in IJVs place a strong emphasis on the strategic positioning motive of conforming to government policy and benefiting from preferential incentives (Beamish, 1988), they not only have a clear understanding that joint venture is a contractual form to accommodate government policy in developing countries (Tatoglu and Glaister, 2000), but they also assume greater confidence over contract compliance on the part of the foreign partners (Moorman et al., 1993). It is therefore hypothesized that

H5: The positive relationship between trust and IJV performance is stronger when the perceived importance of strategic positioning motives on venture formation is high than when it is low.

On the other hand, conformity to host governmental policy may not the primary motivation for venture formation. As in case of IJVs motivated by genuine desires to share risk and resources, to gain knowledge, and to obtain access to new markets (Dacin, Hitt, and Levitas, 1997), development of trust in situations *without* legal protection is inherently a risky endeavor. The need for other contractual safeguards to protect partner interests (e.g. technology transfer, product diversification) would arise.

Similar logic can be extended to argue that strategic positioning motives moderate the relationship between prior quanxi and IJV performance. When local partners place a strong emphasis on the strategic positioning motive of conforming to government policy and benefiting from preferential incentives (Beamish, 1988), they are expected to assume the role of go-between in China (Yeung and Tung, 1996) and use their good back door rapport with governmental authorities to assist foreign partners in partner search, business negotiation and problem solving (Chadee and Zhang, 2000). The resulting resources that local partners solicit in the forms of trade contacts, competitive intelligence, pricing information, and administrative approvals, enhance performance outcomes of IJVs. It is therefore hypothesized that

H6: The positive relationship between prior quanxi and IJV performance is stronger when the perceived importance of strategic positioning motives on venture formation is high than when it is low.

On the other hand, when local partners' motive on conforming to governmental policies is not strong, that using prior quanxi to set up a business in foreign country may receive less attention. Although prior quanxi might provide initial market contacts and knowledge of a partner firm (Saxton, 1997), prior quanxi is not predictive of a successful relationship in the long run that depend on actual benefits and shared outcomes.

There exists another type of strategic positioning motives that emphasize on transferring technology, enabling high quality production (Tatoglu and Glaister, 2000), and coping with intensifying domestic competition (Harrigan, 1985; Porter and Fuller, 1986). This latter type of motives on venture formation offers a different set of arguments for explaining the moderating role of partner relationship characteristics on IJV performance. When local partners involved in IJVs place a strong emphasis on the market-positioning motive of enabling high quality production and coping with market competition (Tatoglu and Glaister, 2000), they clearly expect to learn more and gain more from foreign partners, and welcome to a greater extent the values of related planning activities. It is therefore hypothesized that

H7: The positive relationship between shared norm over planning and IJV performance is stronger when the perceived importance of strategic positioning motives on venture formation is high than when it is low.

In contrast, when facilitating high quality production and coping with domestic competition is not the primary motivation for venture formation, the potential values of shared planning may subject to debate. Given that the local partners are caught in inherently power imbalances (Tatoglu and Glaister, 2000), even though local partners may be willing to learn, foreign partners may not always put top priority on transferring technologies. In short, the extent of congruency of motivations on venture formation between foreign and local partner may affect whether shared planning can be realized, quality of decision outcomes be improved, and performance outcomes be enhanced.

Similar logic can be extended to argue that the motive of enabling high quality production and coping with market competition moderates the relationship between two-way communication and venture performance. When the motive on enabling high quality production and coping with market competition is strong, local partners may communicate more frequently with foreign partners and exchange timely information to a greater extent that may in turn enhance market performance as the firms can better able to respond to changing demands. It is therefore hypothesized that

H8: The positive relationship between two-way communication and IJV performance is stronger when the perceived importance of strategic positioning motives on venture formation is high than when it is low.

On the other hand, when enabling high quality production and coping with market competition is not a strong motive, on-going communication and other information exchange may be less likely. Furthermore, the complementarity of communication between venture partners may complicate situation. According to Anderson and Narus (1987), the effect of communication involved in working partnerships can happen in both ways: two-way communication may foster complementary partner actions to achieve mutual benefits on the one hand, but communication may give rise to conflict and hamper performance outcomes in the partnership on the other hand. In short, the direction of the effect of communication depends on management of stress in interdependent partnership.

Research Method

Data Collection Method

This study is about IJVs of the hotel industry in China, and it involves Chinese partners of international joint ventures with partner firms from the United States, Japan, Western Europe, Hong Kong, and South-east Asian countries. Sample joint venture hotels were selected according to the information supplied by the Bureau of Tourism in Qingdao. Joint venture hotels in the Beijing, Tianjin, Qingdao, Shanghai, Guangzhou areas in China were contacted about this research project. Random sampling procedure was applied to select 230 firms. An invitation letter asking the potential respondent firms to participate in the present study was sent. Out of originally selected 230 firms, 202 firms indicated their willingness to participate in this survey study. Personal interviews were subsequently arranged for firms indicated their willingness to participate. A team of Chinese collaborators from University of Wuhan visited all the selected joint venture hotels and contacted both local and expatriate managers. All the participants were at the managerial level. In all, 202 responses were received for a response rate of 80 per cent.

The profile of respondent organizations is reported in Table 1. The present sample consisted mainly of medium-sized organizations with the majority employing more than 400 employees (60.1 per cent) and achieving more than 41 million renmanbi annual sales record (65.5 per cent). Most (73.1 per cent) of the organizations were experienced international businessmen with more than ten years international operation history. In addition, the great majority (58.9 per cent) of foreign partner firms came from Hong Kong. And, most (72.8 per cent) of the organizations have only one operation in China. Nevertheless, although the majority (62.0 per cent) of foreign partner firms have less than fifty percent ownership stake in the joint venture, 22 per cent actually have 51 per cent or above stake in the venture. Furthermore, even though the majority (67.7 per cent) of the ventures were 4-stars or 5-stars hotels, nearly one third (32.2 per cent) were 3-stars hotels. Finally, while slightly more than half (53.4 per cent) of the hotels were located in the northern cities of Beijing or Tianjin, nearly half (46.6 per cent) of hotels were founded in southern cities of Guangdong and Fuzhou. As joint venture partners with different size, experience, ownership stake, and location decision might have different performance outcomes in China, this study covered different types of IJVs to provide a representative sample at an institutional level.

Table 1: GENERAL CHARACTERISTICS OF RESPONDENTS

Background Variables	N	%
Number of Full-time Employees		
Less than 200	8	4
200 to 400	72	35.6
401 to 600	72	35.6
601 to 800	24	11.9
801 to 1,000	15	7.4
More than 1,000	11	5.5
Annual Sales Turnover		
Under 20 million	24	12.2
21m to 40 million	44	22.3
41m to 60 million	46	23.4
61m to 80 million	30	15.2
81 m to 100 million or more	21	10.7
Above 100 million	32	16.2
Years of International Experience		
Less than 5 years	10	5.5
5 to 10 years	39	21.4

11 to 15 years Over 15 years	62 71	34.1 39.0
Country of Origin of Foreign Partner		
USA/Canada	18	8.9
Europe	12	6.1
Japan	20	10.0
Singapore	13	6.5
Hong Kong	119	58.9
Others	19	9.6
Number of Hotel Operations in China		
Only 1 operation More than 1 operations	147 55	72.8 27.2
Level of Foreign Ownership		
51% or above	38	22
50%	27	15.8
Below 50%	106	62
Hotel's Grading		
5 stars	42	20.9
4 stars	94	46.8
3 stars	65	32.3
City / Location		
Guandong	50	24.8
Fuzhou	44	21.8
Beijing	58	28.6
Tianjin	50	24.8

Measurement

Prior research suggests controversies over how to measure performance of international joint ventures (Hu and Chen, 1996). As no single measure can capture the diverse goals of IJVs, Chakravarthy (1986) proposes the use of multiple measures of strategic performance. In the IJV literature, the commonly accepted financial goals include: sales growth, market share, return on investment, and profitability (Ghoshal, 1987; Pan et al., 1999; Isobe et al., 2000). Anderson (1990), however, argues that conventional financial measures of performance are not appropriate due to the high level of risks associated with ventures. Moreover, a multinational corporation entering a new country such as China may not consider low short-term profitability as a sign of poor performance, and may place emphasis instead of other non-financial goals such as gaining a foothold in a potentially huge market (Ding, 1997). For these reasons, this study adopted a three-item scale reporting performance as perceived by a partner organization in the alliance. This scale reflects overall satisfaction with the alliance, extent of sales growth of the joint venture operation, and degree of market share performance in comparison to major rivals. The variables discussed in the hypotheses section are summarized in Table 2 that sets out the method of variable measurement.

Table 2: FACTOR ANALYSIS ON INDEPENDENT VARIABLES, AND MEASUREMENTS FOR MODERATING AND DEPENDENT VARIABLES

Factor-based measurement scales for Partner Relationship Characteristics Variables (a)	*loading*	*Means*
Factor 1: Two-way Communications		
Your firm is hesitating to give your partner information that is not part of the contract.	.87	5.52
Your partner firm is hesitating to give you information that is not part of the contract.	.78	5.35
You and your partner firm are generally skeptical of the information provided to each other.	.76	5.45
There is a high level of uncertainty in this partnership.	.69	5.53
If your firm can find another partner, you are likely to switch to a new partner.	.63	5.32
Your foreign partner will be an ideal ally even under poor economic condition.	.59	4.86
Eigenvalue: 5.48, Percentage of variance explained: 23.81%, Alpha: .85		
Factor 2: Mutual Trust		
You and your partner firm generally trust that each will stay within the terms of the contract.	.71	4.85
Your business relationship with this foreign partner is characterized by high level of trust.	.69	5.21
Flexibility in response to request for changes is a strong characteristic of this partnership.	.66	4.86
You can reduce ambiguity and conflicts by having regular meetings with the foreign partner.	.60	5.18
When unexpected situations arise, you would rather work out a new deal with the foreign partner than hold each other to original terms.	.59	4.96
You expect to maintain a good relationship with this foreign partner.	.58	5.74
Annual account performance review with the foreign partner is conducted regularly.	.55	5.80
Eigenvalue: 3.23, Percentage of variance explained: 14.03%, Alpha: .81		
Factor 3: Shared Norms over Planning		
Good marketing planning can help the firm to compete with others.	.71	5.97
You and your partner firm expect to make adjustments to cope with changing circumstances.	.67	5.30
Trust between partners can be improved by more information exchange.	.62	5.76
Shared planning can facilitate mutual co-operation and coordinated activities.	.53	5.42
Eigenvalue: 2.35, Percentage of variance explained: 10.20%, Alpha: .70		
Factor 4: Prior Quanxi		
Your firm had worked with this foreign partner previously.	.89	3.70
A key person in your firm had good connections with a key person at the foreign partner's firm.	.86	3.25
Your firm has a good working relationship with the foreign partner.	.77	3.71
Eigenvalue: 1.67, Percentage of variance explained: 7.26%, Alpha: .83		

Measurement scales for Strategic Motives on Venture Formation Variables (b)	*Means*
The Chinese partner was motivated to joint venture by receiving more preferential treatment.	4.21
The Chinese partner was motivated to joint venture by governmental policies.	4.15
The Chinese partner was motivated to joint venture by the opportunity of quality improvement.	3.48
The Chinese partner was motivated to joint venture by the chance of increasing market power.	3.88

Measurement scales for International Venture Performance	*Means*
The partnership had achieved very high sales growth. *(c)*	3.51
The partnership had achieved very high market share relative to major competitors in China. *(c)*	3.52
The partnership was satisfied with the overall performance of the joint venture. *(d)*	3.51

a Assessment of partner relationship characteristics is measured on a 7 point scale,
with 1 = strongly disagreed and 5 = strongly agreed.
b Strategic motives on venture formation was assessed on a 5 point scale
with 1 = most unimportant and 5 = most important.
Assessment of international joint venture performance is measured in two different ways:
c achievement of sales growth is assessed on a 5 point scale, with 1 = ver low and 5 = very high; and

c	achievement of relative market share is assessed on a 5 point scale, with 1 = ver low and 5 = very high
d	level of satisfaction on the overall performance of the international joint venture is assesses on a 4 point scale with 1= 50% or less satisfaction, 2 = 51 to 70% satisfaction, 3 = 71 to 90% satisfaction, and 4 = 91 to 100 % satisfaction.

Statistical Analysis

The statistical analysis was divided into three stages. First, exploratory factor analysis was performed to identify the underlying dimensions of relationship characteristics of IJV partners. Second, multiple regression analyses were carried out to test the hypotheses (H1, H2, H3, and H4) concerning the association between the four independent variables of partner relationship characteristics and the dependent measure of IJV performance. Next, the hypotheses concerning the moderating effect (H5, H6, H7, and H8) were tested by hierarchical regression analyses (HMR). The basic principle underlying this analysis is the entry of predictor variables in some pre-specified hierarchy where R^2 is determined at this stage. The significance of the hypothesized relationships was tested based on an F-test for the increase in R^2 at each stage as described by Cohen and Cohen (1983).

Research Findings

Factor Analysis Results

In order to identify a smaller number of distinct, non-overlapping independent variables for the sample data, exploratory factor analyses were carried out. The reliability estimates of the measures used in the subsequent analyses ranged from .70 to .85. The results of the factor analyses with varimax rotation and reliability scores were shown in Table 2.

For the independent predictor variables, the analysis produced a four-factor solution that displays good face validity and explained a total of 55.31 per cent of the observed variance. Factor 1 captured six items reflecting two-way exchange of information between venture partners that helps to resolve disputes, align expectations, remove uncertainty, and pave the way for relationship continuity. These items were similarly used by Aulakh et al. (1996) and were in line with previous studies (Anderson and Narus, 1984; Anderson and Weitz, 1987) that examined information exchange in inter-organizational partnership. This factor accounted for 23.8 per cent of the total variance and is named as two-way communication.

Factor 2 captured seven items that explained for 14.0 per cent of the total variance. As these statements pertain to the overall confidence in venture partners' reliability in staying within terms of contract, as well as the specific expectations in venture partners' willingness to make adaptations, as circumstances require, this factor is defined as mutual trust. These items were adopted by Moorman et al. (1993) and Aulakh et al. (1996) before, and fell within the definition of trust in the relationship-marketing domain (Morgan and Hunt, 1994).

Factor three is comprised of four items reflecting venture partners' shared understanding on the organizational values of marketing planning as a means to compete, as an adjustment to cope with change, as a facilitator of coordination, and as a contributor to trust-building. These items were consistent with definitions of shared norms between venture partners used by Saxton (1997) and Sarkar et al. (1997). This third factor accounts for 10.2 per cent of the total variance and is named as shared norms over planning.

The fourth factor is consisted of three items and it explains for 7.3 per cent of the total variance. The same measurement items were employed by Ambler et al. (1999) before in an interorganizational context. As the items were about prior affiliations with partner firm, good working relationships in the past, and good connections between key persons in partner organizations, this factor is defined as prior quanxi .

For the moderator variables of strategic motives on venture formation, four motives pertaining to joint venture formation were assessed. They are the motive to conform to host government policy, to receive preferential treatment, to improve quality of management, and to increase market power. The items were consistent with the domain of strategic positioning motives to joint venture formation (Beamish, 1988; Contractor and Lorange, 1988; Gannon, 1993; Harrigan, 1985; Porter and Fuller, 1986).

For the international venture performance variables, three dimensions of joint venture performance were tapped reflecting very high sales growth, very high market share, and very high satisfaction on the overall performance of the international joint venture in China. Consistent with the international joint venture performance literature, these items captured both financial and non-financial aspects of venture performance in international markets.

Multiple Regression Analyses Results

To further examine the association between partner relationship characteristics and performance outcomes of IJVs, a multiple regression analysis was run for the IJV performance construct. Table 3 shows that the main effect of partner relationship characteristics on IJV performance. The independent constructs together accounted for 27 per cent of the variance of performance of IJVs, with individual *beta* coefficients support H1 ($B = .23, p < .01$), H2, ($B = .36, p < .00$), and H4 ($B = .26, p < .00$). Hypotheses H1, H2, and H4 were thus supported. As hypothesized, these findings indicated that the existence of high levels of mutual trust, two-way communication, and prior quanxi between venture partners leads to superior IJV performance outcomes. Nevertheless, unexpected findings were observed for the effect of shared norms over planning on IJV performance. Surprisingly, shared norms over planning have a significant but negative effect on IJV performance ($B = -.15, p < .05$), thus partially supporting H2.

Table 3: RESULTS OF REGRESSION ANALYSES

Variable	International Joint Venture Performance	
	Model 1	Model 2
Relationship Variables:		
Two-way Communications	.23 **	.20 **
Mutual Trust	.36 ***	.36 ***
Shared Norms over Planning	-.15 *	-.16 *
Prior Quanxi	.26 ***	.24 **
Interaction variables:		
Strategic Positioning Motives X Two-way Communications	NA	-.19 **
Strategic Positioning Motives X Mutual Trust	NA	.24 **
Strategic Positioning Motives X Shared Norms over Planning	NA	.12 *
Strategic Positioning Motives X Prior Quanxi	NA	.07
R^2	.27	.34
Adjusted R^2	.24	.30
Change in F		4.46 **

* correlation is significant at 0.05 level
** correlation is significant at 0.01 level
*** correlation is significant at 0.001 level

Hierarchical Regression Analyses Results

When the four partner relationship characteristic variables were entered into the regression equation at the first step, they accounted for 27 per cent of the total variance. There is a significant increase in explained variance in the relative market share performance (adjusted R square change = .34; p = .01) when interaction variables (i.e. partner relationship characteristics multiplied by strategic positioning motives on venture formation) were entered into the equation at the last step. Table 3 showed the HMR results. With respect to interaction effect factors, two variables – trust times strategic positioning motive on venture formation; and shared norms over planning times strategic positioning motive on venture formation - were found to be significant and in the positive direction as expected. In terms of individual hypothesis, the effect of mutual trust ($B = .24$, $p < .01$) and shared norms over planning ($B = .12$, $p < .05$) on IJVs' performance outcomes is stronger when there is a strong rather than weak emphasis on strategic positioning motives on venture formation, thus supporting H5 and H7.

Contrary to prior expectations, however, the interaction effect of two-way communication times strategic positioning motive on venture formation - was found to be significant but in the negative direction. In terms of individual hypothesis, the effect of two-way communication ($B = -.19$, $p < .01$) on IJVs' performance is stronger when there is a weak rather than strong emphasis on strategic positioning motives on venture formation, thus providing only partial support to H8. Furthermore, the interaction effect of prior quanxi and strategic positioning motive on venture formation was not significant ($B = .07$, $p > .10$) and H6 was not supported.

Discussion, Conclusion and Implications

Although some researchers (Hu and Chen, 1996; Sarkar et al., 1997; Saxton, 1997) asserted that partner-related factors are more influential than joint-venture-related factors in accounting for IJV performance outcomes, to data, empirical evidence has been lacking. To further complicate the search for key success factors of IJVs, there is little knowledge concerning the way in which partner-related factors interact with joint-venture-related factor to affect the performance of IJVs. Yet, according to partner selection literature (Geringer, 1991; Luo, 1997), partner selection factors may have significant moderating effect on the relationship between partner behavior and partnership performance. In order to address these voids in the literature, this empirical study investigates the effect of partner relationship factors on IJV performance. The current results reveal that partner relationship factors have a very powerful direct effect on performance outcomes of IJVs. The other major conclusion of this study is that significant interactions exist between partner relationship and partner motives on venture formation.

With regard to the main effect, it is worthwhile noting that three partner relationship characteristics namely: partners' mutual trust, two-way communications, and previous quanxi have significant, positive effect on all the performance indicators under examination in this study. An interesting finding of this study is that shared norms over planning between partners have a significant but negative effect on the performance of IJVs. One possible interpretation is that while a shared approach towards planning can enhance appropriation and learning of knowledge resident in a partner (Lyles, 1988; Pennings et al., 1994) and contribute to alliance success, the actual benefit of shared planning may depend on the efficiency and effectiveness of ex post integration mechanism (Glaister and Buckley, 1999). As suggested by the diversification literature, integration efforts that unite and bind the operations of partner firms together, are often much more costly, much more time-consuming, and much more difficult than initially forecasted (Hill and Jones, 2001). In case of a *failure of post-integration effort to materialize the expected benefits of shared planning*, partners might perceive worsened performance outcomes like poor sales efficiency and deteriorated satisfaction. Additional research isolating the effect on alliance performance of shared planning in terms of benefits, costs, and synergy involved in shared planning is warranted.

With regard to the moderating effect of strategic motives on venture formation on the partner characteristics-performance relationship, the results supported the notion that partner relationship characteristics becomes particularly important in explaining IJV performance when venture partners attached a high level of importance to strategic positioning motives on venture formation. In particular, when venture partners' desire to work together is dominated by strategic positioning motives (such as conforming to host government policy), foreign partners would trust that local partner's network can promote relationships with various governmental institutions (Luo, 1998) and thus has positive implications for IJV performance. In addition, when venture partners are essentially motivated to cooperate by competitive positioning motives (such as improving quality of management, and consolidating market power), both partners would adopt a shared approach towards planning to obtain scarce production factors, facilitate value chain contributions, and increase effectiveness of market penetration (Luo, 1998).

Managerial Implications

An important finding of this study is that relational factors are key factors in achieving superior performance outcomes in international joint ventures. The clear implication here is that managers must support a relationship management strategy, since it is a critical success determinant of international joint ventures. This study indicates that building an effective relationship with venture partners that enhances performance requires venture partners to communicate frequently, plan cooperatively, use prior quanxi creatively, and cultivate trust continuously.

The findings also indicate that the local partners' relationship-building behavior enhances venture performance when the emphasis on strategic positioning motives on venture formation is strong. The implication is that venture partners must be cautious when prescribing the use of local partners' relationship-building behavior. Given that foreign-country partners and host-country partners enter IJVs with different motives (Tatoglu and Glaister, 2000), it is critical for the foreign partners to identify and understand the motives of local partners prior to engaging in IJVs. By joining force with foreign partner firms, the local partner firms expect better business positioning to contend for domestic market leadership as a result of technical transfer, managerial upgrading, and product quality improvement. In order to motivate the local partner to improve venture performance, all competitive strategies and game plans of the IJV must be explained with reference to the potential constructive impact on domestic market competition. When the local partners were made to recognize the potential benefits of joint venture strategies (Morgan and Hunt, 1994; Sarkar et al., 1997), they were much more likely to buy-in and place great investment and commitment to the venture to make it a great success.

Research Limitations and Suggestions for Future Research

While the results of this study are encouraging, they nevertheless should be evaluated with full awareness of its limitations. First, the framework was examined by using data from international joint ventures based in the People's Republic of China (PRC) thereby limiting the generalizability of the findings to non-Chinese firms. Additional research needs to extend the study to other samples and business contexts to reinforce our confidence in the generalizability of the findings of this study. Second, the heavy reliance on primary sources of data collection in this study may be prone to common method variance bias, and the use of internally oriented performance measure in this self-report study may also exhibit reliability problem in its performance measures. Performance measurement research, according to Katsikeas, Leonidou, and Morgan (2000), would benefit from future studies making comparison between primary and secondary sources, and between subjective and objective modes of assessment to enhance confidence in reliability and validity of performance measures. Third, the relational variables chosen for analysis were incomplete as it does not analyze the effect of other relationship constructs (such as relationship benefits, commitment, adaptation, conflict, dependence, distance, understanding) on IJV performance. Additional studies are required to investigate the effect of a full set of relationship parameters on IJV performance. Specifically, as this study found that shared norms over planning has a negative effect on IJV performance, additional research is warranted to examine whether sharing in terms of increasing similarities among venture partners reduce benefits brought to venture relationship and hamper IJV performance. In addition, further study is needed to investigate whether proper post-integration mechanisms materialize the expected benefits of shared planning and enhance IJV performance. Fourth, the study did not consider other intervening variables both mediating and moderating the effects of joint venture related factors and partner relationship related factors on IJV performance. Given the time-dependent nature of partner relationship involved in IJVs, future research efforts are encouraged to examine the moderating effect of relationship life cycle (Jap and Ganesan, 2000) on the relationship between relational behavior and IJV performance. In addition, further studies are needed to examine the mediating role of competitive strategies (such as customer service strategy, quality strategy, support strategy) by exploring the way in which relational behavior affects competitive strategy and the latter's effect on IJV performance. In short, although the study provides theoretical and practical insight into the concept and performance consequences of venture partner relationship characteristics, future research is needed to replicate and extend the proposed model to reinforce our confidence in the generalizability of the findings of this study.

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Paper proposal :« Impact of transportation infrastructure on SMEs location in Poland ».

par Barbara Despiney* (ROSES/CNRS, Paris-France).

Investments in highway and other types of transportation system improvements are widely recognized as an important means for achieving economic growth and development at the local, regional and national levels. Adequate government transport policy should facilitate the development of this sector, taking into consideration the positive externalities for the whole economy (e.g. extension of markets accompanied by economies of scale, facilitating division of labour, lowering some transaction costs) as well as the negative externalities (e.g. congestion, air pollution, accidents).

The subject of this paper is to present the impact of the motorway system in Poland on regional competitiveness. The results of many Western research usually suggests that transport investments has limited effect on a regional economy, and may actually harm peripheral regions. But, the transport scene in Central and Eastern is changing far more rapidly than it did in the Western Europe, and the results we can extrapolate from those researches may be limited here. The significant new motorway investments could bring in Central et Eastern Europe a »long, sharp shock »to the system, generating relatively more fundamental economic change. The section 1 of article focuses on a proposed highway construction project to create a 1900 km network of higways in Poland. In Poland, the main routes to be constructed first are the A2 and A4 oriented to making Transeuropean links. The polish state should take the lead in the development of infrastructure due to the high costs connected with this, in fact most often too high for the private sector (recent polish experience from 1990s). The importance of transport for socio-economic development is explores in section 2. The importance of good accesibility for the location of new factories often attracts them to the vicinity of major cities that enjoy the comparatively best road connections. There are, for exemple, characteristic clustres of foreign greenfield investments along future motorways and near two metropoles: west of Poznan (Tarnowo Podgorne) and south of Wroclaw (Kobierzyce). The Polish experience of greenfield FDI in the 1990s confirms the considerable role played by local institutions in the process of location choice. The success of Kobierzyce and Tarnowo Podgorne rests not simply on their attractive conditions (location on the highways) but to a large extent on the activity of their local governments.

Section 3 discusses the development of transport policy in the European Union and its influence on the transport sector. The recent developments in the transport policy in the EU and Poland are compared. The integration to EU will pose the problem of concurrence between polish and european transport and forwarding companies. The study made by Platje and Krzekotowski based on an analysis of the development in logistics and logistics services offered by 260 Polish transport and forwarding companies concluded that the Polish transport sector is behind the developments in the EU (PLATJE&KRZEKOTOWSKI, 2001).

Table 1: Three Generations of Logistic Development

Generation	First	Second	Third
Time Period	Before 1970	1970 – 1990	After 1990

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Industrial Structure	Independent factories	OEM and subcontractors	Global and virtual corporations
Focus and Organisational Involvement	Shipment	Material flow	Logistics channel
Economic Impact	Low costs	Reduced costs Increased revenues	Systemwide Cost reduction & revenue increase
Management Position	In other departments	Separate function in company	Joint function of separate companies
Information support	Telephone, Telex	Fax In-house computer systems	Computer network EDI, DSS, AI

Source: OECD, *Integrated Advanced Logistics for Freight Transport*. Paris, 1996.

A few options remain for the Polish transport sector when Poland would join the EU: Polish carriers and forwarders start to co-operate in order to face competition from large companies from the EU in order to obtain a share of the EU market and to keep their position on the Polish market, or being squeezed out of the market by EU competitors, leaving some niches like providing services for large companies with foreign capital and transport eastwards.

Managing Mergers And Acquisitions

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Abstract

Mergers and Acquisitions are a response to the excess capacities in industry and over fragmentation. In lot of economies, which are opening up doors to foreign investment, like India, a lot of mergers and acquisitions are taking place, which need to be managed effectively if these acquisitions have to be beneficial. An increasing incidence of M&A activity is happening in industries like pharmaceuticals, electronics, power, automobile components, finance, chemicals and consumer products. The paper attempts to look at the trends of Mergers and Acquisitions in Indian context, analyze the trends and do a comparison with international mergers and acquisitions. The data has been painstakingly collected over the last seven years and underlying reasons identified for these activities. It then suggests how these mergers and acquisitions can be managed better

Introduction

Indian economy has seen a rise in the merger and acquisition activity since the liberalization process gathered momentum from 1991 onwards. The number of M&A's has been increasing and each industry is witnessing change. The privatization of industry like power, steel and telecom has opened new opportunities. The Monopolistic and Restrictive Trade Practices (MRTP) Act, 1969 that was implemented to check concentration of economic power, control the growth of Monopolistic and Restrictive Trade Practices has been weakened. The Industrial Policy announced on June 24, 1991 by the Government assured the dismantling of the shackles of the regulatory system. Amendments were made in the in MRTP Act omitting all restrictive sections discouraging growth of industrial sector. To attract foreign investment in industry, relaxations were made for foreign direct investment upto 51% foreign equity in high priority industries that has further been enhanced in many sectors. The spate of merger and acquisition activity in the industry has increased led by changes in economic policy.

Methodology

This paper elaborates on the trends in merger and acquisition activity from 1993- 1999. There are two time segments in which this study has been conducted. The first is from Jan. 1993 to 1996. The second phase is from 1997-1999. The information on the acquisitions has been painstakingly collected from the various publications such as CMIE, leading Indian newspapers and business publications. This methodology was adopted, as there is no single source in India, which records all these mergers and acquisitions. For the period 1993-1996, information on 80 mergers and acquisitions was collated. For the period between 1997-99, information on 323 mergers and acquisitions has been collated. For international mergers and acquisitions, data was collated for the year 1994-95. The data for international mergers and acquisitions has been updated till the year 2000. The comparison of trends for these years gives an insight into the dynamics of merger and acquisition activity.

Significance

The study assumes significance, as the very nature of Indian industry coupled with the liberalization of economy will lead to more of M&A activity. This is so on account of the excess capacities in Indian industry, over - fragmentation; lack of requisite size of the firm the firm viable, lack of financial resources and commercial orientation. All these factors characterize Indian industry as the environment was such in India, that long period of licensing regime ensured that industry could not expand beyond a particular size and political influence helped getting licenses for setting up industry. In many industry sectors in India, this led to monopolies as a result of which there was little competition. The industry did not really invest on R&D and innovation as whatever was being produced, it was able to sell. So there was no incentive for making any improvements, which led to stagnation in Indian industry. Suddenly, in 1991 the liberalization process initiated by the government changed the rules of the game. Profitability coupled with productivity and customer orientation became important terms, which Indian industry has been evading for long years. Since the shakeout in Indian industry is inevitable on account of increased competition, merger and acquisition activity is bound to take place. So it becomes necessary to understand what needs to be kept in mind to manage these better. This paper recommends certain suggestions for the corporate and the government sector for managing these M&A's.

Defining merger and acquisition

Verma (1995) defines a merger as a combination of two or more companies into a single company where one survives and the other loses its corporate existence. The survivor acquires the assets as well liabilities of the merged companies. Merger is also defined as amalgamation. It is a fusion of two or more existing companies. All assets, liabilities and stock of one company stand transferred to transferee company in consideration of payment in the form of equity shares of transferee company or debentures or cash or a mix of two three modes.

A takeover (Thakur, 1995) of a company would mean assumption of management control of that company by getting substantial powers of management. This is normally done through an acquisition of a sufficient number of shares carrying voting rights and then taking charge of the management of the company by getting appointed to the Board. The purpose of the takeover is generally unilateral and the offerer company decides the maximum price (Verma, 1995).

Findings

The following are the findings of the study:

Merger and acquisition activity in India (1993-99)

Table 1 gives the segmentation in terms of the number of acquisitions and mergers in different timeframes in India and abroad. It also gives details about the merger and acquisition activity abroad.

Table 1: PROFILE OF MERGERS & ACQUISITIONS IN INDIA & ABROAD

Category	India (1993-96)	India (1997-99)	International (1995-96)
Number of mergers & acquisitions	80	323	270
Number of acquisitions	65(81%)	251(71%)	200(74%)
Number of mergers	15(19%)	72(29%)	70(26%)
Related M&A's	64(80%)	318(99%)	193(71%)
Unrelated M&A's	16(20%)	5(1%)	77(29%)

The total number of mergers and acquisitions has been increasing every year though there is a change in the composition of the same. An analysis of merger and acquisition activity reveals that number of acquisitions as a percentage of total M&A activity declined vis a vis number of mergers. This is probably because many more India firms are restructuring themselves and are merging different group entities, which explains more number of mergers in the second phase. Basant (2000) also echoes a similar viewpoint when he suggests through his research that over 50% of mergers in the 1990's were horizontal in nature. He also suggests that firms were consolidating operations. This is suggested as about 74% of the merging companies belonged to the same business group. Over diversification resulting from earlier business strategies is being corrected. In the pre-reform period, often companies within the group competed with each other for market share. The dominant pattern is therefore consolidation at the business of group levels to derive economies of scale, increase market share, reduce costs, achieve focus and eliminate intragroup competition (Venkiteswaran, 1997).

During 1995-96, the analysis of the merger and acquisition activity internationally reveals that 76% of the activity was confined to US and Europe in the given sample. Asia and Australia comprised of 19% of the M&A activity and the balance was attributed to other countries. In line with the trends in India, acquisitions (74%) were far higher than mergers (26%). The related M&A's (71%) were far higher than unrelated M&A's (29%), which indicates a drive towards focusing on, core competence.

The figure 1 reveals the value of the merger and acquisition activity worldwide.

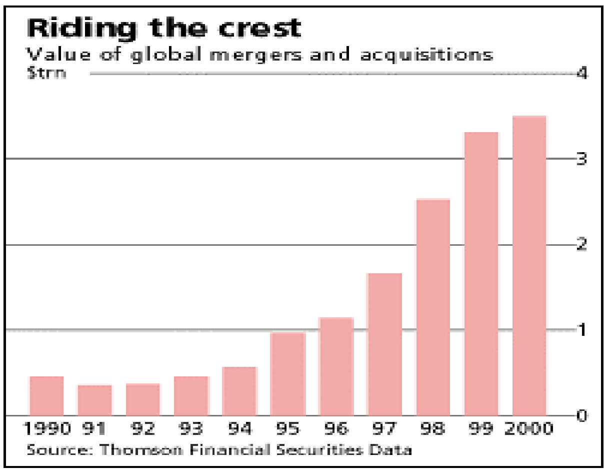

Fig.1 M&A ACTIVITY WORLD-WIDE
Source: Economist (2001) The Great Merger Wave Breaks, Jan. 27

The value of cross-border mergers and acquisitions (M&A) completed in 2000 rose to $1.1 trillion, nearly 50% higher than in 1999. Cross-border M&A has been a driving force behind the recent growth in foreign direct investment. In 1998, according to the Securities Data Company, there were $2.4 trillion worldwide, a 50% increase on 1997, itself a record (Economist, 1999). The figure 2 illustrates the trends in the growth of cross border mergers and acquisitions.

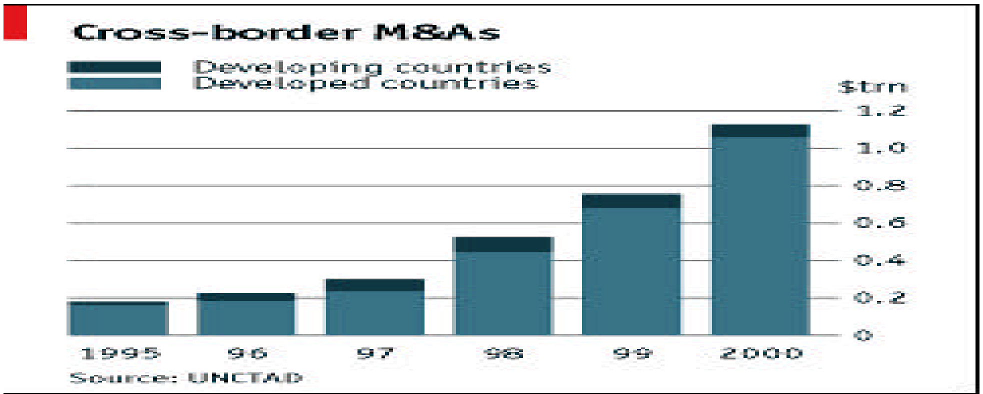

Fig.2: CROSS BORDER ACQUISITIONS
(Source: Cross Border M&A's, Economist, July 5, 2001)

1993-1996

During this phase, some of the largest mergers and acquisitions were reported. Some of these are Brooke Bond with Hindustan Lever in April 1996 leading to the formation of the biggest food conglomerate in India. The merger of Whirlpool with Kelvinator in March 1996, SRF acquisition of Ceat's nylon tire cord division, Union Carbide's acquisition by B.M. Khaitan and Heinz takeover by Glaxo are all examples in this category.

In this period 20% of the M&A activity was in the consumer non-durable sector in areas like food, soaps, cosmetics. The multinationals played a predominant role in acquiring the brand names, distribution strengths and enhancing market shares. The next category was pharmaceuticals and chemicals and electrical and power segment.

The distribution of the firms according to the size, that were involved in the merger and acquisition activity is as follows (see figure 3):

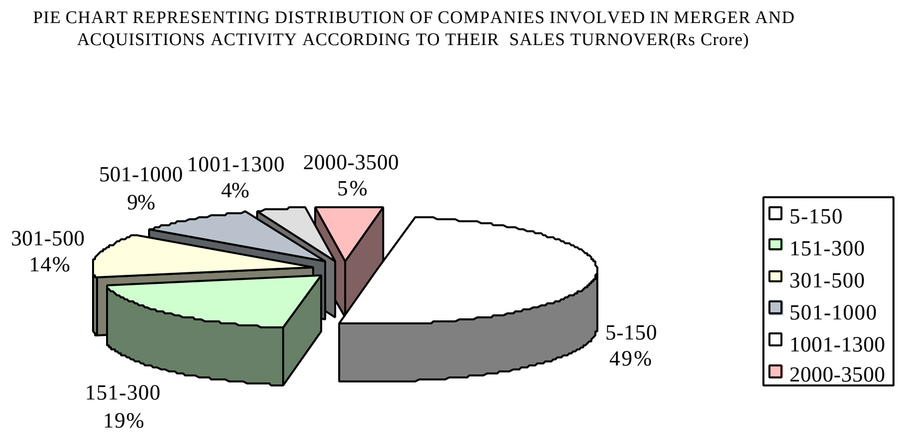

Fig.3: SIZE OF THE COMPANIES INVOLVED IN MERGER & ACQUISITION ACTIVITY

From the figure 3, it can be seen that about 49 % of the companies being taken over or merged with the acquired company in the sample involved have their sales turnover less than Rs 150cr(One crore is equal to 100,00,000). Only 19% of the sample of companies that have been taken over have their turnover lying between Rs 151 cr. and Rs 300 cr.95 % of the M&A activity involves companies that have been merged or acquired with sales turnover up to Rs 1300 cr. Only 5 % of each company's have turnover between 2000-3500.

1994-95 International Mergers and acquisitions

The world's largest firms involved in the merger and acquisition activity analyzed here is Mitsubishi (1995 sales was $175.83 billion). The distribution of US firms involved in M&A activity during this period based on sales turnover is given in the table2.

Table 2: US COMPANIES INVOLVED IN M&A ACTIVITY (1994-95)

Sales (US$ million)	Percentage
900-5000	21.5
5001-10,000	27.6
10,001-15,000	9.2
15,001-20,000	7.6
21,001-25,000	3
25,001-30,000	1.5
30,001-35,000	4.6
35,001-40,000	1.5
40,001-45,000	1.5
70,001-75,000	4.6
75,001-80,000	1.5

In 1995, an analysis carried out by the Securities Data Company revealed that 55% of the merger and acquisitions announced was attributed to just 41 deals or less than 1% of the total number of deals. Since 1991, the deals valued at over $1 billion represent 45% of domestic merger and acquisition activity in US. The top media deals aggregate value of leading deals representing over 12% of overall domestic merger and acquisition activity.

Table 3 indicates the distribution of the merger and acquisition activity in different industrial segments.

Table 3 : INDUSTRY WISE DISTRIBUTION OF M&A ACTIVITY IN INDIA AND WORLDWIDE

S.No.		**India Number of M&A's**				**No. of M&A's Worldwide**	
	Industry	**1993-96)**	**(%)**	**1997-99**	**%**	**1995-96**	**%**
1	Consumer Non Durables	16	20	29	9	15	7.1
2	Chemicals	8	10	100(includes pharma)	31		
3	Pharmaceuticals	7	9			15	7.1
4	Textiles	5	6	15	5		
5	Consumer Durables	4	5				
6	Engineering	4	5	29	9		
7	Electronics	4	5	24	7	34	16.1
8	Steel	4	5				
9	Automobiles	4	5	15	5	6	2.8
10	Group Companies	4	5				
11	Power / Electricity	3	4	5	2	10	4.7
12	Packaging	3	4				
13	Energy	2	3				
14	Others	12	14	20	6	15	7
15	Finance			30	9	36	16.5
16	Entertainment/Media					15	9.5
17	Telecom			10	3	7	3.3
18	Retail					9	4.2
19	Cement			14	5		
20	Marketing Research			11	3		
21	Agribusiness			9	3		
22	Metals			12	4		

Reasons for merger and acquisition activity

1993-96

In this phase, most of the merger acquisition activity was restricted to consumer non-durable and chemical sector. This was on account of liberalization of Indian economy and many MNC's started increasing their stakes in Indian companies.

During this phase, the major reasons were

- Quest for market leadership

e.g. Hindustan Levers (HLL) with Brooke Bond India Ltd. , HLL bought brands like Dollops from Cadbury's, Kissan Products, Tea Estates and Doom Dooma Ltd, Kwality and Milkfood's distribution assets were taken over by HLL). Other examples are takeover of Wiltech by ISPL and stake in Damania Airlines by NEPC.

- Expansion of portfolio

e.g. Takeover of TOMCO by HLL which gave it a penetration into lower end of the market in soaps and cosmetics category, Acquisition of Tata's Lakme and merger with Ponds are also examples in this category.

- Acquisition of brand names

The acquisition of oral hygiene unit - Cibaca, owned by Hindustan Ciba Geigy by Colgate Palmolive in 1994-95, acquisition of Eveready owned by Union Carbide by Williamson Magor group, acquisition of Lauffenmuehle by Arvind Mills are also examples in this category.

- Access to new markets

The takeover of Merind by Tata Pharma helped it to have access to markets in North East India and Russia. Titan bought a plant in Switzerland to have higher acceptability in European markets. Many Indian companies bought firms in US, which have helped them, access to NAFTA partners, Canada and Mexico.

- Encash upon new opportunities

SRF for instance took over an ophthalmic lens plant, which does not bear synergy with its current tire cord business.

- Operational synergy

Many firms took over other firms as it led to either backward or forward integration. E.g. take over of Sesa Goa by Ruia's, which led to operational synergy. The takeover of Lakme by HLL also led to access to Lakme's excellent distribution channel which HLL could capitalize for its other consumer products as well.

- The other acquisitions were takeover of sick companies and group consolidations**.**

1997-99

Most of the mergers in this phase took place in the pharmaceutical segment. The number of mergers and acquisitions in this sector increased because there is a massive fragmentation in the industry with about 24,000 drug manufacturers with 8 top players holding less than 30% of the market share (Jauhari, 2000). Out of these, only 250 units were in the organized sector. The reason for this situation is the lack of product patents and price controls. The reason for the achievement of higher M&A activity is the achievement of higher market share, acquisition of brand names and wide portfolio of products.

During this phase the reasons for mergers and acquisitions primarily remain the same as narrated above. Only the mergers and acquisitions became more expensive during this phase. Also in 1996-98, FDI in India through the M&A route was $1.3 million. The global flow of FDI rose from $60 billion in 1985 to $350 billion in 1996. Out of that $275 billion was spent in M&A's in 1996.

Worldwide the highest number of mergers and acquisitions were taking place in the computer industry. The computer industry, along with electronics segment contributed to 16% of the merger and acquisition activity. The other group, which saw a considerable amount of M&A activity, was the banking sector, food and pharmaceutical segment. This phase saw the merging of Pharmacia and UpJohn, Glaxo and Welcome, Ciba Geigy and Sandoz leading to the formation of Novartis. As far as the numbers are concerned, acquisitions were more than number of mergers and also related M&A was higher than unrelated. The top three bank mergers total nearly 6% of the domestic volume in the commercial industry in the year 1995. The top bank mergers were

- NDB Bancorp/First Chicago
- First Union Corp/First Fidelity Bancorp ($5.4 billion)
- Fleet Financial Group/Shahmut National Corporation
- Chase Manhattan/Chemical Banking ($10 billion)
- PNC BankCorp/MisAtlantic Corp. ($3 billion)
- UJB FinancialCorp. /Summit Bancorp ($1.2 billion)
- Fifth Third Bancorp/Kentucky enterprise ($64.3 million)
- National City Corp./Integra Financial Corp ($2.1 billion)

The figures in brackets indicate the cost of the acquisition of the second bank by the first. Davidson (1985) argues that there are ways other than by mergers for a comprehensive financial institution develop, but such ways are too difficult, unreasonably costly or simply unnecessarily slow. The cost advantage of new institutions simultaneously requires nationwide credit profiles, full investment services and large collection of funds to lend, and then mergers may be the only way for economic viability. The banks worldwide are realizing higher need for range of services and also newer business opportunities arising in the Asian region. They require large size to expand their operation and hence the quest to become bigger in terms of their asset base. The Economist (1996) reveals that during the past two decades the global network of computers, telephones and televisions has increased its information carrying capacity a million times over. Computing power doubles every 18 months or so in line with Moore’s law. The technologies are converging. So electronics, telecommunication and biotechnologies are converging which is leading to number of firms in these segments taking over to reap the benefits of synergy.

It can be deduced from the above examples therefore that the underlying reasons for the M&A activity in this segment could be consolidated as follows:

1. To go in for complementary products which help to, expand the product portfolio.
2. Helps satisfy the customer demand by providing complete range of solutions.
3. By virtue of making available a wide expanse of solution at a single point gives the customers also a competitive edge and enhances customer satisfaction.
4. Access to better technology.
5. Tapping of new markets.
6. To be known as the market leader in its area of operations.
7. Maximization of investment.
8. Consolidation of market situation.

Conclusion

A KPMG report concluded that half of the mergers destroyed shareholder value and a further third made no difference (Economist, 2000). Study after study of the past merger waves has shown that two out of every three deals have not worked; the only winners are the shareholders of the acquired firm, who sell their company for more than it is really worth (Economist, 1999). There are number of considerations that need to be kept in mind while managing the merger and acquisition process.

The merger/acquisition is just the beginning of the real challenge. The signing or physical transfer of assets is just the tip of the iceberg. Integration of operations is extremely important. It’s a simple fact, which is overlooked in most cases. For instance the merger between Union Pacific and Southern Pacific in 1996 was supposed to deliver a seamless rail service and $800 million in annual savings by using Union Pacific’s top-notch computer system. Aetna and US HealthCare also had problems with combining the back office computer systems.

The managing of cultures between different merging entities is also extremely important. There are number of issues which need to be addressed:

Sharing of power at the top: When two companies merge, decisions need to be taken regarding who will be at the helm of affairs at the top. This transition has to be smooth and in the interest of the organization. Also several sensitive decisions need to be taken regarding, which employees will stay and who will leave. An acquisition / merger is accompanied by a sense of fear in the employees about their survival in the organization. This leads to the management of another important aspect- the communication process.

Communication channels: These need to be set up right in the beginning. Asea Brown Boveri had handled the acquisition of ABL in India very well. Letters from CEO had been sent to employees at ABL giving them information of the proposed change. Such a communication instills lot of confidence in employees. In contrast, the merger of Compaq with Digital was fraught with uncertainty and suspicion and many employees from Digital left. Such a scenario can be devastating as losing good employees is a far bigger loss.

Setting up code of conduct

There can be differences in work cultures. These are more striking if a cross border merger is involved. For instance in the merger between Daimler and Chrysler, there was clearly a difference between the work styles. Chrysler liked itself to pride itself on buccaneering approach where speed and ingenuity is prized. The teams of engineers, designers and marketing people worked on each model. Daimler has a more traditional chimney structure in which designers and marketing people mix less- and engineers are in charge.

Mergers should not be a strategy in their own right. Many mergers are undertaken in the name of cost cutting. A study by Anthony Santomero of the Wharton School- examined the cost cutting performance of banks in America and he found that the merged banks had generally cut performance more slowly than their non-deal making peers. Many companies went in for a merger, as it was difficult to survive. McDonnell merged with Boeing as its biggest customer was cutting its spending to half. Chrysler merged with Benz as it was finding hard to survive.

There are industry sectors where size matters. According to some estimates, an automobile maker has to produce a minimum of 4 million cars to survive (JETRO, 2000). There has been substantial restructuring in recent years as a result of weak demand, overcapacity and environmental pressures. The five automobile manufacturers in the world in 1999 produced 30,637 units constituting 54% of world’s production and 10 largest manufacturers constituting 80% of world’s total production (UNCTAD, 2000).

In banking sector, the largest 25 banks measured by assets accounted for 33% of the assets of the 1000 largest banks in 1999, compared with 28% in 1996. The abolition of the Glass Stegall Act in US in 1999 dismantled the wall between banking and securities. Deregulation and the introduction of the single currency in European Union, financial liberalization in Japan and restructuring of banking in countries affected by financial crisis all contributed to large scale M&A’s (Banker, 2000).

In pharmaceutical industry, costs for expensive R&D and to derive synergies have been the driving force for acquisitions. All large pharmaceutical firms have grown bigger in size through the M&A activity rather than the organic growth. In 1999, the top 5 and ten largest TNC’s accounted for 28 and 46 % of the world sales of pharmaceutical products respectively compared to 19 and 33% respectively in 1995. (Financial Times 1997).

However, despite the talk of lot of activity taking place in the domain of M&A, one needs to look at its total contribution in the world economy. In developing countries, the advantage of M&A’s is rarely access to proprietary technology or skills. The advantage lies more in rapid market entry, local market knowledge, established distribution systems and contacts with the government, suppliers or customers (World Investment Report, 2000). In cross border mergers/acquisition, the acquisition offers saving of time as compared to setting up a green field venture along with other reasons as advocated earlier in the text. However from a developing country’s perspective, foreign acquisitions do not add to productive capacity but simply transfer ownership and control from domestic to foreign hands accompanied by lay off of employees or the closing of production or functional activities. However, in any country where M&A’s are being looked at should also take into account the development priorities of the country. Not only must the financial implications but other social and cultural implications must also be weighed when evaluating a merger/acquisition.

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Multinational Performance: Does Cultural Diversity Matter?

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Abstract

This study hypothesized that cultural diversity will have a negative impact on the performance of firms that expand globally. Analysis was conducted on a sample of U.S. multinationals from the computer and chemical industries for the period 1997-2000. Pooled cross-section/time-series regression results revealed significant cultural dissimilarity influences on performance. However, both positive and negative effects were observed.

As the business environment became increasingly global in scope and multinationals began to dominate the business landscape, researchers started to focus their attention on establishing a link between foreign direct investment and organizational performance. The resulting flurry of early investigative efforts has raised a great deal of dust, which has yet to settle. Recognizing the intricacies of their task, recent scholars have begun to examine more complex relationships between global expansion and performance. For example, Sambharya (1995) observed interaction effects between product diversity and multinationality on profitability, Ramaswamy (1995) reported that the configuration of foreign operations moderated the multinationality-performance relationship, and Tallman and Li (1996) found some support for interaction effects between country scope and multinationality on outcomes. More recently, Gomez-Mejia and Palich (1997) attempted to establish a link between cultural diversity and multinational performance and concluded, "cultural relatedness or unrelatedness has no effect on subsequent accounting and market measures of performance" (p.326). This is a rather surprising discovery given their compelling theoretical arguments hypothesizing a negative effect. In a recent paper, Gomes and Ramaswamy (1999) demonstrated a curvilinear relationship between multinationality and performance, arguing that cultural diversity is one of the most important underlying factors of the cost component determining the form the relationship. Thus, there appear to be very strong theoretical arguments to suggest that cultural diversity has a significantly negative influence on multinational performance.

The failure of Mejia and Palich (1997) to discover cultural diversity effects on multinational performance may be reminiscent of the problems associated with pioneering efforts in this field (Gomes and Ramaswamy 1999). First, although these authors took a great deal of care in operationalizing the multinationality construct, the model they tested was linear. Second, their use of averaged data is somewhat of a limitation because it fails to adequately capture what are essentially dynamic effects. This paper attempts to remedy these shortcomings by extending the curvilinear model presented by Gomes and Ramaswamy (1997) to include a cultural diversity variable. Pooled cross-section/time-series techniques are used to investigate the dynamic effects of the relevant relationships. The study sample involves US-based firms in two global industries spanning a period of four years between 1997 and 2000.

The Cost of Cultural Diversity

Multinational companies are characterized by complex flows of products, capital, personnel, knowledge, and information between parent and subsidiaries and among subsidiaries (Ghoshal and Bartlett 1990; Gupta and Govindarajan 1991). By necessity, the organizational structures that must be in place to facilitate such flows are also complex. For multinationals to be successful, therefore, they must be able to undertake effectively the two related tasks of coordinating resource flows and managing a widely scattered organizational network. Both these tasks are influenced by external constraints stemming from suppliers, customers and political entities.

In general, multinationals deal with these difficult challenges through international human resource management strategies (Gupta and Govindarajan 1991). For example, firms routinely send home-country personnel overseas to manage their dispersed subunits. The fundamental responsibility of these expatriates is to help realize company objectives within the constraints of the local environment (Rosenweig and Singh 1991). Understandably, a critical requirement for these positions is the ability to live and work in a culture different from one's own. It can therefore be argued that the more culturally distinct a multinational's network of subsidiaries, the more difficult would be this undertaking. The high failure rate and associated costs of failed assignments largely attributable to postings in unfamiliar cultures (Tung 1993) seem to support this argument.

Beyond the need for individual adjustments, firms must also implement human resources policies that are responsive to the idiosyncrasies of host cultures. For example, life-time employment is common in high uncertainty avoidance countries such as Japan, Portugal and Greece (Adler 1992). In contrast, high job mobility is typical among the low uncertainty avoidance countries of Singapore and Denmark. In high power distance countries such as the Philippines and India, subordinates are very unlikely to bypass their managers under any circumstances. Israeli and Danish workers, on the other hand, readily make decisions without their managers' consent in order to get the job done (Adler 1992). Managers from high masculinity countries have to be paid large salaries because of the great value these cultures attach to wealth (Hodgetts and Luthans 1993). Thus, cultural dissimilarity complicates the task of implementing consistent human resources policies across a global network.

Apart from the use of expatriates to manage their far-flung subsidiaries, multinationals also rely on cross-unit teams to facilitate the coordination and control of resource flows within the organization (Ghoshal and Bartlett 1990). Here again, the more culturally dissimilar the network, the more likely are these teams to encounter difficulties working together. For example, the high priority that U.S. teams place on deadlines and schedules may create friction with teams from many Asian countries who are generally more comfortable with less specific completion goals (Redding 1980). These difficulties of working effectively together between teams from different national cultures have been well-documented in the international joint venture literature (e.g., Killing 1982; Swierczek and Hirsch 1994).

In their classic study on internationalization processes, Johanson and Vahlne (1977), identified several types of knowledge that firms acquire as they expand overseas. *Experiential knowledge*, for example, is gained through operating in a foreign country and is "particularly important in connection with activities that are based on relations to other individuals" (p.28). Also important is *market-specific knowledge*, which concerns familiarity with characteristics of specific national markets and of which, culture is a critical component. The ability of a firm to acquire these crucial knowledge forms would be hindered with increasing cultural dissimilarity.

In summary, cultural diversity would significantly add to the cost and complexity of managing a global network of subsidiaries both, internally, from a strategic human resources management perspective and externally, in terms of dealing with customers, suppliers and regulatory bodies. This suggests the following hypothesis:

Hypothesis: Cultural diversity will have a negative effect on multinational performance

Methodology

The hypothesis was tested using pooled cross-section/time-series regression on longitudinal data spanning the 1997-2000 period for a sample of US multinationals from two global industries. Data were drawn from Standard & Poor's Research Insight, Edgar databases and 10-K reports.

Sample selection

Two manufacturing sectors, chemical and computers and office equipment, were chosen because a large number of firms in these industries have a significant global presence. Additionally, these two sectors involve distinct product characteristics. In particular, chemical goods are essentially commodities while computers and office equipment involve relatively differentiated products. All firms in the sample were either single or dominant businesses (firms with > 70 % of sales originating in a single business). This minimizes the potential for confounding problems stemming from the effects of mode or type of diversification on firm performance (Hitt et al. 1997). The resulting sample comprised 57 firms (chemical: 28; computers and office equipment: 29).

Operational Measures

Cultural Diversity (CD)

Four separate indicators (*DPDI*, *DMAS*, *DIDV*, *DUAI*) of cultural diversity corresponding to Hofstede's four cultural dimensions were used. These measures were derived using the standard formula for deriving variance. Thus, cultural diversity in terms of power distance (*DPDI*) for firm XYZ was computed as follows:

$$DPDI_{XYZ(t)} = \sum_i (PDI_i - \overline{PDI})^2 / (N-1)$$

where t represents the target year, N the number of countries in which the firm has subsidiaries, PDI_i the power distance index for the ith country and $\overline{PDI}$ is the index mean among the countries.

Multinationality (*MULTI*)

Two frequently used indicators for this variable are the ratio of foreign sales to total sales (Grant 1987; Tallman and Li 1996) and the ratio of foreign assets to total assets (Ramaswamy 1995). This construct has also been proxied by the number of foreign countries in which a firm has subsidiary operations (Tallman and Li 1996). In acknowledging the merits of each of these operationalizations in capturing different but equally critical aspects of a firm's global presence, Gomes and Ramaswamy (1999) used a composite index involving all three variables based on principal components analysis. This study employed a similar measure.

Performance

To measure both financial and operational dimensions of performance, return on equity (*ROE*) (e.g., Sambharya 1995) and the ratio of operating costs to total sales (*OPSAL*) (e.g., Gomes and Ramaswamy 1999) were used. Operating costs included cost of goods sold and selling, general and administrative expenses.

Control Variables

A number of studies (e.g., Gomes and Ramaswamy 1999; Haar 1989) have controlled for the effects of firm size on performance. Accordingly, this factor was operationalized as the logarithm of total assets.

Analysis

Data were analysed using pooled cross section/time series regression techniques. This approach has two important advantages over traditional regression methods involving data that are averaged over a number of years (Bergh 1993). First, similar to standard regression techniques, it captures variations among firms within cross-sections. However, it goes beyond traditional methods by simultaneously tracking changes within individual units over time. Thus, pooling enables a much more robust examination of dynamic relationships which data averaging may mask. Another important advantage of pooling is that it increases the degrees of freedom since more observations are created as a result of combining cross-section and time-series data. However, by combining data in this manner, problems related to non-constant variance and autocorrelation are likely to occur. In order to minimize this threat, the Kmenta (1986) autoregressive-heteroskedastic model was applied. This technique involves a two-stage, generalized regression, which first computes the autoregressive parameters for each firm. These parameters are then used to generate a matrix of transformed equations for input to the second stage where the effects of heteroskedasticity are minimized.

Hypothesis testing was conducted for each of the sample sets using the following regression equations:

$$PERF_{it} = \beta_0 + \beta_1\, SIZE_{it} + \beta_2\, MULTI + \beta_3\, MULTI^2 + e_{it} \qquad (1)$$

$$PERF_{it} = \beta_0 + \beta_1\, SIZE_{it} + \beta_2\, MULTI + \beta_3\, MULTI^2 + \beta_4\, CD + e_{it} \qquad (2)$$

where “it” represents the i th firm for year t; “PERF” is a performance variable (*OPSAL*, or *ROE*); and “*CD*” is a cultural diversity variable (*DPDI*, *DMAS*, *DIDV or DUAI*). Equation (1) represents a baseline model based on the curvilinear function established by Gomes and Ramaswamy (1999). The hypothesis would be supported if (1) the R^2 associated with equation 2 represents a significant increase over that of equation 1 and (2) the coefficient, β_4, of the cultural diversity term is significant.

Table 1: MEANS, STANDARD DEVIATIONS AND CORRELATIONS

1(a) Computer Industry

Variable	Mean	s.d.	1	2	3	4	5	6
1. Operational Costs/Sales	.87	.11						
2. Return on Equity	.09	.57	-.24**					
3. Multinationality	65.79	28.04	-.30**	.22*				
4. Power Distance [b]	360.71	145.29	-.28**	.37**	.33**			
5. Uncertainty Avoidance [b]	572.81	148.67	.18*	-.55**	.01	.38**		
6. Individualism/Collectivism [b]	599.45	240.05	.24*	-.12	-.02	.45**	.52**	
7. Masculinity/Femininity [b]	419.44	198.25	.36**	-.23*	.08	-.20*	.02	-.39**

1(b) Chemical Industry

Variable	Mean	s.d.	1	2	3	4	5	6
1. Operational Costs/Sales	.85	.06						
2. Return on Equity	.13	.43	-.22*					
3. Multinationality	71.02	26.48	-.34**	-.27*				
4. Power Distance [b]	340.79	129.57	.31**	-.69**	.24*			
5. Uncertainty Avoidance [b]	511.11	136.79	.01	-.08	.08	.44**		
6. Individualism/Collectivism [b]	676.96	184.00	.32**	-.13	-.04	.48**	.34**	
7. Masculinity/Femininity [b]	334.39	142.55	-.26*	.17*	.41**	-.12	-.23*	-.25*

[a] N=116 for the computer industry; N=112 for the chemical industry.

[b] These are measures of diversity for the corresponding cultural dimension.

* $p < 0.05$, ** $p < 0.01$

Table 1 provides several descriptive statistics for the key variables used in this study. The correlations between the dependent and independent variables were computed by applying the Kmenta (1986) regression technique. That is, each independent variable is regressed on each dependent variable using two-stage regression and the square root of the resulting R^2 is computed to obtain the corresponding correlation coefficient. This approach was taken to minimize the effects of autocorrelation factors inherent in the pooled data set.

Results shown in Table 2 for the computer industry appear to suggest strongly that cultural diversity influences performance. For outcomes measured in terms of operational costs (OPSAL), three of the four models (DPDI, DIDV, DMAS) incorporating a cultural diversity factor show improvements over the curvilinear baseline equation by at least a 0.05 level of significance (Table 2a). Results for profitability (ROE) also show similar influences (Table 2b), with only the DIDV model failing to improve on the baseline model. Of particular interest are the signs associated with the cultural diversity coefficients. Positive signs for the OPSAL regression set indicate that increasing cultural diversity results in increasing costs, as is the case for three (DUAI, DIDV, DMAS) of the four models. Surprisingly, however, the sign for power distance (DPDI) is negative implying that increasing diversity in this cultural dimension results in cost savings. The influence of these cultural factors on profitability (Table 2b) are similar. The negative signs associated with DUAI and DMAS indicate the detrimental effect of their underlying cultural factors on ROE. Although not statistically significant, the coefficient for DIDV also has a negative sign as expected. Consistent with results for OPSAL, the impact of increasing dissimilarity in power distance (DPDI) is favourable on profitability.

Table 2: RESULTS OF REGRESSION ANALYSES FOR COMPUTER INDUSTRY[A]

2(a) Dependent variable: Operational Cost/Sales (OPSAL)

			Regression Models		
Variables	Baseline	DPDI	DUAI	DIDV	DMAS
Log of total assets (SIZE)	-0.14e-01**	-0.11e-01*	-0.11e-01**	-0.21e-01**	-0.15e-01**
Index of multinationality (MULTI)	-0.19e-02**	-0.19e-02**	-0.12e-02*	-0.173-02**	-0.21e-02**
$MULTI^2$	0.14e-04**	0.15e-04**	0.65e-05$^+$	0.13e-04**	0.16e-04**
Cultural Diversity Measure		-0.84e-04*	0.65e-04$^+$	0.82e-04**	0.12e-03**
Adj. R^2	0.19	0.23	0.22	0.33	0.31
ΔR^2		0.04*	0.03$^+$	0.14**	0.12**

2(b) Dependent variable: Return on Equity (ROE)

			Regression Models		
Variables	Baseline	DPDI	DUAI	DIDV	DMAS
Log of total assets (SIZE)	0.30e-01**	0.24e-01**	0.25e-01*	0.33e-01**	0.37e-01**
Index of multinationality (MULTI)	0.41e-02*	0.60e-02**	0.36e-02*	0.33e-02*	0.76e-02**
$MULTI^2$	-0.34e-04*	-0.47e-04**	-0.24e-04*	-0.28e-04*	-0.59e-04**
Cultural Diversity Measure		0.17e-03*	-0.48e-03*	-0.32e-04	-0.26e-03**
Adj. R^2	0.15	0.22	0.18	0.17	0.36**
ΔR^2		0.07*	0.03*	0.02	0.21**

[a] N=116

$^+$ $p < 0.10$, * $p < 0.05$, ** $p < 0.01$

Although not as compelling with regard to the profitability measure, the findings for the chemical industry (Table 3) also suggest that cultural diversity impacts multinational performance. Similar to the computer industry, three (DPDI, DIDV, DMAS) of the four models where OPSAL is the dependent variable show statistically significant improvements over the baseline function (Table 3a). However, only diversity in terms of power distance (DPDI) seems to have an impact on profitability (Table 3b). Once again, the signs for the coefficients of these factors are noteworthy. Although they are not all significant, the signs are as hypothesized except for the masculinity dimension. Thus, cultural diversity (DPDI, DUAI, DIDV) increases cost (positive signs in Table 3a) and reduces profitability (Table 3b). In contrast to the computer industry, however, the influence of DMAS on performance is favourable.

Somewhat puzzling at first glance is the form of the baseline equation for the chemical sector with regard to the ROE model (Table 3b). Several studies (e.g., Gomes and Ramswamy 1999; Hitt et al. 1997) have demonstrated that performance improves with increasing levels of multinationality up to an optimal level beyond which performance degrades. The results presented in Table 3b suggest the opposite effect. The signs for the coefficients of the multinationality term (-MULTI and +$MULTI^2$) indicate that profitability improves only at high levels of foreign involvement. This apparent discrepancy along with the other differences in results between the two industries is discussed next.

Table 3:RESULTS OF REGRESSION ANALYSES FOR CHEMICAL INDUSTRY

3(a) Dependent variable: Operational Cost/Sales (OPSAL)

		Regression Models			
Variables	Baseline	DPDI	DUAI	DIDV	DMAS
Log of total assets (SIZE)	-0.84e-02*	-0.68e-02+	-0.85e-02*	-0.10e-01*	-0.97e-02*
Index of multinationality (MULTI)	-0.14e-02*	-0.23e-02**	-0.16e-02*	-0.20e-02**	-0.15e-02*
$MULTI^2$	0.91e-05*	0.15e-04**	0.10e-04*	0.14e-04**	0.98e-05*
Cultural Diversity Measure		0.83e-04**	0.84e-05	0.42e-04**	-0.39e-04**
Adj. R^2	0.10	0.30	0.10	0..45	0..20
ΔR^2		0.20**	0.00	0.35**	0.10**

3(b) Dependent variable: Return on Equity (ROE)

		Regression Models			
Variables	Baseline	DPDI	DUAI	DIDV	DMAS
Log of total assets (SIZE)	0.15e-01*	0.24e-01*	0.16e-01*	0.17e-01*	0.84e-02
Index of multinationality (MULTI)	-0.34e-02*	-0.34e-02*	-0.36e-02*	-0.33e-02*	-0.31e-02*
$MULTI^2$	0.29e-04*	0.31e-04*	0.30e-04*	0.28e-04*	0.25e-04*
Cultural Diversity Measure		-0.32e-03**	-0.41e-05	-0.43e-04	0.97e-04
Adj. R^2	0.04	0.24	0.03	0.04	0.03
ΔR^2		0.20**	-0.01	0.00	-0.01

[a] N=112

$^{+}$ $p < 0.10$, * $p < 0.05$, ** $p < 0.01$

Discussion and Conclusions

Taken together, the results appear to provide strong support for the hypothesis that cultural dissimilarity influences multinational performance, an effect that has not been demonstrated previously. The direction of this effect, unfortunately, remains indeterminate. Clearly, a finer level of analysis is required to uncover the observed differences both within and between the two industries. The following discussions, therefore, are somewhat speculative and are intended to suggest further avenues for research in this area.

Several important characteristics of the chemical industry may explain the anomalous form of the baseline function. Foremost among these are the economies of large-scale production associated with the industry (Landau and Arora 1999). Indeed, the value of property, plant and equipment comprises 40% of total assets for the average chemical firm in this study. This is in sharp contrast to the 15% figure for the computer industry. Additionally, innovations in the chemical industry are extremely short-lived resulting in rapid commoditization of products and downward pressures on prices (Weston et al. 1999). Among other undesirable consequences, commoditization can increase transportation costs because of the low value to weight ratio of the products. This may compel firms to invest in high-cost facilities near supplies and markets. To compound these problems, the sector is highly dependent on the economy and has experienced low single digit growth over the last several years (Weston et al. 1999). Although the computer industry was also experienced a decline in growth, it was still managing to grow at 25 to 30%. Thus, because of high scale economies, low profit margins and slow growth, chemical firms would need a significant global presence before they can recoup their costs and become profitable.

Some of these distinctions between the computer and chemical industries may also explain the observed differences regarding the impact of cultural diversity on performance, particularly with regard to power distance. The combination of large scale economies, tight profit margins and declining growth, for example, may force chemical firms to adopt a strong cost focus. Such a strategy requires stringent centralized control mechanisms in order to be implemented successfully. Ideally, therefore, these firms should locate their subsidiaries in high power distance countries where stratified, centralized organizational structures are preferred (Hofstede 1980). Thus, as the results indicate, dissimilarity along this cultural dimension would be detrimental to performance. In contrast, although the computer industry similarly experiences short product life cycles, it has a significantly higher growth potential and involves products that are somewhat more differentiated. While cost is also an important consideration, it must be balanced by the need for continued product innovation. Innovativeness is ideally fostered in organic environments characterized by flatter structures and decentralized decision authority. These are the types of organizational environments, which are best suited to low power distance countries (Jones and Teegen 2001). Therefore, in order to balance cost and innovation considerations, computer firms need a combination of high and low power distance diversity throughout its global network. Needless to say, some mechanism has to be devised and implemented to diffuse knowledge and experience gained from individual countries across the entire organization.

The results regarding the masculinity dimension are somewhat more difficult to reconcile. In general, masculine cultures tend to be aggressive, competitive and achievement oriented while feminine cultures value relationships, caring and nurturing (Hofstede 1980). Thus, it may be argued that task-oriented organizations are better suited to masculine cultures whereas relationship-oriented organizations are more appropriate for feminine societies (Jones and Teegen 2001). Chemical firms, having to operate in a global environment characterized by low profit margins and declining growth rates, and where governance mechanisms are highly centralized, are likely to be task-oriented. This combination of factors would render such firms very stressful places in which to work with potentially negative consequences on performance. Tempering the task-oriented approach with relationship-oriented elements in the workplace may minimize these undesirable outcomes. Thus, as the results suggest, increasing levels of cultural heterogeneity along the masculinity-femininity dimension have beneficial effects on performance. Again, an underlying requirement is that these multinationals have processes in place that enable them to diffuse expertise obtained from individual countries throughout their global networks. It is unclear why the results for the computer industry on this cultural dimension are different. Perhaps having a more decentralized approach compensates to some extent for any negative consequences of cultural homogeneity in terms of masculinity. That is, subsidiaries are given the opportunity to adapt their organizational processes to fit their own cultural environment.

Both uncertainty avoidance and individualism diversity factors demonstrate effects that are as hypothesized where these effects are statistically significant. High uncertainty avoidance cultures are typified by a need for stability, formal rules, and structures, intolerance to non-conforming ideas or behavior, and high levels of risk aversion (Hofstede 1980), characteristics that are clearly detrimental to the innovativeness that is critical for success in the computer industry. Individualist societies generally value high degrees of freedom and independence and tend to encourage and reward individual initiative, all of which are important for fostering innovativeness (Jones and Teegen 2001). Thus, computer firms would stand to benefit from cultural homogeneity along these two dimensions provided this homogeneity stems from low uncertainty avoidance and high individualism. A more focused study is required to investigate this assertion but the results show that increasing diversity in this regard are associated with higher costs and lower profitability (Table 2). However, results for the chemical industry show only partial support for the argument (Table 3) where no effect was found for the uncertainty avoidance factor.

As with other studies of this nature, a number of limitations are apparent. There are well-founded criticisms regarding the use of Hofstede’s dimensions as indicators of a construct as complex as cultural diversity. Additionally, the firms were selected on the basis of data availability rather than randomly. This clearly restricts the generalizability of the findings. However, the firms in the sample represent the largest multinationals in their respective industries and are significantly more globalized than their smaller counterparts. Generalizabilty is also limited because only two sectors were examined. Other global industries, including those in the service sectors, may be so dissimilar that results may well depend on particular industry characteristics. Finally, the level of analysis does not allow definitive conclusions to be drawn regarding the observed effects of cultural diversity on performance. Finer grained studies are necessary to provide clearer insights into these apparent discrepancies.

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On a Founding Strategy of Biotechnological Start-up on Campus with International Partnerships: the Case of ViroMed Limited in Seoul National University

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Abstract

I am planning to examine the founding strategy of a campus start-up in Seoul National University, South Korea. For first clinical research of South Korea, researchers except key persons educated in US were sent to University of Pittsburgh to learn know-how. Already in 1994, first domestic research group for gene therapy had been formed around Associate Prof. Kim. In smooth research progress, they developed worldly first virus zero sequence code of vector, while maintaining high level of gene expressions. Thus in 1997, they founded their start-up based on capital from domestic investors even in Asian financial crisis, and started R&D in his institute. While forming partnerships with Oxford BioMedica of UK, Takara Shuzo of Japan, and South Korean investors, they are planning 4 clinical trials in US and South Korea in next 2 years. Eventually the basic driver depends on Kim's research experience at MIT, Harvard, and Oxford.

Introduction

Since the enactment of Technology Licensing Office Act of 1998, as of August 1st, 2001, there are 20 TLOs based on universities, approved by Government and 1 TLO based on national research institute, authorized by also Government. Besides, for biotechnology as a next generation of technology, an emerging problem is how to increase the number of spin-offs from universities. For the reason, biotechnology has as close relationship between basic research and business. And in US, this business seems so far to be proceeded by start-ups more than big pharmaceutical firms. On the other hand, as many fields including genomics are studied and developed mainly in US and Europe, we, from now on, need to expand the roles of Japan and another Asian countries, because of expected increase of ratio of intellectual property within future healthcare cost.

As one of key concepts, the start-up is defined as the catalytic organization in terms of both technology and finance during transitional process between basic research institutes and large manufacturing firms. And the other, gene therapy, is the medical technique that introduces therapeutic genes into the cells or tissues related to diseases. The framework adopted is "business of science" that consists of the knowledge transfer with people, the redefinition of basic research into integration between theory and application, and the sources of imagination for founding strategy of campus start-ups.

As the research target, we will examine Associate Professor Sunyoug Kim's founding strategy of ViroMed Limited, first start-up on campus in Seoul National University, where I visited on June 10th, 2000. The company runs the business based on the result from one of most advanced basic research on vector for genetic therapy, with university-industry partnerships in US, UK, and Japan. Japan's partner Takara Shuzo Co. acquired 50% shares of that company with about 650 million yen in March 2000, and locates it as the research partnership center for Asian genetic therapy market, by using the previous cooperation as agent sales for reagents of genetic therapy developed in South Korea.

World Situation of Gene Therapy and First Clinical Trial in South Korea

According to the research on gene therapy by Wiley Gene Medicine, between 1994 and 1999, there were both scales' increases, from about 100 to 373 of clinical trials and from less than 200 to 3,134 of patients treated. As market size, Frost & Sullivan, in 1995, estimated it as 2.6 billion dollars until early 2000, likewise Oxford Biomedica, in 1997, did so as 6.3 billion dollars until the same time, and Novartis, in 1998, did so as 45 billion dollars until 2010 respectively. And, of world clinical protocols already approved for gene therapy, US shares about 80% of number and may likely have more patents than ownership summation by the other countries. Thus the weight increase of US intellectual property is estimated for future advanced healthcare.

In April 1997, first clinical trial of gene therapy in South Korea, that had been planning to introduce the retroviral vectors for gene expression of IL-12 into the 33 years old of female patient's body, was based on the cooperation among an immunologist, M. Lotze, Human Gene Center, University of Pittsburgh, an oncologist, C. H. Park, Samsung Medical Center, and Associate Professor Sunyoung Kim, Institute of Molecular Biology and Genetics, Seoul National University. In the process, project members except both Park and Kim having experiences of being educated in US, were sent to University of Pittsburgh, in order to learn know-how for a series of procedure of gene therapy by using retroviral vectors. And since the reasons of previous negotiation for regulation clearance with South Korean Food and Drug Agency (KFDA), and of negotiation for introduction of vectors from US with US FDA, and the reason of only one genetic therapy start-up so far in South Korea, the founder, Dr. Kim, is a member of the guideline formulation committee for clinical protocol of gene therapy under KFDA. That is, it seems a sort of transfer of advanced knowledge through human beings.

Research Strategy of Dr. Kim

In early 1994, when first domestic research group of gene therapy was formed around Dr. Kim inside Institute of Molecular Biology and Genetics, Seoul National University, based on research grant from South Korea's Department of Science and Technology, they examined all existing retroviral vectors around the world, and found many problems at those in terms of safety and effectiveness. As the result, for the lab's goal against global competition, they did focus on improving vectors among fundamental technologies and further set about earning high market value of intellectual property. Since in biomedical area, the relationship between basic research and medical needs is very close, and there are many complementary opportunities for both research expansion and business.

Dr. Kim's strategic concept on his laboratory management was firstly to understand the expression of viral genes, and the molecular coordinating process of human genetic expressions through interactions between viruses and host cells at basic research, and also to apply such information to development of the technology and materials for the therapy and diagnosis of the human diseases.

HIV Project

This project team has for recent 2 years focused on the nef gene, which is still unknown about exact molecular mechanism but is considered as its involving in the pathogenesis of AIDS or viral loading into a living body. As the approach, in order to deliver the nef gene to T cells or macrophages, or to construct cell lines producing Nef proteins, they has formed retroviral vectors expressive of the nef gene from various HIV strains. And for understanding the molecular characteristics of HIV strains of entire infected patients in South Korea, they are making database by isolating nef sequence directly from each infected people. This database is expected as useful not only to understand the role of nef at viral pathogenesis but also to track exact infection inside the nation and to develop the diagnostic methods and vaccines. This team has also another related project as the technological development for the anti-AIDS genetic therapy.

HCMV (Human Cytomegalovirus) Project

This project pays attention to both proteins of 72-kDaIE1 and 86-kDaIE2, which massively express as each gene product soon after infection with HCMV. Both express by the same promoter and share N terminal 85 amino acids. However, they seem to have a difference, at molecular mechanism, that while IE1 activates cell transcription factors of NF-.B and AP-1, IE2 increases transcription by interaction with common elements in transcription mechanism. The genetic research on expression of both proteins is expected to make contribution to understanding on the duplication and outbreak of HCMV during latent period, and to elucidation of interrelation between host cells and viruses.

Gene Therapy Project

In November 1994, when first domestic research team of gene therapy was formed by supported from governmental grant, this laboratory played the main role. Since then, this project has rapidly grown and has fruited the articles, patent filing, and first domestic start-up of gene therapy. Initially they selected retroviral vectors for clear advantages to other methods, but recently are searching the alternative potential of naked DNA for possible treatment with low level of proteins. As the approach, firstly they intent to develop materials used for all stages in gene therapy as vectors or packaging sources. Secondly they are developing technologies and reagents necessary to treatment of specific diseases. For instance, at improvement of retroviral vectors based on mouse leukemia, they increased safety by making zero of viral code sequence, and made possible high level of gene expression with high titers of virus, and improved easiness to use and versatility. In next a few years, against target diseases as Hunter syndrome, PAOD, breast cancer, and rheumatoid arthritis, they are planning to develop gene delivery vectors, producer lines, and transfer technology of genes to tissues or cells. And until 2002, they wish to enter into phase one clinical trial of all these diseases by cooperation with clinical doctors.

Diagnostic System Project

In past 6 years, they have succeeded in development of 6 kinds of diagnostic kits for HIV and HCV. From present trends of technology, within next 5 years, they forecast the substitute of chemiluminescence-based immunoassay diagnostic method for present enzyme-linked immunoassy-based method. Then by assembling specialists in molecular biology, chemistry, kit manufacturing, biochemistry, medical diagnosis, and hardware and software of analytical instruments, they seek to develop the automatic chemiluminiscene-based immunoassay diagnostic method for infectious human disease with blood as HCV, HBV, HIV –1, HIV-2, and HTLV-II. Additionally, they develop the production technology of medically important proteins in mammalian cells.

Thus they are constructing intellectually creative cycle through business of science, by bridging the basic research of most advanced medical science and the health care needs of serious diseases.

Founding Process of ViroMed Limited

At gene therapy out of 4 projects, after smooth research progress, they developed global first vectors with no viral code sequence, thus achieved simultaneously safety and effectiveness through maintaining high level of both viral titers and genetic expressions. As the result, in September 1996, they could attain high performance at US conference, articles, and patent filings.

Short History of Foundation

Thus on November 17th, 1997, even in domestic financial crisis, by receiving 200 thousand dollars from 3 domestic investors, they regally founded their start-up. And from June 1998, they started R&D in this new scheme at their institute. As the background for feasibility of campus start-up, there were another entire faculty's acceptance through all members' experience of US education, national government's start-up growth policy from 1997, and the seedbed effect on the domestic investing mood by the previous successful cases of informational start-ups.

For founding strategy, they draw long-term plan on technological development of gene therapy, and do short-term plan on development of the diagnostic kits and recombinant proteins. At the same time, they are constructing the relationships with Britain's Oxford BioMedica, Japan's Takara Shuzo, and domestic investors in terms of grants, licensing, and investment, have 13 of researchers including 5 Ph.D. holders, and about 7 million dollars of cash at hand, and are planning 4 cases of clinical experiments in US and South Korea within 2 years.

South Korea's First Application of Clinical Protocol on Gene Therapy Aiming for Product Development

On November 10th, 2000, this company applied to KFDA for the permission of clinical trial for the drug of genetic therapy on leg ulcer, VMDA3601. This new drug 's basic concept is the vector as plasmid DNA put together with VEGF165, the gene expressing the vascular endothelial cell growth factor (VEGF) inside cells. Its intended effectiveness is, through muscle injection, to deliver the gene into muscular cells, to express high density of VEGF, and to regenerate the blood vessels destructed. As their articles and patent filing showed the potential, this company is pursuing higher expression effectiveness of the gene functions than the protocols of gene therapy already done in US. If they could gain the permission from the government, they are considering the start of business in 2002.

This therapeutic drug development started as the cooperative research between Dr. Kim of Seoul National University and Dr. Kim of Samsung Medical Center, supported by South Korea's Department of Science and Technology and Department of Healthcare. At this new drug investigation, VMDA3601, they have prepared the clinical trial application, by their development of vector inside the company and the partnership on GMP production, toxic test, effective test, and pre-clinical test with a South Korea's big pharmaceutical firm. As only one company of gene therapy in South Korea, ViroMed is doing R&D on gene therapy on not only ischemia disease but also cancers and arthritis, by partnership with Takara Shuzo. And as a specialist of vascular diseases, the cooperative researcher, Dr. Kim of Samsung Medical Center, is considering the drug's applicable expansion as the therapeutic drug for diseases of the coronary arteries, in the future.

In applying, they provided both "examination data on safety and effectiveness" and "data on standards and test methods" as the referable standards for following domestic gene therapies to KFDA. The target of clinical trial is mainly focused on the patients with ischemia leg disease caused from chronic diabetes. The annual patient number undergone of leg cutting operations is estimated from 70 to 80 thousand in Japan, from 30 to 40 thousand in south Korea, and about 150 thousand in US. And the world market of ischemia leg ulcer and coronary artery disease is evaluated as about 100 billion yen. By utilizing the easy situation for development of South Korea where the number of patent filing of gene therapy is not so many than US or Japan, they are planning practical development of gene therapy.

Research Team Organization and Member Allocation to Project

Until April 1st, 2001, Dr. Kim has produced 45 international journal articles, 10 domestic journal articles, and 10 patent filings (2 international patents and 1 patent for main countries) (See table 1). Present engine supporting such high productivity is based on the mixed team consisted of the graduate students in university laboratory and of the scientists and technicians from start-up as table 2. And member arrangement to 4 projects is contrived as Fig. 1. That is, at diagnostic project, all members are consisted of start-up employees, and at transcription factor project, all members are graduate students. However, at both AIDS and gene therapy projects, each team is organized by mixture between the employees paid by start-up and the graduate students. Especially into gene therapy project, a lot of researchers are placed. But each team leader has always an overlapping position in another research team. Thus, different projects are coordinated though human beings as key persons.

Table 1: DR. SUNYOUG KIN'S MAIN RESEARCH ACHIEVEMENT (AS OF APRIL 1ST, 2001)

Sort of Research Performance	Total Number
Articles of International Journals	45
Articles of Domestic Journals	10
Patent Filings	10(1 International Patent)

Table 2: RESEARCH MEMBERS (AS OF APRIL 1ST, 2001)

Affiliation	Qualification.	Number
University Laboratory	Ph.D. Students	•
	MS Students	•
ViroMed	Administrator	•

	Sub- administrator	•
	Senior Scientists.Ph.D. Holders.	•
	Technicians	•

Gene Therapy••••
$\boxed{\textbf{S1}}$
S2•S3
D1 · D2
M1•M2•M3•**M5** · M4
T3•T4•T2•T5

Diagnostics•••...
$\boxed{\textbf{S4}}$
T1

AIDS•••
$\boxed{\textbf{S4}}$
S1
D3

Transcription•••
$\boxed{\textbf{D1}}$
M5.
.

Legend:
S: Senior Scientists, D: Ph.D. Students, M: MS Students, T: Technicians, Numerical Symbols: Number of Each Class, Square: Project Leader.

Fig. 1: SPECIALIZED PARTNERSHIPS BETWEEN PROJECT TEAMS (AS OF APRIL 1ST, 2001)

Thus by campus start-up, they simultaneously improve both productivity of research and business, and from being based on the huge money procured for research, manage the specialization and differentiation of the research of state of the art by human connecting. And such knowledge and experience on management of laboratory as fusing science and business seems to be accumulated from Dr. Kim's study experience in US and Britain.

Table 3:CAREER OF DR. SUNYOUG KIM

Academic Career

Degree	Earned Year	University	Specialization
BS	1978	Seoul National University	Microbiology
MS	1982	MIT	Biochemical Engineering
MA	1984	Harvard University	Microbiology & Molecular Genetics
Ph.D.	1986	Oxford University	Molecular Genetics

Professional Career• as of April 1st, 2001•

Period	Affiliation	Position
1986-87•	Brigham and Women's Hospital /Harvard Medical School	Research Fellow
1987-89	Whitehead Institute for Biomedical Research/Department of Biology•MIT•David Baltimore's Laboratory•	Post-Doctoral Fellow
1989-90	Harvard University	Lecturer of Medical Science
1989-92	New England Deaconess Hospital	Research Staff
1990-92	Harvard University	Assistant Professor of Medical Science (Virology)
1992-96	Seoul National University	Assistant Professor
1996-99	Myles H. Thaler Center for AIDS and Human Retrovirus Research, University of Virginia	Adjunct Member
1996-Present	Seoul National University	Associate Professor
1998-Present	Genethon III (France)	Adjunct Member
1998-Present	Genetic Medicine	Editorial Board Member

Conclusion

The merits of campus start-ups on universities can be considered as utilizing university resources to serious medical needs, realizing private company's efficiency even in national university, transferring stocks to university, giving research fund or access to practical technology for researchers and graduate students, and occurring the opportunity that can simultaneously achieve research, education, and business. On the other hand, for industry, the advantage is the economical access to resources as space, facilities, graduate students, campus technology, and academic environment. The challenges are remained as investors' understanding to technology, finding international partners, and approval of guideline on clinical research.

Dr. Kim has been also an adjunct member of Genethon III. His basic driver of research and Business is based on the research experience at MIT, Harvard University, and Oxford University. Especially when, as a post-doctoral fellow, he belonged to Prof. David Baltimore's laboratory, he did experience the every imagination of the campus start-up and of the strategy for managerial system of laboratory. That is, Prof. Baltimore won Nobel Prize for research of virology at 37 years old in 1975, experienced science advisor for Collaborative Research, and at present, while being president of Caltech, seems to involved with drawing national strategy of nano-scale technology.

Thus not only knowledge of research field but also imagination of managerial system or strategy of laboratory is internationally transferred through excellent human being. Furthermore in addition to research experience in US and Europe, including Japan's Takara Shuzo's money and technology, the ideas of researchers in Seoul National University are utilized. This is a sort of business model of international collaboration between university and industry. Moreover, in conservative Asian climate to university and industry collaboration, this seems a pioneering case of spin-off from university by international investment.

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Small And Medium Enterprises (SME) Financing In Malaysia: Lending Problems Faced By Entrepreneurs?

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Abstract

The small and medium enterprises (SMEs) play an important role in providing linkages to export-oriented industries in Malaysian economy development. It is estimated that there are 11292 SMEs of which 88% are small enterprises and 12% are medium enterprises. The SMEs are expected to contribute significantly in terms of value added and labor absorption in economic growth, particularly in the manufacturing sector, as driver of growth. In Malaysia. The SMEs usually depend on financial intermediaries, particularly the commercial banks in order to obtain credit for their operations it has shown that the commercial bank and government agencies are helping SMEs to obtain loans. The study found that the SMEs' lack of information on loan facilities and loan requirements by the government loan agencies and the commercial banks resulted these loan services rendered by these financial institutions are not fully utilized by the SMEs. The study also discovered that the majority of SME entrepreneurs who were facing problem in getting the bank loans did not provide sufficient business information such as business past records and future business plans. The high cost of loans and the need for loan collateral required by the banks were also problematic.

Introduction

Malaysia is striving to achieve an industrialized and a developed nation by year 2020. The last thirty years (1970-1990) had seen the growth of industry particularly in manufacturing sector playing a central role in the nation's industrialization process. Together, the service sector and information technology sector are currently contributing to the economic development of Malaysia Continuous strategic efforts and programs on industrial development, human resource development, business, government, education, economic and social strategies had been addressed, formulated, design and redesign and implemented in all facets of Malaysia Master Plans. The New Millennium sees Malaysia transforms from production economy (P-economy) into knowledge economy (K-economy).

The economic growth and rapid industrial development has made Malaysia as one of the most open economies in the world. The last 30 years had seen the growth of industry particularly in the manufacturing sector plays a central role in the Malaysia's industrialization process. The current trend of growth shows that the manufacturing sector will be the fast growing sector in the economy. Besides, the service sector has been targeted as another leading growth center By year 2020, the manufacturing as well as the service sector are projected to account for 12.2 percent and 66.3 percent of employment requirement respectively out of projected labor force of 18.8 million with the projected population of 33 million. . By 2020, the manufacturing sector is projected to account for at least 40 percent of the real GDP.

In Malaysia the SMEs are the backbone of the economy. It is expected that the numbers of SMEs are expected to be around 20,000. And the government has designed the SME Development Plan (1999-2005) to assist SMEs to meet the new challenges in the competitive business environment. Problems faced by SMEs area numerous. These include accessibility to capital and credit facilities, guaranteed and consistent supply of raw materials, trained and skilled human resources, accessibility to market channel and marketing information, suitability of location, and employees management and technical skills. As such, the government and the big business corporations and financial institutions are directly involved in entrepreneurial development programs i.e. vendor program, franchising, micro credit, government guaranteed loan scheme, marketing of products, business infrastructure development, licensing, trade promotion, subsidies, and entrepreneurial skill training. Eighteen ministries and 30 provide range of entrepreneurial services and are involved either directly or indirectly in supporting the development of entrepreneurs. The types of support services by the supporting agencies vary and in some cases overlapped each other.

Table 1 shows the types of support services provided by the government agencies.

Table 1

SME Business Financing

The SMEs usually depend on financial intermediaries, particularly the commercial banks in order to obtain credit for their operations (Berger and Udell 1995). In 1991, there were 33 commercial banks (13 foreign and 23 domestic). 23 finance companies and 12 merchant banks (with foreign interests). The effect of the financial crisis in 1997-1999 was the consolidation of the Malaysian banking systems through bank mergers. Table2 shows 10 anchor banks after the merger exercises:

Ten anchor banks are now Local banking institutions continue to represent the most readily-accessible sources of outside capital for small businesses, both for start-ups and expansion of already-established business. Another scheme, known as the Direct Access Guarantee Scheme (DAGS) was introduced in July 2000, to allow small businesses speedy access to bank credit through the CGC. Under this scheme, the CGC will assess the credit risk of lending to the small businesses instead of the individual banks. The credit limit ranges from RM50,000 to RM500,000 and the facilities are for working capital purposes only. The CGC will guarantee up to 100 percent of the facilities granted. The purpose of this scheme is to provide another alternative for small businesses to apply for credit facilities.

Table 2

Source: Business Times, 16 Feb. 2000)

Table 3 shows total loans given by the commercial banks and Credit Guarantee Corporation.

Table 3: TOTAL BANK LENDING AND THE CGC LOANS (IN RM MILLIONS)

	1995	**1996**	**1997**	**1998**	**1999**
CGC Loans	1,900	3,643	3,903	594	2,497
Total Loans	182,078	228,256	289,746	310,291	321,208

Source: Bank Negara Report (1999)

The banks' willingness to provide needed financing was the primary selection criterion given by these small businesses for choosing their lending banks. A survey of small-business owners in Canada revealed that obtaining financing is no longer the most serious concern due to of the industry's effort to gather detailed information about the availability of credit to small business (Canadian Banker, 1997). Thus, insufficient information on loan facilities and loan requirements is one of the factors contributing to lending performance of the banks. As Graeme (1993) states that a small business using bank finance should ask for services, including

1. Flexibility in the type of facilities provides,
2. End of financial year tax planning including payment of interest in advance,
3. Consistency in the interpretation and implementation of the bank's policies and decisions at all levels of the bank,
4. Direct dealing with the bank's officers responsible for the loan facilities and the ability to deal with these people on a continuing basis.

Larry (1992) found that the typical interaction between banker and borrower over prospective business loans often proves unsatisfactory for the small business owner. A point stated out is that bankers do not spend enough time explaining underlying principles behind commercial lending time-tested principles that generally serve as the framework for all commercial loan decisions. As reported by Clarke (1999 the policy makers also need more information from other suppliers of credit and about other types of financing.

Commercial banks are information specialists (Nakamura, 1993, p. 14). Information about borrowers and collateral is thus essential to the flow of credit (Nakamura, 1993. P. 3). Banks rely on information generated by their own past lending activity and that of other banks. Nakamura (1993) mentioned that information externalities constitute the reason for credit markets unreliability. An information externality in credit markets exists when each lender relies on information generated by the lending activities of other institutions. Banks tend to raise their lending requirements more during an economic downturn, creating a *credit crunch* that borrowers have difficulty obtaining credit at any price. This dynamic interaction between information and economic behavior involves an externality - that is the failure of one borrower to conclude a loan and to make loans more costly and harder to obtain for later borrowers. The reduction in economic activity leads to less information and thus a further reduction in economic activity.

Problem Statement And Objective Of Study

It has been observed that SMEs are facing problems in getting business loans from the commercial bank and government support agencies. Most SMEs failed to obtain finance because they fail to provide sufficient business information; financial guarantee as well as they are insufficiently informed or poorly advised about appropriate sources of finance. Hence, the lack of loan information regarding the availability of loans, the high cost of loan, loan requirements and the understanding of the banks on SMEs business operations contribute to the SMEs loan performance of the financial institutions. for the activities of many enterprise agencies which have sought to provide SME with comprehensive information on funding sources (Aston Business School, 1991). This problems had been raised by most SMEs and supported by Bolton Committee (1971, p. 191), *"In this regards, many small firms are prevented from getting loans by a lack of information, by inexperience in presenting application for finance and by a formidable barrier of prejudice against borrowing of all kinds, form making use of the full range of facilities available to them*". Bannock and Partners (1991) and Harvey (1992) discovered that a lack of knowledge or imperfect information found to be the main reason why SMEs failed to approach appropriate funding bodies. On the other hand, Bates and Hally (1982) and CBI (1982) pointed out that the root of the problem often lies with the owner managers themselves. This is because, the entrepreneurs tend to react late to information and they do not approach the appropriate persons for advice until a funding crisis occurred.

The problems faced of Malaysian SMEs, despite the calls for financial institutions to be more liberal in providing financing for small and medium industries (SMEs), continue to gripe about the difficulties faced in securing loans. Thus, the main objective of this study is to survey the SMEs' problems on getting business loans and funds provided by the commercial banks and non-commercial institutions..

Research Methodology

The study was conducted in the Northern states of Malaysia: Penang, Kedah and Perlis which have a total population of 136 SMEs . The profile of SMEs was obtained from directory of Small-Medium Industries Development Corporation as cited in (http://www.smidec.gov.my/list.html). The systematic random sampling was used based on the locations. The 136 questionnaires were sent to CEOs of SMEs and only forty SMEs were received in this study. The pilot test on 10 SMEs was also conducetd by the MBA students (10 copy). In the questionnaire, there are two sections: the first section is about the SME's background and lending information, and second section are the questions about lending awareness. The descriptive analysis, t-test, and ANOVA were conducted by using SPSS statistical package

Findings

The findings of the study were described in Table 4 to Table 11.

Table 4 reported the descriptive information about the respondents. 57.5 percent of respondents are from Penang and others from Kedah & Perlis. The respondents are comparable of ownership between Bumiputra and Non-Bumi that are 57.5 percent and 42.5 percent respectively. From the industry categories, most of the respondents do not involved in major industry (40 percent) as categorized by Small & Medium Industries Development Corporation (SMIDEC). The operation mainly involved small-scale labour that is less than 10 employers, however 27.5 percent of firms are in the category of employment more than 40 employer. It is surprisingly that, more than half of the respondents (62.5 percent) do not understanding SME financing facilities.

In order to see the behavior of bank's prefer, the observation reported that Mayban is the favor used (35.9 percent), following by Perwira Affin Bank (12.8 percent), and Public Bank & Bumi-Commerce (10.3 percent respectively). Of the sample, the main objective of loan financing is operational and product expansion that is 40 percent of the respondents. The need for working capital financing and starting capita is also motivation SME to borrow from commercial banking institutions. This indicated that the lending are directed into long term productive uses instead of short term cash flow problems (only 2.5 percent). We found that the SME still prefer to commercial banking institutions for future financing choices (65%). In relation to the extent of SME financing information, 62.5% of respondents found no understanding about SME financing packages.

Table 4: CHARACTERISTIC OF RESPONDENTS

State of Industry Operated:	**Percent**
Penang	57.5
Kedah & Perlis	42.5
Ownership:	
Bumiputra	57.5
Non-Bumi	42.5
Type of Industry:	
Food beverage & tobacco	7.5
Fabricated metal products, machinery & equipment	20.0
Wood & wood product	7.5
Texite, wearing apparel & leather	7.5
Chemical& of chemical pertoleum, coal and ect.	17.5
Others	40.0
Category of Employment:	
less than 10	40.0
11 to 20	20.0
21 to 30	7.5
31 to 40	5.0
more than 40	27.5
Understanding SME Facilities:	
Yes	37.5
No	62.5
Major Banks Used in Recent:	
Bank Islam	7.7

Mayban	35.9
Mayban Finance	5.1
Public Bank	10.3
Perwira Affin Bank	12.8
Bumiputra-Commerce	10.3
Ban Hin Lee	2.6
MBF	5.1
Hong Leong Finance	2.6
RHB	7.7
Objective of Loans Financing:	
Operational & Product Expansion	40.0
Working Capital Need	27.5
Starting Capita	15.0
Refinancing	10.0
Others	5.0
Cash flow problem	2.5
Financial Institution Prefered for Future Financing:	
Commercial banks	65.0
SME Agency	20.0
Finance companies	12.5
Others	2.5

The following tables (Table 4- 11) indicate the relative problems faced by the entrepreneurs (Bumiputra and non-Bumiputras) when they apply for business loans offered by the government through commercial banks and business loans offered directly by the commercial banks in Malaysia.

Problems Faced For Loan Application Process

Table 5 indicates problems faced by the entrepreneurs when they apply for bank loans. It shows that cost of borrowing (interest rates) is regarded as the main problem followed by the banks' concern for the future business prospects and sustainability. Past business performance and collateral are also problematic to the entrepreneurs. Of the information gap justification, lack of SME information from banking institutions found not to be the major problem of loan applications.

Table 5: PROBLEMS FACED OF LOANS APPLICATION

	Mean	S.D	Rank
Cost of Borrowing	4.15	1.81	1
Prospect of Future	3.60	1.69	2
Past Performance	3.45	1.72	3
Collateral	3.40	1.61	4
Economic downturn	3.33	1.48	5
Lack of SME information from Bank	2.83	2.12	6

Table 6 reveals that the Bumiputra entrepreneurs' lack of collateral, past performance record and loan information offered by the banks is regarded as the most problemic when applying for loans compared to non-Bumiputra entrepreneurs. However, there are significant means differences on past performance records, collateral, future business prospects (business plan) and cost of borrowing between Bumiputra and non-Bumiputra entrepreneurs. Non-Bumiputra regards cost of borrowing is the most problematic.

Table 6.: PROBLEMS FACED DURING LOAN APPLICATION PROCESS ASSOCIATED WITH OWNERSHIP

	Mean: Bumiputra	Non-Bumi	t-value
Lack of SME information from Bank	3.1739	2.3529	1.216
Past Performance	3.8261	2.9412	1.639***
Collateral	3.5217	3.2353	0.550
Prospect of Future	3.0870	4.2941	-2.358**
Economic downturn	3.5217	3.1176	0.852
Cost of Borrowing	3.4348	5.1176	-3.508*

- $\rho < 0.01$, ** $\rho < 0.05$, and *** $\rho < 0.10$

The results in Table 7 show a significant mean difference on the economic downturn faced by the entrepreneurs (those who received SME financing and those who did not received SME financing). During loan application process. The non-SME financing firms consider the economic downturn of the country gives them problem when applying for new business loans. Those who have already received SME financing earlier had less problem in getting additional loans.

Table 7: PROBLEMS FACED DURING LOAN APPLICATION PROCESS WITH STATUS OF SME FINANCING

	Mean SME financing	No SME financing	t-value
Lack of SME information from Bank	2.50	2.93	-0.554
Past Performance	3.80	3.33	0.737
Collateral	3.60	3.33	0.448
Prospect of Future	3.20	3.73	-0.861
Economic downturn	2.40	3.67	-2.502**
Cost of Borrowing	4.50	4.03	0.703

** $\rho < 0.05$

The result of ANOVA analysis (Table 8) reveals that type of industry differs on the problems faced. The Chemical & chemical industry is the major industries facing the problem of lack of SME information from bank. Past performance criteria is the major problem for textile and apparel industry when applying for business loans and financing.

Table 8: ANOVA - PROBLEMS FACED DURING LOAN APPLICATION PROCESS WITH TYPE OF INDUSTRY

	F-statistic
Lack of SME information from Bank **[a]**	2.103***
Past Performance **[b]**	3.515**
Collateral	1.125
Prospect of Future	1.113
Economic downturn	1.905
Cost of Borrowing	1.423

** $\rho < 0.05$ and *** $\rho < 0.10$

Note:		**Mean**
[a]	Food Beverage & Tobacco	1.667
	Fabricated metal ect.	3.375
	Wood& wood product	2.000
	Texite, wearing apparel ect.	1.000
	Chemical & chemical ect.	4.571
	Others	2.500
[b]	Food Beverage & Tobacco	3.667
	Fabricated metal ect.	4.375
	Wood& wood product	2.000
	Textile, wearing apparel ect.	6.000
	Chemical & chemical ect.	3.286
	Others	2.813

Planning For SME Financing

The study also discovered that entrepreneurs need to increase their working capital, they need more information about the availability of loans and they plan to apply for SME loans when needed. The entrepreneurs agree that they have to keep up on any information on SME loans offered by the government and the commercial banks. This shows that the SMEs are more relying on information that provided by banking institutions (Table 9).

Table 9: PLAN TO OBTAIN SME FINANCING

	Mean	SD	Rank
Need to Update business plan	3.95	1.0365	1
Need more working capital in future	3.78	1.2707	2
Need information about SME	3.18	1.3939	3
Plan to apply SME loans	3.08	1.4031	4
Follow-up SME loan announcement	2.65	1.3117	5

From Table 10 , the study shows that Non-Bumi found to be more aggressive to obtain financing facility compared to Bumiputra particularly by their commitment to updating their business plan.

Table 10: PLAN TO OBTAIN SME FINANCING ASSOCIATED WITH OWNERSHIP

	Mean		
	Bumiputra	Non-bumi	t-value
Update business plan	3.696	4.294	-1.972***
Need information about SME	3.217	3.118	0.221
Need more working capita in future	3.696	3.882	-0.455
Follow-up SME announcement	2.609	2.706	-0.229
Plan to apply SME	3.000	3.177	-0.389

*** $\rho < 0.10$

Again, all the type of industries realizes that when they plan to obtain business loans, updating business plan is important (Table 11).

Table 11. ANOVA - PLAN TO OBTAIN SME FINANCING ASSOCIATED TYPE OF INDUSTRY

	F-value
Update business plan	**2.012**
Need information about SME	0.145
Need more working capita in future	0.260
Follow-up SME announcement	0.582
Plan to apply SME loan	0.929

Note:		**Mean**
[a]	Food Beverage & Tobacco	1.667
	Fabricated metal ect.	3.375
	Wood& wood product	2.000
	Texite, wearing apparel ect.	1.000
	Chemical & chemical ect.	4.571
	Others	2.500
[b]	Food Beverage & Tobacco	3.667
	Fabricated metal ect.	4.375
	Wood& wood product	2.000
	Textile, wearing apparel ect.	6.000
	Chemical & chemical ect.	3.286
	Others	2.813

Discussion And Conclusion

The availability of lending in the government and the commercial banks is to support the growth of SME that contribute to the stimulation of the economy. Various initiatives, supports and incentives have been introduces by the government agencies as well as the private sectors. High cost of borrowing and banks' request for collateral are found to be problematic to the borrowers. Lack of information SME financing packages that is currently available is due to the location and availability of information technology on the part of SMEs also hinder to increase the loan applications from SMEs. The bankers, on the other hand, are requested to understand the business activities and business processes of SMEs when making decisions on loan approval. Matters relating to detailed business plans and extensive collaterals need to be reviewed as most SMEs are facing with these requirements for loans.

The results of the study appear to discover that there is a lack of information gon SMEs lending facilities available and provided by the government agencies and the participating commercial banks in Northern region of Malaysia. It is surprisingly that most SMEs in the northern region significantly do not realize the existence of many SMEs financing facilities. This study indicates that the information of loan facilities is the main factors that contributed towards unsatisfactory for SMEs on loan decisions. The results of the study tend to support the past research, which found that the typical interaction between banker and borrower over prospective business loans often proves unsatisfactory for the small business owner (Larry 1992). To overcome this situation, the government and commercial banks should find out the reason for such lacking and perhaps this due to internal and external factors such as promotion and advertisement. Another possibility of lacking in the information could be the socio-economic background and the location of the businesses.

However, the study has some limitations and suggestions. First, the scope of sample only focus on Northern States, Kedah, Perlis, and part of Penang. Second, the information of the study on focus on descriptive information. It is suggested that a study on the determinants of success of getting SME financing from commercial banks for further study.

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SMEs and Government Policies on ICT

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Abstract

Small and Medium Enterprises (SMEs) are widely seen as a key facet of industrial policy. Governments are also anxious to promote Information and Communication Technologies (ICT) within private and public sector organisations (including the government itself) and the Internet and e-commerce more generally within society.
Governments have a compelling need to promote and nurture use of ICT amongst SMEs and enhance their capacity to utilize ICT.

SMEs themselves have particular problems of limitations of resources and expertise in harnessing the full potential of ICT and governments must seek ways to help them overcome these constraints. At the same time, globalisation is resulting both in wider opportunities for SMEs, but also dangers, particularly increased competition.
This paper gives an overview of the current state of global utilization of the Internet, and surveys the range of policies and instruments open to governments.

Introduction

Many governments around the world see Small and Medium Enterprises (SMEs) as a key facet of industrial policy. Sometimes, as in the Republic of Korea it is part of a policy to fragment large (and powerful) conglomerates. In most cases the basic thrust is two-fold. Firstly, SMEs are seen as important creators of employment. Secondly, and in some contradiction to the first, they are seen as incubators of innovation, enterprise and high-tech, high-productivity.

Governments are also anxious to promote Information and Communication Technologies (ICT) within private and public sector organisations (including the government itself) and the Internet and e-commerce more generally within society. This is seen as the wave of the future and one which, ramified through the ‘new economy’, is seen as essential for international competitiveness.

It follows therefore that governments have a compelling need to promote and nurture use of ICT amongst SMEs and enhance their capacity to utilise the Internet, and, as appropriate, embark on e-commerce.

SMEs themselves have particular problems of limitations of resources and expertise in harnessing the full potential of ICT and governments must seek ways to help them overcome these constraints. At the same time, globalisation is being pushed forward by a mix of technological, economic and political forces, and this results in both wider opportunities for SMEs, but also dangers, particularly increased competition. However the political framework of globalisation, and especially the World Trade Organization, limits the powers of governments to protect domestics SMEs.

This paper gives an overview of the current state of global utilisation of the Internet, and surveys the range of policies and instruments open to governments, from financial support to programs assisting SME participation in government e-procurement. It covers government policies in the USA, Australia, New Zealand and selected Asian economies such as the Republic of Korea, India and China.

Global digital divide

The global digital divide is much discussed but data on it is fragmentary, of variable quality, using different, and often unspecified methodologies. The situation is changing fast and although the overall configuration is relatively clear in broad terms, with leaders and laggards fairly obvious, the date of specific surveys and reports can be crucial when considering detailed data. The number of people connected to the Internet is a case in point.

This brief paper utilizes two main sources of statistical data. The first is the latest Human Development Report produced by the United Nations Development Programme [75]. The second is the International Telecommunications Union [38].

Fig 1 shows the ranking of selected countries in the UNDP's Technology Achievement Index (TAI). This composite index brings together data on technology creation (patents granted, receipts of royalties and license fees), diffusion of recent innovations (internet hosts, high- and medium-technology exports), diffusion of old inventions (telephones, electricity) and human skills (mean years of schooling, gross tertiary science enrolment ratio). The countries are grouped into five categories – leaders (18), potential leaders (19), dynamic adopters 26), marginalized (9) others (90). The TAI is not calculated for the last category, because of lack of data, and they are not ranked.

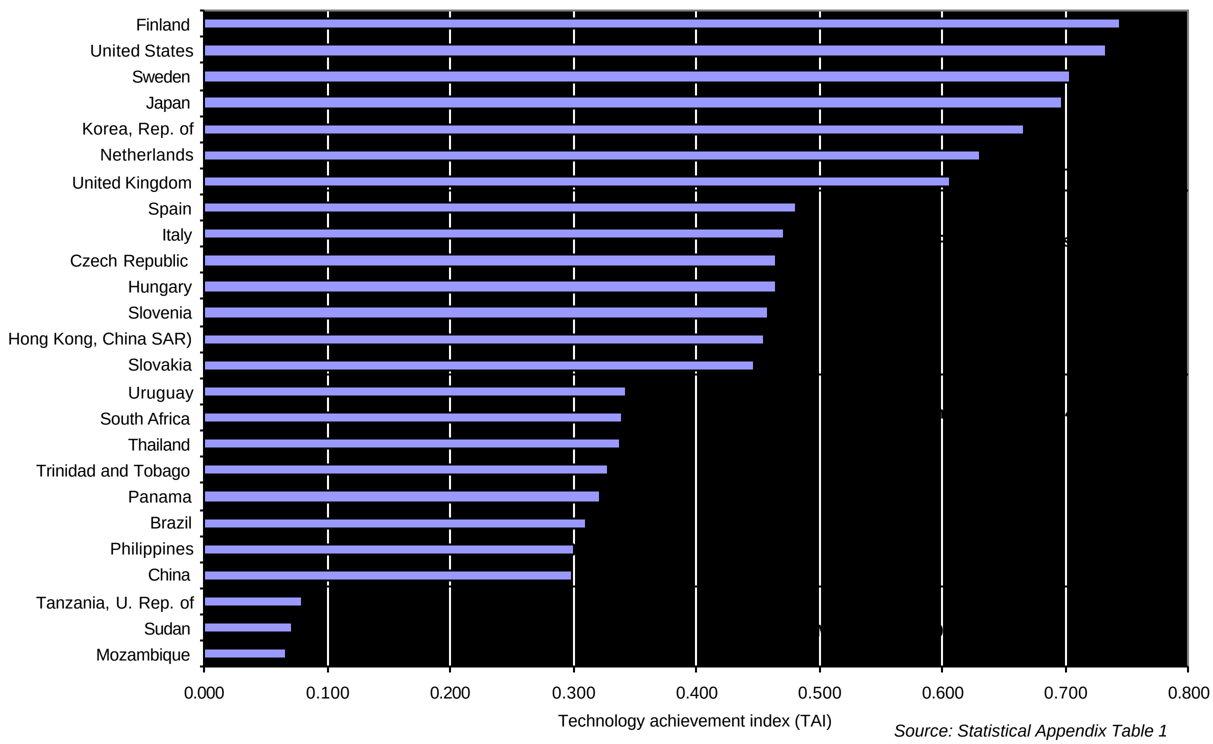

Fig 1: UNDP TECHNOLOGY ACHIEVEMENT INDEX: SELECTED LEADERS, POTENTIAL LEADERS AND DYNAMIC ADOPTERS

This is unfortunate because there are some surprising countries included, such as Switzerland and Russia. Nevertheless, the TAI gives an authoritative, and reasonably comprehensive, picture of the global divide in respect of technology as a whole.

The TAI incorporates an Internet measure, sourced from the International Telecommunications Union (ITU). The ITU provides more detailed data, some of which is used in Fig 2 which looks at figures for percentage of the population who are Internet users. Here we take the top 11 (so as to include the United States) and the bottom 10. The percentage ranges from 59.7865% for Iceland to 0.0010% for Democratic Republic of the Congo.

For reasons of space the many other measures of Internet and ICT use are omitted here but one in particular should be noted, and that is number of users. This is a very important measure because network effects, whereby the value of a network to its participants grows exponentially with the number, and critical mass are key components for market viability. Up until now the United States has had the largest number of Internet users (though users as percentage of population is more modest) and so has provided the largest market, disproportionate to its share of the global economy. English became the natural language of the Internet. However, that dominance is now slipping [72]. China, although only a small part of its population has Internet access 16,17], has a very substantial and fast growing user population [73] The Chinese language area (China, Taiwan, Hong Kong, Singapore and the Chinese Diaspora) has its own dynamic, not merely because of rapid growth and high per capita GDP in parts, but also because of sheer size [18].

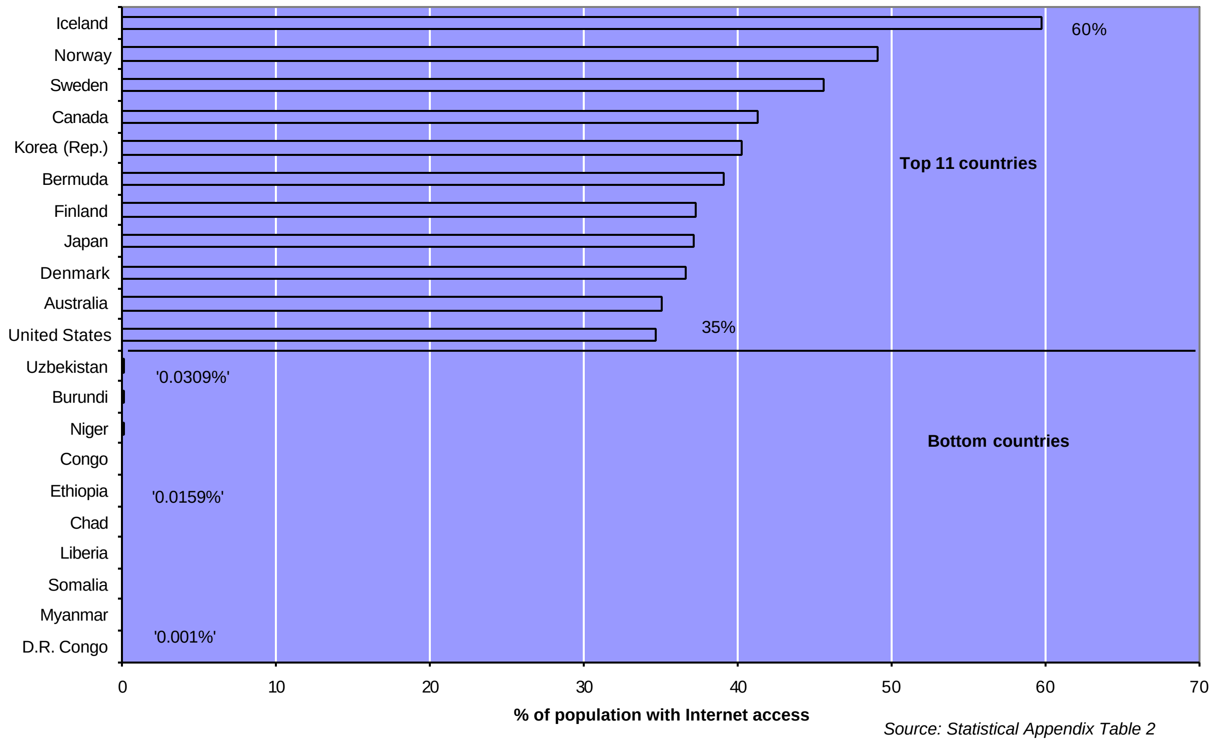

Fig 2: THE INTERNET DIGITAL DIVIDE 2000 – TOP 11 AND BOTTOM 10

All data on ICT, and the Internet, is contestable and there are a number of different estimates published [17,22]. Countries move up and down the league table according to the source used, or the date examined. Some countries, such as North Korea, are difficult to categorize.[i] Nevertheless, the general configuration is clear. There is a wide, and growing, disparity between countries, which are participating in the digital economy, and those, which are not. In between top and bottom there are a number of countries, such as Russia, which have strengths in some areas but weakness in others. The reasons are complex and are not entirely explained by GDP [17] though that is the major factor [37]. No country, however poor, can afford to disregard the development power of ICT, properly harnessed. As the United Nations Development Programme argues 'While it is undeniable that many of the high-tech marvels that dazzle the rich North are inappropriate for the poor South, it is also true that research and development addressing specific problems facing poor people—from combating disease to developing distance education —have proved time and again how technology can be not just a reward of successful development but a critical tool for achieving it [75:iii]. Similarly, no country however rich, can ignore ICT, if for no other other reason than its impact on employment [36]. SME/ICT policy addresses both of these issues. SMEs are seen as innovative, flexible and important engines of growth on developed and developing countries alike [16]. They are also seen as key creators of employment [25].

Government Policy Options

Government policy options in respect of increasing SME utilization of ICT may be conceptualized in three dimensions:

- SME Policy
- E-commerce/ICT/S&T policy
- SME ICT/S&T policy

SME policy

SME policy broadly aims to facilitate SME generation and growth irrespective of industry and ICT use, although ICT may form part of the criteria. In other words, it is not specially aimed at either high-tech SMEs, or enhancing the ICT utilization of SMEs. There is often a high degree of social policy focusing, on women, minorities and depressed areas. The US Small Business Agency is an example [70]. Services range from financing (loan guarantees, export financing, pollution control, etc), equity investment, Federal Government Contracting assistance (procurement), Research and Development, Business Information Services, Advocacy (eg seeking to ameliorate compliance costs imposed by other agencies), Disaster assistance, Veterans Assistance, Assistance for Native Americans, Assistance for exporter, assistance fro small and disadvantaged businesses ('businesses owned and controlled by individuals claiming to be socially and economically disadvantaged'), Assistance for women, empowerment zones/enterprise communities and welfare to work

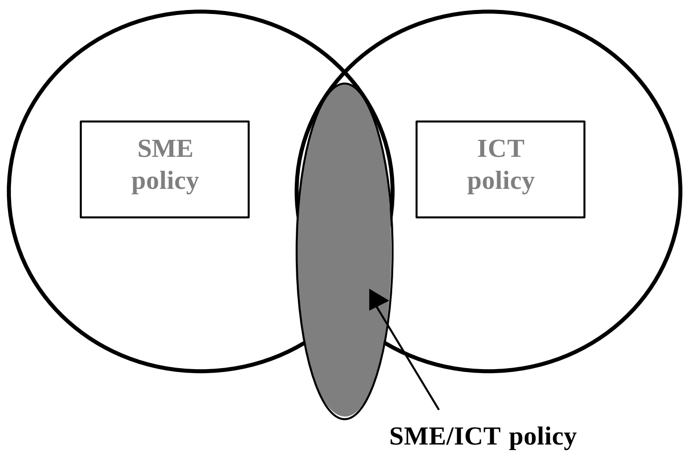

Fig 3. GOVERNMENT POLICY OVERLAPS AND SME/ICT FOCUS

E-commerce/ICT/S&T policy

This covers a wide range of policies which are aimed at enhancing national e-commerce, ICT utilization or Science and Technology (S&T), but which are not SME-specific. Dimensions include

- Infrastructure
- Tax policies
- Education
- R&D
- Standards
- B2B promotion
- E-government

- E-procurement

There is only space to touch on, and give examples, of a few of these. Whilst these measures are not aimed specifically at SMEs they are often of great importance to SMEs given their general lack of resources and expertise.

Telecommunications infrastructure provides, of course, the basis for e-commerce and the Internet. The Internet is a child of US government policy, even though Al Gore's claim to paternity might be unsustainable; the defense industry has a stronger case. Government spending in infrastructure, whether through defense, education or R&D remains important. There is also a concern to lower telecommunications costs. Kirkman and Sachs argue that liberalization is the key to reducing telecommunications costs [44] However, environmental factors also play a large part. The high population density of the Asian city states of Singapore and Hong Kong, and concentrated urbanization in South Korea, where high-rise apartments are common, contribute to the rapid development of broadband; Hong Kong's use went up 56% in the first half of 2001[8], and Korea boasts the highest penetration of broadband in the world [40]. What government can do when this high density of affluent users is absent is a more difficult issue.

South Korea is an interesting example of pro-active government policy aimed at developing e-commerce and ICT usage [6]. The Government has put forward a 'e-commerce roadmap' [29, 39] in order to 'to lay foundation for e-Korea, knowledge-based society' [33]. In August 2001, President Kim Dae-jung pledged 10 trillion won (US$7.8billion) to support R&D in key next generation sectors: information technology (IT), biotechnology (BT), nano technology (NT), environmental technology (ET) and cultural technology (CT) [42]. The aim is make Korea a leader in IT in Asia [42, 45,46]. Korea is not alone in this of course. Another example in a very different context is India's promotion of IT to spur rural development [26].

Since governments are usually the largest economic and social actor in countries – and the United States Government, despite the rhetoric, does not eschew that role – their utilization of ICT has a profound impact. They can be an important source of emulation for SMEs. If governments can save costs by purchasing online [10, 11] so can SMEs, which, even in the United States, have been slow on the uptake [54]. The US government sold $3.6billion online in 2000, through 164 websites [9,12], again a powerful example to SMEs.

There are many ways in which SMEs have to interact with government; of which taxes is the most obvious example. Payment online, with consequent savings in cost and time, is but one way in which governments can stimulate SME ICT use. Governments can also provide strong incentives for SMEs to go online voluntarily to interact with it. Accessing the wide range of services governments supply, such as export intelligence and SME support services, is one example. An even more powerful tool is the use of e-procurement.

Governments are huge consumers of goods and services and e-procurement strategies can be formulated not merely to provide costs savings to governments, and hence to taxpayers, but also to stimulate SME participation. For example, the Australian government's e-procurement strategy 'is designed to satisfy a number of Government policy objectives including. /. encouraging the uptake of electronic purchasing and payment by suppliers to Government by demonstrating the benefits to suppliers, especially small-to-medium sized enterprises (SMEs);/..In seeking to achieve these goals, the Government will be guided by the following key principles: ../.. Minimise barriers of entry to Government markets for both small agencies and SMEs. ../.. Maintain consistency with and support for relevant Government policies, particularly: ./.. ensuring at least ten per cent of purchases of each agency are from SMEs.'[1] Facilitating SME involvement in government e-procurement is also an important way in which governments can seek to foster local industry and yet still be compliant with World Trade Organization regulations.

The corollary of that is to facilitate SME exporting through involvement in trade portals. A recent example is Trade New Zealand's joining of a Swedish-led government trade portal called eMarketServices.com [58].

SME ICT/S&T policy

Such is the overlap between SME and ICT promotion that specific programs aimed at promoting ICT utilization within SMEs are relatively rare. Where they exist they are usually a sub-set of a larger program. An example is the 'E-commerce for Small Business' program of the Australian National Office for the Information Economy (NOIE) [28]. NOIE states that 'Small and medium-sized enterprises (SMEs) are vitally important to Australia's economic and social prosperity. Increasing their awareness and take-up of e-commerce is a Government priority'. The office undertakes research, coordination and consultation to encourage SMEs to take up e-commerce, which it defines broadly as ‘the use of computers and electronic communications networks to do business’ [28]. It does not appear as if NOIE offers financial, administrative or training support.

A contrasting example is China’s ‘Innovation Fund for Small Technology-based Firms’ (Innofund) which is aimed at what we might call ‘high-tech startups’. Innofund ‘is a special government fund set up upon the approval of the State Council. As a policy guide fund, the Innofund facilitates and encourages the innovation activities of STFs and the transformation of research achievements by ways of financing. In the meantime, it works to bring along and allure investment from the whole society so as to promote the establishment of a new investment mechanism conforming to the objective laws of market economy for technological innovations of STFs. Without aiming at profit-making for itself, the Innofund is to contribute to the national economic structure adjustment and the growth of economy, taking revenue increase and job creations as the reward.’ [3]. Innofund is apparently an agency of the Ministry of Science and Technology (MOST) and is part of China’s S&T drive, rather than being a component of e-commerce strategy.

Conclusion

This brief survey of the global digital divide and how governments might facilitate the utilization of ICT by SMEs in order that their countries are on the right side of the divide necessarily raises more questions than it answers. The global use of ICT is complex and not well documented. It varies greatly between countries and within countries. SMEs similarly are difficult to define; the common criterion of number of employees brings together enterprises at opposite ends of the ICT spectrum. [16]. The problems that SMEs encounter are relatively well known, at least in ‘developed countries’ [78]. How to address those problems, and the role of government in that, is another issue. It is part of an ongoing international research project looking at SMEs and ICT. [23]. Effective utilization of ICT by SMEs will become increasingly important for their survival and growth, even in ‘ICT-poor’ countries. And in those countries the modest, unpretentious and cheap harnessing of the power of ICT by SMEs will make an increasingly important contribution to national development.

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Statistical appendix

TABLE 1: TECHNOLOGY ACHIEVEMENT – LEADERS, POTENTIAL LEADERS AND DYNAMIC ADOPTERS

Rank	*Country*	*TAI*	*Rank*	*Country*	*TAI*	*Rank*	*Country*	*TAI*
LEADERS			**24**	Hong Kong, China SAR)	**0.455**	48	Peru	0.271
1	Finland	0.744	**25**	Slovakia	**0.447**	49	Jamaica	0.261
2	United States	0.733	**26**	Greece	**0.437**	50	Iran, Islamic Rep. of	0.260
3	Sweden	0.703	**27**	Portugal	**0.419**	51	Tunisia	0.255
4	Japan	0.698	**28**	Bulgaria	**0.411**	52	Paraguay	0.254
5	Korea, Rep. of	0.666	**29**	Poland	**0.407**	53	Ecuador	0.253
6	Netherlands	0.630	**30**	Malaysia	**0.396**	54	El Salvador	0.253
7	United Kingdom	0.606	**31**	Croatia	**0.391**	55	Dominican Republic	0.244
8	Canada	0.589	**32**	Mexico	**0.389**	56	Syrian Arab Republic	0.240
9	Australia	0.587	**33**	Cyprus	**0.386**	57	Egypt	0.236
10	Singapore	0.585	**34**	Argentina	**0.381**	58	Algeria	0.221
11	Germany	0.583	**35**	Romania	**0.371**	59	Zimbabwe	0.220
12	Norway	0.579	**36**	Costa Rica	**0.358**	60	Indonesia	0.211
13	Ireland	0.566	**37**	Chile	**0.357**	61	Honduras	0.208
14	Belgium	0.553	**DYNAMIC ADOPTERS**			62	Sri Lanka	0.203
15	New Zealand	0.548	**38**	Uruguay	**0.343**	63	India	0.201
16	Austria	0.544	**39**	South Africa	**0.340**	64	Nicaragua	0.185
17	France	0.535	**40**	Thailand	**0.337**	65	Pakistan	0.167
18	Israel	0.514	**41**	Trinidad and Tobago	**0.328**	66	Senegal	0.158
POTENTIAL LEADERS			**42**	Panama	**0.321**	67	Ghana	0.139
19	Spain	0.481	**43**	Brazil	**0.311**	68	Kenya	0.129
20	Italy	0.471	**44**	Philippines	**0.300**	69	Nepal	0.081
21	Czech Republic	0.465	**45**	China	**0.299**	70	Tanzania, U. Rep. of	0.080
22	Hungary	0.464	**46**	Bolivia	**0.277**	71	Sudan	0.071
23	Slovenia	0.458	**47**	Colombia	**0.274**	72	Mozambique	0.066

Source: UNDP Human Development Report 2001 [75], Table A2.1

TABLE 2: THE INTERNET GLOBAL DIVIDE 2000 – TOP AND BOTTOM COUNTRIES

rank	*Country*	*% of pop*	*rank*	*Country*	*% of pop*	*rank*	*Country*	*% of pop*
1	Iceland	*59.7865*	**8**	Japan	*37.0945*	**198**	Congo	*0.0175*
2	Norway	*49.0524*	**9**	Denmark	*36.5852*	**199**	Ethiopia	*0.0159*
3	Sweden	*45.5829*	**10**	Australia	*34.9742*	**200**	Chad	*0.0134*
4	Canada	*41.3007*	**11**	United States	*34.6578*	**201**	Liberia	*0.0102*
5	Korea (Rep.)	*40.2537*	**195**	Uzbekistan	*0.0309*	**202**	Somalia	*0.0021*
6	Bermuda	*39.0137*	**196**	Burundi	*0.0305*	**203**	Myanmar	*0.0011*
7	Finland	*37.2295*	**197**	Niger	*0.0288*	**204**	D.R. Congo	*0.0010*

Source: International Telecommunications Union [38] Re-calculations are mine

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[i] A subject which I am addressing in a paper for the NZ Asian Studies Society conference in November 2001

Some Reflections Upon the Start-up of Companies in Transition Countries

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Abstract

The private corporate sector is the major driving force for stable economic growth in market economies. Firm innovations modernize the economy, strengthen its competitive power and raise the welfare of the society. Due to this, the success of the transition process in Eastern Europe depends on the establishment of innovative private entrepreneurs, ready to invest in production facilities. During the whole transition period, a lot of start-up companies emerge, and some of them disappear quite rapidly, while others sustain the market challenges. Obviously, the perspective of a start-up company in a market depends on criteria affecting the personal dimension of the entrepreneur as well as his direct (micro social) and indirect (macro social) environment. By analysing these criteria, it is possible to select different types of entrepreneurs and their existence in the different phases of market transition.

Introduction

The transition process from one economic system to another affects the economic framework as well as the social and political arrangement. Frequently in literature, the transition process is described as the exchange of constitutive central rules (property and coordination system) without taking into account that this process contains the adjustment of individuals who are forced to live with this new institutional framework. To live with, does not necessarily mean to accept it as God given but also to create an individual environment within this institutional context, which helps to achieve personal objectives in the best way.

The success of a transition process depends on individuals who are able and motivated to use their individual freedom in a way that they function as promoters of the economic development towards a market economy. Due to this the increase in entrepreneurs is an important prerequisite, which is necessary to develop and establish market structures. However, entrepreneurs do not fall from heaven. They have to be stimulated by the institutional environment to create start-ups and to take the entrepreneurial risk that is related with entrepreneurship. This risk is especially high in countries where the stability of market institutions as well as markets themselves are still developing. Administrative bodies can assume a part of the risk by launching investment subsidies concerning entrepreneurs and companies. However, of course, the efficiency of these subsidies depends on the government's capability to use it selectively, which means, to promote only those enterprises that seem to be successful in the long run.[i]

In the early phase of a company's life cycle the entrepreneur dominates the organization and stamps it with his decisions. Regarding the fact that the first five years in a company's life are the most difficult to survive, one can imagine that, on the one hand, the firm's success is strongly linked with the entrepreneur's competence, risk tendency and motivation, whilst on the other hand, the company does not work in a vacuum but is surrounded by social, political and economical institutions.

While institutions, especially in transitions countries, are in a permanent state of change, entrepreneurs often have to work with educational skills, they acquired under a completely different political and economic system. According to the institutional framework and the individual competence, we can distinguish between different types of entrepreneurs whose appearance depends on aspects concerning the maturity of the market system and on individual capabilities and qualities.

Therefore, we can assume that

- transition countries pass through different phases of institutional development and
- the group of entrepreneurs itself can be distinguished in different types depending on their motivation, competence and risk tendency.

This means finally, that different transition periods engender different entrepreneurs.

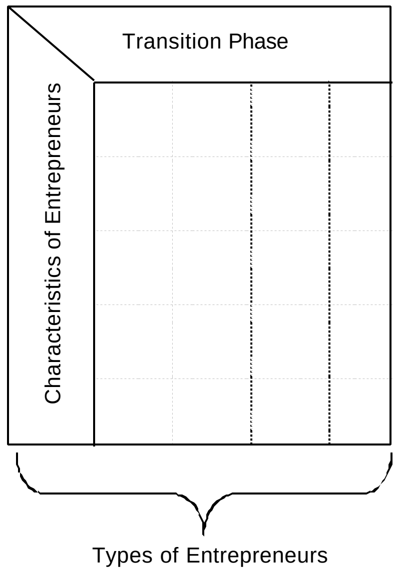

Fig. 1: PATTERN OF ENTREPRENEURS

Start-up Companies: An Idea Becomes Reality

The start-up determines the first phase in the life cycle of a company. Already this period decides whether the company will survive in the long-term. It is a multi-dimensional and interactive process, which involves all activities that are necessary to create an organization, which means to set it up technically and to run it economically.

In general the start-up process can be divided into two different sub-processes, which correspond with the cognitive part of decision-making and the active part of decision fulfilment. Decision-making means to analyse personal and environmental issues concerning the question, what are the individual capabilities to become an entrepreneur and what are the competitive market advantages of running the company. Personal characteristics, dynamism, qualifications, experience, etc. are important factors that, finally, separate the potential from the actual entrepreneur. This means that not everybody thinking about being an entrepreneur becomes one. One can assume that the number of potential entrepreneurs is much higher than the number of those who actually make the step into the phase of realization.

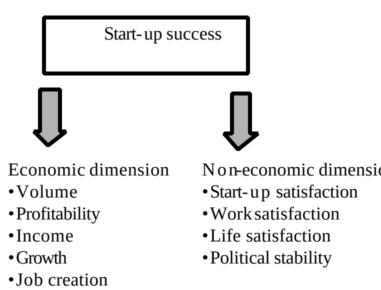

Fig. 2: ITEMS OF START-UP SUCCESS

The realization of an idea is determined on the one hand, by a legal act and focuses on administrative requirements and on the other hand, by entering the market and facing competition and consumer needs. A central aspect refers to the question: what factors promote or hamper the success of a start-up company? Its success can be defined in several ways corresponding to economic and non-economic indicators (Fig.ic 2).

Due to the aspects mentioned above, a company's start-up takes place within a framework of a number of factors belonging to different personal and environmental dimensions (Fig. 3):

- Personal dimension
  Directly characterized by the entrepreneur.

- Micro social dimension
  Factors influencing activity and success of a start-up process and which form the organizational structure.

- Macro social dimension
  General institutions in the social, political and economical context that affect a company indirectly because they describe the coherence of the society.

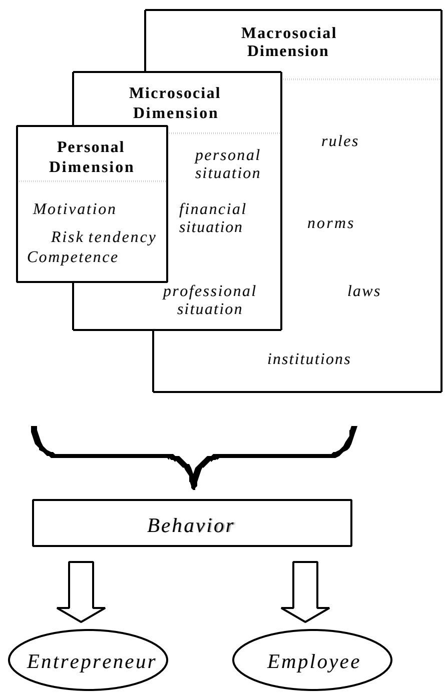

Fig. 3: MODEL OF INDIVIDUAL BEHAVIOUR

Personal Dimension

The entrepreneur holds the key role in the start up process and has a crucial impact in the early phase of a company's life cycle. The question rises, what kind of individual conditions are needed to assume such an important role and what makes the entrepreneur different to employees?

Theoretical Approaches

The Functions of Entrepreneurs

To explain the phenomenon of entrepreneurship, many authors in economic literature use a concept elaborated by Schumpeter that regards the entrepreneur as someone who acts as a pioneer in discovering and using market opportunities.[ii] According to Schumpeter, the market consists of information that is not equally distributed among individuals. Entrepreneurs benefit from this situation, by first, gathering information about market opportunities and second, exploiting them. Therefore, the existence of entrepreneurs depends on the existence of market imbalances, in the sense of unsatisfied demand, and the entrepreneur's willingness to attend this demand. Usually, these markets are marked by an above average profitability, therefore, a pioneer or first mover in such a market is followed by rivals. The average profitability tends to decrease and companies try to resist this tendency by launching product variations and innovations. This type of entrepreneur described by Schumpeter gets his motivation because of extrinsic incentives. The creation of ideas and the realization of these ideas are central functions of an entrepreneur. By doing this his striking qualities are: initiative, authority, far-sightedness and leadership capability.[iii] According to Schumpeter, to be an entrepreneur is something that you cannot learn but is an inherited natural ability. Entrepreneurs are born and not made.[iv]

However, the passion to be an entrepreneur does not only reflect the objective of making a profit but also that certain feeling of creativity and to be better than others. This type of entrepreneur drives the economy forward, shifts productivity and increases economic output.

A second type of entrepreneur lacks these qualities and is called by Schumpeter ´an administrator of economic resources´. He is competent but without the spirit of an entrepreneur. Often, we find this type of entrepreneurs at the top of big companies, although, their innovative creativity is limited by a lack of risk tendency. The ´administrator´ prefers a conservative rather than an aggressive firm strategy.

To summarize these reflections, a start-up entrepreneur can be characterized as someone:

- who stimulates markets because of his ideas and initiatives and who tries to find solutions by a process of trial and error,
- who is innovative because of his know-how, that is very often based on a technical background,
- who is a promoter of institutional change because of his creativity and flexibility and who is able to establish innovations in the market.

The Motivational Approach

Dynamic characteristical features incorporate an inherent, based in the genetic code, and a cognitive dimension. Many studies focusing on start-up companies point out that the entrepreneur's success depends on both characteristics. In the end, these characteristics find their expression in many ways concerning the aspect of self-fulfilment. Advocates of the motivational approach emphasize the fact that activities base on motivation (active component) and prioritise objectives (cognitive component). Due to this, entrepreneurs need to prove their capacity by starting and managing their own businesses and competing successfully with their rivals. They accomplish their own goals by trying to be better than the rest and measure success only by the company's performance.[v] This approach involves the assumption that the success of a company depends on the risk tendency of the executives, which means that successful organizations accept risk only in small doses and try to fix realistic goals that can be achieved. Their profit seeking is characterized by rational decision-making and not by chance. "In fact, the whole purpose of life for an entrepreneur is to avoid risk and let somebody else take it."[vi]

Referring to this approach, typical characteristics of entrepreneurs are:[vii]

- average risk awareness - the entrepreneur relies on his capabilities
- innovation mentality
- feeling of personal responsibility
- visionary mind
- organizational skills

The Theory of Personality

The core element of this approach lies in the hypothesis that the success of an entrepreneur depends on his capability and charisma. “The single most important determinant of a positive investment decision is the […] entrepreneur”.[viii] Especially start-ups, are characterized by an authoritarian leadership of the entrepreneur who is involved in almost all decision processes. He satisfies his need of unshared leadership in small companies and is against far-reaching delegation. This ´craftsman entrepreneur´ is able to manage small firms with a simple organizational structure. His advantages are:

- practical intelligence
- creativity
- aggressiveness
- independence.

Articles from the beginning of the nineties dealing with East European entrepreneurship mention the lack of these personal characteristics. But a decade later, we have to admit that this is no longer a problem, especially, when we have a look at the most successful transition countries.

The Micro social Dimension

This aspect contains factors that are directly linked to the entrepreneur and affect his personal environment. Empirical analysis confirms this close relationship. Concerning the start-up process, the following situations play a certain role:

Personal Situation

It is proved that a key factor that drives people into entrepreneurship is the professional autonomy of his parents. It is more probable that someone, whose parents were entrepreneurs, also becomes entrepreneur than someone whose parents worked as civil servants. Therefore, it is possible to draw a positive relation between entrepreneurship activities of the parents and the tendency by following generation.

Financial Situation

The market entrance also requires access to finance capital. The amount of capital the entrepreneur has at his disposal depends on personal reserves and his ability to acquire external capital. Banks as well as venture capital companies are the classical institutions, which lend money to start-up companies. In general, start-up companies face the problem that they need to have collateral securities to obtain external capital. They cannot show figures from previous periods and cannot hint on past success stories. A typical problem is the bottle neck of disposable capital especially in East European countries. We see that, still, today, a lot of money remains in the public sector to finance public companies.

Professional Situation

The step to becoming an entrepreneur can result from various work situations:

- someone starts his own business because he is unsatisfied with his work situation
- someone can be unemployed and is looking for a possibility to earn some money.

It can also be pointed out, that entrepreneurs start their organization in a field where they have experience. Often, the company who they worked for before, functions as an incubator organization, which means that the new entrepreneur produces similar products or his focus is directed on the same group of customers.

The Macro social Dimension

Economic welfare depends on the division of labour, which drives production efficiency. The concept is that not everybody is producing all goods they need but only these that they are able to produce because of their personal capabilities. To guarantee the functioning of this concept everybody needs the certainty of the existence of the supply of goods. The basic thought is that an economy needs formal laws and informal habits that protect producers of goods and services as well as consumers.[ix] This means, that an entrepreneur can expect to be paid, while the consumer can expect not to become injured by the use of a certain product. Both parties act under a pattern of generally accepted rules that reduces uncertainty in the market. This is a central aspect concerning market development: people invest or spend money, if they feel secure in their environment and can foresee certain kinds of behaviour. In other words, it is not anarchy that drives the economy but a stable set of rules and norms (economic and social institutions). Developing a market economy means to activate potential entrepreneurs to start-up their own company. To do this, means creating an institutional environment that they can work within. "The transition process consists largely of changes in institutions and modes of business conduct that are difficult to quantify."[x]

Institutions, understood as a "set of socially prescribed patterns of correlated behaviour"[xi], regulate a society. What is the advantage of setting institutions? Companies can reduce their transaction costs when they are sure that their contract partners will behave within the given norms. This is an important condition to stabilize market transactions and to increase market efficiency. Expectations play a central role in a company's survival if we take into account that not only capital resources, interest and profitability but also the forecast of market tendencies affect the decision as to whether a company enters a market or not.

These abstract reflections have a direct link to the East European transition process. One can assume that design and stability of the institutional arrangement are essential development factors in the process from a centrally planned to a market economy.[xii] Private entrepreneurship increases and drives the economy when the institutional environment is stable and conforms to the needs of the corporate sector. This means that without a framework of legal institutions, entrepreneurs won't be prepared to invest in production plants and technology. Entrepreneurs in an uncertain environment invest only the minimum and try to make a profit as soon as possible. Such an economy does not accumulate productive capital and cannot turn into an emerging economy. The main task of transition countries is to convince potential investors about the stability of their legal framework. "Jeffrey Sachs, a Harvard Economics Professor, claimed that the single most important policy for promoting entrepreneurship in Central and Eastern Europe is getting the macroeconomic environment right. This is the laissez-faire method: work on getting the macroeconomic environment right, eliminate regulatory barriers and everything else will follow."[xiii]

Economic Framework

Open Markets and Competition

Market entrance and market exit as well as private property rights are essential conditions to stimulate entrepreneurship. The competition in the market between already existing and potential entrepreneurs causes a dynamic process that puts pressure on costs and prices. Potential entrepreneurs, are individuals able to enter the market at any moment with a new product or production idea or only to make money from an already existing mature product or production technology.

From an evolutionary point of view, innovation processes occur in relation to their historical context. Innovations do not fall from heaven, they are part of an endogeneous socio-economic development process. This aspect is important when we discuss the current transition process in Eastern Europe. These countries have to create market institutions and private entrepreneurship without any historical institutional links. The change process from a centrally planned to a market economy is obviously a macroeconomic innovation which does not follow an endogenous development path. In fact, the economic and political transition involves a dramatic break and needs to be managed without having historical experience. This explains, why, with the exception of the East Asian transition countries, Poland, Slovak Republic and Slovenia, none of the other transition countries could achieve its output ratio of 1989, the year before the process began.

Table 1: SELECTED CHARACTERISTICS OF TRANSITION COUNTRIES[xiv]

Transition Country	Year Transition Began	Starting Date of Stabilization Program	Real Output Ratio 1999/1989
EU accession countries (excluding Baltics)	**1991**	**Mar-91**	**0,95**
Bulgaria	1991	Feb-91	0,67
Czech Republic	1991	Jan-91	0,94
Hungary	1990	Mar-90	0,99
Poland	1990	Jan-90	1,28
Romania	1991	Jan-93	0,74
Slovak Republic	1991	Jan-91	1,01
Slovenia	1990	Feb-92	1,05
Baltic countries	**1992**	**Jun-92**	**0,68**
Estonia	1992	Jun-92	0,78
Latvia	1992	Jun-92	0,56
Lithuania	1992	Jun-92	0,70
Other south-eastern European countries	**1990**	**Jun-93**	**0,77**
Albania	1991	Aug-92	0,93
Bosnia and Herzegowina	....	....	0,93
Croatia	1990	Oct-93	0,80
Macedonia, Yugoslavia	1990	Jan-94	0,59
Commonwealth of Independent States	**1992**	**Aug-94**	**0,53**
Russia	1992	Apr-95	0,55
Ukraine	1992	Nov-94	0,35
Georgia	1992	Sept-94	0,31
……			

The implementation of open markets can be seen as a special challenge for transition countries. No former structures exist that can be adopted. Except some rudimentary market structures in the second economy, these countries had not built up markets under the communist regime. Of course, we have to admit that the second-economy has been very creative because of its restrictive circumstances and people have learnt to deal in this ´crypto-private´ area. Probably, some of them have developed capabilities, which help them in their handling of the transition process, but this is not comparable with the situation in market economies.

The Different Phases of Market Maturity

Parallel to a company's life cycle, it is possible to distinguish between different stages of market performances. Our central hypothesis is that different market phases engender different types of entrepreneurs. The production volume is the key indicator to identify the degree of maturity of a market. It links the market performance with the activity of the corporate sector.[xv] If we consider a market as mature when production and market activity as well as investment is high, then we have to look for factors that stimulate business and investment. Here, we have the link to the importance of the institutional environment, as mentioned above. Additionally to our hypothesis we can point out that corporate activity depends on institutional security, which finally means that business and long-term investment are strongly related to stable institutions. Considering the growth rate of the GNP as an indicator, which measures the development of production in the economy, we can draw some important conclusions concerning emerging markets in transition countries:

- Economies that have just turned into a market find themselves in the experimental phase. People are not accustomed to living and working within the new economic system. Market institutions exist but are not yet completely established into daily life. There is still institutional uncertainty and some economic activities do not occur because of a lack of confidence in future development. In this period, the growth of GNP is low or decreasing.[xvi] Business relationships break down, investments in productive capital do not exist and people investing in their own business try to benefit from opportunities that exist because of institutional gaps.

  At the beginning of the nineties, just after the collapse of the communist system, all East European countries slipped into this first evolutionary stage of market economies. The typical small scale business took place in the field of trading with alcohol, cigarettes etc. Entrepreneurs avoided investing in capital goods and tried to obtain short-term profits.
- The second stage is reached when countries begin to create a competitive corporate structure. Price competition is the main way in which companies compete. Constitutional institutions that rule the competition come into existence. Entrepreneurs with a relatively high risk tendency begin to invest and enlarge the capital stock of the economy. Economies in this phase can be defined as markets in expansion, whilst this period can be called the phase of expansion. In this situation a country begins to become a recipient of foreign direct investment.
- The expansion phase is followed by the maturity phase. Political and economical institutions are fixed, there is no institutional uncertainty. Markets are stable and entrepreneurs can make rational decisions. Individuals, starting-up a business in this type of environment, are more conservative than those of the experimental or expansion phase. The maturity phase is less risky because of its institutional stability.
- Last but not least, economies reach a turning point when they enter into the stagnation phase. Shrinking market potentials decrease the process of growth and slow down the innovative dynamic of the economy. In such a situation, companies look for new markets abroad, which mean they internationalise their business, or they change their strategy and turn from profit seeking to a rent seeking.[xvii] This strategy does not focus on the creation of economic welfare but on its re-distribution. Subsidies and market regulation are these companies´ interests. Obviously, growth rates are very low; sometimes negative, and the economy suffer from a lack of innovative input.[xviii] The country loses its attraction to foreigners, ready to invest in business activity (Fig.4).

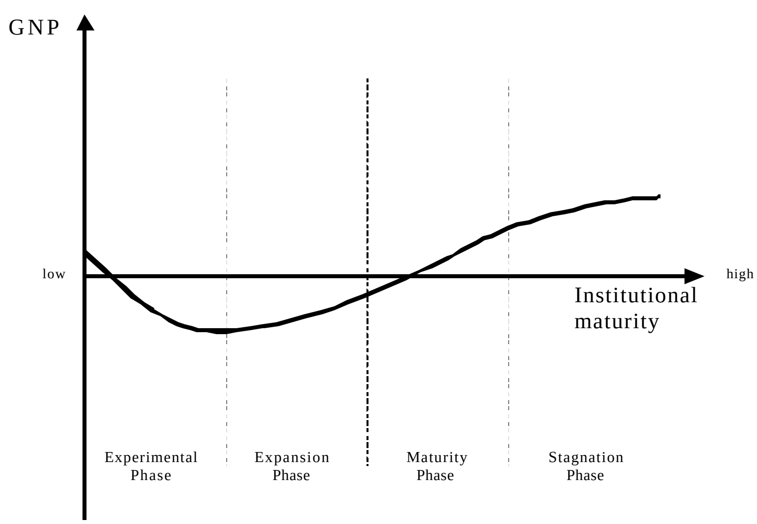

Fig. 4: PHASES OF MARKET MATURITY

The East European transition process runs through these phases mentioned above. In the early period of the nineties, market institutions evolved, at first, in sectors, which already had market experience. Examples are:

- the private agricultural producer associations established in the Soviet Union in 1988. People in these associations had the possibility to work in self-responsibility.[xix]
- private food markets, accepted by the communist administration.
- illegal private trade relations in the shadow economy.

Today, the transition countries find themselves in different stages of market evolution, which means in different stages of institutional stability.

Private Property and Trading Liberalization

The implementation of private ownership plays an important role in the dawning of a market economy. Only the existence of private property, protected and legalized by private property rights, puts a potential entrepreneur in the situation to start-up his own business and to build up productive capital. An entrepreneur is ready to absorb market risks as well as to invest capital, if user rights are exclusive and clearly defined. Otherwise, people won't invest private capital and business activity will be concentrated on less capital-intensive sectors like service and trade.

Due to this, property rights stimulate the production process, increase the capital stock and improve productivity. Private entrepreneurs are interested in long-term profits and try to adjust their firms to market tendencies, which mean satisfying consumer demand and being open to innovations.[xx]

Entrepreneurship and privatisation policy are two essentials of the transition process and have led to a fundamental change in the institutional framework in Eastern Europe. To privatise a public company, it is necessary to

- value the company's assets, including the human capital;
- define the ownership structure;
- declare the economic and ecological burden for the potential buyer.[xxi]

Nevertheless, the privatisation of a company is marked by a high degree of uncertainty for the buyer, which, first of all, results from investment efforts to make these companies fit for competition. This problem can become a major obstacle when we think about the privatisation of highly specific industries delivering into niche markets. A look at the privatisation process in East European countries in the early nineties shows that the process began with the privatisation of small companies in a broader sector.

A fundamental condition in market economies is the individual right of private and autonomous negotiation. These rights are exclusive property rights that give the opportunity to carry out transactions according to individual needs. Of course, the individual freedom is limited by social responsibility, which finds its expression within the framework of social rights. Legality in this context, means individual freedom without private or political arbitrariness. In the terms of business processes, responsibility lies within rules of liability and creditor protection. The absence of political arbitrariness and the existence of creditor protection as well as rules of liability are the basics to promoting private entrepreneurship.

As Posner pointed out, trading liberty corresponds with economic efficiency.[xxii] This aspect becomes clearer if we think in terms of the individual readiness of payment, which means that materials and products flow in the direction where people are willing to pay the highest price. Due to the fact, that this is connected with peoples´ needs, it is obvious, that people with the highest needs pay the highest price.

Countries in transition often suffer from a lack of the above-mentioned freedom of economic activity. National protection of public companies or the fixing of prices that represents political rather than economic preferences are only two examples that restrict the sphere of private enterprises. The implementation of private and liberal markets is a prerequisite to establish monetary institutions and market based trade relationships.

Political Framework

In literature, we find a broad discussion about the failure of political institutions concerning the economic sector. The majority of theories assume that egotistical behaviour of political and bureaucratic decision makers, leads to a redistribution of economic assets from the production into the bureaucratic sphere. In keeping with its aim of increasing income, the bureaucracy tries to influence the institutional arrangement and pull resources from the corporate sector. Complicated administrative processes and corruption are some typical examples. As a consequence, institutional insecurity rises as well as economic inefficiency.

Another important factor is the potential influence of interest groups on political institutions. Due to welfare expectations, especially in transition countries, a variety of interest groups appear, fighting for the biggest piece of the cake. It is obvious that first of all, those groups who are in danger of losing their level of welfare spend most resources on maintaining their situation. In innovation processes, i.e. organizational change in companies or institutional change in political or economic systems, we can identify all those as opponents, who lived very well before the innovation was initiated. The initiation of new rules threatens former comfort. Concerning the transition process, it can be assumed that this affects first of all political and the economic elite of the communist system. They can still be regarded as obstacles in the implementation of a market system in some transition countries. The East European transition process has shown that especially the class of older elite try to maintain their privileges, whilst the younger elite are looking for income possibilities by combining good connections with the freedom to start-up their own business.[xxiii]

Despite these inherent problems of the political system, the core question about the role of the State in the transition process is as follows: Given that the success of the reform process in Central and Eastern Europe depends on the creation and growth of a large number of private enterprises, what can public authorities do to promote entrepreneurship? Heinrich von Moltke, European Commission, mention three aspects:

1. Establishment of a profound macroeconomic, financial, legal and fiscal environment.
2. Promotion of a suitable financial, educational, technological and service infrastructure.
3. Release conditions to ensure international trade, investment and cooperation.[xxiv]

Especially in the early phase of the transition process, we could notice that private entrepreneurs were not being given access to property and it was very difficult for them to get the various permits from the govemment. It was also difficult to get sufficient office and industrial space allocated to their entrepreunrial activities. Still today, we can expect these problems in some transition countries, where the policy follows the limited administrative capacity to adapt on the transition process.[xxv]

Types of Entrepreneurs in the Transition Process

Criteria

The reflections make it clear that companies work within an institutional environment and that start-up decisions are influenced by institutions and the entrepreneur's personality. With regard to the model of Heuss, it is possible to separate the market development process in different phases, due to its institutional maturity. Therefore, each phase has its particular set of institutions.

Beside this, individuals themselves can be described by a variety of characteristics that define and initiate corporate behaviour. Relevant are:

- motivation,
- risk tendency and
- individual competence.

Theoretical approaches of motivation focus on:

- the entrepreneur's tendency for self-fulfilment and his search for autonomous decision-making and responsibility,
- the tendency to benefit from profits and to substitute a fixed salary by a less secure but eventually higher profit income.

However, of course, sometimes this tendency turns into a necessity when we think about unemployed people who prefer to work as an employee but cannot find work and decide to try out their own business. In this situation the individual realizes a second best solution, often with a lack of competence. Supposedly, these entrepreneurs face a higher risk of failure in running a company.

Risk can be defined as the possibility of whether to reach a defined target or not. An environment where we have secure expectations is free from any risk. Behaviour can be completely planned, but instead of this security, risks exist and affect also the entrepreneur:

- risk to realize a certain profit,
- investment risks,

- business risks,
- market risks and institutional risks.

The difference between a higher and lower risk lies in the aspect of chance. A certain activity contains a risk when its result depends more on chance than on personal effort. The transition process involves some special risks because of institutional instability. It is evident that the start-up of a firm is more difficult during a change environment, when expectations are less secure than in a situation of economic and political maturity. Therefore, an entrepreneur who runs a company in the early phase of the transition process has to take more risks than someone starting-up his business later. From an individual perspective, three different degrees of risk tendency can be defined:

- risk aversion,
- risk neutrality and
- risk attraction.

A third criterion, deals with the aspect of competence. In general, we can distinguish between free-floating knowledge that is freely accessible and tacit knowledge, which is related to an individual's experience. Experience is difficult to communicate and has to be gained by one. In the context of entrepreneurship, start-up or leadership experience is important criteria in managing the start-up process.

Phases of Transition and Types of Entrepreneurs

The combination of personal criteria and institutional market phases provide 11 types of entrepreneurs, whose appearance varies in the process of transition (Fig. 5).

The Experimental Phase

The first step into a market economy is characterized by the giving up of the centrally planned economic system. Private business activities become legal and the first privatisation acts take place. Nevertheless, the economy suffers from insufficient patterns of rules and norms, which provide institutional insecurity. Political promises produce a certain kind of illusion and raise the expectations of the population, but political conflicts prevent the elaboration of a complex transition strategy, therefore they only muddle by. People do not believe in the system as a whole, the economy overall, or in the political climate overall. So, whoever is trying to set up a business will think about short-term profits not long-term success. The whole business is characterized by short-term effects and trying to get profits within a day and then disappear.[xxvi]

This environment engenders entrepreneurs, whose common characteristic lies in their tendency for risk:

- Type A1: This type of entrepreneur is looking for self-fulfilment. He is very clever in doing business in a hostile environment. Despite all problems, he prefers to work autonomous which characterizes him as someone with idealism and high intrinsic motivation. Due to a lack of institutional security this type of entrepreneur prefers to share risk by running the company in a team.
- Type A2: This type of entrepreneur has the same individual characteristics as the type mentioned before, except, the aspect of competence. He is lacking leadership experience, sector know-how etc. Therefore, this type realizes a company's start-up in a less specific and less capital-intensive area. They disappear from the market with the rise of competition.
- Type B1: This entrepreneur has only one aim: To make money in the fastest way and by doing this, benefit from institutional unclearness and personal contacts. He tries to take advantage from a situation that is marked by a lack of institutional clarity, which means that his activities stretch the borderline between legality and illegality. They avoid investment expenditures and plan only in the short-term, because they know that the advantage that they benefit from is only temporary.
- Type B2: This type of entrepreneur is similar to the type before, only with the exception that this entrepreneur does not have know-how and business or leadership experience. He typically deals with consumer products, has no personal contacts that could take him forward and often disappears from the market with growing competition.
- Type C1: The main drive of this type of entrepreneur is income security. It sounds contradictory that someone becomes an entrepreneur to stabilize his income flow, but in this situation, it is the necesity to have an income, that drives him into autonomous work. Entrepreneurs of this type will probably be made redundant during the ongoing transition process. To avoid unemployment they look for alterna-

tives. In such a situation they can take the risk and decide to become an entrepreneur. This would be in a field where they feel competent. Initially, these entrepreneurs are competent and inclined to take risks but concerning their motivation they would prefer to work as an employee. Only the threat of unemployment drives them into entrepreneurship. Management-Buy-Outs are typical examples of start-ups of this type of entrepreneur.

The Expansion Phase

This part of the market evolution begins after the market system is legally fixed within the political and economic system. This is the moment of constitutional change, but one aspect is the legislation, another, is the implementation of market rules in individual thinking and behaviour. The market economy is still young and privatisation and liberalization policies have to promote and to stabilize market competition. The constitution of legal market rights pushes private investments, because it underlines the government's intention to continue seriously with the market-oriented transition policy. This is the situation where the GNP begins to rise, but where also evolves a drift of income disparity.

Low institutional uncertainty makes it possible that also entrepreneurs with a lower risk tendency begin to start-up their own businesses. The economy is carried by the demand of investment. At the same time, competition becomes more intensive and the market select entrepreneurs with a lack of professional competence and experience. The following types of entrepreneurs can be identified:

- Type A3 (similar to the A1-type) dominates the more intrinsic trait of self-fulfilment. He believes more in his capacities than in luck. His urge to start-up a company is not that strong that he underestimates risks. This entrepreneur calculates the business risk and is ready to invest, i.e. in production plants, when the institutional environment is sound.
- Type B3: This type of entrepreneur starts-up his business to make money. He sees a market opportunity and tries to fill a supply gap. His activity is based on a profound idea and not on institutional instability. In the phase of market expansion, product innovation and quality are key success factors. These entrepreneurs are ready to invest and plan their business in the long-term. Start-ups are often realized with foreign partners in capital-intensive sectors.
- Type C2: An entrepreneur belonging to this type starts-up his own business when he is already unemployed and without alternatives. Like type C1, he is pushed into entrepreneurship by circumstances but he would never start-up a business in the previous phase, because of a lower risk tendency.

The Maturity Phase

The transition process comes to its end, when the market mechanism is entirely adapted to the institutional system of norms, rules and behaviour. The setting of market rules is accompanied by a living with market rules. The institutional stability of the legal framework attracts foreign and domestic investors to spend money in production processes and to create employment. This directly affects income, purchasing power and domestic demand.

The types of entrepreneurs in this phase are the same as in the previous phase, however with the difference, that the C2-entrepreneur probably increases his share percentage within the group of entrepreneurs because of countrywide privatisation and consolidation processes.

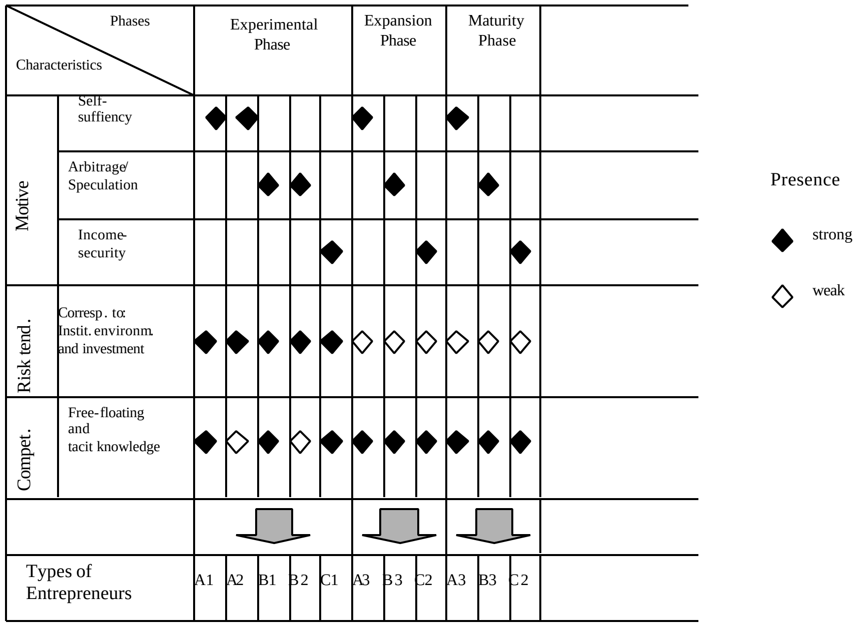

Fig. 5: TYPES OF ENTREPRENEURS IN THE TRANSITION PROCESS

Results

We can now summarize the different types of entrepreneurs and get four clusters of entrepreneurs.

The ´idealist´ is someone who starts-up a company, although the risk is high, and who does not look at gaining short-term profits, but for strategic options in the long-term. His motive is to create something new that gives him satisfaction (intrinsic motivation). Types A1, A2 and, with restrictions, A3 can be defined as ´idealists´.

The ´gambler´ can be characterized as the entrepreneur who starts-up a business to make short-term profits (extrinsic motivation). In doing this, he benefits from institutional insecurity. Types B1 and B2 describe the ´gambler´-entrepreneur. He accepts high risks and disappears from the market when it begins to stabalize and when competitive conditions will dictate life and death of a company.

A third cluster is defined by the B3 and A3 entrepreneur. This is the classical entrepreneur, ready to invest and to plan strategically for the long-term. He can be called a ´rationalist´, which means that he calculates profits, costs and risks. He starts-up his business in phases of institutional stability and looks for long-term profits (extrinsic motivation) as well as for self-fulfilment.

The start-up of a company with the aim of avoiding lack of income due to unemployment is realized by the entrepreneur who feels ´threatened in his existence´. This entrepreneur is pushed into entrepreneurship because of a lack of employment alternatives. The C1 and C2-type represent this group of entrepreneurs. The difference between both types lies in their probability to survive in the market. While the C1-type is threatened because of a lack of competence, the C2-type has a his disposal some useful know-how that helps him to sustain market challenges.

Conclusion

The transition process towards a market economy is always dynamic and marked by the creation, adaptation and selection of rules, norms and behaviour. Corresponding with the literature, we can call it ´institutional environment´.

The East European transition process needs entrepreneurs pushing the economy. In how far entrepreneurs can play that role depends on the institutional environment and its activating or obstructive influence.

Analysing the transition process means to analyse personal characteristics (the personal dimension), the direct environment (the micro social dimension) and the institutional conditions in the economy (the macro social dimension). In doing this, we can analyse social and economic change resulting from institutional change.

The analysis of the institutional environment allows us to identify barriers of entrepreneurship and personal characteristics of entrepreneurs. This aspect is important, when we think about the role of entrepreneurs in the process and their contribution to giving support. It makes no sense that public institutions give financial subsidies to all entrepreneurs, if some of them plan their business only in the short-term and want to benefit from short-term profits. It seems better to limit the allocation of financial resources to those entrepreneurs, who really have an interest in investing in production capacities. An effective promotion of entrepreneurship presumes the identification of those who improve the productive capital in the national economy.

A common characteristic of entrepreneurs in the early phase of the transition process refers to their high tendency for risk, which is necessary to start-up a business within an unstable institutional framework. Due to the uncertainty, entrepreneurs have a short-term perspective and often use illegal methods to speed up or to manipulate decision processes in public administration. The best way to develop legal business activities is to fix market institutions that allow long-term expectations, reduce uncertainty and, therefore, are the basis for investments in productive capital.

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[i] Twaalfhoven points out that the average life cycle of a start-up business is less than six years. See Twaalfhooven, 1993, p. 7.
[ii] See Schumpeter, 1964; Knight, 1971.
[iii] See Witt, 1987, p.37
[iv] See McClelland, 1974, pp. 11
[v] See Simon, 1979. Simon talks about the need to satisfy personal objectives. In this context, the motive to run a company is purely subjective.
[vi] Stevenson, 1993, p. 3.
[vii] See also Hitt, M.A./Ireland, R.P./Sexton, D.L., 2001; Amit, R./Zott, C., 2001.
[viii] Tybee/Bruno, 1981, p. 319.
[ix] See North, 1992.
[x] IMF, 2000, p. 91.
[xi] Bush, 1988, p. 126
[xii] Institutional reforms are still on a low level in the CIS-countries as well as in Croatia, Macedonia, Yugoslavia, Albania and Bosnia. See European Bank for Reconstruction and Development, 1999.
[xiii] Tyson, 1993, p. 36. Fischer/Gelb estimate an average duration of the institutional reforms of about 10 to 12 years. See Fischer/Gelb, 1991.
[xiv] Source: European Bank for Reconstruction and Development, 1999.
[xv] See Heuss, 1965.
[xvi] "The European and CIS-transition economies suffered a substantial output concentration at the start of the transition." IMF, 2000, p. 94.
[xvii] See Tollison, 1982.
[xviii] See Olson, 1985.
[xix] See Malle, 1992; Murphy, 1993, pp. 149.
[xx] See Kornai, 1990.
[xxi] See Labes, 1991.
[xxii] See Posner, 1977.
[xxiii] See Rahe, 1998.
[xxiv] See Moltke, 1993, p. 41.
[xxv] See IMF, 2000, p. 120.
[xxvi] Roure/Birley, 1991, p. 35.

Think Domestically And Invest Internationally: Are Multinational Corporations Effective International Diversification Tools?

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Abstract

This study reviews international diversification using new sets of global, regional, and sector indexes of multinational companies. In line with previous studies, it can be demonstrated that U.S. investors cannot aspire to strategically balanced portfolios through positioning in global indexes. This is in parts due to the fact that U.S.-based companies – still largely impacted by the same monetary and fiscal policies that affect a portfolio of purely domestic firms – frequently dominate these indexes. On the other hand, the puzzle seems to be more than adequately answered when regional and sector indexes of multinational companies are used. There are diversification advantages to be gained from direct investment in these indexes.

Introduction

A relatively new generation of investable stock indexes representing multinational companies–the Dow Jones Global Titans Index, the FTSE Global 100 Index, and the S&P Global 100 Index–has been introduced as important tools for global equity diversification. More recently, Dow Jones launched the Dow Jones Asian Titans, an index of blue chip companies headquartered in the Asia/Pacific region, and the Dow Jones Sector Titans Indexes, representing the world's most important companies in each of 18 market sectors. With barriers to trade coming down and global deregulations of various industries such as telecommunications, banking, or utilities in full swing, these indexes are thought to allow investors to pick up "true" multinational companies, no matter where they are headquartered.

The impetus for these new indexes comes from various directions including the multinationals and the index compilers themselves. The multinationals see them as an answer to their request to have their performance measured against their global competitors rather than their domestic peers. As to the index providers, they are hoping to capture more business from fund managers who no longer invest with traditional national criteria, such as fund managers in Europe who are switching to a regional approach in their investment strategies after the arrival of the euro.

The rush of releases also underlines the growing popularity of exchange-traded funds in the U.S. since their birth in 1993 when they were largely seen as obscure products reserved for institutional investors. The new multinational indexes are expected to expand the use of exchange traded funds to retail investors, seen as a bigger target, by moving these products from their birthplace on the American Stock Exchange to larger arenas such as the New York Stock Exchange and Deutsche Borse. The business press is filled with examples of mutual funds already filing registration documents with the Securities and Exchange Commission for a number of exchange-traded funds tied to global indexes.

The true test, however, remains of whether these multinational indexes offer investors true international diversification. After all, this idea has had its skeptics as early as the 1970s. For example, in 1978 Jacquillat and Solnik investigated whether the gains from international diversification could be realized by multinational firms. They tested the assumption that firms doing business in many countries may be viewed as a diversified international portfolio by examining multinational firms from nine countries and found that their stock prices behave very much like those of purely domestic firms.[i] Clearly, their results did not support the hypothesis that positioning in multinational firms provides additional diversification benefits to a portfolio of purely domestic firms.

To have a full understanding of what is at stake here, we will first briefly review the merits of international diversification and some of the reasons for the ongoing home bias that seems to restrict its implementation in spite of its demonstrated benefits. We will then review the aforementioned three global indexes by comparing them against each other. The Dow Jones Asian Titans Index (DJAT) and the Dow Jones Sector Titans (DJST) are not included at this stage of the analysis because of their narrower focus. We will finally determine, using standard industry tests, whether this new generation of global, regional, and sector indexes of multinational companies provide any further explanation to the international diversification puzzle.

The Merits of International Diversification

A key contribution of the Markowitz diversification strategy is the formulation of an asset's risk in terms of a portfolio of assets, rather than in isolation. Markowitz diversification seeks to combine assets in a portfolio with returns that are less than perfectly positively correlated, in an effort to lower portfolio risk without sacrificing return. Investment portfolios that satisfy this requirement are called efficient portfolios.[ii]

Since Markowitz's seminal work, many studies have explored the merit of holding international assets as a part of a strategically balanced portfolio.[iii] In fact, international diversification has become one of the major themes of modern portfolio theory. In addition to holdings of many different assets including traditional securities such as stocks and bonds and less traditional ones such as options and futures, these studies have investigated whether investors should also consider holdings of foreign securities as a means to further enhance their portfolios' efficiency.

They point to the fact that nonsystematic risk at the national level can be reduced with international portfolio diversification. After all, business cycles do not happen uniformly across countries; when one country is experiencing rapid growth, another may be in a recession. By investing across countries, investors should logically eliminate from their portfolios part of the cyclical fluctuations that would arise from the domestic business cycle. Thus, limiting one's investments to securities representing firms located in only one part of the world would most likely result in a relatively low rate of return per unit of risk

The International Diversification Puzzle

In spite of the theoretical and matter-of-fact groundings of international diversification, many studies have demonstrated that investors nevertheless hold portfolios that consist nearly exclusively of domestic assets. This violation of standard theories of portfolio choice is known as the "international diversification puzzle." In the past, this could be explained by the lack of international financial integration and national barriers to capital flows. However, the growth and integration of capital markets over the past two decades has not led to similarly dramatic portfolio reallocations.

For example, in 1991 French and Porteba report that U.S. investors hold about 94 percent of their financial assets in the form of U.S. securities. For Japan, U.K., and Germany, the share of domestic assets in each case exceeds 85 percent. In 1995 Tesar and Werner showed that domestic assets continue to overwhelmingly dominate portfolios despite the rapidly growing volume of international financial trade.[iv] They examined the foreign investment positions of major industrial countries and found that international investment as a fraction of the total domestic market of stocks and bonds equaled about 3 percent for the U.S., 4 percent for Canada, 10 percent for Germany, 11 percent for Japan, and 32 percent for the United Kingdom. Of course, calculations of an optimal investment portfolio would have much higher fractions devoted to international assets.

So why do investors seem to have this bias in favor of securities of their home country? Standard models of optimal portfolio choice cannot rationalize this pattern of asset holdings, even in the presence of unhedged foreign exchange risk. Of the several possible reasons, taxes and transactions cost are considered the most significant irritants.[v] But these reasons can be easily dismissed. Taxes paid to foreign governments can usually be credited against domestic taxes whereas the fact that investors trade their foreign securities more frequently than domestic securities (per Tesar et al findings) suggests that transactions costs cannot explain home bias in investment either.

Others find an explanation to the apparent tendency for investors to overweight their own equity market in other explicit limits on cross-border investment. In the U.S. for example, pension funds still interpret the "prudent man" rule as limiting their degree of international exposure. In Japan, insurance companies cannot hold more than

30 percent of their assets in foreign securities whereas in France a foreign investor may not hold more than 20 percent of any firm without prior approval from the *Ministère de l'Economie et des Finances*. But again, the current level of international portfolio investment seems to be well below these institutional constraints. Obviously, the home bias has not been answered adequately. It may be that there is no answer that can be related easily to financial models of investment. Or perhaps, evidence given by Gatti and Tverski in 1990 that households behave as though unfamiliar gambles are riskier than familiar gambles even when they assign identical probability distributions to the two gambles should be given serious thought in future investment portfolio research.[vi]

A New Line of Global Multinational Equity Indexes

Three global multinational indexes were launched within a relatively short period of time: the Dow Jones Global Titans Index in July 1999, the FTSE Global 100 Index in September of 1999, and the S&P Global 100 Index in February 2000.

These indexes are being marketed as a solution to the home bias problem in international investment because they measure the performance of "true" global multinational corporations. Most importantly, they offer all the diversification benefits available from direct investment in foreign securities such as ADR's**,** yet they do not expose participants to the difficulties and costs involved in foreign capital markets. Also, for the U.S. fund manager, better information is available on these global multinational companies than on many of the less familiar firms quoted in distant stock markets. Lastly, like other regional and sectoral indexes they can be used for comparative performance and risk measurement.

Table 1, which summarizes both background and construction methodologies of these global indexes, highlights a number of similarities but also shows differences that could be material in the management of equity portfolio and other financial products linked to these indexes.

Table 1: INDEX CHARACTERISTICS

	Dow Jones Global Titans	FTSE Global 100	S&P Global 100
Background:			
No of constituents	50	100	100
Launch date	7/1999	9/1999	2/2000
History from	1992	1999	1989
Total market capitalization	US$ 9.4 trillion [1]	US$ 7.4 trillion [1]	US$ 7.7 trillion[1]
Sponsorship	Dow Jones	FTSE Int'l.	Standard & Poor's
Top five companies	General Electric [8.3%, US]	General Electric [5.9%, US]	General Electric [6.2%, US]
	Exxon Mobil [5.2%, US]	Microsoft [4.2%, US]	Pfizer [3.9%, US]
	Microsoft [4.7%, US]	Exxon Mobil [3.7%, US]	Exxon Mobil [3.8%, US]
	Citgroup [4.4%, US]	Pfizer [3.6%, US]	Microsoft [3.7%, US]
	Intel [3.4%, US]	Intel [2.6%, US]	Citgroup [3.4%, US]
Main Sectors	Technology [29.1%]	Technology [25.5%]	Info Tech [18.1%]
	Telecom [18.3%]	Healthcare [18.0%]	Financials [15.8%]
	Financials [15.0%]	Financials [11.7%]	Healthcare [15.7%]
Regional Weightings	USA [67.2%]	USA [58.2%]	USA [59.4%]
	Europe [28.6%]	Europe [35.3%]	Europe [34.2%]
	Asia [4.2%]	Asia [5.7%]	Asia [5.3%]

		Others [0.8%]	Others [1.1%]
Construction methodology:			
Selection criteria			
• Primary:	Dow Jones Global Index	FTSE World Index	S&P Global 1200
Index			
• Secondary:	Top 100 by adj market cap	Global exposure (30% of sales	Global exposure
(significant foreign			
		must be foreign)	sales and foreign
employment)			
• Tertiary	Fundamental factors	Top 100 by market cap	≥ US$ 5 B adj. market
cap			
Weighting by	Float-adjusted market cap[2]	Float-adjusted market cap[2]	Float-adjusted market
cap [2]			
Calculation frequency	Daily	Daily	Daily
Review of constituents	Quarterly (March, June, Sep, Dec)		Quarterly (March,
June, Sep, Dec)	Quarterly (March, June, Sep, Dec)		

[1]Float adjusted
[2]Based on shares that are available for trading, but may vary slightly across index providers

There seems to be significant overlaps among these indexes. The most important overlap is the result of the current bent of equity markets worldwide. Technology firms dominate the composition of these global equity indexes, followed by telecommunication, healthcare, and financial firms.[vii] One can also easily notice a bias in favor of U.S. firms in the composition of these indexes as quite a few of them have positioned themselves as technology leaders. Regardless of the methodology used in the compilation of these indexes, they seem to be included more frequently and as a result tend to dominate.

Although the providers of these indexes claim that the methodology underlying their compilation is inherently different, one can see that the selection criteria are closely related. To start with, they all use membership in their respective global indexes as a starting point in their selection procedures. The rest of the criteria such as importance of foreign sales, proportion of foreign employment, or liquidity of the company as measured by adjusted market capitalization are similar although not applied in the same order. The Dow Jones Titans seems to be the only index that puts some emphasis on specific financial factors such as book value and net profits. This does not seem to affect the end result, however, in view of the striking similarities observed on the list of the top multinationals comprising these indexes. Dow Jones also tracks only the top 50 multinationals as identified by its selection methodology compared to the other two indexes with 100 each.

Performance Review

Table 2 shows the correlations of the three global indexes with the S&P 500 and selected regional indexes such the Dow Jones Stoxx Europe, the Dow Jones Asian Titans, and the Nikkei 225. As a rule of thumb, two variables are strongly positively correlated if their coefficient of correlation is at least 0.50. (The interested reader can find a source for this informal rule in Farrar and Glauber's discussion of a related topic.[viii])

On average, they all tend to move up and down together, showing almost perfect synchronization. This indicates that, to some extent, increasingly common world factors are equally affecting expected cash flows of the multinational firms comprising the indexes. Logically, increasingly closer economic and government policies between the countries where most of these multinationals are domiciled could contribute to the observed commonality in the indexes' performance behavior.

Table 2: CORRELATIONS OF SELECTED GLOBAL AND REGIONAL MULTINATIONAL INDEXES WITH THE S&P 500 INDEX

Based on September 30, 1999 to September 29, 2000 daily returns (US$)

	S&P 100 GLOBAL	FTSE GLOBAL 100	DJ GLOBAL TITANS	DJ ASIAN TITANS	S&
S&P 100 GLOBAL	1.00				
FTSE GLOBAL 100	0.92	1.00			
DJ GLOBAL TITANS	0.91	0.83	1.00		
DJ ASIAN TITANS	0.12	0.09	0.19	1.00	
S&P 500	0.87	0.86	0.88	0.02	
NIKKEI 225	0.17	0.11	0.10	0.27	
DJ STOXX Europe	0.63	0.53	0.49	0.13	

But most likely, these strong co-movements are justified by the aforementioned fact that, without exception, U.S.-based multinationals comprise an important fraction of these indexes. For example, as of March 1, 2001, the FTSE Global 100 included no less than 46 U.S. multinationals that account for 58.2% of the index gross market capitalization. In the case of the S&P Global 100, 39 US multinationals account for approximately 59.4% of the index gross market capitalization as of February 28, 2001. As to the Dow Jones Global Titans, out of the 50 multinational firms that comprise the index, 27 are headquartered in the U.S. and make up 67% of the index market capitalization as of February 25, 2001. This means that although a sizable portion of their revenues is generated outside the U.S., their performance is still largely determined by the same monetary and budgetary policies that guide U.S. economic growth. This could explain why, as shown in Table 2, the performance of these multinational indexes is highly correlated with that of the S&P 500, widely recognized as a good gauge of the U.S. market portfolio.

The fact that these indexes are moving in step with each other could also indicate that, to some extent, increasingly common world factors are equally affecting expected cash flows of the multinational firms comprising the indexes. Logically, increasingly closer economic and government policies between the countries where most of these multinationals are domiciled could contribute to the observed commonality in the indexes' performance behavior. Although the U.S. clearly dominates these indexes, they are also loaded with multinational firms headquartered in countries such as the U.K. and other European countries with economic policies known to be similar to those applied in the U.S.

However, before the U.S.-based globally minded investor becomes alarmed, one thing to keep in mind is that the correlation matrix is based on only 12 months of daily data since the historical data on the FTSE Global 100 could only be secured from September 30, 1999 to September 29, 2000. To be sure, correlation coefficients are not constant and although the data used in this analysis are high frequency daily data thereby more capable of capturing in step movements of the indexes than, say, monthly data, evidence of a systematic trend toward a synchronization of world markets needs to be grounded on a much larger historical database.

What Now?

Table 2 shows that there is still some room for international diversification through the regional indexes. Without exception, the correlation coefficients of the S&P 500 and of the multinational indexes with the DJAT are at best modest. This result seems to be quite reasonable considering that Japan, a country that dominates the DJAT, and the U.S. have experienced different business cycles in the 1990s. The 1990s saw the U.S. in a long and strong business cycle expansion, but the decade brought severe recession in Japan.

Japan's dominance of the DJAT is explained by the main selection criteria underlying the index, which are significantly different from those underlying the other multinational indexes. For example, rather than emphasize the importance of foreign sales, which usually favors U.S. corporations, the DJAT first includes only those companies from the Asia/Pacific region. Of the 50 companies included in the index, 25 are automatically selected from Japan with the rest going to the region's other major countries, such as Australia, Hong Kong, South Korea, and Taiwan. Due to this substantial allocation and the relatively larger size of its companies, Japan alone accounts for a whopping 75.8% of the index's market capitalization as of October 31, 2000.

Although a similarly strong conclusion between the S&P 500 and the Dow Jones Stoxx Europe does not hold, a correlation of 0.34 indicates that there is nonetheless an argument to be made in favor of diversifying in Europe for an investor who holds the S&P 500. Most importantly, however, these results indicate that for now the global multinational indexes are best marketed in the Asia/Pacific region, where the benefits from diversification seem much greater thanks to the paltry performance of the economy of the country that tends to dominate the DJAT and Nikkei 225. The results also show that although policymakers from the US and the other major economies are increasingly coordinating their macroeconomic economic decisions, it is still too soon to say whether the gradually visible integration of their markets is the consequence of these concerted policies or due to the current dominance of these global indexes by U.S. multinational firms resulting in a high average correlation of 0.87 with the S&P 500.

How About Sector-based Indexes?

Recently, the most prominent index providers are each offering sector indexes that are subsets of their respective broad-based global indexes. These sector indexes include companies that are market leaders in their sectors regardless of their location. Simply because this approach is sector based, it could prevent companies satisfying the current bent of the equity markets (a serious flaw in the global indexes' current methodologies) from dominating multinational indexes. Case in point, investors' appetite for telecommunication and technology firms have fueled their market capitalization, especially in the late 1990s, which in turn enhanced their overall rank and led to their recent dominance of the global multinational indexes. To make matters worse, the technological leadership of the US in these two areas has clearly compounded the problem as indicated by the correlation of these indexes with the S&P 500.

Of course, one might rightly argue that if telecommunications stocks (or whatever sector is most popular) soared the world over, they would contribute significantly to the performance of a telecom-overweight global multinational index. But, if they plummeted --as they have done recently--portfolios relative to that benchmark would suffer significant losses. What that means is that the outperformance of such an index is not curbed under its current methodology, but more importantly, the underperformance one might expect from the same bet is not reduced.

The importance of sector investing in global asset allocation can be explored using the same standard industry tests on a set of 18 sector-based multinational indexes available from Dow Jones. To evaluate their role in global asset allocation, we will assess whether they provide additional diversification benefits to a U.S. investor holding the S&P 500.

Although only recently released, historical daily data on the Dow Jones Sector Titans (DJST) Indexes are available starting from December 31, 1991, when each was assigned a base value of 100. Because the DJST Indexes are composed of stable companies, it has facilitated backtesting and the development of index histories. For the sake of a fair comparison with the previously assessed global indexes, the historical correlations shown in Table 3 are also based on the same September 30, 1999 to September 29, 2000 period. Assuming that the S&P 500 represents the U.S. market portfolio, its average correlation of 0.02 with the sector indexes seems to clearly indicate that this approach could be effective in offering investors true global diversification.

Further Issues

However, before we state that sector indexes of multinational corporations represent an effective answer to the international diversification puzzle, we need to withhold our judgment until several other important questions are answered. Is their correlation coefficient with the S&P 500 likely to persist if a more substantial historical database is used? Is additional diversification gained by adding all the sector indexes or only a selected few to the U.S. market portfolio? How should these sector indexes fit into asset allocation?

To answer the first question we used the entire index history provided by Dow Jones (i.e., January 1, 1992 to December 31, 2000) and correlated it with that of the S&P 500. The result is an average correlation coefficient with the S&P 500 (-0.01) that is barely different from the one we obtained from a much shorter history. The consistency of this result supports the sector indexes as practical international diversification tools from the point of view of a U.S. investor seeking global exposure.

Although the second question is less straight forward, the answer can be found in the correlation matrix shown in Table 3. Although individually these indexes show insignificant links to the S&P 500, a pairwise comparison indicates that some sectors show stronger correlations with each other than others. This means that the advantages from diversifying in sector indexes could easily come undone if they are indiscriminately selected. Undoubtedly, a core portfolio of S&P 500 stocks is more likely to be considered diversified if it adds stocks from two sector indexes weakly correlated with each other such as ENG and TEL (-0.02) rather than adding stocks from two sector indexes moving in step with each other such as BAK and FVS (0.71). The strong co-movement of BAK and FVS indicate that the underperformance of one is more likely to be mirrored by the underperformance of the other, resulting in a less than expected overall portfolio performance. Because Table 3 indicates that quite a few sector indexes exhibit borderline significance when correlated individually with the S&P 500 and with each other, we are confident in saying that the diversification properties of more narrowly focused indexes based on sectors are much more evident than those of globally focused indexes.

Table 3: CORRELATIONS OF MULTINATIONAL SECTOR INDEXES

Based on September 30, 1999 to September 29 2000 daily returns (US$)

	S&P 500	ATO	BAK	BAS	CGS	CHE
S&P 500	1					
ATO	0.067625	1				
BAK	0.074476	0.498917	1			
BAS	0.030861	0.437348	0.440712	1		
CGS	0.072046	0.324146	0.388954	0.296175	1	
CHE	0.045599	0.54873	0.474088	0.614925	0.226134	1
CNS	0.040242	0.457216	0.429824	0.449937	0.368445	0.538536
ENG	-0.02819	0.1512	0.206711	0.318692	0.048259	0.221882
FOB	0.038769	0.236712	0.38345	0.312327	-0.05506	0.417343
FVS	-0.03444	0.347596	0.705776	0.265004	0.501857	0.372724
HCA	-0.06028	0.218133	0.340652	0.279222	0.109806	0.326481
IGS	-0.01824	0.371091	0.457428	0.252269	0.604396	0.328599
INN	0.044541	0.435874	0.663108	0.381396	0.292987	0.542946
MDI	-0.04263	0.255819	0.358235	0.150133	0.664892	0.208148
NCG	-0.03366	0.306132	0.414081	0.22687	0.37541	0.372959
RET	0.08306	0.3354	0.421943	0.304178	0.485941	0.366687
TEL	-0.05514	0.276066	0.347652	0.128705	0.582454	0.179019
THE	0.057752	0.281588	0.275653	0.101869	0.52553	0.107631
UTS	0.0491	0.327189	0.404166	0.307001	0.207308	0.360452

ATO - Automobiles; BAK - Banks; BAS - Basic Resources; CHE - Chemicals; CNS - Construction; CGS - Cyclical Goods & Ser
HCA - Healthcare; IGS - Industrial Goods & Services; INN - Insurance; MDI - Media; NCG - Non-Cyclical Goods & Services; R

Finally, the case for treating the sector indexes as a new asset class invariably begins with their low correlation with each other and with other asset classes such as the S&P 500. But as is the case with stocks and bonds, the classic example of asset class division, low correlation is neither necessary nor sufficient for establishing separate asset class status. More persuasive than correlations is the need to demonstrate that these indexes have unique risk characteristics such as unpredictable liquidity, distinct legal structures (such as different claims to firms' net income streams), and perhaps links to political factors that are unrelated to global markets. These considerably complex questions would need to be addressed in a different study. For now, it is sufficient to focus on the important fact that, much more so than global indexes, sector indexes could be treated as legitimate segments of an investor's core portfolio because they present, on average, compelling arguments for their use as effective foreign diversification tools.

Conclusion

From the perspective of a U.S.-based investor, the gains from diversification depend on the correlation of returns between the S&P 500, a widely recognized gauge of the U.S. equity market, and cross-border holdings. Using a set of three methodologically different multinational indexes, we have established a solid case in favor of combining regional and/or selected sector-based equity indexes with the S&P 500 as a means to build strategically diversified portfolio.

By the same token, we have also addressed the concerns of previous researchers who concluded that international diversification couldn't be effectively achieved through positioning in multinational corporations. Obviously, if the sample used is dominated by multinational corporations domiciled in the U.S. or in countries whose monetary policies are synchronized with those of the U.S., it is only normal to dismiss them as effective contributors to a strategically diversified portfolio. Therefore these studies need to be revisited in light of the constituents of the samples on which their results are based.

On a different note, a switch to a sectoral approach to global asset allocation also solves the problem of cross-borders deals that force country-indexed fund managers to sell stocks that are deleted from an index. Daimler Chrysler is a good example. Actually, the recent successive waves of mergers and acquisitions have made *nationality* one of the top issues in the agenda of both portfolio managers and index providers.

[i] B. Jacquillat and B. Solnik, “Multinationals are Poor Tools for International Diversification,” *Journal of Portfolio Management*, Winter 1978.

[ii] Harry M. Markowitz, “Portfolio Selection,” *Journal of Finance* (March 1952), 77-91.

[iii] See, in particular, K. French and J. Poterba, “ International Diversification and International Equity Markets,” *American Economic Review* (May 1991), 222-226.

[iv] L. Tesar and I.M. Werner, “Home Bias and High Turnover,” *Journal of International Money and Finance* (August 1995).

[v] T. Horst, “American Taxation of Multinational Firms,” *American Economic Review* (1977), pp. 376-89.

[vi] I. Gatti and A. Tverski, “A Differential Weighting of Comment and Distinctive Components*,*” *Journal of Experimental Psychology: General* (1990), pp. 30-41

[vii] With all but a very few technology firms rapidly falling out of favor in today’s highly volatile equity markets, this dominance is highly questionable in the future.

[viii] D.E. Farrar and R.R. Glauber, “Multicollinearity in Regression Analysis: The Problem Revisited,” *Review of Economics and Statistics*, vol. 49, 1967, pp.92-107.

Why Do Firms List Abroad? Evidence from an Emerging Market [A Managerial Survey Approach]

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Abstract

The growing internationalization of capital markets suggests that an increasing number of firms perceive the benefits of listing their securities abroad directly or in the form of Depositary Receipts (DRs). Many other firms, however, still limit listing their securities to their domestic exchanges. The existing research has investigated the factors that influence foreign listing decision of firms either by taking a sample of firms from developed economies or by a mixed sample of firms from developed and emerging economies. So far there have not been any major study done specifically to investigate the factors, which influence the foreign listing decision of firms from emerging markets. Therefore, no clear conclusions have emerged for firms from emerging markets regarding the factors that influence their foreign listing decision. This study intends to fill this gap by taking a sample of firms from an emerging market like India. We will do a managerial survey of Indian firms that have listed their securities on foreign markets for knowing the factors that have influenced their foreign listing decisions[1].

Introduction

In recent years, there is a trend towards the internationalization of capital markets. This process gained impetus during the decades of 1980s and 1990s. The main drivers for internationalization of capital markets are: sophistication in information technology & capital market participants (borrowers, investors and financial intermediaries), a greater co-operation among financial regulators, lowering of capital barriers across national boundaries and the liberalization of capital markets in emerging economies[2] [Helliwell, 1998 and Kulikov, 2000]. The national governments across the globe are adopting liberalized and outward looking policy initiatives with regard to their financial markets. A growing number of countries - developed and developing – are opening their stock markets to foreign investors and abolishing laws restricting their citizens from investing abroad. Companies that previously had to raise capital only domestically can now tap foreign sources of capital. In order to do so, companies may list their stocks on foreign stock exchanges while investors may trade overseas. An examination of trends in global markets over past few years reveals that many companies are looking beyond their home markets to develop an investor base and to raise international capital [Gande, 1999]. By the end of December 1999, the number of foreign listed companies in major markets was quite substantial (see Table1)[3]. While the vast majority of foreign firms choose to cross-list their stock through the use of Depositary Receipts (DRs), some firms (primarily Canadian and Israeli) choose to list their equity directly on foreign exchanges[4,5]. Especially during 1990s there was an increased flow of DR programs from emerging markets.[6]

This has prompted a competition amongst stock exchanges of developed markets to attract the listing of DRs from emerging markets [Huddart et al, 1998]. Even stock exchanges from some of the emerging markets are in the race of attracting the foreign listings. For any stock exchange to be successful in its endeavor to attract the listing of DRs, a supporting legal regulatory framework is of utmost importance. In their competitive struggle[7], the winners are the exchanges that manage to understand the underlying dynamics of a firm's decision to list on foreign stock exchange(s). *Thus stock exchanges and regulators confront a question for which an obvious answer is not yet available: Why do firms from 'emerging markets' list abroad? A clear answer to this question is also of interest to the corporate managers who are involved in taking crucial decision of listing on foreign exchanges.*

Despite the importance of the issue, little is known about the factors that influence firms from **'***emerging markets***'** to list abroad. A few earlier studies have tried to understand the factors that influence firm's foreign listing decision by drawing their samples of firms from developed countries or from both developed and emerging markets (mixed sample). From these existing studies, we can only conjecture as to what factors influence the foreign listing decision of firms from emerging markets. The question of listing factors generates three intimately related issues: (a) What are the benefits of listing in the foreign markets? (a) If there are potential benefits from cross-listing firms, what then deters firms from listing abroad? (b) Once the decision to list in foreign markets is made, what considerations influence firm's choice of its final listing venue(s)? The objective of this study is to investigate the factors that influence foreign listing decision of firms from emerging markets. *A managerial*[8] *survey of Indian firms, which have tapped international capital markets with their DR issues between June 1992 and December 2000, will be conducted for this purpose.*

In the present context, the Indian market is of particular interest for various reasons: First, Indian firms have floated the largest number of DRs from amongst all emerging markets. A majority of these programs are GDRs[9] and therefore are listed and issued in countries other than U.S. Second, India has over 7000 domestic listed firms and many of these firms represent a ready clientele for the stock exchanges abroad for foreign listing. Third, India is the sixth largest economy after USA, China, Japan, Germany and Canada in terms of its Gross Domestic Product (GDP). India's economy is expected to experience a growth rate of 6-7 percent[10] in its GDP. Indian economy remained unswayed by Asian Financial crises of 1997 because of its strong fundamentals and inherent strengths. With a population of over one billion the size of India's middle class exceeds the population of the USA or the European Union. All firms operating in India have competitive advantage of a lower labor cost. These factors will have a positive impact on the profitability of firms operating in the economy. Finally, India with its fair judicial system and parliamentary democracy presents a much safer political environment for doing business and making investments compared to many other emerging markets. India is also said to be committed to its process of economic liberalization. India's Union Budget for 2001-02 announced many policy initiatives to further liberalize the Indian Economy such as privatization of more state owned enterprises, introduction of two-way fungibilty for ADRs/GDRs and raising the limit of portfolio investments by FIIs from 40 percent to 49 percent. These policy initiatives are expected to increase the number of Indian firms tapping the foreign capital markets with their DR programs. This would encourage the security market regulators and stock exchanges[11] to prepare strategies for attracting the Indian firms to their countries for listing on their stock exchanges. *Therefore, an inquiry to understand the factors that influence the Indian firms to list abroad is of special interest to the stock exchange authorities, regulators and investors abroad as well as in India.*

The study proposal is structured as follows. In the next section we trace the evolution of DR markets in the past century with a special reference to growth in number of DR programs from emerging markets during 1990s. Third section presents the summarized findings from the review of relevant literature related to the: (a) factors that motivate firms to list abroad; and (b) restraining factors in process of foreign listing. In fourth section we provide an overview of methodology and data sources. Finally, in the fifth section we discuss the possible limitations of the proposed study.

Evolution and Growth of DR Markets

It is now over 70 years since the first DR program was launched in 1927. Morgan Guarantee Trust, predecessor of current bank J.P. Morgan, created the first ADR in 1927 for UK retailer "Selfridge Provincial Stores Limited". Another 17 ADR programs were opened around that time and three of them still survive viz BAT Industries, Cortlaulds plc, and The General Electric Co. This early growth wherein 18 ADR programs were established came to an abrupt halt at the time when stock markets crashed in 1929. The depression following the crash implied that the demand for new capital was very low. By the time the demand started to pick up, the outbreak of World War II led to the institution of extensive capital controls, in 1939. These controls made it illegal to sell domestic securities to foreigners, as well as to buy foreign securities. Therefore, until early 1950s no fresh ADR programs were established. In its present form ADRs came into existence in 1955, when the Securities Exchange Commission (SEC) introduced its Form S-12, for registering all DR programs. Australian and South African mining companies were the first to introduce DRs in a form as they exist today. Subsequently several Japanese firm also issued ADRs during 1960s. In 1970s and 1980s several more firms from other countries also adopted the DR route for raising capital and/or listing in major capital markets. During 1970s and 1980s a few countries also allowed the domestic companies to directly sell and list their equity stocks on the foreign markets.

In 1990s there was a spurt in number of DR programs (also an increase in number of cross-listed equity issues), notwithstanding intermittent periods of financial crises in Asian and Latin American countries. Several variants to basic structure of DRs, viz., GDRs, SDRs, EDRs were successfully used by firms from developed and emerging countries. The following facts are indicative of the growth experienced by DR market during 1990s [BONY, 2000, 2001]:

a) The number of sponsored DR programs has grown from 352, representing 24 countries in 1990, to over 2100 programs from 78 countries (that include more than 50 emerging countries) in January 2000. Till 1981 there were only five countries, viz., Hong Kong, South Africa, Japan, Australia and the United Kingdom that had any DR program.
b) The dollar trading volume for ADRs increased by 36% during 1997 and 1998. This exceeds 32% growth posted by the New York Stock Exchange dollar trading volume (excluding ADRs) for the same period.
c) The annual dollar volume of listed ADR programs in 1996 was $341 billion, while it is expected to be around $1.35 trillion in 2000, more than double the 1999 figure of $667 billion. An estimated 1.50 billion DRs valued at $20-25 billion are traded on an average in the over-the-counter Exchange and European markets every year.
d) Companies from 38 countries established one hundred eighty-two new programs in year 2000. Capital raising through ADRs has also set new records. Companies and governments from 32 countries raised more than $29 billion via DRs, a 32% increase over 1999, through 115 depositary receipt offerings in the United States and European markets.
e) Total global market capitalization of companies that have ADR programs exceeds $6 trillion at the close of 1999.

Prior to 1990, firms from developed markets such as Australia, Hong Kong, Japan, the Netherlands, Sweden and the U.K. dominated the DR market. However, during nineties, firms from emerging markets, such as Argentina, Brazil, Chile, China, India, Indonesia, Malaysia, Russia and South Korea have accessed the DR markets. The DR programs from emerging markets now constitute a major chunk of all listed and traded DR programs (see Table 2). In this context, the following facts about the DR programs from emerging markets are noteworthy:

a) Unlike the firms from developed markets that have historically used ADRs for listing purposes, most of the firms from emerging markets have used ADRs for mobilizing international capital [Gande, 1999). Since 1992 a majority of new capital-raising DR programs have come emerging market firms. In 1999, total capital raised by emerging market companies rose to about $13 billion, compared to an average of $7 billion over 1990–99. In recent years, DR issuance has typically accounted for 60–70 percent of total equity raised in international markets by emerging market companies.
b) Some companies from emerging countries have changed their domicile country and have listed on the exchange of their new domicile country. This is done to reduce the risk premium which investor associate with companies from emerging markets. Two South African companies changed their domicile country to U.K.
c) Many newly listed companies from emerging markets have had their initial public offerings in mature markets, bypassing local markets completely. For example, Internet companies from Israel and Latin America have recently chosen to list directly on the U.S. Nasdaq market.
d) Over the years there has been a strong regional shift in new programs from the dominance of Latin America in the first part of the 1990s to a preponderance of new programs from Asia in 1999.
e) There has been a significant increase in the capital raised in technology, media, and telecommunications sectors, which accounted for almost half of the capital raised by emerging markets in 1999.

DR Programs from emerging markets were an instant hit amongst international investing community. According to Porter [1993] this is so because emerging markets (a) represent a fast growing part of the world economy (see Table-3); (b) have delivered superior returns; (c) provide further diversification of global portfolios; (d) are attractively valued; (e) represent huge marketplaces; and (f) are underweighted in global portfolios. Hauser Marcus and Yaari [1994] showed that during 1986-91 the correlation between monthly return in US and UK was about 0.65 as against a low correlation of developed markets with emerging markets. This signifies the attractiveness of emerging market stocks in providing greater diversification benefits.

Review of Literature

Finance literature documents two sets of studies that investigated the factors affecting the firms' foreign listing decision: (a) survey-based studies that assessed the managerial perceptions of the listing factors; and (b) studies that empirically estimated the selected factor(s) affecting listing decision.

Major survey-based studies are- Baker [1992], Mittoo [1992], Fanto and Karmel [1997], Foerster Karoyli and Wiener[1998], Yamori and Baba [1999], and Bancel and Mittoo [2000]. In all above studies, authors investigated the factors affecting foreign listing decision of firms by doing managerial surveys with sample of firms drawn from the foreign listed firms of developed countries. *We are not aware of any earlier survey-based study done with an exclusive sample of foreign listed firms from an emerging market.*

Another set of studies empirically estimated the selected factor(s) that affect the foreign listing decision of firms. Karoyli [1998] and Damm [2000] provided a detailed review of many such studies. A few major studies of this type are: Howe and Kelm [1987], Alexander Eun and Janakiramanan[1987], Saudagaran [1988], Saudagaran and Biddle [1992; 1995], Foerster and Karolyi [1993], Mittoo [1997], Karoyli [1998], Domowitz Glen and Madhavan [1998], Gande [1999], Ramchand and Sethapakdi [2000], Reese and Weisbach [2000], Pagano, Röell and Zechner [2000], Pagano, Randl, Röell and Zechner [2000]. These studies do not study all but only some specific factor(s) affecting the firm's decision to list abroad. Most of these studies lack comprehensiveness of the survey-based studies. A few of these studies that are more comprehensive have drawn their sample of firms either from the developed countries or a mixed sample of firms from the developed and emerging countries.

Based on our review of literature, the major factors [12] that influence the firm's foreign listing decision are summarized below:

Corporate Motivations for Listing Abroad

a. Shareholder's Wealth Maximization
b. Reducing Cost of Capital
c. Increasing Liquidity
d. Controlling Stock Price Volatility/ Improving Stock Price Stability
e. Raising Currency for Foreign Acquisitions
f. Stock Options for Foreign Employees of Firm
g. Enhancing Access to External Capital Markets
h. Boosting Firm's Profile and Visibility in the Foreign Markets
i. Strategic Gains via Linking Product Markets and Capital Markets
j. Relative Mispricing in Domestic Market
k. Gaining Political Acceptance in the Foreign Markets
l. Global Strategy Motivations

Restraining Factors in the Process of Foreign Listing

a. Financial Disclosure Levels
b. Disclosure and Regulatory Costs of Foreign Listing
c. Protection of Minority Shareholder Interests
d. Geographic proximity
e. Tax concerns
f. The Firm's Industry and Company Characteristics

1.

Methodology and Data Sources

A managerial survey[13] is proposed to be conducted wherein a structured questionnaire[14] would be used. All Indian firms[15] that have issued their DRs in the foreign markets would be approached through personal interviews, mailing the questionnaire and telephonic discussions. The questionnaire to be used is similar to that used by Mittoo [1992], Fanto and Karmel [1997], Foester Karoyli and Wiener[1998], Yamori and Baba [1999] and Bancel and Mittoo [2000].

The questionnaire includes questions that provide insights into the following issues: (i) what are the major perceived costs and benefits of foreign listing? (ii) what are the key determinants of cross-sectional variation in the perceived net benefits? The questionnaire consists of eighteen questions. Question 1 requests the respondents to rank all possible motivating and restraining factors for foreign listing on a five-point scale. In questions 2 to 5 we will ask managers to present their opinions on the issue of divergent Generally Accepted Accounting Principles (GAAP) in different countries. Managers will compare the GAAP requirements of all countries wherever Indian companies are listed. In question 4 respondents will be asked to categorize various provisions of U.S. GAAP and International Accounting Standards (IAS) GAAP in terms of they being an obstacle for Indian companies listing in foreign markets. Fifth question asks managers to choose between Indian GAAP, U.S. GAAP and IAS GAAP. In next two questions, managers will be asked to reason out their choice of foreign stock exchange(s) for purpose of listing their securities. Eighth question gathers information on percentage of company's equity issued as ADRs/GDRs. Then in ninth question managers will provide an approximation of percentage of traded volumes of company's equity in form of ADRs/GDRs. Question 10 and 11 discuss the factors and prerequisites for making a successful overseas offering. Next question gives an idea about the net effect of foreign listing taking both costs and benefits associated with an overseas offering. Managers will tell whether their expectations from overseas listing were fulfilled or not. Question 14 gathers information about the profile of the company i.e. the company's total number of employees, percentage of its foreign employees, the company's percentage sales in the foreign markets, company's manufacturing / operating facilities in foreign markets including its foreign subsidiaries and information on corporate governance in the company. Last four questions gather personal information about the respondent, viz., name, designation and company of the respondent, if respondent wants his responses be kept confidential, if respondent want to receive a copy of the final survey report. We will assure the confidentiality of individual responses to increase the response rate. All respondents will be promised a copy of the final report to further increase the response rate.

Final findings of the study will be based on the *univariate analysis and multivariate analysis using multiple regression model and logit model.*

Limitations of Study

A study of this nature suffers from certain limitations. For example, it would be really difficult to know the role of management's own interests in listing abroad. Further the values, experiences, and objectives of individual managers will influence their answers. Similarly there is a problem of selection bias. Only the companies that actually decided and completed a foreign listing would be covered leaving out the companies whose management ever considered, but refrained from, affecting a foreign listing.

Results

Results of the study will be presented during the conference. For the required brevity of the conference paper, results are not included here.

Table 1: NUMBER OF DOMESTIC AND FOREIGN COMPANIES WITH SHARES LISTED ON MAJOR STOCK EXCHANGES AND PARALLEL MARKETS, DECEMBER 1999 EXCLUDING INVESTMENT FUNDS

Exchange	Total Number of Companies	Domestic Companies	Foreign Companies
Nasdaq	4,829	4,400	429
NYSE	2,592	2,187	405
Toronto	1,456	1,410	46
Buenos Aires	125	125	0
Lima	241	229	12
Rio de Janeiro	514	513	1
Santiago	282	282	0
Sao Paulo	479	478	1
Amsterdam	387	233	154
Athens	262	262	0
Barcelona	496	492	4
Bilbao	275	273	2
Brussels	278	159	119
Copenhagen	243	233	10
Germany Deutsche Borse	9,017	1,043	7,974
Helsinki	150	147	3
Irish	103	84	19
Italy	270	264	6
Johannesburg	668	652	16
Lisbon	125	125	0
Ljubljana	130	130	0
London	2,791	2,292	499
Luxembourg	274	50	224
Madrid	727	723	4
Oslo	215	195	20
Paris	1,144	968	176
Stockholm	300	277	23
Switzerland	412	239	173
Tehran	295	295	0
Vienna	114	97	17
Warsaw	221	221	0
Australian	1,287	1,217	70
Hong Kong	701	688	13
Jakarta	276	276	0
Korea	712	712	0

Kuala Lumpur	752	749	3
New Zealand	172	113	59
Osaka	1,281	1,281	0
Philippine	226	226	0
Singapore	317	274	43
Taiwan	462	462	0
Thailand	392	392	0
Tokyo	1,932	1,889	43

Source: Adapted from website of the Federation Internationale des Bourses de Valeurs (FIBV, International Federation of Stock Exchanges): www.fibv.com

Note: The dominant stock markets in the U.S. are the NYSE, the NASDAQ. The NYSE is the largest world exchange for market capitalization and in the value of trading, Tokyo is second, London is third. NASDAQ leads in the number of listed companies. London leads in the number of foreign listed companies.

Table 2: NUMBER OF DR PROGRAMS IN TOP TWENTY COUNTRIES AS ON JANUARY 12, 2000

Country	Emerging market	Number of DR Programs
United Kingdom	No	248
Japan	No	163
Australia	No	150
Hong Kong	No	111*
India	Yes	111
Brazil	Yes	95
Mexico	Yes	95
Russia	Yes	87
South Africa	Yes	85
Germany	No	63
Taiwan	Yes	63
France	No	61
Netherlands	No	53
Italy	No	38
Korea	Yes	36
Argentina	Yes	32
China	Yes	31
Turkey	Yes	31
Ireland	No	30
Chile	Yes	29

***** Most DR issues by firms from Hong Kong were done before 1997 when Hong Kong was transformed from a British Crown Colony to a ‘Special Administrative Region’ of the People's Republic of China. So DR issue from Hong Kong are not treated as coming from an emerging market, though under IFC categorization Hong Kong is an emerging market.

Source: Adapted from: ftp://ftp.bankofny.com/anonymous/adr/geogdir.exe

Table 3: MARKET CAPITALIZATION IN EMERGING MARKETS AND OTHER MAJOR MARKETS AS AT YEAR END 1990 (IN US$ BNS)

United Kingdom	868
Emerging Markets (taken together)	470
Germany	379
France	342
Canada	242
Italy	148
Australia	107

Source: Adapted from: International Finance Corporation, quoted in Porter [1993].

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Endnotes

1 In a separate study by Kumar and Saudagaran [2001], authors empirically estimate the selected factors that influence the Indian firms' foreign listing decisions. Two studies complement each other.

2 'Emerging economies' or 'Emerging markets' or 'Emerging countries' or 'Developing markets' mainly cover countries that the World Bank, the International Finance Corporation and the United Nations have determined to have a low or middle-income economy. Stock markets in these countries have not yet developed to the same levels of sophistication and market capitalization as in a number of developed countries. Presently 45 nations are classified as emerging markets.

3 In 1999, Germany and Luxembourg had more foreign companies listed than domestic companies.

4Firms have a choice of raising capital either via direct-listings of their securities in foreign markets or through DR listing. Canadian companies represent the largest foreign contingent of cross-listed firms on the NYSE, AMEX, and NASDAQ [Gande, 1999]. Large multinational corporations have been directly listing on foreign stock exchanges since at least the 1970s. Moden and Oxelheim [1997] reported that Swedish companies, limited by a small home equity market, have directly listed on foreign stock exchanges since the 1920s. Direct listing is a common way of foreign listing in Europe. Even numerous Israeli companies have preferred a direct listing of their shares on US stock exchanges. However preferring DR listing to direct listing has some inherent advantages. Direct listings of securities is more expensive as they incur additional costs of separate stock transfer agents and registrars for the home shares and foreign shares, whereas each of these services is provided by one depositary bank for both the DRs as well as underlying home shares.

5 Foreign listings used in this study are ADR / GDR programs of Indian companies.

6 For a detailed discussion on increased flow of DR programs from emerging markets refer to section 2 of this paper.

7 All major stock exchanges are vying to attract new listings from foreign firms and to retain existing listed foreign firms. For example, a key component of the strategic plans of the Nasdaq and NYSE is the aggressive solicitation of new listings of non-domestic corporations. Similarly many other stock exchanges, viz., Frankfurt, London, Luxembourg, Tokyo, Hong Kong and Singapore have plans to aggressively market their exchanges so as to attract more listings of securities of foreign firms.

8 The decisions whether and where to foreign list firms' securities are likely to be taken at the highest echelon, essentially involving the Chief Executive Officer ["CEO"], Chief Financial Officer ["CFO"], and the Investor Relation Officer. We will refer to them jointly as the "managers".

9 A majority of Indian DRs programs are issued pursuant to Rule 144A and/or Regulation S of SEC. Indian firms dominate markets for Rule 144A and/or Regulation S depositary receipt programs. These programs are listed in London Stock Exchange, Luxembourg Stock Exchange and are traded in US market mainly through PORTAL system. Since 1999 a few Indian firms have issued ADRs and are listed in Nasdaq and NYSE. Most early studies of firm's motives for international listing have taken sample of non-U.S. firms listed on U.S. exchanges [except for Saudagaran, 1988].

10 See Asian Wall Street Journal [2000]; India Economic Survey 2000-01; Asian Development Bank [2000].

11 In February 2001 Nasdaq opened its branch office in Bangalore in India [third office outside US]. The idea for opening a separate office in India is to attract potential Indian firms for listing on Nasdaq. Speaking on occasion of inauguration of new office Mr. Alfred Berkeley, vice chairman of Nasdaq said, " . . .India is a huge potential market for us, and we are here for the long haul . . . "[Source: Business Today, February 22-March 06, 2001]. Other markets, viz., NYSE and LSE have initiated similar measures to attract the foreign firms to their exchanges.

12 These factors are self-explanatory and for brevity a discussion on individual factors is not included here.

13 The managerial survey approach offers several advantages. Firstly this approach provides insights into the real motives of the managers who are responsible for the foreign listing decision of the firms. Secondly survey approach can address the factors for which appropriate empirical proxies cannot be developed. Similarly the problem of non-availability of data on the appropriate empirical proxies in the public domain can be tackled.

14 A detailed questionnaire is available with authors. For brevity it is not being attached with the conference paper.

15 As on December 2000, 70 Indian firms have floated 111-DR programs [Source: Instanex Capital Inc., NewYork.]

Section 5

Information Technology, E-business & E-governance

Corporate Governance of Malaysian Public Listed Companies

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Abstract

The importance of corporate governance lies in its contribution both to business prosperity and to accountability. Good corporate governance could become a fundamental driver in attracting foreign investments and promoting economic growth of the nation especially in times of economic uncertainty as currently faced by the countries in the Southeast Asian region. This study focused on the perception of accountants towards the accountability of Malaysian public listed companies (PLCs) in Malaysia. The results indicate that the current standard of corporate governance and the current state of accountability of the PLCs, as perceived by the accountants, are very low. The respondents also perceived that the regulatory authorities had not effectively enforced current legislation, had not brought offenders to book and also had not protected minority shareholders, due to the interference of patronage to prevent actions from being taken against offending parties. As for the relationships among the variables studied, the results indicate that the standards of corporate governance have a significant positive relationship with the accountability of the PLCs, especially the adherence to the corporate disclosure rules and regulations, and the pivotal roles played by the internal and external auditors. A significant negative relationship was also found between the current state of accountability of the PLCs and the need for improvement in the current corporate governance regime.

Introduction

Corporate governance is meant to ensure that directors and managers act in the best interests of outside investors including shareholders and creditors. Where a corporation relies on internal finance, there is no separation between management and financing or between ownership and control. Thus, corporate governance is not an issue as control and cash flow rights are perfectly matched.

Designing an appropriate corporate governance system becomes a problem where the corporation places reliance on external finance. This will make for a separation between management and financing thus giving rise to an agency problem. The directors and managers may end up having an enormous discretion about what is done with the funds, often to the point of being able to expropriate much of it. The corporate governance mechanism should be designed primarily to protect shareholders and creditors. It aims to put in place a system, which will have full accountability, transparency, responsibility, disclosure, honesty and integrity among directors and other decision makers.

The scope of the study focuses on the accountants' perception towards the accountability of the PLCs and the influence of the corporate governance regime as well as the regulatory authorities' expertise. The study attempts to investigate the relationships between the various attributes of corporate governance and the regulatory authorities' expertise towards the accountability of the PLCs and also to encourage the public listed companies to ensure better corporate governance are embedded within their governance procedures and identify any gaps to be addressed. Internal control and business risk management need to be strongly endorsed, and the effectiveness of all controls, including operational, financial and compliance-control are required to be reviewed regularly. Better corporate governance, effective control by the regulatory authorities, and high accountability of the PLCs will definitely put foreign investors in a good position to make better investment decisions.

Review Of The Literature

Most of the empirical research on corporate governance has focused on the major industrialised countries (Prowse, 1995; Franks & Mayer, 1990). There is, however, a dearth of knowledge about governance practices and their effects in developing countries. The few papers written in Malaysia are mostly prescriptive in nature rather than empirically based (Philip, 1994; Lewis, 1998; Marjuni, 1999; Thillainathan 1998). The East Asian crisis has focused attention on the importance of corporate governance. In order for East Asian countries to resume sustained high growth, they need to improve corporate governance (McKinsey, 1998). Indeed, there is mounting evidence that the long-term health of any financial system or economy depends on corporate governance practices that adequately protect outside investors. Countries that have better investor protection appear to have larger, deeper and, generally more well developed capital markets, which thereby lower the cost of capital to domestic firms.

Literatures on corporate governance (Prowse, 1999) suggest various ways to protect the interests of outside investors. For example, one way to control how managers use their discretionary power over a company's resources is contractual arrangements, which will depend on the security that the outside financier holds. Another way is that concentration of either debt or equity in the hands of a few investors will increase their control over the corporation. There is also evidence that take-overs address governance problem by concentrating ownership quickly. However, the most important rein on poor or corrupt corporate governance is corporate law, because it supports the effectiveness of both contractual arrangements and ownership concentration. Outside investors receive control rights in exchange for their funds and, to be effective, the law must protect those rights. If managers violate the terms of their contracts, outside investors can seek redress in the courts.

Although Malaysia scored slightly above average in terms of efficiency of its judicial system, rule of law and on accounting standards (Porta et. al., 1996; Schleifer & Vishny 1997), the government through its various regulatory agencies has initiated further improvements to the corporate governance framework since 1998. One of the most significant move by the government is the recommendation by the Finance Committee on Corporate Governance. The report from the Finance Committee covered three broad areas – the Malaysian Code of Corporate Governance; recommendations for the reform of law, regulations and rules; and training and education.

In facilitating the debate on corporate governance, the Kuala Lumpur Stock Exchange ('KLSE'), together with PricewaterhouseCoopers, commissioned a survey on the Malaysian public listed companies ('PLCs') in April 1998. The purpose was to determine the extent to which corporate governance policies were implemented and to identify areas where these companies saw the need for further development. A parallel survey was also conducted amongst institutional groups to evaluate the degree of emphasis they placed on corporate governance in the overall framework of their investment decisions. The survey was targeted at analysts/fund managers and financial journalists. Nearly all PLCs and well over a third of the institutional groups surveyed viewed improvements to Malaysia's corporate governance regime as necessary. More than a third of the companies cited the key reason as being to maintain and enhance investors' interest and confidence in the capital markets. The areas cited for improvement were mainly in existing regulations, which they felt should be further clarified and simplified. More than half of the institutional groups indicated that if further improvements were made, they would be encouraged to invest in Malaysia. Institutional groups ranked corporate governance policies as the least important of six investment factors crucial to their investment decisions. Companies' financial results and solvency were the most important factor. Where corporate governance policies were concerned, they were more interested in the extent of related party transactions than in other policies.

Research Methodology

The dependent variable is the accountability of the Malaysian PLCs, which is the variable of primary interest, the variance in which is attempted to be explained by the three independent variables i.e. the attributes of corporate governance, and the regulatory authorities' expertise, and the need for improvement.

The attributes of corporate governance include corporate disclosure rules and regulations, roles and responsibility of executive and non-executive directors, qualification and experience of executive directors, roles of internal and external auditors, effectiveness of audit committee, and the introduction of nomination and remuneration committees. The regulatory authorities' expertise covers the rules and regulations governed by the relevant authorities such as the KLSE, Securities Commission (SC), the central bank, the Registrar of Companies (ROC), and the Government of Malaysia.

Accountability, transparency, responsibility, disclosure, honesty and integrity are all closely associated with the concept of corporate governance. But this concept relies on compliance by companies rather than enforcement by way of law (Black and Kraakman, 1996). However, when we combine the concept together with the enforcement of law, we believe that the results of getting better accountability among the PLCs should be very encouraging. The above relationships are diagrammed in Figure1.

1. ATTRIBUTES OF CORPORATE GOVERNANCE:
    - Corporate disclosure rules and regulations;
    - Roles and responsibilities of executive directors and non-executive directors;
    - Qualification and experience of executive directors;
    - Roles of internal auditors and external auditors;
    - Effectiveness of audit committee; and
    - Introduction of nomination committee and remuneration committee.
2. REGULATORY AUTHORITIES' EXPERTISE
3. NEED FOR IMPROVEMENT

→ Accountability of the Malaysian public listed companies (PLCs)

Fig 1: THE THEORETICAL FRAMEWORK

Hypotheses

1. The greater the standard of corporate governance, the higher will be the accountability of the PLCs. (Six sub-hypotheses were tested under this hypothesis).
2. The stronger the regulatory authorities' expertise and enforcement of their rules and regulations, the higher will be the accountability of the PLCs.
3. The greater the need for improvement in the current corporate governance regime, the lower will be the current state of accountability of the PLCs.

Measuring Instrument

Data was collected by means of a questionnaire, developed according to the five dimensions of relevancy, sensitivity, reliability, acceptability, and practicality. Some questions were adopted from the study conducted by KLSE/PricewaterhouseCoopers. The respondents were asked their extent of agreement/disagreement on a seven point Likert scale on questions regarding the adequacy of existing practices in corporate governance, the regulatory authorities diligence in discharging their responsibilities, the perceived level of accountability among the PLCs, and their opinions on the need for improvement in the current corporate governance regime. The Cronbach alphas for the variables obtained ranged from 0.5 to 0.9.

Sampling

A total of 100 professional accountants were randomly selected from the population of recognised professional accountancy bodies. The selected accountants were drawn from various industries or organisations mainly located in Penang, Malaysia. The main characteristic of the population sample was that all respondents are qualified accountants who have gone through a formal education and/or professional training as well as have a number of years of experience in finance, accounts and/or corporate finance sectors. The underlying assumption on the population sample was that the respondents have the basic knowledge on the corporate governance regime and the regulatory process in Malaysia due to their background as qualified professional accountants.

Results Of The Study

A total of one hundred questionnaires were sent out. Out of this number, 38 filled in and returned the questionnaires, giving an overall response rate of 38 per cent. Around 60 per cent of the respondents were male, and the mean age of the sample was 33.05 years. The respondents were also divided by membership of professional organizations. It turned out that 22 or 57.89 per cent of them were members of MIA only, with the remaining 16 or 42.11 per cent being members of other professional organizations such as ACCA, MACPA, CACA, and CIMA. When the respondents were grouped according to period of qualification, it was found that 9 or 23.68 per cent of them qualified between 1986 and 1992. The majority of them (22 or 57.89%) qualified during the 1993-96 period. Only 7 or 18.42 per cent of them qualified after 1996. Finally, the respondents were grouped according to the status of the company they are working for. An overwhelming proportion of them (i.e. 81.58%) were found to be working for companies without the PLC status. Only 18.42 per cent of them were found to be working for companies in the PLC category.

The results of the correlation analysis in Table 1 indicate that the overall corporate disclosure rules and regulations, with a mean of 3.39, are not adequately dealt with by the PLCs. The respondents also agree that the PLCs have not disclosed sufficient information on the directors' dealings and the related party transactions. The executive and non-executive directors of the PLCs are perceived to be not fully aware of their respective roles and responsibilities by most of the respondents, with a mean of 3.61. The results show that the qualification and experience of executive directors of the PLCs are perceived to be very important by the respondents, with a mean of 5.67.

Table 1: CORRELATION ANALYSIS

Variable	**Mean**	**P**	**Sig. P**
Corporate Disclosure Rules and Regulations	3.39	.7001	.000
Roles and Responsibilities of executive Directors	3.61	.4746	.003
Qualification and experience of executive directors	5.67	.1776	.286
Roles of internal auditors and external auditors	4.33	.5436	.000
Effectiveness of audit committee	3.88	.6101	.000
Introduction of nomination committee and remuneration committee	4.76	.3569	.028
Overall Corporate Governance	4.27	.7507	.000
Regulatory authorities' expertise	4.16	.6969	.000
Need for Improvement in corporate governance	4.97	-.6681	.000

The external auditors are perceived to have independently reported to the shareholders in accordance with the statutory and professional requirements with a mean of 5, but the internal auditors are perceived to be not effective with a mean of 3.6. The respondents agree with the important role played by the independent directors making up the audit committee but do not agree with the view that the existing audit committees of the PLCs have effectively discharged their duties and responsibilities. Nomination Committee and Remuneration Committee are indeed very rare in Malaysian companies. However, most of the respondents do agree that the introduction of Nomination Committee and Remuneration Committee is the best practice to ensure transparency in the appointment of directors and the determination of directors' salaries. Even though the overall mean for the regulatory authorities' expertise is 4.16, most of respondents feel that the regulators have not effectively enforced current legislation, brought offenders to book and protected minority shareholders due to the interference of patronage to prevent actions from being taken against offending parties.

The general perception of the accountants on the accountability of the PLCs is very low with an overall mean of 3.3. The respondents strongly agree that the current corporate governance regime is not sufficient to ensure accountability of the PLCs, and the relaxation of the regime will not be able to enhance the accountability of the PLCs as well. Therefore, we need to improve the current corporate governance regime, in order to enhance the current state of accountability of the PLCs.

Hypotheses Testing

The results obtained from the application of the step-wise regression are given in Table 2 below. It can be seen from the –square that 73.258 per cent of the variance in accountability of PLCs can be explained by all eight independent variables combined. The model is adequate, as the F-statistic is high at 47.9 and significant at the 1 per cent level. There is no evidence of serial correlation and the condition index is below 30.

Table 2. REGRESSION RESULTS – THE STEP-WISE METHOD

	Beta	T-ratio	Sig T
CDRULREG	.094533	5.830	.0000
ROLEAUD	.091764	4.388	.0001
NEED	.106828	-2.194	.0352
PRESDIR	.058842	.610	.5458
QUAEXDIR	.129003	1.498	.1437
EFFECAUD	.145440	1.395	.1722
NOMREMU	.035866	.363	.7190
REGAUTEX	.167874	1.445	.1579
R^2	.73258		
Adjusted R^2	.71730		
F-statistic	47.94046		
Sig F	.0000		
Condition Index	24.4		
Durbin Watson	2.27255		

Hypothesis 1

'The greater the standard of corporate governance, the higher will be the accountability of the PLCs.' from the results in Table 1, it is noted that the correlation coefficient is 0.7507, which is significant even at the 1 per cent level. This implies that the hypothesis is not rejected, leading to the conclusion that the greater the standard of corporate governance, the higher will be the level of accountability of the PLCs. Although the correlation analysis identified five of the six variables on the standard of corporate governance to be significantly correlated, the regression analysis results in Table 2 however, shows that only were significant. They are the level of perception towards the adherence by the PLCs on the corporate disclosure rules and regulations (0.0945), and the effectiveness of internal and external auditors in discharging their duties and responsibilities in accordance with the statutory and professional requirements (0.091).

Hypothesis 2

'The stronger the regulatory authorities' expertise and enforcement of their rules and regulations, the higher will be the accountability of the PLCs.' From Table 1, it can be seen that the correlation coefficient for this test is 0.697, which is significant at the 1 per cent level. Thus, this hypothesis is not rejected. However, the step-wise regression result in Table two is not significant. Thus, that this hypothesis is rejected.

Hypothesis 3

'The greater the need for improvement in the current corporate governance regime, the lower will be the current state of accountability of the PLCs.' The correlation coefficient for this test is negative 0.668, which is significant at the 1 per cent level. The step-wise regression result was also significant.

In summary, the results from the above indicate only four independent variables are found to be significantly related with accountability. The variables are: the corporate disclosure rules and regulations, the roles of internal and external auditors, the standards of corporate governance and the need for improvement in corporate governance. All the other independent variables have been dropped. The conclusions that can be derived from the results are:

1. There is a significant positive relationship between accountability of the PLCs and the adherence to the corporate disclosure rules and regulations.
2. There is a significant positive relationship between accountability of the PLCs and the roles of internal and external auditors.
3. There is a significant positive relationship between the accountability of the PLCs and the standard corporate governance.
4. There is a significant negative relationship between accountability of the PLCs and the need for improvement in the current corporate governance regime.

Discussion And Conclusion

The findings in this study support the calls on the need for further improvement in the current corporate governance regime and the need for increasing the standard of current corporate governance in Malaysia. The findings also support the theories on the importance of adherence to the corporate disclosure rules and regulations and the importance of the roles played by the internal auditors and the external auditors.

The rationale behind the drive for higher standards of corporate governance is easy to understand. For instance, corporate transparency and full disclosure will become the norm and this may well play a key role in restoring and promoting investor confidence and investments into Malaysia. Good corporate governance also reduces systematic market risks, promoting the stability of the market environment in which companies conduct business and guarding against financial crises. This facilitates greater access to capital in global markets at lower cost. Over the long term, good corporate governance will strengthen the competitiveness of businesses and enhance their ability to function well.

Therefore, the call made by the Finance Committee on Corporate Governance through its report, which was released by the Securities Commission in March 1999, is a far-reaching corporate governance reform and a landmark emerging vote in the need for transparency, board accountability to shareholders and protection of minority shareholders.

The insignificant influence on the directors' understanding of their roles and responsibilities as well as their qualification and experiences, on the accountability of the PLCs may be explained by the fact that those directors may be assisted by senior management teams in the day to day running of the operations. And most of the senior management teams consist of professional managers. Meanwhile, the roles played by the internal auditors and the external auditors also help to ensure proper management of the companies. Therefore, these may mitigate the importance of these variables.

The insignificant influence of the audit committee on the accountability of the PLCs was not expected. Perhaps, this may be explained by the nature of the independent non-executive directors being appointed to the board of directors. Perhaps, they are selected on the basis of being 'old-boys'. If this were true, the selections were not made on the basis of expected benefits and contributions of the non-executive directors to the PLCs.

The insignificant influence of the nomination and remuneration committees on the accountability of the PLCs may be explained by the fact that Malaysian companies seldom establish these types of committees. Perhaps, the respondents were not familiar or do not have much knowledge on the roles played by these committees. As we can see from the recommendations made by the Greenbury Committee and the Hampel Committee, nomination committee and remuneration committee in fact play a very vital role in ensuring transparency in the appointment of directors and in determining a fair remuneration package for the directors. The purpose is to protect the interest of shareholders/investors, particularly minority shareholders.

Another surprise in the findings was the insignificant influence of the regulatory authorities' expertise including the regulating and enforcement of their rules and regulations, on the accountability of the PLCs. Perhaps, this may be explained by the fact that corporate governance relies on compliance by companies rather than enforcement by way of law. In order to ensure compliance of good corporate governance, a monitoring system on compliance must be established and the monitor may be any person having interests in that particular transaction. Monitoring is best carried out by only one party since duplication may not result in improved monitoring and would waste resources. But shareholders cannot cooperate to hire somebody to monitor because of a free rider problem; each would want others to bear the costs of monitoring the monitor.

Implications and Limitations

Financial markets play a vital economic and social role that has a profound influence on the quality of investment decisions and the well-being of the general economy (Naik, 1997). Well functioning financial markets bring borrowers and lenders together, improve risk sharing, allow separation of ownership and management, lead to the efficient allocation of resources, provide information to market participants and help the monitoring of management. Together they improve the quality of investment decisions and the welfare of all market participants. Therefore, good corporate governance regime will ensure the well functioning of the financial markets.

The current economic turmoil offers the best opportunity to look at corporate governance in Malaysia. When things are going well people forget what the directors are doing. Everyone is happy because everyone is making money. But when things are slow as is now, they will start looking at the nitty gritty. During this economy crisis, the corporate culture in Malaysia need to be changed and good corporate governance could become a fundamental driver in attracting foreign direct investments and promoting economic growth. Therefore, the establishment of the Malaysian Institute of Corporate Governance (MICG) in late 1998 is right on time. The role of MICG is to create awareness – people have to be aware and understand their responsibility as directors because the public's money is involved.

It cannot be denied that the Malaysian Government have put in considerable effort to create a transparent and accountable business culture in Malaysia. It is noted that company directors now face the prospect of spending time behind bars for serious breaches of corporate governance, instead of just paying a fine. For instance, the recent case of KFC Holdings (M) Bhd whereby the executive chairman and the managing director were charged under Section 32(B) of the Securities Commission Act, which deals with disclosures in the issuing of securities. If convicted, the penalty will be a jail term of up to 10 years or a fine of not more than RM3 million, or both. Fig. 2 shows some of the actions taken by the SC against those in breach of listing requirements.

One limitation of the study concerns the responses from the accountants, which may not be representative of the general opinion of professional accountants in Malaysia. This may be due to the simple reasons that some may not keep abreast with the latest development in the corporate governance regime in Malaysia or some may have promoted out from the accounting and finance functions into general management. A letter containing a package of questionnaire was sent to the respective accountants.

Table 3. PUBLIC REPRIMAND BY THE SC

Date	Company	Board	Rules Breached	Fine Imposed
10-4-99	Malaysian General Investment Corporation Bhd	Main	Section 60 of Main Board Listing Requirements	RM100,000
10-4-99	KLIH Bhd	Main	Section 60 of Main Board Listing Requirements	RM100,000
10-4-99	Kelanamas Industries Bhd	Main	Section 60 of Main Board Listing Requirements	RM100,000
10-4-99	Rekapacific Bhd	Main	Section 57 of Main Board Listing Requirements	RM100,000
16-4-99	Perdana Industri Holdings Bhd	Main	Section 335(4)(b)(x) of Main Board Listing Requirements	-
16-4-99	Repco Holdings Bhd	Second	Clause 5.4 & 5.6 of the Second Board Listing Requirements	RM300,000
16-4-99	Rahman Hydraulic Tin Bhd	Main	Section 60 of Main Board Listing Requirements	RM100,000
16-4-99	MBf Holdings Bhd	Main	Section 114 of Main Board Listing Requirements	-
16-4-99	Ekran Bhd	Main	Section 335(4)(b)(iv) of Main Board Listing Requirements	RM84,000

Source: Investors Digest, May 1999

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E-governance in India - A method in madness

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Abstract

The employment of Information Technology was rather slow in India; and, very often the officials seemed very indifferent to the very idea. The scene, today, is however, very different. Starting from the central government itself, every state government has set up an exclusive ministry to look after the manipulation of Information Technology for its benefit. The concerned bureaucrats, well versed in the jargons of the new economy, are found ubiquitously in all the happenings of the IT industry, be they cocktail parties or technology conferences. The most significant aspect is that every state government has begun jumping into the e-governance bandwagon with a, *"me too"* determination. It is infradig not to be part of the IT wave.

This paper traces the evolution of IT deployment in India and attempts to point at the formula for success in introducing e-governance in the Indian Administration.

Introduction

The late prime minister of India, Mr. Rajiv Gandhi exhorted the Indian administration with the motto of riding into the 21st century on information technology. Until then, the government officials were wary of using computers, insisting that they had no relevance to the way the governments worked. Mr. Rajiv Gandhi's exhortation changed it all. Suddenly, one found the governments begin to employ computers in many of their departments. Still, most of the implementations were ad hoc and, very often, computers were used in stand-alone mode for word processing, at most for spreadsheets, wherever the departments did take serious cognizance of computer usage.

The National Informatics Centre (NIC), set up under the aegis of the Department of Electronics, became the agency to support and oversee all governmental computerization activities in the country – nay, quite often it began to dictate the information technology, or, IT deployment at the state and central government levels.

A major thrust initiated by the NIC - in the 80's- was to create a nation wide database related to major sectors of the economy and a wide area network that allowed the state governments and research/educational institutions to access information on line.

Technologically speaking, this network was the first of its kind in India on such a large scale. Given that no body talked about e-governance then, not much hype was created about this endeavour and it was treated as yet another, but major, activity in the move towards using computers in government. This system failed not because of technology but because, NIC disclaimed any authentication of and maintenance of the databases

(Most of the data was taken from dated government statistics) and no other agency was made responsible for it.

NIC, today, provides specialized information in areas like agriculture and medical research through web access.[8] A feather in NIC's cap as an enabler of Information Technology in governance has been the ICES – Indian Customs EDI system – that facilitates customs operations by linking importers, exporters, freight agencies, banks, etc. through electronic data interchange (EDI).[1]

Karnataka[1] was one of the states that believed in employing computers to support governmental administration even during the late 70's. It was probably the only state to have set up an independent department called the "Karnataka Government Computer Centre" (KGCC) with an independent head. The KGCC provided computer services to government departments with the help of IBM1401, IBM370 and an EC1030[2] series machines. The major areas it supported were, registration of automobiles, police criminal records, public food distribution system, high school examination results and so on. Today, this department has been renamed; "Department of Information Technology" has a senior bureaucrat as its Director who reports to the secretary of information technology, within the ministry. It has moved up the value chain from being a support division to one that guides and, sometimes determines, information technology strategies of various state departments.

One initiative that forced the use of computers was a directive that came from the Reserve Bank of India, the country's federal bank, in 1994, for all the government owned banks to employ computers for their ledger posting and reconciliation activities. The directive was to computerize, totally, at least 4000 bank branches by the end of 1996.[5]

An information technology initiative that did make a major impact on the citizens of the country was the large-scale online railway reservation system that was initiated regionally in 1986 and has today grown to cover most of the major towns in India.

Today, it handles almost 100 million passengers a year over 40 Indian cities[3].

Thus, a rather quiet revolution had been going on in leveraging computers and information technology for better administration in the government. This was driven by some who were convinced by the advantages of deploying information technology in areas that they were directly involved with, who managed to extract the required budget from the powers that be and committed themselves to the implementation of the projects. These have also been the people who realized that using computers just for the sake of doing so, investing in the hardware and then finding an application that can run on it, did not serve any purpose.

The question is, when did all this noise about E-governance begin?

What is E- Governance?

Thanks to the PC, the Internet and the World Wide Web, there has been a quantum leap in the availability of and the need for information at every level. Ordinary citizens have begun clamoring for information-based services like never before. Privately operated commercial services, and some non-commercial too, have been able to oblige, often increasing the thirst of these citizens.

According to Tapscott, – in his book, The Digital Economy - a Canadian government report, written by public servants, candidly recognized the public's frustration: "Many consumers of government services appear to have lost their tolerance for bureaucracies. They feel they receive better service from banks, car rental companies, even supermarkets that have transformed business with innovative information technology. The government increasingly appears to be out of date. Many want to know why they have to spend their precious time finding answers to their questions, after being bounced from department to department …". [11]

This seems to have become a general attitude of citizens all over the world, including India.

The significant point, however, is the realization by the government machinery that it is possible to satisfy this need thanks to the current status of information technology (IT).

Even as several state governments, and particular departments within, began to take up the initiative to revamp whatever their current use of IT was; and, even introduce new areas of computerization, a very conspicuous impact was made by the government of Andhra Pradesh which came out with a vision statement and a blueprint for computerization of government services over the next 20 years. The government did not stop with the vision statement – it began pursuing the policy with specific projects very aggressively.

This government's approach to introducing IT is indicated by a statement made by one of its special secretaries. To quote, "Successful change requires a sense of urgency in order to attack inertia and complacency. Often visible crises can be enormously helpful in raising urgency levels….". This indicates that IT deployment was first of all treated as a total change management paradigm and, then it was introduced with a sense of urgency.

Its "Vision 2020" statement also gives an indication of what e-governance means to the Andhra Pradesh Government: "Andhra Pradesh will leverage information technology to attain a position of leadership and excellence in the information age and to transform itself into a knowledge society. The state will use information technology to improve the quality of life of its residents and help them achieve higher incomes and employment. It will also aggressively promote the pervasive use of IT to achieve higher levels of efficiency and competitiveness in both public and private enterprises"[4].

The aggressiveness of the Andhra Pradesh Government became so conspicuous that many other governments also started giving hype to their endeavours in the direction of IT deployment giving, in a sense, to the birth of the e-governance revolution in India.

It was obvious, that these governments realized that it was no more just a matter of upgrading their current state of computerization but working through long term strategies, investing in related infrastructure, accepting major changes in the working ethos and, in general, working in a new paradigm, as it were, focused on e-governance.

So, what is e-governance? A formal definition, supposedly accepted by the research community is that e-governance is SMART governance, where SMART stands for [2]:

- Simple
- Moral
- Accountable
- Responsive and
- Transparent Govemance.

This definition itself requires further elaboration of what each of the above term means to a government – or a citizen.

I would prefer to say that, rather than a cryptic definition, e-governance begins when a government consciously realizes and operates with the premise that governance is a service that it offers the citizens and that the use of information technology should be directed towards providing these services in the most efficient manner possible that results in maximum customer satisfaction.

Going by this definition, E-governance began, in India, in 1986 with the railways reservation system.

SERVQUAL, a model used for measuring quality of service, points out several gaps that need to be plugged to enhance quality of a service. One of them is the gap between management quality policy and the delivered service. That is, though the management may have serious intentions of providing high quality of service and make policy statements regarding it, the actual quality delivered will be based on the intentions of those way down the line who actually deliver the services. This gap – between management and deliverers – is very difficult to bridge. The larger the organization, the greater the reach of the service, the larger is this gap. [9][10].

Disinter mediation is the best way of reducing this gap; and, information technology is the most effective means of doing so. E-governance is doing this. We see evidence of it in the railway reservation system.

I believe that the real hype, as we see it today, came about through a political angle.

The government had been changing hands too frequently in India, and every new government mouthed the same old platitudes but failed to deliver. The people, in general, were becoming indifferent. People at the helm of affairs were normally well above sixty years of age and no one expected fresh ideas from any one, any way.

It was in this scenario, that Mr. Chandra Babu Naidu won with a thumping majority and became the chief minister of Andhra Pradesh, a very large state in the south. He was also one of the youngest men to occupy this position.

Mr. Chandra Babu Naidu, it turned out, was also a computer savvy person like many of the newer generation. So, when he began speaking of computers to support administration effectively, he not only said it but also began using computers himself and saw to it that this fact received enough publicity through the media. He further used the brute majority of his party to make changes in the administration that cut through a lot of traditional red tape. And, like a moving juggernaut, he cleaved his way into the IT world with his ‘Vision 2020’ plan, began implementing some of them aggressively, and attracted a lot of attention for himself and his government in the deployment of Information Technology for effective governance.

Even though some did question all this brouhaha about something that did not really reduce poverty, provide jobs or increase the quality of life of the rural population – a segment that accounts for 80% of the total population – not only did others get into the bandwagon with a “me too” attitude, often putting on the show case what they had been already doing without much ado, both society and the government was shown to reap some concrete benefits out of the new paradigm.

E- governance, that is improving the quality of service of the government due to the citizens, with the help of Information Technology, has thus come to stay. Examples like that of Madhya Pradesh has clearly challenged the notion of critics that e-governance is meant only for the urban mass.

As Patterson and Hanson state, "In the 21st century, electronic government is no longer an option. It is inevitability. The kind of public-private collaboration that occurred in the summit represents the dynamics that must happen for information technology to transform government". [3]

Method in Madness

So, there it seems to be: the writing on the wall! If for nothing else, an e-governance initiative is required by every government for creating a brand image for itself and its party. To what extent do they really serve the objective of e-governance is not clear.

It is said that Information Technology initiatives are usually triggered by a crisis, competition, a CEO's vision or benchmarking. In Karnataka, the finance department discovered to its horror that a nondescript officer of a low rank had methodically swindled the treasury of rupees 60 crores[5] by manipulating the payments disbursed through his department. This scam triggered off a massive computerization drive (to provide the treasury department with the ability to monitor treasury transactions) christened "Khajanne[6]". This involved linking up all the treasury offices spread through out the state, over 200 of them, through WAN using VSATS. This was entirely the initiative of the department, which had to initially struggle for sanction from the ministerial cabinet.

Interestingly, even as this project was taking its root, there was a general election in the state, the existing government was thrown out, a new party was elected, and a relatively younger chief minister took over. He began to champion e-governance from the moment he took over. In a sense, he began to restore Karnataka's reputation as the pioneer in using IT in governance, feared to be overtaken by Andhra Pradesh. The media began to notice an apparent rivalry between him and his neighboring chief minister, Mr.Chandra Babu Naidu of Andhra Pradesh[7]. Thus, what began as a solution to a crisis in one department ended up as a major showpiece of e-governance of the state. What is more interesting is that the principal secretary of the finance department (a non-technical person) who initiated this project was appointed by the new chief minister as the secretary of the ministry of information technology, responsible for all IT planning implementation in the state.

Some of the other e-governance programmes in India, as reported in the media, are:

•Andhra Pradesh
–CARD
•*Computer assisted Administration of Registration Department*
•Punjab
–PRISM
•*Punjab Registration Information System Module*
•*File monitoring system*
•Kerala (Thiruvananthpuram)
–FRIENDS
•*fast reliable instant efficient departmental services*
•WWW.tn.gov.in
-*Download over 70 application forms*
•Gujarat
–*Computerized Check post Project*
•Karnataka
–*Mukhya Vahini*
–*Khajjane*
Madhya Pradesh
Gyandoot

CARD provides transparency and quick registration of land documents, valuation of property, sale of stamp paper and related services. Two important benefits: transactions that took up to 7 days are now done in an hour; and, there is total transparency in land registration and valuation leaving little scope for suspicion.

The PRISM of Punjab is an attempt at replicating the success of CARD but local social and political environment has prevented it from making the same impact so far. Its file monitoring system is working well within some areas.

The FRIENDS of Kerala, available only in Thiruvanthapuram, the capital of the state, is a portal service that enables payment of utility bills.

The Tamil Nadu state has hosted a site, www.tn.gov.in, with no particular acronym, through which the citizens can down load forms required to apply for various services, without having to go physically to the respective departments.

In Gujarat, computerization of check post transactions, that keep track of merchandise moving across and within the state, has resulted in an increase of almost 5 times in the collection of taxes.

"Mukhya Vahini", is the name given to the project in Karnataka, which is a portal through which every district collector can record the status of industrial and agricultural investments, made in his/ her district, which the chief minister himself can monitor and take appropriate actions required at his end. This is also planned to become a portal that will connect citizens with all departments of the government. The Karnataka government regards "Khajanne" (not yet fully implemented) as a showpiece e-governance initiative. This involves networking all the sub-treasuries – 240 in all – all over the state, and all payments made to be verified, electronically, approved and accounted for within the allocated budget, instantly.

The e-governance initiative that seems to have stolen the limelight as the true citizen oriented and relevant to rural India is "Gyandoot[8]" of Madhya Pradesh State. This project won the Stockholm Challenge Award of Year 2000.

The web site hosted by the center for electronic governance of the Indian Institute of Management Ahmedabad, provides a fairly comprehensive list of such projects in various states of India [9].

The point to be noted here is that there has been a mushrooming of web and non-web based applications implemented by all the states in some form or other– not always to the full benefit - to get into the e-governance bandwagon. One has no idea of how much of effort has gone into duplication in different states and how much of money has been sunk into these efforts, with what cost.

Some how there seems to have been achievements, and credit has to be given where it is due. But, is there madness in all these methods? Could one be more organized and extract the maximum out of one's effort?

There is also this issue of economics. It is not easy – and may not be always meaningful – to carry out a cost - benefit analysis; but we are talking about the public exchequer and some sort of discipline is warranted in investing in e-governance facilities.

Then, again, there is the question of understanding the systemic process in employing information and communication technology effectively for governance.

For example, some other state governments have tried to replicate the CARD system of Andhra Pradesh but without the same degree of success. The CARD system included not just the technology part of it but a major exercise of assessing the status of land holdings, authenticity of existing documents, creating new procedures and selling the idea to both the administrators as well as the citizens – a pains taking process. As Mr. Sudan, special secretary of Andhra Pradesh put it, e-governance is not technology - it is change management. To quote him, "The induction of IT in government has to be addressed more as a major change management exercise, rather than one of merely providing technological solutions to existing problems".

The officers of Madhya Pradesh Government have offered to help other states set up systems based on the successful "Gyandoot" model. But one should realise that "gyandoot" is not just technology but a whole lot of issues put together – a technical institution provided a technology of cheap and reliable local networking; there were entrepreneurs at the village level who were prepared to invest and learn to run the kiosks at their own risk; and there were dedicated officers of the government who cooperated with each other, having no idea at that moment that they would vying for an international award. Plus, of course, there was the necessary political will and leadership in that state.

The following abstracts from report of the Government of Madhya Pradesh shows the effectiveness of "Gyandoot"

"*A complaint costing Rs. 10 made available drinking water to a tribal hamlet of 39 households:*

A small hamlet of village Mafipura*, named* Baidi Awar *has only one hand pump for clean drinking water for 39 households. The hand pump was out of order for six months and villagers were fetching their drinking water from over 2-km distance. The villagers lodged complaint to the concerned department officials and were not responded properly. One villager named Ramesh Gobaria went to nearby* Soochanalaya *to lodge a complaint. Initially he was very sceptical about the payment of Rs.10 for sending a complaint, as he was not sure that the complaint would be properly attended to. To the surprise of the villagers, a hand pump mechanic reached the hamlet within two days of filing the complaint at* Soochanalayas *and he repaired the hand pump within three hours".*

The incidence built the confidence level of the villagers and they become habitual of using Gyandoot services.

"*A cow for rupees three thousands:*

This is the first real e-commerce transaction in the rural area of the tribal district. Kalsingh of village Mirjapur *wanted to sell his cow. He registered at* Soochanalaya *of nearby* Gunavad *village to put up his offer of the animal on-line. He received four trade enquiries on his account and he finally sold his cow to the highest bidder Premnarayan of village Dilawara."*

The auction facility of the Gyandoot enables trading of commodities like milch animals, cultivable land, tractors, agricultural tools etc, creating virtual market place to benefit villagers from expanded horizons and increased competitiveness. The facility has really done its job in providing true market to the villagers of the tribal hinterland and benefited them economically. The service is becoming very popular making the virtual market place deeper and wider.

"256 milch animals vaccinated in one day:

Hiralal sent an e-mail from Gunavad Soochanalaya *that an epidemic has broke out amongst the milch cattle of the village* Kot Bhidota*. A vetenary rescue team was despatched on the same day by the district head of the veterinary department. The team was informed that there was no death due to the epidemic. The disease of haemorrhage septicaemia was detected. The team promptly started curative treatment and vaccinated the rest of the animals against the disease. They also made search and survey operation in the neighbouring villages for detection of any disease symptoms and did preventive vaccination."*

Tivradoot facility of the Gyandoot caters to natural calamities and epidemics providing instant information to the right government functionary. An instant relief and preventive measures are possible due to timely availability of information."

(Soochnalaya, meaning information centre, is the name given to the kiosks)

How much of all this was as planned is very difficult to point out.

The well-meaning secretary in charge of IT of another large state, where many of the e-governance projects are still paper plans, presented a conceptually comprehensive architecture of e-governance that would provide a structural model for all. He presented his concept diagrammatically as shown in fig. 1 below:[10]

Towards An Integrated Information Management Strategy : Information Architecture

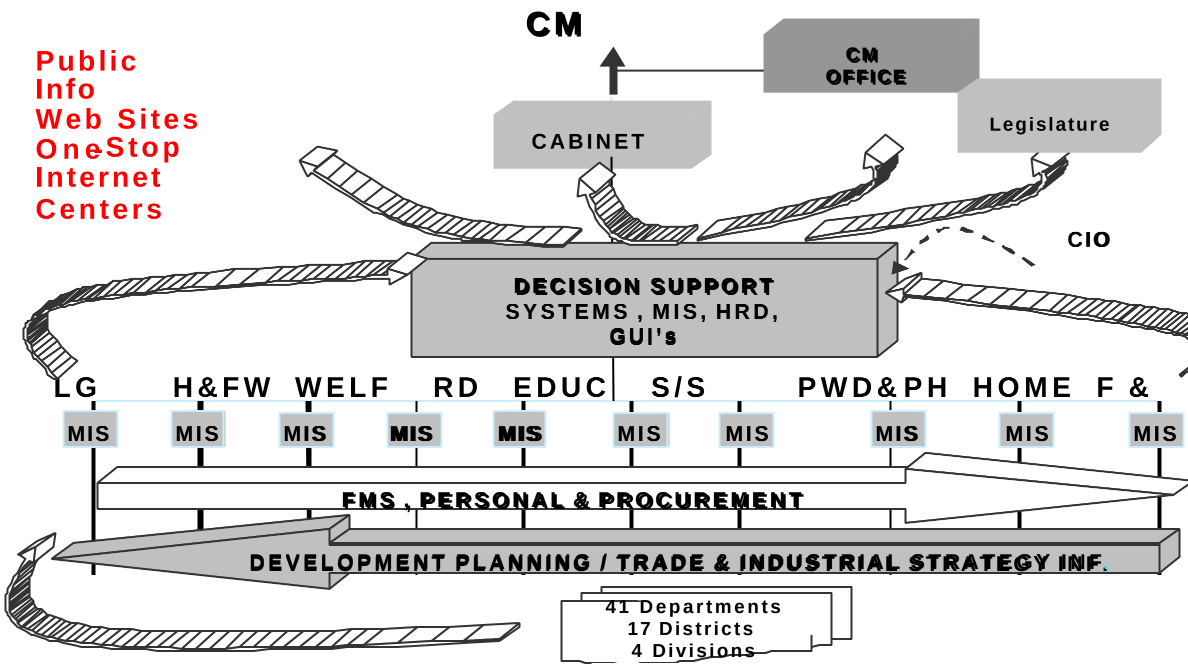

Figure 1

At the heart of the system, we note the requirement of Decision Support Systems, MIS and Human Resource Development. These cannot be developed and implemented in short frames of time. Enormous amount of effort, on multi-dimensional fronts, is required to organise and maintain these systems. One finds it difficult to visualise a complete, working system of this kind even when developed in an evolutionary mode. Because, at the crux of it all, the major driver of a successful e-governance initiative is the very powerful nexus between politics, bureaucracy and social ethos. In this particular state, for instance, there is a very strong resistance to accept anything that doesn't enable the rural farming community to understand easily or help them directly ("Gyandoot" model of Madhya Pradesh state is more likely to work here). Architecture of the above kind is less meaningful unless it incorporates the presence of the political nexus. Jens Hoff, in his paper, "Towards a Theory of Democracy for the Information Age" writes about different levels of democracy and corresponding attributes like view on citizenship, political nexus, central form of political participation, main political intermediary, etc [4]. From the table presented by him, it appears that Indian democracy is in the Demo-elitist stage. According to Hoff, the dominant "technologically mediated innovations in political practices"(TMIPP) for this kind of democracy is more of a hierarchical communication between citizen and the government (web sites, direct mail, bulletin boards); and, that precisely seems to be the kind of model working in India. CARD, Khajanne and Gyandhoot, all three of them relate to an interactive communication and data access between the government services and the citizen, without, necessarily a strong backbone of decision support systems, integrated databases and MIS.

Now, let us take these three, highly acknowledged e-governance initiatives and examine what was common about them in their development. They all belong to entirely different domains, their triggers were different, in investments they range from a very economical Gyandoot to a massive infrastructure investment required by Khajanne; and, what is more, the project processes were also very different. But they all have the following three factors in common:

All these projects received a strong backing by the respective chief ministers, they had at least one bureaucrat who could sell the idea amongst his people and take active interest in pursuing the project, and they could muster up competent technology vendors through due process.

This fits in perfectly with Mckenny's model for successful implementation of IT [6]. After studying the history of several IT-driven strategies, he concludes that three roles – a strong CEO convinced of the utility of IT, an empowered entrepreneurial manager of IT (the Maestro) who understands the business, and an innovative group of IT technologists – are essential to the effective deployment of IT. "All these were insiders looking out, not outsiders, such as vendors, rushing in with a solution."

The similar roles played by the chief ministers, the champion bureaucrat and a group of technical advisors are conspicuous in these three situations. In other situations, where there may have been similar attempts, but not as effective, at least one of the above roles would be missing. In many cases, though the chief minister might have sanctioned the budget, their active involvement is absent.

The government of India has proposed that every state allocate 1.7 % of its annual budget towards IT deployment and has prescribed certain guidelines to be followed in doing so. The Ministry of Information Technology of the central government has set up 25 "Objectives and Indicative Road Map" to be followed in its white paper on e-governance [7]. These are very nice to read but unless the triumvirate of the above model plays its role sincerely and is capable of playing a balancing act between the social ethoses of the state, the political muscle power available with the government and the availability of technical skills, it is unlikely to succeed in its endeavors.

Conclusion

There has been a sudden spurt of projects related to the introduction of e-governance, in India, over the last 3 –4 years. Most of them are seemingly ad hoc and many of them are grandiose ideas on paper. Worse yet, there may be re-invention of the wheel, taking place in different states – even in different departments in the same state. Many of these projects seem to be introduced in a hurry with a "me too" attitude. There is no single coordinating agency that can transfer technology from one state to another and/or oversee the implementation of the projects. This should of concern because it affects the exchequer and has political ramifications.

Each state is following its own method – Andhra Pradesh has created posts of Chief Information Officers (CIO's) who, themselves have been trained in methods of IT management; Karnataka government has set up technical advisory panels consisting of technical and management experts who oversee projects; Madhya Pradesh has formally collaborated with institute's of technology and so on. All these may seem mad, but one pattern that clearly emerges is the presence of a universal model of success that Mckenny has pointed out as a result of his study.

To ensure maximum success in the implementation of e-governance, the government should go beyond technical and financial support and encourage the development of people who have both social as wells technical skills to champion the deployment of IT.

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[1] Karnataka is a state in the southern part of India where Bangalore, a major center for Information Technology is situated.

[2] An indigenous computer system manufactured in India.

[3] Review of CMC Ltd.

[4] " Towards a SMART Governement: the Andhra Pradesh Experience" Presentation received,courtesy, Mr. Randhir Sudan, Special Secretary to Chief Minister, the Government of Andhra Pradesh

[5] 1 Crore equals 10 million.

[6] Khajjane means treasury in the local dialect, Kannada.

[7] Incidentally, a recent nation wide poll voted the chief minister of Karnataka as the best among chief ministers.

[8] Gyandhoot means messenger of wisdom

[9] http://www.iimahd.ernet.in/egov

[10] A presentation made to senior government officers at the programme on e-governance at the Indian Institute of Management Bangalore , June 2001.

Interlocking Corporate Governance Structures In The Electronic Commerce Industry: An Emerging Market Perspective

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Abstract

Electronic commerce has been instrumental in making the marketplace more global, crossing international borders and opening up the world's economies. In order to improve their performance vis-à-vis more stable markets and to better their economy, emerging markets are investing in information technologies and especially electronic commerce endeavors. This paper is concerned with emerging markets, and the importance of the governance structure of the electronic commerce industry in such markets. Specifically, the different reasons that firms in emerging markets may engage in interlocking directorates are discussed; these include legitimacy, cooptation, monitoring, and career advancement.

Introduction

With the advent of information technology and the ensuing emergence of electronic commerce (e-commerce) the marketplace has expanded across international borders. This is true for all economies, including emerging economies. The Internet, the main conduit for e-commerce transactions, is becoming a global information system accessible from nearly all countries [4]. Thanks to the Internet and advanced communication information technologies, society is moving towards a global village. Business as we know it is changing: business activities involving information seeking, gathering, marketing, advertising, purchasing, banking, supplying, collaborating, meeting, selling, servicing, and retailing will be affected by the capabilities of new information technologies. In essence, the information revolution is reshaping the business world and markets worldwide, and fundamental changes are resulting. Increasingly, emerging markets are investing in information technologies, in an attempt to better their economy and to improve their performance vis-à-vis more advanced countries. In setting up new companies, one issue that needs to be taken into consideration is the corporate governance structure. This paper focuses on why it is important to pay special attention to the board of directors of e-commerce companies in emerging markets.

This paper first defines what an emerging market is and outlines the benefits that e-commerce can bring to emerging markets; also, some of the more potentially problematic issues facing the adoption of e-commerce firms in emerging markets are presented. A few examples of how e-commerce has been successful in some emerging markets are reviewed. The paper then introduces the notion of interlocking directorates, reviews prior research on the topic and looks at, in some depth, several reasons that firms may elect to engage in interlocking directorates with other firms. The four reasons discussed, which are especially applicable to e-commerce firms in emerging markets, are legitimacy, cooptation, monitoring, and career advancement.

Emerging Markets

In general, an emerging market is a market, which develops in a country, which is making an effort to change and improve its economy in order to raise it performance to, that of the world's more advanced countries. An emerging nation strives to make its "economy strong, more open to international investors, and more competitive in global markets" [9]. Because such markets are often in a state of transition, their social, political, and economic situations can change drastically and unexpectedly.

This paper does not address those emerging markets where the necessary infrastructure is not in place, IT is not accessible to the population at large, and the appropriate legal and regulatory framework to support its use is non-existent. Rather, this paper addresses those emerging markets that are in a relatively advanced state of IT adoption, one in which information technology and commerce are integrated.

Table 1: COUNTRIES WITH SIGNIFICANT EMERGING MARKETS

Argentina	Egypt	Israel	Nigeria	Russia
Brazil	Gulf States	Ivory Cast	Peru	South Africa
Chile	Hungary	Malaysia	Philippines	Thailand
China	India	Mexico	Poland	Turkey
Czech Republic	Indonesia	Morocco	Romania	Vietnam

Source: Emerging Markets Directory (2001).

An emerging market, as defined for this paper, is a market in a country that has a substantial element of free trade, industry self-regulation, relative ease of exports, and compliance with international standards and trade agreements. Some of the countries in Table 1 already have host country companies (as opposed to foreign firms operating in the emerging country) that participate in e-commerce, and thus have the necessary requirements to be deemed 'e-commerce ready'. These requirements include basic infrastructure and technology to enable connectivity (speed, pricing, access, market competition, industry standards, foreign investment); access to network services and information security (bandwidth, industry diversity, export controls, credit card regulation); use of the internet in business, government, and homes; promotion and facilitation (industry led standards); skills and human resources (information and communications technology (ICT) education, available skilled workforce); positioning for the digital economy (taxes and tariffs, industry self-regulation, government regulations, consumer trust); and an appropriate e-business climate (competition, political and financial stability, foreign investment, financial infrastructure) [6].

It is important to understand the socio-political and economic context of the market in which e-commerce is developed. No country will find itself in exactly the same state as another country - and differences need to be taken into consideration and accounted for. Issues that need to be taken into account on a per country basis include differences in the political culture, the nature of political organizations, leadership patterns and the extent of a country's/market's infrastructural, scientific, agricultural, industrial and commercial development [1].

Possible benefits of e-commerce

Much has been written on the benefits that e-commerce can potentially bring to emerging markets. First, one of the main advantages for small businesses and entrepreneurs on the Internet is their ability to now compete with larger organizations and multinational companies, although they may have no or limited inventory, no warehouses and but a few employees [4]. Large capital investments, innumerable staff and extensive multi-lingual transnational infrastructures are no longer requirements to be able to compete in the global arena of multinational firms. Moreover, e-commerce may improve productivity and enhance trade in emerging markets. Furthermore, according to Berry [4], transaction and communication costs are reduced, market potential is expanded, communications are improved, connectivity is increased and global reach is facilitated through the use of the Internet to conduct business.

A case in point of introducing the Internet into emerging markets is demonstrated by the efforts of Africa Online, the largest pan-African ISP [15]. As of March 2001, Africa Online had created a presence in eight African countries, by mid 2002 it plans to expand into Zambia, Nigeria, South Africa and Egypt. E-commerce, though not yet widespread in Zimbabwe has its takers: one individual, who has already bought a car online, plans to set up a business over the Web buying cars from Japan. Conducting business over the Web and shopping online can, in some cases, save a car buyer the sales tax, an amount often equal to the car's price [15].

In 1998, Brazil, Latin America's largest country in terms of size and population (165 million inhabitants), had the world's third highest number of Internet users; 9 million Brazilians have access to the WWW, there are twelve million Brazilian websites, and 2000 new domain names are registered every month. Brazil is an e-commerce ready nation and has become a world leader in information technologies; the country's telecommunications and computer industry has an annual turnover of $50 billion and Brazil invests 1.2 % of its GDP in research and development. This figure represents more than what the rest of Latin American countries combined spend on research and development [11].

Potential drawbacks of e-commerce

The other side of the coin cannot be ignored. There are legal, security and privacy issues that need to be addressed. For example, security measures need to be taken to ensure that data and systems are reliable and valid; the government role is important in easing constraints on electronic commerce, especially access to telecommunications. When organizations need to rely on foreign governments or business partners to provide access to the Internet, as well as to inventory, to shipping and delivery, to billing, and to customer service, problems may be compounded when dealing with emerging markets since, relative to traditional business organizations and models, e-commerce relies far more heavily on technology and business partners. Further, potentially problematic issues may concern consumer trust in e-commerce, security and privacy, the need for better security technology, more trained workers and lower training costs, less restrictive public policy, new business adapted to the information age, and issues related to the need for lower costs for e-commerce technology.

In South Africa, the government has been trying to adopt Western-style capitalism, and hence emphasizing protection for personal property, encouragement for entrepreneurial projects, and privatization of government-owned industries [19]. On a more dismal note, foreign direct investments have only reached $2.8 billion and the annual rate of growth of South Africa's national economy is only approximately two percent. However, there are already a number of Internet companies – the first step in setting up e-commerce capabilities.

Interlocking Directorates

Research on interorganizational relationships, such as joint ventures, networks, consortia, trade associations, and alliances has gained popularity in the last few years [17]. One specific type of interorganizational relationship that has been the topic of much research is interlocking directorates, defined as firms who share one or more board of director members. In fact, interlocking directorates have been the focus of research since the turn of the last century [10].

The first studies of interlocked directorates were conducted in Germany: in 1905, Otto Jeidels looked at the relationship between the German Big Banks and industry; in 1909, Hilferding associated the development of finance capital with the monopolization of industry, which needs a huge supply of funds for investment; Riesser in 1910 and Hagemann in 1931 published research which examined the relationship between banks and industry [10]. Stearns and Mizruchi [21] found a relationship between firms whose board of directors is interlocked with those of financial institutions and the amounts and types of financing the firms achieved. Similarly, Levine [13] looked at the relationship between boards of major banks with the boards of major industrials

In the United States, study of interlocked directorates emanated from public debate, was stimulated by the anti-trust movement and was sponsored and carried out by the government [10]. Mainly, this research was of interest to economists and congressmen. In the 1950s, interest in interlocked directorates shifted to sociologists, mainly those interested in organizational issues (for example, [2] [13] [22]). Topics that have been examined include the type of firm that is interlocked, the direction of the interlock between two companies, whether there is a geographical basis for the interlocking of directorates, and which type of director carries the interlock. Also, Allen [2] suggested that interlocking corporate directorates is a strategy for reducing sources of uncertainty in the environments of the associated firms.

Several theoretical orientations have been proposed to explain the interlocked nature of the American corporate system. The four sources of such theories are, namely, the management control theorists, the environmental control and reciprocity theorists, the financial control theorists, and the class hegemony theorists [20]. According to the management control theorists, the board of directors "is appointed by management essentially at will, and is used for advice, criticism, prestige, and to a minor extent, for business contact" (p.197) [20]. Environmental control and reciprocity theorists view interlocked directorates as mainly a means for management to facilitate cooperation to achieve mutual benefit, especially when scarce resources must be shared between several organizations. Financial control theorists view interlocked directorates as a way for financial institutions to control and manipulate investments; being interlocked with financial institutions helps to stabilize the environment of firms that are increasingly capital-intensive and for whom access to capital resources is uncertain. Finally, class hegemony theorists predict that interlocked directorates will be based on social ties and on class, as well as on ethnic background. Essentially, this orientation sees American upper-class participation in business through interlocked directorates as a way of promoting upper class cohesion, self-consciousness, and consensus on social issues.

Galaskiewicz [12] looked at the personal networks and attitudes towards clients of corporate giving officers; he found that the proximity of two officers in the professional network affected the way prospective investors were evaluated. Also, his research showed that job status and professional associations also had some effect on the knowledge and evaluations of giving officers.

Although the study of interlocked organizations has drawn its critics, such networks are still able to determine the network ties among firms and to provide significant insights into the behavior of firms [16].

In his study of 788 firms, Burt [5] found some support for his hypotheses that the ability of a firm to obtain unusually high profits is a result of its ability to create networks with firms in the economy's sectors that are most problematic for its industry's profits, and that firms should interlock with other firms in industries in proportion to the extent to which the industry is able to limit the industry's profits.

A study conducted by Mizruchi [16] showed that over seventy percent of the sample of 456 Fortune 500 firms had at least one member of the board of directors that sat on the board of a financial institution. A board can be made up of inside and outside directors. Inside directors are managers who serve as directors; their primary affiliation is with the firm, and usually includes the organization's CEO and other top officers. Outside directors are managers who are not full-time employees and whose primary affiliation is with firms other than the focal organization [20] [23]. When a board member of one firm is primarily affiliated with another firm, an interlock between those two firms is automatically created. It is important to recognize that these automatic links are not always the result of a conscious decision by management to link the two firms in question. Although such automatic, implicit or inadvertent interlocks are important, this paper focuses mainly on interlocks that are a result of explicit decisions from management to form interlocks between firms. Reasons that firms consciously create interlocks include legitimacy, cooptation, monitoring, and career advancement [16].

The following section examines prior research that has looked at the different reasons why firms have chosen to interlock their boards and attempts to provide some answers and direction regarding why an e-commerce firm in an emerging market may want to pay attention as to whether its board is interlocked and why it may even seek to interlock its board. E-commerce firms have been recognized as more uncertain, riskier and unstable than traditional firms. This uncertainty is compounded when placed in the context of emerging markets, which are also risky, less certain environments. While Mizruchi [16] reviews several reasons that firms engage in conscious interlocking of their boards, four of these may play especially significant roles in e-commerce firms in emerging markets, namely, legitimacy, cooptation, monitoring and career advancement. These four reasons will now be looked at in more depth.

Legitimacy

Perhaps the most important reason for firms in emerging markets to interlock is to seek legitimacy; before investors decide to invest in a firm, they must evaluate the firm's strength, potential, and quality of management. One way to evaluate these issues is by considering who sits on the board of directors, since the board plays an important role in the reputation of a firm. A firm that has individuals who have important ties to other organizations on its board sends a strong signal to potential investors that it is a legitimate firm worthy of support and investment.

Cooptation

Prior research in interlocking directorates has taken several different avenues. For example, Allen [2] and Warner and Unwalla [22] found that firm size (measured in terms of a firm's assets) was positively associated/correlated with the number of interlocks involving the firm. Financial institutions, especially banks, have more interlocks with other firms than non-financial firms have and as such are in the center of groups of firms in social network analyses [2] [13] [22]. These findings are in line with Burt's [5] notion of interlocked directorates as a cooptive mechanism. Burt [5] uses Selznick's definition of cooptation as "the process of absorbing new elements in the leadership or policy-determining structure of an organization as a means of averting threats to its stability or existence." Following from this rationale, one could expect firms to seek and establish cooptive interlocks with financial institutions in order to be in a position to secure financial resources when it may need them. By coupling the cooptive argument with the legitimacy argument, it is possible to see that since e-commerce firms are often in need of securing financial and other resources, a financial institution may be more likely to lend money to a firm if it is directed by reputable individuals and thus deemed legitimate.

Cukier and Faucon [7] describe a textile cooperative in Cameroon that is using e-commerce to sell its products. The company's initial investment came from a small financial institution rather than a commercial bank, since the firm lacked collateral and was seeking a level of funding too low to attract the larger banks. It is in a case like this that having an interlocked directorate with a financial institution may provide a wider array of alternatives.

Monitoring

Another reason that firms may use interlocked directorates is to monitor other firms; essentially, interlocks between firms can be seen as a means of corporate control [8]. Since the early 1900s, organizations have used board seats as a way of exerting control over the firm. It is not unusual for large stockholders, bankers and clients to expect to be represented on the board of firms; this is because they then will be in a position to control and monitor the firm. Furthermore, and to continue with the thread of financial institution examples (especially banks), several studies (for example, [18]) have found that bankers often join a board when a company is in financial difficulty. This seemingly demonstrates a firm's propensity to want to use representation on a firm's board as a means to monitor its operations.

According to Maman [14] societies in which business groups prevail (as opposed to the individual firm) such as Israel use interlocking directorates as an instrument to control and coordinate the firm in a group. This reasoning is in line with the resource dependence theory, in which firms depend on each other for resources [3].

With respect to e-commerce firms in emerging markets, it is important to recognize that although individuals who may seek representation on their boards may do so in an attempt to monitor the firm, they may also provide legitimacy to the firm in question and may even offer an instrument to carry out a cooptive strategy. As with many business relationships, this can be seen as a case of give-and-take.

Career Advancement

Concerning the appointment of a board member, the organization may invite an individual to sit on its board or the individual may choose to elect to sit on a firm's board. In the former case, an organization will usually seek individuals who will provide prestige to the firm as well as advice and valuable input. Firms also seek individuals who are "good citizens", and known to the corporate community as conscientious and non-controversial [16]. In this case, once again, the firm is seeking legitimacy by being associated with individuals who can provide it.

In the latter case, when an individual decides to join a firm's board, there may be an array of reasons, including financial remuneration, status and prestige and the establishment of potentially valuable contacts. Firms, especially those in emerging markets, need to carefully evaluate individuals who seek membership on their boards. It is important for firms to screen such individuals to ensure that they are the kind of individual that will add value to a firm and not detract from it.

E-commerce firms in emerging markets need to consider the composition of their boards, especially since the members who sit on the board may be valuable in terms of contacts, sources of legitimacy as well as resources.

Future Directions

This paper examined why it is important for e-commerce firms in emerging markets to address the issue of board of director composition. Specifically, it looked at issues of legitimacy, cooptation, monitoring, and career advancement. Future directions of research that could extend the theoretical perspective adopted in this paper are numerous. In order to conduct research on interlocked directorates, most often social network analysis is used. For example, using a social network methodological approach it would be possible to examine which firms are central and powerful in a network and hence to identify the coalitions that exist in the network. Recognizing these coalitions and identifying the firms involved is a tool that can be used to gain knowledge about anticipated resistance or support for action or change, be it in the area of new policy or new information technology adoption. Moreover, by studying the network of interlocked directorates, one could trace the diffusion of certain technologies and establish how much influence key firms have on the diffusion of information technologies.

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Managing Global Teams: How ICT Can Facilitate Team Communication and Performance

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Abstract

With the demands of globalization and integration among culturally diverse global teams (GT), communication is becoming a more challenging task, thus rendering information communication technology (ICTs) an indispensable tool. The questions explored in this paper are (1) how can global teams work most effectively, enhance team performance, and transfer the information they have across borders despite their cultural differences? and (2) in what ways can teams best utilize information technology to facilitate cross-cultural communication in a more efficient and effective way?

Introduction

Without a doubt, we are experiencing demographic and social changes, which affect the nature of work due to globalization. Many scholars believe that the rapid advancement of computer and information technology has, and will continue to have, the most intense impact on the way people work and live (Hakken, 1993; Howard, 1995). Many multinational companies (MNCs) are increasingly employing teams that transcend distance, time zones, and organizational boundaries known as 'global teams.' Lipnack and Stamps (1997) stressed that most people will work in global teams and the new form of boundary-crossing teams will be the working conditions of information age organizations. Global teams are used because they are considered to be a powerful tool to enhance organizational creativity and problem-solving capabilities. Also, global teams are increasingly becoming the decision makers in MNCs, addressing challenges that are broad in scope and essential to performance (Maznevski, & DiStefano, 2000).

MNCs such as Intel, Hewlett-Packard, and Microsoft are tapping the best talents of engineers from all over the world to work side by side with local teams to gain synergy and consequently increase competitive advantage (Zachary, 1998). The use of electronic mediated communication tools such as ICTs promote the growth of global teams even more. Microsoft uses virtual teams to support major global corporate customer sales and post sales services as do other organizations that service global clients with interdependent customer needs crossing national boundaries (Jarvenpaa, Ives, & Pearlson, 1996).

Working anywhere, anytime, and with anyone is the new reality of how business is conducted. ICTs become more prominent as they coincide with the demand for global teams in MNCs. Previously, the concept of the global village gave rise to greater face-to-face interactions of the global workforce from diverse cultural backgrounds (Zakaria, 2000). In the information age, the opposite is true. Not only are people able to communicate and collaborate without the need to meet or interact face-to-face, they can do so through time and space. What is new about this form of teamwork and communication is the mediation of team-support technology. Nonetheless, the basic nature of teams, as well as the challenges of managing those teams, will remain demanding and complex. In fact, Zack & Serino (1996) note that, "the real challenge for global teams is to learn how to use the technology-enabled capabilities to enhance performance beyond that of traditional teams."

Our paper examines the challenges that surface when global teams use ICTs. There are three main objectives:

a. To understand the challenges global teams encounter from a cross-cultural perspective.
b. To understand how the global teams are impacted by the use of ICTs.
c. To understand the role of ICTs in facilitating the process of global team communication.

What are Global Teams?

The first question to ask is, what are global teams (GTs)? Are GTs similar to or different from multicultural teams? How about virtual teams? It is important to be aware of the differences in these definitions as they often overlap, which can lead to confusion. Global teams are defined as "a team that is comprised of individuals located in many different countries or geographic areas and team member differ in their functionality, which adds complexity to the group dynamics" (Wheatley and Wilemon, 1999). The main idea behind this concept is that people are geographically dispersed and functionally diverse. Conversely, traditional teams are people that work collaboratively but usually are located in one location and may or may not be functionally different. Mono-cultural teams are people that share the same or at least similar national cultures. In this paper, a global team is defined similarly to a multicultural team with assumptions: (1) teams are comprised of people from diverse cultural backgrounds and, (2) geography boundaries exist.

A virtual team, on the other hand, is defined as "a temporary, culturally diverse, geographically dispersed, electronically communicating work group" (Kristof, Brown, Sims Jr., & Smith, 1995). The notion of "temporary" describes teams members who may have never worked together before and who may not expect to work together again (Jarvenpaa & Ives, 1994; Lipnack & Stamps, 1997). A virtual team is considered global when their backgrounds are culturally diverse, and they are able to think and work with the diversity of the global environment (DeSanctis & Poole, 1997; Jackson, Aiken, Vanjani & Hasan, 1995). Global teams are also sometimes referred to as heterogeneous and electronic groups, while traditional teams are homogenous and non-electronic groups. In summary, this paper will use the term global teams to represent the meaning of both multicultural and virtual teams. Global teams include three main characteristics: team members with diverse cultural backgrounds--comprised of heterogeneous members, work across geographical/national boundaries, and the use technology to facilitate communication and collaboration.

The Effects of National and Work Culture

Historically managers have not always acknowledged the effects of national culture on management (Shea and Lewis in Szewczak and Khosrowpour, 1996). For example, when setting up an organization in the US, American managers tend to structure the management system according to their own cultural norms, developed out of their common practices. But with the rise of MNCs, or setting up a branch in foreign countries, the same cultural assumptions may no longer be applicable. Thus Shea and Lewis proposed that "societal factors such as culture must be explicitly considered for effective operation of the organizations, and the cultural environment in which a firm operates has a significant impact on information use" (p.257).

Apart from national culture, organizational culture has a strong effect on management systems. Organizational culture is embedded in the national cultures in which the organization operates. Although both cultures play different roles, each influence the way things are operated in MNCs. Thus, both factors need to be considered, especially in the context of global teams using ICTs. To better understand organizational impact on teamwork, some pertinent questions need to be addressed: Does the organization support teamwork? Does the organizational culture support the use of ICTs? Do team members willingly exchange and share their work with the use of ICTs? How much of a global team's use of information technology is directly reflected in their existing work culture? In order to address these questions, one must recognize the complexity, range, and distinctiveness of corporate cultures. By definition, organizational or corporate culture includes the values and beliefs expressed in artifacts, symbols, and practices as well as organizational language, traditions, myths, rituals, and stories. As

Schein (1999) views it "… it is the way we do things around here. In essence, corporate culture is the learned, shared, and tacit assumptions such as values, beliefs, and assumptions" (1999, p.48). Hence, organizational impact varies greatly on ICT usage by global teams – it may act as a barrier or restraint to ICT usage or provide the necessary support in regards to technology, infrastructure, and organizational culture, to actively foster it.

Managing Global Teams

Global teams evolve differently than do traditional face-to-face teams. As a result, different solutions and ways to manage them need to be developed. Duarte & Snyder (1999) emphasized that technology is only one of the critical success factors for virtual teams. In fact, virtual teams and their leaders seldom claim technology as the primary reasons for success or failures (Nunamaker Jr., O.Briggs, Romano Jr., Mittleman, 1997). Virtual teams that are also global in member composition raise additional challenges in their management The preparation of global team members, individually and collectively, to effectively communicate cross-culturally is a prerequisite to successful collaboration and is as important as the team's technological competency and skill.

Proliferation of international business necessitates organizations to provide adequate and appropriate cross-cultural training to all its members (Zakaria, 2000). The purpose of this training is to help people recognize, adapt and adjust to a culturally diverse work environment. In regards to global teams, cross-cultural training also addresses and educates members about the cultural differences that they face through electronic communication. Training should make clear to the team that cross-cultural communication (electronic or otherwise) does not require a total transformation of behavior to suit cultural differences but does demand an ability to work within a culturally diverse framework.

Although using ICTs could reduce cross-cultural barriers, people still need training in order to provide them with the desired cognitive, affective and behavioral competencies (Chen & Starosta, 2000). With adequate knowledge, and training, possible international blunders could be avoided, thus minimizing the frustrations and discouragements endemic when collaborating.

The Need for Intercultural Communication Competence

It is imperative for global teams to inculcate global communication skills to enable them to collaborate effectively and enhance their functioning over the period of time they work together. As suggested by Schrage (1990), communication is not the only factor that influences collaboration, yet communication is a prerequisite to effective collaboration. The diverse nature of global teams accentuates the issue of cultural differences. Thus, communicating between and within teams requires people to be fully aware of and to be sensitive to their cultural differences and/or similarities. In order to overcome the differences and take advantage of the similarities within global teams, people need to have intercultural communication competence to enhance their communication behaviors (Zakaria, 2000). This competence requires people to have the ability, skills or knowledge about the cultures in question. According to Chen and Starosta (2000), there are basically three competencies required—cognitive, affective, and behavioral. These competencies respectively mean that people need to understand and recognize cultural differences; feel comfortable with various cultures; and thus act accordingly to suit cultural differences. Furthermore, Wiseman & Koester (1993) conceptualized this competence as culture-specific understanding of other, culture-general understanding, and positive regard of other.

To gain this competency a global team, individually and collectively, must develop a global mind-set. Having a global mind-set means global teams are open-minded, embed appropriate behaviors, and are sensitive to the divergences they encounter during the communication and collaboration processes. It is not only in the mind-set, feelings and behaviors must support what a person thinks. So, all in all, people need to free themselves from any misconceptions, preconceived notions, and ill feelings that would lead to failure in understanding cultural differences. Instead people need to be positive, more willing to learn, be tolerant, and most importantly be patient.

The Use of Information Communication Technologies

Technology is simply a tool that needs human operations. No matter how sophisticated the technology can be, the implementation of technology has the potential to fail if insufficient considerations are given from the user perspectives. User considerations include training, user interface, and user competencies. Moreover, collaboration and electronic mail software need to be sturdy enough to handle large volumes of data and software applications must be interface reliably (Igbaria & Tan, 1998). To date, there are many types of information technology that enable people to communicate without the constraints of geography boundaries. Abdul Karim (2001) uses the term information communication technology to represent all types of electronic technology that mediate human communication, collaboration, and coordination, which simultaneously incorporate tasks such as data mining, knowledge management, workflow management, etc., across temporal and spatial boundaries. It is a broad reference to electronic systems that integrate both software and hardware (Khoshafian & Buckwitz, 1995). There are synchronous groupware, such as video conferencing, audio conferencing, electronic display, and electronic meeting systems, while asynchronous groupware are e-mail, bulletin boards, web pages, non-real time database sharing, and conferencing.

For instance, terms like GroupWare, computer-supported collaborative work (CSCW), teamware, electronic meeting system (EMS), group-support system (GSS), computer-mediated communication (CMC), and group decision support systems (GDSS) are commonly used to highlight the use of any form of computer mediated communication. Our paper decides to use a generic term, ICT, to illustrate the same basic understanding and meaning of all the available electronic communication technology. The most important concern is the specific features of technologies, which constitute anonymity, language, and interface options that may have an effect on group meetings and their outcome (Scott, 1999).

Significance of Global Teams

From the above discussion, we realize that organizations in the new millennium have the capacity to reshape and transform traditional teams into global teams. Teams consist of people from different background, attitudes, perceptions, and beliefs. Whether they are domestic or global, both types of teams experience some degree of individual difference and conflict. In global teams, the barriers can be larger because of national differences. Teams of people from Malaysia, the USA, Britain, Germany, Japan, and France are more complicated to deal with than teams of people from New York, Nebraska, Massachusetts, and California.

We now examine how this new form of team can benefit or hinder MNCs by examining the advantages and disadvantages of GTs. In understanding the significance of global teams, it is useful to note that while advantages can benefit the MNCs, disadvantages can help MNCs recognize certain problems inherent to a cross-cultural, geographically diverse employee base.

Potential Advantages of Global Teams

- Create cultural synergy
- Enhance creativity and cohesiveness among team members
- Better acceptance of new ideas
- Gain competitive advantage

Possible Disadvantages of Global Teams

- Ineffective decision--making process
- Creates stress and conflicts among team members
- Miscommunication and misinterpretations

The Role of ICTs as a Facilitating Tool

Traditionally, managers traveled great distances to be present at a meeting, or to close a deal. The fact is, without the use of any kind of communication technology, traditional teams need to be in one location to communicate and work collaboratively. Hence, matching meeting time with location is a common problem for MNCs. As McGrath & Hollingshead (1994) point out, "groups using electronically enhanced communication systems could transcend the time and space constraints that burden groups who usually meet face-to-face" (p.4). With the use of communication technology, mobility and flexibility become the essential attributes to global teams' success. People can be thousands of miles apart and still be able to work as efficiently and effectively as traditional teams.

It is useful to note that our paper does not focus on which technology is used, whether it is asynchronous or synchronous mode; but it primarily attempts to understand the role and impact of ICTs' use on global teams. Some useful assumptions were made by the study of McGrath & Hollingshead (1994) in regards to the effects of electronic technology on work groups which are: (1) improved task performance, (2) elimination of space and time constraints, and (3) increased access to information. These assumptions fit very well with the concept of global teams in our paper. Furthermore, we propose that the use of electronic communication technology has the capacity to overcome

or reduce cultural differences within global teams. Yet, we are not proposing that ICTs will totally eliminate the cultural differences of team members. Merely that ICTs facilitate intra-team interaction by introducing a shared framework and virtual work setting. In that light, the role of ICTs is regarded as a *functional* tool that will facilitate the cross-cultural collaboration and communication.

ICTs can promote cross-cultural collaboration and communication by providing a common medium for work and shared meaning. ICTs also can foster interdependence between less and more powerful team members and promote equality of participation (Strauss, 1997), reduce organizational hierarchy (Kock & McQueen, 1997), and generally enhance member participation in virtual meetings compared to face-to-face meetings (Bikson, 1996; Sheffiled & Gallupe, 1994; Slater & Anderson, 1994; Williams & Wilson, 1997). Global teams that exclusively use ICTs exclude social or physical presence; rely on a depersonalized form of communication between team members (Ketrow, 1999). Over time, the exclusion of social and physical presence can foster positive intra-team coalitions and strengthen working relationships that would be less likely to thrive in a more traditional team framework. However, initial relationship building between members faces more challenges, as does the establishment of intra-team trust. Jarvenpaa, Knoll, and Leidner (1998) posit that virtual teams have no time to gradually develop trust and therefore require a high degree of "swift trust" to be demonstrated by enthusiastic and proactive team member behavior. The absence of non-verbal cues may pose certain initial difficulties for some whose culture rely on body language, gestures, facial expressions, and proximity (Farmer & Hyatt, 1994). For example, in high-context cultures, people in general value subtle and indirect speech when communicating. Visual cues such as a nod, smile, posture, voice, and eye contact provide important indications and meanings to establish certain understanding of what is communicated by another person. Without these cues, it may be initially difficult for these people to carry out tasks as complex as making decisions to as basic as communicating. "Low social presence generally is unsatisfying and leaves people in some situations, such as those involving conflict, unable to resolve differences effectively or meet their goals" (Ketrow, 1999, p.272). The challenge for high-context people is the difficulty in establishing trust and relationships with the diverse team members because they do not have enough verbal cues. As Rosa & Mazur (1979) concluded; "…when a group is composed of strangers, they very quickly make use of whatever limited status cues are immediately at hand, even such subtle signs as eye contact and speaking order." Thus the impact of ICTs can be exacerbated by the lack of both elements, which further intensifies the communication challenge of global teams. For global team members from cultures that value directness and informality, ICT usage can promote dialogue since it already fits within their own cultural framework. The absence of physical cues may actually promote understanding when intra-team trust has developed, as they will not be faced with potentially confusing dissonant cultural cues from culturally diverse team members.

Not all people favor the 'cyberspace' notion of working. The absence of face-to-face interaction with ICT use eliminates most verbal and social cues, which can be intimidating for members from certain cultures. Thus, in selecting team members, some attributes or characteristics are worth considering such as: open-mindedness, a willingness to learn, those who favor challenging and new environments, an ability to acculturate, and those who are competent in using ICTs. Experience working in a virtual or global environment is also important. Besides retainable recruits, an attractive reward systems must also be developed to recognize people working across boundaries and working virtually. Rewards must clearly corresponding to the performances shown by team members because this can be a key motivation factor to some team members.

Advantages of ICTs

- Greater anonymity of team members
- Transcend space and time
- Access to wider and faster information sources
- Allows equal participation
- More flexible communication structures
- Better information retrieval and repository

Disadvantages of ICTs

- Lack of communication modalities such as non-verbal or verbal cues
- Implementing ICTs are costly
- Differences in technologies used
- Slower decision-making

Managerial Implications

Creating and managing effective global teams are daunting managerial tasks. Group collaboration is a complex matter, with or without electronic technology. Geographic, linguistic and cultural diversity further complicates intra-member interactions and group cohesion. As the reality of global village sets in, the issue of interactional complexity needs to be addressed more by teams due to cross-cultural communication, as well as diversity within cultures (Glenn, 1981). McGrath & Hollingshead (1994) further assert that collaboration is more than simply the notion of information exchange. It involves cognitive, affective, as well as the motivational aspects of communication. In our paper, there are significant managerial implications as we anticipate that more complexities and challenges will emerge when we integrate the issue of ICTs use with the culturally diverse nature of global teams, such as: Do ICTs enhance the process of intercultural communication within global teams? Do ICTs promote more effective ways of working and enhancing a team performance? Can ICTs help reduce the cultural barriers that often exist between and among global teams?

Deploying ICTs intensify the challenges of global management, whether it be team-based or not. For example, ICTs can shape the way people perform their tasks in organizations, as much as ICTs can impact the way people communicate and collaborate globally. Without a doubt, we are focusing on new ways of working across borders. ICTs are not just simple tools, instead they need to be integrated and aligned with team design, behavior, and process of new ways of collaborating and communicating. Gallupe, Cooper, Grise & Bastianutti (1994) showed that without anonymity, parallel input, and brainstorming memory input, electronic groups performed more poorly than non-electronic groups. Can we then say people are actually comfortable communicating using ICTs? Basically, many studies have shown that using ICTs can enhance communication, while other studies have shown that some people still prefer face-to-face interaction.

Global teams cannot be viewed merely as traditional teams that are geographically dispersed - in creating and in maintaining global teams, managers must recognize that different skill sets are required by individual team members and by the team as a whole. Group cohesion remains much more of a problem for virtual teams in comparison to traditional teams. Despite the ease of communication with ICTs, studies have shown that teams that wholly rely on virtual communication, replacing all face to face communication, report less satisfaction with group interaction (Warekentin, Sayeed, and Hightower, 1998). Research on both virtual teams and global teams indicates that team members face very different challenges than do their counterparts in traditional teams. They are more likely to experience information overload, social isolation and uneven power distributions – domination of certain group members over others - within the team (Rogers and Albritton, 1995). Seemingly, this last observation challenges the notion that ICT usage actually diminishes reliance upon organizational hierarchy and levels power-distance relations between members. However, it may indicate that the authority of traditional roles and power relations diminish but that power dynamics between members of virtual teams continue to exist and influence group structure. How intra-group power dynamics develop and how they impact team cohesion and work effectiveness may depend on whether the team member or members exerting control are recognized by the team as in a legitimate leadership position within the team.

At times, the emergence of leaders is ambiguous in the electronic communication setting. In certain situations, leaders can be team members or more frequently, tend to be managers outside of the global team. Leaders need to be open to changes, supportive of global teams, and most of all encourage team members to communicate effectively. Leaders play the role as facilitators, as well as intermediaries in the event people face difficulties to send and receive the intended messages across the borders. Since ICTs eliminate the verbal and social cues that are prerequisite to certain cultures, leaders must help team members build and maintain trust, ease the transition process, select and use appropriate electronic communication and collaboration technologies, and coach and manage performance without the traditional forms of feedback (Duarte & Snyder, 1999).

Global teams must develop alternative ways to create trust and maintain group unity, whether that is through virtual socialization and/or through a variety of strategies to foster effective communication and collaboration (Jarvenpaa, Knoll, and Leidner, 1998). Intra-team communication becomes more effective if multiple communication media, such as email, fax, telephone, video conferencing, etc., is used by team members (Gayand Lentini, 1995). Using multiple channels of communication also contributes to group cohesion and enhances collaboration overall.

Conclusion

With a positive note, ICTs will increasingly play an important role in helping teams move beyond the constraints of the face-to-face context. It can be expected that ICTs have the capacity to greatly enhance global teams' collaboration and communication efforts and processes. Mobility of information and flexibility of informational transmission processes are the two fundamental concepts that will reshape the traditional teams to global teams. Thus, preparing team members for the challenges that they will encounter in the international arena, rewarding, and reassuring them for their successful efforts are some crucial responsibilities global managers need to fully understand and implement effectively.

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Managing Virtual Enterprises

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Abstract

The Internet has given rise to immense possibilities of collaboration between different business entities, leading to "The Virtual Enterprise ". A virtual enterprise is a collection of geographically distributed functionally and/or culturally diverse entities that are linked by electronic forms of communication and rely on lateral, dynamic relationships for coordination. It allows each individual and unit to remain independent and continue to pursue their own growth and development while simultaneously ensuring that their activity helps further strengthen the stated mission. This paper proposes a model of a virtual organization, discusses the application of this model in the manufacturing sector and extends these concepts for providing a novel approach for a virtual organization in the service sector. The paper also highlights some of the success factors for a virtual organization and indicates the scope for future research work in this area.

Introduction

We live in a world that has changed rapidly in the past five years. Internet-based electronic business is booming and is expected to rise from the current level of US $26 billion in world wide revenue to about US $1 trillion by 2005 (p 12, OECD, 1998). This is due to the huge growth in the Internet use worldwide.

The growth of electronic business can be attributed to many business drivers. With the prices of real estate going up, business enterprises are finding it hard to invest precious resources in huge physical infrastructures. The dynamics of the market place are becoming extremely fluid with a significant rise in the power of the customers forcing organizations to incorporate flexibility and agility in there functioning to the extent which could have never imagined before. Organizations, once co-located for reasons of efficiency and management, may now be geographically distributed because of a significant decrease in the cost of co-ordination associated with the Internet era. This has given rise to immense possibilities of collaboration between different business entities with the barriers imposed by size, scale, geography etc reduced by a significant extent with the rapid advent of eBusiness. What we are moving towards now is the "The Virtual Enterprise ".

A virtual enterprise is a collection of geographically distributed functionally and/or culturally diverse entities that are linked by electronic forms of communication and rely on lateral, dynamic relationships for coordination. It knits individuals, organizations and units into a single unified mission, so that they think and work together just like a single large organization. The virtual organization allows each individual and unit to remain independent and continue to pursue their own growth and development while simultaneously ensuring that their activity helps further strengthen the stated mission.

Despite its diffuse nature, a common identity holds the organization together in the minds of members, customers, or other constituents. The virtual organization is often described as one that is replete with external ties [8], managed via teams that are assembled and disassembled according to need [12][17], and consisting of employees who are physically dispersed from one another [7][1]. The result is a "company without walls" [11] that acts as a "collaborative network of people" working together, regardless of location or who "owns" them [2][12][14]. As an example, take Barclay's virtual global bank [18]. This entity is a new global network created by linking together extant networks of smaller, regional banks. Customers of the regional banks now have the feel of being a part of a large global bank because electronic media bring them the worldwide services of Barclay, though they remain members of the smaller, regional banking entity. In this way, tensions between global and local are reconciled, and smaller groups or firms can exist within larger entities and realize their advantages [20]. Thus, virtual organizations can help extend the power and reach of individual units and people to a larger canvas or national level without adding resources or burdens.

To summarize, the components (individual workers, teams, departments, units or firms) that make up a virtual organization are geographically distributed, functionally or culturally diverse, electronically linked, and connected via lateral relationships. These attributes enable the organization to dynamically modify business processes to meet market demands, to coordinate via formal and informal contracts, to define the boundaries of the firm differently over time or for different customers or constituencies, and to re-arrange relationships among components as needed. Figure 1 summarizes the attributes of virtual organization and the implications for organization design. It is important to note that these attributes can be applied to employee-employer relationships, to teams, to firms, and to inter-organizational arrangements.

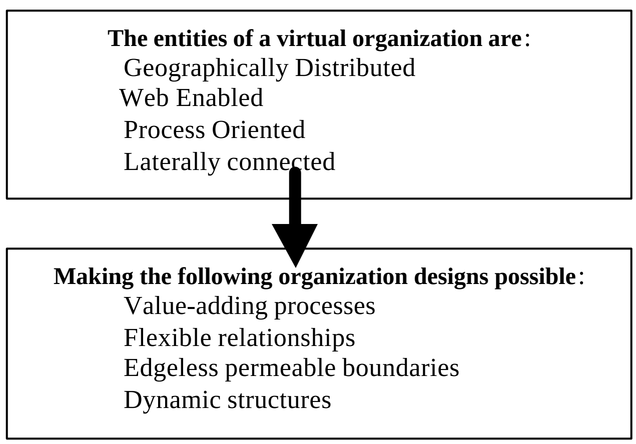

Fig.1. SUMMARY OF THE ATTRIBUTES OF VIRTUAL ORGANIZATION

A lot many articles and papers have been written on what these virtual organizations are, focusing specially on the manufacturing sector. But little is known about their presence in the service sector and how these organizations work. This paper describes a framework for the analysis and strategic management of virtual organizations in the service sector, sectors like virtual consultancies, virtual health care management system, virtual financial management system etc. The paper begins by discussing the need for virtual organizations. We introduce a generic model for virtual enterprise and show how the management of virtual organization takes place in the manufacturing sector. Drawing the learnings from the manufacturing sector we discuss the model of virtual organization in the services sector and how it can be managed. We have also highlighted some of the critical success factors for this organizational form to succeed. We finally conclude with a theoretical and research agenda for future work.

Need for Virtual Enterprise

Need for Global Markets

With growing competition, the need of the hour for the companies is not to confine themselves to their national boundaries alone, but to mark their presence on a global scale. As companies expand globally, face increasing time compression in product development, and use more foreign based subcontracting labor [22][26], virtual teams/enterprises promise the flexibility, responsiveness, lower costs, and improved resource utilization necessary to meet ever-changing task requirements in highly turbulent and dynamic global business environments [21][25]. The concept of virtual implies permeable interfaces and boundaries, project teams that rapidly form, reorganize, and dissolve when the needs of a dynamic marketplace change, and individuals with differing competencies who are located across time, space, and cultures [16][21].

For companies the focus has changed, from primarily keeping a narrow customer base to expanding their search for potential customers worldwide. This develops a need for the companies to be present near its customers, not only to capture the consumer behavior but also to cater to their needs at the earliest. In such a scenario, moving towards becoming a virtual organization can prove to be the best solution.

Growing competition necessitates highly efficient and flexible organization

The single biggest change we see in business practice today is the need for speed. Either an organization moves, or it gets run over. Consequently, any tool we can use to make our organizations more agile adds directly to the bottom line.

In this era of speed and efficiency, no company can afford to be rigid in its operations and structure. This demands companies to move towards forming a virtual organization, which not only brings flexibility in their organization structure, but also felicitates easy addition/ deletion of human resource strength and need for quick retraining and redeployment. The Virtual Organization has the potential to be more proactive than a traditional organization. Access to information, and people, through the resources of the technology-enabled organization make it a far more nimble entity, able to act and set market direction, rather than react to market changes.

Need for adopting innovative practices

Success in appealing to desirable market segments so as to maintain visibility, create defensible market positions, and forge institutional identity is considered to be a central key to survival and growth for business in the new electronic marketplace. In short, the key to success is Differentiation.

Setting up and managing a Virtual Organization brings out the very best that a company has to offer: skill and expertise at working with internal customers to meet changing requirements, evaluating and selecting strategic partners with capability to meet them, and managing relationships with these partners to streamline buying processes and control costs. Thus the enterprises are focusing more on the concept of outsourcing, resulting in reduced cost and improved performance. Further, it also helps them offer a much bigger basket of product/service mix to the customers.

By concentrating on their core competences and outsourcing other activities, managers can leverage their company’s resources in four ways: they maximize returns by focusing on what they do best; they provide formidable barriers against the entry of competitors; they fully utilize external suppliers’ strengths and investments that they would not be able to duplicate; and they reduce investment and risk, shorten cycle times, and increase customer responsiveness [19].

Innovative practices by enterprises helps give them an added advantage as compared to their competitors. Innovation at Citicorp generated many new products that were used to new clients and to cross-sell to existing clients. The bank employed a generic brand name prefix “Citi” with its new products (eg., Citicard, CitiTeller). This practice branded generic products and proved that Citicorp provided an innovative, one-stop shopping service for all needs of the customers that could be reported on one unified financial statement [19].

Need for forming vertical and horizontal alliances across national boundaries

Organizations linked on a long-term basis by joint ventures, contracts, franchises, projects and alliances create globe-spanning networks that " are able to mobilize resources and pursue opportunities more effectively than even giant firms unaffiliated with such networks" [13]. Microsoft uses virtual teams to support major global corporate customer sales and post sales services as do other organizations that service global clients with interdependent customer needs crossing country boundaries [15]. VeriFone, a multinational company, is reported to rely on teams that interact electronically to run its everyday business. Company management, including its top executives, are distributed geographically [27].

Another form of cooperation that can be advantageous to Virtual Organizations is the "information partnerships" where information, research, and other data are shared with other firms. The firms can share investments in hardware and software and reduce risks in " cutting-edge" technology investments.

Savings in cost (includes real estate cost), time, energy and other physical resource utilization-

The single biggest expense in holding a symposium is logistics. Ticket prices, meals and accommodations account for two-thirds of the travel costs associated with a major conference. Considering that the goal is to foster communication, and the transfer of information, the fact that only one-third of the expenditures are used towards that end means that we have a relatively inefficient process. Moving information, instead of people is the ultimate goal for cost savings.

Today, busy professionals have little time to update their skills, yet this is one of the most important steps a business can take to stay competitive. The costs associated with professional development can be lowered, and the schedule pressure reduced by conducting this type of training in a virtual fashion. Web based courses with instructor interaction via video teleconferencing converts the desktop into a virtual classroom, without sacrificing the instructor-student interaction. One of the most interesting aspects of this type of training is that it can be implemented incrementally, and that a training course, once implemented in multimedia interactive presentation technology is easy to update.

A Generic Virtual Enterprise Model

Based on the definitions and concepts of a virtual organization discussed so far, we have developed a generic model of virtual organization (see Fig. 2). In the center of the model is the "main organization" and all its partners are connected to it through web or other networking technologies. Each entity involved in the model has three layers: (i) Web- Enabled ERP (ii) IT-Driven SCM and (iii) eCRM.

The partners in the model include suppliers, distributors, outsourcing partners, strategic alliance partners, professional organizations, regulators, end-customers, and all other stakeholders of the main organization. A close relationship with suppliers, distributors, professional organizations, and customers et al yields several benefits. The firm and partner can identify opportunities for mutual benefit (just as joint cost reduction by removing purchasing and sales functions or off-peak scheduling). Ideas for new product development or execution of rapid design changes needed in a product can originate from the suppliers. Professional organizations can provide superior talent. Regulators can facilitate and hasten product or manufacturing quality approvals. Distributors can provide market access and customer information. Customers can suggests new competencies that the firm should develop [19]. One of the added advantages of the virtual organization is that it can easily overcome language barriers because the customers can gain access to the partner of virtual organization that is closest to his/her location and culture. This leads to enormous savings in training as well as development of various customer interfaces.

Developing close relationships is important in the global environment. Firms can leverage their international distribution reach. A strong relationship with a local partner can be used to leverage a firm's other assets internationally. Firms can also reduce their financial foreign outlays by conducting international business through close relationships with other organizations instead of through creating and operating subsidiaries abroad. Siemens produces large capital equipment goods such and markets these high-ticket items in over 120 countries. Siemens close relationship with various German banks provided Siemens with ample, low-cost financing for its customers, enabling the firm to make international sales to many countries. Siemens' international competitors based in other countries may not have this close relationship with their banks and cannot exercise such a financial advantage.

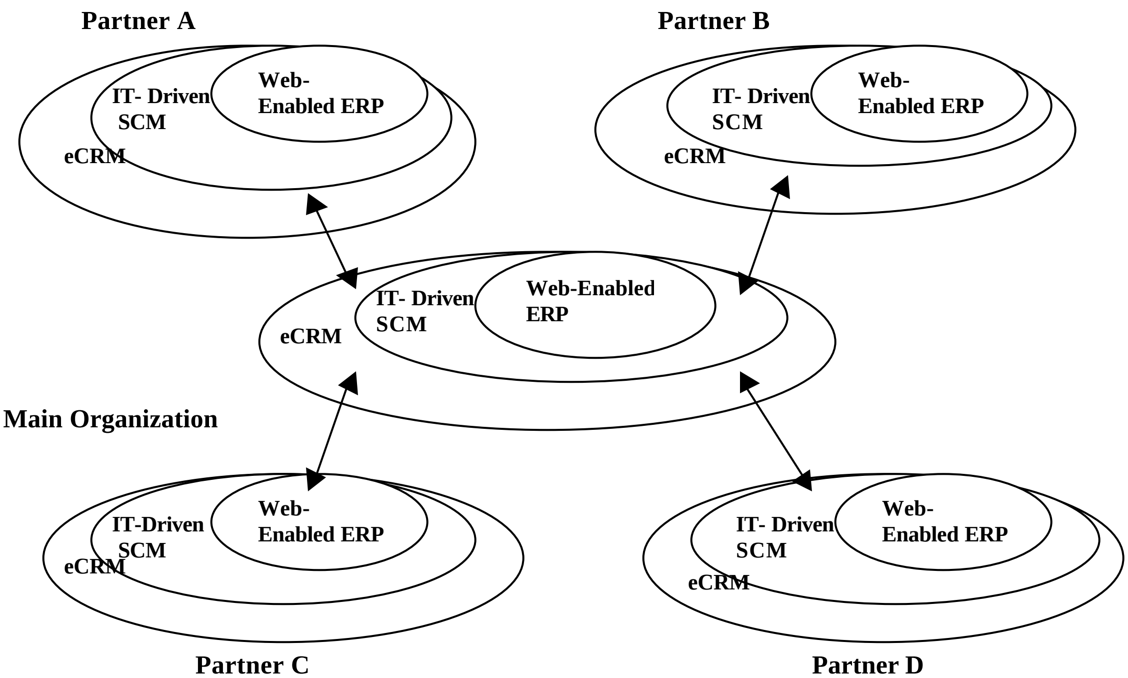

Fig. 2. A VIRTUAL ENTERPRISE MODEL

To forge such strong bonding and relationships among the main organization and all of its partners, the three layers of processes in each constituent of the virtual organization are as follows:

Web-Enabled ERP

A web-enabled Enterprise Resource Planning (ERP) system is software designed to model and automate many of the basic processes of a company, form finance to the shop floor, with the goal of integrating information across the company and eliminating complex, expensive links between computer systems that were never meant to talk to each other [6]. Such systems can help organizations in addressing needs like reduced cycle time, reduced inventories and sharing information seamlessly across the organization. Although the benefits of web-enabled ERP are manifold, businesses are adopting this technology, primarily because they provide a source of competitive advantage**.** Such systems are central to a virtual organization since they help in help in achieving integration with the other two outer layers and also amongst the other partners of the organization.

IT-Driven SCM

Supply chain management is the management of the flow of material and information through the supply chain. This is a complex process requiring the coordinated efforts of countless knowledge workers distributed functionally and geographically.

E-Supply Chain includes Web-based applications focused on managing the interfaces among knowledge workers within and among enterprises in the area of supply chain management. Keeping material and information flowing through the extended value chain is the prime objective of e-supply chain collaborative applications. IT-Driven SCM has reached global proportions, thereby pushing the limits of the meaning of virtual. Virtual supply chains deliver products and services to customers by breaking conventions of time and apace. Modular consortia factories provide a significant departure from the conventional relationships that manufacturers have with their suppliers. Virtual supply chains can be constructed using the internet to connect globally dispersed suppliers, customers and other supply chain stakeholders such as freight forwarders. The collaborations of virtual supply chain are of two types:

(a) **Supply-side collaboration:** This is an example in which supply chain players are interested in improving the flow of material among enterprises and their suppliers and will do so by synchronizing schedules, providing visibility into each other's manufacturing environments or even by allowing suppliers to assume responsibility for placing actual replenishment shipments.

(b) **Demand-side collaboration**: In this scenario, suppliers are looking to improve their planning processes, and increase customer service by speeding up the order entry process and giving customers the ability to evaluate early on the feasibility of their orders. The customer can access the supplier's browser-based order-entry system. The customer could place orders on the system, which would dynamically update the supplier's view of customer orders. The customer would also be able to track the progress of the order the customer submitted.

eCRM

In simplest terms, eCRM provides companies with a means to conduct interactive, personalized and relevant communications with customers across both electronic and traditional channels. It utilizes a complete view of the customer to make decisions about messaging, offers, and channel delivery. It synchronizes communications across otherwise disjointed customer-facing systems. It adheres to permission-based practices, respecting individuals' preferences regarding how and whether they wish to communicate with you. And it focuses on understanding how the economics of customer relationships affect the business.

The critical success factors of a virtual organization are development of global standards and installing uniform IT facilities across all the constituents. Development of global standards can be achieved by maintaining common definitions: benchmarking performance data and distribution of best practices. The key to achieving uniform IT facilities lies in formulating an appropriate IT strategy and planning. A related issue deals with IT deployment in all aspects of all the organizations and the necessary change management initiatives required for the same.

Virtual Organization In The Manufacturing Sector

In essence the virtual organizations go beyond the normal supplier manufacturer-customer model. They also include the customers' customers and the suppliers' suppliers. In addition the manufacturer is viewed as a modular consortia, which can be changed with the changing needs of competition and price. The essential ingredients of such a virtual organization are best exemplified by Cisco's business systems [23]. Cisco does not stock finished goods but uses web-enabled systems to quickly communicate the information about its products with its business partners. Cisco has developed an IT-driven supply chain model that connects its 32 manufacturing plants worldwide, 30 of which are not owned by Cisco. Cisco uses a web-enabled ERP from Oracle to collect orders and send them to one or more of their assembly vendors. The ERP software of all the vendors can interoperate with Cisco's ERP and SCM systems. Cisco has also developed an in-house e-commerce system to communicate with all of its resellers and maintain excellent customer relationship. The company has declined the number of call centers to further consolidate its customer relationship management system (eCRM). With this eCRM system, orders can be routed directly to the distributor's ERP system. In this way Cisco has effectively used the web-enabled ERP, IT-driven

SCM and eCRM systems not only to integrate its activities but also to provide effective communication and coordination with all of its business partners for forming a virtual organization.

Virtual Organization In Service Sector

The virtual organization model for the manufacturing sector, as briefly described above in the Cisco example provide a number of lessons that can be extended to the service sector. First, it is not necessary for the main organization to own all the core competencies required for it to do business. Second, there is no limit in time and space for the size and operations of the organizations. Third, the customer is the key component of the organization that determines the overall character and composition of the organization. As an illustration of this concept in the service sector, the concept of a Virtual University is described below.

The partners in a virtual university include students, teachers, course content developers, industry recruiters, strategic alliance partners (colleges and education institutions spread across the world), professional bodies, regulators, and all other stakeholders of the main organization.

The virtual university can offer as many programs and courses as is done by any conventional university. However, the main difference is that the various departments of the virtual university are spread worldwide depending upon the availability of the competence and expertise for offering a particular program. A student of the virtual university can undergo a program/ course in any partner of the main university without realizing that he is getting his requirements fulfilled from a different institution other than the main university. The activities and operations of the virtual university are integrated by the three layers of the virtual organization model (refer Fig.2).

The web-enabled ERP system takes care of activities pertaining to enrolment, attendance, scheduling of programs/ courses, maintaining a database of study material and courseware and other such administrative aspects of the university. The eCRM layer facilitates receiving feedback from the students, maintaining and improving the overall standard of the various programs and provides a forum for online interaction and facilitating answering of queries pertaining to administrative and academic aspects of the virtual university. It also provides facilities for evaluation and assessment of the students and teachers.

Conclusion

Few pure virtual forms exist today [10]. Because purely virtual firms are still rare, the processes for developing virtual organizations and the eventual impacts of virtuality are still unknown. Proponents of virtual organizing extol the benefits in terms of greater adaptability, faster response time, and task specialization, while critics argue the potential downsides, including greater conflict, decreased firm loyalty, and higher probability of catastrophic effects [3][5][9]. From a communication perspective, both positive and negative attributes might be envisioned. For example, greater geographical reach of the firm might be enabled via electronic communication, but the firm also may struggle with maintaining a coherent identity. Similarly, more participation in discussion by larger groups of people may be possible, but information overload may be a burden to participant; and more efficient communication may be possible but so might greater alienation. Realistically, what will virtual organizing bring? Specifically, how will changes in communication processes support virtual organizations and, in turn, be changed by virtual processes? While exploring these issues, it is important to keep in mind that the virtual organization concept is bound up in our social fascination with the future – the coming of a new century and our collective imagination for new ways of doing business [1]. The virtual organization provides a metaphor for considering an organization design that is held together, literally, by communication.

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Online Security and Privacy

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ABSTRACT

This paper offers a commentary on the current state of security and privacy in the electronic marketplace. These issues are cause of regulatory uncertainty and informed political debate. Although interrelated, the two issues are different. The commentary begins by defining terms and outlining issues. Security is shown to be a concern of those who buy online and of business vendors alike. Advances in security are primarily a matter of technology and cost. Privacy is different because an inescapable tension exists between the objectives of business and maximization of individual privacy. Safeguarding privacy extends beyond technology into questions of custom and ethics. Considerable differences of opinion and interest exist. There are also cultural differences to be acknowledged. The author concludes with the judgment that improvements in security and privacy are likely to require more than business self-regulation and industry codes of conduct. There is also a place for legislation and international convention.

The Issues

There is no doubting the fact that security and privacy online are issues of widespread concern. That business and customers, alike, share this concern as is attested by many independent surveys [7, 5]. Indeed, these are the two issues of greatest concern among those engaged in electronic business.

Online security relates to access and use of electronic data and systems. Both access and use need to be controlled and restricted if a high level of security is to be maintained. Put briefly, control of access requires verification of a user's identity and control of usage requires encryption of message content. Despite the growing attention paid to security issues, contemporary internet users remain concerned by the risk of non-legitimate access to electronic information, outright theft of online financial and payments data, and increasingly, electronic subversion of entire systems leading to denial of service. Among the more common practical concerns are unofficial disclosure of personal data, credit card data theft, and malicious tampering with stored information.

Privacy is a closely related issue. Privacy can also be safeguarded by adequate security. However, privacy is a human matter that typically involves some controlled sharing of personal information, perhaps medical records or educational records, which thereby brings questions of permission, judgment and ethical standards into sharp relief. In addition, items of individual biographical data, including vehicle ownership and registrations, may be legitimately entered into certain public records, yet in a moral and ethical sense such data remain personal and 'private'.

There is a further practical difference between security and privacy. Though absolute security is presumably unattainable, in the context of electronic business at least, the higher the level of security, the better it is for everybody. There is absolutely no question that better security is better for business and for individuals, alike. With privacy it is not so simple. If individual buyers want to do business direct with a supplier online, as many do, they cannot remain anonymous. If buyers want 'personal' attention, or, 'customized' products, as many do, they are obliged to reveal something of their preferences. When it comes to making payment, if not before, buyers are also likely to reveal financial information and something about their credit status. In short, the convenience of online commerce involves a degree of trade-off between individual privacy, on the one hand, and disclosure to third parties, such as merchants and financial intermediaries, on the other hand. So while both security and privacy are totally desirable in themselves, the latter, unlike the former, involves an inescapable trade-off for the buyer. In the case of security, the interests of seller and buyer are completely aligned but in the case of privacy this is not so. Online businesses want as much personal information about individual buyers as possible in order to develop their one-to-one marketing capabilities, but householders often want to preserve their privacy to the maximum extent compatible with their individual purchases. The interests of the two groups diverge.

Online Security

Introduction

There are a good few people across the 'wired' world who have cause to remember the year 2000 as year of the 'Love Bug'. A Filipino student, now in a well-paid job overseas, brought hundreds of businesses around the world to a halt with a fairly simple intrusion. It is reported he later told police that he had no idea his prank would have such severe and widespread repercussions. Revealingly, his country had no law under which he could be charged. Yet his action was global and costly in its impact. Others, both more sophisticated and more malevolent, raid business sites for fraud and government sites for espionage. Put simply, security online is important and insecurity online can be very costly.

An overview of the contemporary state of Internet security can be gained by reading Richard Power's book "Tangled Web" [31]. He documents the range of cyber crimes and offers plenty of examples, including cases of financial fraud, trade secret theft, computer break-ins, sabotage, identity theft and child pornography. Along the way he notes the high cost of such illegality. The well-known Melissa virus, for example, caused at least US$80 million in financial losses. The American Computer Security Institute have called Power's book "a definitive statement on the 21st Century realities of cyber crime". While its scope extends beyond commercial use of the Internet, it serves to underline how much is still required to make the internet safe and reliable for business.

Magnitude of Issue

In monetary terms, the Federal Bureau of Investigation (FBI) estimated the cost of United States' online crime in 1999 at around US$10 billion. Moreover this figure was thought to be growing at up to 50% per annum. The FBI believed at that time that up to 94% of all websites were *not* secure. The 6%, which were secure, belonged mostly to the big financial institutions. These are willing and able to spend large sums on protection [8]. Jupiter Research have independently come to much the same conclusion, estimating that 90% of US sites are vulnerable to some form of security breach. US-based Pilot Network Services estimate there are 75 million attempted e-security violations every month [25]. On an international level, the Internet Fraud Complaint Center (www.ifccfbi) based in the USA, received 12,812 complaints over the year from May 2000 at an average monetary loss of US$800 per complaint [40]. In Australia, according to The Australian Computer Emergency Response Team, there has been an explosion in virus and hacker attacks and the incident level has risen from about 2000 in 1999 to some 8000 in 2000 [4]. Against this background it is hardly surprising that one of the prime barriers to the growth of online commerce is widespread business and consumer concern about security.

The Technicalities

The two main cornerstones of e-business security today are the SSL (Secure Sockets Layer) and SET (Secure Electronic Transaction) protocols. The first, SSL, is designed to secure data in transit between browser and server through encryption, but does nothing to reduce the vulnerability of either source server or target server [32]. Moreover, SSL encryption renders traffic invisible to network intrusion detection systems which otherwise monitor traffic and detects unauthorized activity. The second, SET, is primarily designed to increase confidence in the payments process and only encrypts sensitive information such as credit card details. Introduction of SET is being driven by the banks, which are steadily establishing the network infrastructure. The other two cornerstones of security are the actual cryptography utilized, which can vary greatly in the level of protection it offers, and the 'trusted third-party' issued 'digital certificates' which are used to authenticate an individuals' right to access. While no system can be perfectly secure, contemporary systems leave very much to be desired. For example, hacker Kevin Mitnick is known to have accessed over 20,000 credit card numbers on a single company server [7]. Further, an IBM experiment designed to test site vulnerability in 1998 found that 90% of online retail outlets at that time succumbed to unauthorized entry and readily yielded access to files containing customer credit card details. Although online security becomes more sophisticated all the time, so do those who seek improper access. For example, a growing problem at the time of writing is industrial espionage by ‘worms’; which are programs that spread through networks unobtrusively. These do not have to break in to a computer directly, they can open it from within, so a recipient may not even notice that a new product design or a customer database has been stolen [39]. Indeed, the penetration and propagation power of ‘worms’ has been well demonstrated by the so-called Code Red attack. This infested 250,000 computers in a matter of hours on 19 July 2001 [22].

Unresolved Problems

The single issue of greatest concern to buyers and, therefore, to business, is the perceived insecurity of payment systems; in particular, credit card security. In the US, up to 95% of all online purchases are made with credit cards [28] and credit card theft is a major concern. In Britain, research shows that around two-thirds of Internet users remain reluctant to conduct financial transactions online because they are afraid that credit card details might be stolen. Further, they will not bank online in case their account or its contents somehow vanish. This fear may be out of proportion and is not necessarily rational but it is certainly bad for e-business. According to Apacs, the card payment organization, only 2% of British card losses are currently attributable to the Internet. There have been some breaches of security online, of course, and some cases have received wide publicity but no householder in Britain has lost any money as a result. Furthermore, even though many smaller e-commerce sites are not protected by encryption, the more *reputable* e-commerce sites are protected by 128-bit encryption, which is a higher level of encryption than is probably necessary. So buyers who stay with sites they know or which are well established run little risk. Yet, British concern has been sufficient for The Direct Marketing Association, the Association of British Travel Agents and the Consumers’ Association to join in promotion of a government-backed scheme to increase public confidence in e-commerce. Together they launched a “TrustUK” logo, which appears on those commercial sites, which sign up to a set of requirements covering order fulfillment, payment security and data privacy [15]. Visa and MasterCard suggest the problem is a lot worse elsewhere. They claim worldwide credit card fraud in 1999 amounted to US$2.8 billion [8]. In addition, there are responsible press reports that Ukrainian criminals have managed to access US databases packed with consumers’ financial details and have stolen more than 1 million credit card numbers (Jay, 2001). While this paper was being written, in Australia, an Internet company director already under investigation for fraud fled overnight to Russia with details of at least 6500 personal credit cards [19]. One part of the problem is that even if a site uses smart encryption, there is no guarantee credit card details will not be captured by hackers long after a transaction is completed. This is because most card information is eventually stored in a data warehouse and only 10% of commercial sites are thought to have secure warehouses. Card details end up in data warehouses after every single transaction, irrespective of whether the use has been online or offline; at this point the data become vulnerable. The single biggest payment security problem is online auction sites, which in the US are said to generate some 80% of all Internet fraud [21]. Another major problem zone is a Caribbean porn site. While such sites cater to the household customer, business-to-business e-commerce is no different. Although big business may have other means of payment more readily available to them, most notably legacy EDI systems, the growth of business-to-business e-commerce is also being held back by the lack of a secure Internet payment system. A growing concern is the unauthorized use of a firm’s website and systems by a ‘direct mailer’ to send ‘spam’. This infuriating action can result in the innocent intermediary having their email address completely banned from the systems of other Internet users. This so-called ‘sending to Coventry’ response by those wishing to avoid ‘spam’ can be devastating if email communication is important to them [34].

Possible Solutions

Happily, advances in credit card technology are soon likely to overcome the warehouse hacking problem. The same is true of the perceived danger of putting credit card details on a commercial website. This is because we shall soon be using chip-bearing ‘smart’ cards instead of contemporary magnetic-strip cards. These will be supported by ‘smart’ card readers built into everyday PC hardware. The readers are already in development and will make confirmation of a cardholder’s identity much easier, faster *and* more secure. Mainstream card issuers like American Express have already released smart cards with built-in electronic chips in at least some markets. The potential payoff is obvious when it is recalled that France, which switched to microchips a decade ago, has only one-fifth of the average European rate of credit card fraud [3]. Europe generally and the German Sparkassen (mutual savings banks), in particular, are at the forefront of smart card adoption. They are already giving chip cards embedded with electronic signatures to 20 million customers in an attempt to kick start smart card use in order to improve online security. European countries are also rapidly adopting digital signature laws and all credit card terminals are being upgraded to accept chip cards [27] The encrypted signatures, from US security company VeriSign, at present provide near-total security for online transactions. With European countries rapidly adopting digital signature laws and all credit card terminals being upgraded to accept chip cards, public familiarity with smart cards will very quickly spread. At the same time, Microsoft, with VeriSign and others, are exploring ways of facilitating the use of digital certificates [29]. These identify individuals and companies using ‘public key infrastructure’ or PKI. The issue of online transaction authentication may be gradually resolved by the combination of encryption and the steady spread of PKI. An effective PKI can validate the identity of online parties at the time and place of access, ensure that information is not intercepted in transmission, and ensure system reliability. ‘Pretty Good Privacy’ (PGP and Open PGP), the de facto standard for secure email, uses a public key system. As ever, such technology comes at a cost. Security, however, is a benefit most are willing to pay for. Moreover, the cost of new technologies falls significantly once they become widely adopted. So a greatly enhanced level of online security, at affordable rates, is soon likely to be available. Then, the important issue will be that of gaining global acceptance for ‘agreed’ mechanisms and standards of online security.

Online Privacy

Magnitude of Issue

A report produced by Washington’s Pew Research Foundation in August 2000 found that over 80% of US Internet users were concerned about invasion of their online privacy by businesses [23]. The Director of the research, Lee Raine, is quoted as saying Americans want “Don’t do anything unto me unless I give you permission” elevated into a golden rule. This is despite the fact that a majority of users remain unaware that many of their computer hard drives are implanted with cookies. Similar research released by PricewaterhouseCoopers in December 2000 found that 75% of Europe’s consumers are uncomfortable disclosing their credit card details online and revealed that in the UK as few as 17% of Internet users want to bank online. Moreover, nine out of ten said they would opt out of providing personal information online [30]. It is worth noting in this context that Amazon.com, the best-known consumer cyber brand of all, was found by the Federal Trade Commission to have probably deceived customers about its privacy practices. Privacy groups had accused Amazon of using its Alexa Internet unit to collect personal information without informing the customers involved. In April 2001, Alexa agreed to settle a class-action lawsuit against its privacy policies by paying $40 to each person whose identifying information was collected [2].

Less serious but nonetheless noteworthy is the fact that many Internet users value their online anonymity. They do not wish to lose it even though anonymity was not necessarily a feature of their offline world. They are familiar with the old joke that, on the Internet, “no one knows you are a dog”. Today, however, geo-location software can sniff us all out by tracing backwards the connection route established by any online user, locating back at least to the city where a person logs on. Such software is commercially valuable, not least to advertisers, because it enables site managers to use the location of customers to adjust services and promotions on a geographical basis. At the same time, the software has raised concerns about online privacy and is proving controversial [24].

Commercial Aspects

The commercial significance of online privacy stems from the fact that while privacy safeguards are important to business as well as the public, the commercial promise of the Internet lies primarily in its capacity to facilitate personalization and customization; for which the Internet is particularly well suited. Of course, buyers want these benefits also, in both the B2B market and the B2C market. The problem is that to personalize and customize effectively, business needs buyer-specific information to enable it to do so. Once a buyer has decided to place an order online, the need to surrender individual information is obvious, the purposes for which the seller needs the information are also obvious and there is seldom any perceived privacy problem. However, business needs to go beyond simple order taking; business needs to actively market and promote to its potential customers as well. To do this requires the use of customer data in ways initiated by the seller rather than by the buyer. Indeed, businesses commonly wish to transfer data to associated companies for cross-selling purposes and, also, sell such data to third parties for profit. This is where the privacy issue becomes really controversial.

In the online marketplace, site content can be frequently and routinely adjusted to meet the needs of individuals and companies. This personalization and customization increases the relevance of the site to the individual user. This is most commonly welcomed in the context of fare price changes on the websites of budget airlines. The process is more generally managed by capturing navigation patterns and buying preferences of users as they spend time on the site. The most commonly understood mechanism is the so-called ‘cookie’, which is a small piece of information that a website can insert in a designated file on a visitor’s computer. This can be used to identify the visitor when logging on and track the visitor’s usage of the site. Many software products enable companies to do much more. Profiling software and electronic agents resident on a site will match a user’s behavior and preferences and provide 100% accurate and detailed information about how the site is used. At the same time these agents give users the ability to profile what they might like to see during their next visit to the site. In the B2B marketplace, such profiling is widely regarded as a benefit by both company and user. For example, a service engineer may regularly visit a manufacturer’s site to find information about products being serviced. In the B2C marketplace on the other hand, although profiling is well established, it has generated controversy and is seen by some as invasive of their privacy. Most systems build on the information collected by profiling and create a visitor registry for incoming visitor data, a content catalogue for use in personalization and a customization module to create content to match the user profile [10]. Similarly, banner advertisements can be precisely targeted by triggering them to appear only in response to keywords, typically words entered into a search engine. All in all, an impressive degree of customization can now be achieved. Yet a private individual who is just surfing the web and is not actively interested in doing business on a particular site, may view the fact that all this information is being collected as an invasion of privacy. Whatever your view, the tracking process raises cultural and ethical questions as well as purely commercial ones. For business, it poses a delicate dilemma: online business needs such data but the business does not own it. Rather, the private citizens to whom it relates have ownership; and a moral ‘right’ to it.

Another delicate issue is the status of customer data, once collected. Who owns it? How may it be used? When, if at all, can or should customer databases be bought and sold? At present there are no definitive answers to these questions, even within a single legal jurisdiction let alone when more than one jurisdiction is involved. The sale of customer data has came to the forefront of public attention as the number of dot.com failures has risen and creditors of bankrupt online firms have struggled to capitalize on all available assets. The issue gained particular attention in the US with the bankruptcy of Toysmart.com in 2000. Toysmart advertised the sale of its customer list and database in The Wall Street Journal after it ceased operations [35]. The company overseeing the asset sale, Recovery Group, said several parties had bid for the customer information but disagreement among creditors led to the issue being turned over to a federal bankruptcy judge. As Toysmart promised in its privacy policy that it would not share or sell that information [37] the judge accepted a proposal from Toysmart’s backer, Disney, that Disney buy the list for $50,000 and then have it destroyed [36]. To date, however, despite various draft internet privacy bills being introduced in Congress, there is no agreement on their content and a state of partial industry self regulation prevails. The Federal Trade Commission is under growing popular criticism for weakness on the issue and privacy advocates demand stronger laws to prevent the exchange of customer information when companies merge or are sold. Yet Internet companies are not the first or only ones to collect customer data and pass it on to others following merger or sale. In the United States, at least, it is regarded as routine for banks and hospitals to transfer intimate consumer or patient data following an acquisition. However, US public opinion on this issue is now aroused and volatile.

Legal Aspects

From a legal perspective, the privacy of customer data is viewed quite differently in different parts of the world. In Australia, for example, online privacy has only recently been recognized as being of widespread public concern. Early drafts of privacy legislation completely exempted government and small business from its scope [26]. However newer drafts oblige *all* companies to develop a code of practice for handling private information. At present, according to Arthur Anderson's Internet Privacy Survey 2000, only half of the top 100 sites in Australia have any formal privacy policy, or, any online statement to say what information is being collected [17]. Under legislation due to come into force on 21 December 2001, this will have to change. From that date companies will be required to meet three basic obligations [18]:

- To disclose all data held about a customer when it is requested
- To permit modification of the data to ensure its completeness and accuracy
- To ensure customers have an absolute right to opt out from use of their data

Early pioneers of the Internet wanted to keep it apart from government altogether. In particular, they hoped to keep it free from regulation, censorship and taxes. However rapid commercialization has thrown up all sorts of issues, which make that impossible. These range from basic business concerns like fraud and copyright, which require legal resolution, to the most socially sensitive concerns like gambling and child pornography. So it can no longer cause surprise that modern governments are moving to fill the void. For example, the German government's 1997 Multimedia Law, for example, regulates everything from identity authorization to the obligations of internet service providers. Even Hong Kong has introduced laws governing Internet copyright [11].

It is self-evident that cyber crime is a global issue and that national legislation and enforcement cannot alone achieve so very much. Online crime is by its nature global in scope and very obviously requires both harmonization of national laws and international cooperation if the collection of electronic evidence and pursuit of cyber criminals across international borders is to be effective. Despite the fact that many nations still lack any domestic law governing electronic commerce, first steps towards international law in this field are slowly being taken. Under the auspices of the Council of Europe, 43 member nations, together with several non-European governments, including the US, have finished a final draft of an international treaty on law enforcement in cyberspace. Separately, the Secretary of the United Nations Commission on International Trade Law, Professor Herrmann, has proposed the establishment of international Internet arbitration bodies to help overcome the legal and jurisdictional problems of Internet commerce. He also recommends the UN Sales Convention be adopted as a law of default to cover instances where the nationality of a party is in dispute [12].

Quite independently of differing approaches to legislation, attitudes towards personal privacy are to a considerable extent culturally driven. There is, for example, considerable difference between attitudes in the US and Europe. Broadly speaking, Americans take issues of privacy less seriously than Europeans and regard privacy of personal data as basically a contractual matter. Europeans, in contrast, very often take their personal privacy very seriously and regard it as a fundamental human right. Moreover they expect the state to protect and defend that right.

Over and above cultural differences, the unprecedented speed and global character of the internet has served to highlight these factors over recent years. The consequence has been a worldwide move towards the legislative definition of privacy rights. In the more 'wired' economies, this is paralleled by moves to identify and establish acceptable business practices governing the handling of personal information. The Advertising Federation of Australia (AFA), for example, has recently issued new online privacy guidelines advising its members to "tread carefully through the path of online privacy … in a way that avoids alienating consumers or creating legal issues" [6]. The practicalities of privacy legislation, however, are not yet well understood. The UK, for example, already has an unintended problem with medical research being delayed or blocked by confusion over new legislation [9]. There, guidance issued to all doctors by the General Medical Council, arising out of The Data Protection Act and other legislation has resulted, contrary to the intent of Ministers, in guidelines, which are unworkable for public health surveillance and large-scale studies involving the dead. A sensible, workable balance between the individual's right to privacy and society's right to understand the health risks we all face, is yet to be achieved.

Ethical Aspects

A host of ethical problems surround the question of privacy. This seems everywhere the case. Indeed the US government fails to meet its own four Internet privacy standards as set by the Federal Trade Commission, which it seeks to impose on commercial Internet business. These standards are:

- Notice; of a website's data collection practices
- Choice; as to whether and how personal data is used
- Access; to view and contest the data
- Security; from unauthorized use of collected data

Worse, the General Accounting Office of Congress, after reviewing 65 government websites found that 22% allowed third party online marketing companies to place cookies on viewers' hard drives. Further, the FBI had ordered Internet service providers to allow it to install powerful 'Carnivore' software to enable it to covertly scan private emails [13]. Similarly, in 1999, the Singapore government-controlled telephone company SingTel, used its Internet division to secretly scan 200,000 of its subscribers' computers at the request of the Home Ministry [14].

In the private sector meanwhile it is becoming increasingly common for businesses to monitor employee emails. This may or may not be thought to matter but many people object when employees are not so informed. Interestingly, in 1999, the Governor of California vetoed a bill, which would have required companies to inform employees when their emails were being monitored [38].

A wider and even more delicate issue is the question of who should have online access to our personal medical records. Traditional doctor-patient confidentiality is hard to guarantee once personal medical data is electronically accessible. It is also ethically sensitive when there is no protection of the patient's right to know who has access to it. With doctors in a position to sell such information for private gain it is obvious that their professional ethics will sometimes be strained; strongly suggesting a place for legislation to make the covert selling of such data explicitly illegal. According to the Pew Center of Public Interest, among American consumers who have gone online to make health enquiries, only 17% have submitted personal information voluntarily [1].

Possible Advances.

The common core of consumer groups' privacy demands, in the US, EU, Australia and elsewhere are three:

- a simple, routine, one-step, opt-in or opt-out provision for the commercial filing of personal data on all sites
- no unacknowledged monitoring of Internet use or cookie placement
- guaranteed access to filed personal data with an unequivocal right to make corrections

The first and third of these demands will probably be met in most of the 'wired' world within the fairly near future. In the case that cookie control is overlooked, individuals who care will easily be able to install anti-tracking, 'cookie-management' programs instead. In fact, one protocol for communication privacy called 'P3P' (Platform for Privacy Preferences) is supposed to be able to tell a user what kind of personal data a site collects and what it will do with it if it gets it [16]. However an important practical issue is whether sites should demand personal data as a price of entry in the first place. While it may be the right of any site owner to set entry requirements of their own choosing, there is growing evidence that burdensome entry information demands, prior to purchase, are a major disincentive to potential customers. So market forces will contribute to the timing and manner of data collection as well.

The way in which the detail of consumer privacy demands are handled will naturally vary somewhat across the world. Legislative mechanisms will inevitably reflect different constitutional traditions. Yet very considerable common ground is likely to be imposed by the open, global nature of e-commerce. Attitudinal and cultural differences will persist but practical realism is likely to lead to increasingly similar national legislation. As in more established areas of law, the international differences which matter most online are less likely to be the differences in law and jurisdiction and more likely to be in the quality and processes of law enforcement.

Conclusions

Security

Security, in principle, is a simple matter. Everybody benefits by improvements. Advances will cost money, but provided improvements are not cumbersome or inconvenient, business and the community will be willing to pay for them. However, ‘the security problem’ will not disappear. Cyber criminals will also become more technologically sophisticated and continue to pose a threat. Within a relatively few years, though, the position will stabilize and business, supported by insurance industry actuaries, will be able to estimate and manage the risks.

Privacy

Privacy is a sensitive matter. It is particularly sensitive for private householders but can also be acutely sensitive in certain sectors, like medicine, and certain activities, like commercial research. Moreover once modern privacy legislation is in place, any business which ignores legal requirements will run the not inconsiderable risk of a public relations disaster if found out and publicly exposed by the media. At the same time there are no universal solutions to privacy ‘problems’. This is because our attitudes to privacy vary greatly, reflecting both the diversity of human culture and the diversity of context in which the privacy issue can arise. If there exists a general guide to handling the issue well, it is to be fully aware of its existence and of the need for delicacy and sensitivity in handling it whenever it surfaces. Irrespective of national laws, the commercial ‘ownership’ of personal data pertaining to others can be contested on ethical grounds. So it will soon be regarded as essential that all personal data collected, can be shown to be voluntarily given. Many, though not all, believe we each have an inherent ‘right’ to privacy. Yet the practical reality is that trade-off, or, compromise, has to be made between that right to privacy and the convenience benefits of sharing information with others. It is important for business to note that personal privacy involves individual decision. Society embraces a spread of opinion on the issue so it cannot be legislated to everyone’s satisfaction.

Overall

As electronic commerce matures and becomes a part of every business, the twin concerns of security and privacy will remain with us. Fortunately, businesses worldwide are aware of the desirability of handling these issues on a common, agreed basis. The ‘wired’ world has already made a start in the search for common ground though agreement may not come easily. Advances in security will flow from technological progress and the new technologies are likely to find ready acceptance worldwide. Resolution of differences in attitudes towards privacy will prove much harder to achieve. Nonetheless, an open, global, instantaneous and personal trading system demands a uniform, global operating environment. Eventually, that is what e-business and e-business customers, alike, will come to regard as fairest for everybody. So it will soon be demanded. How quickly it can be achieved is another matter.

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Ownership, Corporate Governance & Organizational Strategies

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Abstract

The paper traces the ownership pattern of firms in India from 1999-2001. The paper examines the organizational practices in corporate governance in India, focusing on corporate boards and directors, operational management and control, shareholder democracy and role of financial institutions. It also looks into the environmental responsibility and concern for employees in certain industrial segments having hazardous impact on them. It also traces the institutional mechanism for corporate control and the state of Indian legal system.

Introduction

Achieving higher levels of growth is dependent on the ability of all sectors of the economy to function at an optimum level. In 1998, the GDP of India was US $430 billion out of which the contribution of agriculture was 29.3 %, industry constituted 24.7% and services accounted for 45.9% (Human Development Report, 2000, p.208). Despite the growing share of the service sector in the economy, it is important that all nations make efforts to move towards a regime of sustainable growth, which will ensure the coexistence of humans with nature in perfect harmony. As we have moved on the path of development, we with our technological superiority and dexterity have been able to plunder the natural resources to an extent that the whole eco system is on the verge of collapse.

Most developing nations have blindly followed the western models of development. This has led to collapse of the important economic and social chain: *economic growth-employment-political success in the form of democracy- increased resource consumption-waste and environmental damage* (Report of the Independent Commission on Population and Quality of Life, 1996). There is little doubt that all governments merit higher consumption as a means of stimulating economy and reducing unemployment. Yet higher consumption, under present conditions, is bound to result in an unsustainable level of energy use especially energy coming from fossil sources, which poisons the air and water.

Today the need for better governance is felt at all levels and is not restricted to international agencies and the corporate sector. The entire fabric of the society needs to be rejuvenated, needs some degree of soul searching and introspection to make this world a better place to live. The word – a better place to live- by no means of imagination implies a utopian state- but a state where everyone thinks for the ordinary citizen and the overall welfare of the society we live in. Strategy to be profitable cannot be sustainable unless it is rooted in the ground realities of survival of the human race. There is an urgent need to identify the real issues that confront humanity especially in the developing countries. India for example, is mired in poverty with 1.2 billion people(World Bank Report 2000/2001). The rate of illiteracy is alarming and a large section of the population has no access to sanitation, drinking water or health care. Even today the ratio of doctors to per thousand populations is extremely low, disease such as tuberculosis are widespread and new diseases such as AIDS are in the rise at an alarming rate. Despite spectacular achievement such as the genome project, speech recognition, and the magnificent opportunities exploited by the software industry, there are still instances of gas leakages at cities such as Bhopal, Minamata disease in Japan caused by mercury poisoning in fish, and the Arsenic poisoning of water in Bangladesh and West Bengal in India are a common sight. All these point out the potential disasters that are waiting to cause traumatic situations for humanity and its environment.

All these and the recent financial crisis in emerging markets have led to renewed discussions and the need for good governance practices. A company that does not indulge in self-discipline ruins its chances of success in the long run. Studies of firms in India and abroad have shown that markets and investors take notice of well-managed companies and respond positively to them (Kumar Managalam Birla Committee, 1999). Strong corporate governance is thus indispensable to resilient and vibrant capital markets and an important instrument of investor protection. There is a need for transparent corporate disclosure and high quality accounting practices. Without financial reporting premised on sound, honest numbers, capital markets will collapse and will not be able to provide the degree of confidence required for development and growth.

Methodology

This paper analyses the regulatory framework governing corporate governance in India. It also sensitizes about the ethical and environmental concerns that Indian organizations need to address. The monthly data on formation and closure of companies has been collected from Ministry of Law & Company Affairs and has been collated and analyzed. Various reports have been analyzed for getting insights into the working of Indian corporate sector.

The traditional model of corporate growth keeps innovation at the center stage of an organization. The corporate sector not only needs to address the consumer but also look at the seething problems of humanity in its totality. It cannot shy away from this responsibility because it's a part of the emerging society and its problems. Are we then saying it's a failure on part of the government as it cannot act as a watchdog and the responsibility be transferred to the corporate sector? No, it is the pragmatic analysis of the whole scenario; it's an intelligent way of analyzing the ill effects of the operation of the firms. There is a need to monitor that the end objective is not just to raise money and profits but also to give back something in return to the society for a better future. The Bhopal tragedy is just one indication of the tragedies that can be cause due to negligence and irresponsible corporate behavior.

To achieve corporate excellence, corporate governance is one of the pre requisites. In developed economies, there is evidence to suggest that corporations are well known for their standards for transparency, accountability, professionalism, social responsiveness, corporate citizenry and ethical business practices. The corporate governance entails that the organization must not only enhance shareholder wealth but also be responsible to its various stakeholders i.e. customers, suppliers, employees and other shareholders. It has to have a societal welfare element strongly built into the prevailing systems. Various international institutions have expressed their ideas on corporate governance. The 1998 OECD document on corporate governance observes that though the primary objective of corporations in market economies is generating economic profit so as to enhance shareholder value in the long term, corporate governance must simultaneously fulfill broader economic, social and other national objectives.

Institutional Framework in India

Internationally, corporate governance norms have been initiated through a judicious mix of three available routes: legislation, regulation or self-discipline and free violation. Another driver is societal pressure. In India, legislation has been the main instrument for improving corporate governance. The Companies Act 1956 had a strong influence on the structure of corporate management in India. This Act among other things legislated the abolition of managing agencies. With this the instrument for siphoning off corporate wealth for the benefit of a few dominant and controlling shareholders was destroyed. The Securities and Exchange Board of India (SEBI) also has responsibility of reforming the primary and secondary capital markets. The stock exchanges in the country mandates salutary requirements that every trading company has to comply with. The Institute of Chartered Accountants of India has emerged as a mature body regulating the profession of public auditors and counts among its achievements the issue of number of accounting and auditing standards. The Institute of Company Secretaries of India has also taken a major initiative in constituting a Secretarial Standards Board comprising senior members of eminence to formulate secretarial standards and best secretarial practices and develop guidance notes in order to integrate, consolidate, harmonize and standardize the prevalent diverse practices with ultimate objective of better corporate practices and corporate governance. The task force for Corporate Excellence constituted by the Department of Law & Company Affairs in 2000 suggests that the best corporate practices in the field of corporate governance practices may be grouped into four categories related to:

- Corporate boards and directors
- Operational management and control
- Credibility and transparency of reporting
- Shareholder democracy and minority protection

In the United Kingdom, the Cadbury Report placed the corporate board at the center stage of governance system which is described as one by which companies are directed and governed. The Canadian Guidelines of 1994 give a comprehensive outline of board's responsibilities. The Cadbury Report too delves at length on the same subject.

Emerging Ownership Patterns in India

The Indian corporate sector has 5,32,580 companies with paid up capital of about Rs. 2,72,865 crores as on January 1, 2000 (Department of Company Affairs, Ministry of Law and Justice, Annual Report 1999-2000). These comprised 1253 government companies and 5,31,327 non-government companies with paid up capital of Rs. 95,842 crores and Rs.1, 77,023 crores respectively. Nearly 75% of all these companies were concentrated in six of the major industrial states of the country namely: Maharastra (21.6%), Delhi (18.4%), West Bengal (13.2%), Tamilnadu (8.7%), Gujarat (6.7%), and Andhra Pradesh (6.1%)(Collated from three years data). All these states constitute for nearly 75% of the 5,32, 580 companies at work.

Table- 1: DISTRIBUTION BY TYPE OF COMPANIES (2001)

Category of Company	**Government Company**		**Non-Government Company**		**Total**
	Public	**Private**	**Public**	**Private**	
Companies Limited by Shares	655	612	75602	493949	570808
Guarantee Companies	4		2918		2922
Unlimited Liability Companies					466
Total					**574206**

Source: Ministry of Law, Justice and Company Affairs, Department of Company Affairs, www.nic.in/dca/mcg/pressapr2k1.htm, 2001

Table –1 shows the distribution of companies by the extent of liability. We find that the maximum number of companies fall in the category of private non-governmental companies limited by shares. A large majority of the Guarantee Companies falls in the category of non-governmental companies.

Formation and Winding of Companies in India

We also find some very interesting insights when we look at the data on formation and winding up of companies, which were collected from Department of Company Affairs for the years 1999-2001. There were a total of 53,330 new firm that were created of which 92 percent were non-governmental private companies, only 7.9 percent were non-governmental public companies, and the remaining fell into the other categories (See table 2).

Table- 2: DISTRIBUTION OF NEW COMPANIES FORMED BETWEEN 1999-2001. (Monthly Data)

Year	Number of New Companies Formed/ Month	Public Sector (8%)			Private Sector (92%)		
		Number/ month	% of Total	Percentage Change	Number/month	% of Total	Percentage Change
1999	2350	164	7	-	2186	93	-
2000	2570	237	9	44.5	2334	91	6.7
2001	2006	123	6	48.1	1883	94	-19.3
Total	6926	524	8	-	6403	92	-

It is evident from the table-2 that private sector accounted for over 90 of new company formation during each year as well as the cumulative for the three years. This is an indication that in the liberalized economy the private sector seems to be making progress and providing opportunities for new start-ups. Even though the public sector is small, we find that the percentage change in the public sector is much higher than that of the private sector. This is mainly due to the fact that there are more closures in the private sector than in the public sector.

If one looks at the ownership patterns for firms from June 1999 to March 2001, one finds that 92% of the firms were non government, private companies, 7.9% were non govt. public companies and the other categories were just 0.01% of the whole sample. This implies that in 92% of company shares were closely varying from minimum seven to maximum of 50 shareholders. Such a closely held share holding has resulted in closed-door practices in Indian corporate sector. In India family businesses account for about 70% of the total sales and net profits of the biggest 250 private sector companies (Economist, 1996). Most Indian firms have problems of lack of business focus which led to excessive diversification, ad-hoc way of operations with short term profit orientation, little investment in training, lack of integrity, lack of benchmarking, cultural traits among other factors (Jauhari & Misra, 2001). There are though organizations like Reliance and Ranbaxy among many others, which are professionally, managed firms.

Table 3 shows the category wise segmentation of the 53,330 companies formed during June 1999 to March 2001. Estimates show that collectively the manufacturing and the financial sectors accounted for 69% of the new companies. Out of the total number of 895 companies that ceased to exist in this period, 86% were private limited companies and 14% were public limited companies. In this period, out of the sample about 18 % of the companies were from Kerala, about 13 % from Pondicherry, 12% from Assam, and 7% from Goa. Almost 50% of the total companies that were wound up were from these areas. It is also clear from Table-2, that manufacturing and financial sectors account for maximum number of new companies as well as the closed companies.

Table-3: PERCENTAGE DISTRIBUTION OF COMPANY FORMATION & CLOSURE BY CATEGORY

Category	Percentage of Total formations (1999-2001)	Percentage of total Closures (1999-2001)
Manufacturing	36	51.60
Finance, Insurance and Real Estate	33	31.80
Wholesale, retail, and Restaurants & Hotels	8	7.90
Agriculture	-	3.90
Transport	2.9	-
Trading	9.0	-
Social Service	3.8	2.49
Construction	4.1	1.30
Other Activities	2.4	3.40

Table 3 provides a better perspective on company formation and closures as it has been derived from the monthly averages for the three years in analysis. The monthly averages were used to project the data for the complete cycle of three years as for some months the data was not available.

The following pages evaluate the corporate governance practices in India.

Corporate Boards and Directors

Indian company law prescribes a minimum of three directors for a public limited company. The size of the board is left to the company itself. It is also mandatory for listed companies to have fifty percent of the board as non-executive. The task force on reforms suggests minimum five directors for all listed companies. According to the Cadbury Committee, non-executive committee should bring an independent judgment on issues of strategy, performance including key appointments and standards of conduct and their appointment must be for a specific term and reappointment should not be automatic.

In India, the KMB Report recognizes the differing roles of the Board Chair and the chief executive officer and expresses itself in favor of separating them but stops short of mandating this as a requirement. In public sector organizations and financial institutions like banks and insurance companies, it is virtually axiomatic to have a combined Chairman and Managing Director even when these positions are separated to have the Chairman as a full time executive. The Listing Committee also envisages an Audit Committee comprising three or more directors out of which two thirds be non-executive. There is a clause that mandates that the recommendations of the Audit Committee on any matter relating to financial management including the audit report shall be binding on the board. Given the fact that the Audit Committee is a part of the full board and derives its authority there from, it is difficult to accept a situation where the delegating body becomes a captive of the delegated body. Such a practice is not in line with rules of good corporate governance.

It is also important to clearly define the roles and responsibilities of the directors. In recent years there have been many changes that have been introduced through legislation to this extent. Corporate legislation currently prescribes that an individual cannot hold the position of director of more that twenty companies. In practice, due to several permitted exclusions, this number can be significantly higher. The Confederation of Indian Industry (CII) code prescribes a ceiling of ten listed companies of which an individual could be the director. Neither the KMB Report nor amended agreements have any explicit provisions regarding total number of directorships. It is recommended that the executive directors, which include the company-managing directors, functional directors and other such persons who hold a full time appointment with the company, should be discouraged to be serving on the boards of other companies as non-executive directors. The non-executive directors, which include all members on company boards other than those employees whole time by the company themselves.

The criteria for acceptance of board memberships should be their time commitments with their own personal or professional obligations and any associations with the other company boards. A recent study of directorships in United States placed the average between 2 and 3 directorships. The Vienot Committee report on Corporate Governance in France indicates three directorships as the preferred maximum. There is a case of gradually reducing the number in India consistent with the availability of a suitable pool of potentially non-executive independent directors. The Task Force suggests that such directorships be limited to 15. The rights, responsibilities and liabilities of the directors need to be clearly specified. Also nominee and ex-officio directors form a distinct subgroup of the non-executive directors category. Most of these nominees are senior full time employees of the nominating organizations and have little free time to devote to the affairs of the company.

Till recently it has been the practice of most companies in India to fill the board with representatives of the promoters of the company and independent directors if chosen were also handpicked thereby ceasing to be independent. This has undergone a change recently with three categories of directors figuring in the boards-Promoter director, executive and non-executive directors.

The key to good corporate governance is a well functioning, well-informed, board of directors (Skaria, 1999). Dabur, an Indian family run business started the process of spinning off from its board-which comprises six members of the Burman family, two professional managers and five outsiders all responsibilities for budgeting, recruitment and appointment of vendors, suppliers and distributors, handing them over to management committee. The influence of the owner family on decision-making has automatically, been reduced which is a requirement of corporate governance. In Hindustan Lever Ltd (HLL) even within the conventional structure, the distribution of influence can tilt the scales in favor of good governance. HLL gives a significant voice to its internal directors, all of whom head operations within the company.

ITC and Larsen & Toubro rely heavily on non-executive directors, drawn from the ranks of other stakeholders to ensure conformance to good governance practices. While L&T's 10 member board has only three insiders, the rest being professionals drawn from owner groups like the financial institutions. Just four of ITC's 13 directors work with the company, the rest being professionals and representatives of BAT industries and financial institutions.

The composition of the board needs to be matched with the specific governance needs. Infosys selected non-executive directors on the basis of their familiarity with global markets. The specific competencies it looked for included strategy, technology, finance, quality and human resource management. From governance point of view, people with functional strengths will have to dominate the non-executive component of the board.

Operational Management and Control

The board and the executive management of the company have to address the process of creating and protecting wealth creating assets and resources. Shareholder wealth maximization with due regard to other stakeholders interests and societal responsibilities is the primary concern of management which for this purpose should equip itself with the skills and competencies that would enable it to achieve its goals. The board also has to satisfy itself that the control mechanisms within the organization are in place and are operative.

The Indian position is well articulated in the KMB report in which the board is responsible for controlling the company and its management by laying down the code of conduct, overseeing the process of disclosure and communications, ensuring the appropriate systems for financial control and reporting and monitoring risks are in place, evaluating the performance of management, chief executive, executive directors and providing checks and balances to reduce potential conflict between the specific interests of management and the wider interests of the company and shareholders including misuse of corporate assets and abuse in related party transactions. The audit committee and the board need to be assured from time to time that necessary and appropriate systems are in place within the company and that they are being followed. Independence of company auditors is extremely important. Economic independence is almost invariably the fundamental determinant of professional and personal independence.

Given these insights, it is important to mention that if the Indian Companies are to be competitive on a global basis, it must be ensured that their reporting requirements also match global standards. The present reporting requirements for Indian corporates are archaic and utterly out of tune with the reality of the information needs of the shareholders and other stakeholders.

Shareholder Democracy & Protection of Minority Interests

Protection of shareholder interests must be applicable to matters relating to transparency in accounting and reporting, majority oppression, biased management, non-conformance to obligatory requirements. In United States, institutional investments in the top 1000 companies rose from 46.6% in 1987 to 57.2% in 1995. In UK, from 30.3% in 1963 to 61.8% in 1993. Though its recommended in the Report that the,"corporate India needs to go that extra mile to retain and to enlarge the six of NIMS component in the structure of share ownership in companies. It is too idealistic approach to think that corporate world would make that effort on its own in India.

There have been increasing incidences of vanishing companies, mismanagement, oppression, widespread shareholder dissatisfaction and unethical business practices. Indian market has also been a witness to a number of scams damaging the reputation of Indian Corporate sector (Report on Corporate Excellence, 2001). The number of vanishing companies in India is large. It also has international leadership in terms of listed corporations even though it lags behind substantially on other parameters such as market capitalization or trading volumes. Most of these listed companies have obtained their listed status for tax and other reasons while others do so for the limited purpose of accessing capital from public. De-listing hurts minority investors more than it does the shareholders in control or dominance.

The Securities and Exchange Board of India has identified that by May 2001, 229 listed companies which had collected funds through public issues were not available at the registered offices (Department of Company Affairs, Ministry of Law & Company Affairs, 2001) 5087 companies were under liquidation during the year 1998-99 (Department of Law and Company Affairs, Annual Report 1999-2000). Of these 1431 companies were under Member's Voluntary winding up, 580 under Creditor's Voluntary winding up, 2478 under winding up by court and 12 companies under winding up subject to supervision of court. The Capital market in India witnessed a boom during the period 1993-94 and 1994-95 when many new companies tapped capital market and collected funds from the public through issue of shares and debentures and fixed deposits. Many of the companies have defaulted in their commitments made to the public while mobilizing funds. It is important that the Indian Corporate Sector takes its responsibility seriously when of using the funds raised from the public.

A look at the figures of industrial sickness is quite alarming. The government has initiated a disinvestments programme for public sector enterprises under the with the aim to bring down government equity in all non strategic PSU's to 26 percent or lower, if necessary, restructure and revive potentially viable PSU's, close down unviable units. The government has set up a new Department of Disinvestments for this. Table-4 points out at the gaps existing between targeted and achieved disinvestments:

Table-4: TARGETED & ACHIEVED DISINVESTMENT IN INDIA

Year	Target (Rs crore)	Achievement (Rs. crore)
1991-92	2500	3038
1992-93	2500	1913
1993-94	3500	Nil
1994-95	4000	4843
1995-96	7000	362
1996-97	5000	380
1997-98	4000	902
1998-99	5000	5371
1999-2000	10000	1829

Source: Economic Survey 2001 Ministry of Industry, Government of India

There were 3.06 lakh sick units as on March 31, 1999. These were enterprises, which had obtained loans from banks and other financial institutions. An amount of Rs 4,313 crore has been blocked in these units. Of these only 18,692 units were considered potentially viable by the banks with their outstanding credit amounting to Rs. 3,746 crore. The number of small-scale units operating in India is 32,25,000 providing employment to 312,000 people (Ministry of industry, Economic Survey, 2001). Some of the common reasons for sickness are obsolete technology, lack of economy of scale, lack of orders, low productivity, surplus manpower, resource crunch, heavy interest burden, non availability of raw materials etc.

Role of Financial Institutions

Financial institutions are an important part of the corporate world. They have always had the pressure to perform and meet their bottom lines. But many financial institutions in India are saddled with non-performing assets estimated at about Rs. 57,000 cr. (Jayakar, 1999). The number of sick companies in the portfolio of financial institutions such as IDBI, the ICICI, and the IFCI rose from 425 in March 31, 1997 to 496 within a year. The bulk of these companies are concentrated in recession-hit industries like chemicals, textiles, cement and metal products. Accountability of banking institutions has increased due to pressure from private shareholders and the need to raise resources and prevent downgrading of ratings. There is thus, an urgent need to develop capabilities for risk management. The banking crises in Asia and Japan were caused by faulty lending decisions influenced by cozy nexus of politicians, bureaucrats and industrialists. The problem with Indian organizations is that companies attract funds for one project and then divert them to diversifications. The use of funds for the purpose for which they were raised needs to be monitored carefully by financial institutions by developing the needed industry expertise. The decision to use the funds and ability to set exposure levels does not fall into the purview of institution's rights. At present the Reserve Bank of India's Prudential Norms specify (Jayakar, 1999):

- The exposure limit to any industry should be 15% of the portfolio
- The exposure to a single company should be 25 percent of the institution's net worth. And the exposure to any group should be 50 percent of institution's net worth.

It is also recommends that to avoid potential conflicts with the companies, they must maintain an arm's length relationship with the company by not putting a member on board. Indeed they would serve their cause better and protect their interests better if they make more effective and proactive use of their significant voting power at the General Body meetings. However in situation when there is a case for term lending, institutions should have nominees on the boards of the borrower companies to protect their interests as creditors. In such cases the nominee directors must play an active role in the management of the organization.

The issue of imposing regulation on to the corporate world to follow prescribed norms may have very few takers. However it is well known from the experience of the western world that the level of non-legislative and non-regulatory intervention is a function of the maturity of the market and economy. Until acceptable levels of such maturity and market influence are reached, it may be necessary to support self-discipline and self-regulation with appropriate legislative and regulatory support.

It is also important to take note of the fact that financial reporting and disclosure, which are also related to the accounting policies of a company and existing accounting standards and auditing practices, are corner stones of corporate governance. A Committee appointed by SEBI under the chairmanship of Shri Y.H. Malegam has been examining these issues with the Institute of Chartered Accountants of India. The Committee on Corporate Governance also considered the following critical issues having a bearing on the quality of financial reporting:

- Consolidation of Accounts of subsidiaries.
- Segment reporting where a company has multiple lines of business.
- Disclosure and treatment of related party transactions.
- Treatment of deferred taxation.

Corporate Governance Practices Initiated by some Indian Companies

Tata Steel won the National Award for Corporate Governance for the year 2000. The organization believes in the philosophy, "Let us not forget that our job is much bigger than making steel: Wealth created must go back to the community." At Tata Steel, corporate governance is defined as making the proper use of and being accountable for the rights and values that have been reposed in the corporate body by shareholders. As Asea Brown Boveri, which conducts employee and customer satisfaction surveys as part of the corporation's governance practices states "Governance goes beyond external shareholders". As responsible corporate citizens, organizations need to widen their linkages with issues of social development, especially in the area of education, health, environment and community development.

Wipro Corporation and Infosys Technologies, which are both Indian firms, have strong commitment to employees and shareholders. Infosys thrives on its objectives of making thousand of its employees millionaires through the company's stock sharing programmes .The Hindustan Lever's CEO feels that governance is not a matter of creating checks and balance; it is also about creating an out performing organization: increasing customer satisfaction and shareholder value." At HLL, the board as opposed to individual directors collectively examines issues like fit between innovation and strategy, between brand statements and customer requirements, between human resource availability and organizational needs. Meeting at least 10 times a year, the board draws on the expertise of external directors for improving managerial practices in the organization, arguing that shareholders can then be confident of the company's performance.

Indian corporate sector has for long been dominated by family run firms, which of late have, been realizing the importance of professional management. As India moves towards globalization, it will have to source global capital through ADR's, GDR's, FDI and financing by way of debt. The market scenario is changing. The competition is increasing; consumers have choices so they would prefer organizations, which have higher level of transparency.

Ethics and Corporate Values

The appalling work conditions in the eighteenth and nineteenth century brought with it the factories acts, clean air acts, labour protection laws and a range of regulations to provide better working conditions to the workers (Walker, 2001). Latest evidence suggests that exposure to industrial chemicals both inside and outside the workplace has been responsible for a large and growing proportion of cancer deaths. But instead of moving towards more stringent controls, government is fighting hard to keep known killers in the workplace (Hazards, 1998).

Deaths from asbestos rose constantly between 1975 and 1995. Death certificates stating asbestosis as the cause of death doubled during this period, and disablement benefit for the illness almost quadrupled. Deaths from mesothelioma, a cancer associated with asbestosis, have increased over the last 30 years, from around 153 reported in 1968 to 1527 in 1998. Analysts believe that by 2020 there could be 5,000 to 10,000 deaths annually (National Health and safety Staistics, 1999/2000). The US National Institute of Occupational Safety and Health estimates that the problem has grown over the last 10 years from 18 percent of all workplace illness to 56 percent (What Doctors Don't Tell You, 1999). Many doctors still refuse to recognize it as a condition, and the government refuses to accept its lay definition for fear of claims against employers (15).

Research has also shown that computer users have a higher level of triphenyl phosphate in their blood than nonusers. Triphenyl phosphate is used as a fire retarding coating for many computer parts and turns into a gas as the computer heats up. Exposure to triphenyl phosphate produces allergic reactions including skin problems and headaches (Crompton, 2000). The problem of Repetitive Strain Injury (RSI) has become well known in recent years. Polyvinyl chloride (9PVC) is a gaseous material used in the manufacture of plastics. Both the gas and the plastic have carcinogenic qualities. PVC derivatives are used in bottles and food wrap products. Workers who produce these products have been found to suffer from a high level of liver and other cancers. Some researchers put the risk of liver cancer in vinyl plastics workers as high as 200 times greater than average (Surgeon 1979). In 1999, a Swedish study, carried out at the Institute of Environmental Medicine at Stockholm, concluded that people living in areas with heavy traffic pollution over 30 year periods had a 40 percent greater than average chance of developing lung cancer whether or not they were smokers (Walker, 2001).

Oil companies are especially controversial. They are located in underdeveloped areas and also more likely to operate in pristine environment and disrupt the lives of indigenous people. And because they operate in volatile settings, oil companies become entangled in security operations conducted by their own or by government forces, with all the risks of human rights violations involved in the process (Ottaway, 2001) Nevertheless, even Human Rights Watch, one of Shells harshest critics, admits that development spending by the oil companies has also brought schools, clinics and other infrastructure to remote parts of the country that otherwise would be far more marginalized by the Nigerian government. (Ottaway, 2001) According to a recent CIA study, companies spilled some 2.5 million barrels of oil in the Niger delta from 1986 to 1996 and they contribute to global warming by flaring large quantities of gas for which they have no market. Their presence disrupts local communities that are normally not consulted about decision that impact their lives.

Legal System

The best practice within companies depends on best practice outside companies, above all in the legal system (Economist, 2001). Laws can be promulgated but more important is the question of implementation. There are over ten million cases pending in various courts all over India and some of them have been in courts for decades still undecided (Transparency International, 1999). The inadequacy in the number of judges in that, the number of judges per million population is already on the lower side with only 25 judges per million as against an estimated requirement of 60 per million population. 25 to 30 percent of posts are normally lying vacant at any point of time. A judge has seventy to eighty cases on the list everyday as against a maximum of twenty that can be handled by him.

China has for instance does not have a problem of good lawyers but of good judges. It has 1,70,000 judges, but have no proper qualifications, their social status is low and their pay miserly. Being short of money increases the vulnerability to corruption.

Winds of Change

United Nations Secretary General Kofi Annan exhorted the world business leaders to “embrace and enact” the U.N. Global Compact, whose nine principles covering human rights, labor, and the environment “unite the powers of markets with the authority of universal ideals.”(Gereffi, Garcia-Johnson & Sasser, 2001)

Certification has appeared in almost every major industry targeted by environmentalists, including chemical, coffee, forest products, oil, mining, nuclear power and transportation sectors. Certification is also prevalent in the apparel, diamond, footwear and toy industries to name a few segments. Organization for Economic Co-operation and Development (OECD) listed 246 codes of corporate conduct, while the Global Reporting Initiative, an organization dedicated to standardizing corporate sustainability reporting, estimates that more than 2000 companies voluntarily report their social, environmental and economic practice and performance. Certification institutions have two key components: a set of rules, principles or guidelines (usually in the form of conduct) and a reporting or monitoring mechanism (often a corporate environmental report, or social audit) 1. The monitoring of the codes of conduct is an expensive business. The cost of monitoring is particularly high, if the practice expands worldwide. Consider the case of Gap Company, which spends $10,000 a year on monitors for Charter, the Taiwanese owned factory in El Salvador originally, named Mandarin International. If Gap were to duplicate these efforts worldwide with its 4000 subcontracting factories around the globe, the annual bill would amount to nearly $40 million or some 4.6 percent of the company’s total year 2000 profits. Orders from

US footwear and apparel makers alone support between 40,000 and 80,000 production sites around the globe. Individual inspections run from $1,000 to $6,000 a piece. Companies foot the bill for their own inspections although the FLA reimburses firms for up to half of the inspection costs. The Apparel Certification has achievements to its credit with the formation of Workers Rights Consortium (WRC) in 2000, which, advocates a living wage for garment workers, independent unions, unannounced factory investigations, and full disclosure of factory conditions. More than 80 universities, compared with 155 universities that have signed on with FLA, support the WRC. Aggressive campaigns by labor groups, NGOs and student activists have compelled apparel corporations to adopt stringent codes of conduct and establish independent monitoring as well. There have been revelations of children employed in these factories, For example in Feb. 2001, the Global Alliance for Workers and Communities released a 106 page, Nike funded report on the labor conditions at nine Nike contract factories in Indonesia. The report detailed a variety of labour problems, including low wages, denial of the right to unionize, and verbal and physical abuse by supervisors, sexual harassment and forced overtime. Similar problems surfaced in Kukdong International factory in Pueblo, Mexico- which produces Nike and Reebok sweat shirts for the $2.5 billion annual collegiate market. It was not inline with Nike’s code of conduct including freedom of association, harassment and abuse and health and safety conditions. By early February, the independent non-profit monitoring organization, Verite, an Amherst, Massachusetts, sent a five-person team at Kukdong to examine the factory’s workplace practices. Nike released the report on March 14, 2001 and its plan for corrective action.

Conclusion

In such a miserable state and with stories of horror that come to foresight, one wonders whether is this a humane place to really live at all. Its not only wealth but also well-being of the people that is important. The corporations need to look beyond the paradigm of profitability and shareholder value. Shareholder value will automatically increase if the ways of doing it are right. The environmental factors have to be taken into consideration. If the ship is sinking, any talk about productivity and costumer satisfaction will not deliver. One will have to strike at the root of the whole malaise to bring about the change in the orientation of the whole concept of governance.

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State Promoted Technology Consortia In India: Internal and External Factors Influencing the Realization Of Initial Objectives

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Abstract

The factors, which influence the functioning of state, promoted technology consortia are studied here. Two cases, one a technology development consortium and the other a technology deployment consortium were studied in this research. Both the internal and external factors were taken into account to understand the performance of the consortia. While in both the cases the non-participatory, but facilitating role of the state helped the consortia getting established and achieves its initial objectives smoothly. From the point of view of internal organization, corporate governance through establishment of independent corporate entities wherein the workforce was independent of functional loyalties to any of the consortium participants helped immensely in the success of the consortia. In both the cases, market attractiveness played a vital role of the consortium success. Among the external factors, availability of alternatives and the lack of competitive positioning of the impeded the growth of the technology deployment consortium studied. Participation of the technology users as stakeholders in the consortium aided the success of the technology development consortium. The user base was also small and formed part of the consortium. It was however not the case with the technology deployment consortium where the technology users were outside the consortium. The user base was quite large and had no stakes in the consortium. This resulted in the success of the technology deployment consortium not being as high as what was initially expected. The participation of the state in competing ventures also impeded the speedy realization of initial objectives in the case of the technology deployment consortium.

Introduction

State promoted technology consortia have been instrumental in enhancing national competitive advantages of various countries. Researchers [26], [29], [16], [10] have observed that technology consortia have been formed with various goals ranging from funding of basic R&D, technology and market coordination, overcoming technological discontinuities, funding risky ventures, standardization of technology and products, byproduct utilization, management training, competence building to improve national competitive advantage etc.

Worldwide, various consortia were established with government support and participation. SEMATECH, established in 1987 to develop semiconductor production technology with a US$ 1.7 billion budget as of 1996 had half of its funding from the government. The European Strategic Programme for Research and Development of Information Technology (ESPRIT), the EUREKA, the Japanese Fifth Generation Computer Project etc., are just a few more examples of state promoted technology consortia. In a recent study of over 200 consortia in Japan [23] it was found that governmental support is declining in technology consortia and the benefits expected now from governments are more of an intangible nature. It was also found that even the motivations for the formation of such consortia and expectations from the non-government partners are different now compared to what they were in the earlier cases. While the experiences of Sematech, Eureka, the semiconductor industry consortia in US, Japan and Taiwan were well researched [15], [5], [9], [27] the technology consortia in India with state participation are yet to be studied in detail.

Research Objective

While studying collaborative ventures, researchers [11], [2], [13], have defined unsuccessful collaborative relationships as those with less longevity or stability. However, exceptions to this school of thought have been the researches which looked at such relationships more from the point of view of achieving the initial objectives [19], [7], [22]. The authors subscribe to the latter worldview on inter-firm relationship success. The present paper is an effort to study the dynamics of Indian technology consortia with state participation and from the point of view of the determinants of success.

The following research questions were addressed:

1. What are the motivations for the formation of state promoted technology consortia in India
2. What are the internal and external factors that effect the realization of these objectives

Methodology

Technology consortia typically cover a range of emerging technologies including Information Technology, Biotechnology, Pharmaceutical, Telecom and Speciality Chemicals. These consortia represent a new organizational form and they pose management challenges. This study is based on case studies of consortia with private sector participation with a degree of government involvement. Government can have a significant influence on the formation of consortia including input on the type of participants who will be involved and the directions the consequent results will take [23]. The consortia selected for case studies are based on the criteria that the projects and the output of the consortia involve cooperation among private sector firms. In other words, consortia which involved primarily government participation and those in which the government agency simply allocated tasks without the initiative of the private sector were excluded. The cases considered were the International Technology Park Ltd., Bangalore in the Information Technology industry and the Biotech Consortium India Ltd., Delhi in the Biotechnology industry. These case studies include cooperative projects sponsored by the Department of Biotechnology, Government of India and the Government of Karnataka (through the Karnataka Industrial Areas Development Board – KIADB).

At the outset, the target population of case leads considered for the study was the following.

1) Technology Development Consortia
    a. Biotech Consortium of India Ltd., New Delhi (Biotechnology industry)
    b. Non-ferrous Materials Technology Development Center, Hyderabad (Defence Sector)
    c. Custom Molecules Pvt Ltd., Hyderabad (Pharmaceutical Industry)
2) Technology Deployment Consortia
    a. International Technology Park Ltd., Bangalore (Information Technology Industry)
3) Marketing Consortia
    a. VSNL-MTNL-TCIL consortium (Telecom Industry)

As the VSNL-MTNL-TCIL consortium was more of a marketing entity between three state owned firms and no private sector participation, it was not considered for the purpose of the study as a technology consortium. Custom Molecules Pvt. Ltd., a newly formed consortium between the Bulk Drug Manufacturers Association, the Government of Andhra Pradesh and 8 SMEs was also not considered for the study as it is a relatively new entity and it may not be possible to understand as of now whether or not the initial objectives are met. The Non-ferrous Materials Technology Development Center, a consortium between the Defence Metallurgical Research Laboratory and four state-owned firms in the mining and metals business was also dropped from the study due to strategic reasons as it addresses the defense sector.

Eventually two consortia were chosen for the study, the BCIL, which is a Technology Development Consortium, and the ITPL, which is a *Technology Deployment Consortium.*

Limitations of the Study

Data was collected from each department and government board through direct contacts after examining information available over the Internet put out by the government agencies and other press publications. The consortia and their activities were documented through personal contact with those officials involved in the formation and administration of the consortia. The data set for the paper is not a comprehensive representation of the perspective of all the stakeholders of the consortia as access, to the government officials involved in structuring and managing projects in the consortia, was difficult and obtaining appointments for interviews from private sector partners in the consortia was not an easy task given the busy schedule of these senior managers. Eventually, data was collected through a combination of face-to-face interviews and telephonic question and answer sessions.

Both the consortia considered here viz., the ITPL and the BCIL were not predominantly state funded and therefore the government did not have a majority stake in the consortia. Thus, the findings of this research may not be generalizable for consortia with predominant state funding. Both the consortia, which form the focus of this study, are separate legal entities. Thus, the findings may not necessarily apply to consortia formed without a separate legal identity being incorporated.

Use of Technology Consortia

The need to leverage scarce scientific and technical talent, and the desire to share the risks associated with technology generation and commercialization drives firms to band together in cooperative activities. Technology activities are complex and hence call for reducing the risks for firms involved in either developing or deploying them. Such activities are characterized by uncertainty, indivisibility and inappropriability [14]. The uncertainty associated with new technology development and deployment makes it difficult for firms to understand or predict the possible outcomes of associating with the technology. The indivisibility of the technology calls for firms to share their resources and knowledge, in order to collectively deal with the various interlinked elements of the technology. The difficulties associated with appropriating technology calls for firms to partner for transferring the knowledge to the right users at the right time. The knowledge involved in transferring the technology is very critical here. Time and again governments have participated in facilitating such multi-lateral partnerships between firms either for Technology Development or for Technology Deployment. Such efforts have lead to the formation of consortia.

Consortia are considered to be intermediate governance forms between markets and hierarchies [30], [13]. Consortia can be distinguished from other interorganizational forms such as joint ventures, technology licensing, subcontracting etc., along the following parameters:

- They typically involve multifirm rather than dyadic interfirm cooperation
- They usually involve horizontal collaboration among direct competitors

Technology consortia thus constitute a subset of organizational forms involving formal interfirm cooperation among potential competitors from the same industry [6] and most of the collaboration is in the precompetitive stages [14]. However, with the pressure on time to market increasing and also the product development cycles being compressed into the product marketing activities, the very nature of the consortia is also changing with the line between pre-competitive and competitive stages slowly getting effaced.

In a comparative study between R&D consortia in US and Japan, it was found [1] that internal diversity and interorganizational relations in consortia have an impact on information exchange and governance mechanisms. Thus the diversity among participating firms and the nature of relationships they engage into would have implications on the success or failure of a consortium and also the governance costs that influence such a success or failure.

Factors Effecting Consortium Performance

Since consortia are often composed of companies that seek mutual benefits but remain competitors otherwise, they are composed of personnel from radically different corporate cultures, shareholders with different managerial priorities, policies and procedures. As a result, managing consortia poses a major challenge. There are a variety of possibilities in terms of the organizational structure, technological emphasis, funding mechanisms and personnel make-ups possible in consortia. These choices are a fall out of the mechanisms in place to avoid failure of the consortia and also in order to achieve the initial objectives set forth. The geographic shift, person-to-person, group-to-group and organization-to-organization interactions influence the ease of governance of a consortium and also the benefits accrued to the participant firms.

The performance of technology consortia has thus been found to be effected by a host of internal governance issues of the consortium like structure, culture, goal congruence between the partners, information processing, equivocality of objectives, organizational processes relating to recruiting personnel, obtaining resources, decision making, evaluation of outputs, bureaucracy, retention of members etc., and external issues like culture of the country, institutional environment, legal issues, distance between the partnering firms, competitive positioning of the consortium etc [24], [6], [12], [17], [3]. Researchers [17] have found that all these governance issues lead to an increase in the transaction costs, which have been found to be the key determinants of the success or failure of consortia. They have also found that the effect of power dependence is much less compared to the effect of transaction costs.

Apart from incongruity of goals, bureaucracy and cultural factors, many technology consortia were found to be failures on account of the improper split of activities across various participating firms [28]. Closely related to this is the level of importance each of the partners attach to the technology being dealt with. Typically in consortia dealing with technology transfer, the willingness of the recipient to receive the technology as well as the willingness of the owner to transfer the technology are critical for the success of the consortium [20]. Recipients of the technology can be outside the consortium also. These are the end users in the marketplace. The market conditions and the utility value the end users attach to the technology as a tool or a product in the marketplace becomes critical here.

The nature and internal alignment of the relationship between the participating firms signified by the degree of procedurality, competitiveness or collegiality, involvement or distance, individualism or supportiveness, apart from the stress in the relationship determines the success of consortia [31]. Apart from this, the perception of the participating firms about the consortia also matters much in the performance of the consortium. Often firms view consortia as forced cooperative ventures [3]. This attitude of indifference could lead to opportunism and thus erode the benefits of a consortium. Several organizational mechanisms like individual structures and central controls are employed in order to overcome this problem in consortia. The importance attached to the consortium by the individual firms, the resulting involvement by each of these firms in the consortium, as well as the alternatives available would determine the success of the relationship [17].

On the relationship front, consortia performance has also been found to be closely coupled with the tightness of the individual level relationships between the decision makers of the consortia and the proponents of the consortia [18]. Thus more than the organizational-level networks, the individual level networks also play a vital role in the effective functioning and success of the consortia. The value addition each partner brings on account of their network ties with participating members, also determines the success of a consortium [17], [8], [4], [21]. Such ties would prevent the participating firms from indulging in opportunistic behavior. The ties that firms have outside the network could add additional value to the relationship as this could help commercially sustain the technological efforts of the consortium.

The functional loyalty [3] of the staff to their parent companies plays a vital role in their allegiance to the consortium and thus has a positive or detrimental effect on the results gained. Staffing is a key problem in consortia. The staff could be directly hired for the new entity floated or they could be deputed from the individual firms partnering in the consortium. Researchers have also found that the attitudes and expectations of the direct hires and deputed employees of the shareholders are different and the effects of these are reflected in the performance of the consortium [25].

In summary the factors, which influence the performance of consortia both internal and external to the consortia, are listed below:

Table 1:INTERNAL AND EXTERNAL FACTORS INFLUENCING STATE-PROMOTED TECHNOLOGY CONSORTIUM PERFORMANCE

External Factors	Internal Factors
Contribution of the State	Contribution of the State
Cultural distance between firms	Struggle for control between participating firms
Geographical distance between firms	Network ties between participating firms
Distance from commercialization space	Opportunism on account of the perception that the consortium is a temporary arrangement
Equivocality	
Motivation to keep the consortium operational	Management Structure
Willingness of end recipient	Culture
Market conditions	Goal congruence
Importance of the consortia in the market place	Split of operations
Involvement of the end users	Functional loyalty of the staff
Network ties outside the consortia	Willingness to transfer technology
Alternatives available to the participants	Willingness to receive technology
Pre-competitive Vs. cooperative nature of the association	Approach towards the relationship – functionalist Vs. culturalist
Knowledge ownership	Cohesion in the unit
Newness of technology	Work coordination
Resource constraints	Feedback motivation
Competitive positioning of the consortium	Job involvement of the partners
Autonomy of the entity	Stress on the consortium
Lost opportunity	Inefficiencies on account of improper functionality

These factors could however be different for *technology development consortia* and *technology deployment consortia*. Not all of these factors could be relevant for both types of consortia. The following sections would chart the evolution and functioning of one case each of the *technology development consortia* and *technology deployment consortia* and bring out the distinctions between the internal and external factors that effect the performance of the same.

Case of a Technology Development Consortium: Biotech Consortium India Ltd., Delhi

This consortium was started in 1990 at the initiative of the Department of Biotechnology of the Government of India, with a core capital of US$ 1.2 m. A major part of the initial investment came in from five Indian Financial Institutions viz., IDBI, ICICI, IFCI, UTI and RCTC. Apart from this a host of companies from the corporate sector viz, Ranbaxy Laboratories, Glaxo India, Cadila Laboratories, Lupin Laboratories, Kothari Sugars and Chemicals, Rallis India, SPIC, Madras Refineries, Zuari Agro, EID Parry, ACC and Excel Industries joined the consortium, with some investments from their side.

In the biotechnology industry, as realization of technological initiatives into commercial ventures could not take place in the absence of adequate scale up, the Department of Biotechnology felt the need to set up BCIL to undertake a continuous exercise to screen these technologies, interface between technology sources and technology seekers, assist in technology sourcing, marketing tie-ups and identification of joint venture partners.

The consortium was set up with the following objectives:

- Providing the linkages to facilitate accelerated commercialization of biotechnology
- Technology development
- Technology transfer
- Project consultancy
- Fund syndication
- Information dissemination

- Manpower training and placement

The technology commercialization process was facilitated by the following:

- Financing scale up from lab scale to pilot plant demonstration unit
- Packaging to enable entrepreneurs/industry and financial institutions to assess the commercial potential
- Industrial tie-up for scaling up from pilot plant to commercial level
- Patenting of technology
-

Role of the State

The consortium was first initiated by the State through the Department of Biotechnology. There was however no funding from the state. The State consciously refrained from having its personnel in the workforce of the company. However, the Secretary of the Department of Biotechnology and the heads of the CSIR and ICAR, two state run R&D councils are Directors on the board of the company. The Directors add value by bringing in the linkages from the basic R&D labs in the country. The state through the Department of Biotechnology also helps in developing specifications for the technology and standardizing the technology. The conscious step taken by the state to refrain from any management control over the consortium has enabled the consortium record good performance leveraging the flexibility that was built into the system.

Role of Other Stakeholders

The firms, which are part of the consortium, help in gauging the technology trends and also in taking the consultancy and technology development services of BCIL. They play the role of a captive market and also that of designers and drivers of the technology being incubated in the labs. Apart from this they also act as technology transfer channels for the company.

The financial institutions have their presence in the company more as equity holders as they had brought in the initial investment.

Market Attractiveness

All the firms in the consortium apart from the financial institutions are users of the technology and help BCIL incubate and commercialize those specific technologies, which they intend to transfer to the marketplace for being used by the end customers. The presence of a captive market and also the involvement of the recipients of technology as partners in technology development and commercialization has resulted in BCIL catering to a highly attractive market.

Governance Structure and Staffing

The consortium is being operated as a separate legal entity and was incorporated as a separate company according to the Indian law. This gives the consortium a high degree of flexibility in its operations and also having direct hiring for its employees. As a result it does not possess any conflict of interests between its goals and those of its employees, as these employees do not have any affiliations with the partnering firms. This has been a critical success factor of the consortium.

Network Ties of the Parties

The state leverages on its network with the other R&D labs in the country to bring in value in the basic research, thus adding quality to the work being done at BCIL. The participating firms add value to the consortium by leveraging on the network relationships they have with their end users and business partners to commercialize the technology being incubated at in the consortium.

In summary the following table captures the major factors, which enabled BCIL to be a high performing state promoted technology consortium.

Performance of the Consortium

The facilities are currently benefiting over 120 clients, scientists, technologists, research institutions, universities, first generation entrepreneurs, the corporate sector, government, banks and financial institutions. The company has successfully commercialized and licensed out a host of indigenous technologies in the areas of biopesticides, neem pesticides, bacterial biofertilizers, Microbial aerobic fermentation, Lactic acid and derivatives etc., and a host of international technologies like spirulina production, extraction of papain from papaya, b-carotene production etc. Apart from these, blue green algae, bacterial biofertilizers, HIV detection kits and Pearl culture are some of the technologies in the process of commercialization.

The consortium was a recent recipient of the National Award for the Best Efforts in Commercialization and has been recording profits over the years. Apart from the initial investment, there has been no further funding for the consortium and the revenues are being generated purely through their own activities.

Table 2: INTERNAL AND EXTERNAL FACTORS INFLUENCING PERFORMANCE OF BCIL

External Factors	Internal Factors
Contribution of the State - by *interfacing with the basic R&D institutes of the country* Distance from commercialization space – *the partners were also the users of the technology* Equivocality – *there was a clarity of purpose as all the partners joined on account of a need to speed up commercialization* Motivation to keep the consortium operational Willingness of end recipient Market conditions – *attractive as the partners themselves were using the technology* Leveraging personal relationships - *high* Importance of the consortia in the market place Involvement of the end users Network ties outside the consortia – *high contribution both by the state and the partnering firms* Alternatives available to the participants - *low* Pre-competitive Vs. cooperative nature of the association – *the focus was clearly on the precompetitve phase* Knowledge ownership – *rested with BCIL* Newness of technology - *high* Resource constraints – *high* Competitive positioning of the consortium - *high* Autonomy of the entity – *extremely high*	Struggle for control between participating firms – *there was no struggle for power as BCIL has been incorporated as a separate legal entity with no majority shareholding for any company* Network ties between participating firms – *high* Opportunism on account of the perception that the consortium is a temporary arrangement - *low* Management Structure - *independent* Goal congruence - *high* Split of operations – *there was no split all rested with BCIL* Functional loyalty of the staff – *high as they were all employees of BCIL* Willingness to transfer technology - *high* Willingness to receive technology - *high* Approach towards the relationship – *functionalist* Cohesion in the unit - *high* Work coordination - *high* Feedback motivation - *high* Job involvement of the partners - *high*

Case of A Technology Deployment Consortium: International Technology Park Ltd., Bangalore

The city of Bangalore in South India has come to be known as the Silicon Valley of India. It has over 900 IT companies contributing a major chunk to the US$ 1.58b software exports from India. Over the years 1999-2000 Bangalore has experienced an exponential growth of 73% in its software export revenues and has reached a business of US$ 16.6m. One of the major infrastructural requirement for IT companies in India is the technology in terms of uninterrupted power supply and high speed communication backbone to their clients in US in order to have a 24 hour interface and make effective use of the differentials in time zones. With the latest advances in broadband and Internet technologies it was felt that there was a need to make these technologies available at a pool for IT companies in Bangalore. Also the power supply fluctuations called for establishing power generation units to cater to multiple users under the same roof at lower prices.

The Information Technology Park Limited was set up with an initial outlay of US$ 1.2m to provide efficient & reliable infrastructural services offering a dynamic business platform of international standards to the IT companies based in Bangalore. It was conjured by the best brains and corporate enterprises from both India and Singapore, who are experts in the formation and management of high-tech business superstructures. The consortium was formed between The Tata Industries Ltd., the investment arm of the Tata Group one of India's largest conglomerates with more than 80 companies in diverse businesses, the Singapore Consortium, a consortium of Singapore companies, led by Ascendas Land International Pte. Ltd., associated with successful industrial and science parks in Singapore, China and other Far East nations and the Karnataka Industrial Areas Development Board (KIADB), a statutory body of the Government of Karnataka, India.

The International Tech Park, Bangalore was set up to provide a one-stop solution to multinationals and other conglomerates for conducting high-tech and knowledge-base business in India in an environment based on the integrated concept of work, live and play. High quality professionally-managed services apart from state of the art communication facilities like video conferencing, high speed data transfer links, uninterrupted power supply etc., were provided at the park.

The Park already houses corporate majors operating in a wide range of businesses, such as information technology, biotechnology, electronics, telecom, R&D, financial services, and other IT-related services. With the commissioning of Stage 2, the park is gearing up for extending its commitment to the new occupants.

The fully occupied Phase 1 of the Park stands on a 27 hectares (68 acres) plot in Whitefield, Bangalore. Whitefield is located 12 kms from Bangalore airport and 18 kms from the city. The ready-built facilities; infrastructure like power, water, telecommunication and satellite connectivity as well as other value added services offer companies a quick start up - a distinct advantage over others who have to start from scratch and put in heavy upfront investment. The first phase of the project comprises three buildings - Discoverer, Innovator and Creator, totaling close to 1.2 million square feet of built up office, production and retail space. A 51-unit residential tower, situated in the Park, also enjoys the facilities of the Park like power, water and recreation.

Electricity being a major constraint in Bangalore. ITPL as its own 9 MW (3x3) Dedicated Power Plant. This is synchronized with the 220 KV grid of the Karnataka Power Transmission Corporation Limited. The synchronized power is redistributed to the clients thereby ensuring reliable and clean power supply 24 hours a day. ITPL is the only such establishment in Karnataka to receive power from the Utility Board (KPTCL) at the highest voltage level i.e. at 220,000 volts. The power supply at 220 kV ensures that is far more dependable than what is available at lower voltage levels to other consumers in the State (11 kV for e.g.) The supply to the Park is through two such 220 kV lines from two different substations of KPTCL thus ensuring 100% redundancy.

As most of the firms operating in ITPL are information technology firms, the park had established an dedicated high speed internet access link. A Videsh Sanchar Nigam Limited (VSNL) Earth Station featuring a very high bandwidth provides direct connectivity with destinations across the world for high-speed data transfer. The 13-m wide satellite dish supports high-bandwidth requirement in multiples of 2 mbps for superior quality data transmission. It comes with optional benefits for Internet and Video Conferencing. The connectivity has an efficiency of 99.99%. The Park provides leased lines from 64 Kbps to 2 Mbps.

Role of the State

The participation of the state in the consortium was through a statutory body called the KIADB. The objective of the state in participating in the venture was to help in the overall industrial growth of Karnataka and also to generate employment. Since it was expected that most of the companies occupying the park would be from the IT industry, the state expected to have Bangalore on the IT map of the world by providing high quality infrastructure, which could attract the best companies in the world to Bangalore. The state helped in procuring the land and the necessary clearances.

Role of Other Stakeholders

The Tatas were instrumental in bringing in the investment and the Singapore consortium with its vast expertise in building similar technology parks enabled to develop the park as a good international destination by bringing in its technical expertise and apart from the investment. The Tatas also leveraged on their relationship with the government and helped the Singaporeans cope with the cultural aspects of managing the consortium and its dealings with the external interfaces.

Market Attractiveness

As mentioned earlier, the market for software exports has been quite attractive and Bangalore as a destination for IT companies had also been an attractive proposition. India has a great advantage in the IT world map as it has a good low-cost high-quality manpower, and is the second largest English speaking manpower resource to the world. The IPR laws in the country are also quite attractive.

Governance Structure & Staffing

As the state helped in procuring the land and the necessary clearances and in return was given a 20% equity in the consortium. The rest of the partners the Tatas and the Singapore Consortium were given a 40% state each. Each of the partners have a proportionate representation in the board. The ITPL was incorporated as a separate corporate entity under the Indian law and has employed its one sole employees. The park is currently headed by a CEO from Singapore. The government refrained to depute its employees as staff of the ITPL. It was agreed that the Chairman of the consortia would be a nominee of the Tata group and the CEO would be a nominee of the Singapore consortium. Initially some personnel were deputed at the senior level from both the parties in order to establish the consortium. There was however no such participation from the state.

Network Ties of the Parties

The government was able to leverage its linkages by getting the necessary clearances and also procuring the land.

Performance of the Consortium

The consortium is considered to be moderately successful as it was not at the pace, which was expected. Plans are however afoot for the phase-II. The schemes offered by the STPI (Software Technology Parks of India), an autonomous association floated to promote the software industry, were taken as a better proposition by many firms due to the tax and import duty concessions and the flexibility in location. As a result large corporates set up their own technology parks closer to the city of Bangalore than ITPL and still enjoying the same infrastructural facilities built by them as those existing at ITPL. It was the smaller firms, which could not afford their own infrastructure in communication, and power that opted for ITPL. However, as the STPI also set up cost effective large technology parks in the Electronics City promoted by the Government of Karnataka, some of the smaller IT companies found attractive to occupy those office spaces due to proximity to the city of Bangalore and availability of cost effective space.

The factors influencing the performance of the consortium are summarized below:

Table 3: INTERNAL AND EXTERNAL FACTORS INFLUENCING PERFORMANCE OF ITPL

External Factors	**Internal Factors**
Contribution of the State - *by interfacing with the government for clearances* Distance from commercialization space – *high* Market conditions – *attractive* Importance of the consortia in the market place – *not very high as there were other alternative sources* Network ties outside the consortia – *high contribution both by the state* Nature of technology – *investment intensive* Competitive positioning of the consortium - *low* Autonomy of the entity – *moderately high*	Struggle for control between participating firms – *there was no struggle for power as ITPL has been incorporated as a separate legal entity with no majority shareholding for any company* Management Structure – *independent. However it was agreed that the Chairman would be from the Tata group and the CEO would be from the Singapore consortium.* Split of operations – *there was no split all rested with ITPL* Functional loyalty of the staff – *high as they were all employees of ITPL*

Summary of Findings

The following grid depicts the critical success factors and the detrimental factors both internal and external for the technology development and the *technology deployment* consortia. The role of the government, which enables the consortia to reach a level of success, is also listed.

Table 4: CRITICAL SUCCESS AND IMPEDING FACTORS INFLUENCING PERFORMANCE OF STATE PROMOTED TECHNOLOGY CONSORTIA

TECHNOLOGY DEVELOPMENT CONSORTIUM	**Success Factors:** - Participation of the technology users in the consortium - Attractiveness of the market - Usage of network ties by the partners - Involvement of almost all the technology users as stakeholders	**Success Factors:** - Facilitating, non-participatory role of the government - Structuring as a separate legal entity independent of the government - Independent workforce
TECHNOLOGY DEPLOYMENT CONSORTIUM	**Success Factors:** - Attractiveness of the market **Impediments:** - Lack of competitive positioning - Availability of alternatives outside the consortium to technology users - Participation of the state in similar	**Success Factors:** - Facilitating, non-participatory role of the government - Structuring as a separate legal entity independent of the government - Independent workforce

	competing ventures - Large number of technology users and the inability to incorporate them as stakeholders	
	EXTERNAL FACTORS	**INTERNAL FACTORS**

While in both the cases the non-participatory, facilitating role of the state helped the consortia getting established. From the point of view of the internal organization of the consortium, corporate governance through the establishment of independent corporate entities where the workforce was independent of any functional loyalties to any of the participating firms helped immensely in the success of the consortia. While involving the technology users as stakeholders helped the technology development consortium, such a possibility could not be experienced in the technology development consortium. Moreover, the number of technology users who could be involved as stakeholders was high in the case of the technology development consortia compared to the technology deployment consortia, where the technology users were much more higher and could not be incorporated into the consortium as stakeholders. Among the external factors, participation of the technology users helped in making the technology development consortium as stakeholders a success. In both the cases, market attractiveness played a vital role in the success. However, the availability of alternatives and the lack of competitive positioning of the consortium impeded the growth of the technology deployment consortium. The participation of the state in competing ventures also contributed to the slower growth of the technology deployment consortia compared to what was initially expected.

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The Implementation of E-Commerce in India: The Human Aspect

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Abstract

Despite obvious benefits, e-commerce in India has not expanded as rapidly as elsewhere in the world. The question is why, when India has become a global leader in developing software and providing IT enabled services, does it lag behind in using e-commerce? The reasons proposed here are not the obvious mechanical problems of technology or infrastructure but the more difficult human problems. To explore the human aspects of e-commerce in India, this paper presents secondary data on the attitudes of business to e-commerce and primary data from eight Focus groups plus a survey on the attitudes of consumers.

E-commerce can be broadly defined as any sale that is handled electronically. According to this definition, e-commerce is some 150 years old, dating from the first use of the telegraph. Since then, e-commerce has incorporated the use of the telephone, electronic transfers, and electronic data interchange (EDI) to link companies' remote offices, business partners and customers. The use of the Internet is a logical extension of these earlier methods of electronic transactions.

This definition of e-commerce includes the sale of goods or services over the Internet but not the provision of IT-enabled services; for example, Amazon having e-mail answered in India. Nor does it include the development of e-commerce software and services. Both IT enabled services and e-commerce software are areas in which India is becoming a world player (*ebusinessforum.com* 2001). But Indian e-commerce itself is still in the nascent stage.

The actual scope of Indian e-commerce is difficult to estimate. A year ago, NASSCOM, the Indian National Association of Software and Service Companies, estimated that there were 770,000 Internet subscribers. Adding in those who accessed the Internet from cyber cafes raises the estimated total number of Internet users to some 3.2 million. The number is expected to reach 100 million by 2008, 10% of the population. The estimated e-commerce sales in 2000 vary anywhere from $96 million (*India Express)* to $120 million (*eMarketer.com*). The consulting group McKinsey projects that Indian e-business will be worth $10 billion in 2008.

Despite the rosy predictions for the future, e-commerce in India is currently still limited. The *Wall Street Journal* (February 12, 2001, p. R12) calls e-commerce in India, "disappointingly small, estimated at half of even China's low level of online sales." According to *Business Week* (March 12, 2001, p. 4EU2) "E-Commerce (in India) promised much but delivered only a trickle of transactions." A study by Ipsos-Reid (*timesofindia.com,* May 16, 2001) placed urban India "almost at the bottom of heap" of countries based on the number of its inhabitants who had heard of the Internet. The *Economist's* Intelligence Unit (*ebusinessforum.com*) rated India 3.79 out of a possible 10 in e-business readiness, placing India in the second from lowest quartile. This group is characterized in that they "have begun to create an environment conducive to e-business, but have a great deal of work to do." All these reports indicate the e-commerce in India is lagging behind the rest of the world.

The projected growth of e-commerce in India is based on the assumption that the impediments to its implementation will be removed. Already the need for an adequate legal infrastructure has been remedied, with India being one of the few countries to adopt an e-commerce law. The new Information Technology Bill law negates the need for paper records for the law of evidence and provides legal recognition of e-commerce transactions, thus making it possible for electronic fund transfers. The law also allows 100% foreign ownership of Indian e-commerce firms, thus increasing the possibility of foreign direct investment in Internet service providers, which will further facilitate Internet access.

Another oft-cited impediment to e-commerce in developing countries is the lack of technical expertise. India, however, is the exception. It is a leader not only in software development but also in e-commerce software, exporting its wares around the world. The problems of infrastructure, however, still remain: the lack of a reliable electricity and phone system, the lack of a credit card system, the lack of access to computers and the Internet.

The premise of this article is, however, that given India's creativity and technical expertise, these mechanical problems will be solved in time. The more difficult problems are the human ones. As the chief executive of *AuctionIndia.com*, Mani Sam, says, the greatest obstacle to development of e-commerce is "attitude" (*Petroleum Economist*, May 2001, p. 40). The issues being addressed here are whether Indian businesses will adapt to a new style of management required for e-commerce and whether Indian consumers will adjust to a new style of impersonal trust.

Business-to-Business (B2B) E-Commerce

Most e-commerce transactions are now business-to-business, worldwide as well as in India. In India, studies by both *eMarketer.com* and *India Express* agree that B2B comprises 90% of e-commerce sales. A rudimentary examination of the Internet indicates an incredible proliferation of Indian e-commerce sites. There are innumerable virtual trade fairs, and many different portals for plastics, chemical products, textiles, agriculture, etc., etc., etc.

B2B e-commerce in India is facilitated because payments are commonly made by a parallel transaction outside the net, so the need for credit cards or electronic funds transfer is not an issue. Consequently, B2B e-commerce has not been severely hindered by the lack of financial infrastructure. Also aiding the development of B2B e-commerce is the country's tradition of small businesses. Both Fukuyama (1995) and Castells (1996) argue that small businesses benefit greatly from their flexibility.

Another plus to Indian B2B is the active interest of Indian business in the introducing ERP (Enterprise Resource Planning) systems. ERP systems integrate corporate functions of financial management, distribution, materials management, manufacturing and human resources. SAP, the largest ERP provider in India, as well as Oracle and others have now introduced Customer Relationship Management (CRM) applications to link internal functions with external customers.

Nevertheless, despite these unique aspects of Indian business, which facilitate the development of B2B e-commerce, whether Indian businesses will actually benefit from these advantages is still problematic. At present, according to an Ernst and Young survey, only 25% of Indian companies use any form of e-commerce (*Travel Trade Gazette Asia*, December 8, 2000). Bruce Elliott, founder and executive director of World Wide Web Institute in Geneva contends, "the major hurdle is psychological preparedness of people for E-com. Indian companies are not psychologically ready to accept E-commerce or do transactions through this method" (*Living Media India*, October 31, 1999, p. 128).

A serious impediment to the development of e-commerce, according to a PricewaterhouseCoopers (PWC) report in 1999, is that Indian firms have simply not paid attention to e-business. Indian executives have not developed an e-commerce strategy and have not made a major commitment of resources. The PWC survey of Indian firms indicated that 89% reported no revenues from e-business compared to only 35% of businesses worldwide.

One reason for their lower level of interest in business-to-business e-commerce is that Indian business people do not yet perceive the potential benefits. According to a UN Report on "Business Facilitation Needs" for e-commerce (Janardham 1998, p. 3), small and medium sized enterprises (SME's) in all of Asia generally "do not perceive that electronic commerce can substantially assist them… SME's appreciation of the potential for electronic commerce to provide competitive advantage and support export opportunities is still relatively low." The head of the PWC Indian corporate strategy group claims that Indian companies "do not perceive business to business opportunities with suppliers and trade partners as very important" (*Asia Intelligence Wire*, July 12, 1999).

Another reason for the low interest is the recognition that implementation entails more than just technology. The PWC survey showed that 59% of the Indian managers interviewed believe that e-business will have a significant impact on their industry and may completely reshape their business (*Asia Intelligence Wire*, July 12, 1999). "E-business is not just having a corporate web-site or selling over the web. In reality e-business is changing the way each company or organization operates," states Jarvis, the head of Oracle's worldwide marketing division (*Asia Pulse*, June 14, 1999, p. 12). As Robert Litan writes in *The Ottawa Citizen* (March 26, 2001, p. D8), "New technologies do more than just create new firms and consumer products. They change the way that firms throughout the economy do business."

E-commerce is part of a global technological trend that makes it possible to provide information throughout an organization. As a result, all levels of the organization are empowered and the old organizational hierarchy is flattened (Kelly 1998). The new organization is a decentralized and autonomous network where knowledge is distributed, leading to egalitarian relations between boss and staff. Malone and Laubacher (1999, p. 58) explain that "even within large corporations, traditional command-and-control management is becoming less common. Decisions are increasingly being pushed lower down in organization. Workers are being rewarded not for efficiently carrying out orders but for figuring out what needs to be done and then doing it." In the new flatter corporate structure, "the role of the traditional business manager changes dramatically and sometimes disappears completely" (Malone and Laubacher 1999, p. 63).

What is emerging is a virtual company where managers and employees are connected electronically. However, according to Handy (1999, p. 110), virtuality "isn't always as much fun as it is supposed to be. A room of one's own, or at least a desk of one's own, has been the executive security blanket for a century or more." In the new organization, the role of a manager is being robbed of both power and prestige.

It is particularly difficult for Indian executives to adapt to being cyber-managers since the role does not fit into their normal social structure. India, according to the Hofstede (1997) classification, is a high power-distance country that prefers a simple business structure with direct supervision. Coordination is facilitated by the owner's direct personal intervention. The owner acts as the father figure in a family hierarchy where there are strict roles for each of the members. Power is centralized. This hierarchical system typical in Indian business is in stark contrast to the decentralization power structure of the new network organization. "The hierarchical way many Asian businesses are run…is a hindrance to e-Commerce," states Dr. Paul Burrin, Oracle's VP or Asia-Pacific Market Development (*Business Times* [Singapore], October 18, 1999, p. 12). Consequently, for B2B e-commerce to develop, Indian businesses must somehow adapt.

Business-to-Customer (B2C) E-Commerce

Business-to-customer e-commerce, or "e-tailing", encompasses all electronically transmitted marketing transactions between businesses and customers. It involves displaying products, taking orders and payment over the net and then having the product delivered. The prototype is Amazon.com.

E tailing has only just begun in India. *e-Marketer.com* reports that at the beginning of 2001, the Internet was used by only 0.4% of the population, or some 1.8 million persons. Nonetheless, there are also signs that Indian customers are interested in buying over the Internet. At the end of 2000, India Market Research Bureau (IMRB) reported that 38% of PC owners are willing to buy over the net (*The Economic Times*, January 2, 2000). A recent study of 1,328 Internet users by *BrandQuiver.com* showed that 35% shopped frequently on the web, most often for audio or videocassettes and books (*Business Line*, April 19, 2001).

Despite these positive signs, the amount of B2C e-commerce in India is still minimal. The IMRB study showed that only 2.9% of the 1.4 million active Indian Internet users have actually used e-commerce (*India Business Insight*, December 27, 2000). The low response to e tailing in India has caused many dot.coms to perish. Others stay open only in anticipation of the future. For example, the MD of *wahindia.com*, Madhu Trehan, explains that their strategy is "basically to keep the web alive until the timeframe comes when India is really active on the web… In 3-4 years, when the Internet takes off, we will be there" (*Hindustan Times*, April 15, 2001).

A major impediment to the development of B2C e-commerce has been the lack of credit cards. According to the CEO of Rediff, only 10% of the Indians have credit cards and only 40% of those who surf the net have them (*Canada NewsWire Ltd.*, September 7, 1999). A second impediment has been lack of access: there are only 2.2 telephones per 100 people in India.

The impact of these problems is demonstrated by Rediff.com, the first, oldest and most successful B2C site. Back in 1998, the Rediff site was already getting 1.8 million hits per month (*Business Today* October 7, 1999). Of these, however, only one per thousand resulted in a purchase. Two-thirds of the purchasers were Non-Resident

Indians, two-thirds of whom lived in the United States. The situation has not changed radically in the past three years. The *Wall Street Journal* (February 12, 2001, p. R12) reports a recent survey by Rediff showing that just 4 out of 100 Indians who visited their site actually put something in their shopping cart. Of those, 93% left without making a purchase, often because they were shopping from cyber cafes, and their phone lines had been disconnected. As a result, Rediff has still not earned a profit.

These mechanical problems, however, are not insurmountable. Not waiting for the growth in credit cards and Internet connections in India, creative retailers have been finding ways to circumvent the obstacles to e-commerce. They have tried to use the post office not only to make deliveries but also to collect payments. They have made deliveries through retail outlets like Kumars that collect the money (ft.com, November 24, 1999). In Bangalore, they introduced a system for using television sets for Internet transactions. In New Delhi and Mumbai, new Internet kiosks with interactive payphones have been installed that accommodate e-commerce payment with credit cards (*Canada NewsWire Ltd.*, September 7, 1999). In addition, electronic Bill Presentment and Payment now makes it possible to send a bill electronically and receive payment through electronic fund transfer (*Asian Business*, February 2001).

As a result of these efforts, the market for e-commerce has been expanding, although not as fast as once was forecast. What appears to be holding it back is the human element. The success of e-tailing depends on whether its perceived benefits of e-commerce out-weigh its drawbacks. At least more affluent Indian consumers seem to perceive potential benefits from e-commerce, but they are still ambivalent about it.

The affluent Indian consumer is the most likely target market for B2C e-commerce. To understand the attitudes of this group, the author had eight Focus groups conducted in India, two of which focussed directly on e-commerce. These Focus groups were conducted by a university professor and a book editor, both Indian, in Uttar Pradesh, close to New Delhi. The participants in the e-commerce groups were all middle-class housewives except for a retired Army Colonel. They all had sufficient income to make them potential e-commerce customers. To quantify the qualitative data of the Focus group, a survey of 240 middle-class Indian consumers was conducted in Bangalore and was compared to a survey of a similar group of 203 Americans.

The results of these studies demonstrated the ambivalence of affluent Indians in regard to e-commerce. Some of them perceive a greater selection of products and greater convenience to be potential benefits, but others do not. They agree that shopping is a hassle, but they also enjoy it. They think that finding the best price is time-consuming, but they are not convinced that e tailing would help. While a minority has faith in direct mail purchases, the majority lacks trust in retailers and is generally skeptical about buying over the Internet.

Selection: The potential of the Internet to provide a wide assortment of goods will, according to *Business Today* (October 7, 1999), be the catalyst that gets e-commerce going in India. The reasons given are that the top 10% of affluent Indians are geographically dispersed; they lack easy access to retailing outlets which themselves are small and geographically disperse. In contrast, as a housewife in the Focus groups explained, "The Internet offers a wide variety of sizes and price ranges."

Nonetheless, affluent Indian consumers are not convinced that direct mail in general and the Internet in particular will actually provide a better selection. As one housewife declared, "I have never tried anything from teleshopping networks because whatever they offer is available outside. Even if they offer something which is not readily available in the market, I am not tempted to buy it."

Convenience: The Internet makes shopping far more convenient. Instead of having to take the time to go out and shop, consumers can place orders from home at their convenience. This should be a distinct benefit to affluent Indians who, according to the consumer survey, find the stress and hassle of shopping significantly worse than Americans (see Table 1). At the same time, saving time and reducing stress are significantly more important to the Indian consumer (see Table 2).

Table 1: COMPARISON OF INDIAN AND AMERICAN CONSUMERS ATTITUDES TOWARD SHOPPING

Question	**Indian response***	**American response**	**Significance (p-value)**
Finding the best price is a tiring chore	3.7	3.4	< .05
Traveling to different stores is exhausting	3.9	3.3	< .01
I just shop where it's easiest	3.6	3.0	< .01
I go out of my way to shop where there's less stress	3.8	3.2	< .01
Shopping generally takes to much time	3.6	3.0	< .01
Time spend shopping is time wasted	3.6	3.0	<.01

- 5-point scale where 1 = totally disagree, 5 = totally agree

Table 2: IMPORTANCE OF SHOPPING FACTORS

Shopping factor	**Indian response***	**American response**	**Significance (p-value)**
The amount of energy required to go shopping	3.9	3.0	< .01
The stress of shopping	3.8	3.0	< .01
The time required to go shopping	3.9	3.2	< .01
The price itself	4.4	4.1	<.01
The price compared to your income	4.4	4.1	<.01
The total sacrifice of price, time and energy	4.0	3.6	<.01

* 5-point scale where 1 = very <u>un</u>important, 5 = very important

Nonetheless, despite the survey evidence that affluent Indian consumers are more inclined than Americans to go out of their way to avoid stress by shopping where it is easiest, there are also data indicating that shopping in India is an enjoyable social occasion, that interacting with the shopkeeper is a pleasurable experience that the Internet cannot match. As the retired Colonel in the Focus group explained, "One must not forget that in India, shopping is not just a routine activity. It is also a social exercise where one meets friends and associates and interacts with others. For me, shopping or merely strolling through the market is also a form of relaxation after a hard day's work that cannot be attained over the computer. The latter is merely a mechanical tool, whereas the physical shopping activity is a very human part of our culture."

Similar thoughts were expressed by many of the respondents. For example, a young mother asserted, "Computer marketing is not what I call shopping. Shopping is an active participation -- it involves exploring new markets, identifying products, budgeting and then purchasing. All this can't be done on the computer." And still another said, "Armchair shopping takes all the fun away from shopping, as most of the fun in shopping lies in going to the market and choosing from a wide variety of clothes. Computers can never replace the physical shopping experience."

Price: The Internet should provide a great benefit to affluent Indian consumers by making it easy to research price. Because retailers in India are dispersed and not disposed to advertise price, making price comparisons takes time. The survey indicated that affluent Indians feel that finding the best price is a tiring chore. There is, however, evidence that Indians do not view e-commerce as a timesaver. As a young Indian mother said, "Only people with a lot of time on their hands or active interest in computer can enjoy Internet shopping."

The survey showed that getting a good price is more important to Indians than to Americans. Even when affluent, Indians are highly price sensitive and take pride in finding the best price (Maxwell 2001). That is an important part of the shopper's role. It is evident, however, that Indians do not value price information received over the net. The reason is that Internet information is impersonal whereas information in India is gained through personal networks. For example, the Focus group members agreed that word-of-mouth is more important than advertising. As one housewife explained, "Since Mrs. X (another participant in the Focus group whom the speaker had never met before) is so experienced in buying saris, I would blindly rely on her advice rather than follow a newspaper advertisement."

It is a limitation of the Internet that, while it allows shoppers to compare prices against others on the web, it does not allow them to negotiate prices on the street. As a result, the Indian consumer does not trust that the price is a good one. The Colonel in the Focus group declared, "I, for one, will never buy anything over the Internet. I know through my personal acquaintance with a supplier to Burlington's that products offered by the latter are grossly over-priced. For instance, a brand of luxury towels, which are available for Rs. 100 per piece in the open market are priced at Rs. 300 each in the Burlington's catalogs. I could be similarly cheated over the Internet and there is nothing I would be able to do about it."

In some cases, e tailing does make price negotiations possible; for example, with retailers such as Priceline or E-Bay. However, auctions in India are viewed as a means to dump inferior goods and not an opportunity to get a good price. In more common sites such as Amazon.com, price haggling is not possible.

Trust: "Consumers make Internet buying decisions on the basis of trust" (Urban, Sultan and Qualls 2000). But Indians tend not to trust the marketing system. India is what Fukuyama (1995) calls a "low trust" country, one that is built on "familist" rather than impersonal trust. There are no nationwide retailing chains, which can be trusted. There are few national brands. The size and quality of goods vary due to the many small-dispersed manufacturers. Returning goods is difficult and usually the price of goods is not returned.

Since they lack trust in the marketing system, Indians in general frequent only sellers they know or are recommended by someone they know. They prefer face-to-face interactions with sellers to see for themselves whether they can be trusted. Such personal interaction is not provided over the Internet. Hence, there is a general distrust of e-commerce.

The Focus group, however, appeared to be somewhat ambivalent about trusting purchases over the Internet. As a housewife explained, "The real fun of buying clothes, especially a sari, lies in touching the fabric and selecting from a wide variety. I would not like to buy a sari from a computer." Another housewife agreed: "One must physically see the fabric, texture and design of the clothes before buying, apart from actually trying on the clothes for fitting and comfort." But another woman in the Focus group reported, "buying over the Internet entails very little risk as one can return or exchange the product." So the Internet could potentially provide a more trustworthy channel for the Indian consumer.

The Focus groups and survey provided evidence that more affluent Indians are ambivalent about e tailing but still perceive some potential benefits. But it is doubtful that the same is true of less affluent consumers. Even if they have access to the net through kiosks and satellite-based networks, it is questionable how much they will benefit from e-commerce, particularly if they are illiterate or do not read and write English. First, the convenience of the Internet is not that compelling, given that the quality is not reliable. Second, the selection available in the local markets is already quite varied. Third, the price is often non-negotiable. Finally, it is difficult to trust an impersonal, unknown seller. Hence, the use of e-commerce by less affluent Indian consumers is unlikely, at least in the near future.

Conclusion

E-commerce will come to India as soon as business people are convinced of the benefits and affluent consumers overcome their ambivalence. Although e-commerce in India provides obvious benefits for B2B transactions, it will require an adjustment to new organizational structures. Managers will have to give up power to their subordinates and to share power with their customers. Indian producers have enjoyed the power of a sellers' market where they controlled distribution and reserved to themselves information on the product quality. They will now have to share that information with buyers. In addition, they will have to provide the buyer with some assurance of quality: service warranties and ISO certification and guaranteed returns without penalties.

There are certainly signs, however, that the culture is changing. Indian business people are implementing ERP systems, which spread information throughout the organization and necessarily lead to flatter organizational structures. Although changing the role of manager is difficult, the small size of Indian businesses makes change easier. As a result, Indian businesses have the potential to adapt.

As far as the Indian consumer is concerned, the future is less clear. In favor of e-commerce in India is the Nehruvian ideal of modernization: the Internet has perceived value to Indians just because it is modern. It is apparent that a new eCaste is emerging, a group of affluent, educated, westernized young people who embrace the ideal of modernization and are more comfortable with impersonal communications. In addition, B2C e-tailers can build trust in the system by providing guarantees and price-back offers, by ensuring the security of credit cards, and by generally reducing the risk of buying over the net.

At present, the variability of quality and problem of returns with Indian e-tailers may result in affluent Indian consumers purchasing branded products from foreign countries, bypassing the Indian seller. At the same time, it is doubtful that the less affluent Indian consumer will recognize any benefits from e-commerce. Compared to the social interaction of the marketplace, the Internet is cold, impersonal, and not to be trusted.

Indian businesses need to adjust to the new style of e-business in order to benefit for B2B e-commerce. Even then, it will be a while before they will benefit from e-commerce with Indian consumers. It is only when the market structure is changed, when the relationship between buyers and sellers has been altered so that consumers are confident of their rights, and when consumers have been convinced that the relationship has really changed, that Indian consumers will conduct business with Indian businesses through the Internet. As Cox (1999) concludes, "The whole complex development process comes back to the people." This applies to not only social and economic development in general, but the development of e-commerce in particular.

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The Knowledge Focused Marketing Strategy Model: Internet Service Business

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Abstract

The marketing strategy recommended in this study is called the knowledge focused marketing strategy or the k-marketing strategy. It is driven by the 3Cs knowledge, knowledge related to Company, Customers and Competitors, integrated with the values of the business ethics. This integration ensures the company reaching beyond its mission and vision. The knowledge focused strategy model suggests that the company grows as a knowledge company; customers are treated as partners and competitors as complementary or collaborative entity in the company's strategy implementation. The model consists of the knowledge circle, quantity flow, quality flow and the usage flow. The knowledge circle plays a significant role in driving the quality, quantity and usage flows from the current performance position towards the targeted position. The optimization of the quantity, quality and usage flows, are done using the squeeze and stretch algorithm.

Introduction

Marketing Strategy involves the following main steps: Strategy formulation, Strategy Implementation and Strategy Evaluation. This study focuses on the second step that is Strategy Implementation. This paper touches in detail a proposal of the knowledge focused marketing strategy model for gaining the competitive edge from the Internet service business experience. It also touches on the knowledge flow, which includes both the tacit and explicit knowledge. It concludes with a topic that relates to the management of the required knowledge in implementing the marketing strategy successfully.

Squeeze And Stretch Algorithm

The basic step in developing the knowledge focuses marketing strategy (k-marketing strategy) is to look at firstly the physical objectives. For the Internet business, it requires to answer the HOW question to all the three objectives identified.

[1] HOW do we maximize the number of users?
[2] HOW do we maximize the Average Rate per User (ARPU)?
[3] HOW do we minimize the termination rate?

Maximizing the Number of Users

The term used here is users not subscribers. It is important to understand the difference between users and subscribers. Subscribers are customers who purchased the Internet accounts but yet they might not be using them at all. Thus, operationally when subscribers are captured, the ISP needs to ensure that they are users. This can be achieved by providing good contents and incentives. In the effort to maximize the number of users, we need to look into two aspects, maximizing in terms of breadth and height. The height represents the customers' categories distribution in terms of percentages. The breadth represents the total number of subscribers to the service. The height constraints comprises of the ideal percentages of customers' categories distribution identified. The breadth constraint is the optimal number of customers targeted by the company. To gain optimal volume of customers we need to maximize both the breadth and the height.

Optimal Volume = Max [Breadth + Height]
Subject to
Height Constraints [1]
Breadth Constraints [2]

Maximizing the Height

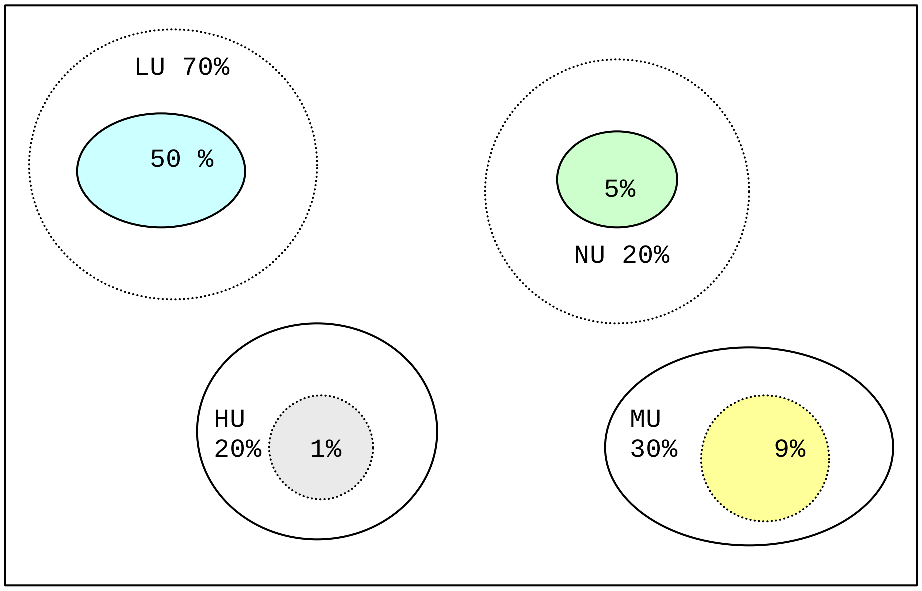
This model is based on the assumption that the organization is going towards the ideal users distribution with expected 20 per cent High User, 30 per cent Medium User and 50% Low User group. Each user group is represented by a circle. The dotted circle represents the actual users distribution in terms of percentage. The ideal circle is represented by the solid line circle. Refer to figure 1.0 for the Ideal and Actual Distribution of the User group within the Internet users population of TMnet. The total percentage of the dotted circle, which represents the actual users distribution, cannot exceed 100 per cent. This is the same as the solid circle. The information regarding each circle is contained in the following manner:

User Group Category = [ID, AD, DD]
where
ID is the Ideal Distribution
AD is the Actual Distribution
DD is the difference between the Ideal and the Actual Distribution

[1] If DD is positive value; squeeze the dotted line circle until it reaches the size of the solid line circle in terms of percentage.
[2] If DD is negative, stretch the dotted line circle until it reaches the size of the solid circle in terms of percentage.

There are two types of variants in the squeeze and stretch model, the vertical squeeze or stretch and the horizontal squeeze or stretch. The vertical variant requires activities related to incentives to users. The activities as such are promotions, which offers physical discounts, rebate and value add sufficing customers' needs. The vertical squeeze or stretch requires repeated activities at an interval of time. The impact of the activities related to the vertical variant is short term, thus need repetition in an interval for significant impact. The horizontal squeeze or stretch variant comprises of activities educating the customers with the products or services and the Internet knowledge. Horizontal squeezing or stretching involves higher cost but giving long term positive impact to the objective function of maximizing the Internet revenue. Note that the horizontal squeeze or stretch activities gives direct contribution to usage increment apart from the increment of the number users. Regardless of the choice, whether it is stretching or squeezing, it is obvious that the knowledge regarding the customers in terms of attitude behavior and satisfaction is required.

For example, referring to figure 1.0, the information regarding each users category are as follows:
HU = [20, 1, 19]
MU = [30, 9, 21]
LU = [50, 70, -20]
NU = [5,20, -15]



Ideal User group Circle with its given percentage Actual User group Circle with its percentage

Fig.1: THE IDEAL AND ACTUAL DISTRIBUTION OF THE USER GROUP OF TMNET POPULATION

If the difference between the ideal and the actual is positive the recommended action is to squeeze the circle until it reached the ideal percentage. On the other hand, if the difference is negative the circle needs to be stretched until it reaches the ideal percentage. Refer to figure 2 for the high user and the low user categories.

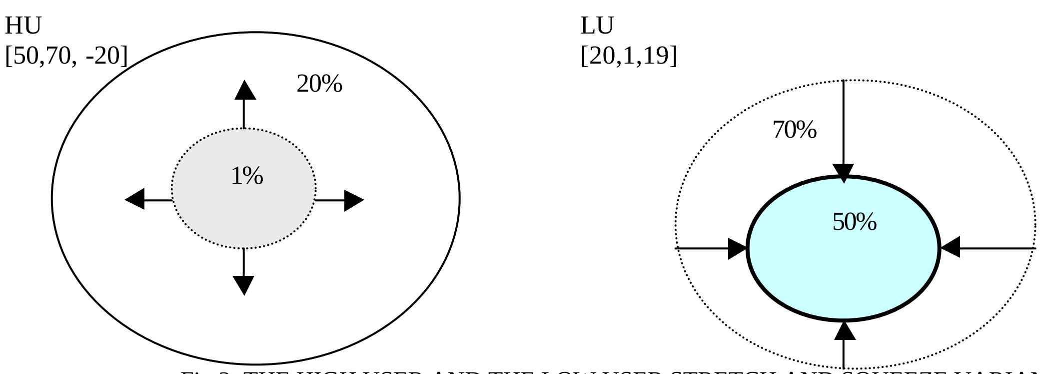


Fig.2: THE HIGH USER AND THE LOW USER STRETCH AND SQUEEZE VARIANTS

The assumptions when applying this model is that all the support required to be in the [2,2] quadrant have been fulfilled. The support factors are as follows relating to the three objectives pursued. Following are the assumptions:

[1] Adequate Operational Requirements
[2] Adequate Network capacity and Fast Network Failure Recovery
[3] Strong Customer Relationship Management
[4] Continuous Improvement on Content Provision and Development

[5] Flexible supportive organizational structure

[6] Good and reliable motivational and incentive system

Refer to fig.2. The dotted circle needs to be stretched outward vertically and horizontally until it reaches the 20% distribution of the solid circle. This is translated, as the work plan should comprise of activities that will increase the number of high users from 1% to 20 % of the total Internet users population. The activities migrate the next lower level users to the high user group. For the lower user group, the dotted circle which represent the actual distribution needs to be squeezed inward vertically and horizontally until it reaches the ideal 50% distribution. This requires migrating the customers from the LU group to the next higher level that is the MU group.

Maximizing the Number of Users in Terms of the Breadth

The next question to focus is HOW TO MAXIMIZE THE OPTIMAL NUMBER OF INTERNET SUBSRIBERS? To maximize the number of subscribers require us to identify the source of the subscribers. The source of potential TMnet subscribers can be categorized into two categories: Internal source and External Source. The internal source is Telekom Malaysia (TM) Customers Database. The external source is the Malaysian population between the age of twelve years old to forty five years old excluding TM customers. It is highly recommended to look into seriously the potential of inviting the TM customers to become TMnet subscribers.

Internal Potential Customer

Currently, Telekom Malaysia has approximately 4.36 million customers as reported by Telco Strategy up to September 1999. TM Customers can be categorized into two main groups namely Internet Users and Non Internet Users. Internet Users are defined as those who have used the Internet either at home or at work. These two main categories can further be divided into the following sub group in the process to identify the quantity of the TMnet potential customers.

Figure 3 depicts the customers' categories within TMB. TMnet 1515 potential customers are derived from CNB customers which is categorized into four as follows:

- R10 - Revenue band of less than RM1000
- R20 - Revenue band of more than RM1000
- S10 - Revenue band of less than RM10,000
- T10 - Within Telekom Malaysia

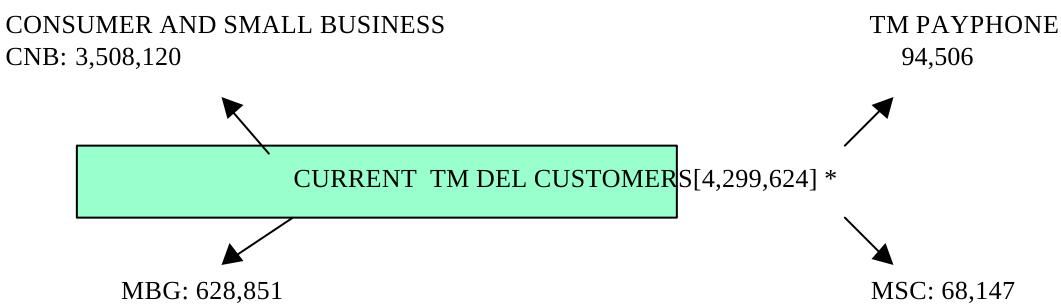


Fig.3: CUSTOMER CATEGORIES WITHIN TMB

CNB comprises of 62 per cent R10, 19 per cent R20, 12 percent S10 and 7% T10 customers. Potential TMnet 1515 customers will directly derived from R10, R20 and S10 customers. The total number of CNB customers refers to accumulated figure until September 1999. From our experience and projected figure, it is expected a maximum of 5% migration TMnet1515 customers to TMnet 1525 from R20 and S10 category. Termination is pessimistically expected at 1% by the year 2000. This will result in potential market of [487600 - (.05 X (97522 +63388)) - (.01 X487606)] = 474,678 customers within our internal market. To successfully capture this market depends heavily on internal and external factors' impact. The internal factors comprises of our customer service, network capability and system reliability whereas the external factors are the economic stability, which affect the consumer power.

Potential Within External Market

[1] Qualitative Approach- Delphi Method

By interviewing local experts in the economics and forecasting area from universities, research departments and related organizations, the Access Services Section of TMM, has gathered several findings that assisted in determining projected potential internet market from 1999 up to 2004. The interviews were done via telephones in October 1998 and October 1999. By end of December 1999, it is expected that the number of TMnet 1515 customers is 8.5% of CNB DEL (Fixed Telephone Line) customers. The expected GDP for the year 2000 will be 4%, however, approaching with caution a 3% GDP value will be used in computing the forecast. From previous experience, DEL growth is approximately 5% above the GDP. This translates to expected 8% growth in the year 2000 on DEL demand. However, due to our economy instability, again, with cautious approach, it is assumed that DEL growth will follow a plus of 2.5% above the expected GDP. Thus, for the year 2000, DEL demand growth is expected at 5.5%. This projects [4,367,000 +(.055 X 4,367,000)] = 4,607,185 DEL customers by end of 2000. It is also projected that potential Internet customers is approximately 30% of TM DEL customers [1] giving us 1.4 million new Internet customers in 2000. Also, assuming 97% of the Internet market by the year 2000 still heavily focuses on dial up (analog) technology, there is a potential of (.97 X 1.4 mil) 1.358 million Internet dial up customers by end 2000.

[2] Quantitative Method

The potential Internet market is assumed to take up 30 per cent of the forecasted DEL customers. Table 1.0 displays the potential Internet market from 1999 –2004 based on a study done in 1998[2].

Table 1: POTENTIAL INTERNAL MARKET FROM 1999-2004

Year	Potential Internet Market [millions]
2000	1.735
2001	1.939
2002	2.167
2003	2.422
2004	2.695

Due to our economic performance where our GDP drops significantly, the market that can be captured is estimated at 60% of the potential market derived. This is based on the worst scenario where consumer power will drop by 40% from the norms [3].

Ways To Maximize Number Of Customers

There are two main approaches in the effort to increase number of customers. One is through promotion both physical and value add promotional offer. Example of physical promotional offer is discount rate and rebate whereas value add offer includes giving additional related service or products and additional free usage. Value add promotional offer secure higher probability of subscribers who are users compare to the physical promotional offer. The medium of promotion is newspapers, radio, television, posters and brochures. TM Multimedia needs to migrate from merely treating the customers as subscribers and users of their service to treating customers as their partners. A knowledge company should treat customers as partners creating a win-win long-term relationship. The company should provide quality service and educational and training program to the partners and extend it to the family members of the customers. The company needs to know the customers and their needs and problems.

Next approach is through partnership program. This approach promises higher number of customers but not users if not managed properly. This scenario has been faced by the TM Multimedia in implementing the partnership program. Note that the partnership program can increase the numbers of customers by more than 100 per cent as compare to the promotional program which able to increase by approximately 40 per cent. However, with knowledge and experience, the partnership management can be improved which will drive higher number of customers. If resources of manpower are low, it is recommended that the partners be categorized into Tier 1 and Tier 2 Partners. The Tier 1 partners are the main partners who have good performance record in meeting the target and are given the role of managing the Tier 2 partners whom generally are smaller companies promising smaller targets. In this program TM Multimedia needs only to manage the Tier 1 partners and these partners will managed the Tier 2 partners. In the long term, partnership program is mostly recommended, as TM Multimedia will need few resources to manage the Tier 1 partners. The number of Tier 1 partners must be a manageable numbers relative to the manpower resource. The selection of partners is very critical to TM Multimedia if this approach were to be taken. The advantage of doing this is that, it allows the marketing and sales people to focus on the more complex *high tech* and potential revenue generating new products or services.

The Knowledge Focussed Marketing Strategy Model

To be a leader in any business in the future, the company needs to migrate itself to become a knowledge company. A knowledge company is a living entity that possesses the attributes of a living thing. Thus, in formulating, implementing and evaluating the strategy, knowledge plays a vital role in the success.

The marketing strategy recommended in this study is called the knowledge focused marketing strategy. It is defined as a marketing strategy that is driven by the 3 Cs knowledge, knowledge related to company, customers and competitors. The definition of customers are firstly the first level customers known as employees, followed by the second level customers, the partners and subscribers or users. Satisfied and productive employees are the most important entity in this model. It is via satisfied and productive employees that can assists in ensuring the satisfaction of the second level customers

C1 relates to knowledge regarding the company and its products or services. The strategy implementers are required to be knowledgeable on the company's mission and vision, its strengths, weakness, opportunities and threats. Knowledge on the products or services are important for the success of the strategy implementation.

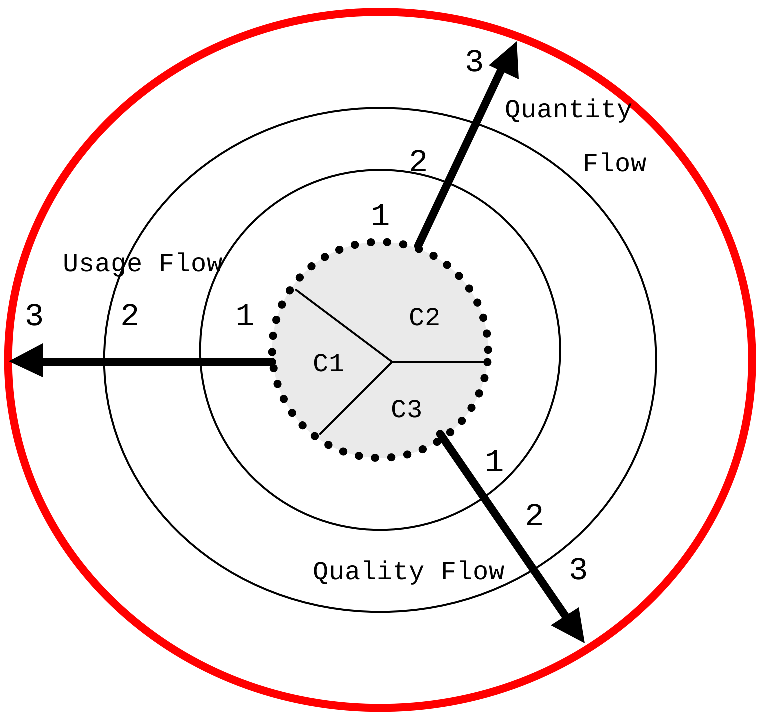
Finally, the C3, which represents the knowledge related to competitors, is undeniably important in ensuring the competitive advantage. The 3Cs knowledge in this model should be integrated with the business core values. The business core values are determined by the company and may differ from others. The integration of the knowledge and the core values ensures the company ability to reach beyond its mission and vision. The integration ensures that the knowledge creates the environment of trustworthy, responsibility and productivity. The knowledge focused strategy model suggests that the company grows as a knowledge company; customers are treated as partners and competitors as complementary or collaborative entity in the company's strategy implementation.

When knowledge is involved, the process of learning becomes an important activity and the knowledge flow needs to be managed. Figure 4 summarized the recommended knowledge focused marketing strategy model. The knowledge, which is located at the center of the model, holds the power and drives the energy to stretch the dotted circle, which represents the current status of the business towards the solid bold circle, which is the targeted status. The Quantity flow relates directly to activities that increase the number of customers. The usage flow relates to the activities to increase the Internet usage, which involves directly to events such as providing good content development and education and training. Finally, the Quality flow relates to activities that optimize the customer relationship management. The knowledge circle plays a significant role in driving the outward flow from the current performance, represented by the dotted line circle to the targeted objective, represented by the bold solid line circle. Region 1,2 and 3 represent the milestones in monitoring the performance of implementing the strategy. The k-marketing strategy model needs to be supported by the following elements: Good Communication, Well Planned and Reliable Tactics and Strong Support.

C1 - Knowledge related to Company
C2 - Knowledge related to Customers
C3 - Knowledge related to Competitors

Current Status

Targeted Status



1.Communication	2. Support	3. Tactics
Knowledge Workers		

Fig. 4: THE RECOMMENDED KNOWLEDGE FOCISSED MARKETING STRATEGY MODEL

Communication, Support and Tactics

Communicating the strategy to others in the organization is the first required step in the strategy implementation after the strategy has been formulated and selected. To gain the support from the work force, they need to understand the selected strategy. Thus, it must be communicated clearly to avoid misunderstanding. Communicating is the pre requisite to the support of the work force. Clear communication regarding the strategy, will assists better understanding thus helps in the smooth running of the strategy implementation. It is the first requirement to reach the first milestone that is region 1. Next, is a well-planned and reliable tactics. These are tactical plans that have been tested and have proven achieving the targets. Tactics encompass developing annual objectives and functional strategies. Annual objectives have specific purposes required for strategy implementation. It represents the basis for allocating resources, mechanism for evaluating managers, monitoring mechanism for progress and priorities setting. Annual physical objectives can be stated in terms of market share, growth and profitability. The objectives in the k-marketing strategy model also include the knowledge related objectives such as the level of knowledge gain and knowledge sharing among the knowledge workers. The knowledge related objectives are more difficult to measure than the physical objectives. The presence of a well-planned and reliable tactics drives towards the next milestone that is region 2. Support is the final and important element that determines the success to reach the targeted objectives. One of categories of support required is the functional strategy. Functional strategy describes the methods to be used by each functional area of the organization such marketing, production, finance, HR and R&D in carrying out the business strategy. It requires much more active participation by lower level of management, covers shorter time span and more specific and action oriented than corporate strategy. The purpose of annual objectives can be summarized as follows [4].

- Serve as guideline of actions, directing and channeling efforts and activities of organization members
- Provide a source of legitimacy in an enterprise by justifying activities to stakeholders
- Serve as standards and incentives for employees to perform
- Provide a basis of a knowledge organizational design.

Organizational structure needs to match with the selected strategy. It determines how the objectives and policies are established and dictates the resource allocation. If an organization is structured based on market segments, policies and objectives are stated in terms of the related market segments. Resources are also allocated in the same manner.

Policy is required to make a strategy work. It provides the environment where the employees know the company's expectation; thus, increase the probability of implementing the strategy. Thus, reinforcing the policy will ensure the drive towards strategy implementation success. The greatest challenge in implementing this model is providing the guideline for knowledge level and knowledge sharing performance measure. A proper motivational system is required and it must be personally satisfying and economically beneficial for the employees so that they will work towards the business objectives. The implementation of a strategy can still fail without a sound leadership. The strong leadership is required as the changes need to be managed and the employees need to be lead, in order to achieve the targets. The support elements mentioned above determine the success to reach the final milestone, Region 3, which is the final destination line, that is the target. Good communication, well-planned tactics and strong support are only meaningful if the strategy implementers are knowledgeable about the company, product or services, customers and competitors. In other words, the business objectives or targets are materialized with the presence of knowledge workers.

The Knowledge Flow

Knowledge can grow and deplete. Knowledge flow needs to be navigated effectively to ensure that the required knowledge is being sent and received successfully. Traditionally, knowledge is merely transferred to few recipients, which is very much reflected in the hierarchical organizational structure. This knowledge flow is different to the ideal knowledge flow of a knowledge-focused group. Figure 5.0 and figure 6.0 depict the knowledge flow in the traditional and the knowledge-focused group.

Note that the knowledge flow in the traditional business environment has few knowledge links and possesses two main characteristics:

[1] One way flow

[2] Knowledge flows in a Formal Manner

We see that if any one of the knowledge links is disconnected, the overall knowledge flow is disturbed, thus, affecting the success of the strategy implementation. Referring to the ideal knowledge flow in a knowledge focused marketing division in figure 6.0, the major differences are the knowledge link which is a two way link, number of links increases, existence of redundant links and the manner the knowledge is transferred via both formal and informal manner.

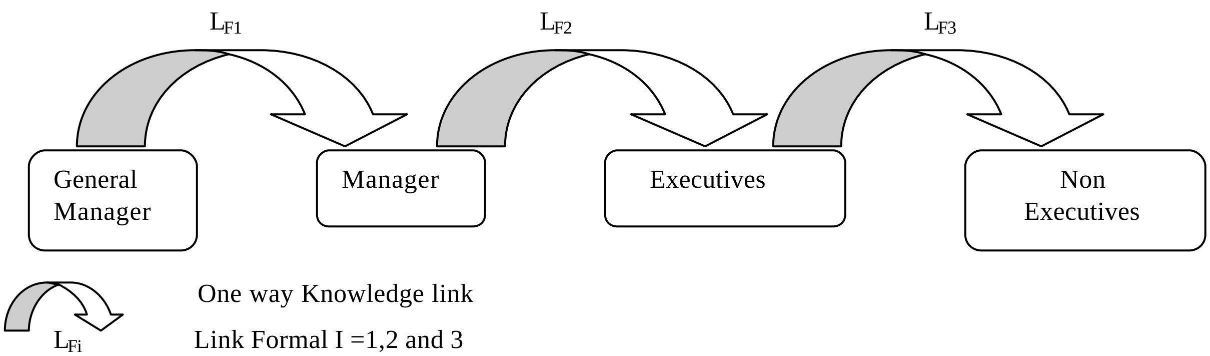


Fig. 5: THE KNOWLEDGE FLOW IN A TRADITIONAL MARKETING DIVISION

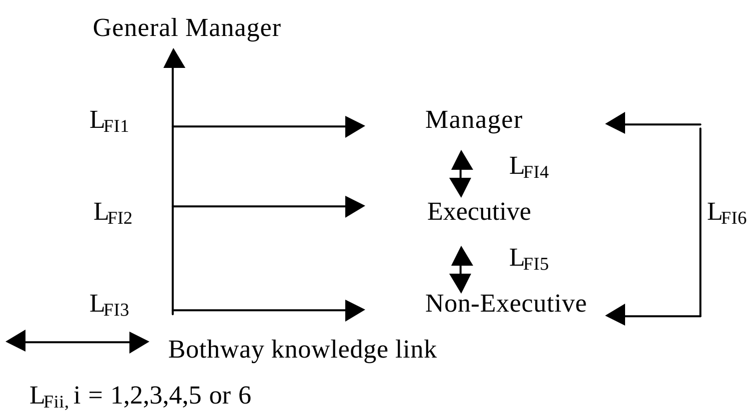


Fig. 6: THE KNOWLEDGE FLOW IN KNOWLEDGE FOCUSED MARKETING ORGANIZATION

The redundant links depict more effort required in the knowledge flow process, however, provides security in maintaining the flow from a sender to a recipient and vice versa. The knowledge links are responsible for both the tacit and the explicit knowledge flow between the sender and the recipients. Tacit knowledge is the non-codifiable and complex knowledge [5]. It is deeply rooted in action and in an individual's commitment to a specific context. Tacit knowledge consists partly of technical skills, the kind of informal, hard-to- pin-down skills captured in the term "know-how" [6]. Tacit knowledge can be transferred in the following manner: Language, Learning by Doing and experiential learning. Tacit knowledge is best transferred via the informal manner. It is easily communicated and shared [7]. Explicit knowledge is formal and systematic. It is transferable through the following manner: language and documented instructions. Explicit knowledge is transferable via the formal and the informal way.

Conclusion

Knowledge building requires a combination of technological and social actions. To ensure the success of the k-marketing strategy implementation four main components are required [8]: Knowledge Systems, Networks, Knowledge Workers and Learning Organization.. Knowledge systems include the data capturing system, database management system and the decision tools. The network encompasses local, corporate and external. The knowledge workers components are the people challenge. The knowledge workers are the core assets as their experience, their continuous knowledge acquisition and skill made them valuable to the organization. Knowledge cannot be maximized by merely the existence of the knowledge workers. It needs to be supported by a learning organization. A learning organization promotes collaborative organizational functioning. In other words, teamwork is highly exercised in the learning organization. The skill workers requirements indicate the focus on training by such organization. Education in learning organization is continuous. The final requirement is that there is a need for a culture of knowledge as strategy. The strategy must be supported with incentives to ensure that the organizational members are willing to share, collaborate and continuously learn in the learning organization.

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Web Exchanges: Structural Models for Government Policy

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Abstract

The impact of e-business on the economy is emerging as a public interest concern, and the role of policy is being recognized in encouraging e-business. We develop a framework of transaction costs in the use of web exchanges and propose a set of exploratory hypotheses. Taken together the hypotheses define a structural model of business perceptions and web use behavior. We test the model with a survey data set, using path analysis. The results indicate that perceptions of transport industry, industrial taxes, third-part authentication, the legal system, and self-perception of the firm's innovativeness are linked with web exchange use. The closeness of the business to the customer also is a determinant. The results point to priorities and potential for policy in enhancing web exchange use.

Introduction

Business enterprises are part of a larger system of information handling, marketing, production operations, transportation, and so on that involve inter-firm relationships domestically and across borders. The regulatory and industrial policy frameworks under which businesses operate influence their perceptions of transaction costs. We are concerned with usage of web exchanges, an important new medium for transacting business across borders. The success of web exchanges cannot be taken for granted, as many instances are reported of web markets folding in recent times. What can states do to encourage web exchanges and improve enterprise participation? The paper builds a conceptual model of transaction costs in B2B Web exchanges, and identifies the role of the State in impacting these costs.

The key questions we ask are: What are the links between transaction processes perceptions and web usage for purchasing and marketing? And which perceptions should policy concentrate on to most effectively influence usage? This paper reports on an exploratory study to seek preliminary answers. We develop hypotheses on the relative impact of perceived transaction costs involved in business practices on the use of web exchanges. Primary survey data is analyzed from a selected industry to gain insights on the relative magnitudes of these transaction costs. A path analysis model is developed to test these hypotheses. Based on the empirical results, we propose policy interventions for States that would encourage the growth of Web Exchanges and participation of smaller firms in these exchanges.

Web Exchanges and Policy: A growing realization

Increasingly, organization processes span international geographies for the sourcing raw material, intermediate products and finished goods. Even human resources are increasingly sourced internationally; and distribution of finished goods is increasingly in cross-border markets. With more countries coming under the purview of WTO agreements, quota restrictions and tariff barriers will soon be eroded, and volumes of cross-border trade in processed goods will rise dramatically. Moreover, web exchanges will have to justify their existence by bringing together suppliers and buyers from all over the world, across different tax, legal and customs duty regimes, in order to build sufficient numbers of participants (and critical mass of transactions, as opposed to subscribers).

A recent study (Coppel, 2000) sums up the policy relatedness of these developments:

> "If the expansion in e-commerce continues at this rapid pace, as is expected, then in four to five years from now, e-commerce transactions between businesses (B2B) and between businesses and consumers (B2C)

will account for about 5 per cent of inter-company transactions and retail sales respectively…At the aggregate level, productivity and economic growth could rise, at least for some time, as a result of more efficient management of supply and distribution, lower transaction costs, low barriers to entry and improved access to information. Moreover, even if the impact of e-commerce on GDP is small and uncertain it could enhance welfare because, for example, of saved time, greater convenience and access to a wider selection of goods and services more finely tuned to individual needs. Nonetheless, to fully exploit the opportunities much remains to be done to ameliorate user and consumer trust, improve access to the Internet infrastructure and services, and to create a stable, predictable regulatory environment."

While bigger players seek to source from international suppliers within the gambit of integrated supply chains, small domestic players are hampered by high costs of participating in networked business systems, especially in global markets. However, with web exchanges allowing networked supply chain management taking root, it is possible for these small players as well to operate in the global economy. Small and medium enterprises play a large role in exporting manufactured goods. For instance, we estimate that exporters of manufactured goods from the US using traditional channels earned more than 3.5 times the foreign sales dollar volume of the world's top fifty non-financial MNC in 1992. Calof (1994) concludes from an empirical study that smaller firms may well have the appropriate resources to engage in exporting behavior, and managerial perspectives on exporting should focus on issues other than firm size.

Most B2B transactions involve long term contracts (either implicit or explicit) intended to serve organizations' strategic and operational needs. These contracts are arrived at after a detailed and careful process of vendor selection, product/service evaluation, trial, and testing, alignment of buyer/supplier operations in case of major contracts, payment terms, and dispute settling mechanisms. Because the long-term interests of the companies are tied with their suppliers, vendors and dealers, enormous effort is invested in building long-term relationships among them. IDC reports that among thousands or so B2B exchanges launched in the past 18 months, only about a hundred are handling genuine transactions (Economist 2001). The initial euphoria about B2B exchanges has subsided and drawbacks in nascent operations of these exchanges have become evident. It is critical to study fundamental issues facing the survival of exchanges. We believe that a better understanding of the issues facing these exchanges could be achieved at three levels. At the industry level, issues on the nature of industry and supplier-buyer concentration need examination. At the company level, issues of size, scale of operations, IT readiness, position in the value chain and managerial or behavioral aspects gain relevance. The third level focuses on product/service being transacted across the B2B exchanges. In reality, key issues at the three levels interact with varying levels of complexity obscuring causal relationships enabling exchanges to function. The current literature on functioning of B2B exchanges has focused on some of these issues. Kaplan and Sawhney (2000) have developed typology presenting the complex relationships between products being transacted and the purchasing processes for these products. At company level, Grewal et al (2000) have shown that in the jewelry business, organization motivation and IT capabilities interact to determine company's participation in the exchange. This participation varies with the level of clarity that the company has about its objectives participating in the web exchange. We believe that these issues lie at the heart of downslide of one-time strong B2B players.

We believe that important issue of regulatory mechanism for cross-border trade, taxation, dispute settling mechanism, and enactment of legal framework to deal with newer forms of business practices will encompass the above three issues to varying degrees. In fact, a strong initiative from governing bodies is needed. For instance, the US government has investigated whether Covisint led to monopolistic behavior and buyer cartelization by the big three auto giants. Similar developments across the world, and in various industries could have some impact on the structures of future B2B exchanges, (Doyle et al 2001) i.e., exchanges that are consortia-led, independent or privately controlled.

We intend to draw some policy implications for web exchanges by developing and testing a model of determinants of use of web exchanges in organizational buying processes. The paper is organized as follows. The next section briefly lists the sources of transaction costs in web exchanges; following this we develop the model and hypotheses; we next report the measures, methodology and results of the path analysis; we discuss the policy implications; and conclude the paper with a summary of the main contributions.

Transaction Costs in Web Exchanges

Williamson (1986) discusses contractual relationships in the Transaction Cost Analysis (TCA) paradigm. Research based on TCA has explored channel decisions in international contexts, and significant empirical evidence of TCA's predictive value for channel integration has been published (Klein et al 1990; John & Weitz 1988). We briefly survey the main sources of transaction costs that arise in, but may not be unique to, Web Exchanges. Classify these as "supply side" and "demand side" sources based on whether the costs are primarily incurred by suppliers or buyers.

Supply side transaction costs

- Numbers of strategic suppliers.

The suppliers are usually risk averse, and the uncertain nature of web contracts creates a burden of financial risk. Large contracts of the winner-take-all variety make the award process even more risky, and breaking up the procurements between multiple suppliers is desirable. Suppliers will commit necessary resources to projected volume of trade when these trades are less risky. The resource commitment is a source of transaction costs.

In fact, any industry where there is market fragmentation on the buyer or seller side, or both, has the capacity to benefit from a B2B exchange. This means that some industries can adapt more easily to B2B trading than others (Tully 2000). For example, the automotive industry is primarily a buyer-driven sector with a fragmented seller base, which is why Daimler Chrysler, Ford and General Motors have so quickly dominated the market with their Covisint B2B exchange. Other example could be drawn from chemical, energy, mining, steel and hospitality procurement exchanges.

- Length and duration of contracts

Long-term contracts require the parties to depart from spot-market rates and enter into relationships. However, costs of raw materials, international exchange rates, technological developments, and other cross-border influences are liable to rapid change. When significant change occurs in the course of the contract, the agreements depart from optimality for one or both parties to the contract. When such changes are not foreseen and made contingent, there is an incentive to violate the contract, giving rise to transaction costs.

- Transportation and other Infrastructure

Fulfillment of web exchange agreements require the involvement of third parties, primarily for transportation and financial management -- insurance and banks. Cross-border movement of physical goods often involves airports and seaports as well. The transparency, predictability, delays and magnitude of costs in the performance of these critical functions are a source of transaction costs.

- Supply volatility

A variety of capacity and raw material fluctuations may introduce supply volatility. The requirement for flexible capacity may impose a burden on suppliers that has to be paid for in terms of forecasting efficiency or options on capacity that might eventually be wasted. The transaction costs are particularly high here since web exchanges will not allow sole supplier arrangements that reduce such uncertainty.

- Technology intensiveness

The technology for electronic business on a routine basis is not universally available. In many local economies, the ability to transact electronically and link up reliable with a world wide web is expensive. Access costs are not trivial and skills required are much above average. Acquiring and deploying the technology and skills is a source of costs.

- Length of the sales cycle

The sales cycle varies widely for a variety of goods and services transacted over the web. From initial interest to closing of the transaction with payment and delivery, the cycle could be as short as a few days to as long as a few months. The length of the sales cycle influences the planning efficiency of transacting parties, and supply chain effects that snowball lead times create immense costs.

Demand side transaction costs

- Number of strategic buyers

Many buyers create competitive markets where suppliers can seek alternative business opportunities. Then entry into specific bidding competitions may be a problem for buyers, since the profitability may not match the suppliers' opportunity costs. The ability of a buyer to assess the supplier's alternatives the web exchange business and put into place appropriate mechanisms for supplier selection may be costly.

- Geographic spread of dealer network

The dealer network is often a huge strategic advantage for any manufacturer. When web exchanges are an add-on channel in parallel with other distribution networks, the buyer face various forms of price discrimination related to channel conflict. The costs of interference between conflicting channels often create delays and sub-optimal service for the buyer.

- Demand volatility

When buyers are unable to forecast their own needs efficiently, there is a problem of demand volatility. Often buyers are themselves entities in a value chain, perhaps value added resellers, or suppliers to OEMs in some vertical sector. When the sector is in fluctuating economic uncertainty, the demand volatility imposes costs of inventory and work-in-progress.

- Third Party Logistics

The buyer-end of third party interactions are fraught with fulfillment problems as well. The companies involved in the later phases of the transaction may be out of the loop when the transaction is cemented over the web exchange and planning could become inefficient as a consequence.

- Security and Privacy

The buyer is often more concerned about security and privacy of the nature and items involved in the transaction. Loss of intellectual property is a real possibility and becomes increasingly important as the value embedded in the chain rises. Often the competition is interested in the supply chain of the buyer in order to assess competitive bids.
This brief listing of potential transaction costs in web exchange based transaction is indicative of the hurdles that need to be overcome. In the next section we describe a simple model that links various sources of transaction costs in a framework of causal relationships.

Model and hypotheses

The transaction costs model aims at identifying the mediating effects on the firm's use of web exchanges for selling and sourcing its requirements. Selling and sourcing of requirements by buyers are an important motivation in the use of web exchanges. The perceptions of managers in buyer organizations on transaction costs are likely to influence the degree of web exchange in the firm. The model objective is to identify the main effects and indirect effects of the perceptions, in order to isolate the appropriate targets for policy.

A schematic version of the model is in Fig. 1. There is one behavioral construct (Usage of the web for purchasing and marketing) and one demographic construct (Nature of business). The rest of the five are perceptual constructs to do with the favorability of -- Transportation and delivery, Legal systems, Industrial taxes, Third party authorizations, innovativeness in the adoption of e-business initiatives. The model links the exogenous variables (Nature of business and Transportation and delivery perceptions) to the endogenous mediating variables, and in turn to the endogenous behavioral variable, Use of web exchange. The hypotheses are conveniently depicted on the model paths of Fig.1. The rest of this section discusses the hypotheses.

Hypotheses: We briefly describe the seven exploratory hypotheses that define our model.

H1. More upstream businesses are more likely to perceive themselves to be innovative in their adoption of web exchanges.

Firms that are not in direct contact with end-users are likely to use technologies that shorten customer distance and increase customer touch points. Electronic media helps to achieve this.

H2. More upstream businesses are more likely to uses their web sites for purchasing and marketing.

The intermediate goods and services required by upstream businesses are more likely to have "thin markets" where only a few local buyer and sellers are available. Therefore, there will be advantages in looking at remote markets via web exchanges for the upstream intermediate goods.

H3. More firms perceive themselves to be innovative in their adoption of web exchanges the more use they make of their web sites for purchasing and marketing.

Innovative firms will be leaders in the adoption of e-business. The early movers are more likely to have moved up the learning curve in use of web exchanges.

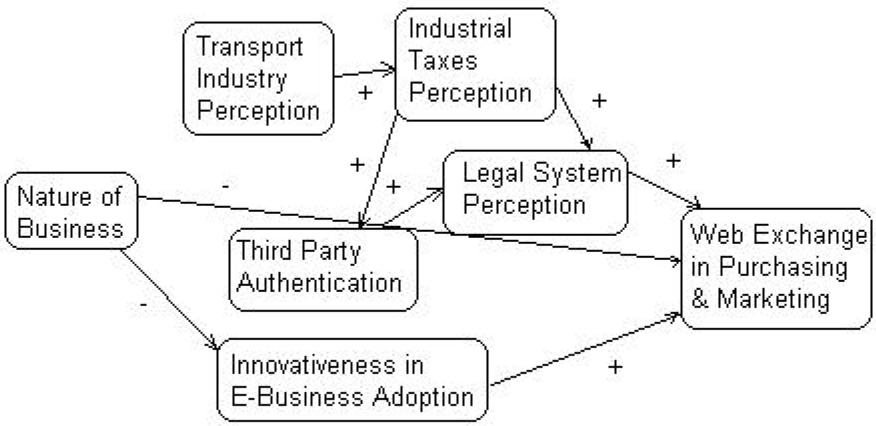

Fig.1: PATH DIAGRAM OF MODEL AND HYPOTHESES

H4. More favorable perceptions of transport industry lead to more favorable perceptions of current Industrial tax laws for web exchanges.

The transport industry addresses the physical infrastructure for exchange, and therefore is key to a variety of perceptions. The competence of the transport industry will determine whether the modern corporation can rely on them to understand and comply with cross border tax laws that apply to exchange (like customs and octroi).

H5. More favorable perceptions of Industrial tax laws lead to more favorable perceptions of legal systems for electronic contracts.

Legislation on tax is enforced through the courts. Better legal institutions and systems of company law are associated with more modern tax laws. Contract law usually will benefit from simpler and comprehensive tax structures. These can be encoded in electronic procurement packages.

H6. More favorable perceptions of third party authentication lead to more favorable perceptions of legal systems for electronic contracts.

Web exchanges try to certify their members (third parties) as genuine businesses that will engage in authentic transactions. Clearly, the greater the ability and authority of the exchange to authenticate third parties, by physical visits, credit checks, audits, etc., the more likely the parties will appreciate the legal framework for electronic contracts.

H7. More favorable perceptions of legal systems for electronic business lead to increased usage of web sites for purchasing and marketing.

These perceptions will impact behavior. The key perception of legal systems will affect the use of web exchanges. Selling and sourcing activities over the web will rise when parties perceive their economic interests to be safeguarded by the legal system governing the transactions.

These hypotheses are tested next with a statistical estimation procedure.

Methodology, measures and results

The data set was prepared from sixty respondents of a national level customer survey of industrial products. The sample was industry specific and the customers were firm specific, and the sample of customers was a convenience sample. Therefore the results should be interpreted as exploratory for internal validity, rather than as representative of all firms and product-markets. The scales used were as follows.

1. *Nature of Business Closeness to Customer*: This scale was termed NATBZ, and represented distance from the end-customer. The closest to the end customer was the dealer, while the furthest was the manufacturer of products used by OEMs. The specific choices were: Manufacturer of end-products (1); Original Equipment Manufacturer OEM (2); Consultant (3); Contractor (4); System House (5); and Dealer (6). Therefore a low score implied a more upstream (or distant) firm.
2. *Transport Industry Perception*: This was a five-point scale TRAN P and measured the perceived favorability of the transportation industry in the delivery of goods transacted over the web. The specific question was: Transportation industry in India will rise up to the needs of better and efficient Logistics Management (rescaled to strongly agree 5 ; strongly disagree 1).
3. *Legal System Perception*: This was a five-point scale LEGSP and measured the perceived favorability of the national legal system in enforcing electronic contracts of the sort of transactions in sourcing over web exchanges. The specific question was: Legal systems in India sufficient to enforce electronic contracts (rescaled to strongly agree 5; strongly disagree 1).
4. *Industrial Tax Laws Perceptions*: This was a five-point scale INTLP and measured the perceived favorability of the industrial tax laws operative in cross commercial district transactions when the physical movement of goods is involved. The specific question was: Sales Tax, Excise, Octroi etc - laws and procedures not a major block (rescaled to strongly agree 5; strongly disagree 1).
5. *Third Party Authentication Perceptions*: This was a five-point scale THPAP and measured the perceived favorability of third part authentication over the web exchange. The specific question was: 3rd Party B2B exchanges give the assurance on genuineness of vendors listed by them (rescaled to strongly agree 5; strongly disagree 1).
6. *Perceived Innovativeness in E-Business Adoption*: This was a five-point scale IEBAP and measured the self-perception of innovativeness of the firm in adoption of e-business initiatives. The specific question was: How would you rate your company in terms of adoption of e-Business / Internet? The choices were: Bleeding edge (4); Early adopter (3); Close follower (2) late follower (1).
7. *Use of Web in Purchasing & Marketing:* This was a scale UWPMG created by summing four categorical scales to reflect the degree of usage in sourcing and purchasing over the web. The specific questions were: Is (a) sourcing information published on your website? (b) used for sourcing / purchasing Raw Materials; (c) used for sourcing / purchasing Other Items (Utility items) ; and (d) used for marketing and selling activities? Coding was Yes=1; No = 0; therefore, the maximum on the scale was 4, and the minimum was 0.

These measures were correlated and subjected to a Path Analysis based on the model in Fig.1. For the data set all variables had 64 observations complete, except UWPMG, which had only 37 complete. LISREL 8.30 (Karl Joreskog and Dag Sorbom, 1999; Scientific Software International, Inc.) was used to estimate the coefficients and the statistical summary of the estimation is reported in Table 1(a) -(c). We discuss the main results below.

1. The univariate results in Table 1(a) show the perception variables TRANP, LEGSP, INTLP and THPAP have averages on the mildly favorable side of the perception (Neutral is [3]). IEBAP corresponds to late follower on average. UWPMG indicates a very low average use of web exchanges, but the use is quite dispersed. NATBZ indicates that firms are at the OEM level of customer distance on average.
2. Table 1(b) indicates that the Path Analysis model is in the acceptable validity range. The goodness of fit statistics are well within the norms for field research.
3. Table 1(c) presents the standardized effect for the various paths. All hypotheses are in the right direction as shown in Fig. 1, except H3. . Table 1(c1) examines the total effects of exogenous variables (X) -- TRANP

and NATBZ -- on the rest of the endogenous variables (Y). TRANP has the largest net effect on INTLP (.6). The largest net effect on UWPMG is of NATBZ (-.16). The *indirect* effect of NATBZ on UWPMG is .34, while the total effect is negative. The direct effect acts opposite to the indirect effect. Downstream firms perceive themselves to be later adopters, but later adopters actually use web exchanges more effectively. This is surprising, and was not expected. Therefore, H3 is not supported. TRANP has a negligible effect on UWPMG (.05).

4. Table 1(c3) shows that INTLP has significant mediating effects on THPAP and LEGSP; and THPAP has significant mediating effects on LEGSP. In turn, LEGSP and IEBAP have significant mediating effects on UWPMG.
5. Other indirect effects are also noted in the Tables 1(c2 & 4). These show that some intermediate effects are of lesser importance. The squared multiple correlation (analogous to the R-Square) for UWPMG is fairly high at 28%. This indicates that more than a quarter of the variation in use of web exchanges is explained by the other variables in the model.

Table 1: PATH ANALYSIS ESTIMATION- SUMMARY OF STATISTICAL RESULTS

(a) Means and Standard Deviations

	INTLP	THPAP	LEGSP	IEBAP	TRANP	UWPMG	NATBZ
Mean	3.51	3.90	3.75	1.17	3.12	.73	2.95
Std. Dev.	1.6	1.7	1.6	1.37	1.6	1.04	2.0

(b) Goodness of Fit Statistics

Degrees of Freedom = 13
Chi-Square = 6.02
Root Mean Square Error of Approximation (RMSEA) = 0.0
Normed Fit Index (NFI) = 0.91523
Non-Normed Fit Index (NNFI) = 1.22744
Root Mean Square Residual (RMR) = 0.29368
Standardized RMR = 0.058374
Goodness of Fit Index (GFI) = 0.95443
Adjusted Goodness of Fit Index (AGFI) = 0.90184
Parsimony Goodness of Fit Index (PGFI) = 0.44313

(c) Standardized Total and Indirect Effects

C1: Standardized Total Effects of X on Y

	TRANP	**NATBZ**
INDTLP	0.60500	- -
THPAP	0.28132	- -
LEGSP	0.27709	- -
IEBAP	- -	-0.58400
UWPMG	0.05585	-0.16320

C2: Standardized Indirect Effects of X on Y

	TRANP	**NATBZ**
INDTLP	- -	- -
THPAP	0.28132	- -
LEGSP	0.27709	- -
IEBAP	- -	- -
UWPMG	0.05585	0.33589

C3: Standardized Total Effects of Y on Y

	INDTLP	**THPAP**	**LEGSP**	**IEBAP**	**UWPMG**

INDTLP	- -	- -	- -	- -	- -
THPAP	0.46500	- -	- -	- -	- -
LEGSP	0.45800	0.33942	- -	- -	- -
IEBAP	- -	- -	- -	- -	- -
UWPMG	0.09231	0.06841	0.20156	-0.57515	- -

C4: Standardized Indirect Effects of Y on Y

	INDTLP	**THPAP**	**LEGSP**	**IEBAP**	**UWPMG**
INDTLP	- -	- -	- -	- -	- -
THPAP	- -	- -	- -	- -	- -
LEGSP	0.15783	- -	- -	- -	- -
IEBAP	- -	- -	- -	- -	- -
UWPMG	0.09231	0.06841	- -	- -	- -

Discussion

The overall fit and specific causal links supported in the hypothesized model are useful to interpret for leads in policy formulation. The following claims are supported in the estimation:

1. Perception of the legal system is important and has a bearing on the use of web exchanges in selling and sourcing decisions. However, a far more significant impact relatively speaking is that of the nature of the business. The more upstream the business, or in other words, the further from the customer in terms of intermediaries, the higher the likelihood of the web exchange use in selling and sourcing. This indicates that policy should aim at improvements in the manufacturing and OEM arena where web exchanges will be more useful initially, and those improvements in legal systems for protection and transaction cost reduction should initially be focused here.
2. Perceptions of industrial taxes being conducive to web exchange are a key influence on legal system perception, both directly and indirectly through the ability of the exchange to provide authentication of the genuineness of members. What are the influences of industrial tax policy on members' authenticity? Disparities in taxes and uneven tolls across commercial districts tend to distort the location decisions of firms. Virtual addresses of firms may not then correspond to physical location and fulfillment becomes complicated. Legal jurisdiction may be a problem when physical and virtual locations do not match. Policy has a major impact on perceptions in this domain.
3. Transport is a key influence on taxes, and perceptions of the two are related. Policy should aim at affection the overall favorability of industrial taxes perception by rationalizing in the transport sector. For instance, logistics firms that are national or international in scope and have streamlined tariffs and prices incorporating tax structures will greatly impact the perceptions. Policies that encourage the evolution to such business infrastructure is important. Ports and customs procedures that simplify the transportation function ought to be a high priority.
4. Upstream firms are more likely to be innovative in adoption of e-business. However, early adopters actually had lower web use in our data set. This requires to be validated with other studies, since it is a counter-intuitive finding. One explanation is that early adopting firms are not benefiting from the network effects of web exchanges. The network externalities require a critical number of firms -- which would include late adopters -- before they are large enough to deliver benefits. The early adopter advantage may therefore be absent for web exchanges. In any case, policy initiatives should focus on improving the rate of adoption in all firms to accelerate the network advantages of web exchanges. Special tax breaks and write-offs for innovative measures in e-business would be welcome initiatives.

In sum, the paths we estimated link a variety of intermediate perceptions that can be influenced by policy measures, indicating that web usage can be improved by definite interventions. We conclude the paper with a summary of its contributions, some directions for further research.

Conclusions

We set out to identify some of the major sources of transaction costs when buyers and sellers seek to transact business over web exchanges. The role of policy in reducing these transaction costs was implicit at this exploratory stage. We then defined a simple model and hypothesized various paths through which perceptions of buyers (customer firms) would influence their use of web exchanges in selling and sourcing. The model was estimated with a survey data set prepared from customers of a large multi divisional industrial products company in India. The model found acceptable fit and the hypotheses were largely supported. The implications of the hypotheses and the relative importance of the effects indicate directions for policy. More obviously, States should re-examine and reformulate policies for supply and distribution chain management in business networks. State policies that facilitate aligning tax, excise and custom duty policies with the SCM practices for expediting business processes, and laws governing financial transactions and foreign exchange need to be suitably aligned with the industry specific requirements. Moreover, the role of state and SCM in public distribution network can not be understated given the plethora of middlemen involved in the distribution system and the inefficiencies involved in collection, transport, storage and disbursement processes. Clearly, Governments could play a seminal role in streamlining the public distribution system by adopting supply chain management concepts.

Policy implications may be further explored by linking other business process perceptions and electronic business usage variables. The approach taken here could be extended to issues on security of business transactions, signage and digital signatures, intellectual property protections, and other specific issues. Clearly, larger data sets with more representative firms would be necessary for generalizations, and to take this work beyond the exploratory level, especially in the important area of international business.

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Section 6

Management Strategies, HRM & Knowledge Management

A Model Of Employee Structure: A Knowledge Management Perspective

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Abstract

Knowledge management and knowledge sharing are critical to an organization's success. Market leaders in stable environments have recognized the importance of knowledge management; emerging markets can adopt similar practices in order to survive in today's knowledge-intensive business environment. This paper reviews the notions of knowledge management and knowledge sharing and presents the Employee Structure Model (ESM) in an organization. This model is based on two dimensions, namely Knowledge, captured through competence and Knowledge Sharing. The combination of these two dimensions creates four categories of employees that are described in some detail. Examples from existing organizations of the different categories of employees give support to the ESM.

Introduction

Knowledge management is, at best, difficult to define. Yet, it remains a critical aspect of a firm's functioning and success. There are several domains that make up knowledge management, such as intellectual capital, intellectual assets, information management, learning organizations and organizational learning. Again, these domains have not been unambiguously defined and described. Focusing on knowledge, its management, and the sharing of it in an organization is of prime importance for several reasons. For example, from a resource-based perspective, it is hard to imitate or reproduce the knowledge-based advantages of a firm, especially when the factors contributing to high performance cannot be easily identified or controlled [12]. From a practical point of view, although it is easier to transfer explicit knowledge than tacit knowledge, it is necessary to focus not only on procedures and processes but also on capabilities and judgments [9].

This paper first defines knowledge. This is followed by an introduction to the concepts of knowledge management and knowledge sharing, how they are defined and why they are important in an organizational environment. How knowledge can be measured by ascertaining someone's competence is then described, followed by why knowledge management and knowledge sharing is important, especially in emerging markets. Then, the Employee Structure Model is introduced; the four cells and the type of employees who fall into each of them are described in some detail. Finally, future streams of research are identified.

Knowledge Defined

Nonaka and colleagues [28] define knowledge as justified true beliefs and bodily-acquired skills and describe two types of knowledge: explicit and tacit. Explicit knowledge can be stored, sorted and easily shared, while tacit knowledge is strongly tied to persons, actions, and emotions, thus making it much harder to articulate than explicit knowledge.

Since knowledge is not stable over time and space, we cannot apply technical procedures to control its development and sharing [44]. If knowledge is not used at a certain time and place it has no value [28]. Knowledge can be described as dynamic, partly tacit, and partly explicit. It can be tied to individuals as well as groups of people. Only explicit historical knowledge can be controlled although this kind of knowledge does not increase a firm's competitive advantage, since it is publicly available [28]. It is therefore tacit knowledge sharing that is important for a company to sustain its competitive advantage.

Knowledge Management

Defining knowledge management

An abundance of definitions of knowledge management (KM) exist. Though seemingly so basic, part of the difficulty in understanding the phenomena of KM, according to Despres and Chauvel [11] is our ability, or rather inability, to define it. Below we present several definitions so as to give the reader an idea of how KM has been defined, both in the academic as well as the practitioner literatures. From these definitions, we then extract several key points that each of the definitions have in common.

A rather simple, basic definition, though no less accurate, is one afforded by Remez [32], namely that it is 'having the right information at the right place at the right time so people can make good decisions and act on them". In essence, KM promotes the development and application of tacit, explicit, and embedded intellectual capital; that is, leveraging understanding, action capabilities, and other intellectual assets to attain the enterprise's ultimate goals, e.g. to achieve profitability, ensure long-term viability, or deliver quality services [47]. Coleman [6] defines KM as a "process by which individual learning and experience is accessed, reflected upon, shared and used to foster enhanced individual knowledge and organizational value" (p.119). While Sveibey [43] defined KM as "the art of creating value from an organization's intangible assets," Barclay and Murray [4] describe it as a business activity that (1) treats the knowledge component of business activities as an explicit concern of business, which is reflected in the organization's strategies, policies, and practices and (2) makes a direct connection between a firm's intellectual assets, both explicit and tacit, and positive business profits. Alavi and Leidner's {1} definition which takes into account the content of the above definitions refers to KM as "the systemic and organizationally specified process for acquiring, organizing and communicating both tacit and explicit knowledge of employees so that other employees make use of it to be more effective and productive in their work" (p.15).

Although different terms are used in each of the above definitions, what they have in common is their focus on organizations and the people who make up the organizations. These definitions emphasize that the organization plays a critical role in the knowledge creation process; however, the knowledge itself is developed by individuals where many people know pieces of information but no one knows it all [37]. What accelerates the creation of ideas are the interactions between individuals, and these interactions occur in an organization whose role is to support creative individuals and create an environment that would articulate and amplify that knowledge [26]. Knowledge creation is critical for a company because through this process creative ideas can be translated into innovative technologies and processes [17] [42].

Importance of KM

There are several reasons why an organization needs to concentrate on KM. According to Barclay and Murray [4], these reasons include: the marketplaces are increasingly competitive and the rate of innovation is increasing; informal knowledge needs to be replaced with formal methods of knowledge capture; loss of knowledge results from early retirement and an increased mobility of the workforce; the size of the workforce is decreased as a result of competitive pressures and valuable lost business knowledge must be captured.

KM is increasingly recognized as an important strategic and tactical approach to improve organizational performance [47]. As more and more firms realize that networking of competent and collaborating individuals establishes the solid foundation of behavior and success of firms, KM is likely to become more people-centric [46] [47], since it is the people who possess the knowledge, especially the tacit knowledge, which is able to create the competitive advantage for the firm. Information can be generated by computers and technology; knowledge is created by people [6]. The emphasis in KM is on people, not technology [23] [32]. Similarly, knowledge cannot be managed unless it is captured and converted into an asset, whether tangible or intangible; it can then be considered a commodity that can be used to improve a firm's performance and contribute to generating profits [3].

Organizations do not own human capital; that is, firms do not own their employees. In many ways, employees may break their working relationship with the firm: by quitting, by taking leaves of absences, by accepting reassignments, by getting fired, and so forth [41] [47]. While firms do not own human capital, they do own their intellectual assets or property. It is therefore in a firm's best interest to promote and encourage knowledge codification by its employees so as not to lose the employees' knowledge once they leave the firm [41]. In this way, even once an employee has left, the firm can still make use of the individual's knowledge. For KM to be successful, organizations need to create a corporate culture that promotes and encourages collaboration and rewards employees who contribute and share their knowledge [8].

Knowledge sharing

Traditionally, knowledge is something that exists in the minds of employees; given the choice they would prefer to keep it that way and not share it. However, the value of knowledge is increased when it is shared; thus, cooperation between parties is a sound strategy for all parties concerned [18]. While the rallying cry of information professionals used to be that knowledge is power, Ojala [29] argues that knowledge sharing (KS) is power. To gain a competitive advantage, organizations need to pool their knowledge, set up a central knowledge base, and reward employees for sharing knowledge. Evans [15] argues that the biggest barrier to sharing knowledge in an organization is the behavior modification that is required from employees. Therefore changing the organizational culture (behavior, rewards, shared objective, priorities, teamwork) is critical to making knowledge management work in practice. Similarly, experience at Buckman Laboratories has shown that it is not technology that opens the door to KS, but rather a change in corporate culture [30] [38]. Baladi [2] describes how Ericsson developed an instrument to measure culture through which the firm is able to assess and understand what the culture in the organization is and how far it is from its target culture. The company adopted the 'DO IT" culture: D - decisive, O - open, I - innovative, T - trusting.

How knowledge can be shared

In marketing, the promotional mix for a product is influenced by the sales strategy that a firm decides to use: the *pull* or the *push* strategy [24]. Analogously, KS modes that correspond to the push and pull strategy are *sharing without prompting* and *sharing with prompting*, respectively. Which mode is applied depends on both the knowledge owner and the knowledge seeker. In the sharing without prompting strategy the knowledge holder realizes that: (1) a specific person in the organization needs knowledge (either explicit or tacit) that s/he owns and without a prompt from a knowledge seeker supplies the knowledge, or (2) there may be people who can make use of some source of knowledge. The knowledge seeker neither has to necessarily know that the knowledge holder possesses a specific type of knowledge, nor know a source where the knowledge is located, yet can still have access to it since the knowledge holder shares it without prompting. The second mode, sharing with prompting, corresponds to the pull strategy in marketing. This mode refers to situations in which the knowledge seeker contacts the knowledge holder. The knowledge seeker either: (1) knows that this particular person possesses the knowledge s/he is looking for, or (2) believes that this person can give him/her directions on how to acquire the knowledge for which s/he is looking.

In either of the two modes described above an employee can share explicit or tacit knowledge. Nonaka [26] based his definition of these two types of knowledge on Polanyi's work. As described earlier, explicit knowledge refers to knowledge that is transferable in formal language. Tacit knowledge cannot be easily transmitted because it is embedded in action, commitment, and involvement. An example of sharing explicit knowledge is the sharing of a book or an article that specifically gives instructions on how to solve a particular problem. Sharing tacit knowledge however is not as simple to describe since it incorporates experience, so that when sharing tacit knowledge one is sharing one's experience.

Since every individual possesses unique knowledge [37], firms are developing knowledge management systems where people can contribute their knowledge in order to make it accessible and beneficial to everyone in the organization [10] [20]. Active participation of both the knowledge sharers and the knowledge users is an important factor for the success of a knowledge management system [21].

Encouraging Knowledge Sharing

Several techniques of how to “make” employees share their knowledge have been reported. Marks [25] discuss the influence of managerial control and organizational support on KS. Ellis [14] provides various illustrations; for example, putting people together under extreme pressure makes them naturally trust each other and therefore share knowledge. There have also been some attempts to reward KS; however, as soon as the rewards were eliminated the sharing stopped [14]. What seems to help people share their knowledge is the reciprocity of KS. Employees want to make sure that they not only give knowledge but that they also receive knowledge. Moreover, knowledge “receivers”, when searching for help must admit that they need help and have to expose their weaknesses to others [37]. This constitutes an additional potential obstacle to beginning the search process. Another way of promoting KS is the opportunity to be elected a subject matter expert among peers [14]. Recognition as an expert in a specific matter is a driving force for sharing knowledge.

One challenge to studying this subject matter is the difficulty of measuring knowledge. The following section discusses one approach to overcoming this obstacle.

Measuring knowledge

Knowledge of employees may be ascertained by focusing on their level of competence [9] [34]. Covey [9] differentiates between unconscious and conscious competence: individuals are said to be unconsciously competent when they are not able to identify the principles that lead to good or poor outcomes. Alternatively, individuals are consciously competent when they are able to not only identify the procedures, processes, and principles but are also able to make them explicit. Without the latter type of individuals, organizational learning cannot and will not occur. The process of making these principles explicit to other members in the organization is known as KS, which, as seen above, has been identified as a critical success factor for a firm’s competitive advantage [13]. In a like manner, Bassellier and colleagues [5] define the competence of business managers through their IT-related explicit and tacit knowledge. They extend this notion of competence by including the concept of knowing who knows what. This, in turn, enables managers to leverage the knowledge of other employees.

Emerging markets

Industry leaders have realized that investments in knowledge can increase productivity and lead to increasing returns. Organizations such as Chevron, Xerox, Johnson & Johnson, Royal Dutch/Shell, Ford, Whirlpool, Sun Microsystems, World Bank, Buckman Laboratories International Inc., Sharp, Toshiba, and many more spend millions of dollars on KM [27] [38] [39] [45]. Since knowledge does not depreciate like capital does, investments in KM maintain long-term economic growth. Major OECD countries claim that more than fifty percent of their GDP is directly related to the production, distribution and use of knowledge and information [45]. In order to survive in today’s knowledge-intensive environment countries in developing markets should consider spending a considerable amount of time and money on KM.

Knowledgeable, effective behavior has become the competitive advantage that individuals and firms are seeking in the new business environment brought about by globalization; increasingly organizations are turning to explicit and systematic KM in order to gain that competitive advantage [47]. KM can bridge the gap between the haves and the haves not of the world and as such can be seen as an equalizer. This can be especially important in emerging markets where the divide between those who know and those who do not is a veritable abyss. For firms to benefit from KM, it is important that employees possess and have access to better applicable knowledge and that work is organized so as to promote application of best knowledge [47]. Through education, it is possible to give knowledge to those who do not possess it and hence, to some extent, level the playing field.

What has emerged from the literature review of knowledge management and KS is the importance of the organization, as well the people who make up the organization. What the rest of the paper now focuses on is a model, the Employee Structure Model, which evaluates employees on two dimensions, namely, whether they have high or low knowledge with respect to their job responsibilities and whether they share or do not share their knowledge.

The Employee Structure Model (ESM)

The first dimension represented in the Employee Structure Model is knowledge. Knowledge is operationalized as competence. Individuals can be categorized into one of two groups, those with high competence and those with low competence. These are represented in the matrix in Fig.1 as “have knowledge” and “have not knowledge”, respectively.

Much of an individual’s experience, intelligence and overall competence reside in his or her head; as a result when an employee leaves a company, these attributes are lost. For this reason, the transfer of the employee’s knowledge to other employees is vital to the continuing successful performance of a firm since even though the employee may leave, his or her knowledge should have been shared with at least one other employee.

With respect to the second dimension, an employee can be categorized as either “sharing knowledge” or “not sharing knowledge”. Individuals are classified as sharing knowledge if they provide knowledge to others in the organization. As a knowledge provider, employees can fall into one of two groups: (1) sharing with prompting, and (2) sharing without prompting. Sharing with prompting includes serving as a source of knowledge (ability to make explicit his/her knowledge to others) and serving as a pointer of knowledge (informed as to where knowledge is available). Sharing without prompting refers to an employee’s willingness to offer help, advice, and suggestions without it being asked of them. Individuals classified as “not sharing knowledge” do not fall into the above categories. Although an employee who is not a knowledge provider but rather a knowledge seeker, that is, someone who seeks help, advice, and suggestions from others, can be considered as supportive of KS as s/he encourages others to share knowledge, he or she will be classified as part of the “not sharing knowledge” group since that employee is not providing any knowledge to others. The four cells, which make up the 2x2 matrix, will now be looked at in more depth.

Employees can be grouped according to these dimensions into one of the four cells of the 2x2 matrix represented in Fig.1.

		Knowledge	
		High	Low
Knowledge Sharing	High	Seeing eye dogs	Peacocks
	Low	Foxes	Ants

Fig 1: EMPLOYEE STRUCTURE MODEL (ESM)

Seeing eye dogs

Employees in the upper left hand cell, that is, those who have knowledge and share it, are identified as seeing eye dogs. Employees who fall in this cell are of the greatest importance for an organization. They are, in essence, the pillars of the organization, which in turn gives the organization its knowledge-based advantage. An organization that is made up mostly of employees who fall in this cell is likely to be a firm with a culture that emphasizes learning and teaching and that has knowledge-based advantages, which are not easily replicated by competitors.

There are several examples of this type of employee, or groups of employees, in both the academic and practitioner literature. For example, Stewart [40] describes a technique launched at Viant, a consulting company.

Top consultants from this firm are called off their work and, for several months are placed in a position of "agitator." The agitator's or "project-catalyst's" responsibility is to approach employees who are working on specific projects and to give them advice, show examples of possible solutions, and so forth. The seeing eye analogy can also be found at Buckman Laboratories and the World Bank. The 'seeing eye dogs' are those employees who use storytelling, analogies, and metaphors to share their tacit knowledge. This technique allows the context of important information that was gained by an individual through his/her expertise to be established [45]. Further, we can find the concept of seeing eye dogs at BP Amoco. Kent Greenes, head of knowledge management, says: "*knowledge guardians* constantly probe the unknown and bounce it off project teams to get them thinking about new ideas" (p.27) [45]. Similarly, at Ericsson seeing eye dogs are referred to as "knowledge brokers" and are responsible for tracking which problems are being dealt with in various offices and bringing together the people who are able to solve them [2]. Von Krogh, Nonaka, and Ichijo [44] introduce the notion of a knowledge activist as a knowledge sharer. They identify a knowledge activist as some individual, or some group or department, who takes on the particular responsibility of energizing and coordinating knowledge creation efforts throughout the corporation. A knowledge activist has three roles: (1) catalyst of knowledge creation, (2) connector of knowledge creation initiatives, and (3) merchant of foresight. The authors identify people in organizations who can act as knowledge activists, for example, employees from R&D centers, strategists, or employees from knowledge and technology transfer units. While these individuals are in positions that allow them to be easily identified as knowledge activists, according to Von Krogh, Nonaka, and Ichijo [44] the most efficient and effective knowledge activists are those based on assignments to that role. Such an assigned position is in line with Stewart's [39] description of an "agitator." Applying this idea to emerging markets, it is of utmost importance that certain employees be assigned to the position of seeing eye dog for certain periods of time. It is important that those in this position are rotated from time to time; this position entails a significant amount of mental exertion and thus requires new employees to come in and renew the batch of ideas.

As can be seen from the above discussion seeing eye dogs play a critical role in the future of a company; therefore firms that wish to be successful require this type of employee.

Foxes

The cell in the lower left hand side of the matrix represents employees who have knowledge but who do not share it with others. Such employees hoard their knowledge; this, however, does not preclude them from seeking knowledge from others. This behavior is analogous to the behavior of foxes – sly and crafty. Organizations need to be aware of employees who fall into this cell as they represent a weak link and can lead to a knowledge breakdown in the organization.

Even if self-determined and demand-driven mutual learning increases employees' competence and flexibility [21] individuals are often resistant to share their knowledge. Goodman and Darr [16] and Peters [31] argue that one of the reasons why people do not want to share their knowledge is because unique knowledge can be a source of power. According to Cook [7] KM will suffer if knowledge is equated with power. Often, individuals choose to keep knowledge to themselves, to not share it; they keep it in store. One problem with this is that knowledge that is not used loses its value. This can be detrimental to an organization's source of value, since the knowledge in the organization is not used and therefore loses its timeliness value. In an organization, leadership is closely related to the distribution of formal power; informal power is often obscured in a firm's culture and only emerges through the firm's values. According to Cook [7], in order for KM to succeed, both formal and informal power sources must be aligned and both must be in favor of sharing knowledge, skills and experience. Moreover, because of the increasing number of mergers and acquisitions that are taking place, employees are often wary and cautious about their potential career advancement and are thus prone to guard their knowledge, taking precautions not to share it. Another reason that employees do not share their knowledge or contribute to management systems is that they feel that "they are just dropping their knowledge into a black hole" [14].

Because much of a firm's intellectual capital is shared through informal networks, also known as the 'grapevine', individuals who do not partake in such informal structures and relationships do not have access to the knowledge. In fact, an organization's grapevine is a conduit through which skills and experience are easily and efficiently transferred and shared [7].

Peacocks

Employees who fall in the upper right hand cell have low knowledge yet are willing to share. This is best represented by peacocks, which use their tail to inflate their size so as to appear larger and more powerful to would-be predators. In a similar manner, in some instances employees who are less competent are willing to share whatever they do know in order to appear more competent than they actually are. Often this behavior backfires as the true level of competence of the employee is then exposed.

Employees need to feel that their knowledge is there for other employees and that somebody else actually makes use of it. When KS is viewed from the "receiver's" point of view, she/he needs to trust that the knowledge that s/he receives is accurate. Wah [45] describes how in the chemical industry the accuracy and validity of the information is of prime importance since an inexact solution mixture may have grave consequences. Moreover, in the chemical industry, high levels of safety and environmental standards must be maintained.

It is important for firms to recognize the 'peacocks' among them. In some cases, the firm must even take precautions so as not to create peacocks, which can be done by implementing reward systems based on the number of contributions of an employee. When employees are rewarded based on the quantity of contributions as opposed to the quality of contributions, employees may tend to contribute for the sake of contributing. This behavior however, does not lead to an increase in an organization's knowledge base.

Ants

Finally, employees who have low knowledge and are not willing to share fall into the lower right hand cell of the matrix. Such employees are able to use the explicit knowledge of other employees but their competence is unconscious, that is, although they are able to perform certain processes or procedures, they are unable to make informed adjustments as to the performance of their tasks. Such as ants that work hard at maintaining the proper functioning of the ecosystem, these employees are essential to the organization. Without them, routine tasks would not be performed and the everyday workings of the firm would come to a standstill.

During the hiring process, firms look to fill "ant" positions, for example, calling center employees by individuals with qualifications such as basic reliability, problem-solving skills, and so forth [22]. These qualifications represent the top qualifications for such positions. Timeliness and responsibility are also required of such employees for them to perform their duties properly. Schultz [35] reports that a one percent error rate in basic business operations results in a ten percent increase in logistics' costs. This is a representative of the critical importance of ants in any organization.

Since organizations often do not recognize the value of their work, ants are frequently compensated poorly. The work of ants is, in most cases, taken for granted. For example, custodians who empty office wastepaper baskets, clean washrooms, and, generally, maintain a clean working environment are critical to an organization's proper functioning. Ants and their work are, as stated above, taken for granted, until they fail to perform their responsibilities and tasks. It is then that the organization comes to realize ants' importance.

From the examples presented, it is clear that ants play a significant role in the effective and efficient functioning of any firm. Therefore, in hiring ants, organizations must ensure that the individuals have the competence to adequately perform their tasks. If they fail to do so and do not pay enough attention in ensuring that employees filling ant positions are qualified to do so, the organization may suffer and the work of other employees may be negatively affected.

ESM is a dynamic model

The ESM represents a horizontal "cut" in the employees' structure at a given time in a company. Therefore, at different points in time different employees will be in a particular cell of ESM. Over time, an employee may fall into different cells. From a strategic point of view, the most important cell in the ESM for a company's future success is the seeing eye dog cell. Because this is a position involving extensive responsibility, one individual cannot be expected to hold it for a long period of time. This dynamic view of ESM is consistent with Nonaka's [26] dynamic theory of organizational knowledge creation, SECI (Socialization, Externalization, Combination, and Internalization). These building blocks, namely, the socialization, externalization, combination, and internalization activities form the spiral of knowledge creation in time just as the ESM represents static points in a dynamic model of employee structure in an organization.

Conclusion and future research

Knowledge management and knowledge sharing are of prime importance to a firm's success. Of equal importance is an employee's propensity to share the knowledge s/he possesses. The ESM presented in this paper categorizes employees according to their level of knowledge, operationalized as their level of competence, and whether they share their knowledge.

Wiig [47] suggests that the theory of the firm may need to be revisited and revised in order to establish a solid foundation for future KM. Spender [36] suggests that a knowledge-based theory of the firm can provide new dimensions to the functioning of firms which are not captured by production-function and resource-based theories of the firm. Through this knowledge-based view of the firm, the dynamic character of organizations is taken into account and comes into play when organizations realize that the knowledge of their employees is the platform on which the future of the firm is founded. The knowledge of employees is highly critical, since it is through this knowledge that new ideas are created. It is this knowledge creation that is critical for a company because through this process creative ideas can be translated into innovative technologies and processes [17] [42]. In today's environment good quality is required, but it is not this, which distinguishes one organization from another. Innovative services and products give organizations additional competitive advantage [33].

Furthermore, as Spender [36] suggests, it is important for firms to apply "diffuse, nonbureaucratic management styles" (p. 47) to support knowledge creation and its sharing. By applying this management style, organizations will be able to recognize the seeing eye dogs among its employees and will hence be able to provide a superior working environment, which will lead to the exploration of new innovative strategies and thus enable the firm to achieve a competitive advantage.

Extensions of this paper could follow several paths. First, for example, measurement instruments to explore both dimensions could be developed in order to test the model in stable and emerging markets. It will then be possible to compare and contrast the different employee structures that are found in these two markets. Furthermore, after identifying firms considered industry leaders, it will be possible to compare the different employee structure patterns by classifying them according to the ESM.

Second, according to Hansen and colleagues [19], organizations adopt different KM strategies that best suit their firm's business strategies. The authors describe two approaches to KM, namely, codification and personalization strategy. The former focuses on the automation and application of IT, while the latter emphasizes the learning organization. Based on the ESM, it may be possible to predict which type of employee is more likely to engage in either codification or personalization and what strategies may be adopted to promote either type of KM.

Although Despres and Chauvel [11] state: "the domain of knowledge management is pre-pre-paradigmatic in the sense that a fragmented mosaic of views exists within the general framework of an emerging cognitive science" (p. 11), it is our hope that this paper has contributed to the literature on KM that will help knowledge management and knowledge sharing principles, as well as models, to emerge.

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K-Economy: Implications For Human Resource Development In Malaysia

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INTRODUCTION

The New Millennium sees Malaysia transforms from production economy (P-economy) into knowledge economy (K-economy). Consequently the managers are now concerned for production efficiency, workers' productivity, dynamism, creativity and product and service innovation, work ethics and changing functional work culture. The increasing use of computers in business and marketing of products and services is encouraging in line with the development of ICT and multimedia super corridor (MSC). As such, many have noticed the rise of internet- business as a result of improvement and development of ICT infrastructure and other government incentives such as the National IT Council (NITC) that provides grants to applicants to develop the networks which enhance these five areas: E-Public Service, E-Community, E-Economy, E-Learning and E-Sovereignty.

In Malaysia, the k-economy is driving the development of information technology and telecommunication. The Malaysian Multimedia Super Corridor (MSC) is the case in point. The MSC, which is stretching to year 2020, is facilitated by the Multimedia Development Corporation (MDC), which also grants MSC status to companies. The MSC area is from the world's tallest twin towers at the Kuala Lumpur City Center in the north to the new Kuala Lumpur International airport in the south. Two new intelligent cities, Putrajaya and Cyberjaya are already in the MSC area, measuring 15 km wide and 50 km long. The seven flagship applications in the MSC currently developed by the international and domestic companies are: electronic government, multi-purpose Smart Card, Smart Schools, telemedicine, R &D clusters, world wide manufacturing web and borderless marketing.

E-Environment In Malaysia

In Malaysia, the rapid growth in information and telecommunication sector is not only changing the life styles of the society but also the work-life of both the public and the private sectors. Mobile phone, facsimiles, Internet, teleconferencing, intranet, website access and E-Commerce are becoming necessary in line with the ICT hardware, software and infrastructure development. The significant importance of information technology and telecommunication (ICT) is reflected by the increased number of ICT firms, dot.com companies, application service providers, e-commerce and the Internet users in Malaysia. Table 1 and Table 2 show the number of Malaysian Internet Users compared to other Asian countries and the number of MSC status ICT companies in Malaysia.

Table 1:INTERNET USERS

ASIAN INTERNET USERS (million)			
Japan	43.3	**Malaysia**	**3.5**
China	22.5	Hong Kong	2.7
South Korea	19.0	Philippines	2.0
Australia	6.7	Singapore	2.0
Taiwan	6.3	Others	5.8
India	5.0		
INTERNET PENETRATION USERS/10000 PEOPLE			
Singapore	4907	Taiwan	2820

South Korea	4025	**Malaysia**	**1502**
Hong Kong	3997	Macao	909
New Zealand	3921	Brunei	758
Australia	3490	Philippines	285
Japan	3412	Maldives	207

ASIAWEEK, June 1-8, 2001

Table 2:TYPES OF BUSINESS OF MULTIMEDIA SUPER CORRIDOR FIRMS

SECTOR	Number of Firms
Software Development – Engineering / Specialized Applications	83
Software Development – Business Application	73
Content Development	68
Internet based Business – Application Service Provider	55
Internet based Business – E-Commerce Service / Solution Providers	60
System Integration	39
Hardware Electronics	28
Telecommunication / Networking	26
Production / Postproduction / Animation	20
Consultancy	13
Computer / System Security	12
Education / Training / Consultancy	13
Internet based Business – Web-Hosting / Web / Online Publishing	8
Heavy User	5
Total	**503**

Source: MSC, June 2001

Human Resource Policy Thrusts

The Malaysian population increased at an annual rate of 2.4 percent during the period of 7th Malaysia Plan (1996-2000) to reach 23.27 million in year 2000. It is projected that the Malaysian population is around 33 million and the projected labor force of 18.8 million. Table 3 and Table 4 show the Malaysian population and labor force and employment for the 8th Malaysia Plan (2001-2005).

Table 3:POPULATION IN MALAYSIAYEAR 2000

Population (million)	**Bumiputra**	**Chinese**	**Indian**	**Others**
23.27	66.1%	25.3%	7.4%	1.2%
Median age				
23.9				
Dependency Ratio				
(the ratio of dependents to every 100 persons of working age)				
59.1 percent				

Source: Eighth Malaysian Plan (2001-2005)

Table 4:LABOUR FORCE AND EMPLOYMENT, 2001-2005 (‘000 PERSONS)

	2000	2005		Average Annual Growth 7MP	8MP
Total Labor Force	9572.5	11161.9		3%	3.1%
Local	8823.3	10591.9		3.6%	3.7%
Foreign	749.2	570		-2.6%	-5. 3%
Unemployment Rate	356	224.6			
Employment Rate	3.1	2.7			

Source: Eighth Malaysian Plan (2001-2005)

The development of ICT in Malaysia is reflected by the wider and greater usage of Internet and e-mail at home, in businesses and in other non-business related activities. This ICT development also includes the establishment computer community centers in small towns and in the rural areas, the increasing number of computer vendors, technology-based companies, retail dot.com companies and other computer-related service, the rapid usage of websites by the government departments, agencies, the businesses. Such development is also shown by the increased public demand of hand-phones, Internet, LAN, intranet and ICT education and technical training across the nation. The development of ICT the increased demand for qualified and trained manpower in the growing private sector and in the education sector in particular, and the increased number of qualified school leavers to enter into higher institutions, had drastically changed the environment of the business and education sector in Malaysia.

As Malaysia transforms from a production economy (P-economy) into a knowledge-based economy (K-economy), one must place importance on the generation and exploitation knowledge to create new values in the economy (BNM, 1999). Consequently Malaysia is focusing on k-work. Demand for knowledge workers and organizations’ emphasis on creating learning organizations is found relevant in this global competitive environment in which Malaysia exists and operates. As such the outlined human resource development policy thrusts for year 2001-2005 (8MP) enable Malaysia to move forward towards the industrialized nation in year 2020. Table 5 shows 10 human resource policy thrusts in Eighth Malaysia Plan (2001-2005).

Table 5:HUMAN RESOURCE DEVELOPMENT POLICY THRUSTS IN 8TH MALAYSIA PLAN (2001-2005)

<u>10 HUMAN RESOURCE POLICY THRUSTS:</u>

1. Supply of skilled labor
2. Quality of training and education
3. Improvement on training and education delivery systems
4. Promoting long-life learning
5. Optimizing local labor
6. Increasing supply of science and technology workforce
7. Accelerating productivity-based wage system
8. Strengthening human resource information systems for labor Mobility
9. Promote Malaysia as regional education center of excellence
10. Reinforcing positive value

Source: Eighth Malaysia Plan (2001-2005).

In the 8MP, the total employment by selected occupation (2000-2005) is shown in Table 6

Table 6:EMPLOYMENT BY SELECTED OCCUPATION, 2000-2005 (PERSONS)

8MP			
	Stock 2000	Employment 2005	Net Increase
Engineers	55,485	108,400	52,915
Engineering Assistants	130,024	247,739	117,715
Medical Health Professionals	21,270	36,835	15,565
Allied Health Professionals	45,052	115,821	70,769
School teachers	298,083	349,086	51,003

Source: Eighth Malaysia Plan (2001-2005)

It has been reported that the reason for the manufacturing sector greater capital and knowledge intensity is to overcome labor shortage. The manufacturing is expected to create 642,000 new jobs or 40.4 percent of the job created. The employment in the manufacturing sector is expected to amount to 29.5 percent of total employment by end of Eighth Malaysia Plan (2001-2005). The service sector is expected to grow at an average rate of 3.8% per annum. The administrative and managerial category will continue to grow at an average rate of 6.9 percent during the plan (see Table 7). The productivity grew at an average of 1.6% contributed by the shift towards high technology production processes and increase in labor efficiency

Table 7:EMPLOYMENT GROWTH RATE

Sector	Average Employment Growth rate per annum during 8MP (2001-2005)
Manufacturing Sector	4.6%
Service Sector	3.8%
Administrative & Managerial	6.9%
Production workers	2.0% (during the 8MP period)
Agricultural Workers	2.0% (during the 8MP period)
Service workers (tourism, hospitality, ICT, transportation	4.25 % per annum.

Source: Eighth Malaysia Plan (2001-2005)

In the area of training, technology-based training is moving forward. Many manufacturing firms and the education institutions are adding TBT into their training and education systems. In the case of TBT tools, videos, intranet, Internet and CD-ROM are commonly used. The development of TBT packages was however developed by the external vendors. As such the responsibility of updating and maintenance of training materials lied on these external vendors rather than by the internal training staff. At the same time, the non-availability of new technology products has hindered the development of TBT usage in the organizations. Many agreed that TBT was easy to use, easily accessible and yet TBT would not be able to completely replace other traditional methods. The videos could only be used to demonstrate a process while Internet and intranet could only be used to allow the trainees to access to database and try out new work methods before they actually implement them in a real situation. Thus TBT is considered as one of effective means of delivering training and TBT is found to complement the traditional training rather than a complete substitute.

Liberalization Of Education System

One of the strategic moves to increase the supply of skilled workers to meet the needs of global market is to encourage private sector participation. The reform in the education system in the country such as the introduction of Private Higher Educational Institutions Act, 1996 is to facilitate the private sector and the Government corporations such as Petronas, Telecom and Tenaga Nasional to play a greater role in the provision of education at tertiary level. Other measures are also being taken to encourage the private sectors' involvement in training, retraining and upgrading of the workforce for the needs of the manufacturing, information technology and service sectors. Better learning environment for students and utilization of ICT in schools, virtual (web-based training), upgrading teaching skills and improved compensation systems to attract more competent teachers are being considered. Greater emphasis is given to the retraining and skills upgrading of the workforce through various apprenticeships, vocational, technical and functional skills training programs offered by the private and public training institutions. The Human Resource Development Fund (HRDF) under the Ministry of Human Resource, will further expand to include, energy, agriculture and other services such as hospital, transportation and water supply. Numerous training providers registered under the HRDF offered training courses in 7 approved training schemes, including training scheme for retrenched workers.

Conclusion

Malaysia is moving forward to achieve the industrialized nation by year 2020. Continuous economic, social, technological and business strategies had been long formulated and implemented in the Malaysian Master Plans. Human resource and technological development, product innovation, industrial competitiveness, effective management practices and efficient government are crucial factors that are given priority and greater attention in the New Millennium. In the quest to attain the status of a "developed nation" by the year 2020, his is necessary not only to increase the knowledge and skill intensity of the workforce, but also to equip them with specialized and up-to-date skills with positive attitude as production techniques become increasingly automated and business practices are more dynamic and sophisticated as a result of ICT explosion in the region.

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Knowledge Management in Learning Organizations

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Abstract

The paper provides a framework for examining a company, based on its "learning orientations," a set of critical dimensions to organizational learning, and "facilitating factors," the processes that affect how easy or hard it is for learning to occur. The paper also suggests to integrate all five ideas (proposed) of a learning organization into a single organization and pursue them simultaneously within the framework of knowledge management. Our research is dedicated towards helping organizations become better learning systems. We define organizational learning as the capacity or processes within an organization to maintain or improve performance based on experience. Learning is a systems-level phenomenon because it stays within the organization, even if individuals change. One of our assumptions is that organizations learn as they produce. Learning is as much a task as the production and delivery of goods and services and hence production systems should be viewed as learning systems.

Introduction

Knowledge Management: Paving the way for change

Knowledge Management - the term is used to refer to a broad collection of organizational practices and approaches related to generating, capturing, and disseminating know-how and other content relevant to the organization's business. Some would argue that "knowledge management" is a contradiction in terms, being a hangover from an industrial era when control modes of thinking were dominant. Thus knowledge is not just an explicit tangible "thing", like information, but in retrospect is information combined with experience, context, interpretation and reflection. Others would prefer to emphasize "learning", since the real challenge in implementing knowledge management is less in the "sending" and more in the "receiving", particularly the processes of sense making, understanding, and being able to act upon the information available.

We define organizational learning as the capacity or processes within an organization to maintain or improve performance based on experience. Learning is a systems-level phenomenon because it stays within the organization, even if individuals change.

Overall, whatever the term employed to describe it, knowledge management is increasingly seen, not merely as the latest management fashion, but as signaling the development of a more organic and holistic way of understanding and exploiting the role of knowledge in the processes of managing and doing work, and an authentic guide for individuals and organizations in coping with the increasingly complex and shifting environment of the modern economy.

The Learning Organization

The term *learning organization* is the label now being used for an integration of a set of ideas that have emerged from organizational research and practice over the past three or four decades on ways of organizing work in such a way that the often-conflicting demands of organizational effectiveness and individual job satisfaction are simultaneously met. The learning organization is, in many ways, a natural evolution of older participatory management themes of the 1970's and more recent emphasis on empowerment and self-managed work-teams. A learning organization is not so much characterized by its altered structure (flater and less hierarchal) and redesign of work (emphasis on teams), but by the transformation of the relationship of the organization to the individual and increased capacity for adaptation and change. The previous overriding concern for control (e.g. motivate others, organize work for others, set goals for others, etc.) is replaced by a concern for learning by <u>all</u> organizational members on behalf of the organization. Learning about technical things and things about the external environment is greatly valued, as are learning things about itself including its organizational processes. A learning organization expects its members to " . . . act as learning agents for the organization, responding to changes in the internal and external environment of the organization by detecting and correcting errors in organizational theory-in-use, and embedding the results of their inquiry in private images and shared maps of organization" (Argyris & Schon, 1979, p. 29).

Characteristics of Learning Organizations

1. There exists a shared vision, which everyone agrees on.
2. People discard their old ways of thinking and the standard routines they use for solving problems or doing their jobs.
3. Members think of all organizational processes, activities, functions, and interactions with the environment as part of a system of interrelationships.
4. People openly communicate with each other without fear of criticism or punishment.
5. People sublimate their personal self-interest and fragment departmental interests to work together to achieve the organization's shared vision.

Major Ideas Behind Learning Organizations

The following are some of the major ideas of learning organizations:

Systems Thinking

Persons in learning organizations engage in systems thinking as they view their role in their work team, the role of their work team in the organization, and the organization's relationship to the larger environment. At the heart of systems thinking is an awareness of the interconnectedness (and varying levels of interdependency) of persons in teams, of teams in organizations, and organizations in the larger environment. To take a systems perspective also means to function individually and as part of a work team to optimize the organization as a whole (even if that means that one's work team subsystem is sub optimized).

Personal Mastery

In learning organizations the individual's personal and professional development are viewed as crucial to the organization's success. Personal mastery means charting a course of development that leads to a special level of proficiency through life-long learning. This learning is not only in the areas related to the product or service of the organization but includes such areas as enhancing interpersonal competence, personal awareness, emotional maturity, and an enlarging understanding of the ethical/moral dimensions of organizational life. This kind of personal mastery leads people to make a unique contribution because of their deepening understanding of and commitment to their personal vision expressed in concert with others pursuing personal mastery.

Mental Models

Our responses to new situations are influenced by our ingrained assumptions and generalizations about how things work in organizations. These mental models enable us to rapidly size up new situations and take action and can be found at the individual, team, and organizational level. The problem is that sometimes these mental models are limiting or even dysfunctional and prevent adaptation that would strengthen the person, team, or organization. In the learning organization mental models are freely shared, rigorously scrutinized, and revised as necessary at the personal, team, and organizational levels. If an organization is to become a learning organization it must overcome the fear or anxiety that prevents its members from challenging established ways of thinking and doing. Some organizations may also have to overcome a "bias for action" that can prevent a more self-reflective appraisal.

Shared Vision

Goals, values, and missions will have the most impact on behavior in an organization if they are widely shared and owned by persons throughout the organization. This larger shared picture of the future emerges from the partial visions of individuals and teams. A shared vision produces a much higher level of sustained commitment than is possible when the vision is imposed from above.

Team Learning

Teams exist in all organizations. They may be called departments, units, divisions, committees, etc. Often a person functions on several teams. For example a person may be part of the X Department, a member of Y Committee, and a member of Z Taskforce. Each of these team settings will have its own dynamic processes. Team learning has to do with improving the processes in a team to improve its effectiveness. Of particular interest is the phenomenon of defensive routines (activities that help a team avoid knowing) that can undermine learning by preventing a team from accurate appraisal of its processes and the consequences of those processes on the work of the team (see Argyris & Schon for a discussion of defensive routines). When effective processes are in place the team can engage in its primary task of providing a product/service.

Learning Organizations core competencies

The core competence of Learning Organizations are Aspiration, Communication and Conceptualization promote open communications, enhance collective understanding, and build systems thinking skills which enable officers to deal with complexity and to understand the larger systems and forces at play. Table 1 presents the institutional, organizational, and cultural structure of the learning organization compared to the classical (non-learning) organization. Please refer appendix 1.It is crucial to understand the interactions among institutions, behavior, and culture within organizations and how these interactions translate into on-the-ground results. Structures and institutions influence individual behavior within the organization, and they shape the culture of the organization. Individual behavior is recursively related to organizational culture: organizational culture shapes behavior, and behavior influences and reinforces the culture itself.

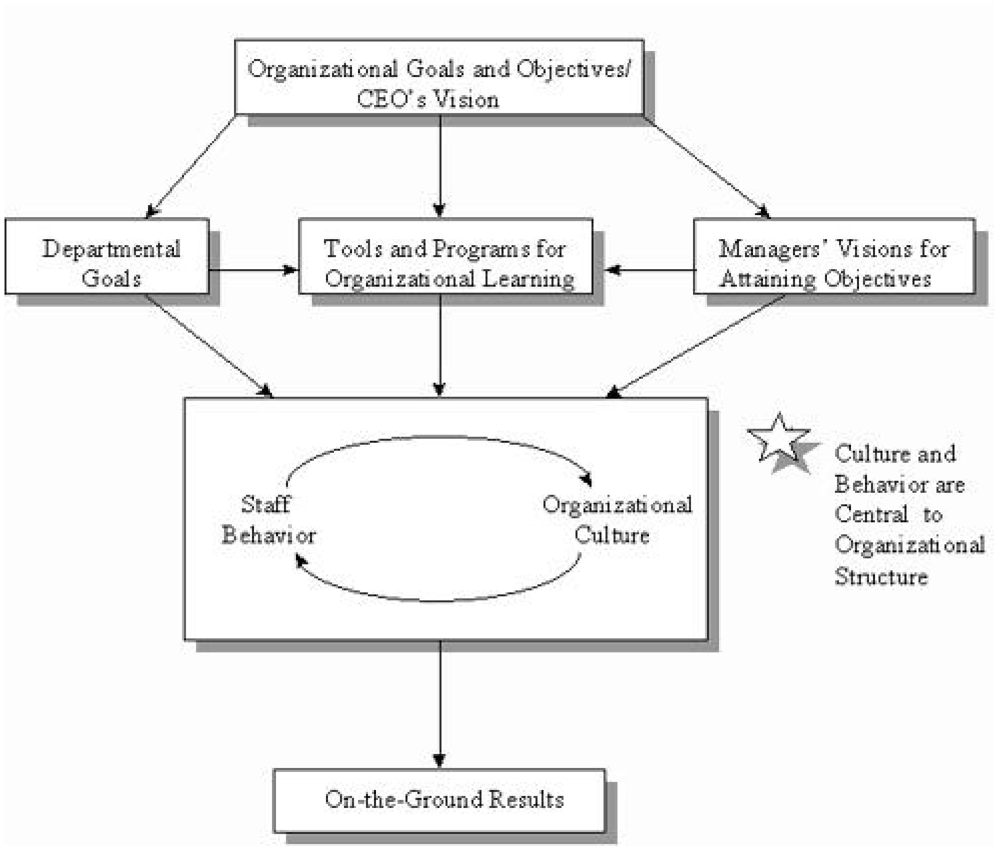


Fig 1: ORGANIZATIONAL LEARNING SYSTEM

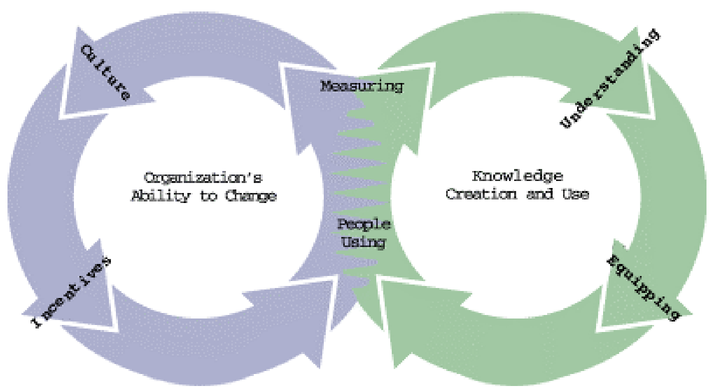
As this causal model shows, the only path from overall business objectives to on-the-ground-results is through individual behavior and the organizational culture. It is through these mechanisms that the objectives of the organization are carried out. And these mechanisms themselves are simultaneously influencing each other. Individual behavior is influenced by organizational culture; how individuals frame problems, problem solve, carry out tasks, work are influenced and shaped by the culture of the organization. Those very behaviors have a reinforcing effect on the culture of the organization. Thus, it is critical in any type of organizational restructuring or organizational reform to actually change the very culture of the organization. In building a learning organization, staff behaviors and the organizational culture must be embedded with the principles of the learning organization.

Learning organization & Knowledge Management – Our Synergistic Research Focus

Our research is dedicated to helping organizations become better learning systems. One of our assumptions is that organizations learn as they produce. Learning is as much a task as the production and delivery of goods and services. We do not imply that organizations should sacrifice the speed and quality of production in order to learn, but, rather, that production systems be viewed as learning systems. While companies do not usually regard learning as a function of production, our research on successful firms indicates that three learning-related factors are important for their success:

1. Well-developed core competencies that serve as launch points for new products and services. (eg. Canon has made significant investments over time in developing knowledge in eight core competencies applied in the creation of more than thirty products.)
2. An attitude that supports continuous improvement in the business's value-added chain. (eg. Wal-Mart conducts ongoing experiments in its stores.)
3. The ability to fundamentally renew or revitalize. (eg. Motorola has a long history of renewing itself through its products by periodically exiting old lines and entering new ones.)

These factors identify some of the qualities of an effective learning organization that diligently pursues a constantly enhanced knowledge base. This knowledge allows for the development of



competencies and incremental or transformational change. In these instances, there is assimilation and utilization of knowledge and some kind of integrated learning system to support such "actionable learning." Indeed, an organization's ability to survive and grow is based on advantages that stem from core competencies that represent collective learning.[2]

As a corollary to this assumption, we assume that all organizations engage in some form of collective learning as part of their development. [3] The creation of culture and the socialization of members in the culture rely on learning processes to ensure an institutionalized reality.[4] In this sense, it may be redundant to talk of "learning organizations." On the other hand, all learning is not the same; some learning is dysfunctional, and some insights or skills that might lead to useful new actions are often hard to attain. The current concern with the learning organization focuses on the gaps in organizational learning capacity and does not negate the usefulness of those learning processes that organizations may do well, even though they have a learning disability. Thus Argyris and Schön emphasize double-loop learning (generative) as an important, often missing, level of learning in contrast with single-loop learning (corrective), which they have found to be more common. [5]Similarly, Senge makes a highly persuasive case for generative learning, "as contrasted with adaptive learning," which he sees as more prevalent.[6] The focus for these theorists is on the learning required to make transformational changes--changes in basic assumptions -- that organizations need in today's fast-moving, often chaotic environment. Their approach does not negate the value of everyday incremental "fixes"; it provides a more complete model for observing and developing organizational learning. After periods of significant discontinuous change, incremental, adaptive learning may be just the thing to help consolidate transformational or generative learning.

Proposed model of organizations as learning systems.

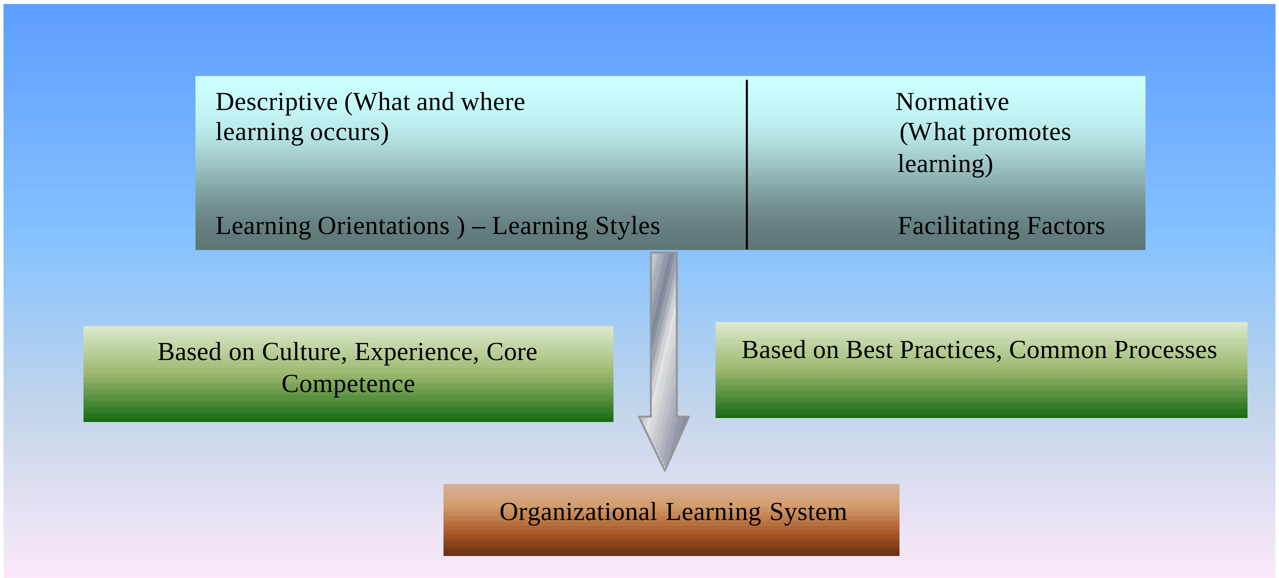


Fig 2. A MODEL OF ORGANISATIONS AS LEARNING SYSTEMS

Another assumption we make is that the value chain of any organization is a domain of integrated learning. To think of the value chain, as an integrated learning system is to think of the work in each major step, beginning with strategic decisions through to customer service, as a subsystem for learning experiments. Structures and processes to achieve outcomes can be seen simultaneously as operational tasks and learning exercises; this holds for discrete functions and for cross-functional activities, such as new product development. The organization encompasses each value-added stage as a step in doing business, not as a fixed classification scheme. Most organizations do not think this way, but it is useful for handling complexity. With this "chunking," we are able to study learning better and to see how integration is achieved at the macro-organizational level. This viewpoint is consistent with a definition of organizations as *complex arrangements of people in which learning takes place.*

While we have not looked at organizations' full value-added chains, we selected our research sites so that we could examine learning in different organizational subsets. In addition, we gathered data indicating preferences or biases in investments in learning at different points of the chain and to understand how learning builds, maintains, improves, or shifts core competencies.

Our last assumption is that the learning process has identifiable stages. Following Huber, whose comprehensive review of the literature presented four steps in an organizational learning process, we arrived at a three-stage model:

- Knowledge acquisition -- The development or creation of skills, insights, relationships.
- Knowledge sharing -- The dissemination of what has been learned.
- Knowledge utilization -- The integration of learning so it is broadly available and can be generalized to new situations.[7]

Most studies of organizational learning have been concerned with the acquisition of knowledge and, to a lesser extent, with the sharing or dissemination of the acquired knowledge (knowledge transfer). Less is known about the assimilation process, the stage in which knowledge becomes institutionally available, as opposed to being the property of select individuals or groups. Huber refers to the assimilation and utilization process as "organizational memory." While this is an important aspect of knowledge utilization, it is limited and works better when discussing information, as distinct from knowledge. True knowledge is more than information; it includes the meaning or interpretation of the information, and a lot of intangibles such as the tacit knowledge of experienced people that is not well articulated but often determines collective organizational competence. Studies of organizational learning must be concerned with all three stages in the process.

Early in our research, it became clear that organizational learning does not always occur in the linear fashion implied by any stage model. Learning may take place in planned or informal, often unintended, ways. Moreover, knowledge and skill acquisition takes place in the sharing and utilization stages. It is not something that occurs simply by organizing an "acquisition effort." With this in mind, we shifted our emphasis to look for a more fluid and chaotic learning environment, seeking less-defined, subtler embodiments.

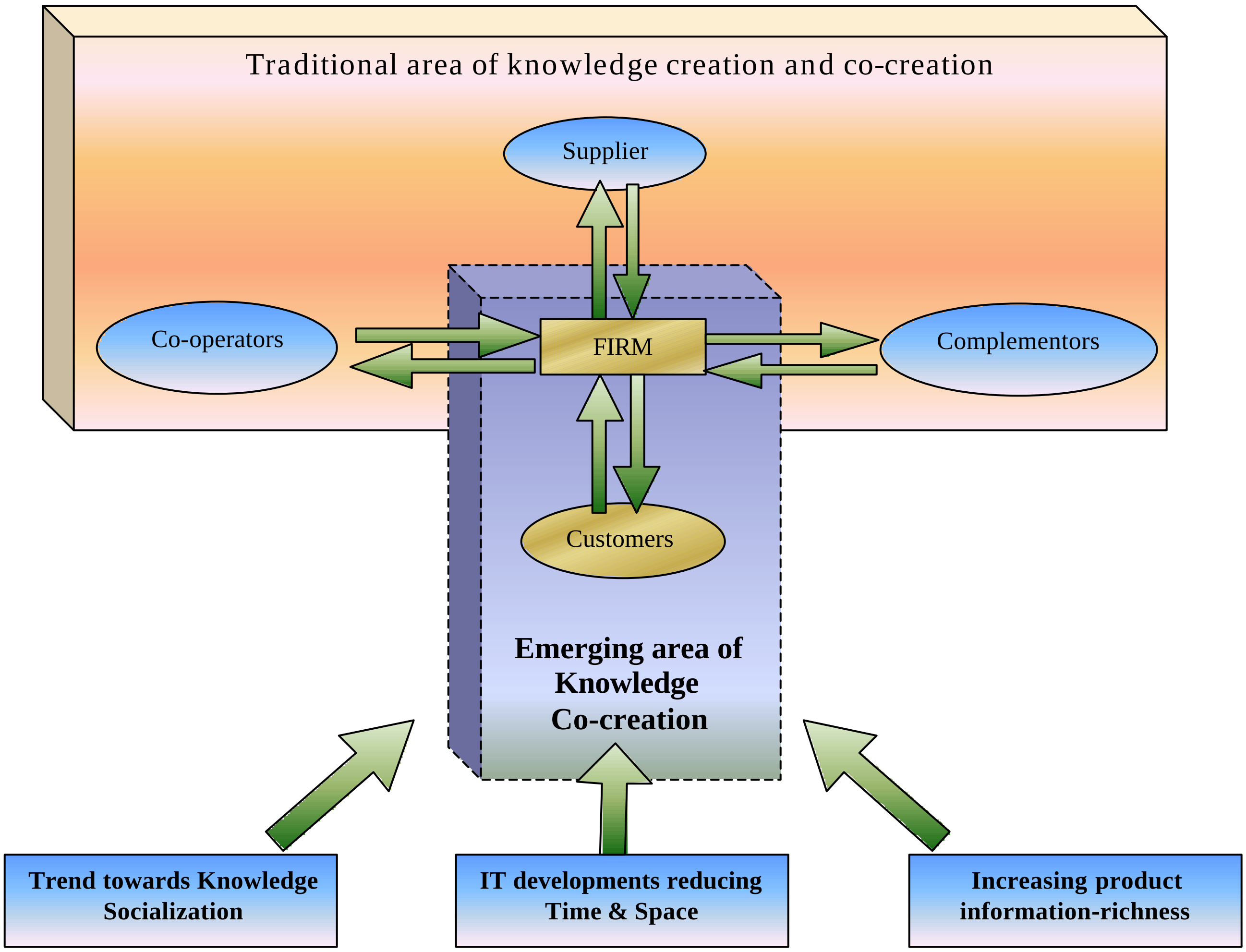
Organizations as Learning Systems: A Proposed Knowledge Sharing Model

First, *learning orientations* are the values and practices that reflect where learning takes place and the nature of what is learned. These orientations form a pattern that defines a given organization's "learning style." In this sense, they are descriptive factors that help us to understand without making value judgments. Second, *facilitating factors* are the structures and processes that affect how easy or hard it is for learning to occur and the amount of effective learning that takes place. These are standards based on best practice in dealing with generic issues. In addition, separating the parts enables organizations to see that they do indeed function as learning systems of some kind, and that their task is to understand better what they do well or poorly. (The idea of assessing what exists is more useful than the pejorative notion that there is only one good way to be a learning organization.) Finally, a refined, detailed list of factors related to organizational learning may help companies select areas for learning improvement that do not demand drastic culture change but, rather, can lead to incremental change over time.

Learning Orientations and Factors

The Learning Orientations and the Facilitating Factors identified by us are:

- **Knowledge Source: Internal-- External.** Preference for developing knowledge internally versus preference for acquiring knowledge developed externally.
- **Scanning Imperative.** Information gathering about conditions and practices outside the unit; awareness of the environment; curiosity about the external environment in contrast to the internal environment.
- **Product-Process Focus: What?-- How?** Emphasis on accumulation of knowledge about what products/services are versus how organization develops, makes, and delivers its products/services.
- **Performance Gap.** Shared perception of a gap between actual and desired state of performance; performance shortfalls seen as opportunities for learning.
- **Documentation Mode: Personal -- Public.** Knowledge is something individuals possess versus publicly available know-how.
- **Concern for Measurement.** Considerable effort spent on defining and measuring key factors when venturing into new areas; striving for specific, quantifiable measures; discussion of metrics as a learning activity.



- **Dissemination Mode: Formal -- Informal.** Formal, prescribed, organization-wide methods of sharing learning versus informal methods, such as role modeling and casual daily interaction.
- **Experimental Mind-set.** Support for trying new things: curiosity about how things work; ability to "play" with things; "failures" are accepted, not punished; changes in work processes, policies, and structures are a continuous series of learning opportunities.
- **Learning Focus: Incremental-- Transformative.** Incremental or corrective learning versus transformative or radical learning.
- **Climate of Openness.** Accessibility of information; open communications within the organization; problems/errors/lessons are shared, not hidden; debate and conflict are acceptable ways to solve problems.
- **Value-Chain Focus: Design -- Deliver.** Emphasis on learning investments in engineering/production activities ("design and make" functions) versus sales/service

activities ("market and deliver" functions).

- **Continuous Education.** Ongoing commitment to education at all levels of the organization; clear support for all members' growth and development.
- **Skill Development Focus: Individual -- Group.** Development of individuals' skills versus team or group skills.
- **Operational Variety.** Variety of methods, procedures, and systems; appreciation of diversity; pluralistic rather than singular definition of valued competencies.
- **Multiple Advocates.** New ideas and methods advanced by employees at all levels; more than one champion
- **Involved Leadership.** Leaders articulate vision, are engaged in its implementation; frequently interact with members; become actively involved in educational programs.
- **Systems Perspective.** Interdependence of organizational units; problems and solutions seen in terms of systemic relationships among processes; connection between the unit's needs and goals and the company's.

Strategies for Improving Organizational Learning Capability

1. When starting to improve its learning capabilities, an organization may decide to focus on any stage of the learning cycle -- knowledge acquisition, dissemination, or utilization. While it may be possible or necessary to look at all three phases simultaneously, focusing on a single area is more manageable. The next task is to select an option for focus:
2. Improve on learning orientations. There are two reasons for selecting this option. First, the organization may decide to shift its position on one or more learning orientations. Second, the current pattern of learning orientations has resulted in identifiable strong competencies, so improving or expanding them may be the best way to enhance the unit's learning capabilities. This focus assumes that facilitating factors meet an acceptable standard and that more can be accomplished by adding to the strong base established by the learning orientations.
3. Change both learning orientations and facilitating factors. An organization should select this option when it sees the other variables as inadequate. This option assumes that large-scale change is necessary and that changing one group of variables without changing the other will be only partially successful. Each organizational unit or firm must make the decision to pursue one strategy or another for itself. While there are no rules for making this decision, the three options are incrementally more difficult to implement (i.e., one is the easiest to implement; three is the hardest). From the first to the third options, the resistance to change within the organization increases significantly. It is one thing to develop a plan for improving what is already done reasonably well; it is another to engage in nothing less than near-total transformation. It is one thing to stay within accepted, assimilated paradigms; it is another to replace institutionalized models. Whatever the organization's choice, we offer three guidelines for developing and implementing a chosen strategy.
4. Before deciding to become something new, study and evaluate what you are now. Without full awareness and appreciation of current assumptions about management, organization, and learning, it is not possible to grasp what is being done well and what might be improved or changed. Though the systemic issues and relationships in organizational life require that change be approached from multiple directions and at several points, organizations can change in major ways if people experience success with more modest, focused, and specific changes. As with many skills, there is a learning curve for the skill of managing and surviving transitions. Large-scale change requires that many initiatives be put into place in a carefully designed, integrated sequence.
5. Organizations must consider cultural factors in choosing and implementing any strategy, particularly when considering how it does specific things. For example, in a highly individualistic society like the United States or the United Kingdom, skill development focuses on individual skills; in comparison, more

communitarian societies such as Japan or Korea have traditionally focused on group skill development. Moving from one pole to the other is a major cultural change; to simply improve on the existing orientation is much easier.

Strategic Benefits of KM in Learning Organizations

Given the right degree of investment in KM systems and technologies, and the right level of organizational commitment to their deployment, upkeep and regular use, the following benefits for KM may be realized:

• Re-use of existing knowledge elements prevents recurring costs related to repeated research of the same topics, and repeated formulation of the same solutions.

• Access to in-depth knowledge elements for support staff, partners and customers improves the customer service experience and speeds the time from problem statement to problem resolution.

• Support organizations can deliver faster, more accurate responses to questions. Be it from a successful self-service support, or from an assisted service call, customer satisfaction improves when problems are resolved quickly.

• Faster resolution of support calls means improved support staff productivity: support organizations can handle more incidents overall (particularly when self-service works for common problems and queries), and support staff can concentrate on helping customers with more serious problems or questions.

• As a knowledge base is used over time, continuous feedback from its users helps the system improve relevance ranking, identify new and improved solutions, and establish the applicability of known solutions to all related problems. This increases the value and usability of the knowledge in the knowledge base.

• Because KM systems can capture and manage knowledge from just about any subject area, organizations can use their KM systems to handle problems across a broad range of topics and job functions. This permits the knowledge base to become a real repository of collective organizational wisdom.

• Because support volume can increase dramatically with little or no increases in cost for support personnel, and the most needed knowledge is available online 24/7/365, organizations that deploy KM systems become much more competitive than those which don't. They can offer more services more often at the same price as those organizations that still rely on 8-hour or half-day telephone support coverage. The proper use of a KM system to support even tough calls ensures that answers based on shared knowledge come up quickly and are far more likely to be correct. The paybacks from a committed investment in KM systems and technology go beyond controlling escalating support costs. They also involve an increase in customer satisfaction, the ability to capture knowledge and resolve related problems of all kinds, and an increasing ability to recognize and deal with an organization's problems, no matter where and how they occur.

As a result, proper deployment and use of KM systems and tools promise a substantial payback. Not only can organizations do more with the same or fewer resources, they can also deliver a better quality of service to their customers.

Conclusion

The paper has tried to integrate all five of the ideas suggested into a single organization. Learning organizations should take these five very powerful ideas and pursue them simultaneously. Because the simultaneous pursuit of these is difficult, Peter Senge calls them "disciplines" in the sense that one has to deliberately and studiously attend to them in the course of functioning as a member of an organization.

The exercise of the five disciplines contributes to increased organizational effectiveness in carrying out its primary mission, greater capacity for organizational adaptation to changing internal and external environmental demands, a fuller utilization of the members' abilities and motivation, and higher level of job and personal satisfaction by organizational members.

Learning organizations deploying KM systems have to move to a 24/7/365 eBusiness model. In this nonstop environment, the quality of the customer or end-user experience is key to maintaining market and mind share in the new economy. Enterprise executives who recognize this new business paradigm and who are willing to commit their organizations to a process aimed at embracing this reality will gain a tremendous advantage from deploying knowledge management systems and technologies. By building on their organizations' customer support experiences and by making the most out of their current investments in support staff, these enterprises can gradually move from seeing customer support as a costly and reluctant overhead to recognizing it as a business advantage. KM technology holds the keys to capturing the most precious of all business commodities—employees' knowledge. Turning that knowledge into a dynamic, re-usable resource that is always improving in value provides a level of customer satisfaction that is unsurpassable in today's competitive eBusiness world.

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Appendix 1.

Table1: Institutional, Organizational, and Cultural Structure of the Learning Organization

	Classical Organization	Learning Organization
Institutions	Routinized; static; maintain the current organizational structure	Always in question; fluid; constantly changing; only institutions that are constant are those that continuously encourage dynamic action and change within the organization
Specific Institutional Practices	Following directions; learning to think like superiors Localized and fragmented thinking; workers responsible for own tasks; managers responsible for own section, dept., or division Leadership responsible for vision, workers responsible for working information asymmetries between management and workers Individual training seminars and sessions Lectures, giving and receiving orders Precise action based on maximum information Get the job done	Explicit and shared mental modeling Systems thinking Shared vision Public learning; team learning Dialogue generatively Acting in high levels of ambiguity Personal mastery; ask: 'how should we get the job done?'
Culture	All above institutional practices taken as givens	Principles of the learning organization routinized to become unconscious action
Growth and Change	Static; lack of change	Constant and continuous change

Tool For The Communication As A Management Change Of Organizational Culture - The New Economy Of Feeling

Javier Revuelta Blanco
Spain

Abstract

The Management of Knowledge constitutes, in practice, a management of information, which leads to a creation of knowledge. This idea of continuous backfeeding between the management of information and the creation of knowledge, incorporates another one of a very different nature, learning. The creation of knowledge inevitably generates information, which leads to new knowledge when it is managed. We witness then a cycle in which individual and organizational learning, is at the same time the transmission belt between the information that is being managed and the knowledge created, making the communication cycle either cadenced or virtuous.

The present situation of social communication

Be that as it might have been, in the 40s and as a consequence of the consolidation of the new System of Social Representation –Mass Media -, the possibility to reach a wide and distant public introduces the urge to reopen the organization of the markets, and together with that the distribution systems, the production processes and the identity of organizations: MARKETING is born as a management tool. At the beginning of this century, Telematic Nets, at the head of Internet, incorporate changes in the System of Social Representation, which influence the whole Social System. These changes can be summarized as follows:

The "Culture of Diversity" substitutes the "Mosaic Culture"

The communication of messages is changing from being massive to being diverse, from not differentiated to selective, from anonymous to localized and from unidirectional to bi-directional.The effect reached by the new widening of communication will revolutionize the whole previous model, which will penetrate in 95 % homes in the first world during the first decades of the XXI century.

The world interprets itself and becomes the most genuine social mirror

Information, apart from multiplying its contents and sources exponentially, will stop to have its mediatic meaning in order to pay attention to a group of expressive modalities much wider, at the end of which communication in its purest state: referential communication, will be established –presumably with success. The "reference data" –images, sound and words, will change from being interpreted by the commentator, presenter or newscaster, to being constituted in the very essence of the event being communicated.

The order of a few ones will turn out to be the chaos of many.

The traditional mediator, undistinguished among hundreds of thousands of transmitters, will cease to be a communicative authority and the narrative order which serves at present in our culture as reference, will suffer an immediate emptying and a later recovery. And we must not forget that all that happens in a scenery – that of the New Technologies, which apart form impeding our seeing the social changes it induces – as it has always happened with innovations in communication, it also facilitates them, since the resistance against social change decreases when its dominant system of representation vanishes.

Let's not think that technology is neutral, transparent, harmless…

The direct influence that the New Technologies provoke on the biological field at an ontogenetic - how long life lasts, and philogenetic- about our offspring- level, has likely a direct effect on social behaviour, since beyond the diverse nature of contents or narrative or receptive modalities, the relationship of the human being with technology enhances some feelings above others, some “ways of thinking” instead of others.

A new cultural order and a new conception of the world and reality will emerge. We will witness the birth of new social groups and roles, of new economic activities, laws, spiritual values… although, for this new transformation to settle down in the present model of society, it is necessary to intervene the very society –not just its system of representation, so that the model we create in the nets has an individual sense and a cultural value.

In short, we witness a change in the Social System – SS, provoked by the surge of a new System of Social Representation –SRS. This circumstance is producing in fact a Cultural Change in the organizations, which has two sides, a positive one and a negative one.

Positive Aspects

- Communication becomes bi-directional.

The amount of casters and possible relations increases exponentially –in time and space.

- The effective cost of communication decreases.

Communication via electronic mail and web pages responds to a 0 cost, which introduces complete accessibility to the system.

- The expressive possibilities increase.

The presence of the New Information Technologies, Communication and Decision, and the widening of the communicative capacity of the web, will allow us to produce and send elaborate messages, using the referential image and technique.

These three circumstances accelerate social change and produce a general effect of stability in the system.

Negative Aspects

- Contents become universal.

This means a gain in uncertainty on the system’s part. Traditional filters, which organize reality according to culturally defined schemes, are lost and, in exchange, an increase in complexity is produced. This increase is a direct consequence of the incapacity of the organization to assimilate all the information that circulates in its surroundings and to redirect it towards its necessities and development potentials.

All this might lead to states of “ organizational stresses “ that end up in “brusque reorderings”, normally expressed through regressive behaviour. To develop without any cultural criteria in a technology-saturated surrounding, undermines the culture of organization, which may also end up in losing its identity, to incorporate itself in a more complex system.

This circumstance is true about small and medium sized companies, which at present lack a well defined identity of their own, which is why their culture is based in the identification of their processes with their objectives: to obtain a benefit.

This creates a general effect of social dysfunction in the system.

Towards a progressive balance

To achieve a progressive balance – reducing the cost of energy generated during interchanges but with a well defined and accepted sense, the SS will precise of the filters capable of managing the information circulating in virtual webs, towards the different social sub-systems that form it - the diversity of its interests and necessities. This implies a hierarchical order of contents and criteria in which possible simplicity –the one allowed by the body or disciplinary relation that is established, and probable diversity –or cultural, social or economic sceneries that may follow as a consequence of the election and assessment of certain criteria and contents, get together.

This is called real social change.

This social change will be slowly incorporated into the society of information, through close expert systems of multiple variability, organized by semantic relations. These systems will in practice constitute discourses, which will facilitate an actional operative as the nowadays signaletic –only much more complex, simultaneously giving sense to the reality which they act upon, which is why they will constitute ideological options and, what is more important, they will start an unstoppable process of continuous creation of knowledge.

This is maybe the great challenge global society must face, the creation of a culture that leads the new systems of semantic relation, as options of a different sign, beyond the aforesaid actional operative. Opposite, the risk is our emptying the sense of culture and assigning a money value to all virtual relation that may be generated, for the only sake of being produced.

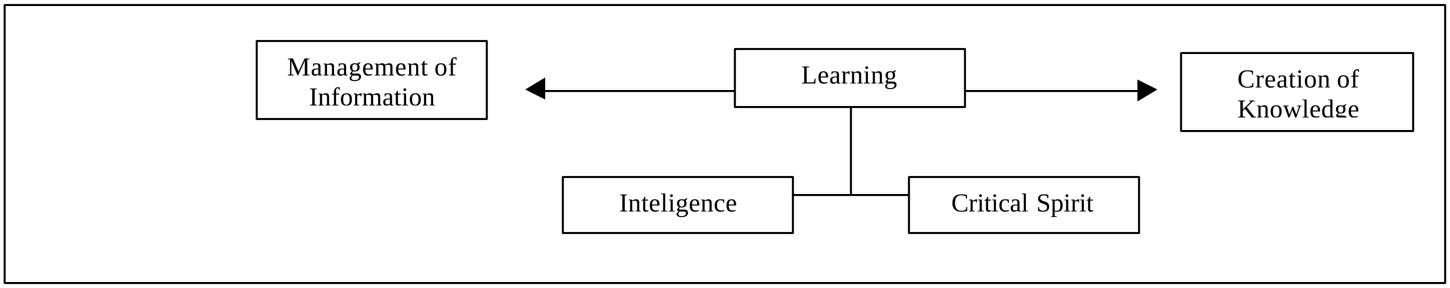
THE 40s		XXI CENTURY
MASS - MEDIA	System of Social Representation	TELEMATIC NETS
Unifying Proposal between Production, Distribution and Consumption		Proposal of Differentiation between the Market (product/personalized service,of the Company in relation to its Surrounding(out-sourcing, and Competence(benchmaking.
MARKETING	Management Tool	COMMUNICATION
STATE OF WELFARE	Main Ideology	ULTRALIBERAL MOVEMENT
BASED ON AN ECONOMIC RELATION	Business Communication	BASED ON AN ECONOMIC AND SOCIAL RELATION
IT REFERS TO PRICE, QUALITY AND SERVICES	Management Tool	OBVIATES PRICE AND QUALITY, TO CONCENTRATE ON SERVICES AND ADDED VALUE -INTANGIBLE.
CONSUMPTION	Associated Social Action	CONSUMPTION, , ENVIRONMENT, ART.CULTURE. SOCIETY
ECONOMIC POSITIONING	Competitive Advantage	IDEOLOGICAL POSITIONING
TECHNO-ECONOMICISTICAL PARADIGME	Paradigm	COEXISTENCE OF THE ECO-CULTURAL AND TECHNO-ECONOMICISTICAL PARADIGME

Joint Situation

Main characteristics of the organizations associated to the cultural change

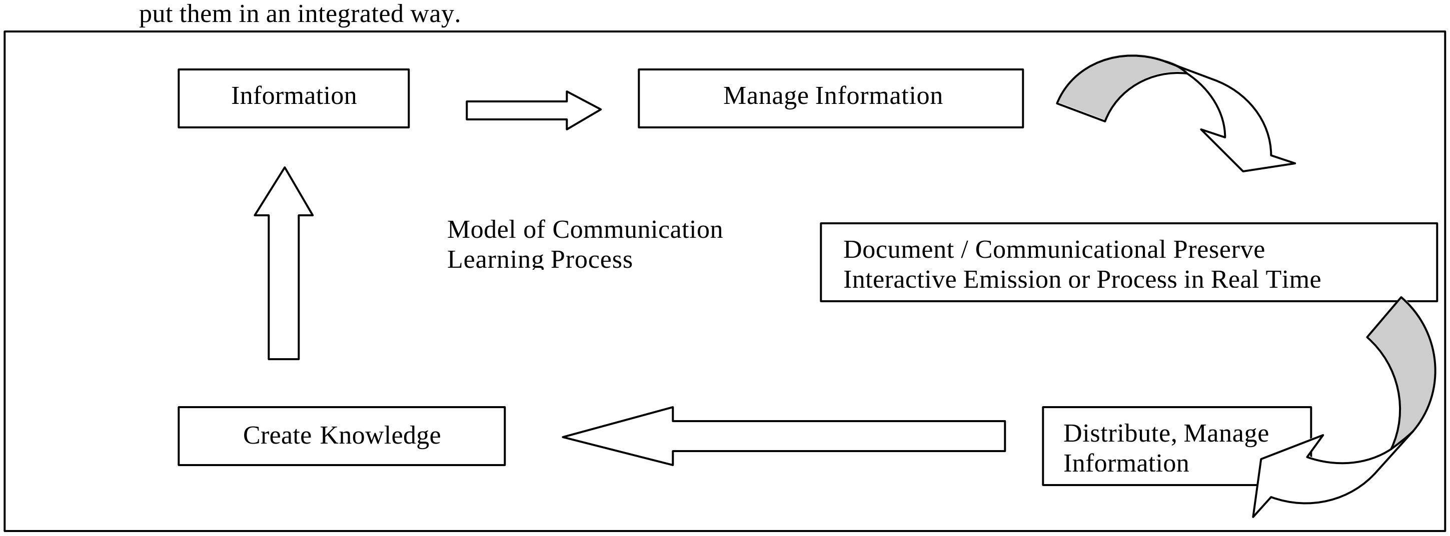
Once established the starting frame we find three differentiated problems:

1- How to manage information?
2- How to make knowledge created tangible?
3- How to learn during the process, so that the positive cultural change materializes?



Cultural Change

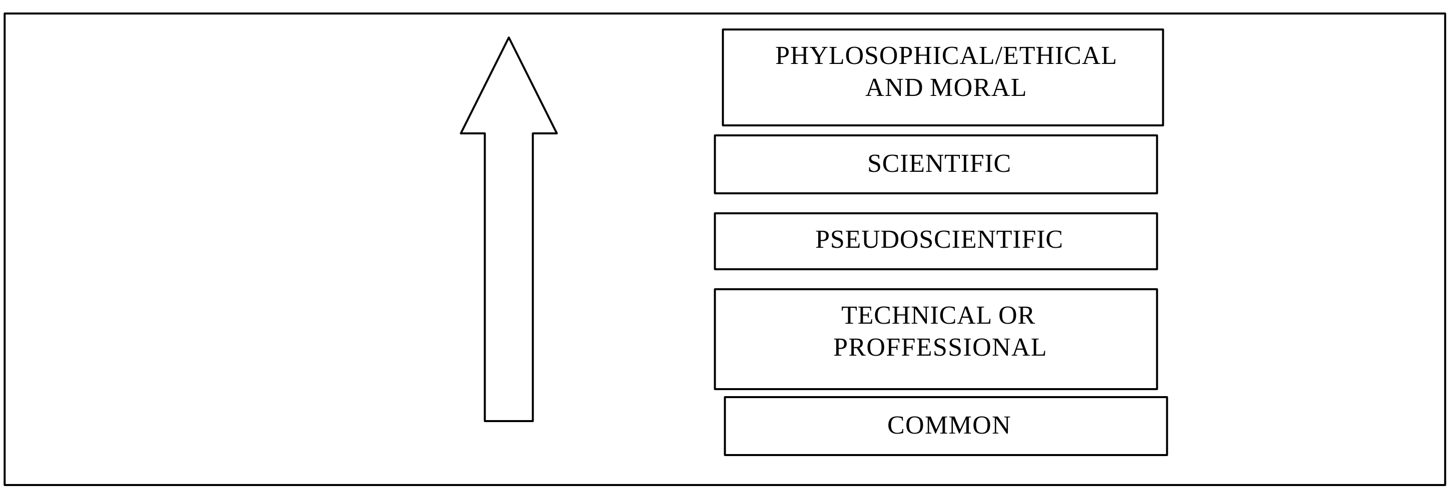
Our aim is not to answer these questions separately but to create a Communication Model In which to put them in an integrated way.



Cycle of the Management of Knowledge

One of the reasons why the "Management of Knowledge" requires an associated Cultural Change is because of the evolution it experiments in the management cycle. This evolution is expressed in the following diagram:

Types of Knowledge



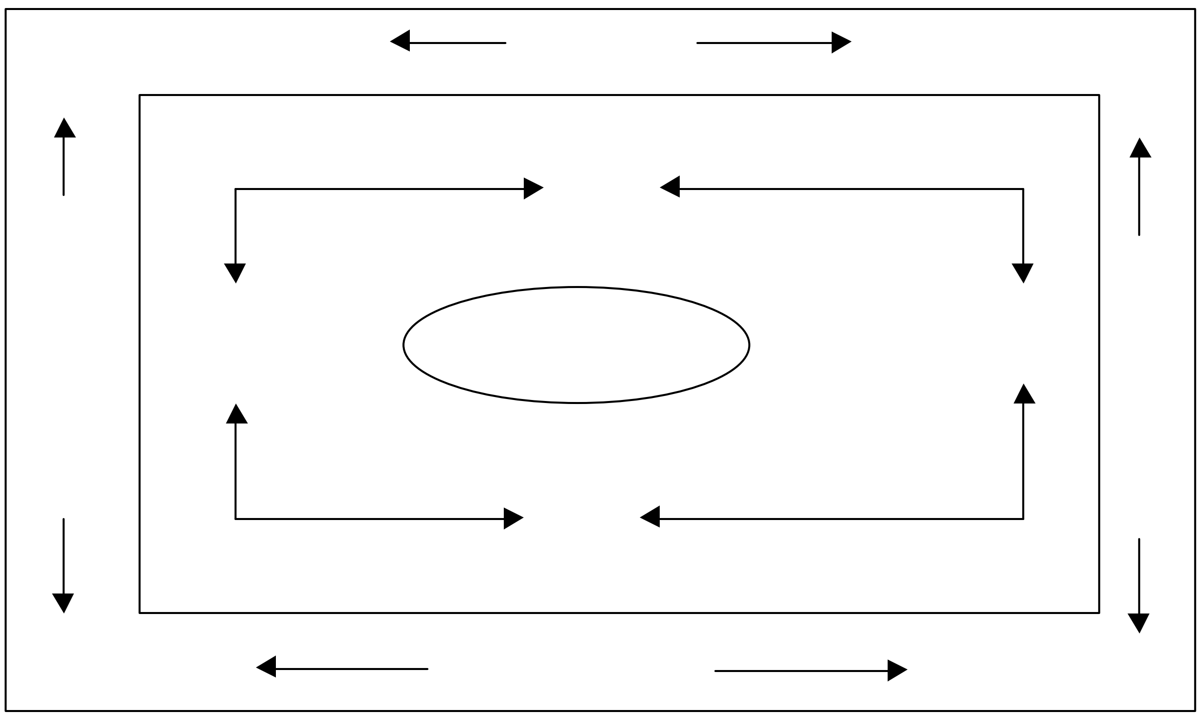
As we progress in the cycle, the knowledge changes its nature until it becomes part of an axiological corpus of values, that is, objectively recognised by their organization. This relation between the management of knowledge and change of values is very interesting since these values are built upon an interdepartmental and also institutional, of environment relationship. We can thus talk of the birth of a new company concept, the result of the influence of the Social System in the definition of its identity and its culture.

The objective of any organization that manages its knowledge is that of generating an added value, that is, an intangible something, which may be identified, structured and valued. This is what we know as “ to compete in a cloud”, that is, to compete for the value of a trademark, which is not nowadays only associated with visual perceptions, but framed in a wider context called Social Ecology of Communication.

The model of organization that assumes the cultural change

The idea of a model of organization comes from a detectable functional relation, which makes possible the existence of a particular structure by which each function suffers but also benefits from. The presence of patterns or general models of organization facilitate the birth of singular structures belonging of each organization. These general models are defined according to the following categories:

Environment Relationship



The internal relationship

Organization Development Level **Characteristic**	**STABLE**	**REACTIVE**	**ANTICIPATIVE**	**EXPLORATORY**	**CREATIVE**
Main Value	Custom	Order	Fraternity	Curiosity	Creativity
Main Objective	Internal Order	Efficiency	Planning	Efficacious Adaptation	Creative Expansion
Structure of the organization	Functional	Functional	Divisional	Matricial	Latent Opportunity
System of	Precedents	Historical Behaviour	Extrapolation	New Futures	Contingent

Information					
Patterns of Behaviour	Particularism	Adscription	Acquisition	Structural Readaptation	Universalism
Executive Behaviour	Prove and error	Diagnosis	Optimization	Collective Orientation	Creation
Behaviour towards Change	Refusal	Accept only when necessary	Search for family change	Search for unknown change	Create change
Localization of power	Production	Relationship with the Market	Relationship with the Market	Relationship with equals	Investigation
System of Management	Systematized Procedures	Controlled Regulation	Long-term Planning	Periodical Planning	Planning in Real Time
Criterium	Supervision	Efficiency	Achieve Synergy	Global Vision	Innovation
Threats	Brusque Changes in Environment	Everything must work like a clock	Objective must not be missed	Criterium must not fail	Isolation through Abstraction
Opportunities	In Conformism	In Reflection	In Intuition	In Negotiation	In Risk

Level they can achieve of knowing themselves

FAINTHEARTED
Does not know and does not act in consequence
HYPOCRITE
Knows and does not act in consequence
COMPETENT
Knows and acts in consequence
ACTIVIST
Does not know and acts in consequence

The Context in which the Communicative Action Takes Place

Of the Community

Very well defined contexts during which communication answers to a specific normative defined with relation to rituals and protocol.

Societarian

These contexts are defined by friendliness and informal relationships in which the normative in communication is constructed in a particular way. They constitute the most frequent sceneries inside the enterprise and their presence is bigger the smaller their size is. In the Societarian Contexts all the Subrogated Communication is manifest through figures such as rumour, cabals, leaders of opinion, voluntary inattentive, etc and it corresponds with the latent function of communication.

Of Custom

The contexts of Custom respond to mechanisms of functioning known and accepted by the organization as a whole. They are usually explicit and correspond to the manifest function of communication, that is, to that which relates the different functions –or departments, in companies. It is expressed through public acts, bureaucratic relationships, etc

Strategic

These contexts normally define the relationships the company has with its surroundings although they also occur in the case of very big organizations. The actions have very well defined objectives, in a context of well-known rules and they foresee the decisions a rational opponent may take. In this context the presence of the Image and the intangible derived from the management of knowledge have a great importance.

Organizational frame in which the cultural change happens

Every cultural change must happen according to an accumulative and constructive scheme. From the point of view of its dynamic and functioning this scheme is organized around four fundamental questions:

a- Complexity determined by the number of possible relationships
b- Stability yielded by the effort employed in communicating.
c- Functioning determined by the inner cogno-diversity.
d- Communicative output yielded by the real cost of the communication put into practice.

These four factors constitute the keys, which determine the evolution of the cultural change.

Complexity

Is defined in accordance with the number and the nature of the relationships established within the organization and also in the context in which this is produced.

	A lot of relationships	Few relationships	
A lot of people in the organization	*maximum complexity*	*medium complexity*	Strengthening Curls
Few people in the organization	*medium complexity*	*minimum complexity*	Deterioration Curls

Synergies Inertia

Ner. of people in the organization	Maximum number of possible relationships
5	10
10	45
20	188
30	465
50	1.225

According to the coincidence or divergence of criteria and also with frequency of communication, we find different types of relationships. The pathological relationships are of special interest since they are very frequent in organizations and constitute barriers to any proposal of a cultural change.

Frequency / *Criterium*	LOW	HIGH
Coincidence	INTERMINTENT RELATIONSHIP	SLOW RELATIONSHIP
	Dependence/Cooperation Function	
Divergent	PATHOLOGICAL RELATIONSHIP	ABSENT RELATIONSHIP
	Pathological Function	Wait/Taboo Function

Stability

Has to do with the effort employed by the organization in the process of communication. It is expressed mainly in time, money and psychological effort.

	A lot of things done	Few things done	
Little Time	*Maximum Stability*	*Medium Stability*	Little effort
A lot of Time	*Medium Stability*	*Maximum Stability*	A lot of effort
	Low cost	High cost	

Functioning

Is determined by the "filters" present in the organization. If these are operative it means that the information that comes from the surroundings is collected, classified and adapted to the necessities and potentials of development of the different subsystems that form the organization.

	Maximum distribution	Minimum distribution	
A lot of Knowledge	*Maximum Diversity*	*Medium Diversity*	Responds to detected Potentials of Development
Little Knowledge	*Medium Diversity*	*Minimum Diversity*	Does not respond to detected Potentials of Development
	Responds to detected Necessities	Does not respond to detected Necessities	

Communicative Profitability

Is estimated according to the cost generated by the communication practiced by the organization.
Profitability = level of relationship achieved/ cost of communication

Level of relationship achieved = Ner. of people it reaches + time communication lasts + degree of internalisation achieved.

Cost = physical effort + $ + time + psychological effort

The perception of change by the organization

It is essential to know how the different public of the organization – internal and external, perceive the cultural change. This perception is established from two parameters:

Anthropological Parameter

The cultural change is perceived as a "ritualised expression" of the progress of the organization, that is, from a symbolic point of view in which what matters are the values that comprise the whole organization, being of especial interest the historicity of the organization. This perception is generated intuitively, in the definition of culture and visual identity phase and is consolidated through the communication of results. The image constitutes a factor of synthesis and integration of the other perceptions.

Sociological Parameter/The Function of Culture

The cultural change is perceived as a real change, which affects the relationships held by the organization. This change is perceived as decisions related to the results of the auditories are taken. It must be perceived as a betterment.New working practices are incorporated in this phase, which are mainly communicative and respond to a triple functionality:

Establishes physical boundaries: constituted by colour, signalectics, furniture innovations…

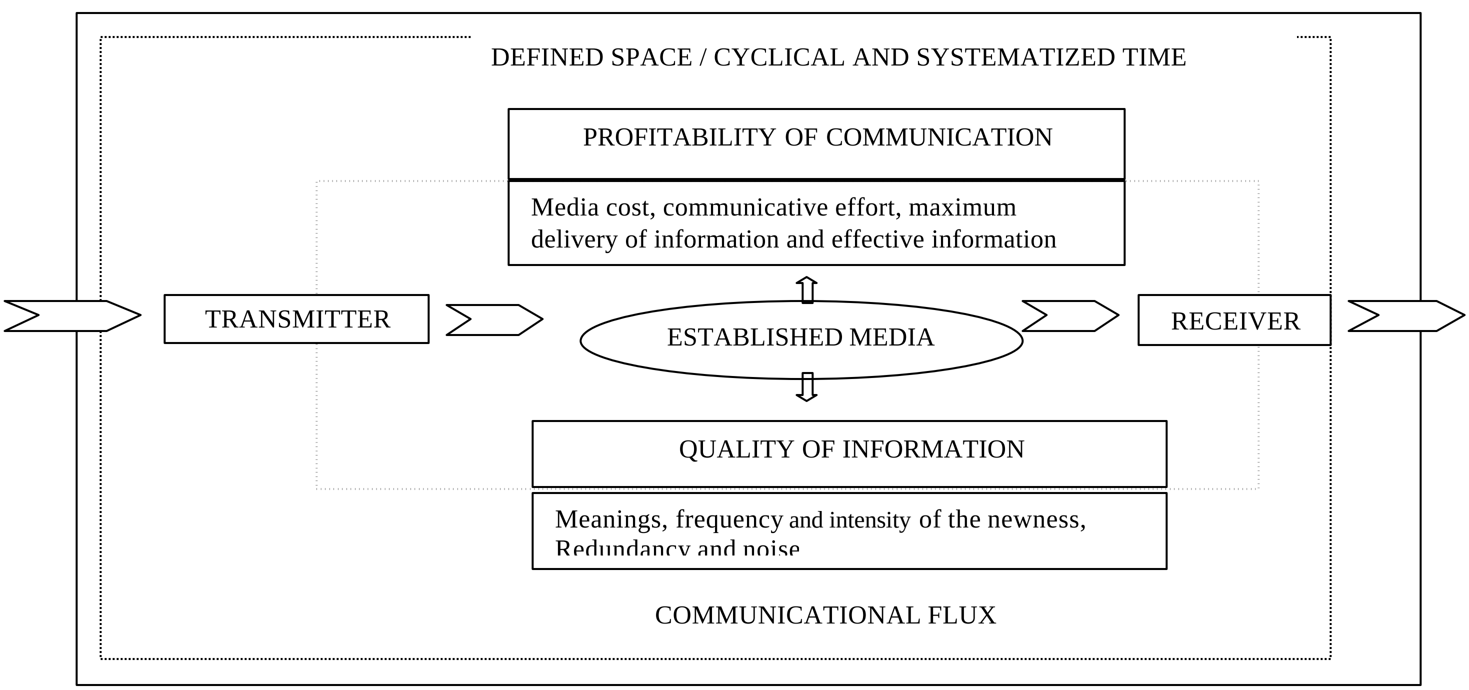
Establishes psychosocial identification and differentiation mechanisms: These mechanisms are established using the previous ones (a), as a base, incorporating meanings through the new working functions, working procedures or incentive systems, so that subcultures are created in the organization. In this phase the existing culture in the organization (previously unnoticeable), starts to be valued clarifying the necessary perceptions for the induced cultural change (through the new practices), materialize successfully. This phase is of constant redefinition of the internal processes and ends in a practical acceptance (not only attitudinal), of the cultural change.

Existential Parameter: The process of the creation of knowledge constitutes a depot of knowledge of a different nature which illustrates and concedes freedom of election to people, in a defined normative and legal frame. In this phase the attitudinal and behaviour incorporation as regards the cultural change is an accepted fact, which is why each member or group of the organization reaches a higher level of knowledge.

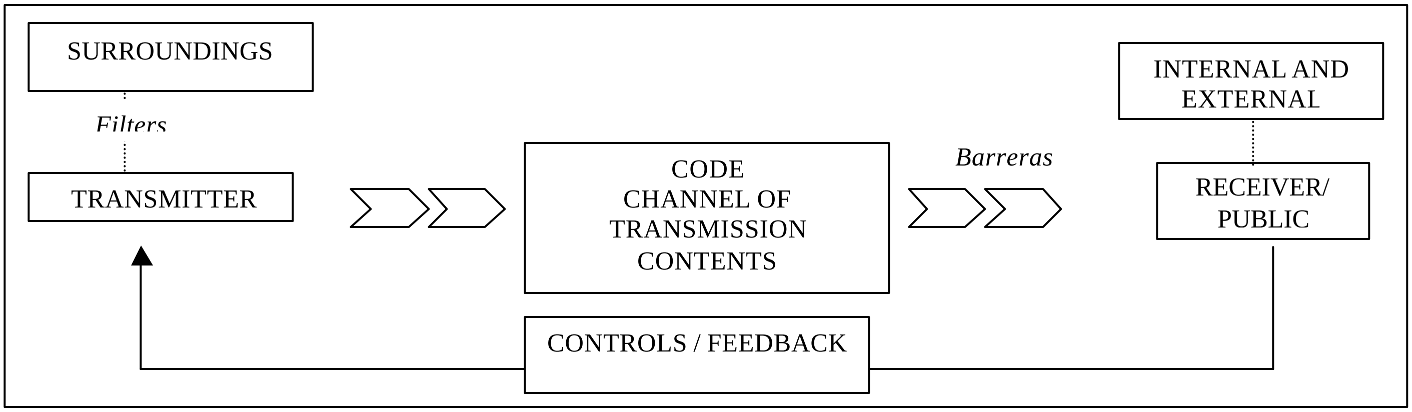
Communication as a management tool

Communication, as a management tool, must take into consideration some general characteristics and an adaptation to the management of organizations. As expression of a human impulse it always seeks to establish a relationship and its lasting in time. This idea incorporates the idea of Model of Communication, that is, of a defined construct in which relationships happen according to certain objectives.

The general scheme of any Model of Communication is the following



Model, which becomes operative in the already classical scheme



In this relationship context we consider a series of conditions previous to communication, which are the following:

a- To know the characteristics of my direct and indirect addressees and their relationships.
b- To establish the contents we are going to transmit through a tree system.
c- To approach technological media we will use according to the maximum delivery of information they are able to absorb.
d- To determine the type of Language we will use for each kind of public and medium.
e- To design messages using a certain Narrative Structure and a level of relationship in sound, written word and image.
f- To establish Introductory Rituals appropriate for the program, with the object of obtaining a communicative link and a human relationship.
g- To create own symbologies so that the messages sent may suit in a coherent discourse that acts upon memory.
h- To establish a Strategy and develop it into different tactics.
i- To project communication according to the division of the communicational flux.
j- To use the Charismatic-Functional Relationship as a reference.

Addressees

Leader of Opinion, Pressure Group, Public Opinion, Authority, Mass Media Channels, Supplier, “Client” of Final Addressee, Internal Staff, Opponent/collaborator

Effects of Communication on the Objective Public

The message affects Effects	Groups	Social Scheme	Scheme of Reference
Enforcement of Opinions and Attitudes			
Change of Opinions and Attitudes			
Yield Predetermined Behaviour			

+ ← → -

Contents

The transmitted contents must be selected according to: a criterium, a hierarchical organization, a style, a level of presence, according the level of novelty, the level of complexity, determined function

Media

They are the Technological Media used according to the maximum delivery of information they can absorb. The Technological Media incorporate one or several codes, which are defined in the following diagram

Criterium Code	CHARACTERISTICS	OBSTACLES	ADVANTAGES	IT IS USED TO
ORAL	Close	Is forgotten soon	It is direct It is in mediate	Look for agreement
WRITTEN	Rational	It is cold	It lasts Acts upon memory Can be controlled easily	Plan
VISUAL	Emotional	Difficult to correct	Moves people	Get into action

The Media determine a great deal of the communication strategy that is being articulated. They are chosen according to categories of media – leaflet, poster… and also to certain series of parameters, these are as follows:

The criteria for the election of communication media are the following: proxemics, personal communication, public or mass-media, durability – emission, media, communicational preserve, cost – low, medium, high, reach – short, medium, long, narrative structure, main function – to plan, to look for agreement, to get into action, form – image, sound, word.

Language

The choice of language is surely the most difficult part of the whole process. It implies a great deal of imagination, strategic capacity and creativity. There are two types of discourse: deductive and inductive, and four types of language according to the main function they have in the whole of the informative, persuasive, didactic, lucid discourse.

Narrative Structure

To consider a narrative structure is to consider to tell a story. A story is a fable presented in a certain way. A fable is a series of logically and chronologically related events that some actors cause or experiment. The story presents a fable in the shape of a tale, film, book… or related documents. Any story is organized by four elements: time, space, action, and character.

Narrative Modalities

Narrative Caract./Modality	FIXED	SEQUENTIAL	SEQ. MOVEMENT
Relationship Time/Space	Hierarchical	Equi-powerful	Equi-powerful
Reading	Reversible	Reversible	Irreversible
Time of Reading	Free	Free	Predetermined
Meaning	Unique	According to Order	According to Order
Rhythm	Static	Dynamic	Dynamic
Sign	Image, word	Image, word	Image, word, sound

Introductory Rituals

It is the proceedings through which a communicational link and the possibility to establish a relationship between transmitter and receiver are generated. Occasionally, it is as important as the contents themselves. It does not influence on the nature of the document, but it may be necessary to articulate them according to the public the program is aimed at. The opposite of Ritualized Communication is the Spontaneous Communication.

Symbologies

The creation of symbols in communication is the best guarantee of continuity for the development of future projects. Symbols are formal creations that refer to a variety of meanings. The opposite of symbol is stereotype.

Strategy

Variable image

Objective / phase	Birth	Consolidation	Growth
Situation	Positive Image	Social Profitability	Internal Motivation
Differentiation	Of the surroundings	Believable Image	Mass Media
Definition	Internal	Social Relationships	Original Image

Variable communication

Objective / phase	Nacimiento	Consolidation	Crecimiento
Situation	Minimal Communication	To gain notoriety	To deny rumours
Differentiation	To keep a margin of coverage	Discreet Communication	To augment presence
Definition	To plan a strategy	To keep established relationships	Transparent and controlled communication

Distribution of the communicational flux

According to three variables:

- Budget (according to profitability)
- Calendar (rhythm in communication)
- Geographical Space (reach)

The Charismatic-Functional Relationship

This relationship is established taking into consideration proxemics, that is, the presence of the human element in communication. In this sense communication polarizes around two opposite modalities.

HOT OR CHARISMATIC COMMUNICATION	COLD OR FUNCTIONAL COMMUNICATION
Close	Distant
Personal Election	Diffusion Mass Media
Bi-directional	Unidirectional
Free	Restricted
Aesthetic	Semantic
Connotative	Denotative

Method for managing communication in organizations

The creation of a competitive advantage resides then in the following assumptions:

a- In a definition of its identity based on:

a.1- The analysis of the self-perception of employees towards the organization.

a.2- The analysis of the opinions employees have about the cultural and social topics with which the company may commit.

a.3- The analysis of the image the different publics perceive.

a.4- The analysis of the visual identity the company projects in through its different media – posters, uniforms, indoor architecture, vehicles, advertising…

b- In the definition of the communication policy to follow, as a consequence of the information extracted from the previous point and in its application inside and outside the company.

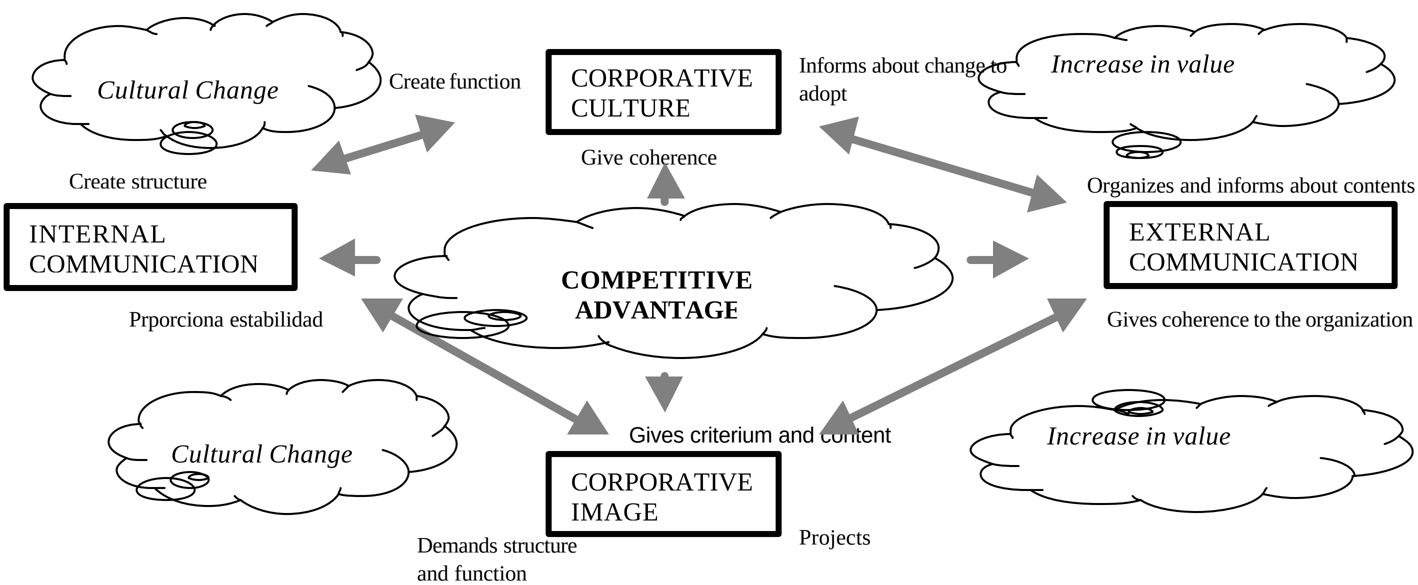
c- In the definition of the visual Identity and its strategic employment of it , adapted to the communication policy.

d- In the demonstrative character of actions, which must transcend what is merely testimonial. This implies a good relationship with organizations that hold the know-how and part of the logistics.

e- In a detail explanation of this compromise through the communication actions the company undertakes, both internally and externally.

As a result this competitive advantage has a social and cultural meaning, which represents an ideological positioning, and a relationship with the social system, based in economic synergies and affinity feelings. Were this practice to become general and internalised among the public opinion, we would be able to think in an induced social change and a practical identification between the company, society and culture, that is, a new Economy of Feeling.

In order to achieve this competitive advantage, communication must be managed around four fundamental pillars: the CORPORATIVE CULTURE, the CORPORATIVE IMAGE, the INTERNAL COMMUNICATION and the EXTERNAL COMMUNICATION.



The Management of Communication

Section 7

Production, Quality, Marketing & International Trade

A Comparison Of Perceived Organizational Effectiveness Between Chinese And Thai Rural Enterprises

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Abstract

As one of the important organizations in agricultural countries, rural enterprises play an important role in providing productive employment and earning opportunities for local residents. Rural enterprises are widely recognized as a powerful instrument for economic growth and balanced sectional development in the rural community, and they have become an important research topic in development economics and a hotly debated topic among policy makers.

This study surveyed managers and participants in rural enterprises in China and Thailand. The resulting data were used, in the context of a proposed model, to evaluate the different attributes and determinants of organizational effectiveness and to examine differences in organizational effectiveness between Chinese and Thai rural enterprises.

The results showed significant difference in organizational ownership, organization structure, leadership, distribution system, motivation and attitudes toward changes between Chinese and Thai rural enterprises. Conclusions were drawn and recommendations for future operations are outlined in the paper.

Background

Agriculture is the most important primary industry in China. Agriculture and its related fields absorb almost 80% of the total labor force. About 80% of the Chinese population lives in rural areas.

Rural areas in China have been going through a period of major institutional reform and economic development since 1978. Rapid rural industrialization has occurred in China during the 1980s. From 1978 to 1990, the number of rural enterprises firms increased from 790 thousand to 7.22 million, the number of employees increased from 17.34 million to 55.72 million, and the total gross output value of rural industry, in terms of current prices, increased from Y38.5 billion to Y709.7 billion. Consequently, the share rural enterprises contribute to China's total industrial sector rose from 9.1 percent to about 29.8 percent in terms of gross output, and from 28.5 percent to 46.3 percent of the total industrial labor force in this period [1].

The rapid expansion of rural enterprises in China is widely believed to be the instrument for rural industrial sector development and economic growth. But there are still many problems faced by Chinese rural enterprises. With greater market competition, the challenges facing rural enterprises are being more and more magnified. Many deep-seated problems stick their chins out bit by bit, the two greatest being unclear equity ownership; and unclear rights and responsibilities between government and enterprise functions. The competitive power of many products is decreasing as a result of these problems. All of this leads to a lower effectiveness and lower motivation among employees. Many administrators feel considerable pressure from the unprecedented difficulties that are facing them. How to face this new challenge? What is the way out? Researchers thought that adapting to the changing environment and increasing the vital force by reforming, depending on technology to develop the organization and earning benefit from administration would be the answer.

Thailand, a close neighbor to China, is also an agricultural country. Agriculture is more important than any other sector of the economy in Thailand's economic and social structure. This is to be seen not only in the proportion it occupies of the GDP (1990:12%), but particularly in its significant position in the employment sector: circa 65% of the total work force is employed in agriculture [2].

This means that agriculture, which has been the backbone of the Thai economy, will remain the backbone for many years to come.

Thailand's industrial sector is just being developed and in many ways the country is not ready for full-scale industrialization as it lacks experienced qualified personnel, raw materials, technology and know-how. If the country is to become a NIC (Newly industrialized country), it therefore makes sense to base this industrialization on agriculture to start with.

Facing complex global competition, both China and Thailand recognize the importance of the industrialization of agriculture. How should the rural enterprises be invigorated through organization development? What are the differences between Chinese and Thai rural enterprises, based on the similar culture background? What can they learn from each other's successful experience in reaching the highest organizational effectiveness and what lessons can they learn from each other?

For many years, researchers paid more attention to study the rural enterprises' function of providing productive employment and contribution to households' income, to look for problems, and try to find solutions for individual countries' rural enterprises. Unfortunately, few studies have been done in comparing different agricultural countries' rural enterprises for their organizational effectiveness, especially like China and Thailand.

This study could help the rural enterprise managers in understanding the importance of organizational effectiveness and help organizations to assess themselves and their environments and revitalize and rebuild their strategies, structures, and processes. It can help the managers in both countries to learn from each other's successful experience reaching the highest organizational effectiveness and draw lessons from each other's bad experience. And it will be especially useful for the rural enterprises, which are doing or planning to do business with each other.

This paper built on the perceived organizational effectiveness of both managers and employees from Chinese and Thai rural enterprises and finally answer the research questions: What are the differences between Chinese and Thai rural enterprises in terms of organizational effectiveness?

Literature Review And Research Hypothesis

Organizational Development

Organizations live in an ever-changing environment and their survival depends on their ability to adapt to new demands and opportunities. Over the last ten years or so managers have gained more experience with, and more confidence in the management of change. The reality is that the stability which seemed to characterize the corporate world in the 1950s and 1960s has given way to increased and global competition, technological innovation and change, limited resources, deregulation, privatization of public sector organizations and change in much more besides.

All these facts facing the organizations are interrelated and changing rapidly, making a highly uncertain and chaotic environment for all kinds of organizations, in manufacturing and service industries in both the public and private sectors. Therefore, in order to be more competitive and perform effectively, organizations should be streamlined, nimble, and more responsive to external demands. Organization development, a series of planned systematic changes introduced into an ongoing organization is playing an increasing key role in helping organizations to change themselves. These changes, typically referred to as interventions, are designed to improve the effectiveness of the organization and to help it respond to a changing environment. It is helping organizations to assess themselves and their environments and to revitalize and to rebuild their strategies, structures, and processes. Organizational development is also helping organizational members to go beyond surface changes to transform the underlying assumptions and values governing their behaviors.

Although a number of conceptions of organizational development exist, with considerable overlap among them, the following definition given by Swierczek [3] incorporates the most current views: Organization development is a system wide application of behavioral science knowledge to the planned development and reinforcement of organizational strategies, structures, and processes for improving an organization's effectiveness.

Organizational Effectiveness

There are several major orientations towards effectiveness that reflect the perspective for which one views organizations. One point view is the societal perspective. Here the concern is how the organization performs its functions and impacts on the large system of which it is part [4]. A second view is the managerial perspective, which concerns about how well the organizations identify, and solve relevant problems, to provide services and products, and make best use of available resources [5]. A third view is the individual perspective. In the context, effectiveness is the degree to which the organization has a positive impacts on the well being of individuals both inside [6] and outside [7] of its boundaries.

According to Carnall's [8] definition, efficiency comprises achieving existing objectives with acceptable use of resources, Effectiveness means efficiency plus adaptability. The effective organization is both efficient and able to modify its goals as circumstance change. This definition will be accepted in this study.

All organization development efforts are to increase effectiveness in organization's performance and to improve organization health with the ability to remain effective. Thus, an evaluation of effectiveness can be a cornerstone to help the people detect the existing problems and possible solutions.

We need to assess effectiveness for two reasons. First, identifying sources of ineffectiveness might lead us to restructure or reorganize in order to improve. Second, ineffective organizations present a tougher context in which to implement technological, product or service changes. We are often involved in both. We need to introduce new technology and discover that progress will be impeded by lack of in-house expertise and by poor attitudes to change. Part of our preparation for the new technology involves bringing in the expertise (whether by forming new department, through secondments or transfers or by hiring consultants). Also involved may be a training program designed to introduce the people to the new technology carefully.

Dealing with sources of ineffectiveness as part of the implementation of change provides us with two advantages. First, it will allow us to implement change more effectively, and more speedily. Second, it will make future changes easier to implement because the organization will have become more adaptable. A positive experience of change, properly exploited by all those involved, leave the people more capable of handling future change. Following Itami [9], this means that the organization has developed its invisible assets. Invisible assets are the knowledge base forms, which all employees operate. To quote Itami:

Invisible assets are the real source of competitive power and the key factors in corporate adaptability for the three reasons: they are hard to accumulate, they are capable of simultaneous multiple uses, and they are both input and output business activities.

Research Hypotheses

Although China and Thailand are very different in size, there are many similarities between the two countries: they are both agricultural countries, with more than half of the total population engaging in agriculture (see table 1-1), they are both developing countries and both are trying to realize the industrialization in agricultural sector. They are very near to each other, and have similar cultural backgrounds. Their business relationship has existed for centuries and has expanded and developed over the past several decades since official diplomatic relations were instituted.

Table 1: INDICATORS OF ECONOMIC DEVELOPMENT IN EMERGING MARKETS [10]

Country	GDP per capita	Percentage of rural population in 1992	Percent of total employment (1990-1992)		
			Agriculture	Industry	Service
China	2100	72	73	14	13
Thailand	5900	77	67	11	22

Hence, we propose the following hypotheses:

Hypothesis 1: There are no differences of organizational effectiveness between Chinese and Thai Rural enterprises.

Hypothesis 2: There are no differences between Chinese and Thai Rural enterprises in terms of environment influence, functional analysis and organizational diagnosis.

Method

Research Site and Subjects

In order to select more comparable industries from both countries, small and medium sized enterprises were selected for this study because most of the rural industries are small. Due to the difference of labor source, the small and medium sized enterprises were defined by registered capital. Companies with a registered capital less than 100 million Baht (25 million Yuan) but more than 5 million Baht (1.25 million Yuan) were the targets of this study. 37 Chinese rural enterprises and 38 Thai rural enterprises, mostly dealing with food processing or based on agricultural raw materials were selected from each country. One manager and one employee from each rural enterprise were asked to answer the questionnaires. They were respond to questionnaire A and questionnaire B respectively.

In order to make the data collection procedure more convenient, the enterprises were chosen from Henan Province, China where the researcher is from and Chiang Mai Province, Thailand where the research was staying.

Conceptual Framework

Since there is no dominant theory of organizations, different theoretical perspective will lead to different constructive specifications of organizational effectiveness. The summary of 17 major organization effectiveness models indicates this point. Under this condition, in order to provide an easy way to assess organizational effectiveness, a model based on Carnall's assessment (1990) has been developed. In this study, two kinds of questionnaires have been used, Questionnaire A and B.

The conceptual model consists of three parts:

- Environment influence
- Functional analysis
- Organizational diagnosis

This research study is an empirical one, using the proposed model to evaluate the different attributes or determinants in the model, to reveal the organizational effectiveness differences between the two country rural enterprises.

Based on the proposed model, the questionnaires were designed. There are two kinds of questionnaires: questionnaire-A, for managers, questionnaire B, for employees. Questionnaire A consists four parts, environmental influences, functional analysis, organization diagnosis and demography; questionnaire B consists organization diagnosis and demography only which are the same as part three and four of questionnaire A. Under this design, there are four kinds of comparisons in this study:

(1) Comparison of environmental influences on the organizational effectiveness;

(2) Comparison of functional analysis responses by managers from China and Thai rural enterprises;

(3) Comparison of organizational diagnosis responses by managers from Chinese and Thai rural enterprises;

(4) Comparison of organizational diagnosis responses by employees from Chinese and Thai rural enterprises;

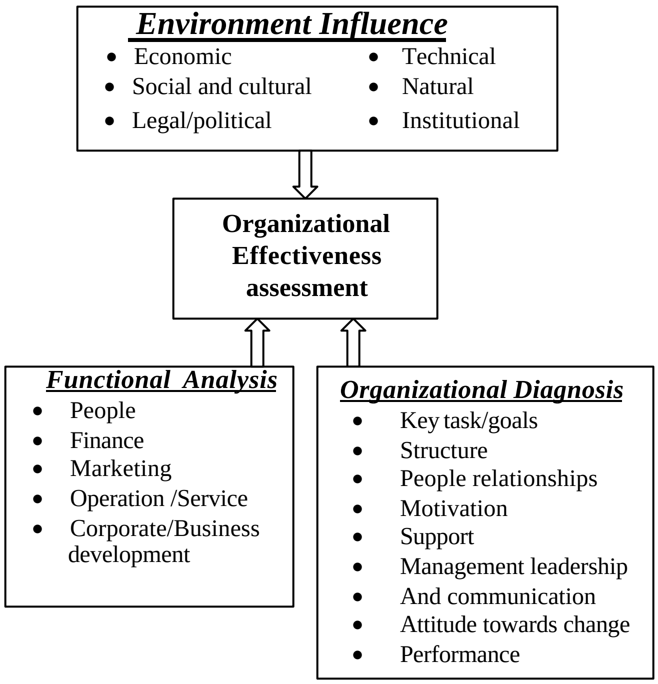

Fig. 1: PROPOSED MODEL FOR ASSESSING ORGANIZATIONAL EFFECTIVENESS

Results

This research study has been based on the realization of the fact that to survive and grow in today's competitive, turbulent changing environment, firm, industries and the nation at the large have to rely heavily on organizational change and development to adapt and cope with the change effectively.

Through the analysis of the surveyed rural enterprises, various conclusions can be drawn. According to the final result analysis (see table 2, data used in the table are obtained from managers rather than employees because only managers respond to all the questions) one can find, overall, Thai rural enterprises performed more effectively than Chinese rural enterprises, regarding to each attributes or determinants section namely environmental influence, functional analysis and organizational diagnosis respectively in the assessment models.

As of environmental influence and functional analysis, although Thai rural enterprises got a better score, they are not significant different (P-value >0.05).

While the result of comparison of organizational diagnosis between the two countries' Rural enterprises has shown significant difference (P=. 000<0.05). Thus cause the total organizational effectiveness of both Chinese rural enterprise and Thai rural enterprise significantly different (P=0.004<0.05) and make Thai rural enterprises show a better total performance records than Chinese rural enterprises.

Table 2: STATISTICAL COMPARISONS OF ORGANIZATIONAL EFFECTIVENESS BETWEEN CHINESE AND THAI RURAL ENTERPRISES

Sections	Chinese rural enterprises (N=37)		Thai rural enterprises (N=38)		T-Value	P-Value
	Mean	Std Dev	Mean	Std Dev		
Environmental Influence	3.7200	.2797	3.8785	.5332	-1.618	.111
Functional Analysis	4.0158	.3795	4.0861	.5682	-0.632	.530
Organizational Diagnosis	3.7646	.3837	4.3259	.5069	-5.417	.000
Total Organizational Effectiveness	3.8335	.2802	4.0969	.4545	-3.030	.004

Conclusions Derived From The Study

There are many significant differences existing between Chinese rural enterprises and Thai rural enterprises, to go through these differences, one can find that the sound operating mechanism and good organization behavior are the keys factors in performance, while the problems exiting with Chinese rural enterprises shown in the differences are the reasons why most of them did not perform as well as Thai rural enterprises. These differences can be expressed in following aspects:

Management leadership system and leadership style

In Thai rural enterprises, the private owners manage the enterprises. In order to make the best profit on their investment, the owner decide all major issues relating to the enterprises and responsible for the enterprises' interests. They are in charge of the daily affairs. If it is necessary, they will try to use their own family members in the management in order to cut the administrative cost. They will hire some medium level managers only when it is necessary. Under this leadership system, each manager has clear authorities and responsibilities.

Rather in Chinese rural enterprises, the manager (in China they were called cadre) were appointed by the superior authorities, with the traditional concepts, one can go for higher position even if he is in poor performance. As a result, bad social mood "connection" (in Chinese *Guan xi*) have been spread.

Also in Thai rural enterprises, the relationships between the employers and the employees are interdependent. Employees would quit their job whenever they do not feel comfortable with their leader's management style. This is also something related to the Culture. Whenever conflicts occur, Thai people prefer to leave it there and go away from the problems. You will always hear "*Chang man ter*" which means, "let it be" when people encounter troubles. As a result, management will always try to let the individuals feel to be motivated involving in the enterprises' management and decision-making in order to encourage them to work well.

Organization structure

Most Chinese rural enterprises have imitated the setting of organization structure like some superior administrative institutions, thus huge organization structures have been formed and there are often many people within these organization than it is really needed especially at the administrative level. Many people come through "*guan xi*". This caused many departments to have the overlapping duties, which are blurred, leading to low efficiency and bad phenomenon " disputing with each other over trifles."

For Thai rural enterprises, since they are mostly private owned, in order to maximize the benefit of the organization, the management level will always be concerned about the cost. They always followed the principle of only necessary position will be created and the principle of less employees but the best. Responsibility, authorities and personal benefit have been integrated. According to the external market changes and its product and production characteristics, streamlined organization structure has been constructed in according with less management level and efficient management teamwork, which is most suitable for their development.

Labor and Personnel System

In Chinese rural enterprises, most of the employees come from rural areas and superior authorities appoint managers. The people from the villages, which own the Rural enterprises, have priorities to be hired first no matter whether they are qualified or not. There are no clear selection criteria in most Chinese rural enterprises, "Back Door" and "connection" phenomenon still existing in most Chinese rural enterprises in hiring and firing of the employees.

While for Thai rural enterprises, as the enterprises are independent economic equities, the enterprises got autonomous right of their own and independent decision-making power to recruit the managerial and technical personnel according to their own criteria. They can make policies on selection and replacement.

Distribution System

In Thai rural enterprises, the employees' income is set based on their job post and equal to their performance. Bonus distribution has been used as more effective motivation mean, which thoroughly discards the egalitarianism.

In Chinese rural enterprises, Although " distribution according to work" is a very popular distribution system with the mechanism of motivating and self-restriction, without a integrated job specification system and proper evaluation system, it does not work well in most Chinese rural enterprises and the phenomena of "eating from on big pot" is till exists.

Ownership

For Thai rural enterprises, the enterprises are independent economic entities with self-managing and self-operation function, and they are fully responsible for their profits or losses. They are owned by the investment parties or families, this may be the greatest difference of Thai rural enterprises from Chinese rural enterprises which are most still the attached organizations to the superior administrative authorities. Although there are some privately owned enterprises, most of the Chinese rural enterprises now are collective, village owned, or township enterprises. The relationship between the Thai rural enterprises and the state is very clear, just the economic one. From the point view of the state, the duties of the enterprises are those following the business law or the ethical code of profession, pay taxes. As a result, the enterprise cast off the interventions from the administrative authorities; they can put all their efforts on business operation and adapt the changing environment autonomously.

Recommendations And Discussions

Through this study, some lessons came up that the successful operation by TRE is due to their ground operating mechanism and good organization behavior as we saw before. Based on the factors, which caused the differences derived, some of recommendations as strategic guidelines in helping CRE to improve its organizational effectiveness have been proposed:

In order to achieve this goal, CREs might concern about clearing the property right; shortening the levels of management and establishing the streamlined organization structure according to product or production characteristics; constructing highly efficient organization management system and effective command chain; establishing human resources management system, implementing MBO; adopting relatively advanced and appropriate technologies and process techniques; enhancing the quality consciousness; being strict with labor discipline and corresponding evaluation and examination system; clearing reward regulations; carrying out total quality control policy; Commonly adopting and applying the advanced management know-how and marketing technique; enforcing the reasonable and profitable vertical and horizontal integration, or conglomeration among various REs to build the co-operation and conjunction mutually involving different industry categories in a broad geographical area.

Of course, these are easy said than done. There are always many objective situations to be concerned. Government also needs to provide a better business environment in order to help the REs to reach their goal.

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Agriportals As A Model Of Customer Relationship Management

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A Strategic Assessment Of Agriportals In India

The Internet has made profound change in both our personal life as well as business life. It has become more than a simple and an effective way to exchange e-mails and documents, it is emerging as a critical backbone of global connectivity in general and commerce in particular. And, it is happening at a faster pace than thought possible and with which few feel comfortable. And in these heady days of E-everything why should agriculture be left behind. Indeed why should it remain behind when it engages around 65 percent of India's population. Agriportals are but the logical step towards modernizing Indian agriculture and making agricultural development a nationwide phenomenon. Many new-economy-enthusiasts are already on their way to leverage on the advantages Internet provides and help not only agriculturist transform the face of rural India but help agro-input companies to become more sensitive to the farmers needs.

There are around twelve agriportals already in being today and many more are on the anvil. Consulting groups around the country are forecasting further increase in the number of these portals. Majority of them are being promoted by agribusiness's, namely, agrochemical, fertilizers and tractors) seed and other input companies. Some portals are also promoted by agribusiness consulting groups, who are trying to leverage on the invisible phenomenon of high valuations. If not developing portals, almost all agri-businesses are updating their web page to corner the opportunities, the new economy provides.

But if you ask the managers to describe their Internet businesses, you will get a bewildering array of responses. Some mention the functionality of the web; some highlight their choices of platform. Some trumpet how they use the web to enhance customer service, whereas others point to their success in integrating the physical and digital infrastructure to provide seamless service. Some mention their initial success in creating customer communities. Some managers tend to do discard the role of the net in Indian agri-businesses pointing towards the dismal state of rural infrastructure in the country and disparate levels of development.

These different observations point towards important characteristics of the net. Its potential functionality is so broad and varied that we should not and cannot restrict our attention to a few narrow domains. Indeed it is like the proverbial blind men describing their elephant: Different managers see different facets of benefits but do not see the complete picture. Although most businesses are cognizant of the impending changes, the business landscape is fuzzy and fast changing. We are navigating in uncharted waters.

How should companies develop effective portal strategies in such a situation? Given uneven development of the rural economy and extremely low telecommunication networks, how is Internet going to add value to those agribusiness which are going digital to support and enhance their business value? Does it make any business sense to go digital? Are Independent Agriportals going to create value for themselves or they just a phenomenon of following the leader like a herd? What could be done to make these agriportals and their strategies work?

This paper is an attempt to answer some of the above raised questions. The paper is divided into four sections. First section, deals with the status of agriportals in India. The second section looks at the whole process of integration of physical and the digital infrastructure to provide seamless advantage to the firms. The third section deals with the views of managers, consultants and academicians on how to make agriportal a successful business investment. The last section delineates the way to make these portals successful in creating future opportunities for their brick and mortal businesses.

Research Design

Working to understand the economics of agriportals in conjunction with industry leaders, we decided that the research design should be as follows:

1. Search secondary sources of information - journals, magazines, newspapers, the Internet, promotional material for educational offering and advertisements.
2. Analyze the secondary search information obtained.
3. Determined the primary research needed to understand agriportal strategies
4. Conduct a primary research among practitioners (the top management).

Role Of Information In The Agriculture System

The future of agri-businesses depends upon the way agriculture economy develops. The need for an integrated approach has always been felt in India in the area of agronomy. The essential of such an approach should form the major system to link the laboratory to the land and land to the kitchen, in a triangular design. This Triangle is not complete unless we make everybody a partner. There is a need to emphasize upon value addition in the food chain from laboratory to the land and from land to the consumer. When one looks at agriculture as a holistic matter, one sees the following five aspects.

1. Land and water management
2. Management of Human Resources
3. Scientific management of the field, including integrated crops protection and total farm solutions
4. Pre-harvest and post harvest technology
5. Efficient trading and marketing system

Once these five criteria are integrated into agri-systems, there will be enormous value addition to food chain as well as overall agri-business value chain too. It is in this connection that portals can not only help in enhancing value to the farmers but also to the agri-business itself. Anyone familiar with the Indian agriculture knows clearly that there is a significant positive relationship between years of growth in agriculture and profitability of agri-businesses. Agribusiness cycle is a function of agriculture situation in India.

In the new economy challenges in the agricultural sector are quite different, from those met in the previous decades. The enormous pressure to produce more from less land with shrinking natural, resources is a tough task for the farmers. This calls for the special effort to manage the key inputs eroding the ecological assets and sound knowledge base to sustain agricultural productivity and profitability.

The information revolution or information super-highway that has brought about remarkable changes in the industrial sector will be an ideal tool for achieving the goal of knowledge and skill development among the farmers. A simplified version for information technology backed by an easy to flow text and illustrations highlighting environmentally benign agricultural technologies would prove to be a low cost and powerful tool in imparting training to the farmers. Internet could be an effective medium not only to disseminate this knowledge, which farmers critically need, but also to facilitate commodity trading by acting as a virtual intermediary or future exchange. Firms in the business of agri-inputs can leverage the net to create and manage customer relationship successfully.

Information revolution or information superhighway can play an effective role only when one can classic, identify and define various component of information required for a sustainable and profitable agriculture. There should be a mechanism through which this information can be reached to the user of this information. Internet Information kiosk and any other form of information dissemination process may fail unless they are within the reach of farmers. For this one has have to identify the kind of information, which the farmer may require.

Information required by the farmers can be classified in to four categories, they are:

- The first level information required by the farmers is information, which is localized and is about their own agro-climatic area and Government support prices for their crop. Information regarding crop rotation inter-cropping and multiple cropping should also be made available. This information should consist of weather conditions, soil conditions, soil and water conservation methods applicable to the area. Soil fertility and the respective use of fertilizers, and the kind of farm equipment suitable for their agro-climatic reasons. Extension education suited to their areas should also figure in this category, farmers must have the necessary details about contact farms and successful adoption of newer techniques and technology on these farms. The optimal, timely and efficient use of pesticides as well as fertilizers information is also critical and should be agro-climatic region based rather than one solution to the country as a whole.
- Second level information should consist of various agricultural related schemes both of the Central Government and the state Governments, and the way to go about availing these schemes.
- The third level information should consist of newer agriculture businesses like horticulture, sericulture, apiculture, vermiculture, plasticulture, and floriculture. This should also be supplemented by the support activities of the Government, as well as incentives and subsidies offered by the Government and other developmental agencies. This should be further supplemented by information regarding the possibility of exports and way to go about exporting this produce.
- The fourth level information should consist of prevailing prices of different commodities in the neighboring markets as well as in various part of the country. In terms of crops, which could be, exported international border prices should be also quoted.

Agriportals: An Assessment Of Their Content

The IT revolution has arrived in India and has brought a sea change in our lifestyles. It is redefining the way all economic activities are being conducted. It is already playing a very important role in Indian industrial and financial sector. But it has tremendous potential in the activity, which engages 62% of Indian population i.e. agriculture. Many have realized this and agriportals are becoming a reality in India. During the last couple of years' agriportals like krishiworld, krishiudyog, ikisan, kisan, etc. have been launched.

The Government has also awakened to need for agriportals and the site of Ministry of Agriculture and Co-operation is dedicated to Indian agriculture. Before we look at what all facilities these portals offer, it needs to be examined what information is needed, which can be beneficial for agricultural purposes.

Broadly, information on weather and soil conditions, agricultural inputs, agriculture markets and new agriculture practices are very crucial for farming. But agricultural activity is not as standardized as industrial or financial activities, but it is as specific. Hence information required by the farmers need to be specific to a particular area.

Information on existing soil condition and forecast of weather along with advice on the following:

1. crops and the seed type suitable to local conditions
2. preventive measures that ought to be taken to avoid outburst of diseases, which are likely to affect a given area
3. inputs required to maintain optimum soil nutrient level
4. arrivals and prices in different mandies.

This would be of tremendous use for the farmers. But it is important that this information is updated regularly. Since independence, various institutions like the agricultural research stations, agricultural universities, Indian Council of Agriculture Research centers, various soil testing laboratories, etc. have been developed under National Agriculture Research Systems to constantly monitor the cropping patterns, changes in soil nutrients and provide solutions to agronomic problems specific to an area. Information regarding local weather conditions is also available with Metrological Department of India and other related organizations. Moreover, remote sensing network can be developed to generate information on local weather conditions. The above-mentioned information is useful before harvest. Post harvest information on prevalent prices of agriculture produce in various parts of the country along with market arrivals and the freight charges and transportation period) etc. would enable the farmer to get best price of his produce. This supplemented with various programmes / schemes being run by the Government to develop agriculture, would constitute the information relevant to the farmer. Along with this, agriportals can provide a trading floor to buy and sell agricultural produce, inputs, machinery, etc. and provide a base for interaction between farm experts and farmers.

The present portals are trying to provide information somewhat on these lines. The home page of krishiworld.com, kisan.net, krishiudyog.com, ikisan.com. Ministry of Agriculture and Co-operation have contents on weather, soils, diseases of crops, fertilizers, crops, agricultural events like agriculture fairs, new products, market watch, etc. but most of the information is not of any use to the masses as they are theoretical in nature. The weather links also are restricted to forecast for major cities. Sites like that of krishiworld and Ministry of Agriculture and Co-operation, providing information on prevailing market prices, the available information is of poor quality. And are not updated and do not provide latest rates. The table given on following pages below is an attempt to analyze the current status of these agriportals:

Table 1: CURRENT STATUS OF AGRIPORTAL IN INDIA

NAME	PROMOTER	INFORMATION	TRADING	ONLINE ADVICING	LINKS
Kisan.com	DECCAN EXHIBITIONS PVT. LTD.	Information on jobs related to agriculture profession, events like agriculture fairs, new agriculture products and information on Indian agriculture industry, developing database on organic farming	In form of net bazaar and bulletin board	Not available	Government of India, Department of Agriculture and Food Supplies, ICAR, Indian Weather and Indian Agriculture Trade Organizations
Krishiudyog.com	GOLD REED INNOVATIONS PVT.LTD	News on agriculture and agriculture related corporate, businesses, machinery and events. Information on Sericulture, Apiculture, Vermiculture, Plasticulture, crops, agriculture related industry business, and schemes /reforms with some useful information on Horticulture and agriculture related careers and jobs.	Not available	Advisory Board consisting of experts from various fields of agriculture	Not available
Krishiworld.com	CYBERDYNE	Information on soils	Facility allowed	Advisory	Agriculture

	SOLUTIONS INDIA LIMITED	water conservation, diseases of crops, farm equipment, farm management, mushrooms, home gardening, crop, geographical utilization of land and water resources, agricultural amenities, weather and bio-technology. Useful but outdated market prices all across Maharashtra. Business directory of agriculture related industry, chat and discussion forum	only to registered users	Board of experts on agriculture	Universities, sugar industry sites and weather links.
ikisan.com	NAGARJUN FERTILISERS	Information on crop, information systems limited, detailed information on rice and rice management, area specific information on a district in Andhra Pradesh	Not available	Not available	Not available

Department of agriculture and co-operation, government of India	DEPARTMENT OF AGRICULTURE AND COOPERATION GOVERNMENT OF INDIA	Useful information including eligibility criterion and person to contact on all schemes and programmes undertaken by the department, outdated farm produce prices in different parts of the country	Not available	No advisory desk but help desk for public information and facilitation	Weather links
Indiaagronet.com	AGRO NET SOFTWARES PVT.LTD	Domestic and international news, market update and prices giving some useful information, technology and resources giving useful	Seeds for sale from Maharashtra State Seed Corporation	Advisory Board in form of expert panel advice	Not available

		and other information on wide variety of topics related to agriculture, information on crops and new products, weather and crops information on organic farming, insurance, agriculture finance, agri-economics, agi-laws, marketing, farm management, cargo services, agriculture companies and organization, useful advice for farmers of Maharashtra under monthly planner.			

Though the intent of the these portals seems to serve the common farmer, presently these are of use only for entrepreneurs and those engaged in specialized farm activities like floriculture, horticulture, etc. they provide plenty of information on these. Moreover, the successful deals done on trading being done on trading floors being provided by krishiworld.com and kisan.com seem to be restricted to these farm activities. The site of krishiudyog.com also gives news on agriculture-related developments, businesses and organizations. Krishiudyog.com along with kisan.com also advertise jobs for agriculture professionals and agriculture industry, which is of no use to the farmer. None of the portals except ikisan.com tries to give information local to an area. But this site is not at all developed and is hardly of any use. The site of Ministry of Agriculture and Co-operation gives all the schemes and programmes of Government for farm sector along with the eligibility criteria and support process of various crops as fixed by the government. But sites of other institutions like Indian Council of Agriculture Research and various agriculture universities do not give any information on the work being done by them or any other information, which might be useful for the agriculture purposes. There seems to be a promising portal named India agronet.com, this portal provides information on all agriculture related variables, including agri-laws, agriculture finance, farm management, cargo services, agriculture companies and organizations, useful advice for the formers of Maharashtra under the monthly planners schemes. All portals need to evolve themselves on the pattern of India agronet.com. If we look at the agriportals in India today, we find that there are two groups of promoters. ' First group of promoters are agribusiness companies in input and farm equipment. The second group of promoters is agriculture consultants. Even if we give benefit of doubts to these firms, their dot.com ventures are in infant stage and will over a period improve their contents. The major question, which arises, is about their dot.com strategy, more so a question which comes up in our minds, as to how are they going to service their customer and earn money? Is their dpt.com strategy aligned to their larger business strategies? In the case of independent promoters, the question arises about their business model and their sustainability in the case of their dot.com ventures? How are they going to consolidate themselves? What are the major difficulties in making their portals a successful business model?

Agriportals: The Industry View: Finding of the survey

In order to get the feel of industry on these issues, we conducted an exploratory study by surveying around 25 top managers from various agri-input and farm management companies. We discussed the issue facing agriportals with these professionals using semi -structured questionnaires. Multiple responses were sought. The analysis was presented in percentage response terms. The unit of analysis was individual firm or strategic business unit.

Table 2: INDUSTRY RECEPTION INDUSTRY RECEPTION

	Response
Internet will bring entire information highway within farmers' reach	52%
It will help in building customer relationship and managing it better	48%
It will put a string pressure on distribution channel to change from a push based to a pull based. The interest of farmers will be first priority.	46%
It will also help to build post sales customers relation	34%
It will help companies to respond better in terms of identifying new products and services localized to the needs of farming ex.new pests, etc.	32%

On the issue of importance of information for agriculture, all respondents believed that its availability is critical for the farmers. Asked about the role of agriportals in disseminating the right kind of information to the right place, around forty percent of the respondent said that portals would not work in the rural India. Asked whether they are ready to venture into portal as a source of consolidating their business, many respondents believed that their website could play an important role. Only 25 percent of » the respondents were either into agriportals or were planning to start one. Rest said that they prefer field contact farmer programmes as it is need-based location specific and has the element of human touch, which the Indian farmers expect. Some of the respondents, who were not sure of the advantages of agriportals, said that they do not mind partnering with similar interest companies to set up portals localized to the needs of the farmers. It will help building more meaningful relationship with the farmers.

Most input companies which depended on pushing the product through their distribution channels by offering huge incentives to the dealers will be forced to service the end client farmers better, in fact respondents from agrochemical companies were of the view that internet in a way will re-define the whole of the distribution networks in India. Farmers' interest will also lead to post sales services and relationship with the farmers. Almost all the input companies, which are foraying into agriportals, are also faced with the reality of changing Indian agriculture. To help enhance productivity tractor industry has to take into account the size of the land holding, and other agro- climatic factors, it has now to customize its offering to the farmers based on the need of the farmer. To make agriculture sustainable agro-chemical firms are faced with the challenge of introducing sustainable farming friendly products, internet or agriportals could play an effective role in educating farmers to use new farming friendly products.

Table 3: KEY BENEFITS SOUGHT FROM AGRIPORTALS

	Response
Enhanced customer satisfaction	58%
Better tracking of customer contact	36%

Improved business efficiency	25%
Improved responsiveness	24%

About key benefit sought from agriportals, respondents said that it will help enhance customer satisfaction, better tracking of customer contact, improved business efficiency, improved knowledge of customer, and improved responsiveness. (Refer Table - 3.)

As forty percent of the respondents said that agriportals will not work in rural areas. We tried to explore factors, which could hinder the success of Internet or agriportals in future as a strategic information or business tool.

Table 4 AGRIPORTALS: MACROECONOMIC CONSTRAINTS

	Response
Lack of supporting telecommunication and electricity infrastructure	80%
Excessive control of Agriculture in India by the Government, i.e. Ban on inter-state movements and exports	78%
Repressive price-policy in India	78%
Lack of physical infrastructure like roads, canal irrigation, marketing and storage facilities	75%
Falling public investment	73%
Despite agriculture being State subject, Central Government decides financial allocations and policy	55%
Ineffective extension system	54%
Outdated Agri-laws	53%
Future trading restricted	51%
Lack of an effective insurance policy	50%

n = 25

Majority of the respondents said that lack of supporting telecommunication and electricity infrastructure will make the application of Internet restricted. This will in its own way restrict the penetration of Internet. Majority of them also believed that excessive control of agriculture in India right from price policy to ban on the movements of goods within the country as well as ban on exports kills farmers' initiative. Agribusiness in the area of inputs and farm equipment face enormous credit risk for this reason. All of the respondents were also of the opinion that agriculture, despite the general oft-repeated opinion that is highly subsidized, is actually been kept out of mainstream. Public investment, which forms the backbone of infrastructure, has been falling since 1985. They believe that there is significant positive relationship between public investment in agriculture and private expenditure. For this reason the state of agricultural infrastructure is very poor, be it irrigation facilities, roads, marketing or storage facilities, and all this leads to a higher transaction costs for the farmers. Some of them were also critical of the present extension system based on the training and visit system, and they said that it has outlived its utility. One of the major concerns was regarding money allocated to agriculture never reaching the states; as a result 40 percent of the allocations remain idle, despite the need for basic infrastructure in most part of the rural economy. Concern was also raised regarding agri-laws, which restrict leasing of land holdings, contract farming by the corporates and thus restrict enterprise in the country. Lack of future trading exchanges and restriction on future trading was also a major concern of these respondents, who happen to be the industry leaders also. They raised their concern about an effective farm insurance policy, as well.

The next logical question was, what can these firms do to leverage on agriportals as a source of competitive advantage. Most of these respondents felt that the following question should be kept in mind while meeting the challenges of the new information economy which agriculture cannot be devoid of.

COMPANY: What is your mission? What are your key business processes? What information assets do you hold?

*CUSTOMERS***:** What are their connectivity needs? What issue can they solve online?

*BUSINESS PARTNERS***:** How well their business processes inter-operates with yours?

*COMPETITORS***:** How are they positioning their online efforts? Where are they succeeding? Are their any companies outside your industry that are implementing technologies that could be deployed to provide services to and help advance your relationship with the customers?

INDUSTRY: Are standards emerging from Internet businesses?

During informal discussion with the industry leaders regarding the use of agriportals as a source of competitive advantage and source to create and manage customer relations, an alternative view emerged. Most of the leaders agreed that farmers now are demanding satisfaction. There is a need to move from selling or marketing towards value creations. This would require moving from pushing the product to pulling the customer. There is thus, a need to provide more services beyond product promotion. The companies' leaders are of the view that just from being a company selling fertilizers, agro-chemicals and tractors, the companies in order to remain and sustain their business will have to provide total farm solutions. Some of the tractors' industry like John Derre Larsen Toubro Tractors Ltd. are already talking about it. Agro-chemical companies like Novartis Crop Protection and Aventis Crop sciences are moving towards Integrated Pest Management to Integrated Crop production.

Knowing all aspects of crop husbandry and Demonstration evidence of higher yield per hectare is becoming the reality. But it also involves building customer confidence. It can be done through help line centers, Internet, i.e. agriportals, and strategically allying with Government extension system. The kind of helpline centers, which are required, can be weighed against its cost and benefits. Apart from providing critical information necessary for agricultural operation, there is a need to take up farmers training programme in almost all the agronomic practices. Farmers training in scouting and forecasting techniques. These helpline centers should also have training sessions in spraying equipments and soil testing. They should arrange for farm visit by the professionals provides on the spot advice. Most of the industry professional felt that, physical helpline centers are a better source of customer relationship management than agriportal and Internet based information.

The Way Ahead

According to us in an information age, agricultural economy of India cannot be left behind. Though Agribusiness's feel that agriportals have a long way to go, because the inherent backward agricultural economy in India. Whatever be the initial hick-ups, to our mind agriportals are going to play an important way of managing customer relationship for the companies or a good business for a consultancy firm who have set up these portals. The firms must be content-driven is the necessary condition for their survival but not the sufficient. Firms should prepare a strategy for locating kiosks in a phased manner and develop a revenue model for the kiosk as an independent activity and look for strategic alliances with similar interest businesses or NGOs.

In the present day of privatization spree, privatization of farm extension also assumes great significance. The private extension could be started as a joint effort of Agri industry like seeds, fertilizer, irrigation system, biotech, farm equipment's and agro-chemical industry. This will make agriportal, which can act as Internet kiosk a good business sense. Firms must weigh the option of starting their own portals against co-opting for a joint portal catering to the overall needs of the agricultural economy as has happened in the auto industry in India recently.

The question which these businesses should try to address is "How best to assemble and deploy the key resources, i.e. human, technological and financial for succeeding in the dot.com world. Traditional companies need these resources to leverage on the opportunity provided by the net. It must be realized that strategies for dot.com world are based on the pattern and timing of resource deployment. Assembling of resources from multiple sources and managing them, as a dynamic basis is the need of the hour. Agri-firms can put resources together not only to create Internet kiosk but also the basic helpline centers merged with this dot.com operation.

Given the rates of literacy, both general and the computer literacy, it is but evident that internet-based information kiosk can play an effective role in future only when backed up by good helpline centers which can use the information critically.

This will pave way for a new model of agriculture extension where all the parries in the business of agriculture will be a partner once the internet-based information kiosk is in place.

Being a private venture, the new extension system should focus attention on providing all the information needs of the forming community, which have not been addressed by the present system. A committed and systematic approach to organize farmers' groups and assembling various technologies could prove to be rewarding. The extension personnel should act as a two-way channel for communicating with the farmers and getting their feedback.

These extension professionals should help farmers with all the necessary information, regarding timely inputs, marketing, and their entitlement to various governmental programmes and benefits. The private extension should aim at filling all the gaps found in the present system. An extension officer and two field assistants should be able to cater to the needs of about 10 villages or an active group of 1000 farmers who will pay a monthly subscription. The farmers should be convinced that they are paying for efficient and productive services and supplies.

The extension staff should visit the villages or group of member farmers at a specified time on fixed days of the week. The staff should have sound knowledge of the various farming enterprises in the region. They should also have hands-on experience in dealing with field problems such as enhancing production from the farm, value-addition to the farm produce, post-harvest technology and marketing facilities. Good exposure to the concepts of Integrated Intensive Farming Systems (IIFS) and recycling of farm residues will prove advantageous.

The extension personnel should be able to co-ordinate the efforts of farmers and tie up with an efficient transport and marketing network and provide solutions to field problems. To retain the youth in farming, agriculture has to be not only economically rewarding but also intellectually stimulating and challenging. The tenets of ecological agriculture are derived from environmentally benign technologies coupled with time-honored wisdom and knowledge from farmers.

The educated youth crave for information, which will enrich their knowledge and fetch more dividends. The challenge before the private extensions lies in constantly feeding useful information of economic value. The concept of "precision fanning", which is backed by "knowledge-intensive" farming practices, will provide an ideal platform for launching the private extension. Once the farmers realize that they are able to reap more from their farms because of timely information or a new technology, they would appreciate the efforts of the private extension and support it. The private extension service will then become an integral component of the farming communities. However, it is not easy to set in motion a proactive private extension machinery to complement the efforts of the present extension system. The task is to win the confidence of the farmers through regular interaction and liberal exchange of information on technologies and markets. The farmers should become partners in this effort, and they may be encouraged to actively participate and contribute with conviction.

The subscription should not be taken as initial payment at the time of enrolling members. Instead, it should follow the "use now and pay later" concept. It has been a general experience that farmers do not hesitate to pay a fee for any additional returns they get at the time of harvest. For, it is always "harvesting is believing" for them. A blueprint of such private extension system, underscoring, the economic returns from such a venture, has established a good linkage between various on farm and non-farming enterprises at the village level.

The private extension should not be misconstrued as competitors to Government extension programme. It should be taken as a complementary effort. With the private extension in place, the governmental agency will naturally be fine-tuned to meet the supply and services demand of the enlightened farming community. This healthy trend will facilitate free information flow in rural areas, and make agriculture more productive and profitable.

Once farming becomes a paying proposition, there will be more and more educated youth getting into active participation. The spin-off of this process will generate more jobs in a healthy environment and also contribute to reversing the trend of rural-urban migration. A private agricultural extension will become a focal point and active platform to promote rural marketing of various consumer products. It can also effectively serve as a forum for consumer protection and redressal.

Rural marketing and advertising is emerging as a new thrust area for several commercial firms in the country. If properly designed and run, the private agricultural extension can also take advantage of the opportunities springing from rural marketing and advertising efforts making these helpline centers financially viable in the future.

Conclusion

If Agriportals act as a source of critical information and set up a complementary helpline centers, the future of agriportals is secure. In the last three years, there has been heavy emphasis on agriculture and rural development in the country. Watershed development. Integrated rural infrastructure fund, setting up of future exchange for agricultural commodities, move towards putting Panchayats into the forefront, providing farmers with the Kisan Credit Card are all an attempt to put the agriculture into the mainstream of Indian economy. Agri-input companies should come together not only to set up portals which can act as the basis of information for the farmers but also venture into private extension model to compete in the new economy by catering to the need of the real customer, i.e. farmers.

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Designing Marketing Strategy in Competitive Environment: Customer Focus is the Key to Success

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Abstract

With aggressive competition in marketplace, companies have to position their product/ service offerings so as to establish the points of superiority over the competitors, whether domestic or global companies. Delivering superior customer value is the key in achieving marketing success. It is necessary for the marketers to have correct perceptions of customer expectations. Customer focus unleashes the creative powers of a company so that it can reconceive what its core products are, envision new products, anticipate customer needs, and all the value that separates them from the competitors. Companies have to look for newer ways of doing business by focussing on strategy that helps the firm to achieve competitive advantage. The paper discusses the framework with highlights on issues, viz. Focus on unmet needs/value expectations, understanding competition, gaining sustainable competitive advantage, designing appropriate product/service support strategy, responsiveness to customers, and innovating products and marketing processes that help the firm to surge ahead of the competition and gain success in dynamic markets.

Introduction

Markets are cluttered with competitive product offerings that try to outperform each other in a race to gain increased market share. Truly, the markets are turning into corporate battlefield with each player fighting for the same target customers. In the global market, the supply-and-demand pattern is changing, and becoming more competitive. Information flow through the Internet and convergence is impacting businesses much faster.

The company not getting a grip of what the customer wants, in terms of price and product and has old mindset and attitude toward the market does not succeed but fail in aggressive competition. To succeed in aggressive competition the firm must be better at something than its rivals. Corporate strategy for survival into the twenty-first century requires an ability to look forward at the competitive, technological, and regulatory environments and to create a path for the company to build and thrive in that context. Companies need to focus on identification of individual product/ technologies as a possible way of satisfying a specific customer need in conjunction with both the capabilities of the supply organization and in comparison to products of the appropriate competitors in a given competitive situation.

Companies are seeking competitive advantage by streamlining the processes through which they interact with their customers: product creation, pre-sale, sale and after-sale service assurance. Business success depends on evaluating a marketing strategy that imparts a superior value proposition based on the firm’s capabilities to differentiate itself from the competing firms in the eyes of the customers. The real key is a customer focused marketing strategy in a market-driven environment. Value-driven companies spend enough time with customers so that they have a fundamental understanding of their customers’ businesses and of their current and latent needs. Customers expect products and services in terms of performance, convenience, and value and all these factors have a profound effect on customer satisfaction.

Changing Face of Marketing

Customers are fundamentally changing the dynamics of the marketplace. The market has become a forum in which consumers play an active role in creating and competing for value. The distinguishing feature of this new market place is that consumers become a new source of competence for the corporations. The competence that customers bring is a function of this knowledge and skills they possess, their willingness to learn and experiment, and their ability to engage in active dialogue [11].

The manufacturer has to look at the value chain through the customer's eyes, examining a product throughout its life cycle, from sale to disposal. While some manufacturers already provide financing and replacement parts, the downstream opportunities are usually much broader. From the customer's perspective, however, the downstream chain is much more complex. It includes financing and leasing, maintenance, scheduling and capacity planning, catering and servicing, parts–depot operations, and refurbishment and resale, etc. All the emergence of outsourcing and virtual businesses means that capital – intensive assets can be acquired through alliances or contracts. Rather than functioning as sources of competitive advantage, large asset bases increasingly tie a manufacturer to obsolete strategies, allowing innovative competitors to swarm in [16]. Today, many companies are trying to have greater control over the distribution channel through sophisticated operating systems for effective and efficient interface with the end customers.

Firms have to constantly provide more and more value to customers while lowering prices or at least holding them steady. In terms of the value chain, firms have to come up with creative solutions whereby the value-creating activity can be delivered at costs that are lower than the competition's. The productivity approach forces firms to look at how to increase efficiencies from current activities. By focusing on outcomes that reside on the value frontier, firms can more easily identify new activities that can expand the productivity frontier beyond its existing configuration as well have an impact on the perceived value. Focusing on outcomes allows firms to be creative and reconfigure their value chains, and in doing so they deliver more value to customers at the same or lower costs [4].

The pressure on profitability is forcing auto firms worldwide to relook at the way they have defined their business. Using the metric of expected lifetime value, or the total spends during the entire period a person owns a car, auto firms discovered that they were getting only a small fraction of these spends, while the rest are literally frittered away to players who are out of the auto firm's loop. Each time a consumer bought a car, auto companies had to be content with 30% of its lifetime value. Almost 40% of the remaining amount was accounted for by fuel costs. The rest, and that's a cool 40% and above, was spent on maintenance, repairs, replacement parts, accessories, warranty schemes, insurance packages and other related services. That's changing as automakers in the West set up their service initiatives. Spotting this trend, Indian auto firms too have jumped onto the bandwagon. Today, not only Maruti Udyog Limited, but also others like Hyundai, Ford, Mahindra & Mahindra (M&M) and Hero Puch are branching out into series of downstream businesses [3].

A Framework for Customer Focused Marketing Strategy

The framework for customer focused marketing strategy has been developed on the basis of the work of various researchers and practitioners in the field of marketing strategy and other related areas of marketing and business operations, and author's conceptualization. Key variables were identified from the existing literature and on the basis of informal interaction with executives. This paper presents a conceptual framework in designing marketing strategy in aggressive competitive environment.

Focus on Customer Needs/ Value Expectations

To stay ahead of the competition, companies focus on delighting customers by delivering actual performance that exceeds the customer's expectations. It is unmet needs which offer opportunities to delight customers. An unmet need is one that is not being met by the existing product offerings. Unmet needs are strategically important because they represent opportunities for firms to increase their market share, to break into a market, or to create and own new markets.

Sometimes customers may not be aware of their unmet needs because they are so accustomed to the implicit limitations of existing equipment, product and service. Unmet needs that are not obvious may be more difficult to identify, but they also represent a greater opportunity for an aggressive business because there will be little pressure on established firms to be responsive to them. The key is to stretch the technology or apply new technology in order to expose unmet needs [1].

All customer needs are not equal. Beyond simply having the customers rank and prioritize their needs, another business metric was possible: categorizing needs and wants based on the actual impact they can have on buyer behavior. This could result in customer-defined investments to fulfill a business strategy via Customer Value Management: A business strategy to differentiate or compete on either low cost or on high customer value can be implemented by understanding a hierarchy of customer values and needs that drive their buying behavior [13].

Value driven companies want to understand what product features really provide customer benefits and which ones are merely going to add to product cost without giving customers an additional reason to buy. They also determine the price that will deliver value to their customers early in the product development process [12]. Performance expectations have a significant, positive effect on performance perceptions and satisfaction only in conditions of price-performance consistency, that is, when the delivered performance is commensurate with the price charged [14].

When there are groups of customers with different needs, and when a tailored set of activities can serve these needs best, it is called need based positioning. Some groups of customers are more price sensitive than others, demand different product features, and need varying amounts of information, support, and services. A variant of need-based positioning arises when the same customer has different needs on different occasions or for different types of transactions. The same person, for example, may have different needs when traveling on business than when traveling for pleasure with family [10]. Access based positioning occurs when different customers are accessible in different ways, e.g. rural versus urban customers, which helps in configuring the activities of marketing, order processing, distribution, after sales service etc. more effectively.

Understanding Competition

Competitors are defined as firms operating in the same industry, offering similar products, and targeting similar customers. A firm will experience different degrees of competitive tension, the extent to which the firm would consider a given competitor as a primary competitor, from each of its competitors because of differences along the market and resource (or strategic) dimensions. The understanding of resource similarity is important for competitive advantage because firms with similar resource bundles are likely to have similar strategic capabilities as well as competitive vulnerability in the marketplace [8]. Many firms may not be direct or primary competitors because of a different market focus.

Competitor analysis is directed at understanding the relative size of resources because it is possible to make direct comparison and ranking of competitors on key inputs such as : distribution coverage (no. of dealers/retailers); no. of service and sales people by territory, region, and market; scale of manufacturing facilities and capacity utilization; total investment in dedicated computer systems and software support; expenditure on advertising and promotion support; financial capacity and cost of capital – both debt and equity; cost of raw materials and purchased inputs such as energy, etc. Brand names are also a resource with a value based on goodwill built up from the residue of past successful efforts to compete [5].

The firm that builds its competitive advantage on economies of scale is known as a cost leader. Until flexible manufacturing and customized production becomes fully operational, cost leaders may be vulnerable to firms that use product differentiation to better serve the exact needs of customers. Lower cost will attract customers away from other market segments; some customers are willing to pay a premium price for unique product features that they desire. Uniqueness may come in the form of comfort, product performance, and aesthetics, as well as status symbol and exclusivity. Smaller companies may pursue a limited differentiation strategy by keeping a niche in the market. Firms using a niche strategy focus exclusively on a highly specialized segment of the market and try to achieve a dominant position in that segment. However, particularly in an era of global competition, niche players may be vulnerable to large-scale operators due to sheer economies of scale needed to compete on a global scale [7]. Competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value.

An integrated strategy captures the synergies between competitive strategies that seek superior performance in the marketplace and non-market strategies that shape the competitive environment. For many companies, the rules of market competition are crucial to their performance, and they explicitly participate in the process of shaping those rules. One focus of competitive strategy is on addressing threats to the competitive advantage of firms – threats from current rivals, new entrants, substitutes, and the bargaining power of suppliers and customers. The emphasis on threats gives too little attention, however, to competitive opportunity. Opportunity is often controlled by nonmarket forces, and thus nonmarket strategies often focus on unlocking competitive opportunity [2].

Gaining Sustainable Competitive Advantage

Competitive advantage must be considered from a customer perspective that has three key dimensions, viz. the product/service itself, the perceived value, and the convenience of obtaining and using a product or service. The factors leading to competitive advantage through better acceptability are superior product/service benefits, better in-use characteristics, intangible advantages, relationship advantages while factors that lead to greater affordability are lower overall (lifecycle) costs.

Competitive strategy is about seeking new edges in a market while slowing the erosion of present advantages. These advantages result from some combination of low delivered cost and differentiation that offers superior customer value. The promised payoff is market share dominance and above-average profitability. The development of an effective competitive strategy begins with a tough minded understanding of the advantages and deficiencies of a business, and the vulnerability of the current position to copying or leapfrogging by competitors [5].

In essence, competitive advantage goes to firms that disrupt the existing 'status quo' in the market and take advantage of the disruption. There appear to be primarily two approaches to gaining competitive advantage. The competitor-centered approaches involve comparison with the competitor on costs, prices, technology, market share, profitability, and other related activities. Customer-focused approaches to gaining competitive advantage emanate from an analysis of customer benefits to be delivered. In practice, finding the proper links between required customer benefits and the activities and variables controlled by management is needed [7].

To sustain competitive advantage, a business must integrate market-driven learning into its culture because challenges will evolve and life cycles will compress. A learning culture supports the ability to anticipate and proactively confront dynamic market conditions [12].

Performance superiority is achieved through superiority in the skills and resources a business has to deploy in comparison to the competitors. The future success of the existing positional and performance advantage on a sustainable basis depends on the moves of the company in pre-empting the moves of the competitors to attack its markets. As competitors attempt to attack the company by imitating its products, services or strategy, or by innovating them the existing advantage gets eroded. This necessitates the company to gain new advantages by investing in new resources, acquiring new skills, and developing proper information and feedback systems to have insight about the competition and its moves.

A superior resource helps the company to gain advantage through specialized knowledge of the customer needs and value expectations, strong relationship with customers, expertise in innovating its products within shortest possible time, better quality and improved speed of response, ability to capture information from different sources and develop market insight, and to offer easy accessibility and convenience to customers in buying and using its products.

Superior benefit is offered to the customers by differentiating products and services by providing superior quality that reduces customer costs or improves their performance, by improving quality and speed of response in rendering pre-sale and after-sale service, by building a strong brand image, by offering a wider range of products through wide distribution coverage, and by being ahead of the competition in offering innovative products/ services.

Pre-emption is perhaps the most powerful form of a competitive maneuver. Pre-emption is focused on attacking the future moves of a competitor, before they have been made. The key to pre-emption is to determine where competitors or the markets are headed. Often, there are patterns of market development, signals or patterns of behavior by competitors that offer clues to their possible moves. This information can provide insights into opportunity to pre-empt [15].

Designing Appropriate Product/Service Support Strategy

The customers buy the bundle of attributes, a combination of tangibles and intangibles, not just the core product or service. Many companies loose the sales opportunities because the intangible attributes, which surround the core product, are not promoted. Support services with which a product or a service is augmented are important attributes that are normally expected by the customers.

Broadly the customer of equipment (an industrial product) wants the maximum availability of the equipment. Service has an important role in influencing customer's perception of product reliability by good servicing, availability of spare parts, fast response time, skilled customer relations, feedback information to engineering and manufacturing to influence product modifications and future product design. Whenever a machine breakdown occurs, a customer needs easy access to the service department, rapid visit of the service engineer and quick and efficient repair. Customer also expects reasonable costs for the parts and service provided.

Many manufacturers now offer service contracts or extended service agreements on the products they sell. Too many have regarded this as a high-margin opportunity to capitalize on the fact that the products, to which they relate, often offered under condition of price competition, themselves do not yield sufficient profits. Service contracts can serve as a device for improving customer satisfaction, internal operation, and even supplier performance [6].

Service quality is more difficult for customers to evaluate than goods quality. Customers do not evaluate service quality solely on the outcome of a service; they also consider the process of service delivery. Companies need to shift focus from generalized service policy to service standards. Many companies have framed the policy of service such as 'answer the phone promptly', 'return customer calls in a timely fashion' or 'be attentive to customers'. However, in dynamic markets, the companies need to refocus their service policies in the form of service standards that are more specific and measurable such as 'answer the phone within three rings', 'return all customer calls within 24 hours', or 'make eye contact with the customer within 5 seconds of his/her approaching the service employee'.

The problem of eliciting customer complaints has to do with both the way customers behave and increasingly outmoded policies of complaint escalation on which many organizations rely. It is widely observed that customers do not register their complaints regarding dissatisfaction with products or services because it requires too much effort and for too little potential payoff. In face-to-face service encounters, it often involves unpleasantness that most people would rather avoid, thinking that it would be a futile exercise.

The customer dissatisfied with the performance of a product/service makes a decision either to complain or not to complain. While a very few of dissatisfied customers lodge the complaint, a majority of them prefer to talk to others about their bad experience and defect to another seller. Complaining customers represent the 'tip of the iceberg'. Companies should establish the complaint handling system so that the resolution of the complaint to the satisfaction of the customer is ensured.

Responsiveness to Customers

A company's most precious asset is its relationship with its customers. As competitors deliver superior value and promise to do even better, the company, which lags behind, looses customers to the rivals in competitive environment. Yesterday's fantastic service is today's minimum standard and tomorrow's disappointment. Customer relationship is established over a period of time and through a series of specific events.

The value of a learning relationship to the company will vary from customer to customer. Some customers will be more willing than others to invest the time and effort. Those willing to participate are going to have a wide variety of demands or expectations, meaning that the company will have a varying ability to contribute to and profit from each relationship. Companies should therefore decide which potential learning relationships they will pursue [9].

The customer-focused company prevents customer defection by outperforming the competitors continuously in establishing the relationship with customers. Company's improved performance on various attributes and efforts to excel in providing services, delivery, reliability, responsiveness, and quality of human and organizational interaction between the company and the customer help enhance the relationship. Relationship based marketing focuses on total sales to a customer in the long term, individual customer satisfaction, customer care, customer relation, and continuous customer feedback etc.

In the new world of manufacturing, the sturdiest barrier to competition is customer allegiance. The goal is not necessarily to gain the largest share of customers but to gain the strongest relationships with the most profitable customers. By earning their loyalty, a manufacturer can become their preferred supplier of services throughout the product life span [16].

Innovating Products and Marketing Processes

Position for a service is heavily dependent on a company's capability to effectively differentiate itself from its competitors by providing superior value to its customers. Positioning is concerned with the identification, development and communication of a differentiated advantage, which makes the company's services perceived as superior and distinctive to those of its competitors in the minds of its target customers. Differentiation variables are broadly classified into 4 categories viz. (i) product- related variables: features, performance, durability, reliability, reparability, style, design, (ii) service-related variables: delivery, installation, customer training, consulting service, repair, other miscellaneous services; (iii) personnel-related variables: competence, courtesy, credibility, reliability, responsiveness communication, and (iv) image-related variables: symbol, media, atmosphere, events etc. Service excellence provides the real core competency to the company and hence offers the source of competitive advantage.

Commercial corporate customers are becoming conditional to expect their vendors to understand how the business processes of the two companies interact and to take action to reduce not only the defects but also the cost and cycle time experienced by the customer-company processes. This makes a strong case for developing some new ways to listen to customers and to use the voice of the customer to establish the design points for business processes [13].

Successful companies establish strong networks between their operating practices in the areas of customer focus, employee involvement, and change management. Innovation driven companies emphasize on customer feedback that fundamentally shapes the specific nature of changes and the improvements an organization makes in its business processes.

Conclusion

With increasingly aggressive competition, businesses are repositioning their products and services. Today, manufacturers need to shift their focus from operational excellence to customer allegiance, and have a relook at their understanding of value chain. Companies also need to have fundamental understanding of their customers' current and latent needs. Besides, competitor analysis has to emphasize on direct comparison and ranking of competitors on key skills and resources that help them gain competitive advantage. Competitive strategy has to focus on achieving new edge in a market while slowing the erosion of present advantages, which may result in market share leadership and high profitability. Competitive advantage goes to the firms that disrupt the existing 'status quo' in the market and take advantage of the disruption. To achieve sustainable competitive advantage, a company needs to integrate market–driven learning into its business philosophy. Superior skills transform the passive resources into competitive weapons while superior resource offers an opportunity to gain advantage. Thus, to succeed in today's competitive environment, companies need to adopt a customer-focused approach in designing their marketing strategy.

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Direct Response Television Advertising: Its Acceptance, Satisfaction And Effectiveness In North Malaysia

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Abstract

Direct response television (DRTV) is a recent manifestation in media advertising and its use is on the rise compared to conventional advertising. DRTV could invoke a direct response from unsuspecting customers usually through a given specific telephone number. Since it is still a new marketing concept in Malaysia, there are a lot of ambiguity in the overall consumers' acceptance and satisfaction towards DRTV. This study examines the level of acceptance, satisfaction and effectiveness of DRTV as perceived by consumers. A total number of 500 questionnaires were distributed to officials and staff in 30 government offices. 350 responses were collected representing 70% response rate. Findings indicate that 61 percent of consumers accept DRTV. Nevertheless, 57 percent of respondents are satisfied with DRTV programs shown and they will be more satisfied if the advertisement was translated to local language. However, generally the consumers perceive that the products sold through DRTV are expensive. Generally, about 20% of the respondents perceived that DRTV is effective. Consequently, repeat purchase through DRTV is unlikely for the first-time purchasers. The results also indicate that consumer acceptance is related significantly to DRTV effectiveness (r = 0.46). Similarly, consumer satisfaction is also significantly related to DRTV effectiveness (r = 0.61). Regression result depicts that satisfaction is found to account for 13 percent variance in effectiveness. Evidence from the findings is discussed.

Introduction

The direct response television (DRTV) is one area of direct marketing that has experienced unprecedented growth. Its significant development in marketing today is parallel with the technological change and communication developments in the markets. DRTV is used to generate immediate sales by eliciting immediate responses from the television viewers or customers. It is a marketing strategy by which firms directly communicate information via advertising media (television) on products and services to targeted customers. Like any other major promotional campaign, DRTV may be used as an important component of integrated marketing communication (IMC) program or as a complement to other promotional strategies. Due to DRTV development, direct marketing as a whole has realized a significant increase in market share.

In Malaysia, DRTV works well in urban and rural areas. What is obviously seen in today's Malaysian society is that there is a tremendous growth of direct response advertising, which in part has been attributed to the changing lifestyles of Malaysian consumers. This is due to the fact that DRTV presents shopping alternative to traditional store-based retailing that offer more convenience and lesser problems to consumers. All a DRTV customer need is four things: a television set, a telephone, a credit card for a guaranteed payment and an address for the delivery of goods ordered. With these, consumers can shop or purchase goods via telephone without having to leave home or office or get into a car and be hassled in long traffic to the store and searching for parking space. Additionally, DRTV is becoming more popular with the widespread use of credit cards as a means of payment and the increase number of working women and single mothers who seek time-saving purchasing methods. Thus, Malaysian consumers use DRTV as a more convenient way to solve these purchasing problems while at the same time, DRTV offer viewers some relaxation to relieve boredom and to accumulate knowledge about innovative products.

These changes in population demographics suggest that Malaysia is a potential market for DRTV business and Malaysians are segment that direct marketers can no longer afford to overlook. This is because virtually every home in Malaysia has one or more TVs and just about everyone watches television. This has made Malaysian market as a good breeding ground for Direct Marketing (DM) companies, which saw rapidly expanding class of urban and middle incomes. In fact, the lifestyles and living standards of majority Malaysians are comparable to any modern city in the world. The disposable incomes of the population have increased significantly. The most recent report of per capita income of a Malaysian is around RM 12,893 (Central Bank Malaysia, 2000). With this amount of purchasing power, Malaysian consumers have displayed strong preference for goods that could be ordered from DRTV but cannot be purchased in local stores. Among the hot sellers advertised are products for fitness, household, beauty, automotive, health, leisure and self-development. With the Malaysian market numbers around 22 million people in size, there is no doubt that DRTV marketers who are already in the market and who are planning to venture the market will be able to create a marketing boom to meet the demands for the consumer products.

In spite of the positive outlook in the DRTV development in Malaysia, there is inadequate empirical data to support the actual consumer acceptance, satisfaction and effectiveness of DRTV as perceived by the Malaysian consumers.

Past research on acceptance were conducted on the impact of affective responses on message acceptance. For example the relationship between mental responses and message acceptance has been studied (Petty and Cacioppo, 1986). Dillard and Plotnick (1996) found out that fear predict message acceptance. Message acceptance is also related to presenter's voice credibility (Gelinas-Chebat and Chebat, 1992). Consumer's liking for an advertisement is apt to foster message acceptance (Baker and Lutz, 2000).

Satisfaction has been studied from several angles. Fornell et al (1996) contended that antecedents for the American Customer Satisfaction Index (ACSI) are perceived quality, perceived value, and customer expectations. They stated that an increase in overall customer satisfaction should decrease the incidence complaints, thus, increased overall customer satisfaction should also increase customer loyalty. According to Baker and Lutz (2000), consumers' choice goal is to buy the first acceptable brand they encounter after they are satisfied. Consumers are most likely to be satisfied when they perceive significant brand differentiation, economic and social consequences before making an acceptable choice. Satisfaction is also assumed to have a meaningful influence on repurchase behavior (LaBarbera and Marzursky, 1983). Comrad, Brown and Harmon (1997) postulated that a non-linear relationship between satisfaction and customer retention is moderated by relationship quality (i.e: customer's perception on product or service quality, customer's trust and relationship commitment).

Corporate and celebrity credibility are said to play important roles in determining the effectiveness of advertising. A study conducted by Goldsmith, Lafferty and Newell (2000) found that corporate credibility influences consumer's attitude-toward-the-ad, attitude-toward-the-brand and purchase intent. This is consistent with the empirical findings by Davis (1994) and Laroche, Kim and Zhou, (1996), suggesting that product purchase decisions are in part influenced by consumers' view of the parent company's good citizenship and the consumers' confidence in the corporate brand. Investigation on DRTV effectiveness advocates that timing (reach), television programs and product types are significant factors for DRTV effectiveness and cost effectiveness (Danaher and Green (1997). It has been argued that satisfaction in advertising communication may be regarded as another element of advertising effectiveness (Hackman, 1990). The most frequent measure of interactive advertisement effectiveness used today is some form of choice behavior or sales (Stewart, et. al, 1985).

Thus, the first objective of the study is to examine the perception of consumers on acceptance, satisfaction and effectiveness of DRTV methods in North Malaysia. Secondly, the study intends to examine the influence of acceptance and satisfaction on effectiveness. The specific hypotheses are: (1) consumer acceptance of DRTV is related positively and significantly to the effectiveness of DRTV, and (2) consumer satisfaction is related positively and significantly to the effectiveness of DRTV.

Methodology

The study utilizes primary data research design whereby data was collected via a questionnaire. The population of the study was officials and staff working in various Government Departments in the North of Malaysia. It is estimated that the population of the employees in these departments are about 12,000. A sample size of 500 employees were selected randomly and asked to answer a three-page questionnaire. The instruments used are i) 8-item acceptance measure, ii) 9-item satisfaction measure, iii) 5-item DRTV effectiveness measure, and iv) demographic items. The variables are measured using five-point Likert's scale ranging from 'strongly disagree' (1) to 'strongly agree' (5). A total of 350 responses were collected representing a 70 per cent response rate.

Findings

The respondents' demographic profile is first presented, followed by descriptive results and the findings to confirm the hypotheses formulated.

Respondents' Demographic Profile

Table 1 and 1a illustrate that out of the total respondents (N=350), about 55 percent are male and 45 percent are female respondents. The average age of the respondents is 38 years old, having an average income of RM 1140.00. Their average experience in their jobs is 16 years. They are largely Malays (90.4%), with a minority of Chinese (7.6%) and Indian (1.8%). Majority of the respondents are married (86.5%). Only 11 percent are single and 2.1 percent are divorced. About 8 percent are holding 'A' category positions (degree level), 15 percent are holding 'B' category positions (Diploma level), and majority of respondents (77%) are from the 'C' and 'D' positions (Secondary High School level and below).

DRTV related statistics

Table 2 statistics on television ownership shows that 96 percent owns color television while 4 percent still do not own any television. Respectively, the preferred channels watched by the respondents are TV3 (80%), NTV7 (68%), RTM1 (35%) and RTM2 (21%).

Respondent buying behavior

The majority of the respondents (78%) never purchase goods through DRTV, while only 22% have actually purchased. Similarly, the spouse of the respondents do not seem to purchase any goods through DRTV (84%), while the rest of the spouses (16%) have some experience of purchasing.

Table 1: PROFILE OF RESPONDENTS

Variables	Valid Percent (N=350)
Sex:	
Male	54.5
Female	45.5
Ethnic origin:	
Malays	90.4
Chinese	7.6
Indian	1.8
Marital Status:	
Married	86.5
Single	11.4
Divorced	2.1
Position	
A category	7.9
B category	15.1
C & D category	77.0

Table 1a: AGE, INCOME AND EXPERIENCE OF RESPONDENTS

Variables	**Means**	**Standard Deviation**
Age	38 years	8.39 years
Income/month	RM 1281	RM 802
Experience	16 years	8.52 years

Table 2: TELEVISION OWNERSHIP

Variables	**Valid Percent (N=350)**
Television Ownership:	
Color TV	96.2
No TV	3.8
Type of favorite TV Channel:	
RTM 1	34.7
RTM 2	29.4
TV3	79.7
NTV 7	67.6
Purchased of Goods Through DRTV:	
Self: Yes	21.9
No	78.1
Spouse: Yes	15.9
No	84.1

Descriptive Statistics Of Measures

Table 3 shows the descriptive statistic for scales used in this study.

Table 3: DESCRIPTIVE STATISTIC FOR SCALES USED IN THIS STUDY

Variable type	**Variable name**	**N**	**No of Item**	**Minimum Score**	**Maximum Score**	**Actual Study Means (SD) N= 350**
Dependent: Y	Effectiveness	147	5	1.00	5.00	3.30 (0.64)
Independent:						
X_1	Acceptance	318	8	1.25	4.75	3.32 (0.53)
X_3	Satisfaction	280	9	1.67	4.89	3.46 (0.50)

Frequency Results

The frequencies of response of each item used in measuring the three main variables are presented in Table 4 to Table 6.

Acceptance of DRTV

In Table 4, about 70 percent of respondents like to watch DRTV advertising while 59 percent of the respondents generally agree on the suitability of DRTV for the Malaysian audience. However, the respondents disagree on the suitability of DRTV for the whole family (50.6%) and thus the majority of respondent feels that the present show times are unsuitable (61.2%). Even though the DRTV message is easy to understand (67.4%), the respondents feel that they cannot accept DRTV presentation in English (83.8%) or the usage of sexy models (82.9%) Thus, on average the respondents seem to be able to accept DRTV (60.7%).

Table 4: ACCEPTANCE OF DRTV

No	Statements used	% Agree	% Disagree	Answer
1	I like watching short DRTV	71.2	18.8	Agree
2	DRTV advertising method is suitable for Malaysian audience	58.8	41.2	Agree
3	Unsuitable show time	61.2	38.8	Agree
4	DRTV product is accepted	45.4	54.6	Disagree
5	DRTV is not suitable for the whole family	50.6	49.4	Agree
6	DRTV message is easy to understand	67.4	32.6	Agree
7	DRTV in English is more acceptable by Malaysian society	16.2	83.8	Disagree
8	Usage of sexy model is accepted by Malaysian audience	17.0	83.0	Disagree

Average percentage of acceptance level = [71.2 + 58.8 + 45.4 + 67.4]/ 4 = 60.7%

Satisfaction Level of DRTV

Table 5 indicates the percentages of responses to the items used to measure satisfaction of DRTV. The respondents are satisfied when DRTV contains the following characteristics: detailed information (56.8%), creative presentation (55.2); warranty (54.2%); latest innovation (62.9%) and DRTV in local language (80.2%). On average, 57.3 percent of respondents seem to be satisfied with DRTV aired on Malaysian television. Most of the dissatisfaction arises from the usage of sexy models (66.5%) and high priced products (62.6%).

Table 5: SATISFACTION LEVEL OF DRTV

No	Statements used	% Agree	% Disagree	Answer
1	Detail information of DRTV will give satisfaction to the audience	56.8	44.2	Agree
2	I'm not satisfied with usage of sexy model in DRTV	66.5	33.5	Agree
3	Creative DRTV presentation is satisfactory	55.2	44.8	Agree
4	Bad experience with purchase	31.1	68.9	Disagree
5	Dissatisfaction with high pricing product	62.6	37.4	Agree
6	Warranty and 30 days trial period encourage purchase	54.2	45.7	Agree
7	If purchased, I will never recommend to others	30.6	69.5	Disagree
8	DRTV make me more susceptible to the latest innovation	62.9	37.1	Agree
9	Advertisement should be translated to Bahasa Malaysia	80.2	19.8	Agree

Average percentage of satisfaction towards DRTV = [56.8 + 55.2 + 54.2 + 62.9] / 4 = 57.3 %

Effectiveness of DRTV (dependent variable)

From the respondents' profile discussed earlier, it was found that only 22 percent of the respondents have bought products from DRTV. Only those who have purchase products from DRTV were asked to answer the effectiveness items. This result coincide with the level of the effectiveness of DRTV whereby on average only about 21 percent of respondents perceive DRTV as effective. Most of the respondents will not recommend DRTV products to other buyers.

Table 6: EFFECTIVENESS OF DRTV

No	Statements used	% Agree	% Disagree	% missing	Answer
1	I am satisfied with the level of service provided by DRTV	22.3	22.5	55.1	Disagree
2	I am not satisfied with the quality of products I bought	14.6	28.3	57.1	Disagree
3	I will not buy the second time	17.7	25.1	57.1	Disagree
4	I will recommend products bought through DRTV to my friends	20.0	23.8	56.3	Disagree
5	To me the promises given by DRTV are untrue.	21.4	23.5	55.1	Disagree

Average percentage of DRTV effectiveness = [22.3 + 20.0] / 2 = 21.2%

Reliability Results

Reliability tests was conducted on the samples collected. The result is illustrated in table 7. All three measures are found to be consistently reliable with Cronbach alpha readings of above 0.60, therefore the measures are accepted for further analysis.

Table 7: RELIABILITY OF VARIABLE MEASURES

Variable type	**Variable name**	**No of items**	**Cronbach alpha (N=350)**
Dependent Y	Effectiveness	5	0.60
Independent			
X_1	Acceptance	8	0.69
X_2	Satisfaction	9	0.67

Correlation Results

Further correlation analyses show that there are significant and positive relationships between (1) Acceptance of DRTV and Effectiveness of DRTV and (2) Satisfaction of DRTV and Effectiveness of DRTV. Thus, both hypotheses are supported.

Table 8: CORRELATION RESULTS

Variables	**Y**	**X1**	**X2**
DRTV Effectiveness (Y)	1.00		
Acceptance (X1)	0.36**	1.00	
Satisfaction (X2)	0.52**	0.59**	1.00

** correlation is significant at the P<0.001 two-tailed

Table 9: STEPWISE REGRESSION RESULTS

Y = Effectiveness
N = 350 F = 51.727 Sig. F = 0.001 e = 0.46

Variables	**R**	**R^2**	**Beta**	**t**	**Sig. T**
Satisfaction	0.360	0.129	0.360	7.19	0.001
Constant			2.164		

$Y = 2.164 + 0.36 X_1 + 0.046e$
Y = Effectiveness
X1 = Satisfaction

Discussion

Although the North Malaysian audience perceived DRTV as acceptable (61%), and some are moderately satisfied with DRTV, but they are still skeptical about purchasing products through DRTV. This may due to the large percentage of clerical staffs involved in the study that may not have enough extra cash to buy the rather expensive products through DRTV. Furthermore, direct orders have to be made through non-toll free phone numbers, unlike the practices of toll=free phone number provided in the Western countries. The local audiences accept DRTV as a knowledge enrichment and leisure experience when watching it and not so much as a one of the convenience purchasing methods.

For DRTV to be effective, the customers or audiences need to be really satisfied with the presentation of DRTV programs. DRTV marketers need to understand the underlying culture of the target market where the use of the sexy models and foreign language are considered as unacceptable incidents. Since most of the advertisers are foreign marketers, they must first understand the Malaysian culture whereby advertisement are good to see but not necessarily good enough to buy. It is advisable for the DRTV to be short, avoid using sexy models, uses local languages and celebrities, and shown after 10 pm. Overall, DRTV has potentials in Malaysia, particularly for collaboration of international strategic alliances with local marketers so that the diffusion process of product acceptance can be accelerated.

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From Total Quality Management to Learning Organization: Comparative Analysis and Case Study [i]

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Abstract

This article examines and compares the principal characteristics of "Total Quality Management (TQM) and "Learning Organization" (LO) systems as means of achieving the strategic improvement and renewal of the enterprise. We argue that TQM practices lead to choice a LO approach in dynamic environments. The quality is a necessary condition for competing but not enough. Learn more quickly has become the new source of competitive advantages.

The paper has been organized in four parts. The first one, make an introduction into the change and organizational renewal. Next, a comparative analysis between TQM and LO is done. In the third one, the Electrical and Fuel Handling Division (EFHD) case is described. To finish, we submit the work conclusions and their implications for research and management practices.

The core of this paper consists of literature review, comparative study of both management systems and the presentation of a case in which two of authors have participated.

Introduction

At present, companies are obliged to go beyond approaches of efficiency in costs and seek, in addition, innovation, customer satisfaction, the exploitation of new technologies of information, combining their orientation towards the long-term mission of the company with rapid responses to ever-more-complex changes. So, in the words of Lundvall (2000), an organization's capacity to change itself continuously is a necessary condition for its survival (Teece, Pisano and Shuen, 1997). At the same time, the companies must maintain their efficiency, in other words, their capacity to obtain economies of scale and to attain and influence the key standards applicable in their sector. To achieve this difficult equilibrium, companies often experiment with new forms of organizations, forms that in some cases are radically different from those of the past.

Among the more widespread practices in the corporate world for dealing with the problems of renewal, one should mention: i) reduction of the size of the organization or *Downsizing*; ii) Re-engineering; iii) "Total Quality Management" (TQM); and iv) "Learning Organizations" (LO) (Dervitsiotis, 1998). The first two approaches are usually adopted in "emergencies", when the time available for achieving the required organizational situation is short (Pereira and Aspinwall, 1997). However since neither of these solutions pay much attention to cultural factors, they tend not to provide consolidation and maintenance of the change; this is the cause of the high failure rate demonstrated for many of the projects that choose this route for corporate renewal (Hamel and Prahalad, 1994). The alternative, TQM, a management system implemented very widely during the 1990's, is more practicable when the organization has more time to achieve the improvements that it hopes will lead to its renewal. As with the LO, its predominant focus for implementation and reinforcement is on the longer term (Lant and Mezias, 1995). But the TQM system, more oriented towards improvements in efficiency (Hamel and Prahalad, 1994), is limited when the need is for continuous renewal of the sources of competitive advantage of an organization in today's dynamic environments (Dyerson and Mueller, 1999). Against this limitation, the LO provides certain advantages that coincide with the organizational features demanded in the "knowledge economy" (Lundvall, 2000). It is perhaps for this reason that the LO has stimulated more interest in recent years (Crossan and Guatto, 1996; McGill and Slocum, 1994) and its principles and practices are being adopted by important multinational companies (Arthur Andersen, AT&T, Ford, Hewlett-Packard, IBM, Intel, Xerox, etc.)[ii].

The present study is set in this framework, and analyzes the characteristics of the management system applicable in both TQM and the LO. From an evolutionary and convergent focus, and in a dynamic environment, TQM practices lead, on the basis of logical incrementalism, to the adoption of a perspective that is complementary to that of the LO. The review of the literature, the comparative analysis of the two systems, and the presentation of a case in which two of the authors have participated, constitute the nucleus of this paper.

Although the organization of the LO type is a concept that first appeared in the literature more than 30 years ago (Cangelosi y Dill, 1965), it emerged more strongly in the 1990's and is being applied to a wide range of business goals related to renewal and change. LO is conceived as being one of the most important means of achieving the strategic renewal of the company (Crossan, Lane y White, 1999). Such renewal requires the organization to explore and learn new forms, while it exploits what it has already learned (March, 1991). This process of renewal acts on multiple levels – individuals, groups, the organization and the community to which it belongs – and it is determined by economic, psychological and social factors.

This paper is structured in five further sections: The first of these refers to the Strategic Management of Change and to Renewal of the organization. The second section consists of individual analyses of the systems of management of TQM and LO; followed, in the third section, by a comparative study of the two that finishes with an examination of their complementarity. The fourth section is a description of the case of the *Electrical and Fuel Handling Division* (EFHD) of the Ford Motor Company, one of their smallest divisions; the case explains how this company evolved from a TQM system towards one of LO, to become integrated into *Visteon Automotive Systems* (VISTEON). Finally, the conclusions of the study are presented, with their implications for future research and for management practice.

From TQM to the LO

The principal characteristics of the two systems that will be described in this section demonstrate their similarities, differences and complementarities.

The LO concept arose in the second half of the 1990's as a response to the problems of renewal of the sources of competitive advantage. Senge (1990) defines organizations of the LO type as those in which individual members or employees continuously expand their capabilities to produce the results they truly desire, in which new and open models of thinking are promoted, and in which individuals are continuously learning to learn together.

Study of the specialist literature has revealed a very wide set of characteristics typical of this system, which emphasize the conditions of the learning organization (Argyris, 1992), the achievement of mutual trust and commitment among the members of the organization (Kofman and Senge, 1995), the value of setting a personal example and a new class of leadership (Handy, 1995), the need to forget "unquestionable" truths and principle, so that new mental schemes can emerge and learning can be facilitated (McGill and Slocum, 1994), and, amongst others, the importance of a systemic view that enables a shared vision to be adopted and that integrates different levels of analysis (Senge, 1990; Crossan, Lane and White, 1999).

In an attempt to integrate the individual, group, organizational and environmental aspects, Senge (1990) brings together the characteristics of the LO system into five broad categories or disciplines: systems thinking, team learning, shared vision, mental models and personal mastery.

Crossan, Lane and White (1999) present a theoretical framework that correlates the LO with the process of strategic change. In this, the process of learning is the generator of strategic change when an "equilibrium in tension" is maintained between the exploration of what is new and the exploitation of what has already been learned, more in the sense of tension (Shrivastava, 1983), present in the processes of prospective and retrospective analysis (*feed-forward* and *feedback*, respectively), than in that of equilibrium (March, 1991).

In the model put forward by Crossan, Lane and White (1999), the individual, group and organizational levels of learning are related to each other by means of an interactive process termed "the four I's" (4I), which are: i) the Intuition of individuals; ii) the Interpretation that individuals and groups make of this intuition; iii) Integration, or how what has been interpreted is inserted into the organization; and iv) Institutionalization, or how the changes that the preceding phases generate are consolidated (see Table I).

Table I. THE PROCESS OF THE "4 I'S"

Associated processes	*Levels of learning*	*Types of knowledge transfer*	
		Prospective (*feed-forward*) EXPLORATION	Retrospective (*feedback*) EXPLOITATION
Intuition	Individuals	From the individuals and groups towards the organization (New learning: renovative)	
Interpretation Integration	Groups		
Institutionalization	Organization		From the organization towards groups individuals (Old learning: efficient)

The literature on TQM reveals a series of basic aspects that characterize the system (Powell, 1995) and that can be summarized in the fourteen points of Deming (Deming, 1982, 1986; Gartner and Naughton, 1988), the trilogy of Juran (Juran, 1992) and the 14 steps of Crosby (1990). These contributions are grouped into nine sections that are described here next, and that basically coincide with the characteristics of the system as presented by the *European Foundation for Quality Management* (EFQM).

The first place must logically be given to the commitment of the top management to Quality, i.e. committed leadership. This commitment includes, from a broad perspective, a long-term vision of quality (ISO 9000 Standards), and that recently has been extended towards environmental issues (ISO 14000 Standards), the prevention of labor risks/promotion of safety at work, and business ethics.

This leads to a second aspect related to the adoption of a particular corporate philosophy with respect to the culture, the values, the mission and the shared vision of the organization. This vision includes customer focus as the dominant factor of business activity. This third characteristic puts emphasis on close relationships with both internal and external customers, with the aim of determining and satisfying their needs.

A fourth characteristic is the effort of constant improvement in doing what the company knows how to do, in its search for greater efficiency. This aspect basically has one clear external orientation in the form of *benchmarking*, and another internal orientation in the improvement of the processes to reduce wastage and operating cycles.

But in addition, TQM requires a specific kind of creative human resources management. This should cover the continuous training of individual employees in the principles of TQM, the development of team-working and problem-solving skills, safety at work and risk prevention, *empowerment,* and appropriate systems of compensation and incentives. The participation and involvement of all the members of the organization in these processes is a key requisite of this policy.

A sixth aspect of TQM is its greater emphasis on horizontal communication than on the traditional hierarchy. This allows flatter organization structures, with greater facility of access to information and more open communication to provide a basis for greater participation and commitment on the part of all the employees.

The "zero defects" mentality is another of the distinctive characteristics. This refers to the development of a system to detect and correct defects immediately, in the part of the system where they occur, instead of having to do this by the traditional method of inspection and re-working. The key emphasis is on prevention, to minimize the amount of correction needed.

Achieving a flexible manufacturing process is another of the characteristics of TQM. This objective is mainly internal in nature and includes techniques such as *just-in-time* (JIT), cellular manufacturing techniques, job rotation, statistical process control, and design of experiments in working methods, among others.

Lastly, the system is characterized by its quantitative nature; measurement forms an essential part of it. Monitoring and control of objectives and tasks make data treatment a key feature, with permanent measurement of results frequently using sophisticated statistical analysis techniques.

Relationship and complementarities between TQM and the LO

A comparative analysis of the two systems reveals similarities, differences and complementarities. Both systems of management are clearly oriented towards the longer term, although the LO provides more continuity in its actions through its stronger orientation towards effectiveness rather than efficiency. Unlike TQM, in which group and organizational levels of problems and processes are predominant, the LO presents a more complete analysis, working on the levels of the individual, group, organization, and community, but particularly on the individual level, given the importance of individual experimentation as the engine driving the learning process (Cohen, 1995).

In relation to the analysis of problems, TQM puts the emphasis on the group and the organization, since it basically prioritizes processes, whereas the LO, in its systems focus on the resolution of problems (Garvin, 1993), also considers the individual and the community of which the organization forms part. This open approach to the community extends LO beyond corporate culture and relates it to the creation of social capital (Nahapiet and Ghoshal, 1998).

Although, in both TQM and LO, motivation and techniques of *empowerment* are used, differences in emphasis can be appreciated. Whereas in TQM it is stressed that the employees should serve the customer, in the LO this end is achieved indirectly by strengthening learning and creativity, or in the words of Crossan, Lane and White (1999), by stimulating intuition and interpretation, which will enable employees to anticipate changing needs and thus to surprise the customer.

Regarding the general model of decision-making, in TQM there is greater predominance of rational approaches (statistical techniques, mathematical models of quasi-perfect rationality, etc.) than in LO, although these (systems archetypes, process re-engineering, etc.) are used in both. In LO there is particular emphasis on the use of techniques more associated with limited rationality (Simon, 1957), for example, dialogue as a means of achieving trust and mutual respect.

Lastly, and in relation to innovation, although both systems drive change, there are significant differences between them (Crossan, Lane and White, 1999). Whereas TQM promotes continuous and incremental changes, LO pursues more radical changes based on continuous learning by the entire organization and on innovation, which is the consequence of individual intuition and experimentation (Winter, 1995).

The two systems complement each other in the ways by which objectives are established. The LO is more anticipatory and aimed at questions of effectiveness than TQM, which is a system more characterized by its solutions of adaptation and efficiency (Hodgetts, Luthans and Lee, 1994). Between the two they achieve an interesting balance of effectiveness and efficiency in seeking the competitive renewal of the company.

Both TQM and the LO need a culture oriented towards people as individuals. However, there is a considerable difference in the content of this culture (Dervitsiotis, 1998). The LO approach is biased towards human development, in the sense that, by means of “personal mastery”, fostered by the organization, personal fulfillment is achieved both at work and outside the company.

There also exist differences with respect to the vision of the organization from the point of view of TQM and the LO, respectively. Their point in common is that both systems seek to reach a “shared vision”, but the process of achieving this and the actual content of the two visions are different. In TQM the vision is more general and usually has its initial impetus from a leader who communicates it to the lower levels of the organization in a “top down” way (Anderson, Rungtusanatham and Schroeder, 1994).

In contrast, the shared vision typical of the LO is formed more pragmatically, usually this vision is not necessarily derived from a leader figure but rises from the “bottom up”, when all the individual personal visions, based on their own values and aspirations, are projected towards and integrated into those of the organization as a whole. An alternative scenario is when the organization has a visionary leader who recognizes that his or her vision is only a personal view or goal that has to be continuously shared with the other members of the organization. This is a more "democratic" process of development of the shared vision derived principally from shared creation and a common creative attitude (Senge *et al*., 1999).

The LO requires a climate of learning in which the employees can find new and creative ways of carrying out the work, so that changes are effectively anticipated (Hult, 1998). This same climate of learning arises spontaneously through team-working activity under TQM and with a similar objective (Mukherjee, Lapré and Van Wassenhove, 1998). Thus whereas in the LO concept learning is defined explicitly, in TQM it is assumed implicitly through the functioning of groups (Barrow, 1993). The difference lies in the more adaptive nature of learning under TQM (Love, *et al*., 2000), when what has been learned is put into practice according to priorities, as the main process of knowledge transfer (through training, self-monitoring and *benchmarking*), in contrast to the more generative character of LO, in which the exploration of new fields, methods, etc. is emphasized (Garvin, 1993). The complementarity of the two systems comes from the "exploitation-exploration" dynamic, or in the words of Crossan, Lane and White (1999), by means of a *feedback* process of a more professional and specialized character, typical of TQM, and another of *feed-forward* directed towards the future, more generalist in nature and closer to the LO.

Even when the processes associated with learning (the process of the 4I) are developed similarly under the two systems, on the level of the individual, TQM employs the intuition of the "expert", which is based on improvements that are made incrementally to methods already being used, whereas in the LO, the intuition found is that of the "entrepreneur" who typically starts out by "forgetting" or ignoring the previous rules of the game and is capable of perceiving and establishing new rules.

TQM is usually interpreted in "specialist" terms: the communication that takes place in the learning process is dominated by technical dialogue. LO, additionally, is concerned with interpreting the emerging messages in "generalist" terms. This difference becomes evident in the Integration phase of the 4I process: the integration of the relevant proposals that emerge from the process of improvement or learning takes different forms. Whereas under TQM these proposals have a more formal character, since there usually exists a defined procedure or protocol for the acceptance of suggestions for improvement, in the LO both formal and informal procedures are used through sessions of dialogue and team discussions. The institutionalization of changes, the phase that opens a new cycle of improvement and learning, has a greater tendency to be a transitory phase in the LO, being marked by creative tension (Crossan, Lane and White, 1999).

In both TQM and LO systems, and as a response to dynamic environments, organizational structures are sought that are less hierarchical, less bureaucratic, and less centralized, more organic in character (Mintzberg, 1979). In such structures, relationships of horizontal communication, coordination and teamwork are strengthened. There exists, nevertheless, a certain difference in orientation and purpose between the improvement teams and quality circles of TQM, and the learning circles of the LO. In the first case, the teamwork is directly related to the commitment to quality and customer service: in the second, the teamwork is more free-ranging and more specifically related to learning as the source of competitive advantage, with the organization even being thought of as a "community of practice" in the term of Brown and Duguid (1995). The mechanisms of coordination, as a consequence of the factors already discussed in the phases of Interpretation and Integration of the 4I process, have a more professional character in TQM, whereas in the LO, coordination is based on loose, flexible links, termed *"loose coupling"* (Sanchez and Mahoney, 1996).

One of the principal differences between TQM and the LO is the use each makes of situation analysis by cause & effect diagrams. In TQM, cause & effect analysis is normally static, i.e. not essentially dynamic (Dervitsiotis, 1998) and is carried out by interdisciplinary techniques, such as: quality control tools (e.g. the "fishbone" diagrams of Ishikawa), flow-charts and Pareto analysis, statistical process control, value analysis, control charts, etc.; also widely used are quality management tools (affinity and matrix diagrams, decision trees, etc.) and product planning tools (customer/user group interviews, surveys, market positioning analysis, etc.). The most common problems arising from the use of these tools is the difficulty of accumulating the results over time, which tends to limit managers' ability to know with any reliability which past decisions gave rise to the symptoms currently observed, so that a margin of anticipation can be built into new decisions. However, the emphasis of TQM on simplifying complex relationships facilitates the participation of employees in the solution of problems. Thus for plant or immediate operating level problems, such statistical tools are found to be very efficient (Young, 1992; Reed, Lemak and Montgomery, 1996).

Against this, the cause-effect analysis in the LO, also interdisciplinary, is strongly based on the use of simulation techniques using heuristic programs, which makes them much more dynamic. As one deals with higher-level problems, the static analysis of TQM becomes less effective, and it is the dynamic analysis that the LO facilitates, by means of archetypes of systems and modeling techniques, that provides a more efficient approach (Dervitsiotis, 1998). The most critical techniques used are those involving ethnographic studies, “story-telling”, paradigms and dialogue (Levitt and March, 1988).

The case of EFHD and Visteon[iii]

The dynamics of the process of transformation of TQM into the LO is illustrated by the experience of the case studied in the next section, that of Ford’s *Electrical and Fuel Handling Division* (EFHD), which subsequently was extended to VISTEON[iv]. Table II summarizes the principal events of the case.

EFHD was one of the smallest divisions of the *Ford Motor Company*, employing around five thousand people, and is engaged in the manufacture and sale of automobile components such as: starting systems, alternators, injectors and injection coils, among others. In 1991 the Division lost $50 million, which by 1996 had been transformed into a profit of $150 million. Its process of renewal took place between 1991 and 1996 and demonstrates how the Division achieved world leadership in the manufacture of these components (three plants in the USA and ten in the rest of the world) with an unprecedented collegiate management style and by using the tools and methods of the Learning Organization.

EFHD was created in July 1988 with three plants manufacturing mature products related to the combustion processes of automobiles. In 1991 its engineering costs were less than 1% of sales revenues, its quality indicators were low, its labor costs high and its annual financial losses reached $50 million. In 1992 Bob Womac was appointed Chief Executive Officer (CEO) and he proposed to convert EFHD into a LO; his reasons centered on the desirability of increasing the ability of his employees to think in a new way; to obtain a faster response of both his teams and suppliers to customer needs; to drive the strategic transfer of technology; and ultimately to achieve new advantages over the competitors, in a dynamic environment.

Womac admits that his interest in the LO began in 1989 when he attended a seminar given by Ackoff to a group of senior managers of Ford. At that time, the Japanese and their techniques aimed at total quality in the automobile sector were giving superior results to the high productivity of the North American industry; the Japanese were proud of having learned from the North Americans. To learn faster, not only to improve quality, was the key to being more competitive.

Womac with collaboration of the rest of his directors formed the Divisional Operating Committee (DOC) and put into practice the five disciplines of Senge. For this, they established set times for practicing techniques of dialogue between managers and employees; they designated an initial learning team and included LO as a fundamental initiative of the strategic plan of the company. A general course of LO was approved and promoted, and in this way, continuous learning became the foundation for improvements, with some individuals being allocated full time to the implementation of the LO. The efforts of DOC were aimed at radical changes and at identifying the events from which lessons could be learned.

Table II. PRINCIPAL LANDMARK EVENTS OF IMPLEMENTING THE LO IN EFHD AND VISTEON

Year	*Landmark Events*
1988	- EFHD was established, with three manufacturing plants: Bedford (Indiana), Rawsonville (Michigan) and Ypsi (Michigan).
1991	- New plants in Belfast (Northern Ireland) and Alba (Hungary).
1992	- Bob Womac was appointed CEO.

	- The Divisional Operating Committee (DOC) was set up to convert EFHD into a LO. - A first group of people attended Peter Senge's course on "The Fifth Discipline". LO was applied initially to tl launch f new products and substantial cost savings and quality improvements were obtained. - Two Learning Circles were created in which 32 people participated.
1993	- The COD incorporated the concept of the LO into the Business Plan of EFHD. - The principles of the LO were extended to supplier relationships. - The number of Learning Circles increased to 7, with a total of 120 members involved.
1994	- Regular courses on The LO were established in the *Washtenaw Community College*. - Meetings were promoted with suppliers to "learn both sides". - New plant set up in Jarudo (México). - The number of Learning Circles increased to 20, with a total of 500 members involved.
1995	- First international course on "The LO" in the *Washtenaw Community College*. - Session of dialogue were established as a fundamental part of the courses on "The LO". - First international course on The LO in the USA for suppliers to EFHD. - First international course on The LO in Europe. - The Learning Circles grew to 27, involving a total of 1200 members.
1996	- The plant at Cumbinca in Brazil was built. - Learning Circles increased to 30, involving 1730 members.
1997	- Ford created VISTEON with a presence in 22 countries. Its objective: to expand sales of components to other automobile companies. - Charles Szulack was appointed President and undertook to make VISTEON a LO. - He brought in Bob Womac as his Vice-president.
1998	- International training plan to develop the LO in VISTEON. - The University of Cadiz (UCA) initiates a collaboration with VISTEON to develop a LO.
1999	- First course on The LO in Spain for the company Cádiz Electrónica of VISTEON, presented by the UCA.

Source: VISTEON.

The experience was utilized to make in-depth changes. On applying the five disciplines of Senge, use was made of techniques that were already being used within the company and that formed part of the TQM program, especially those relating to team working and to analysis of points of improvement in processes and products. But some of these tools, which were applied to the elimination of practices without added value and reduced the allocation of budgeted funds, were creating vicious circles by reducing participation and the trust of employees, without attacking the deeper causes of why added value was not being generated. The application of systems thinking, the discussion and agreement of the shared vision, and the new practices of dialogue increased the trust of people and reduced the need for supervision. The process of continuous learning revitalized and provided a new dimension to the techniques and tools of TQM, that continued being applied.

Womac, in an internal communication of the company, recognizes that: *"Remembering our experiences with LO, I believe that we have some lessons to share with the managers of VISTEON, Ford Motor Company and the rest of the sector"*. He summarizes these lessons under three main headings.

First, the process of change towards the LO begins with ourselves; it is a personal question. The second point stressed is the importance of the commitment of the Board of Directors and management, states Womac, quoting the words of the Spanish poet Antonio Machado, that *"You set out on your path by walking"*. The third outstanding aspect is the need to create a technical infrastructure to support and develop in an orderly way the Company's own LO. In this respect, the most significant actions taken by the DOC were the following: Specific times were set aside for managers to practice dialogue with the employees; An initial learning team was formed and supported; LO was regarded as a strategic initiative in the Business Plan; training courses in LO were promoted and approved; Learning, taking the experience gained from TQM, was the base for the improvement of the company; Resources and personnel were dedicated full-time to the implementation of the LO; Events and results were considered to be sources of learning, and a plan was drawn up the spread organizational learning throughout the whole company.

In 1997 the VISTEON company was formed, its name, a synthesis of “vision” and “eon” (time or eternity), reflected the concern of the company to revitalize the knowledge acquired in the past with the vision and orientation towards the future. When Charles Szulack was appointed President of VISTEON, he said he was well aware that: *“An organization of 82,000 people can’t be changed just by the work of a group of executives alone”* (Senge *et al*., 1999; p. 13). Szulack knew that in big organizations, people came to be skeptical about the fashions that the new directors wanted to establish. He differentiated between the easy task of adaptation to change, and the difficult one of gaining true commitment to the change, which would last and create an authentic community of learning as the source of future competitive advantages.

In the challenge of making VISTEON into a LO, Szulack was supported by the prior experience of EHFD and, although he did not impose it on them, he went around the various divisions of the company convincing them of the advantages of the LO concept. He made Womac his Executive VP and extended the LO training courses to the whole company; he contracted the services of Peter Senge, and recommended subsidiary companies around the world to reach agreements with local universities and agents to develop communities of learning.

This was the context in which the mission of VISTEON was defined: “In VISTEON we are trying not only to be the best suppliers of automotive systems in the world, but also to create new opportunities – for our own people, for our customers, and for our sector. In short, our vision is to see what is possible”. VISTEON understands that survival in a highly competitive global environment requires not only high quality in its products and processes –for this it continues to apply TQM techniques – but also continuous learning by each individual member of the organization, learning derived from the organization and from people’s relationships with a wider community. It is this kind of learning that sustains and renews the company’s competitive advantages.

Conclusions and implications for research and practice

The principal contribution of this paper in which the TQM and LO systems are analyzed and compared, is to indicate the limitations of the former and the potential benefits and strengths of the latter in confronting the challenge of corporate renewal. In dynamic environments where the continuous renewal of the company’s sources of competitive advantage is crucial, the learning approach is superior and complementary to an approach based exclusively on quality. LO, subject to the limitations inherent in any new framework of organizational model, has emerged as a valid instrument of renewal. Such renewal involves the organization learning to explore new paths forward, while maintaining in tension the exploitation of what has already been learned. From this perspective, the two systems complement each other: LO shows its superiority in the exploratory aspects of this endeavor, while TQM is evidently a useful instrument for increasing efficiency through what is already known.

But this article also raises questions for consideration in respect of future research work. Among these is the need to study in more depth the mechanisms that drive or inhibit the stock and flows of knowledge and learning. A learning process can be compared to a production process: the key to success is to identify the elements and means required to accelerate the process.

For example, the *“feed-forward”* and *“feedback”* equilibria and flows among the levels of the 4I model proposed by Crossan, Lane and White (1999) need to be understood better. But, in addition, reconciling the tension between exploitation and exploration requires the identification of the practices in human resources and the systems of information and management that are best suited to the process of continuous learning and strategic renewal in the company.

A third line of study proposed is that related to the implications of LO for the social community in which the company operates, and therefore also related to the concept of social capital applied to the theory of the organization (Nahapiet and Ghoshal, 1998), a concept that is wider than that of corporate culture and surely involves new thinking about organizations with more flexible boundaries (Ashkenas *et al*., 1995).

Lastly, our paper puts forward useful aspects for the practice of better management of companies and organizations. It shows that there are organizations that progress beyond TQM and learn continuously to renew the sources of their competitive advantages, proposing a model for the LO. To achieve this, in such organizations people are willing to “forget” past successes, that they will not be able repeat in the future, and put into practice new forms of behavior: firstly, reducing hierarchical control to give freedom for experimentation that arises from the intuition of individuals; secondly, stimulating a systems perspective that, with the help of dialogue and open communication, improves peoples’ capabilities of interpretation and the integration of innovations into the organization, thanks to a shared vision; thirdly, making use of expert knowledge of their resources, together with a more generalist and heterodox knowledge, that converts diversity and trust into internal elements of its equilibrium; and fourthly, expressing, planning and taking active measures so as to become organizations in the process of continuous learning.

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[ii] An indication of the importance that many companies attach to the LO concept is the formation of *The Society Of Learning* (SOL), a club in which they exchange experiences of its application and which is aimed at developing a “learning” society. Details can be found at: http://learning.mit.edu:80/index.html.

[iii] This case is used in order to illustrate the evolution from TQM to the LO, and not to give empirical validity to the analyses carried out. Information provided by *Visteon Automotive Systems* (VISTEON) and by Senge *et al*. (1999) has been used. The interpretation of the information is also the result of the collaboration of two of the authors in the international program of the *Learning Organization* undertaken by VISTEON

[iv] VISTEON is a company dedicated to the manufacture of auto-components, with a work force of 82,000 people. It is structured in seven divisions: chassis systems, climate control systems, vehicle glazing systems, interior components, exterior components, electronic components, and power control systems (into which division EFHD has been incorporated). The company has been quoted on the New York Stock Exchange since July 2000.

The Use of Franchising as a Tool for SME Development in Central European Countries

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Abstract

It is generally acknowledged that franchising plays an important role in furthering the development of the Small and Medium Sized Enterprises (SME) sector. In several Central European countries, franchising is already well known and has an increasing role in national economies. In some developing countries, franchising has been adopted by national governments as one of the strategies for faster economic development and is considered a major tool for developing consumer markets as well as the supply chain, and provides faster job creation and new incomes in the SME sector on a sustainable basis where micro enterprises are the prevailing entities. This paper discusses these issues by exploring the use of the franchising concept and the use of franchising as a tool for SME development in developing economies, with a global perspective. It then examines the particular case of Central European countries, and then assesses the domestic franchise systems and development of franchising within this framework. Finally, it summarizes key issues and challenges.

Introduction

It is now widely accepted that franchising plays an important role in furthering the development of the SME (Small and Medium Sized Enterprises) sector. With the growing economic integration of Europe, differences of individual country markets are becoming smaller which is contributing to increased economies of scale. This, in turn, is leading to the growth of cross-border franchising within Europe itself. In several Central and Eastern European countries, franchising is already well known and has an increasing role in national economies, being also assisted by divestment programmes in former state and publicly owned enterprises. In some developing countries, franchising has been adopted by national governments as one of the strategies for faster economic development and is considered a major tool for providing faster job creation, new skill sets and new incomes in the SME sector where micro enterprises are the prevailing entities.

It is suggested that the use of franchising in developing economies could contribute to increased management knowledge and skills, improve productivity, assist in creation of efficient distribution channels and enhance product/market/services development and, consequently, increase overall incomes and the tax base [8]. Various research studies have identified that the failure rate of businesses using franchising is generally lower than that of the 'conventional' start-ups [10].

However, it has also been proven that the development of franchising depends on the overall economic circumstances and that its growth can be significantly impacted by the performance of the economy as a whole [4]. It should also be pointed out that failures in franchising are possible and that franchising is not a panacea to cure ailments in the SME development process.

All these issues highlight the need to understand the benefits as well as limitations of using franchising as a tool for SME development, especially in developing economies. It is also vital to identify which measures/tools should be used, and how, to facilitate and promote franchising for the purpose of optimizing its benefits. It is also important to understand the ways of building up franchising into an overall economic development concept and to identify the needs of all parties involved in franchising, and how they should be met.

Franchising has been used as a tool for SME development in some newly industrialized and developing countries with reasonable success. However, in the countries of Central and Eastern Europe, where it started a few years ago, it has been only considered but not exploited fully for this purpose.

In the Central and Eastern European countries there are large industrial sectors, which have already been privatized or are in the process of privatization with budding new entrepreneurs and managers within newly emerging commercial legal frameworks. The developing environment has been open to those that are genuinely seeking to thrive and survive in these environments and to those who are seeking to make short term gains in the process of reselling, then disappear. The absence of small and medium-sized enterprises in Central Europe and the lack of ability of Governments to cope with the grey economy, enforce laws and collect taxes, has offered opportunities for quick success and hardly justifiable earnings for several entrepreneurs [1]. There have also been emerging alliances of indigenous public administrators and noveaux-riches private entrepreneurs and managers with multinational companies and investors. Franchising could be one of the business approaches that can be or might have been already seriously affected by such practices [7].

In spite of common features there are substantial differences among these Central European countries in terms of GDP per capita, FDI, foreign trade, legal and infrastructural characteristics, size of the population and affluent segments with considerable purchasing power. But even the economically most-developed group of Central European countries is not a homogenous part of the former "Eastern block". As part of the transformation process many new small businesses have emerged in this environment, filling the gap that had existed even before the changes started, marked by the non-existence of small and medium sized firms. Many of them are stagnating, several have already disappeared. Not very common advance by agencies that have been set up to assist such entrepreneurs is related to franchising. However, franchising has started to emerge in developing economies [6]. Franchisers from North America and Western Europe have started to run their operations in this region, encountering problems never encountered in their home countries [3].

One difficulty of importing foreign franchise systems is in their compatibility with the local environment. Organizational, cultural, legal and other types of adaptations have to be made. Related to the specific profile of the franchise there may be several reasons, which may prevent the successful spread of a franchise system. Incompatible business practices, infrastructural deficiencies, underestimated costs of imported ingredients, tariff barriers for input components, the absence of the required demand, lowering the purchasing power of the target groups etc. could be mentioned.

In projecting their long-term strategy and collaboration with local partners, suppliers, joint ventures, franchisees, master franchisees and others, franchisers have had to adjust to the specific context of the developing economies and their market conditions. In some cases investment into the local manufacture of input components used in their operations or their own production and even training of local suppliers have been critical.

Franchisers who decide to enter Central European markets may have to get ready to "cultivate the market niches" and educate consumers. After identifying market niches and acquiring proper marketing information they may choose different strategies at different stages of their expansion into the Central European markets. In addition, careful selection and development of suppliers and franchisees, checking their motivation, managerial experience, trustworthiness and working habits, and identifying locations could be a painful and demanding process. Continuous and comprehensive assistance and support to local franchisees and master franchisees, their staff and management development need to be adapted to the specific training needs of local employees and entrepreneurs. Trouble-shooting and control may have to be more rigorous than in other regions. The testing period of the franchise in a Central European country may require more scrutiny.

Local entrepreneurs may not understand the concept of trade name, goodwill and reputation, or loyalty to the corporation, as they have not had the chance to experience doing business in a competitive environment where business ethics counts. They may undervalue the importance of being shielded by a reputed franchise system. They may compare their financial performance with independent entrepreneurs and with their living standard (this often means spending surplus which would be badly needed for the required expansion of the business). There can be a lack of understanding that sacrifice and hard work by a franchisee may not be as rewarding in a short run. One can assume that the process of market saturation with products and services will bring about fierce competition and lower profit margins. When the survival of independent entrepreneurs will depend more on synergy of good management, established brand names and reliability of strategic partnership, franchising, as an alternative entrepreneurial possibility will be increasingly popular. Conditions conducive to the expansion of franchising, including proper legal regulation, may be created if franchising is to be promoted as a small business development approach.

Governments of countries with developing economies, sometimes restricting imports to strategically important goods and services, are matching the benefits of such imports with the outflow of equity abroad and import of input components required by international franchise systems. Often they do not recognize the benefits of transferred technologies, know-how and quality standards encompassed in it, newly-created jobs within franchise systems and with suppliers, development of domestic suppliers, development of local human resources, income generation for government from taxes etc. that come with the entry of foreign franchise systems and their impact on the economic development of their respective countries. The spill-over effects of the arrival of international franchise systems, primarily those related to learning from such systems and cloning of foreign business practices, following their role examples etc. are often underestimated when discussing the impact of foreign franchise systems on the economic development of developing economies [2].

For a developing economy, the management or even technical training by a franchiser may be equally, if not more important than the commitment of a franchiser to make equity participation as it relates to not only transfer of know-how and key competencies but also development of resource, consumer and distribution markets.

However, caution is due because some franchisers may insist on employing either their own expatriate managers or 'foreign' managers in undertaking the training and know-how transfer processes based on their negative experience or perception of local staff. This practice, if not managed carefully, can have an adverse impact not only on the morale of the local staff, but also on the efficiency and sustainability of the business in long term.

The Central European countries comprise sizeable consumer markets, offering high profile opportunities to develop retailing, wholesaling, distribution, manufacturing and buying channels. Many Western retail and retail-related organizations have already taken the plunge related to internationalization of retailing, accepting this must be viewed as a long-term investment. These are large markets with substantial and growing affluent middle-classes, with comparative advantages in the cost of property and labor. Among several entry strategies of western retail and retail-related organizations to Central European countries, which are in the process of joining the EU, such as organic growth, acquisition, joint ventures and franchising, franchising seems at advantage. Franchising represents a relatively low cost and lower risk form of market entry [7]. At the same time in franchising there are some elements, which are easily understood by those, accustomed to a centrally planned economy [5]. There are differences in entering markets, which are known to the franchiser, or markets that are very different [3].

In Central Europe companies that are proud to use the name of franchising have to overcome locally affected shortcomings and idiosyncrasies causing their low competitiveness, and try to meet the international business standards. Domestic franchising is often limited to various forms of quasi-franchising and has only a marginal role [11]. In spite of their advantages in knowing the local environment and being better able to cope with local macroeconomic turbulence, the existing domestic franchise companies may find it difficult to compete with international business with further opening of these economies to the international trade. One of their shortcomings could be lack of hard-core know-how on franchising itself, of alternative forms of trading and barriers to adequate suppliers. There could be also lack of human resources with adequate managerial and technical skills and capital, as well as non-existence of clearly recognizable markets. If a local franchise system is to prosper or a new one is to be launched, a considerable level of requisite expertise will be required [5].

Most developing economies, where a competitive environment may jeopardize the existence of many newly emerged domestic small businesses, could, in addition to learning from the developed Western economies, study the experience of Singapore and possibly of some other Asian countries.

Issues and challenges in using franchising as a tool for SME development in Central European Countries

Upon evaluating several entry strategies, franchising appears to be much more appropriate as a vehicle for western organizations to enter into CE countries as well as for similar organizations within the CE countries to expand the business. Franchising represents a relatively low cost and lower risk form of market entry. One observer (Sanghavi, 1994) has commented upon the particular suitability of this strategy for rapid development within CE countries, not least because the franchising concept contains elements, which are easily understood by those accustomed to a centrally planned economy.

The key issues and challenges in using franchising as a tool for SME development in developing countries in general, and for Central European countries in particular, are summarized below:

1. At the planning stage, the franchiser must give careful consideration to the cost of serving franchisees. At a certain stage of the business expansion this becomes critical, as it will cost more to service central franchisees than their sales are worth. However, before the final decision is made, the franchiser must evaluate these types of cost/benefit issues very carefully.

2. When any organization is thinking about using franchising as one of the key elements of its business expansion strategy, it needs to assess very carefully the impact this will have on its corporate structure and strategy. It should also evaluate the organization structure and key components of the business environment, such as stability, complexity, disparity and hostility. Only after careful consideration of all these issues, the overall strategic framework should be devised to use franchising as a method of business expansion. The company should be very vigilant about inefficient use of scarce executive skills and resources, as well as avoiding any imbalance between flexibility and stability.
3. One of the most crucial decisions the franchiser faces is the possibility of revising overall channel strategy during the business development, such as replacing all or some of the franchisee/dealers with company owned outlets or centralized production and distribution facilities. These decisions involve reappraising key market variables, with a far-reaching impact on future company activities.
4. From the franchisee's perspective, the potential applicant should carefully investigate the franchiser's management quality, experience, systems, and financial and administrative infrastructure in order to ensure that the franchiser organization can deliver what is promised in the 'hype' and can sustain a network via appropriate backup facilities.
5. Besides attracting franchisee investors in CE countries to establish operations, a prime consideration for the franchiser is the ability to generate demand for the product or service from customers in the target market through its marketing strategy. However, different market conditions in these countries may dictate which areas of marketing strategy must be modified to generate or increase demand.
6. Perhaps the most frequently occurring aspect of strategy variation relates to the type of agreement used to establish franchised operations. Other major strategy change would seem neither necessary nor desirable when expanding into new markets, rather fine-tuning of tried and tested strategies is more appropriate.
7. One of the key challenges for the franchise organization is the maintenance of effective control over both the activities of franchisees and the related quality aspects of the total franchise format.

Conclusions

Support to small businesses operating within credible franchise systems is the key element that attracts the attention of those who learn about its advantages and compare the other business approaches and marketing strategies. Efficient self-regulation within the franchise industry, coupled with adequate public-private partnership in identifying shortcuts and safeguards for its proper functioning, will be critical for the future impact of franchising on the social and economic development. Learning from the environments where franchising has a relatively long history one may better exploit franchising as a method of economic revitalization and small enterprise development. Building upon cases of successful franchise systems that originate in the environments of developing and newly industrialized economies, we may further contribute to the growth of the know-how to be efficiently used in triggering the development process through small industry development.

Domestic franchise systems even in developed Europe, especially smaller ones, have substantial problems with expensive training of franchisees, where there is a lack of adequate management tradition. Leadership and management development capability would have to be strengthened before any franchising activity can be contemplated. The entry strategies of the international franchise systems may have to be improved if they are to become part of the franchise industry in a given country. There are cases of successful operations and failures of international franchising systems that the new international systems may study before entering markets different from those they have been used to. The experience of some Asian countries in providing legal and macroeconomic frameworks conducive to the development of franchise systems and their direct support activities in the development of individual franchise systems may be studied. The perspective of motivating and assisting established companies to help smaller enterprises with their technical and managerial know-how and involve them for the benefit of all parties is at the heart of franchising support and development initiatives. In conclusion, franchising, if managed properly, can play a strategic role for SME development in Central European countries.

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Understanding the cultural differences between the countries of the world

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Abstract

Today, globalization of businesses often requires interaction with people from different cultures. In order to exist in this competitive market place, countries must have access to other markets, natural resources, and capital. Cross-cultural differences must be understood in order to make this interaction effective.

Businesses decide to expand their operations mostly because of the following reasons: Their company is approaching its maturity level in the domestic market, their current overseas operations and their customers indicate that there is potential market out there, their product in the home country is unique and exceptional which motivates for introduction of that product overseas, and economies of scale in certain technologies and products.

Country profiles are generalized, and many subcultures within the societies may exist. This paper provides summary of generalized country data about the differences between their cultures, based on the research from recent journal articles and books. These profiles may be helpful for visitors of foreign nationalities in learning about the culture of the host country.

Introduction

Culture is usually defined to be the way of life for inhabitants of a certain territory and it embodies all kinds of behavior that they have learned and transferred through successive generations. This accumulated culture exists with people who have the same beliefs and values, institution, and technology.

There are two classifications of knowledge regarding culture which a marketing person should possess to cope with the problems of a different culture: (1) the actual knowledge about culture, that is usually obvious and must be known and learned, and (2), the interpretive knowledge, an ability to understand and to appreciate fully the nuances of different cultural traits and patterns *(Cateora, 1990)*. Through research and training, it is impossible to learn about a different culture. Living within the culture, eating, talking and praying with people from that specific culture will assist in understanding the cultural dynamics and elements pertaining to that culture in a more accurate and rapid manner.

Erla Zwingle writes in her article entitled ”A World Together”: “*That I should be sitting in a coffee shop in London drinking Italian espresso served by an Algerian waiter to the strains of the Beach Boys singing "I wish they all could be California girls...." Or hanging around a pub in New Delhi that serves Lebanese cuisine to the music of a Filipino band in rooms decorated with barrels of Irish stout, a stuffed hippo head, and a vintage poster announcing the Grand Ole Opry concert to be given at the high school in Douglas, Georgia. Some Japanese are fanatics for flamenco. Denmark imports rive rimes as much Italian pasta as it did ten years ago. The classic American blond Barbie doll now comes in some 30 national varieties--and this year emerged as Austrian and Moroccan (Zwingle, 2000).*”

When you're dealing with international colleagues, chances are your mind is focused on the language of business: fees, contracts, sales, agreements and so on. But in global business, it can be the little nuances and practices you don't focus on--like how close to stand to someone or when to smile--that can make or break a deal *(Allen, 2000)*. There is no way that we can escape from globalization. It has almost affected every aspect of our lives; from the food we eat to the cars we drive. The integration of globalization within our daily lives has occurred in such a natural manner that, most of the time we do not even realize pay attention to how it has affected our daily lives.

The same action might have a different meaning in two distinct cultures. Differing habits governing eye contact can provoke disastrous cross-cultural misunderstandings. Christmas may occasion a one-or two-day holiday in a U.S. factory, and a ten-to-fifteen day holiday in a factory in Mexico. Hello and Good-bye protocols can depend on cues that are difficult for an outsider to discern. Tasks that are totally appropriate for anyone in one country are seen as demeaning for certain strata (white collar workers for example) in another culture. Seemingly trivial cultural differences (for example, where to put the towel after you bathe) can carry severe repercussions. Differing rules of table etiquette or improper of social deference can be a real turn-off *(Seelye, pg.104)*

Lack of eye contact in American culture may indicate many things, most of which are negative. A physician may interpret a patient's refusal to make eye contact as a lack of interest, embarrassment, or even depression. However, a Chinese patient may be showing the physician respect *(Chin, pp: 74-81)*. If the patient is a Muslim female, and the physician is male, she may be trying to avoid sexual impropriety. If you know the meaning of the eye contact, the patient will not be misunderstood.

By time, cultures of the countries may run into some changes because of varying political factors. As in the case of USSR, the country has transformed itself from being a closed society to an open society. Being ruled by female presidents used to be no-no in Muslim countries whereas it is an accepted norm today (i.e. Turkey, Pakistan) Rather than focusing on the changes in the culture, this paper will attempt to give readers and idea about the basic cultural characteristics of some of the countries.

Thailand

Thailand is a different market. Once one understands the cultural differences and adjust their conduct accordingly, visitors will find it an easier and more enjoyable market to work in. The Thai way of dealing with most things has developed over centuries and has been shaped by the strong influence of Buddhism, the country’s independent history, and cultural values.

Status, seniority and personal connections govern social relationships in Thailand. Status is based on criteria like education, birth and family etc *(Pornpitakpan, pg.1)*. While in general, Thais are tolerant and easy-going people who are very hospitable towards strangers; they do, like other nationalities, place stress on certain social customs. It is necessary to be tolerant and patient in the process of mutual understanding. A Thai will make a big effort not to upset another person, and as a result will expect the same in return.

Values and Business Norms

Royal family and Buddhism are very sensitive subjects in Thailand. Make sure to respect them both. All Buddha images are holy and anything that has a picture or stamping of the king such as documents and money are to be respected. Speaking disrespectfully about the royal family is a criminal offence.

Thais consider touching people on the head as rude behavior (avoid: crossed legs, placing feet on a table or chair, or moving something with your feet). In fact, it is the best not to touch anyone, be it on the arm, shoulder, etc. *(Never, 1990)*. It is customary to take your shoes off before entering a home or temple.

When visiting a temple, the shoulders and legs should be covered (long sleeves). Do not wear shorts, sandals or a revealing dress.

Bargaining

Thais will not respond well to your statement “*best price*”. They need to bargain and feel that they are winning something in the process. The approaches of take *it or leave it* does not work here either. Everything is and has to be negotiable. Your business deal may be judged by your ability to bargain and reach a fair deal.

Appointments

If a Thai businessperson is late for an appointment, it could have been because of the traffic jam or simply because it was inconvenient at the time. This action should not be considered as a sign of disrespect or lack of commitment.

Red Tape

The direct business style accepted in the West is sometimes not considered polite. Politeness is very important in Thailand and is taught from an early age onwards. Aggressiveness, confrontations and arrogance are not tolerated. Life in Thailand will become difficult for those that cannot control their temper. ***Meetings***

Using a loud voice is considered rude. Thais will speak softly even at a business meeting. Thaïs do not care for displays of anger, irritation or even raised voices. To be able to relate to your business contacts is more important than doing business. A positive attitude, perceptive abilities, flexibility, sense of humor, a genuine win-win attitude and patience will go a long way in developing business contacts.

Greetings

Thais often will smile instead off saying good morning, thank you or "sorry". Keep this in mind and respond with a smile.

Business cards

Business cards are liberally used in Thailand. It is proper business etiquette to always present your business card. Bring many and preferably with a Thai language version printed on the reverse side of the card, if you are serious about this market.

Language

Thai executives often speak English. Thai is not easy to master but it is highly recommended that you learn at least a few basic expressions. This will be much appreciated by Thais. It is necessary to speak slowly and clearly. The Thais are very polite and they will not admit that they do not understand what has been said.

Gifts

Giving gifts will help create good first impression. The exchange of gifts is widely practiced in Thai's business. A bottle of imported liquor (especially scotch) is a good gift for an executive *(Conaway, Douress, Morrison: pg. 416)*. Prepare gifts for those that you will visit for the first time. Gifts are opened in privacy, not when received.

Brazil

In Brazil, local customs and standards of behavior influence business relationships more directly than in the United States. Business deals are usually done through personal connections; therefore it is rare for important business deals to be concluded by telephone or letter. It is important to make an appointment before visiting a Brazilian executive. They usually prefer continuous relationships with their suppliers. Brazilian businessmen do not favor one-time good deals.

Business Relations

Due to their polite nature and harmony, Brazilians will not ask for clarification if unsure of a matter. Often they will respond with what they believe you want to hear. Brazilians are not very straightforward. ‘Yes’ can simply mean, ‘Yes, I hear you’. It does not necessarily mean ‘Yes, I agree.’

It is important to keep in mind that personal connections do play a special role in Brazil. Connections with the public sector are also essential in some businesses, but they change constantly. Secretaries play a very important role in Brazil. Try to have a good relationship with them. Never mistreat subordinates; as eventually their assistance may be required

Language

Although many Brazilians speak English, some are modest about their ability and may feel more comfortable in business meetings if an interpreter is present.

Appointments

Have your appointments set up in advance; do not just show up at a company expecting special treatment because you are a foreigner in town. Reconfirm all appointments. Inform where you can be contacted if plans are to change. If your business runs into lunch, be prepared to spend at least two hours.

Brazilian businessmen understand when visitors are late and seldom expect meetings to start on time. Delays are usually due to traffic, and given regional characteristics, may vary from region to region.

Language

Be sure all of your documentation, including business cards, is printed in both Portuguese and English. Do not use Spanish instead of Portuguese; yet, always give preference to English. The same rule applies for initial written correspondence with potential business partners, which should be written in either Portuguese or English.

Greetings and Addressing People

Always conduct your affairs on a warm and friendly basis. Shaking hands when arriving and leaving is normal and accepted. Remember to shake hands with everyone present. Women often kiss each other on alternating cheeks: twice if they are married, three times if single.

While Brazil is one of the most informal countries, people mostly address each other by last names. Most People will be addressed as Senhor (Mr.) or Senhora (Mrs.) plus their last names.

Dress

A conservative dark suit should be worn for all business meetings. Medium weight clothing is suitable year-round for Sao Paulo and the south. In Rio de Janeiro, lightweight clothing is suitable during the months of November-April.

Negotiating

Brazilians are good negotiators. Be prepared to negotiate price and never offer the price first. Sometimes Brazilians find U.S. aggressive business attitudes offensive; do not expect to get right to the point. Avoid confrontations and hide any frustrations. If you change your negotiating team, you may undermine the entire contract. Brazilians value the person they do business with more than the firm name.

Germany

Generally speaking, the German businessmen and women you will deal with are experienced in conducting international business and receptive to well planned approaches, which demonstrate a potential commercial benefit to their companies. It is essential to make research before visiting the market for the first time. Germans tend to be more formal and reserved than Americans and it is necessary to take this into account in order to get the most out of your dealings with them. Germans do not like unexpected sudden changes, even though they might improve the outcome. *(Morrison, pg.149).*

Addressing People

It is customary to use last names in business circles, and it is not acceptable for visiting business people to address their German negotiating partners with their first names. You should wait until invited to do so.

Dress

Business dress tends to be conservative at management level, less so when dealing with technical/engineering staff. Suit and tie are generally required. Most businessmen wear dark suits, and white shirts. Women dress equally conservatively, in dark suits and white blouses.

Business cards

The level of business card use in Germany is similar to America, where cards are normally exchanged at the beginning of a meeting. It is not necessary to have cards translated into German.

Language

While English is widely spoken in business and government circles this should not be taken for granted. Check first to establish whether English will be acceptable. Be prepared to arrange an interpreter for initial meetings, even for making initial telephone contacts.

Introductions

In the business environment, Germans shake hands at both the beginning of conversations and at the end. Handshaking may be accompanied by a very slight bow. It is better to be introduced by a third person than to introduce yourself. It is acceptable to introduce yourself if no one is available. It is very important to use professional titles as Germans rarely address each other by first names. Germans will get quite close to each other before offering a greeting.

Appointments

Punctuality is very important in Germany. Be on time for every appointment. Arriving just two or three minutes late can be insulting to a German executive. Appointments should be made well in advance. Give at least one or two weeks' notice for an appointment made by phone. A short preliminary meeting may sometimes be arranged on a few days' notice. Do not schedule appointments on Friday afternoons; some offices close by 2 or 3 p.m. on Fridays. Many people take long vacations during July, August, and December, so check first to see if your counterpart will be available.

Gifts

German businessmen do not give or expect to receive expensive gifts. When invited to dinner at a German home, always bring flowers for your hostess.

South Africa

There are many cultural similarities between United States and South Africa, which in turn leads to a similar business culture. South Africa is divided into nine provinces, with the main commercial sectors centered in Johannesburg, Cape Town, Durban and Port Elizabeth. When traveling to other major towns in some of the provinces you will find a very informal business environment in comparison to the major commercial areas.

Business cards

It is less common a practice for business cards to be exchanged at the start of a meeting than in United States. Many South Africans will not offer their business cards, or will do so at the end of a meeting. Such an action can be interpreted as a sign that they are encouraging further discussions. You will also find many that do not have business cards.

Smoking

Cigarette smoking is also very common amongst South Africans, and allowed in nearly all buildings and government departments. Business contacts will smoke throughout meetings and it is not considered impolite.

Language

South Africa has eleven official languages and English is the predominant language for business. However Afrikaans is also widely used especially in government departments but this is gradually changing. Outside of the main commercial centers you may find people struggling to express themselves in English.

Security

In visiting companies and government offices a strong security presence will be encountered. All visitors must sign in and out to gain access to buildings and pass through a metal detector. Time should be allowed for these security procedures. It is not advisable and often not possible to hail taxis and transport arrangements should preferably be organized in advance.

Introductions

With most South Africans, a handshake is the most common form of greeting. Although, most South African business people are comfortable dealing on a first name basis, some older people prefer a more formal type of address (Mr., Mrs. etc). Most people should be addressed with a title and their last name, (i.e. President, Engineer, Doctor, etc.), or in lieu of a title, use Mr. or Mrs./Miss. Business meetings tend to be relaxed and informal with South Africans.

Appointments

It can be difficult to secure appointments in South Africa and contacts may take some time to respond to requests. Personal assistants to executives are often very protective of their superiors' time. Due to hot temperatures, the South African morning is the most comfortable part of the day, and appointments often begin by 9 a.m.

Negotiating

High pressure and emotion have little place in dealings with white South Africans. Most would rather let a deal fall through.

India

Business relationships in India are based on personal relationships. Establishing contacts with decision makers will help ease your business activities. Middle managers are key contacts. Although they do not make the final decision, they can bring one's proposal to the attention of their bosses *(Morrison, pg. 175)*.
Avoid getting into lengthy debates on the Indian political system with potential Indian business partners. In particular avoid discussions and criticisms about India's nuclear tests.

Kellogg's introduced Corn Flakes to the Indian market in September 1994 with a $65 million investment. The company's marketing research indicated that 250 million Indians would consume cereal. However, the most popular breakfast in India is usually a bowl of hot vegetables and rice cakes. Kellogg's cold cereals become nothing more than a one-time novelty purchase in the Indian market *(Ramachandran, 2000)*.

Joint Venturing with a native partner has often been recommended for assistance in precisely such delicate situations, when diplomacy and public relations savvy are called for *(Limaye, 1998)*.

Negotiations

Visitors should also be aware of the differing styles of business negotiations existing in different regions of the country. In the North, the style may be more forthright and aggressive, in the South and east lower key and differential. In the West styles would be more akin to those prevailing in Europe.

Appointments

Hosts are usually late for their appointments. When setting the appointment time, it is common to hear that they schedule your meeting between 7 and 8. Showing up may happen during the second half of the scheduled time.

Religion

In India, religion plays an significant role in culture. While Hinduism dominates, there is a sizeable segment of the population committed to other faiths - Islam, Christianity, Sikhism, Buddhism and others. Relationships amongst

Indians are often based on considerations of religion, caste and community. Foreigners are well advised not to discuss or oppose religious beliefs.

McDonald's provides a good example of adapting to the diverse Indian marketplace. Though famous for its beef patty entries, it has introduced vegetable burgers to the large Hindu population *(Ramachandran, 2000)*

Gifts

Restrict gifts to souvenirs and standard business give-away. An elaborate or expensive present may embarrass your hosts since they will be obliged to return an equal value gift.

Language

Most businessmen in India are acceptably fluent in English, however it must be recognized that for most Indians English is a second, or even third, language. Consequently it is not unusual for Indians to break into Hindi or a regional language during a discussion with a foreigner. *(Valentine, 1991)*.

Forms of Address

In business circles Indians tend to be much more formal than Americans, even though the trend is changing with the increasing presence of foreign companies. In a business meeting "Mr. Brown" is a safer form of address than "David." "Sir" and "Madam" will also be acceptable forms of address. Visitors should not be surprised if Indians often address a person by the first name prefixed by "Mr." or "Mrs" - (for example "Mr. David" or "Mrs. Shirley").

Business Cards

Business card is essential when visiting India. Also, Indians tend to be eager to exchange cards even at social gatherings.

Japan

Americans conducting business in Japan will enhance their visit by taking some time to understand Japanese business etiquette before they leave America. Japan is a country which combines sophisticated and high-tech business skills with centuries' old traditions. The Japanese for example, define business ethics in terms of loyalty to their companies, their business networks, and their nation. Americans place a higher value on liberty than on loyalty; the U.S. tradition of rights emphasizes equality, fairness and individual freedom *(Donaldson, pg: 49)*.

Familiarity of these practices will assist an American businessperson in adjusting to a different business environment The Japanese, unlike Americans, do not speak their minds or express themselves frequently, especially in front of their managers. Generally they do not show their feelings through facial expressions and body language.

Appointments

Punctuality is a must in Japan. It is usual to arrive at a meeting at least 10 minutes before the appointed time. In the event that you are running late, it is polite to call ahead. All appointments should be arranged with companies prior to arrival in Japan.

Greetings

Business travelers may find it useful to learn a few basic Japanese greetings. When visiting a Japanese company for the first time, it is necessary to bring a company profile and product brochures with you. Business meetings invariably begin with the exchange of business cards. Business cards should be printed in English on one side and in Japanese on the other.

Business Cards

Business cards should be offered to the person you are meeting with the Japanese-side up and facing towards them. The name of the person as well as the company should be pronounced with a smile and a slight bow as the card is handed over. When receiving a card, it is most polite to receive it with both hands and then take time to examine it.

Meetings

A structured seating arrangement is used in formal business meetings. The most important guest sits furthest from the door and the host sits closest to the door. If in doubt, wait before being seated or ask for an appropriate seat. It is customary for green tea or coffee to be served at the start of the meeting. Wait until all meeting participants are served before drinking the tea or coffee.

Take notes during meetings. Follow-up will be expected within a reasonably short period of time. Failure to follow-up will mean you lose credibility, which may be difficult to recover at a later point of time. Do not expect immediate reaction to your proposals. If you are the one who requested the meeting, you should send a thank you letter to those you meet as a matter of courtesy. Expect to be asked personal questions by Japanese.

Gifts

Although not expected, some good quality American souvenirs will be appreciated by the Japanese.

Forms of Address

First names should be avoided in a business setting. "San" is the equivalent of Mr or Ms in Japanese and should be used directly after a surname when addressing or referring to a Japanese person (for example, Ishikawa-san).

Iran

As Iran is an Islamic Republic, local customs and standards of behavior differ from America. These Islamic standards are to be respected and obeyed to not only to ensure acceptability in a different environment but also because these are a legal requirement in Iran. Non-observance can result in criminal charges being laid. Following are the key points to Iranian culture:

- Alcohol is prohibited.
- Shorts and short sleeves are generally not allowed
- Ties are not to be worn by Iranian men.
- Shaking hands with women is forbidden
- Women must wear a scarf and overcoat at all times in public
- Ramadan is strictly observed by the Government
- Thursday and Friday are the Iranian weekend, Friday being the main prayer day
- Security will keep a close eye on foreign visitors

Customs

Tea, fruit and/or cakes are served at any meeting.

Gifts

Exchange of gifts is a tradition amongst businessmen

Business Norms

Iranians are very formal and it will take several meetings before a more personal relationship can be established. This is particularly true for government officials.

Greetings

Shaking hands with male counterparts and exchange of business cards is the usual form of introduction

Dress

Business dinners with westernized Iranians will usually mean wearing a jacket and tie, known among expatriates as Iranian casual.

Negotiations

Negotiations will be long detailed and protracted. Many approaches by state companies and organizations are for information with which to use in negotiations with a preferred supplier.

Turkey

Turkey is a multicultural country. Considering its history, Turkey has hosted cultures from all over the world. All nationalities are treated equal, and they get respect. Age is respected in Turkey. Defer to elders in all circumstances. Elders are served first, introduced first, and allowed to go though doors first. Since most businesses are family owned, the decision maker is usually the elder. Politeness is very important in Turkey. To disagree with someone in public is usually not considered good, so Turkish people rarely say no (except when bargaining). Make sure to take your shoes off before entering the host house. Do not use your left hand when eating or handing in something. Left hand is traditionally accepted to be used for personal hygiene.

Appointments

Foreigners are expected to be on time to appointments. However promptness is not a virtue in Turkey.

Greetings and Addressing People

Greetings usually start with handshake and some conversation about the health and the family of the people involved. It is customary to kiss the hand of the elderly by bowing and bringing it up to touch one’s forehead. Doing so is a sign of respect to the other person the elderly or higher-ranking people. When leaving, one should say bye to each individual in the group.

Gestures

Unlike United States, when Turkish people want to say no, they nod their head upward.

Meetings

All meetings begin with an informal talk about how visitor's trip was, how they like the county etc. Sports and family are usually the common topics of conversation. The pace of everything in Turkey is much slower than in the United States. This goes for everything from meetings to decision making. Pressuring Turks to speed up will probably be counterproductive. The only thing that moves fast in the country is the traffic *(Morrison, pg. 425).* A visitor cannot expect to conduct business on a Turkish holiday. Holidays usually begin around the noon one day in advance.

Gifts

Gift giving is very common in Turkey. People give gifts (all levels of gifts are considered valuable) to each other without any occasion. If you are invited to someone's house make sure to buy some gift items. It is traditional to take desert (usually baklava -traditional Turkish dessert-), fruits, or nuts. If you take some food on the plate, your plate will be returned to you clean and full of something different in return.

Religion

99% of Turkey is Muslim. Although almost half of the population really does not practice the Islamic teachings, however, everyone is respectful and sensitive about religion. Avoid eating or drinking in public during the month of Ramadan when all Muslims are fasting. Cover your shoulders and take off your shoes before entering a mosque. Do not criticize the religion.

Russia

Try to abandon your distrust of the Soviets, who see themselves as totally honest and trustworthy *(Copeland, pg.255).* Always allow plenty of time to get your visas, make appointments and conduct any business. Presentations are strictly factual and full of technical detail. Patience is a traditional virtue among Russians; functionality is not. Only theaters are on schedule. Visitors should expect business meetings to start one or even two hours late.

Negotiations

Visitors must be aware that "final prices" are never final during initial negotiations. The offer will usually be more attractive if you can hold out.

Gifts

Very little gets done in Russia without proper connections. These include exchange of favors. If you do a favor for someone, they owe you a favor. Gifts, monetary or otherwise, are often part of this exchange.

Addressing People

Unless you are invited to do so, do not use first names. If a Russian has a professional title, use that title followed by the last name. If the person you are dealing does not have a title, use Mr., Miss, Mrs. or Ms. Plus the last name. Despite the length of Russian names, there are relatively few variations of first names and last names in Russia. In fact, some names are so common that additional information is needed to identify a person.

Tips for Succeeding with Russia:

- Be conscious of the emphasis the Soviets place on dealing with the high-ranking executives.
- Soviets will enter all negotiations well prepared in research so it is advisable to be accompanied by at least one member of your technical personnel.
- Continuity is an important factor; so one person should be identified as the project manager throughout all negotiations.
- Be prepared to devote a lot of senior executive time, because of the broad segment of bureaucracy involved.
- Take advantage of the many cultural opportunities and historical sites, than praise your hosts when you enjoy such experiences.

(Harris & Moran, pg.464)

Mexico

Personal relationships are essential to business. A visitor must be prepared to make frequent. Much of the business is done through unofficial channels and one's connections. The family is the most important institution in Mexico. Mexican executives generally put a higher performance on the best interest of their families than on the company they work for. Firing a high level executive can be difficult since he may have several friends and relatives working for the company.

Greetings

Subordinates in Mexico do not make extended eye contact with their bosses. Instead they display respect by looking at the ground. Eye contact is yielded to the person talking, while the listener mainly looks away. Avoid intense, constant eye contact, which is interpreted as aggression. The handshake is the traditional greeting among men. Women have the option of shaking hands with men; men usually wait to see if a woman extends her hand. A man may include a slight bow while shaking hands with women. Women often kiss each other on the cheek

Negotiations

Much of Mexican negotiations will center on personal aspects of the business relationship: trust and compatibility *(Copeland, pg. 243)*. Confirm your agreements in writing. Deliberations will be cautious, and presentations must overcome initial suspicion. Graphs, charts, computer printouts, samples and models are appreciated.

Saudi Arabia

Religion and family is extremely important. In business, Saudis are tough, and cautious. Islamic law is the basis of all commercial and social law. For example: Do not eat or smoke in public during the month of Ramadan; alcohol is against the law. Women's dress must not expose arms, legs, or shape. Avoid discussions about women, politics or religion.

Foreigners usually have difficulty in adapting to Saudi customs and traditions. Learn the rules before you go to Saudi Arabia, follow them the best you can. Remember that foreigners are fully subject to Saudi Law. Work with a Saudi agent. Once the contact is established, the Saudi may prefer to work directly with you, avoiding middlemen *(Copeland and Griggs, pg: 247)*. Begin each meeting with social conversation and tolerate frequent diversions and waiting.

Addressing People

Use the Titles Mr., Excellency (for ministers) or your Highness (for members of the royal family) with the first name until you are accepted as a friend or business colleague. Saudis have conversations with a close distance. Foreigners visiting Saudi Arabia have sometimes claimed that a Saudi doesn't feel close enough until they can feel your breath on their face *(Morrison, pg. 327)*. Saudis feel uncomfortable being far away from others. Eye contact is intense and constant.

Appointments

As a visitor, you are expected to be on time to all business appointments. However Saudis are not sensitive about time. They may be one or two hours late to their appointment.

Privacy

Saudis usually keep their private life out of the conversation to foreigners. For example, a Saudi man might never mention his wife. On the other hand, many things that are usually kept private in Western society might well be publicly discussed in Saudi society.

It is customary to take off shoes when entering a Saudi house. When visitors are invited to the house, everyone is expected to greet same sex members individually.

Conclusion

The biggest barrier in doing international business is cultural differences. One important issue when dealing with a culture is not to judge cultural values as right or wrong. In fact, based on whom you are dealing with, you must be aware and educated about the cultural norms that person is accustomed to. There are generally no excuses for mistakes. Each culture has rules for behavior and a life style that its members take for granted. Innovation is needed by the firms to respond appropriately to the multiple cultural environments in which they find themselves.

Globalization requires that everyone doing business should have some degree of knowledge about the culture they are doing business with. Understanding the culture of a specific country improves the ability to manage employees, market products, and conduct business transactions in the foreign country. Since local tastes differ in every country, mastering the cultures of that area will enable the corporations to modify their products according to customer tastes, which will eventually help the success of that business in the competition.

Whether you are doing business in your home market or overseas, much of the success depends on how well you understand and work with critical "human" factors. No matter how technically competent you may be, your ability to communicate and build business and personal relationships across national and cultural boundaries will determine your industrial effectiveness and ultimate success of your enterprise *(Koslow & Scarlet, pg.29)*.

Global Managers should make a detailed research about the culture of the country they are planning to visit. Paying attention to the details of the host culture, or avoiding actions that might be conceived as offensive in the host culture may result in successful business deals. Cultural familiarity comes with experience. The more a manager is exposed to the world cultures and the more he/she travels, the better understandings that person will have about the issues of that particular culture.

As globalization attracts more and more companies into the international business arena, thinking global while acting local will help managers in succeeding and reaching their goals. Being familiar with the countries' cultures and beliefs will turn managers into more effective marketers, negotiators, and production managers. Here are some finals comments about common Do's and Don'ts across cultures:

Dos and Don'ts across cultures

- *Read about the culture of the country before you travel from travel guides, consulate brochures, and magazines.*
- *Prepare gifts for the people you are going to meet before you travel. Make sure your gifts are not offensive by the host culture.*
- *Try to learn some words on the host country's language. Especially greeting words are helpful.*
- *Dress according to the culture. Choose your color of dresses accordingly. When dressing make sure your either dress style or color is not offensive by the local customs.*
- *Talk about the country you are visiting. Avoid talking too much about your home country. And avoid comparison especially if they are negative.*
- *Talk to the people who traveled to the same country before. Learn about their experiences, and sensitive points of the host culture.*
- *Be on time on your appointments. No matter where you travel and how sensitive are your hosts about punctuality, it is always good to be on time.*
- *Check the holiday calendar of the country before you make travel arrangements. This is true for your account receivables, making appointments, promotion and marketing of your products. For the countries, using lunar calendars, holiday dates shift every year.*
- *Some countries are very sensitive about their religion. Make sure you learn the basics of the religion. For example, if you go to a Muslim country in the month of Ramadan, don't eat and drink in public.*
- *Prepare two-sided business cards. One side should in be in your home language, while the other side should be in host country language.*

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Section 8

Accounting & Legal Issue

Accounting and Auditing in the Former Soviet Union: Progress on Reform

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As elsewhere in the underdeveloped economies of our world, "vested interests, patronage and corruption"[i] cling to outdated habits to keep a few relatively wealthy at the expense of a powerless majority. The appalling complications for those struggling to reform so many corrupted elements in these societies can be measured simply by identifying the number of donor projects based in the capital and principal cities of these corrupt countries. In the case of the countries of the Former Soviet Union (FSU) the list of donors and donor projects is too long for media news clips, too intricate a pattern for any comprehensive publication. One single (and incomplete) country alphabetical list (Table 1) provides evidence of the complexity of the reform issue and the magnitude of generous assistance provided.

Table 1 – TYPICAL FSU COUNTRY'S CURRENT WESTERN DONOR AID PROGRAMS

	More Than one Donor Agency
Accounting Reform	Yes
Auditing Implementation	Yes
Banking Sector Reform	Yes
Curriculum Reform (various)	Yes
Democracy Reform	Yes
Energy Resources Management	1
Environmental programs	1
Forestry Management	1
Fulbright and other education programs	Yes
Journalism Programs	1
Capital Market Development	Yes
Capital Market Legislation Reform	Yes
Commercial Development (various)	Yes
Legal reform projects (various)	Yes
Local Government Reform	Yes
Youth Leadership Projects	1
Small and Medium Enterprise (SME) Reform	1
Peace Corps and other voluntary programs	Yes

*[**Note**: List is incomplete, no comprehensive published list of donors is available.]*

The great surprise in accounting and auditing reform is how long it has taken donor governments to recognize the critical nature of technical infrastructure (i.e. appropriate legal frameworks) to provide a base on which to build economic, especially macroeconomic, reform. Indeed it seems as if the curriculum of the "western" expert macroeconomist itself needs reform with the addition of many new courses on the history of legal and administrative development, which necessarily predated western sustained economic development. As Rome was not built in a day, so accounting and auditing reform has never been accomplished in the short contract periods international donor agencies prefer to work with.

In this respect, the extraordinarily uncontrolled lending by donor governments[ii] may be seen to have reinforced rather than discouraged cronyism and corruption. Evidence for this assertion may[iii] be seen in the banking sector. Prior to *perestroika* in the late 1980's the financial control of commercial enterprises in the Soviet republics of the Former Soviet Union (FSU) was centralized. As countries of the FSU gained their independence and the Soviet Union ended, the Soviet centralized system of financial control was replaced by national systems of financial control.

The newly independent state provided opportunities for vested, crony and insider interests to capture control positions in the emerging government and to exercise their control in their own rather than national interests. In the banking sector this undermined the integrity of the banking system. Government paper replaced citizen deposits. The government paper quickly proved worthless. Thus vested interests appropriated not just a nation's savings, but any confidence in the financial system. The typical FSU[iv] was confirmed, by the early 1990's, as a cash economy with a rapidly growing underground economy, which remains difficult to identify and practically impossible to control[v]. What remained of the banking systems was then the subject of varying degrees of western influence. Unfortunately the western influence began and for some time continued at the macroeconomic level. Funds were lent without the usual western bankers' insistence on adequate collateral or financial controls of the funds lent. No surprise then, except to macroeconomic bankers, that millions of dollars of donor funds disappeared[vi]. The full embarrassing details of these transitions offer extraordinary future research opportunity[vii]. Indeed, a decade of tranche losses in the transition is still not yet fully understood nor properly investigated. Controls in the banking and commercial sector remain inadequate as the implementation of legislation enacting international accounting and auditing standards has only recently got underway[viii]. Indeed "little has been written on either the role of accounting in the transition from central planning to markets, or on the process of accounting change during this transition phase."[ix]

Literature framework for analysis

English-language academic journals on accounting and business provide "very little material"[x] about developments in the FSU and Eastern Europe. The Ehiel Ash and Robert Strittmatter text on Accounting in the Soviet Union together with translations of the texts of the directives of the Central Committee of the Communist Party establish the soviet accounting principles prior to *Perestroika.* National Accounting legislation set national accounting standards thereafter providing rules and regulations, which are not yet in effect or have yet to be strictly enforced. Major political change, western donors (particularly during the process of negotiation for accession into the World Trade Organization and the European Union[xi], and western investors have influenced the process. Most of the developing analytical literature is proprietary, the private reports of donor subcontractors and private entities[xii]. In due course this literature will provide excellent opportunity for further research.

Purpose of this paper

This purpose of this paper is to write about the role of accounting in the FSU and Eastern Europe after *Perestroika.* The process of enacting legislation establishing international accounting and auditing standards is taking place. However the transition from central planning to markets is a learning process and the implementation of national standards piecemeal[xiii]. Analysis of the learning curves offers the future possibility of expediting the process. At present quantitative analysis is limited because, as noted, the available data is proprietary and confidential in the hands of subcontractors of international donor agencies. Ours is therefore a qualitative analysis.

We provide a frame of reference for assessment of FSU country progress in accounting and auditing reform. We hope news of the volume of accounting and auditing activity will begin the process of gaining access to the wealth of proprietary country data generated[xiv]. Our research is the product of more than five years author experience in seven FSU countries working on accounting and auditing reform. Our paper outlines the five most significant potential barriers to accounting change from the Soviet accepted self-support accounting principles to international accounting standards and generally accepted accounting principles. We identify the barriers we encountered and we note the considerable progress being made on accounting and auditing reform.

The legal framework

Under the Soviet Union the framework for commercial and financial law was centralized in Moscow via the General Secretariat of the Communist Party. There were no provisions for the basic elements of normal western commercial activity. Legislation for the maintenance and integrity of capital markets, for example, was limited to government funding and was inflexible. There was no uniform commercial code to provide contract law detail or precedents, no uniform commercial code to provide a detailed process for the sale of goods and services. The concepts of accountability and disclosure were limited to formal activity between enterprise and state with no consideration for disclosure to the public or compliance with international standards of commercial enterprise. Accounting, for example, generally limited to bookkeeping, was a subject within the Economics Faculty at university. Auditing, for example, was not included as a subject even within the bookkeeping curriculum. Insiders reported to the centralized system and no concept of public disclosure of accounts existed.

Thus while detailed financial analysis might be prepared[xv] they appear to remain in many cases extra books.

The insiders who inherited business post independence commerce in FSU enterprises, and whose businesses survived the savage recession in the Soviet Union took control of enterprise. Naturally averse to further sudden change in their commercial fortunes, they sought and continue to seek to prevent the legislation necessary to fully implement western style economic development. Insiders, vested interests, are in position to finance legislators and therefore to delay, discourage, and even prevent the implementation of legislation[xvi].

Two examples demonstrate the power of vested interests. First a careful examination of the implementation of Value Added Tax (VAT) in the typical FSU economy shows cynical adoption of legislation, against which barriers[xvii] are maintained. The principal evidence is provided by continuing World Bank demands that the collection of tax be improved. These demands are satisfied by small incremental changes that are rarely effective[xviii]. Surely those who accepted the VAT legislation to gain donor funds are no less aware than the World Bank and IMF lenders that in a cash economy the full collection of VAT are unlikely. We who have lived in these countries know very well that anytime a receipt is essential the price of goods and services changes or business is simply refused. This evasion of VAT is already a matter of culture, and no wonder at the excessive rates VAT legislation introduced[xix].

A more specific example of barriers to the implementation of a western style legal framework for commerce may be found in Georgia (Transcaucasus). Here, under donor pressure, the Georgian parliament adopted International Accounting Standards (IAS) in full. Conversion to IAS meant a different calculation of profit for accounting purposes. Under IAS significant additional profit are reported. The new profits resulted in such confusion for the tax authorities (who were not familiar with IAS) that they made the enterprise redo their entire accounting. This was in order to be in compliance with tax legislation since, in their tax authority view; this was the only reason to perform accounting in the first place![xx] A Tax Reconciliation was proposed so that the new profit could be reconciled to the old profit for assessment by the tax authorities. The insiders managed successfully to oppose any such agreement. In effect the implementation of IAS was dead on arrival, except, of course that the IAS legislation, albeit ineffective, earned donor reward. Subsequently, after significant training being given to the tax authorities, reconciliation is in process.

Further examples of typical FSU legal frameworks quite unsuited to western style commercial enterprise include the absence of reliable law for property ownership and maintenance[xxi], for debt collection, for insurance, for energy supply, and security of employment. One solution is to press for formal legislation, but as in Georgia, this process is seen by many to be risky. The legislative process, in the hands of insiders, is difficult to control. Unintended results have occurred during the political process and this has led to uninformed legislation, which then prevents rather than enables the desired introduction of IAS and proves difficult to correct.

Accounting Direction

Changes in the practices of accounting and auditing require leadership, including legislation appropriate to a civil code society, to effect change. Some administrative action is needed. The typical FSU region, with its history of centralized direction, prefers to follow a European approach to accounting direction. This usually requires specification of charts of accounts for entity use. Pressure has been exerted to get FSU countries to adopt IAS as the European Union has endorsed and may adopt IAS in the near future. A major hurdle, as noted in the example above, is to generate a book to tax reconciliation so that entities can adopt IAS-based accounting without the prospect of additional tax penalty.[xxii]

The adoption of IAS is not without significant consequences. First a cadre of accountants trained in IAS has to be generated. This process is at least a five-year post High School process in the west and thus effective introduction of IAS is impossible without costly and extensive training programs. US AID in particular has taken the lead in this process. They have committed to a long-term program to train youth, faculty, and professional trainers in international accounting programs. These programs have made remarkable progress. Often taught in English, these programs have identified hundreds of very talented students. In a very short time there will exist the real foundation for the future development of IAS accounting in FSU countries[xxiii]. The European Union TACIS[xxiv] and other donors have also financed programs to promote and implement IAS accounting.

Already the products of this investment in IAS are enabling related developmental programs including capital market, small and medium enterprise, and related commercial development to start up. Again barriers are set in place by vested interests fearing loss of already contracted markets.

Implementation of IAS accounting reform has also meant significant long-term investment in undergraduate and graduate programs at FSU universities. New accounting standards have required a new accounting curriculum[xxv]. Significant effort is in process to gain the confidence of an aging and poorly paid faculty[xxvi]. Changes in the examination process[xxvii] and thus faculty emoluments have also contributed to delay or to defer implementation of IAS-based curricula. However an excellent IAS-based program provided by the Association of Chartered Certified Accountants (ACCA)[xxviii] offers both a university curriculum and a distance-learning curriculum with carefully monitored written exams leading to an international qualification already recognized in Europe and 62 countries. The availability of the ACCA program is leading to relationships between the ACCA and academicians and promoting a more controllable group for future legislation.

Closely linked to the implementation of IAS standards is the licensing of individuals and firms to engage in the audit function. Licensing needs to be based on clearly defined, preferably international audit, standards together with appropriate requirements for education and experience. The legal framework regulating the issue of certification of auditors provides another difficult area particularly because of FSU countries typical lack of experience in this area. The concept of public disclosure of financial data is an anathema to many insiders; the concept of engaging a truly independent auditor is equally unattractive in present circumstances (for obvious reasons given the constraints on business conduct for those who want to survive).

Self-Regulating Professional Organizations

A critical role in the sustainability of accounting and auditing reform is widely agreed by donors to be the self-regulating professional body (SRPO). Working with established accounting and auditing professional organizations whenever possible, a great deal of progress has been made in establishing SRPOs. Financial sustainability for

SRPOs will depend on membership and the provision of technical and financial training courses for students and members[xxix]. Initially SRPOs have been fostered with the provision of major resources, the furniture of offices and the provision of computers and necessary photocopying and printing facilities. In addition training of trainer (TOT) programs and aid in the preparation and revision for the international ACCA exams has provided and sponsored expatriate teaching expertise.

Typical 3-year donor project life cycles have proved far too brief to achieve technical and financial sustainability. This problem is being overcome by adding projects to promote and enforce ethics standards and other projects related to the performance of leadership in promoting legislative and political change. SRPO sustainability may be achievable in the future when training costs and membership fees rise to western levels. In the meantime donors seeing SRPOs as a critical element in the establishment of accounting and auditing reform are working to help sustain them.

Stimulating Demand

Accounting and auditing reform activity in the typical FSU state undertaken to date, includes legislative reform, accounting and auditing education, establishing SRPOs and an important focus on the infrastructure accounting reform requires. Much attention has been paid to the supply of accountants and auditors and this has provided new opportunities to stimulate demand.

Demand for IAS accounting reform may come from tax authorities and external observers like banks. Just as important is the need to stimulate internal management demand by demonstrating the utility of financial statements not only in raising capital, but also in the management of enterprise.

To this end a donor projects are turning to small and medium enterprise development as a means of introducing the advantages of IAS accounting to management. This means going to the next stage and providing not just financial accounting but managerial accounting. Once management starts to receive high quality cost accounting information they will be able to make decisions based on accurate information. This is likely to create an important stimulus for accounting and audit reform in the future. However the process will be time consuming and take time to provide results.

Management advisory services and the maintenance of management information systems therefore appear to be the logical “next generation” series of projects. Careful selection of potential beneficiaries will be needed. It is likely that these projects will seek medium size enterprises that provide opportunity to link accounting and audit reform more directly with bank lending, the raising of capital, and developing profitability.

Regional Groupings and Social Progress

Two significant regional initiatives have been sponsored by the Organization of Economic and Commercial Development (OECD) and USAID. The Eurasia Federation[xxx] includes accounting and auditing SROP members from Russia and the FSU states. A South East European Partnership for accounting development (SEEPAD) also provides a useful grouping for the greater Balkans area.

The International Federation of Accountants (IFAC), and other international bodies have granted recognition to these bodies and frequently participate in their meetings. Other critical support comes from the major firms of international accountants, particularly their employment of students and graduates who are taking part in the FSU programs.

Concern has been expressed that the SRPOs are open to insider influence. This is a risk. However the growing positive influence generated by the growth and recognition of the profession may help dispel insider doubts about the changing accounting and auditing scene. The regional associations also provide positive support as they offer linkage with international accounting organizations. A web site is underway to share cross border experience and the 6th Council meeting in Yerevan[xxxi] confirmed real progress is being made.

Conclusion

Regrettably typical FSU donor nations initially failed to understand the need for microeconomic infrastructure when the typical FSU first presented opportunities for development. In the last 7 years a much more realistic approach has been realized by donor agencies, particularly USAID.

During this period remarkable progress has been made. Progress has been neither smooth nor easy. The best news is the developing cadre of students who are qualifying as international accountants. These talented young people are the future foundation for western style economic development in the FSU. Retaining their talents in FSU countries must be a matter of priority. Quantitative data on the retention of qualified accountants by typical FSU countries is an important area for further research.

Accounting and auditing programs do need to be carefully sustained and monitored over at least the next decade. Such maintenance and monitoring will test the willingness of donor governments to commit to long-term support. As mentioned, the typical donor project lasts for just three years. Consideration needs to be given to longer-term investment in the typical FSU if already tangible progress is to achieve its real purpose, the provision of sustainable accounting and auditing infrastructure to support long-term economic development

We hope this paper provides a summary of actual and potential progress in accounting and auditing reform being made in the FSU. This paper shares knowledge and information on the critical issue of accounting and auditing reform and the sustainability of accounting and auditing reform in the emerging economies of potential future members of the European Union. This process is critical to the development of capital markets and to the attraction of investment to these emerging economies, and to their ability to compete in international markets. The qualitative nature of our paper identifies significant areas for further research. As quantitative data can be extracted from the twelve CIS states of the FSU opportunities for further research will provide useful information for the establishment of accounting and auditing and the expansion of International Accounting and Auditing standards worldwide.

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[i] As in Turkey, so in much of East Europe and particularly in the states of the Former Soviet Union. **The Economist**: May 19, 2001: p 38

[ii] Particularly the World Bank and other international financial institutions who lent without any of the precautions banking legislation requires of European and American banks.

[iii] Includes over 100 interviews with accounting student and hundred of interviews with FSU client candidates for conversion to International Accounting Standards

[iv] The typical "FSU" refers to the 12 former soviets within the Union of Soviet Socialist Republics. These are Armenia, Azerbaijan, Georgia, (Transcaucasus): Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan (Central Asia): Belarus, Moldova, Russia, and Ukraine. Eastern Europe generally refers to the independent states under Soviet influence including the Baltic States, Poland, Romania, Bulgaria, and the former Yugoslavia.

[v] The size of the underground economy in Georgia (Transcaucasus) in 1999, for example, was estimated to significantly exceed the official economy. **Georgia Times,** June & July 1999

[vi] Many examples including the disappearance / loss (**Georgia Times,** May1999) of $600 million to repair the Georgia merchant fleet

[vii] And even potential lawsuits for making inappropriate loans

[viii] For example implementing legislation in Armenia, 2001; Bulgaria,2000: Georgia; 1999

[ix] S. David Young, "From Plan to Market: financial statements and economic transition in the East German enterprise," **European Accounting Review**, Vol. 8: No 1:November 1999

[x] N. King and others, "Developing accounting and auditing in a transition economy: the Romanian experience," **European Accounting Review**, Vol. 10, No 1July 2001

[xi] D. Bailey, "Eastern Europe overview" in Alexander & Archer (Eds.) European Accounting Guide, 3rd Ed, (London: Harcourt Brace & Co, 1998)

[xii] Western Donors require detailed written evaluation and assessment reports on all their projects undertaken with public money

[xiii] Piecemeal because the foreign language most used in translations of financial statements and in accounting records is English. Many of the FSU nations have their own language and their own alphabet. Often their language provides neither equivalent word translation for the English terms (such as gross profit") nor distinction between equivalent terms (inventories and stocks, sales and turnover). Inevitably the precision of the legislation is difficult for courts to determine

[xiv] Including many USAID Accounting Reform Project Assessment Reports prepared under contract by major accounting firms and subcontractors to which we have had access of necessity in our work.

[xv] We have seen such records. They are not necessarily integrated with existing financial records and may be kept away from the entity premises to avoid any dispute with authorities (we were told). Note that accounting error under the Soviet system subjected accountants to possible criminal action for initiative

[xvi] The absence of legislation (e.g. building standards, etc.) severely limits local government, corporate, and individual activity related to property. The acquisition and maintenance of business premises has no reliable timeline.

[xvii] The endemic culture of non-provision of receipts for goods and services

[xviii] Except in gaining a World Bank or international financial loan

[xix] European level (20% VAT) tax on goods and services previously untaxed

[xx] Our experience of pilot tax reconciliations meant increases of corporate tax rates in excess of 50% if no legislation required the tax authorities to accept such a tax reconciliation. Pilot tax reconciliations also affected payroll taxes (in the absence of IAS, wages are often paid fully or partially in cash) with potential increases in excess of 50%.

[xxi] Typical FSU state may own land and provide long-term leases without legal precedents to cover sub-leasing, maintenance, or other uses of the property

[xxii] "Can you buy car insurance?" "Yes, but what's the point?" "What happens when a crash takes place?" "You hope to settle on the spot – insurance companies are notoriously slow or unwilling to pay claims" "Is there not government enforcement?" "No, we do not even have an insurance regulatory agency!"

[xxiii] Providing the graduates stay in country

[xxiv]TACIS, Technical Assistance for the Commonwealth of Independent States, the principal European Union donor agency in the FSU

[xxv] Courses on auditing were not taught under the Soviet accounting system

[xxvi] Both students and Faculty, in private conversation, have confirmed that Faculty pay is supplemented by extensive (untaxed) private teaching fees which provide class entry and exam assurance

[xxvii] ACCA international accounting exams are carefully supervised by British Council or equivalent independent sources and graded abroad beyond local influence

[xxviii] In Russian and English for FSU countries

[xxix] Typical SRPO programs model the FSU SRPO business plan on the experience of the AICPA (USA) and ICAEW (UK) where income is generated (approx.) by dues (40%); publications (30%); Continuing and other professional education (21%); and other sources (9%). The question remains as to whether the western style SRPO with its commitment to service will survive in the FSU without continuing donor subsidy

[xxx] International Regional Federation of Accountants and Auditors – IRFAA Eurasia

[xxxi]6th Council and Committee Meetings, May 2001.

Strategic Review Of Indonesian Financial Accounting Standards In Facing The Globalization Era: A Study of Comparison between the International Accounting Standards and Indonesian Financial Accounting Standards

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Abstract

Development of international business has been trigger accounting harmonization. One of the organizations that has the most important influence in accounting harmonization is the International Accounting Standards Committee (IASC). This organization has issued International Accounting Standards (IAS) that has been widely accepted in a lot of countries. This study undertakes a comparative study of IAS and Indonesian Financial Accounting Standards (IFAS) that have been issued until 2000 by library research. The benefit of this study is to assist foreign or Indonesian investors, financial analysts, standard setters, bankers, lenders, trade-unions, employees, accountants, auditors and general public to understand the information that is prepared follow IFAS or IAS. Specially, the two objective of the study are: (1) to provide a basis for the IAI as a standard setter of IFAS to raise the quality of his or her standard while narrowing the differences between them, (2) to provide a tool for investors, financial analysts and other users of financial statement to use in comparing financial performance of Indonesian firms with firms that use IAS.

Introduction

The earliest modern accounting was developed in Italy that was known as double-entry accounting. Accounting was spread out to other parts of world by international business transaction. This resulted from the importance of accounting in doing business. The essential function of accounting is providing financial information that can help someone to make an economic decision.

Due to the function, accounting was developed as user needs. In another word, accounting was developed as environment where it served. Consequently, accounting in different countries was also different. The differences were not only in accounting practices, but also in accounting standards.

According to Choi, Frost and Meek [1] there are eight major factors that influenced the development of accounting in the world.

1. Legal system: In the world generally there are two kind of legal systems, namely, code law and common law. Code law system is a system of law, which everything are ruled in details, include accounting rules. On the other hand, the law in the common law system only give guidelines. In common law countries, accounting rules are not incorporated into statute law. Indonesia is common law country.
2. Sources of finance: There are two major sources of finance, from capital market and bank. Countries that the dominant sources of finance are from capital market, the disclosure of financial information is extensive, consistent with widespread public ownership. However, in the credit-based countries since the financial institutions have direct access to the companies, the disclosure of financial information is limited.
3. Taxation: In some countries, tax legislation effectively determines accounting standards. Whereas in other countries accounting standards are independent to tax legislation. Thus, in this countries financial and tax accounting are separate, such as Indonesia, USA.
4. Political and economic ties: Accounting development is influenced by the closeness relationship with other countries. The relationship can be built through conquest, international commerce, and participation in economic and political associations. For example, accounting in Indonesia originated from the Netherlands through colonialism and accounting in Eastern Europe countries have become similar after founding European Union.

5. Inflation: Inflation strains historical cost accounting and affects the tendency of a country to incorporate price changes into the accounts. Countries that experienced high inflation rate applied general price level accounting. On the other hand, countries that experienced relative low inflation rate applied historical cost or current cost accounting.
6. Level of economic development: This factor affects the types of business transactions conducted in an economy and, in turn, determines the accounting issues that are faced.
7. Education level: Higher average education level , more sophisticated accounting standards and accounting practices are there in a country
8. Culture: According to Hoftstede, there are four national culture dimensions: (1) individualism, (2) power distance, (3) uncertainty avoidance, and (4) masculinity. This study was linked to accounting dimensions by Gray. Gray proposed four accounting value dimensions: (1) professionalism vs. statutory control, (2) uniformity vs. flexibility,(3) conservatism vs. optimism, and (4) secrecy vs. transparency.

Table 1: RELATIONSHIPS BETWEEN GRAY'S ACCOUNTING VALUES AND HOFTSTEDE'S CULTURAL DIMENSIONS

	Professionalism	Uniformity	Conservatism	Secrecy	Note
Individualism	+	-	-	-	+ = direct relationship - = inverse relationship ? = relationship is indeterminate.
Power Distance	-	+	?	+	
Uncertainty Avoidance	-	+	+	+	
Masculinity	?	?	-	-	

Source: Adapted from Nabil Baydoun and Roger Willet, 1995 (as quoted by Choi, Frost and Meek[2])

At earlier the accounting differences in standards and practices did not make any problems. Business transactions majority were conducted in the national level. However, now the world is borderless. The level of international business transaction is high and the number of multinational companies in a country is a lot. A company can raise capital from capital market in other countries or from creditors or banks in other countries. Besides, the company can do export and import or have a branch in foreign country. Accountancy is needed to do this business transaction such as providing financial performance information to potential and existed investors, creditors, suppliers, and customers. The financial information of the company is prepared follow the national standard accounting, but the users only have knowledge about the financial information that is prepared follow their selves national accounting standards. At this time the accounting differences among the countries become hot issue.

Solving these problems, there is an idea to build harmonization in accounting. This idea was inspirited from the idea about convention to use English as an international language.

Accounting Harmonization

People occasionally use the terms 'harmonization' and 'standardization' interchangeably. However, in contrast to harmonization, standardization generally means the imposition of a rigid and narrow set of rules and may even apply a single standard to all situations. Standardization does not accommodate national differences, therefore it is difficult to implement internationally. Harmonization is much more flexible and open. It accommodates national differences by providing a number of accounting treatments for a number of situations. Harmonization makes narrower variety of accounting standards and practices (Radebaugh and Gray [3] and Choi, Frost, and Meek[4]).

Harmonization has positive and negative aspects. According to Mueller, Gernon, and Meek [5] and Choi, Frost and Meek[6], there are three benefits of accounting harmonization. First, the accounting harmonization would increase comparability of international financial information. Such comparability would eliminate misunderstandings about foreign financial statements. Second, the harmonization would save time and money to prepare consolidated financial statement of reports that follow different national accounting standards. Third, it would increase the credibility of the entire financial reporting.

Particularly, there are six major groups who would get benefits from accounting harmonization, namely governments, trade unions and employees, investors (including financial analysts), bankers and lenders, accountants and auditors, and the general public (Radebaugh and Gray [7] and Nobes and Parker [8]). Government (including tax agency) would be easier to evaluate and control operation of multinational companies that is important for the national government policy. Trade unions and employees who require information about the performance and future prospects of multinational companies would be helped by the harmonization. Investor, including financial analysis, and creditors, including bankers, needs financial information to make a decision to buy, sell, or hold a stock and to give, expand the maturity time or restructure the loan. Accountants and auditors who work at companies or accounting firms would be easier to prepare and audit financial statements, particularly consolidated financial statement of a company that has a lot branches in various countries. General public, such as costumers, accounting students, may interpret financial statements more easily when it prepared using the similar standards.

Besides, the positive aspects of the accounting harmonization, the harmonization have had negative aspects. Firstly, it is doubted that the international standards could be flexible enough to handle differences in national backgrounds, traditions, and economic environments. This resulted from the nature of accounting as a social science. Secondly, some thought that it would be a politically unacceptable challenge to national sovereignty. The accounting standards and practices of a country is absolute authority of this country. Thirdly, the accounting harmonization would create standard overloads. A multinational company must prepare a set of financial information that follow its national accounting standard and another set of financial information that follow the international accounting standard. Lastly, it will be benefits for large international accounting service firms. It is caused by two factors. First, the large international accounting service firms have more capability to apply international accounting standard. Second, due to the international reputation, the multinational companies tend to use the service of the large international accounting service firms.

The two aspects are balance, however, in this last time the benefits of harmonization outweigh the negative aspects. The doubtness about flexibility of international accounting standards can not be approved. For instances, the International Accounting Standards that have prepared by International Accounting Standards Committee are flexible enough for some major national conditions. There are some alternatives of accounting treatment for each type business transaction that depend on the situation. For instance, the standards for foreign currency transaction also considered the countries that experienced high depreciation level in their national currency. However, it certainly cannot be completely suitable for each country such their national accounting standard. This cost-benefit trade off.

The view of national sovereignty depends on how people consider it. People can think positively and negatively about the harmonization. However, in this time countries in the world become borderless. What other country do would influence other countries directly or indirectly.

The standard overloads for the multinationational companies are one of the cost of becoming multinational companies. It would not happen, if their home countries have adopted 100% the International Accounting Standards. In this time, there is an upward trend of the number of multinational companies, therefore they would have important role to their national economy. They could press the national accounting standard setter to adopted or adapted the International Accounting Standards.

The argument that the harmonization would make domination of large international accounting service firm in the market of accounting service is biased. It does not happen only due to application of International Accounting Standards. Although there is not requirement to apply the International accounting Standards, there is market segmentation among accounting service firms, namely, multinational or large companies tend to use large accounting service firms and local or small companies tend to use small accounting service firms. It is caused by some reasons such as price of the fee and the international linkage.

International Accounting Standards Committee

There are a lot of organizations that have been key players in promoting international accounting harmonization. One of the most influential in accounting practices in the world is the International Accounting Standard Committee

(IASC). The IASC was formed in 1973 through an agreement made by professional accountancy bodies from seven countries, namely Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland and the United States of America. in January 2000, there are 143 members in 104 countries, representing over 2 million accountants.

The objective of IASC are [9]: (a) to formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance, and (b) to work generally for the improvement and harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements.

IASC issued accounting standards that are well known as the International Accounting Standards (IAS) and has developed a conceptual framework, which is somewhat similar to that of the Financial Accounting Standard Board in USA. The procedures for the development of an International Accounting Standard is as follows [10]:

a. the Board sets up a Steering Committee. Each Steering Committee is chaired by a Board Representative and usually includes representatives of the accountancy bodies in at least three other countries. Steering Committee may also include representatives of other organizations that are represented on the Board or the Consultative Group or that are knowledgeable on the particular topic;
b. the Steering Committee identifies the accounting issues associated with the topic and considers the application of IASC's Framework for the Preparation and presentation of Financial Statements to those accounting issues. The Steering Committee also studies national and regional accounting requirements and practice. Having considered the issues involved, the Steering Committee may submit a Point Outline to the Board;
c. after receiving comments from the Board on the Point Outline, if any, the Steering Committee normally prepares and publishes a Draft Statement of Principles or other discussion document. The purpose of this Statement or document is to set out the underlying accounting principles that will form the basis for the preparation of the Exposure Draft. It also describes the alternative solutions considered and the reasons for recommending their acceptance or rejection. Omments are invited from all interested parties during the exposure period, which is usually around three months. For revision to an existing International Accounting Standard, the Board may instruct the Steering Committee to prepare an Exposure Draft without first publishing a Draft Statement of Principles or other document;
d. the Steering Committee reviews the comments on the Draft Statement of principles or other document and normally agrees a final Statement of Principles, which is submitted to the Board for approval and used as the basis for preparing an Exposure Draft of a proposed International Accounting Standard. The final Statement of Principles is available to the public on request, but is not formally published;
e. the Steering Committee prepares a draft Exposure Draft for approval by the Board. After any necessary revision, and with the approval of at least two-third of the Board, the Exposure Draft is published. Comments are invited from all interested parties during the exposure period, which is a minimum of one month and usually at least three months; and
f. the Steering Committee reviews the comments on the Exposure Draft and prepares a draft International Accounting Standard for review by the Board. After any necessary revision, and with the approval of at least three-quarters of the Board, the Standard is published.

During this process, the Board may decide that the subject under consideration warrants additional consultation or would be better served by issuing an Issues Paper or a Discussion paper for Comment. It may also be necessary to issue more than one Exposure Draft before developing an International Accounting Standard. In exceptional circumstances, the Board may proceed without establishing a Steering Committee for a relatively minor issue but it always publishes an Exposure Draft before finalising a Standard.

Until 2000 the ISAC has issued 41 International Accounting Standards. In some cases International Accounting Standards permit two accounting treatments for like transactions and events, one treatment is designed as the benchmark treatment and the other as the allowed alternative treatment. The standards are used [11]:

a. as basis for national accounting requirements in many countries;
b. as an international benchmark by certain countries that develop their own requirements (including major industrialised countries and emerging market countries);

c. by stock exchanges and regulatory authorities that allow foreign or domestic companies to present financial statements in accordance with International Accounting Standards, up to know IASC has developed a set of core standards in the work plan agreed with International Organization of Securities Commissions (IOSCO);
d. by supra-national bodies such as the European Commission, which announced that is relying heavily on IASC to produce result that meet the needs of capital markets;
e. by a growing number of companies.

There two problems that is faced by IASC[12]. First, the IASC has no authority of its own and therefore must rely on that of its member, in other word, the members agree to support the objective of IASC by undertaking their best endeavours. Second, the members of the IASC are professional accounting bodies, not government bodies. As result, in some countries where the bodies that have accounting authority are not professional accounting bodies, the compliance with IASC standards is difficult to do.

Accounting in Indonesia [13]

The double-entry bookkeeping were introduced into Indonesia in the 17th Century by the Dutch as a colonial government. Colonial economic activities rapidly accelerated during the 19th and early the 20th centuries, therefore demand for trained accountants increased. They train Indonesian people to fulfil the demand. The interruption of Dutch colonial rule by Japan's military occupation of Indonesia from 1942-1945 succeeded in providing opportunities for local accountants to hold important positions. The post-independence era of the 1950s saw the resumption of commercial activities where in Dutch accounting practices were widely in use. Moreover, training of accountants at the tertiary level was still based on the Dutch accounting system. However, the nationalisation of Dutch-owned enterprises and the expulsion of Dutch nationals in 1958 resulted in a shortage of accountants.

It was a combination of Indonesian nationalist sentiment, directed mostly against the Dutch, and the presence of US educational institutions that encouraged alternatives to be sought to the well-entrenched Dutch accounting. The seeds of this change were planted through active links between Indonesia and American universities established through Ford foundation grants in the 1950s. Further impetus was provided when government sent Indonesian nationals overseas particularly to American universities.

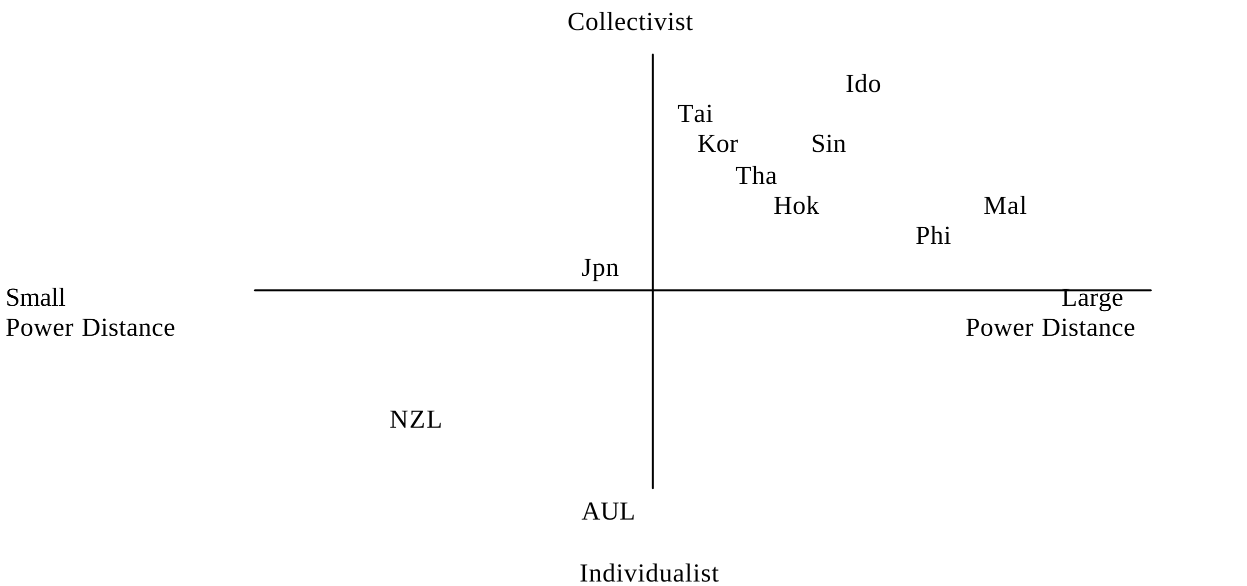
The introduction of US accounting thought and practices, however, blended well with the still widespread use of Dutch accounting methods, particularly in government agencies. During the 1950s and 1960s, most practicing accountants were still trained under the Dutch system. During the period from 1960 to 1975, however, an increasing number of tertiary institutions began to shift their accountancy programmes from the Dutch to the US system. This shift culminated in 1975 in the directive issued by the Ministry of Education and Commerce, mandating that accounting education in Indonesia must from that time modelled solely on the US system.

Accounting in Indonesia has been described using Hofstede concept about cultural values. Position of Indonesian accounting among other countries in Asia-Pacific region showed on the fig.1. Besides, position of Indonesian accounting that was described using Gary's accounting values among other countries in Asia-Pacific region was illustrated on the fig.2.

Indonesian Financial Accounting Standards

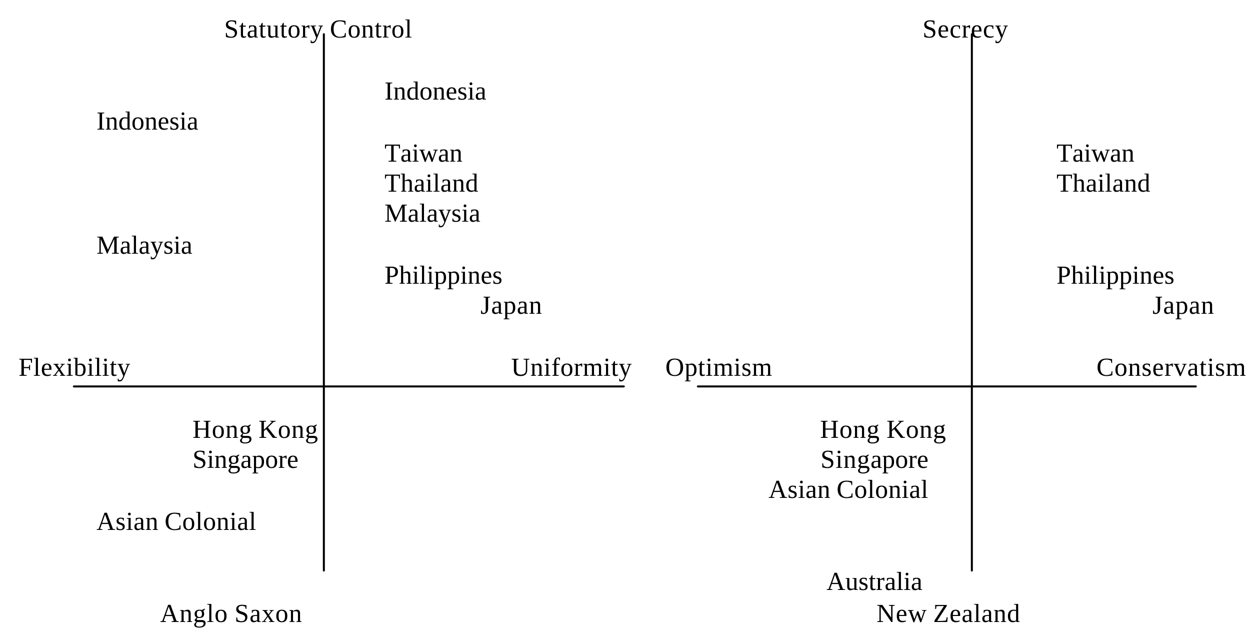
Indonesian Financial Accounting Standards (IFAS) was issued by Indonesian Institute of Accountants. The Indonesian Institute of Accountants is an organization of professional accountants. The Indonesian Institute of Accountant was founded in 1957 by the first batch of graduated of the University of Indonesia accounting course. Now every Indonesian accountant can become a member of the Indonesian Institute of Accountant. Up to now Indonesia has experienced three set of accounting standards. First, in 1973 when Indonesian capital market was active the Indonesian Institute of Accountants issued an accounting standard set that was named Indonesian Accounting Principles. This principle was patterned after Accounting Research Study No.7 " Inventory of Generally Accepted Accounting Principles for Business Enterprises" published by the American Institute of Certified Public

Accountants (AICPA). Second, in 1984 because of Indonesian economic development, Indonesian Institute of accountants revised Indonesian Accounting Principles 1973 with Indonesian Accounting Principles 1984. This principles also used concepts and methods formulated by the US Financial Accounting Standards Board (FASB).



Note: Tai = Taiwan, Ido = Indonesia, Kor = Korea, Sin = Singapore, Tha = Thailand, Hok = Hong Kong, Mal = Malaysia, Jpn = Japan, Phi = Philippines, NZL = New Zealand, AUL = Australia

Fig.1: RELATIONSHIP BETWEEN POWER DISTANCE AND INDIVIDUALISM FOR COUNTRIES OF ASIA-PACIFIC REGION [14]



Australia New Zealand	Professionalism	Anglo Saxon	Transparency

Fig. 2: ACCOUNTING VALUES OF A SELECTED NUMBER OF ASIA-PACIFIC COUNTRIES [15]

Lastly, in 1994 because of globalisation era, Indonesian Institute of Accountants made important shift by adopting International Accounting Standards as an reference for domestic financial accounting [16]. Since 1994, the Indonesian Financial Accounting Standards has been revised three times, namely October 1, 1995, June 1, 1996 and June 1, 1999. Until 2000, there has been 58 statements of the standards and 4 statements of the interpretation of the standards [17]. Procedures for development an Indonesian Financial Accounting Standard is as follows [18]:

a. Financial Accounting Standard Board as an organ of Indonesian Institute of Accountants determines the topic of the new standard. The topic could be arisen from three sources: business demand for a new kind of transactions, development in International Accounting Standards and internal research;
b. Financial Accounting Standard Board do research in order to prepare exposure draft. If it is necessary, the Financial Accounting Standard Board will set up a task force for the particular topic;
c. Having approval from Financial Accounting Standard Board, the exposure draft publishes on media in order to invite comments from all interested parties for a month. In the future, it will extend to six month for publishing exposure draft in order to give more time to collect the comments;
d. Financial Accounting Standard Board invites the interested parties that have given written-comments to give testimony in public hearing;
e. Financial Accounting Standard Board reviews the comments and make any necessary revision on the exposure draft;
f. The revised exposure draft is reviewed again in limited hearing;
g. Financial Accounting Standard Board reviews the comments in limited hearing and make any necessary revision. With the approval of Financial Accounting Standard Board, the standard is published.

Comparison Between Indonesian Financial Accounting Standards and International Accounting Standards

Due to the basis of developing Indonesian Financial Accounting Standards use International Accounting Standards, to some extent the content of each statement in the Indonesian Financial Accounting Standards similar to the International Accounting Standards. The complete comparisons are illustrated on the table 1.

However, in some part there are differences between them. Based on limited research, the differences are caused by two major factors. First, the Indonesian Financial Accounting Standards have not been revised to the new revised edition of International Accounting Standards. For example, Statement no. 3 of Indonesian Financial Accounting Standards about Interim Report refer to original version of statement no. 34 of International Accounting Standards and Statement no. 8 of Indonesian Financial Accounting Standard about Contingencies and Event Occurring After the Balance Sheet Date refer to original version of statement no. 10 of International Accounting Standards. Second, due to different environment, the Indonesian Financial Accounting Standards develop their own standards based on the demand in the Indonesian environment, such as statement no. 6 about Accounting and Reporting for Company in Developing Phase, statement no. 18 about Accounting for Pension Fund, , statement no. 27 about Accounting for "Koperasi", statement no. 28 about Accounting for Loss Insurance, statement no. 29 about Accounting for Oil and Gas, statement no. 35 about Accounting for Communication Service Fee, statement no. 36 about Accounting for Life Insurance, statement no. 37 Accounting for Free Way Contractor, statement no. 41 Accounting for Warrant, statement no. 42 about Accounting for Securities Corporation, statement no. 43 about Accounting for Factoring, statement no. 44 Accounting for Developing Real Estate, statement no. 45 about Financial Reporting for Non- Profit Motive Organization, statement no. 47 about Accounting for Land, statement no. 49 about Accounting for Mutual Fund, statement no. 50 about Accounting for Specific Securities Investment, statement no. 51 about Accounting for Quasi Reorganization, and statement no. 54 about Accounting for Troubled Debt

Restructurings. On the other hand, the International Accounting Standards develop their own standards based on important topic in the world, such as statement no. 20 about Accounting for Government Grants and Disclosures of Government Assistance, statement no. 29 about Financial Reporting in Hyperinflationary Economies, statement no. 40 about Investment Property and statement no. 41 about Agriculture. Indonesia developed these statements based on general accounting practices and his or her internal research. Majority these statements are developed refer to USA Generally Accepted of Accounting Principles. This was caused by USA dominance in Indonesia before Indonesia adapted the International Accounting Standards as his or her basis in order to develop his or her own standards.

Besides, in some aspect there are minor differences in each statement between them. However, this did not make substantial differences. In other word, the concept behind them is same, although the technical rules are different. For example, statement no. 1 of the Indonesian Financial Accounting Standards and statement no. 1 of the International Accounting Standards have minor differences in terms of the timelines criteria of Financial Statement. In statement no. 1 of the Indonesian Financial Accounting Standards, the timelines is within four months of the balance sheet date. On the other hand, in the statement no. 1 of the International Accounting Standards, the timelines is within six months of the balance sheet date.

Table 2: COMPARISONS BETWEEN INDONESIAN FINANCIAL ACCOUNTING STANDARDS AND INTERNATIONAL ACCOUNTING STANDARDS

Indonesian Financial Accounting Standards		International Accounting Standards	
Stat. No.	Descriptions	Stat. No.	Descriptions
1	Accounting Policy Disclosure (revised 1998 to Financial Statement Reporting)	1 5	Presentation of Financial Statement (revised 1997 to Disclosure of Accounting Policies)) Information to be Disclosed in Financial Statements (superseded by IAS 1 (revised))
2	Statement of Cash Flow (issued 1994)	7	Cash Flow Statements (revised 1992)
3	Interim Financial Statement (issued 1994)	34	Interim Financial Reporting (issued 1998)
4	Consolidated Financial Statement (issued 1994)	3 27	Consolidated Financial Statement (superseded by IAS 27 and 28) Consolidated Financial Statements and Accounting for Investments in Subsidiaries (reformatted 1994)
5	Reporting Financial Information by Segment (revised in 2000)	14	Reporting Financial Information by Segment (revised 1997)
6	Accounting and Reporting for Company in Developing Phase (issued 1994)		No statement about it
7	Related Party Disclosures (issued 1994)	24	Related Party Disclosures (reformatted 1994)
8	Contingencies and Events Occurring After the Balance Sheet Date (issued 1994) Contingencies is superseded by IFAS 57	10	Events After the Balance Sheet Date (revised 1999)
9	Presentation of Current Assets and Current Liabilities (superseded by IFAS 1(revised))	13	Presentation of Current Assets and Current Liabilities (superseded by IAS 1 (revised))
10	Foreign Currency Transaction (issued 1994)	21	The Effects of Changes in Foreign Exchange Rates (revised 1993)
11	Foreign Currency Translation (issued	21	The Effects of Changes in Foreign Exchange

	1994)		Rates (revised 1993)
12	Financial Reporting of Interest in Joint Ventures (issued 1994)	31	Financial Reporting of Interests in Joint Ventures (revised 1998)
13	Accounting for Investment (issued 1994)	25	Accounting for Investments (reformatted 1994)
14	Inventory (issued 1994)	2	Inventories (revised 1993)
15	Accounting for Investment in Associates (issued 1994)	28	Accounting for Investments in Associates (revised 1998)
16	Fixed and Other Assets (issued 1994)	16	Property, Plant and Equipment (revised 1998)
17	Accounting for Depreciation (issued 1994)	4	Depreciation Accounting (withdrawn in 1999)
18	Accounting for Pension Fund (issued 1994)		No statement about it
19	Intangible Assets (revised in 2000)	38	Intangible Assets (issued 1998)
20	Research and Development Costs (issued 1994)	9	Research and Development Costs (superseded by IAS 38)
21	Accounting for Equity (issued 1994)		No statement about it
22	Accounting for Business Combination (issued 1994)	22	Business Combinations (revised 1998)
23	Revenue (issued 1994)	18	Revenue (revised 1993)
24	Accounting for Retirement Benefit Cost (issued 1994)	19 26	Employee Benefit (revised 1998) Accounting and Reporting by Retirement Benefit Plan (reformatted 1994)
25	Net Profit or Loss for the Continuing Period, Fundamental Error and Changes in Accounting Policies (issued 1994)	8	Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies (revised 1993)
26	Accounting for Interest in Construction Periods (revised 1997 to Borrowing Cost)	23	Borrowing Costs (revised 1993)
27	Accounting for “Koperasi” (revised 1998)		No statement about it
28	Accounting for Loss Insurance (revised 1996)		No statement about it
29	Accounting for Oil and Gas (issued 1994)		No statement about it
30	Accounting for Leases (issued 1994)	17	Leases (revised 1997)
31	Accounting for Banking (revised 2000)	30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions (reformatted 1994)
32	Accounting for Forest Industry (issued 1994)		No statement about it
33	Accounting for General Mining (issued 1994)		No statement about it
34	Accounting for Construction Contracts (issued 1994)	11	Construction Contracts (revised 1993)
35	Accounting for Communication Service Fee (issued 1994)		No statement about it
36	Accounting for Life Insurance (issued		No statement about it

	1996)		
37	Accounting for Free Way Contractor (issued 1997)		No statement about it
38	Accounting for Restructured Controlling Equity (issued 1997)		No statement about it
39	Accounting for Cooperation Operation (issued 1997)		No statement about it
40	Accounting for Equity Changes in Subsidiary or Associates (issued 1997)	27 28	Consolidated Financial Statements and Accounting for Investments in Subsidiaries (reformatted 1994) Accounting for Investments in Associates (reformatted 1994)
41	Accounting for Warrant (issued 1997)		No statement about it
42	Accounting for Securities Corporation (issued 1997)		No statement about it
43	Accounting for Factoring (issued 1997)		No statement about it
44	Accounting for Developing Real Estate (issued 1997)		No statement about it
45	Financial Reporting for Non-Profit Motive Organization (issued 1997)		No statement about it
46	Accounting for Income Taxes (issued 1997)	12	Income Taxes (revised 1996 to Accounting for Taxes on Income)
47	Accounting for Land (issued 1998)		No statement about it
48	Accounting for Asset Impairment (issued 1998)	36	Impairment of Assets (issued 1998)
49	Accounting for Mutual Fund (issued 1998)		No statement about it
50	Accounting for Specific Securities Investment (issued 1998)		No statement about it
51	Accounting for Quasi Reorganization (issued 1998)		No statement about it
52	Reporting Currency (issued 1998)	6 15	Accounting Responses to Changing Prices (superseded by IAS 15) Information Reflecting the Effects of Changing Prices (reformatted 1994)
53	Accounting for Stock Compensation (issued 1998)	19	Employee Benefit (revised 1998)
54	Accounting for Troubled Debt Restructurings (issued 1998)		No statement about it
55	Accounting for Derivatives Instruments and Value Hedging (issued 1998)	32 39	Financial Instruments: Disclosures and Presentation (revised 1998) Financial Instruments: Recognition and Measurement (issued 1998)
56	Earnings Per Share (issued 1999)	33	Earnings Per Share (issued 1997)
57	Estimated Liabilities, Contingent Liabilities and Assets (issued 2000)	37	Provisions, Contingent Liabilities and Contingent Assets (issued 1998)
58	Discontinuing Operation (issued 2000)	35	Discontinuing Operation (issued 1998)
	No statement about it	20	Accounting for Government Grants and Disclosure of Government Assistance

			(reformatted 1994)
	No statement about it	29	Financial Reporting in Hyperinflationary Economies (reformatted 1994)
	No statement about it	40	Investment Property (issued 2000)
	No statement about it	41	Agriculture (issued 2000)

Reformatted = no substantive changes to the original text
Revised = substantive changes to the original text
superseded = be introduced so as to be used instead of another standard

Conclusion

The pressure of globalisation era has been anticipated by Indonesia. As a result, since 1994 Indonesia has developed his or her financial accounting standards that refer to the International Accounting Standards. However, due to two factors, there are a few differences between the Indonesian Financial Accounting Standards and the International Accounting Standards.

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Volume II

EAST EUROPEAN PERSPECTIVE

Section 1

Globalization & Regional Issue

Communication - Basic Need of Multicultural Society in Globalization

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Abstract

In the time of globalization the meaning of communication in human society increases aiming towards the society of information and services. The sources of wealth in society shift from production of goods to services, entertainment, information technologies and communication. In marketing the trend is moving from massmarketing to individualization and personalization. The involving key terms are confidence and interactive intelligence - the ability and art to win people. The guiding principle is interactive marketing and interactive communication. Homo communicans - growing importance of the need for communication in global society of twenty first century.

"The world is the world of the world". This mysterious and meaningful sentence wrote in 1382 a Japanese monarch (dynasty Juan 1279-1368) to a Chinese imperator.

About 500 years (half a century) later there was a chance, that this definition can become truth. [1] Globalization, its manifestation, problems, the way of its interpretation and understanding became actual theme of present time. It is known, that globalization is not a completely new phenomenon in the human history. Ancient nations were in the active business and also other connection.

In the present time is this approach expressed by time and life space reduction. The shortening of distances in every sense is considered as the biggest change of present life. We are not able to evaluate the effect of this fact.

Globalization is the phenomenon of "whole Earth getting smaller" (that means, events, which has happened on the other side of the planet, can "touch" us in a real time), which can be for example demonstrated by enormous fast transfer of the consequences of financial crisis, or shocks on financial or capital markets form one side of the Earth to another, but also a combination of many explosive social, political and another risks. [2]

Globalization is a phenomenon, which can catch almost all including policy, culture, sociology, economics and also a human communication, globalization is the process, which we can generally characterize as a change to some new order globalization has approximately the same meaning as "planetarization". [3] Because of the fact that it is definite by "planetary possibilities", opportunities but also threats, the human side of should be emphasized. Mankind should come to global civilizing, which assume (require) the acceptance of dignity of all human beings regardless on what passport they own and from what cultural environment they come. So it is "asking for" help by crossing or even minimizing the cultural conflicts, so that we accept also the people from the large scale of cultural, racial, national and religious environment. [4]

Globalization "creates" a new global culture, what does not mean a world without borders or it would be transcultural. It is truth; there is minimally 200 states and ten thousands of cultural differences in the world. So the huge corporations exactly could help by crossnational and crosscultural competencies getting the crucial (basic) stone of the global civilization, which has some real chances to survive. It is not for sure, that such a civilization will survive, also according to historian A. Toynbee has disappeared 21 world civilizations till now. [5]

The phenomenon of globalization is one full of paradoxes and it throws postindustrial societies to antinomies without any solution (according I. Kant there are some insoluble questions close to human existence.) [6]

Belohradský in the formulation: "antinomy of the globalization" gives to the term antinomy also another and simple meaning: that are some problems that it is impossible to solve through deepening of our civilization competency, but it is impossible to solve them, but it is possible to make them stabile and release from potential destruction. Only with <u>the new quality of the communication</u>. (underlined by M. S.) According Belohradský it is possible only in "society of civilization". [7] M. Petrícek, jr. affirms parallel one of the key moments of global knowledge: "The one condition of globalization is not some universal abstraction but <u>expansion of communication..</u>." (underlined by M. S.) [8]

It seems like, that social changes in the world, named globalization, move the process of communication to our interest, which has in the present really a key position in understanding of these changes. To discovery and understanding of the term and the phenomenon of human communication contributed also the almanac of studies of Slovak philosophers, from which I adduce some relevant sentences. [9]

"The shape and level of communication tell us what is the condition and the shape of interpersonal relationships. It seems that in the present times dominates more language and power as empathy and love."[10]

"...human communication is inseparable from human existence as one of the actual ways of its implementation."[11]

"... the respect to life is the condition of human existence and so also of human communication."[12]

"The openness of man to the world is characterized as the first precondition of any human communication."[13]

"If however, the communication is really to be human communication, in spite of a variety of human characters; it assumes tolerance, respect, and understanding of the other, who is different."[14]

"Human being as such is the richest source of all communication meanings and acts."[15]

"Human communication is possible only via some "common code", mutual understanding, consensus, empathy, harmony and tolerance as its complement."[16] There is a sentence interesting in this context: "... the basic transcendental condition of communication possibilities is the well-wishing of individuals." There would not be any human initiative or communication.

"Well-wishing after all enables us to make not needless, that means bad things and let us tolerate the diversity, variety, difference of the orientation and human adaptation of others and have pleasure from difference of others." [17] Selected sentences about the essence of human communication can we connect with another direction of marketing as a discipline of management in the time of globalization.

One of the considerable trends for the 21st century – customer, client, and employee orientation accents the direct communication with. "It is necessary to create the new culture of open communication. [18] It means there will be a change from massproduction to masscustomerization. "Mass-customerization will be based on such goals as to develop, create and offer the products needed, with adequate variability, which can satisfied the individual needs of every customer."[19] It displays markedly in the services, the meaning of corporate culture, with the communication as a core of it and customer orientation will grow. It is a basic challenge of marketing – to give the customer feeling of exceptionality and individuality and make the intimacy of every customer. It is known as the "segment of one", relationship marketing or mass adaptability to customer willing. [20]

According to Kotler there will be another trend in the future of marketing: "enormous entertainment boom". People wish to be entertained, no matter what they will do, if they are working, buying or consume.[21]

The importance of confidence will grow. It is impossible to do the relationship marketing without confidence in each other, because people do not risk with those, who they do not believe. It is not another form of marketing.

"It is the way how to understand the whole marketing." [22] "the confidence is the "output of the whole process" not the "input". It develops and aims to credibility. [23]

According to Covey, confidence is the product of the principles, where belong basic and universal principles, involving human relationship and organizations, for example the principle of honesty, justice, sincerity, integrity and confidence. "They are obviously, no other justifying is needed. There is a similarity to natural laws, which are valid, no matter we decided according to them or not. They are called "magical north principles", because they are never changing. They are at the same place, with the same reliability as the magnetic north on compass." [24]

Communication and interactive competence belong to basic requirements of managerial competency, but it seems that it is often made just as a contract, contact or interaction. [25]

Essence of the communication is something else, something more, it is mutual understanding.

The communication crisis could be in the fact, that despite of mass and global broadening of technical possibilities of communication, the communication is "depersonalizing" and the human core of it becomes "just a thing" including time absence and opportunities for understanding it. People are searching for communication, because he needs it, but can not find. Imaginary (virtual) communication is stronger than the real one (live). Value of the live communication based on partnership, solidarity and understanding, seems to be, despite of proclamations about its consequence, in danger. [26]

Characteristics of the interactive competence of a man, used within his interactions with others can be summarized as followed:

- It is possible for him to achieve the goal completely;
- He is considerably modifying his behavior: he is asking, offering, giving answers...;
- He knowingly regulates and changes his behavior in every case he will: wish to achieve some goal...;
- He always keeps his world (his acting is not stronger than his words);
- He learns from his interactive experiences: he analyses in detail his achievement with angle of view to the goals, plans and this information uses in another interactions. [27]

Modifying the famous sentence: there is (maybe) a possibility for "communication to save the world". It is because of:

- it is the resource for creating values;
- intercultural communication is a basic tool in searching for solutions of political and social problems, as well as problems concerning the civilization as a whole;
- communication successfully replaces exact theories which for decades provided a "satisfactory" explanation;
- communication reopens concepts and procedures which have been considered as finished or fulfilled... [28]

Communication is becoming a basic human need. The people living in 21st century can be characterized as Homo communicans.

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Globalization, Regional Economic Integration and the Foreign Direct Investments

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Abstract

The paper deals with some global trends in the contemporary flows of the FDI as one of the main features of the ongoing globalization. In this respect the paper comes to the conclusion the success in attracting an increased inflow of the FDI to the largest extent depends upon the success how the particular country and/or region is able to adjust its overall pro-investment policy to these global trends. One of the main roles in this respect is played by the success in the regional economic integration. The paper summarizes some results of the ongoing research on FDI carried out by the author in years 1999-2000 at the University of Pittsburgh and in cooperation with the Arab Planning Institute in Kuwait.

Some Main Characteristics and development Trends in the Contemporary FDI

If the main object of our analysis has been the most important characteristics and development trends of the contemporary FDI, then the following main characteristics and development trends on a global level have to be taken into the consideration. Without any specific priority order, they are as follows:

1. The total amount of FDI has substantially increased, but …

The whole concept of globalization has come into the full effect only and after the end of the cold war. Although in no way one could assume that only this one factor could be considered as a decisive one, its important role in these ongoing processes is one of the most important. Because only the end of the former division of the world from the previous antagonistic division to the East and the West has also enabled and contributed to the development of the globalization and all its accompanying main features i.e. also the FDI. Only by this end, in principle the world became technically ready for the true worldwide globalization without any ideological or substantial political frontiers. The main positive aspect as far as the FDI is concerned is that there has been a dramatic increase of their resources. The end of the cold war was also the end of competition in armament, military buildup, etc. This has unexpectedly in the end of the 80s freed a lot of capital previously bound with them. Thus in this respect the total amount of the FDI has enormously increased more than five times from the amount of USD481 billion in 1980 to the amount of USD2,658 billion in 1995. However, this previously unimaginable increase in the amounts of FDI from the index of 100 in 1983 to the index of 468.1 in 1994 (2) have not been spread over the globalized world in any balanced proportions or shares. The most of them have been not only originating but also destined for the so-called Triad of the world economy i.e. the USA, EU and Japan who already in the mid of the 90s have produced over 80% of the outward FDI but also attracting 55% of inward FDI. For example, USA has between 1980-1995 increased its outward FDI from USD220 to 706 billion i.e. more than threefold but the amount of inward FDI from USD83 to 564 billion i.e. almost six times. And the EU itself has attracted over 56.9% of the world inward FDI in 1995 (USA another 29.6%) i.e. together over 86% of the world total, while Japan has increased the amount of its outward FDI from USD19 billion in 1980 to USD306 billion in 1995 i.e. almost six times.

According to the latest available information from the UNCTAD: World Investment Report: Foreign Direct Investments and the Challenge of Development Overview (8) the development trend in FDI according to some selected indicators in the years 1996-1998 has been as follows (Billions of dollars and percentage):

Table 1 DEVELOPMENT TREND IN FDI

	Value at current prices (Billion dollars)			Annual growth rate (Percent)		
	1996	1997	1998	1996	1997	1998
FDI inflows	359	464	644	9.1	29,4	38.7
FDI outflows	380	475	649	5.9	25.1	36.6
FDI inward stock	3086	3437	4088	10.6	11.4	19.0
FDI outward stock	3145	3423	4117	10.7	8.9	20.3

2. But, the numbers of the destinations for FDI have also substantially increased

The end of the cold war in addition to freeing a capital previously being allocated for the military buildups on the both sides of the former "Berlin wall" has mean also the substantial increase in the number of the places and/or destinations for the outward FDI. Previously, the flows of the FDI have been mostly along the above and within the lines of both two antagonistic worlds. They have mainly covered countries of the first and the third world. Since the end of 1980s, an ever growing amount of the FDI has been destined also for investments across the previous ideological borders i.e. also for the countries of the former second world including mainly the former Soviet Union as well as the countries of the Central and Eastern Europe (CEEC) but also PR of China, etc. For example in the CEEC, the total amount of FDI has increased from 0 in 1980 to USD32 billion in 1995. An another new destination for the FDI have been the countries politically formally still being "socialist" but in fact developing themselves more and more towards the advanced market economy. Especially, it is the case of the People's Republic of China and of Viet Nam. These two countries with their nationwide programs of innovations, re-structuralization, privatization and the overall "openess" have created often much more favorable conditions for attracting FDI than e.g. countries in transition or even some countries belonging among the most developed countries of the EU, OECD, etc. That only confirms our previous statement that in the contemporary globalized world, some of the still existing ideological differences do not play such a decisive role as it used to be before. For example, China itself has increased its share on FDI from 0 in 1980 to USD129 billion in 1995 and by its inflow of USD39 billion has become already in 1994, the second largest single-country destination for FDI after the USA with the inflow of USD49 billion.

3. The globalization itself has been creating new investment opportunities

As we have already mentioned, the globalization itself and its acceleration especially after the end of the cold war has created among others also new sources, destinations and opportunities for FDI. However, in addition, it has also been creating new investment opportunities by itself. It has been mainly the case of some of its hi-tech basis such as consumer electronics, telecommunications especially their mobile services, information technologies and in particular microcomputers and computer networking as well as an enormous spread of the air transport and related infrastructural investments which have attracted a lot of FDI. In addition, the globalization has brought into front also the issue of environment and the sustainable development as global issues. Thus FDI have another new destinations e.g. into the new sources of energy (nuclear, solar, etc.) but also modern means of transport and communications, etc. For example only the new mega-airports with all related infrastructures including those in the third world (Hong Kong, Bangkok, Kuala Lumpur, etc.) have attracted amounts of FDI previously representing almost the total annual amounts of FDI worldwide.

4. Especially regional economic integration has been creating new opportunities for FDI

One of the dominating features of the contemporary processes of globalization have been a spread of regional economic integration. According to the particular records of the predecessor of the WTO i.e. GATT there have been altogether more than 80 of such regional groupings of the clusters of mostly neighboring countries. It is now not our intention to analyse in more details if they are "building" and/or "stumbling" blocks regarding the processes of globalization. Although, our opinion has always been they represent one of the ways how countries could be efficiently reacting to the processes of globalization and thus preparing themselves for better and more efficient international cooperation within its framework. In any case, the substance has been that each of the above regional integration groupings has been a positive contribution for the more free flows of goods, services, i.e. for the free trade and the free movement of all various factors of production in general. All these free or at least more free movements are at the same time also one of the basic preconditions also for the more liberal flow of the FDI. In the context of the regional economic integration they achieve several new dimensions and/or features. One of them is that in principle FDI are thus becoming not only "less foreign" but at the same time much more "domestic" with all particular advantages, benefits and other extra bonuses which otherwise are absolutely unachievable by the classical FDI.

In this way, the regional international economic integration groupings become one of the most attractive areas and/or destinations for the inflow of such specific "FDI". In this connection, in addition to the advantage of their gradual "domestication", they have been acquiring also various other important benefits. Among them especially it is naturally a bigger internal market, freer or absolutely free movement from country to country within that integration grouping, higher "domestic" demand, consumption and thus further direct and very efficient increase of the total effect of FDI. They may thus further increase its profit margin and further contribute to own expansion without necessity to invest into otherwise various necessary and related export promoting and supporting provisions. It is so mainly due to the fact, that the most of the production and/or services acquired through FDI have been circulated and spent in the "home" countries of the particular regional integration grouping. For this specific feature of the FDI in the environment of the contemporary globalization and its regional integration it is possible to give numerous examples e.g. in the case of the EU but also NAFTA and other regional economic integration groupings.

The EU itself could – as the oldest and the most developed regional economic integration grouping in the world - serve as the best example for this trend in "domestication" of FDI. The total share of such "intra" FDI has increased from original 25% to 40% in 1988 and currently according to some estimates it is already on the level of about 65-70%. Only so called structured funds of the EU as an institutionalized kind of specific FDI has increased from 7.8 billion EURO to current 14.8 billion EURO annually. In general, the EU used to attract about 90% of FDI coming to Europe. For example in 1995 the EU and NAFTA have still attracted more than 60% of all inward FDI worldwide (EU – 35.5%, NAFTA – 24.9%). In this context in particular NAFTA as a regional integration grouping of the USA, Canada and Mexico can serve as a good example of these positive effects on FDI. Especially it is a case of Mexico as the least developed member of the NAFTA. According to the World Investment Report – 1999 Foreign Direct Investment and the Challenge of Development (9) Mexico became the second main destination (after Brazil) for the FDI within all Latin American and Caribbean countries mainly due to the fact that: "An important proportion of FDI in this country (i.e. Mexico) in recent years has been directed … through the North American Free Trade Agreement (NAFTA)" and of course not surprisingly coming mainly from the NAFTA partners i.e. the USA and Canada.

An another good example regarding the positive role of the regional economic integration vis-à-vis the inward FDI is from the Latin America. According to the same source (9): "As the sub-regional South American integration process consolidates further, with planned agreements between MERCOSUR and the Andean Community …the process of intra-regional investment …is likely to increase both in magnitude and coverage" and in addition: "…all major planned investments (i.e. FDI) after the year 2000 are in South America, particularly in MERCOSUR countries…In this respect the institutionalisation and consolidation of the sub-regional MERCOSUR market is playing a crucial role not only in the strategies of TNCs from the outside Latin America…". In order just to illustrate these trends we could add that in 1998 out of the total FDI inflows into the Latin America region more than 70% were destined for the MERCOSUR countries and most of them to Brazil but that is not changing anything in this overall trend.

However, about the positive effects of the regional economic integration for the inflow FDI are well aware not only in Europe or Americas but also in other parts of the world as e.g. in the South East Asia and namely in its regional economic grouping ASEAN. According to the same source (9): "…member states of the ASEAN agreed in October 1998 on the establishment of the ASEAN Investment Area…to accelerate the realization of the ASEAN Free Trade Area and (thus) …to attract FDI into the region".

5. A changed role in domination of the sources for FDI from the state to private sector and the role of the trans-national corporations (TNC)

An important feature of the current processes of globalization including its regional integration has been the change in the sources of the FDI. While previously their flows were fully controlled by the state policies according to and along the particular political and ideological lines, the situation has substantially changed during the last decade. The flows of FDI as almost all other components of the globalization have become mostly the objects of the free market forces. In this sense, the substance of this change has been that most of the FDI has not been so much effected by the government politics of the particular countries as mainly by the economic considerations of investors themselves. It means that nowadays there are no politically preferential areas, countries as destinations for FDI (otherwise, China could not have its current position in the inflow of FDI). It has, among others, enabled also that the dominant role in the FDI has been shifted from the level of the state domination to the domination by the private sector and especially its most important representatives i.e. trans-national corporations (TNC). At present in this respect they have much more "free hand" to choose where, how and how much to invest. In principle, within the dominant features of the TNC one of the most important changes has been that again as in the case of the international regional integration, FDI have become in many cases not classical "foreign" investments but rather intra-company investments with all direct and indirect benefits related to such a kind of investments.

As such, they have much more flexibility, better knowledge of the investment opportunities and many other advantages in comparison to the classical FDI. According to the authoritative sources (8) page 31: "FDI inflows are more stable and easier to service than commercial debt or portfolio investments…TNC typically invest in long-term projects.". But on the other hand that cannot prevent them to take whatever measures they consider as appropriate for their business plans including repatriation of profits, reassessing their investment strategies due to various "restructuralizations", "rationalizations" etc. which as a whole sometimes discretely lead to the outflow of their original intentions in FDI as we are in many cases witnessing especially in the transforming countries of the Central and Eastern Europe. But in general there has been an important and mostly positive shift in the sources of FDI from the public to private sources as we could demonstrate by the following figures. The total amount of financial flows (including FDI) has during the period of 1989-1994 increased from USD84.5 billion to USD227.4 billion. But what is the most interesting it is the fact that the share between sources from the official sources (governments, international organizations) and the private sectors has changed from the almost equal share USD42.6 billion to USD41.9 billion in 1989 to USD54.5 to 172.9 in 1994. It means that within the period of only five years from a slightly higher amount from the official sources to absolutely opposite share in 1994 when the total increase by about USD140 billion was mainly from the private sources.

Again according to the UNCTAD sources (9) the share of the private sector on the FDI inflows has increased from 28% in 1991 to 56% in 1998 to developing countries and it is estimated that the "discrete" intra-company "FDI" of TNCs could be almost as high as the real FDI themselves.

6. Shift in FDI from their previous production orientation to tertiary (services) sectors

One of the main features of the contemporary FDI has been also their changed sectorial orientation. One change in this re-orientation we have already mentioned above in connection with the creation of the investment opportunities by the globalization itself. It has been the case of the sectors related to hi-tech technologies especially in the area of communications and their mobile structures, microcomputers, computer networking, etc. The other major shift has been from the production - especially those related to traditional industrial productions - to the sectors of services or so-called tertiary oriented sectors. In this connection, of course, there are again some differences between individual types of services. The most promising in this respect have been services in banking, insurance, trade, but also those related to the better and higher standards of living especially in the area of services regarding travel, holidays, recreation, sport and cultural activities and in particular those for attracting foreign tourists, holidaymakers, etc. Thus during the relatively short era of globalization there have been created completely new and ever more popular tourist destinations (beach resorts) in many previously for tourists unknown places in almost every region of the world including the Arab world as e.g. the United Arab Emirates, Jordan, Tunisia, etc. The main interest of FDI in this respect has been focused on their utilization for the direct construction of various complexes of leisure and holiday facilities in attractive destinations with the most favorable climatic, natural, infrastructure conditions, etc.. For example, in the EU which as we know has been the main world destination for inward FDI, the trend in tertiarization of FDI in the countries with the corresponding natural preconditions for tourism and recreation have achieved the share of 51% in Greece, 55% in Spain and 73% in Portugal. Thus it is then no surprise that according to (9): “Services FDI has been growing over the past years at a faster rate than FDI in other sectors, increasing its share in total outward FDI stock of developed countries from 45% in 1988 to 56% in 1997”.

7. Unification of Germany has become an another important factor in the worldwide flow of FDI

As we have already documented above, the end of the cold war has had a very positive impact on the processes of globalization and thus also on the growth and a free flow of FDI. but on the other hand to some extent there have also been some less positive implications as far as the FDI are concerned. The main reason in this respect has been that the unification of Germany has been much more time, effort and especially finance demanding than it would have ever been expected. The unification of Germany and in particular, the main goal in this respect i.e. to achieving as soon as possible the same living standard in the former GDR as it has been in the former FRG has been much more complex than originally expected. The process of unification and equalization between both parts of Germany has costed annually an amount of about 200 billion DM.

If we add to this amount the highest net contribution to the budget of the EU representing another 15 billion US$ annually it has been no surprise that the investment opportunities of the FRG in combination with a relatively high unemployment achieving almost 10% have substantially reduced the role of the FRG as one of the leading “exporters” of FDI.. Moreover, the FRG has traditionally been one of the main investors in the countries of the Central and Eastern Europe what further to some extent reduced the role of the country as the source of the outward FDI for the rest of the world. Thus, in the world context, the FRG after unification (i.e. increase in about 20% in terms of population and territory) has lost its third place (1980) in the outward FDI in the world and fell to the fourth place behind the USA, UK and Japan (1995) and is only by a slight margin before France. Even more illustrative in this respect is a share of the FRG on the total of the outward FDI of the EU. From 41.3% in 1984 it has decreased to 22% in 1994 and this tendency has been continuing as the process of unification of Germany has not been evolving so smoothly as originally expected.

8. China has become a “paradise” for the inflow of the FDI

Another important lesson regarding the inflows of the FDI could be drawn from the People´s Republic of China. For more than a decade it has been heavily criticized especially in the western media for its record of human rights since the tragic events at the Tiananmen squere. However, in spite of these differences with the western standards, right the same last decade has also been a decade of an enormous increase in the inflow of FDI as we have already demonstrated above. Not surprisingly, mainly from the countries which have otherwise so heavily criticized China over its record on human rights. It only confirms results of the research of this and other authors who claim that there is no direct correlation between the human rights and/or other political and ideological problems of a country and its record regarding the inflow of the FDI. In the specific case of China there has been even another important aspect in this respect and it has been its investment and trade relations with its “separatist” province of Tchaiwan. Although in the terms of ideologies, politics, etc. there have been almost no official contacts, on the economic and trade policies and in particular in the foreign direct investments both countries have had more than standard only relations.

In spite of the non-existence of the official diplomatic and/or political relations between both two countries, there has been a mutual understanding and cooperation regarding e.g. an inflow of the FDI from Tchaiwan to the mainland China. The necessary conduit has been found in Hong Kong, which even before becoming a special part of China under the formula “one country – two systems” has been serving as a necessary transfer point for mutual economic, trade and in particular investment relations. In view of such a development it is then even more understandable why in spite of so strong ideological and political differences the particular trade and investment opportunities have been really flourishing and not by an accident especially in the southern Chine bordering with Hong Kong. The main lesson from this specific type of relations between countries with the absolutely different ideological and political positions has been that in case of otherwise sufficiently favorable conditions for foreign investors, they do not pay so much attention to the internal political problems of the particular country. Especially, if it is a case of a market with more than one billion potential customers and they i.e. foreign investors have been fully convinced on the potential benefits and rewards from their investments in the particular country.

Then of course, there is no big problem to overlook also some ideological and/or cultural differences, problems with the human rights, etc. The same what has been presented here regarding China, could be very well documented also in case of some other countries that used to be criticized for their non observance of some basic human rights as e.g. in Singapore, Turkey, Myanmar, etc. In no case it has decreased their attraction for the inflow of the FDI. The total amount of the inflow of the FDI coming annually to these countries has been much higher than the total inflow of FDI to other democratic countries e.g. the countries in transition in the Central and Eastern Europe. On the other hand, it is also a good example of the power of the current TNC and their investments policies which very often do not pay so much attention to the official policies of their governments as they pay to their own global business and investments objectives.

In this case, e.g. Singapore itself - a city state with less than 5 million citizens, with no natural resources, wherein even drinking water has to be imported and the domestic waste has to be “exported” for its final disposal – has managed to attract more than USD85 billion of FDI what is much more than again has managed the whole Central and Eastern Europe associated with and geographically and culturally directly neighboring the countries of the European Union. But on the other hand it is in this connection worth to mention that Singapore has been famous not only for its very liberaland and favorable trade and investment policies but also for its pro-integration policies either within the ASEAN or transpacific economic cooperation between pacific countries of Asia and America. Then it is no surprise that right Singapore has become a natural business and trade hub and the centre of the regional economic integration and thus also the natural destination for the inflow of the FDI. Thus Singapore is a good example of a small country without any natural resources which in spite of this evident deficiency regarding its attractiveness for FDI could become an integral part of the globalized world if and when it follows a reasonably pro investment and pro integration policies.

9. The Former Soviet Union and the role of international organizations has been an another specific case in inwards FDI

Another very well illustrative example of the complexity of the current flows of the FDI has been the former Soviet Union. There has been now, the Russian Federation, another 11 independent countries of the former Union creating together a CIS – Commonwealth of Independent States and in addition three independent Baltic republics. In spite of all problems and weaknesses of some of these new countries regarding their assessment according to the Western standards of multiparty democracy, human rights, including Russia itself with its problems e.g. with Chechnya, with specific problems of the new independent republics in the Central Asia and/or in the Caucasian region, they have also attracted some significant amount of FDI incomparable with the past. There are several reasons for such a change. One main reason has been, there have been for the first time ever made available the new investment opportunities for the foreign investors into the huge natural resources e.g. of oil, gas and other minerals especially in the Central Asia and Caucasian republics. Although, the amount of financial flows from the so-called official sources i.e. governments and international organizations has been relatively declining from 50% of the total flows in 1989 to less than 25% in 1994, it has still represented a more than solid amount of USD54.5 billion (1)

The other important and specific feature of this inflow has been the role which in this case has been played by the United Nations and its specialized financial institutions such as the World Bank and the International Monetary Fund but also by the EU and again its specific financial institutions and/or its member states especially the FRG. Altogether, their loans, assistance programs, FDI and other forms of the financial assistance have created a much more favorable environment for the inward FDI than it would have been without them.

Thus by this example we could illustrate, that although the role of the international intergovernmental financial organizations and/or agencies has been to some extent reduced in this era of globalization – mainly due to the lack of adequate resources in comparison with already mentioned resources of the private investors and especially TNC – their role even under these changed circumstances in no case have to be underestimated and/or overlooked.

10. Current problems in the EU, Japan but also other parts of world and their effects on the FDI

The list of the main features and characteristics of the current trends in the FDI would have been not a complete one if we do not pay some attention also to an another important aspect of the current globalization and international regional economic integration i.e. if we do not deal also with the problem of the current recession and its impact on the FDI. It is again one of the typical features of the globalization that any economic problem and/or “shock” has been effecting very quickly and severely big parts of the world. One of such waves has been effecting with different intensity various parts of the world already for more than two years. However, their effects have been different in different parts of the world. The most severe it has been effecting countries of the Southeast Asia, Japan and to some extent also the EU. In the later one, mainly due to the unsuccessful development of their new common currency – EURO. On the other hand, especially USA has been passing through one of its most successful periods of prosperity. The important lesson of these turbulences in relation to the FDI has also been worth of an adequate attention. Although, as we have already stated above, the FDI are much more stable and less volatile than e.g. portfolio investments, the overall climate in the particular country and/or region could substantially effect their inflow and/or outflow. For example the inflow of FDI into the South East Asia in 1998 was only USD85 billion in comparison with USD96 billion in 1997 i.e. 11 billion less in one year! Among others it clearly demonstrates that even FDI are not resistant to turbulences and crises as it has been generally believed.

The main lesson in this respect has been that the current trends in globalization need not only a very careful mechanisms to screen and monitor investment patterns and especially those acting in the area of the FDI but also in other types of investments and in particular those belonging to the already mentioned much more volatile portfolio investments. The most important in such cases is to have also an adequate institutional framework on the national and/or regional levels for preventing any large scale problems in the particular area. The example of the EU with its network of the supranational institutions, intergovernmental institutions and specialized financial institutions as e.g. the recently opened European Central Bank are one of the ways how to handle the current problems not only in the area of the FDI but in the general regarding the international financial policy as such. On the other hand the current problems with the EURO clearly demonstrate that even such an institutional framework as has been existing in the EU is not able to secure the stability and firmness of the currency if there are some other macroeconomic problems as unemployment, a low and slow growth, etc. That is an another important lesson also regarding the FDI vis-à-vis regional economic integration that not formal existence of an integration entity as such but mainly its policies and overall functioning is important for the success in the overall socio-economic development.

11. CEEC – Central and Eastern European Countries, a specific case in FDI

Another very instrumental case regarding the inwards FDI have been the CEEC i.e. the previous socialist countries in the Central and Eastern Europe. Now, they have already been for more than a decade very closely associated with the EU and as a group represented candidate countries for the next enlargement of the EU. Some of them in the meantime have become already members of NATO, OECD and of various other prestigious international groupings and/or international organizations but it all together has not yet found an adequate reflection regarding the inward FDI into the region.

That all in spite of the fact, that in addition to the above main strategic advantages of these countries i.e. a geographic proximity, historical and cultural closeness and the existing association with the EU, they have possessed a lot of another traditional comparative advantages in this respect. They have had a qualified and at the same time still a relatively very cheap labor force, a relatively good basic infrastructure, an abundance of production and other facilities although under-capitalized and less suitable for the modern market economy but that all makes them not less suitable for privatization by foreign investors. There have already been developed strong trade relations with the EU representing in the case of individual candidate countries between 60-80% of their total trade turnover. There has been an inflow of technical and financial assistance from the EU under the PHARE and other programs, etc.

mainly destined for modernization of their infrastructures and thus making them more attractive for inward FDI Hence, there have been almost ideal preconditions for the foreign investors, but…

After the previous over forty years of totally different socio-economic system, there have been also some evident shortcomings regarding the attraction for the inflow of FDI which individually and/or as a set could serve almost as a text book on the reasons how not become attractive for the inflow of FDI. Among them and according to the foreign investors the most evident ones have been:

- a very complicated and ever changing legislation which has not been giving foreign investors the necessarily favorable legal framework for their investments (tax holidays, repatriation of the profit) etc.
- still existing a relatively high over employment or if "rationalized", then accompanied with the growing unemployment achieving in different candidate countries a share of 10-20% of the total work force
- an inexperienced companies management as in many cases the same inefficient "socialist" managers have become also new owners of the privatized companies in the form of the beforehand, pre-selected privatizers
- unclear and still not transparent programmes of privatization as e.g in the form of a voucher privatization, a sale to the pre-selected nationals, some discrimination of the foreign bidders, problems with the land ownership by foreigners, etc.
- still not existing a fully functioning stock exchanges, very low levels and standards of banking and other financial services causing that even the simplest bank transactions have needed often several weeks or even months e.g. between domestic banks and their foreign partners to cash a cheque even in the case of such otherwise well known banks as e.g. the UBS of Switzerland, Chase of the USA, as many foreigners often complain about, etc.
- in general there has been a relatively high level of the bureaucratic "red tape", clientelism not being totally free of the charges of corruption, monopolistic dominance of previous socialist mega-combinates in particular in the monopolistic price fixing, non transparent programs of the state aid, etc In addition, there have not been adequate living and working conditions for foreign experts, a low level of the knowledge of the foreign languages, etc.

As a result, the CEEC have managed so far to attract only about 35 billion USD of FDI in 1997 (even that insufficient amount has according (9) in 1998 decreased to 30 billion) what is e.g. less than their amount in a single member of the EU i.e. Spain or the already mentioned city-state of Singapore with less than 5 million citizens.

From all the above development in the current countries in transition vis-à-vis also their ability to attract the FDI one could draw an important lesson which in more general terms has been clearly presented also in the particular UNCTAD report (9). FDI comprises a package of very valuable resources (such as)

- capital in the form of investible financial resources
- technology which otherwise would be absent in the host country
- market access especially in the case of FDI through TNC and their already existing or expanding markets
- employment, skills and management techniques also otherwise not being available in the host country
- and last but not least, FDI are able to bring into the host country a new clean, safe, "environmentally friendly" technologies and the necessary public awareness in this important aspect of globalization.

On the other hand as we have illustrated in this specific part on the experiences from the CEEC in transition, the inflow of the FDI could be negatively effected by some reasons which the above UNCTAD Report sees especially in the higher transaction costs i.e. costs which foreign direct investor is facing in the particular host country regarding e.g. an extended approval process, setting up facilities and operating them, training, taxes, importing – exporting possibilities, "red tape", etc.

Evaluation o Some Main Factors o the FDI in the Era of Globalization

If we try in this part to carry out some basic evaluation of the above selected main factors, features and trends in the FDI as well as some of their other characteristics under the current processes of globalization then we could come to the following two main categories of conclusions:

1) Evaluation of the above main factors:

- the current process of globalization has dramatically increased the total amount of FDI. It has been so mainly due to the fact that a lot of capital previously directly or indirectly allocated for the needs of the cold war, armament, subversive activities, etc. has been currently freed for the global utilization without any major political, ideological and/or other non-economic restrictions
- the above increase in the total amount of FDI resources in no case means there would be a glut or overflow of free investments. On the contrary, the same processes of globalization that have increased the amount of FDI have also enormously increased the number of potential destinations for investors. Their efficient and/or even more efficient placement in the new areas and regions includes also such territories previously being absolutely beyond their reach as e.g. Russia, China, Central Asia, Central and Eastern Europe, Latin America, etc
- the process of globalization itself has created new areas for attracting FDI. Especially it is a case of the new hi-tech technologies for the globalization itself (telecommunications, computers, computer networking and their applications) and services as banking, insurance, i.e. serving as instruments and vehicals of the globalization itself but also means of transport, of new sources of energy and environmental protection and sustainable development.
- regional economic integration groupings of countries irrespective of considering them either as a building and/or stumbling blocks in relation to the processes of globalization have further increased the competition on the "world market" for FDI. In general, these integration groupings attract currently most of the incoming as well as they are producing the most of the outgoing FDI. In fact due to that FDI become more "domesticated" than classical foreign investments as within the particular grouping they can enjoy many otherwise unachievable benefits as e.g. free movements, unified legislation, supranational institutions for settling any potential disputes, etc.
- the sources of FDI have been definitely shifted from the state sources to private sources and in particular to the sources from TNC – trans-national corporations which further modify the character of the FDI. More than remaining still "foreign" they become more and more "intra-corporation" with all related advantages but also some potential disadvantages for the receiving countries, integration entities, regions, etc.
- the main trend in the placement of the FDI has been definitively shifted from the "classical" or traditional industry, production oriented sectors to the tertiary sectors of services including such modern ones as services in the area of leisure, vacations, final consumption of the ever growing middle class, etc.
- the role of various international and multinational institutions especially those belonging to the United Nations family of organizations as well as those belonging to various regional groupings as e.g. those of the EU has been in the era of globalization changing but remains a vital one in promoting on some multinational regional and/or global multilateral levels the current trends in liberalization of the world economy and thus creating also some basic legislative and in general a more favorable framework for the FDI
- an internal development in some of the major players in the FDI either on the side of their sources or destinations or both (USA, EU and especially Germany, Japan, etc.) have also substantially contributed to the changing features, trends and directions of the FDI. It is more and more evident that countries as the USA or the members of the EU are more and more becoming favorable destinations for FDI. It is so mainly due to their political stability, clear and favorable legislation, excellent infrastructure, strong and ever growing internal market and demand, competitive advantage and multiplication effects, etc. On the other hand also previously less attractive developing countries as e.g. Singapore, Mexico, Brasil, etc. could become very attractive destination for the inflow FDI if are becoming part of some regional economic integration groupings.
- China, the former Soviet Union and in particular Russia and the Central Asia countries are good examples that in FDI much bigger role belongs to the economic aspects including the size of the internal market for attracting

FDI than to traditional political rhetoric on democracy, human rights, minority rights, stability of democratic institutions etc. as they are often presented as the main criteria for the success in attracting FDI. In this form such requirements have become also a part of the so-called Copenhagen criteria for the CEEC in order they could become the future members of the EU but as we have just documented there has been no direct correlation between these rather abstract terms and the economic reality in the area of FDI

- any problems, turbulences, crises in the world economy which in the era of globalization have an immediate effect on many parts of the world and could be further multiplied by the so-called "speculative" capital can be much more effectively managed within the regional economic integration grouping of countries with the network of their specific integrating institutions than in case of individual countries and/or integration entities with less developed integrating relations among themselves.

2) A brief assessment of various other factors but also misconceptions traditionally considered as important for FDI:

- the role of the ideology, political system, observance of human or minority rights is much less important than generally it has been declared (see examples of China, Singapore but also Ireland vis-à-vis the Northern Ireland, etc.) by some politicians e.g. especially by the representatives of the EU towards the candidate countries of the Central and Eastern Europe, etc.
- the cheap labor and low costs countries are not at all so attractive for the inflow of the FDI as it has been generally believed especially due to the current orientation of the FDI towards high technologies, services, new sources of energies, middle class needs, etc. before various traditional processing sectors
- for the inflow of the FDI it is very important to have in the recipient country the particular banks and other financial institutions as even in the era of globalization the capital is coming mostly through particular national banks as e.g. Japanese capital through Japanese banks, US through US banks, Dutch through Dutch banks, etc. In addition, these affiliations of banks could serve also as good and reliable filters and monitors regarding the character of the capital and its investment pattern
- as a rule, the inflow of FDI is always accompanied by the corresponding expatriate personnel and/or specialists. Then it is quite natural that their arrival and thus also of FDI is conditioned by the availability of the corresponding living conditions as e.g. suitable housing for the experts and their families, education for children, cultural and leisure facilities, etc. It is e.g. well known that for expatriates from some investing countries (Japan and like) it is quite important to have at disposal among others also particular social clubs, schools, golf courses, tennis courts, etc.
- there are numerous examples that being a member of a regional integration groupings does not mean automatically a substantial increase in the inflow of FDI. That is e.g. a case of Greece which started to attract FDI not because it has been a member of OECD, NATO and has become a member of the EU but only when it adjusted its legislation, infrastructure, market to the prevailing conditions of the EU and mainly when it improved its overall domestic pro-investment policy.

In summary, in the era of globalization and regional economic integration, who wants to succeed in attracting more FDI has to:

- think and behave globally i.e. prepare such conditions for the FDI that they become attractive in the worldwide, global context
- cooperate but efficiently within its own regional integration grouping as it always means also a wider market, more opportunities for investors, their diversification, freer movements of goods, services, people and of course also of investments, etc.
- be able to learn from the above main trends and characteristics in FDI and to draw from them its own lessons as no one of them is dominating and be able to secure the expected success in attracting so much needed FDI.

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Restructuring Mining Activities in the Lignite Basin of Oltenia and Environmentrehabilitation Problems

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Abstract

The hill area of Oltenia Province (SW of Romania) is an over one-century-old site of lignite extraction. Mining has caused severe soil degradation (by over 3,000 sq.km.). The number and spread of mines, quarries, dumps near or inside the perimeter of human settlements have a direct impact on the population and the environment. The density of population and settlements tops the all-country average. The radical restructuring of the mining sector (since 1997) has led to the closure or conservation of many pits, with unemployment above the national average. Employment alternatives are limited due to the reduced agricultural area and the weak investment attraction of the newly-established small and middle manufactures. Part of the lay-offs could be employed in environment rehabilitation work. The local impact (currently negative) must be read in the sudden implementation of restructuring measures, without having programmes of professional reconversion and rehabilitation of the severely degraded environment in place. So, what possibilities for sustainable development really exist ?

Introduction

Lignite quarrying and mining is an over two century-old practice in Romania. However, large-scale exploitation began only in the latter half of the 20^{th} century. The effects of this “boom” led to substantive mutations for the population, both in regard of intra - and inter-regional migration, and socio-professional status. The coal basins received waves of migrants from neighbouring regions, but also from as far as the north of Moldavia, from the south and west of the country, or from Transylvania and the Carpathian zones. The young countryside population was massively drawn from agriculture, mainly from the collective sector, being tempted by better paid industrial jobs, which they occupied after a short training period. This situation had immediate as well as medium and long-term effects on the rural and the urban space, bringing about significant changes (Ianos, 1998). Accelerated quarrying was associated with the brutal and fastgoing degradation of all the environmental components, and remedying the situation involved costly programmes for the ecological reconstruction and rehabilitation of the grounds impaired by the coal industry.

Oltenia Province. A brief geographical overview

Oltenia, one of the eight historical provinces of Romania (in alphabetical order within the present state borders: Banat, Crisana, Dobrogea, Maramures, Moldavia, Muntenia and Transylvania) is situated in the south of the country, between the Carpathian Mountains and the Danube River. Its territory displays from north to south the whole set of relief steps extent in Romania: **mountains** (the northern to southern Carpathians), **hills** and **tablelands** (the western part of the Subcarpathians and the Getic Tableland) and **plains** (the wertern part of the Romanian Plain). Also the other environmental factors build on these steps show the same north-south succession: the **climate** of mountains, hills, depressions and the plain; the **water regime** characteristic of mountains, hills and plain; biopedogeographical steps as a reflection a landforms and the climate. (Fig. 1)

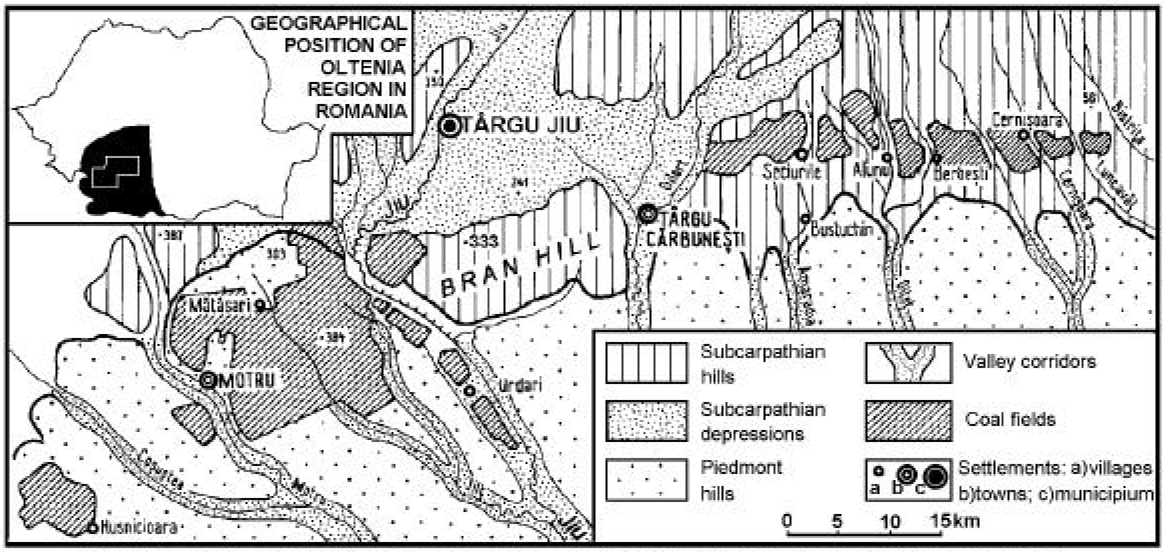

Fig. 1, Coal fields in the Oltenia region: in north the Subcarpathians, in south the Piedmont.

All lignite exploatation sites in Oltenia are grouped along a hill strip of cca. 120 km and 3000 km^2 from the east (Luncavita Valley) to the west (Topolnita Valley) and located on the territory of three administrative units, i.e. the counties of Valcea, Gorj and Mehedinti. The hill region sheltering lignite deposits is 10-25 km wide, with Subcarpathian hills and depressions in the north, following closely the line separating the mountains from the hills: a large S-W arch, with a southwards extension to the plain and the piedmont plateaus cut by valley corridors.

Lignite exploitations in Oltenia

In the present period of social-economic transition (started over ten years ago), Romanian's coal basins, likewise the other economic branches, experienced deep-going transformations that have affected both the society and the environment. The restructuring of the mining sector has materialised in the constant slowdown of production and the closure of inefficient units. As a result, the incomes of the mining population and of the inhabitants of neighbouring regions, too, dropped. The reorganisation of the autonomous companies and firms in the coal-mining sector had in view to improve its management, to reconsider the funds allotted and ensure their efficient use for the retechnologisation of the mines and the implementation of an environment policy in keeping with the provisions of national and regional environment programmes.

A first step was to identify the mines, units or subsidiaries belonging to the autonomous mining companies, which were inefficient and did not meet the requirements of environment rehabilitation programmes. As a result, several exploitations had to reduce their activity, or were abandoned altogether, unemployment soared and the mining population's revenues fell dramatically, affecting also those working in mining – related sectors, or services even. Under the government programmes intended to ease the process of transition, many such zones were declared *disadvantaged* and benefited by funds for the reconversion of their economy and workforce.

The restructuring of Oltenia's coal basin had its own particularities. Thus, the reshuffling of the Targu Jiu Mining Combine resulted in the establishment of the Oltenia Lignite Autonomous Company (R.A.L.O.) in 1990. On October 1, 1997, a Government Decision (No.576/20.09.1997) turned it into a trading company: the Oltenia Lignite National Company SA (C.N.L.O.). This Company preserved the old R.A.L.O. structure of grouping exploitations by company subsidiaries: **Valcea subsidiary** (with the exploitations of Cucesti, Armasesti, Cerna, Panga-Copaceni, Alunu-Berbesti and Oltet), **Gorj subsidiary** (with Bustuchin, Ruget, Seciuri, Albeni, Rosia, Pinoasa, Urdari, Bohorel-Negomir, Jilt and Lupoaia) and **Mehedinti subsidiary** (with Husnicioara).

The coal output of the C.N.L.O. and its workforce followed the same dynamic as the whole coal industry over the past decade: a sudden and sharp drop from 35 mill.tons in 1990 to 23 mill.tons in 1991, a short-lived revigoration in 1996 (33 mill.tons) a steady decrease – 20.5 mill.tons in 1998 and no more than 18.7 mill.tons in 2000. As regards the workforce, it registered a steep numerical decrease from over 37,000 before 1990 to 36,000 in 1991 the rate slowing down until 1996 (33,000). The measures taken to close definitively or temporarily many mines and quarries (the Romanian Government's Ordinance 22/1997) resulted in massive remittences in this sector (over 14,000 employees). In the following year 2,400 more were laid off. The action continuing, only 10,500 people were still employed in the year 2000. The percentage was higher in mines (50-70 %) than in quarries (20-40 %). Notabile territorial disparities depended on the efficiency of the exploitations, the number of employees by subsidiaries or exploitation units and deposit conditions. For exemple, fewer remittences were recorded in the west of Oltenia at the mines administered by the Gorj subsidiary than in the east, at the mines of Valcea subsidiary: twice fewer jobs at Farcasesti, 3.2 times at Dragotesti, and 5.3 times at Cerna.

The impact of restructuring the mining industry of Oltenia on the population and the environment

As known, the Subcarpathian and the piedmont population, as well as the density of their settlements, tops the all-country average; therefore, the fact that the host of mines and quarries stand close to or right inside the perimeter of these settlements has a direct impact on both the population and the environment. Although the number of employees and the production of lignite had steadily decreased, the volume of mine strippings is bigger today (by over 70 %) than in 1990. This affects not only costs (Ianos, Braghina, 2000), but the environment, too.

Over the past ten years, repeated lay-offs in Oltenia's coal basins involved 26,500 persons, more than 16,000 remaining unemployed.

The money received by an employee when remitted amounted to 12 mean monthly wages. But this sum proved insufficient, or perhaps not well enough calculated to enable these people undertake other activities. So, the majority were left inactive, which did and still does affect mining towns (Motru, Rovinari). The region's agriculture cannot take them in because among others, over 60 % had either come from remote counties (mainly Botosani, Iasi and Vaslui), or from limitrophe areas which can offer little in matters of reconversion. There is no clear evidence of how many jobless people had returned to their places of origin, but according to pretty rehable estimates the percentage of those who went back and began working in agriculture is no more than 7-8 (Ianos, 1998).

The environmental impact of coal exploitations over the last fifty years or so (Popescu, 1993) was dramatic. In the beginning, it was the waste dumps coming from the pits; the next step, mine stripping, proved even more aggressive as huge amounts of wastes were dumped on all landforms, actually changing the aspect of the relief. After a time, the senseless policy of efficient quarrying would englobe nearly all of Oltenia's coal fields. Projects of land rehabilitation to protect the environment did exist and even approved, yet never implemented, because the costs of quarrying and the technologies of land reconstruction would spiral up as the price of fuels kept increasing after the 1973 oil crisis. It was only in a very early stage of quarrying that the soils resulting from mine-stripping were stored into temporary dumps (the Garla dump) in order to let the fertile horizon recover. But when more soil was needed, they had to bring it from a long distance, which meant more fuel consumption, so eventually the whole action was dropped. Besides, the progression of working fronts was not simultaneous with the formation of the inside dump within the quarried area, because the waste horizons separating the thin lignite strips were far too thick, and their volume exceeded the dumping rate and the capacity of inside dumps to store them. Therefore, new terrains in the floodplains, on terraces, on slopes, and occasionally in valley catchments were used to build waste dumps (Cioaca, Dinu, 1996). All in all, the lands affected by mining works total nearly 300 km^2, that is 10 % of the hill strip where mining fields exist (Tab. 1).

Table 1 DISTRIBUTION OF MINING-IMPAIRED GROUNDS (BY SUBSIDIARY)

Subsidiary	Mining area (km^2)	Excavated area (km^2)	Waste dumps area (km^2)		Area not affected
			Inside	Outside	
Valcea	**82.35**	**10.66**	**4.41**	**3.55**	**68.04**
Berbesti	**82.35**	**10.66**	**4.41**	**3.55**	**68.04**
Gorj	**193.22**	**44.43**	**26.54**	**30.35**	**91.90**
Rovinari	**123.09**	**27.23**	**23.54**	**20.00**	**52.32**
Jilt	**33.00**	**9.20**	**---**	**4.85**	**18.95**
Motru	**37.13**	**8.00**	**3.00**	**5.50**	**20.63**
Mehedinti	**21.77**	**7.65**	**2.20**	**1.95**	**9.97**
Husnicioara	**21.77**	**7.65**	**2.20**	**1.95**	**9.97**
TOTAL	**297.34**	**62.74**	**33.15**	**35.85**	**169.91**

Moreover, by cutting the underground water sheet, quarries were permanently flooded, water pumping exceeding by far the sums of money planned for this operation.

The funds earmarked to the rehabilitation of impaired grounds had always fallen short of actual costs, but with the restructuring of the vast mining fields of Oltenia, these costs became a real burden. For all these reasons, the impact of coal mining on the environment was devastating, indeed (Table 1), taking up a wide diversity of manifestations:

- changes of landforms (the formation of a man-made relief by excavation and waste dumping);
- increased risk for the catastrophic geomorphic processes to set in (dumps in source areas may trigger huge mudflows, while in the floodplain they may block the valleys themselves);
- the cutting of the underground sheet has lowered the freatic level;
- deforestations have affected terrace stability, also changing the biotopes;
- changes of land use patterns.

Conclusions

Our investigations into the impact of the coal industry on the hilly environment of Oltenia span over two decades. The findings have convinced us that man-induced changes in the relief are the first to appear and the last to go, affecting in time all the other environmental factors. The newly-created relief will at a certain moment enter a new cycle of evolution, in natural regime. The same will happen with the exploitations abandoned by the restructuring of the last decade. In the long run, the geomorphic processes, very active today on the dumps and in the quarries, as well as in their surroundings, will diminish, rebalancing the other environmental factors, too.

For the time being, the problem of the ecological rehabilitation of the mining-affected hillsides on ought to be taken in correlation with the reconversion of the workforce who bears the effects of restructuring this sector.

The question is to find the money needed for short-time projects in keeping with the international programmes of environment rehabilitation and organisation of disadvantaged areas. Medium and long-term projects to balance environmental factors and stabilise the workforce with a view to sustainable development should rely on national an local budgets.

Key-words: lignite exploitation; restructuring activities; unemployment; environment degradation

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Slovakia and Global Business

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Abstract

We witness international integration of commodity markets, markets for service, capital markets and markets for information, and overlapping economic, political, social and cultural processes in space and time – globalization. Globalization is the world matter and post-communistic countries including the Slovak Republic are embraced in this process. In the future Slovakia wants to take a more active role in world international economic organizations, especially in World Trade Organization (WTO). However, joining European Union stays the main priority.

Introduction

Trade globalization is part, subset of the process in human society that goes on in societies and countries all over the world at present. Knowledge acquired in science and practice is ceasing to be the possessions of only some countries. Data carriers are changing, information is becoming goods, and the speed of distributing information is conditioned by many technical means when, literally, an event in one corner of the world can be transmitted to the other in seconds. That is why the changes in society could not be so fast, complex and far-reaching in the human past as they are at present.

The roots of globalization stretch back to the past. For instance, the beginnings of 'mercantile economy' were based on forming 'Sagerský' institution in Portugal in 1419. This implied development of world naval trade that brought improvement in trade in sea bound countries. Qualitatively, the new period in understanding the world-wide coexistence of countries was initiated by declaration of President of the USA, F. D. Roosevelt, and Prime Minister of Great Britain, Winston Churchill, on August 14th, 1941. This is known as Atlantic Charter which contained mutual policies about war and postwar policies. Industrial economy that started in England and culminated in the USA, needed cheap stock and resulted in controlling the great economic fields. It seems that rising information economy needs complex compatibility with world-wide social processes or at least with their large proportions.

We can see that globalization has its own regionality. Domestic market used to expand into international market but, nowadays, it is changing into continental market, and, thereupon, is gaining world-wide character. We can see many international alignments of commercial corporations that have an impact on economic efficiency. They are NAFTA in the USA, MERCOSUR in South America, CEFTA in European Union or more ASEAN in Asia. They all indicate clear tendency towards market globalization and also towards the rules that are applied to this market. They are looking for space for development in specific regions that is difficult for a small country to cover on its own. In accordance with this outlined trend, clear differentiating tendencies are going on in Europe, too. Today, Europe, with its strategies, is facing the principal global question of expanding European Union as well as expansion of Euro-Atlantic co-operation and even Euro-Asian co-operation.

The Slovak Republic is also somewhere in this space. We joined this global process, European and world-wide. In particular, Slovakia is hoping to become a member of European Union in order to establish a good relationship with this most powerful alignment. The Slovak Republic is looking for internal sources to be able to adjust to the terms of forming market and its rules as well. European Union is our strategic and permanent objective. Advantages provided by common market can become advantages for Slovakia if the country is ready for such adjustment. It means that it must be prepared for firm competitive environment, for economic efficiency which is two and a half times advanced than Slovak economy is. Slovakia must be ready to adjust service structure to European standard. And the adjustment should not be in terms of decades but in terms of a few years.

Essential features of world trade global process

Ahead, there is a new period of global civilization whose main feature is information technology. Global information society is part of global policy, so-called building up world-wide society where the standard of technology, education, tourism and modern communication facilities, and their mutual connections have changed the quality of presented information, the meaning of time and culture, and have created fast changes in living and society. Global co-operation practice shares forming the civilization tendencies of humans (technical, economic, cultural, etc.).

Economic living does not go on in isolated commercial environment in any domestic economy. It is a fact known from the far-off past, mainly in consequence of foreign-trade deals. Recently, however, mutual influence among domestic economies has gained unprecedented pace and size, and has changed its quality. Last decade is characterized by dynamism of doing business in international rate and gradual unification of geographically close countries into socially commercial alignments.

The whole human society, every subject aware of it or not, becomes a participant in globalization. International division of labour is specific where co-operative and interchangeable relations are formed amongst countries. Its feature is international specialization in particular production for manufacturers that is determined by equipment of each country as to production factors. The determining function is in content and direction which means commodity and territorial structure of world commerce. The essential economic effect of international division of labour is achievement in cost economies by making use of acceptable equipment with certain production factors. At present, all the countries take part in international division of labour to some extent. The intensity is rated by the country devices, natural resources, and economic forwardness. The results of international division of labour are exchanged by means of foreign trade. The whole world, every country gives grounds for commercial field.

People's preparation for new terms

The difference in economic efficiencies of the countries is one of the most distinct features of globalization that is spreading fast in the areas of world-wide trade integration, financial flows, and development of technologies, information industry and mutual penetration of the national cultures. World-wide economic prosperity benefits from globalization. Nevertheless, globalization process brings weighty negative along with positive features. On one hand, it accelerates general development but, on the other hand, it tends to change country's character as well as its internal and external power. Needless to say that noticeable proportions of inhabitants of especially smaller countries feel fear and hesitation towards globalization despite official declarations of their governments. The fear is caused by concomitant negative impacts on their attitude to the country and traditional values. In other words, they fear the loss of identity as a result of influence of more dominant entities.

Within employment market, demand for highly educated and specialized staff is increasing. These people are becoming the most important capital in the society. Global economy provides the qualified with greater wealth whilst the standard of living of the less qualified is decreasing. The fact leads to a growing gap between these two groups. Slovakia as well as all the post-communistic and poorer countries faces the current so-called leak of brains. Highly qualified specialists accept offers from richer countries in order to improve their standard of living, and leave their country.

From the point of view of future development of Slovakia in integration process, we consider the preparation of people to new conditions the most important. Education of young people should not disregard their respect for abiding values. Yet, education should be adjusted to fulfill global demands. The whole eager-for-university potential of Slovakia should have an opportunity to be able to enroll on universities according to their abilities. We cannot ignore additional education of university graduates. It is essential to enable them to acquire skills and experience abroad, especially in the area of language skills, and to enable them to be of great use in our society and to put their abilities into practice.

Slovak adjustment to world global business

The IMF (International Monetary Fund) report on world economic development in 1997 states that globalization can negatively influence the standard of living in a country by the means of structural and technical changes. This fact does not apply to well-developed economies because they are less vulnerable to globalization processes than other countries. Another global impact is the influence on decision-making autonomy of the countries and their governments. The size and power are noticeable to play the crucial role. The success of adjusting strategy of the Slovak Republic's small and transforming economy depends on the right reflection of determining trends from external environment, on the structure and character of relevant economic entities and their power spread, and on the particular mixture of liberalistic and protectionist elements in their strategy in terms of stricter global rivalty.

Adjusting strategy of our economy must be realized as a dynamic set of short-, medium- and long-lasting adjusting processes. The set should be aimed at target-forming costs and qualitatively innovational comparative advantages, and, therefore, increasing competitiveness. Moreover, it is important that this set respects both general logic of adjusting processes started in the 70's and intensified in the 90's, and, sufficiently, weak and strong features in economic opportunities and menace.

In term of routing the structural adjustment of the Slovak Republic's economy, speeding the changeover towards information society has crucial importance based on top exploitation of effective acronyms. That means to avoid repetition of interstages where possible. Well-developed countries got through the interstages while adopting information technology and the rest should share the current and perspective tendencies.

Creating national competitiveness of products of Slovak companies in world global market should be based on superior, useful and reliable information. Information about a problem is a determining factor accuracy of which will influence the success of advocacy of Slovakia beyond the border. Furthermore, it should cope with competing imported goods. Consequently, the best solution is to deal with the problem of information systems encouraging national competitiveness, to give it the right academic-logical dimension in order to avoid many errors and defaults in practical realizaton.

There is sufficiency of approaches and methods how to deal with it to be found in methodologies as well as in practice, domestic and foreign. The point is to rise to the occasion without senseless mistakes and within the right direction.

Foreign-business relations between Slovakia and European Union (EU)

In the future, Slovakia wants to play more active role in world international economic organizations, especially in World Trade Organization (WTO) and regionally it prefers development in co-operation on the grounds of Central-European Initiation (CEI) and Central-European Free Trade Association (CEFTA). However, joining EU stays the main priority.

Foreign-business relations between Slovakia and EU are fulfilled in terms of integration activities and efforts of Slovakia. At present, obtaining the full membership in EU comes under the top strategic concerns and political, economic, and foreign-business priorities. Reaching this goal will lead to reinforcement of international status of Slovakia and the further economic development. The importance in economic and foreign-business relations between the Czechoslovak Federative Republic and EU has grown since 1989 when the market of central and east Europe fell apart. One of the key criteria for success of Czechoslovak economic reform preferring market economy was deepening and extending economic and business relations with advanced industrialized countries, especially the members of EEC. Generally, bigger space for development of mutual business relations and vital technical and financial resources was expected to gain from those contacts.

Similar processes were going on in other countries of Central and Eastern Europe. In December 1991 Maastricht summit of EU started to consider expanding EU to the east. Paragraph 238 of EU treaty became a base for the process. The paragraph states: "The alignment can conclude agreements on affillation with one or some third entities or international associations that establish mutual terms and obligations, common activities and particular tactics." The result from the mentioned is that every European country can apply for membership in EU. The Slovak

Republic ratified European agreement on affillation between Slovakia and European associations and their members in 1993. This agreement came into effect on February 1^{st}, 1995. At European Council summit in Cannes in June 1995 sovereign representatives of the Slovak government officially applied for full membership to EU. The criteria for membership is achievement of stability in institutions insuring democracy, law and order, human rights, of respect and protection of minorities, of existence of commercial market, and of ability to deal with competitive pressure of market economy functioning within EU[1].

Conclusion

Over the last years of existence, the Slovak Republic has sustained its viability and is still trying to present itself in associations of countries. At the same time, the country is trying to degrade prejudices and doubts that are natural to accompany the view of the world on newly-formed country. It also should be said that the above mentioned process has not finished and there is a lot of intensive struggle waiting for Slovakia to achieve final objective which means the full membership and the deserved place.

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Section 2

Issues in Transition & Sustainable Development: States & Markets

Challenges of the Economic Transition in Croatia - Changes in Managerial Efficiency

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Abstract

Enterprise business efficiency is reflecting a level in achieving convenient and acceptable relations between inputs and outputs. Business indicators are the one of the most frequently used instruments. The simplicity in their shape and use is the reason why we have a lot of business indicators, which led us to the following questions:

1. **Which one and how many to choose?**
2. **How to make a ranking between them?**
3. **How to incorporate many indicators into a final conclusion?**
4. **How to choose a base for comparison?**

The concept of pre-indicator hierarchy makes a good base for the choice of several relevant business efficiency indicators.

The business efficiency empirical research of 400 biggest Croatian enterprises was measured within a 4-year period (1996-1999).

Final conclusion of empirical efficiency research for the 400 enterprises in Croatia shows generally insufficient levels of total efficiency of business activities and the tendency is becoming higher.

1. Introduction

Conducting research of business efficiency is an extremely interesting field of interest for every economist, especially for those working in the research sector. Common topics of discussions and lump conclusions on the level of efficiency of our enterprises collect specific arguments and enable established conclusions, which match with these researches.

The business efficiency empirical research of the 400 biggest Croatian enterprises was measured within a 4-year period (1996-1999). It is target intended to discover typical values of chosen business indicators, as a reflex of its efficiency. Those typical values of business indicators would be a quantitative expression of typical qualitative characteristics. Results of this research are determined by available data which have been statistically calculated using average value analyse. Results obtained in this way have triple values:

- They are reflecting a typical business efficiency for Croatia’s biggest enterprises
- They are show changes in business efficiency in a 4-year period
- They can also be used as an objective basis for efficiency comparison in any enterprise

2. Business Efficiency

Business efficiency of a single enterprise reflects a level in achieving convenient and acceptable relations between input and output [3]. Efficiency can be achieved by producing products and services «in a right way», that is, making profits too. An enterprise is effective when it shows favourable relations in given terms between produced goods and services, on the one hand, and spent resources, on the other. For achieving efficiency, it is important to have a wide palette of information on possible and real relations between performances and investments needed for production of those performances at one's disposal. Instruments used to examine efficiency in most cases are - budget, investment budget and business indicators.

Business indicators are one of the most frequently used instruments in business research and analysis. The simplicity in their shape and use is the reason why we have so many of them, which brings us to the following questions:

- How to select them?
- How to rank them?
- How to incorporate those indicators into a final conclusion?
- How to select basis for comparison?

Selection of indicators is a complex question which has its qualitative and quantitative dimensions: which of them to choose, and how many to use. It is easier to answer the second question using the attitude: «as many as needed and ad little as possible». Sometimes, we will use only three chosen indicators, sometimes four, sometimes even more, depending on how precise an evaluation we want. Although, in addition, using several number of business indicators could explain some dimensions of effectiveness or confirm general evaluation, using several numbers of indicators is tried to be avoided so that a flood of information would not disperse the attention, and befog the essential image of business activities. Qualitative dimension of choosing indicators refers to the question which one of them to use. Numerous empirical researches proved that indicators of the total investment structure, profitability of the total investments and dynamic liquidity, would, in most cases, be used as business indicators.

Question that refers to *ranking of indicator* results from the fact that different indicator has a different meaning, especially if you take time-dimension into consideration. When we want to estimate short-term efficiency, the major importance will be given to one of the indicators, on the other hand for estimating long-term efficiency to the others. So it is very important to establish how much importance we give to every single indicator, and what the reference of importance between them is.

Question of *incorporating indicators into a final conclusion* appears regularly in every research, enterprises where all indicators refer an identical level of business effectiveness is rather rare. In empirical researches the most often situations are where all indicators for single enterprises refer to a wide range of effectiveness. In those cases the following question appears - how to form final conclusion, how on the ground of several indicators, which refer to different dimensions and efficiency levels and how to form a judgement about business activities? These questions are being solved in practice by using different models - for example the Altaman model, or with application of some methods - for example the Scoring-method.

Selection of basis for comparison is particularly important for comparing business efficiencies. Most often data from previous period, planned extent, and data concerning business activities of another enterprise at standard, typical value are used. It is known that in comparison with someone worse, we always look better; and in comparison with someone stronger, we always look weaker. According to this, selection of principle for comparison in advance qualitatively determines final judgement. It is desirable to use the most objective principle for comparison, which represents the result of standardisation of indicators and their values. By conducting standardisation, we can reach typical, common indicators and their values for certain periods. Those indicators are reflecting dimension of typical, ordinary business activities, in this case, typical business activity efficiency.

Preliminary mentioned questions concerning selection of indicators, ranking those indicators and incorporating them into a final conclusion are being solved in different ways. In European theory and practice, hierarchy of pre-indicators is generally used as an answer to preliminary questions. Selection and formation of objective principle for comparison is solved in this work with results of empirical researches of the 400 biggest Croatian enterprises measured within 4-year period.

Hierarchy of pre-indicators is part of a model-integrated system of management, and in European theory and practice represents generally accepted conception of describing, explaining and foreseeing business activities. Hierarchy of pre-indicators makes it transparent that extent on which it should concentrate in managing and evaluating efficiencies of business activities. Pre-indicators are based on sequence of business aims: preserving and increasing of assets and liquidity of business activities are essential and also initial forms of current business efficiency. The realisation, securing, and optimisation of profits are further forms of permanently business efficiency, and in essence, they reflect success and usage of existing potentials. Development and creating new potentials is the final demonstrative form of permanent business efficiency. In other words, development and preserving potentials are prerequisites for preserving/increasing assets and preserving business liquidity.

It is important to emphasise that relation between single hierarchy levels is relation with symptoms and causes: As shown in Fig. 1 a decrease of asset-value and insufficient liquidity are symptoms of insufficient success and revenue to expenses relation of business activities, where there are real causes of low liquidity. Insufficient success is a symptom of inadequate use of potentials and insufficient profitability. Final causes of insufficient use of potentials and low profitable business activities lies in neglected development of potentials, and insufficient research and development in a largest sense. Some hierarchy levels of pre-indicators reflect the hierarchy of importance for several dimensions of business efficiency and emphasise their temporal range. To make judgement on chances for long-term efficiency, it is the most important to evaluate the stage of potential development, while for short-term efficiency it is enough to research the stage of preserving and increasing the assets and business liquidity.

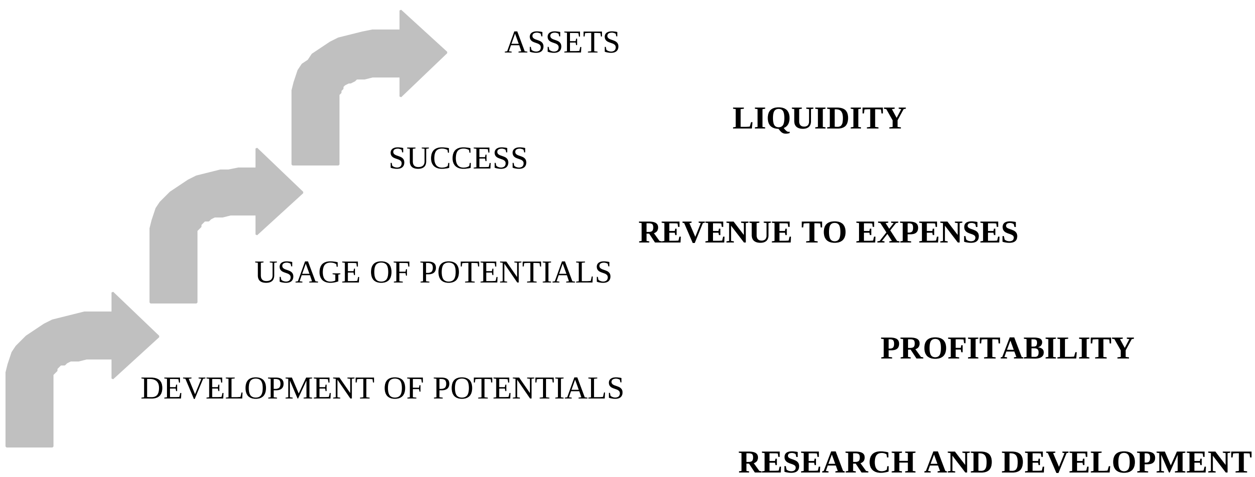

Fig. 1. HIERARCHY OF PRE-INDICATORS

Hierarchy of pre-indicators is a ground (base) for selection a small number of relevant business indicators. Depending on need for detail insight in state of business efficiency, number of indicators can expand. For testing business efficiency, primary are used following indicators:

- On the first level of assets preserving and liquidity – dynamics of assets value, indicators of capital structure, indicators of liquidity, and financial stability
- On the second level of success and revenue to expenses indicators – indicators of success, productivity, revenue to expenses, and activity indicators
- On the third level of using potentials and profitability –return on investment, net income indicator, and return on equity
- On the fourth level of construction of potentials, and research and development - indicator of intensity of research and development

Above-mentioned selection of indicators is the widest choice that enables precise and gradual identification of weak and strong sides in realisation efficiency of business activities. However, it is not always necessary to use all indicators; indeed, for quick evaluation one is going to be enough, maybe two indicators from several hierarchy levels. At the same time, selection of single level indicator will be often determined by characteristics of base for evaluation of business efficiency. Hierarchy of pre-indicators gives a wide range of possibilities in selection of several pre-indicators and, in the same time, it also gives clear criteria in their mutual relation.

3. Empirical Research: Defying Statistical Set and Research Methods

Defining statistical set includes and determines its temporal, spatial and conceptual dimensions. Business efficiency research of the 400 biggest enterprises in Croatia corresponds with data on their business activities between 1996 and 1999 [5], [6], [7], [8]. Spatial aspect corresponds to the Republic of Croatia, while conceptual aspect corresponds on enterprises, which can be defined as big enterprises; in observed sample enterprises are divided according to one of the size criteria, according to value of total income.

Statistical set can be defined as a set of elements needed for business efficiency research. Element of the set is every business data while units of reviewing and information gathering are enterprises themselves. Due to the fact that research has been done accordingly to the published business data, the business efficiency research was determined in advance with input data. Following data on enterprise business activities was used:

- Number of workers
- Total income
- Balance sheet values
- Capital and reserves
- Earnings before taxes
- Earnings after taxes (net earnings)

Sample size, number of observed units, those are enterprises, as amplified in the heading; however, the sample excludes data for some enterprises so that real number of observed enterprises is 370 in 1996, 385 in 1997, 366 in 1998 and finally 376 in 1999. Attempt of choosing and forming business indicators is to enclose their typical values that would reflect business efficiency of the biggest enterprises in Croatia. Such typical values of business indicators represent quantitative expression of typical qualitative characteristics.

During statistical analysis, the problem of calculating and determining average values accrued due to the fact that in few occasions that element of set equalled zero. A Sample of the 400 biggest enterprises in Croatia in the period between 1996 and 1999 also included enterprises, which did not show profit, as well as enterprises whose capital and reserve value equalled zero. Therefore, the pattern excludes all enterprises which registered single data equalled *zero* (gross profit, net income, capital and reserves). There were 88 such enterprises in 1996, 74 in 1997, 96 in 1998 and 95 in 1999. In this way we reached definition of the final sample in relative efficiency research for the biggest enterprises in Croatia: such enterprises numbered, 282 in 1996, 311 in 1997, 270 in 1998 and 281 in 1999. Purified in this way, a sample of data allows setting standards for successful enterprises among the biggest ones. Since the text does not analyse definition of successful enterprises [2] in more detail, absence of profit and business activities without personal capital will be considered as an indicator of unsuccessful enterprise.

Applying procedure of statistical average value analysis allows calculation of typical values. Average values characterise statistical sequence, which gives major importance as a comparison for application method of comparing. Average values as typical and characteristic numeric expressions could be for certain statistical sequence determined in two different ways: as a full average values (arithmetic, geometrical and harmonic average) and as measures of location values (median as a central value and mod as a dominant value).

The intention of this research is to calculate typical values of business efficiency indicators for the 400 biggest enterprises in Croatia. Regarding to restrictions in application of certain average values, standardisation procedures was conducted through application of arithmetic average value and not on calculated indicators but on value of those elements required by shape and calculation of indicators. Standard values of certain indicators are given by dividing of corresponding total values for all unites in the pattern [3]. Results of conducted standardisation procedure are given in Tab. 1.

Table 1. THE BUSINESS EFFICIENCY OF THE 400 BIGGEST CROATIAN ENTERPRISES IN PERIOD 1996-1999 - ARITHMETIC AVERAGE

Indicator		**Year**			
Name	**Description**	1996	1997	1998	1999
ASSETS AND INDEBTEDNESS					
Assets	value of assets (eur)	57869	67667	60628	53034
business conditions	assets per capita (eur)	90864	107448	96581	94053
equity to assets	equity to assets (%)	75.9	66.2	62.9	61.1
SUCCESS AND REVENUE TO EXPENSES					
productivity	total revenue per capita (eur)	54689	69742	70674	74391
	gross income per capita (eur)	2466	3497	3215	4355
	net income per capita (eur)	2042	2924	2450	3486
revenue to expenses	revenue to expenses (%)	104.7	105.3	104.8	106.2
activity ratio	revenue to assets	0.6	0.6	0.7	0.8
USAGE OF POTENTIALS AND PROFITABILTY					
Return on sales (ROS)	gross income to sales (%)	4.5	5	4.5	5.9
	net income to sales (%)	3.7	4.2	3.5	4.7
Return on equity (ROE)	gross income to equity (%)	3.6	4.9	5.3	7.6
	net income to equity (%)	3	4.1	4.0	6.1
Return on investment (ROI)	gross income to assets (%)	2.7	3.3	3.3	4.6
	net income to assets (%)	2.2	2.7	2.5	3.7

During the research a very high dispersion of elements in the analysed set was determined what raises the question how representative arithmetic average values really are.

Tab. 2 shows balance sheet values, total income values, number of employees, criteria for dividing enterprises in small, average and large groups and at the same time shows arithmetic average value and coefficient of variation.

Table 2. ARITHMETIC AVERAGE VALUE AND COEFFICIENT OF VARIATION IN 1999

Statistical analyse	Value of balance sheet	Total income	Number of employees
Arithmetic average value	53034 (eur)	41947 (eur)	564
Minimum	1863 (eur)	11597 (eur)	1
Maximum	3443212 (eur)	93327 (eur)	15 185
Coefficient of variation	4580%	1550%	1880%

Co-efficient variation reflects very high dispersion in elements, which leads to the conclusion that the arithmetic average value is not representative. In such situations it is far more appropriate to use median as located, central average value, because it reflects average values but does not fall under influence of extreme values. There are differences in value level if arithmetic and medial values are used. Tab. 3 shows both average values for balance sheet values, total income and number of employees.

Table 3. COMPARMENT SURVEY OF AVERAGE VALUES

Year	Value of balance sheet (eur)		Total income (eur)		Number of employees	
	Arithmetic value	Median	Arithmetic value	Median	Arithmetic value	Median
1996	57869	17869	34830	18120	637	339
1997	67667	18545	43921	21185	630	263
1998	60628	17834	44365	20547	628	255
1999	53034	15828	41947	21181	564	258

Comparative demonstration of arithmetic values and median actually do reflect same tendencies but also very high differences in values of these average values: as values of arithmetic average are twice as high as median values and therefore question of choosing the right base for comparament seems justified. Since values of arithmetic average value are under influence of extreme values and the gap of extreme values is very high, choice of median as average value seems the best. Therefore, Tab. 4 shows the typical research results of business efficiency for Croatia's biggest enterprises in with use of median as average value was used.

Table 4. THE BUSINESS EFFICIENCY OF THE 400 BIGGEST CROATIAN ENTERPRISES IN PERIOD 1996-1999 - MEDIAN

Indicator		**Year**			
Name	**Description**	1996.	1997.	1998.	1999.
ASSETS AND INDEBTEDNESS					
assets	value of assets (eur)	17869	18545	17384	15828
business conditions	assets per capita (eur)	61216	84631	82828	87800
equity to assets	equity to assets (%)	54.9	44.1	41.7	40.9
SUCCESS AND REVENUE TO EXPENSES					
productivity	total revenue per capita (eur)	69303	94645	91011	97951
	gross income per capita (eur)	1530	2281	2213	2322
	net income per capita (eur)	1325	1926	1585	1817
revenue to expenses	revenue to expenses (%)	101.8	101.9	102.2	101.8
activity ratio	revenue to assets	1.2	1.3	1.3	1.3
USAGE OF POTENTIALS AND PROFITABILTY					
return on sales (ROS)	gross income to sales (%)	1.8	1.9	2.1	1.8
	net income to sales (%)	1.6	1.5	1.7	1.6
return on equity (ROE)	gross income to equity (%)	5.4	9.0	8.8	9.1
	net income to equity (%)	4.4	6.7	6.1	7.7
Return on investment (ROI)	gross income to assets (%)	2.5	2.8	2.7	2.8
	net income to assets (%)	1.9	2.4	2.1	2.3

4. Empirical Research Results and their Interpretation

Results of empirical efficiency research for the 400 biggest enterprises in Croatia during a 4-year period are listed in Tab. 1 and 4. Tab. 1 shows empirical research results for middle value indicators of business efficiency for “the biggest 400” in Croatia derived through use of arithmetic average value, and in the Tab. 4 derived through usage of a median. The level of calculated results significantly differ: standardisation which is based on arithmetic average values presents more than two times higher results than the one which uses median as a standardisation base. Due to the set characteristics and the arithmetic average value characteristics that procedure, although it is the usual one, is considered to be inappropriate. Hence, standardisation results using a median as a base are considered as final ones for revealing typical, usual values of business efficiency for the 400 biggest enterprises in Croatia. However, regardless to the differences in procedure it is undeniable fact that during the four-year analysis period business efficiency of the 400 biggest enterprises in Croatia has increased.

Research of typical value indicators of business efficiency for the biggest 400 in Croatia during the period from 1996 to 1999 shows:

- On the assets preservation and equity to assets level about
  - diminishing assets value, that is assets value utilised by enterprises is diminished what can reflect in increased rationalisation of business activities
  - better business conditions as a result of primary decease in number of employees
  - decreased self-financing degree, that is increased indebtedness levels
- On the level of success and revenue to expenses
  - significant increase in work productivity
  - low revenue to expenses level and its stagnation
  - low activity indicators and their insignificant increase
- On the level of potential utilisation and profitability
  - very low and unchangeable level of net income indicators
  - very low return on equity and its increase, mainly caused by decrease in equity capital
  - very low return on investment and its slight increase

As a comment of calculated research results amplified can be generally very low current potential utilisation level (return on investment), what causes low success and revenue to expenses levels of business activities which cause nominal asset values to decrease. Liquidity of the 400 biggest enterprises in Croatia, unfortunately, can not be calculated due to the lack of information, but the fact is that business is financed from equity capital 54,9% in 1996 and 40,9% in 1999 reflects rising indebtedness and pressure on the business liquidity. Additional burden for the enterprises is low efficiency, which amplifies equity to asset problems and raises it to an even higher level. Reached indebtedness level in 1999 is actually lower than typical indebtedness level in developed market economies, but regarding to the low level of capital utilisation it could become a problem in future.

Final empirical efficiency research for the 400 enterprises in Croatia shows generally insufficient efficiency of business activities. It is enough to remember annual interest rates on long term debts for business entities in December 2000 which were usually between the 15% to 20% range and Croatian National bank discount rate of 7.9%, to conclude that return on investment yields at 2,8% annually (ROI Tab. 4) for the biggest enterprises is simply to low. Congruent to hierarchy of pre-indicator values, insufficient liquidity and business unliquidity are just consequences and symptoms of insufficient business activities. Therefore, discussions about amortising and solving problem of liquidity in our economy needs to be directed in a way to raise levels of business efficiency, mainly in the sense of strengthening research and development, and after that strengthening profitability and revenue to expenses of business activities, as a real ground for constant liquidity. Accent is on managing cause, not symptoms.

5. Conclusion

Conducting empirical research of business efficiency is an extremely interesting field of interest for every theorist, especially for a research worker but also for business practicians. We wanted to find out how efficient Croatian enterprises really are; therefore we raised questions such as selection of indicators and procedures to discover their typical values. The business efficiency empirical research of the 400 biggest Croatian enterprises measured within a 4-year period (1996-1999) has discovered typical values of certain business indicators as quantitative expression of qualitative features. Hierarchy of pre-indicators is theoretical foundation for selection of business efficiency indicators, but volume of this empirical research was determined by available data. Applying procedure of statistical average value analysis allowed us calculation of results in two separate ways: use of arithmetic average and median. Due to characteristics of arithmetic average value and analysed set, choice of a median as average value seems the best. Results obtained in this way have triple values:

- They are reflecting a typical business efficiency for Croatia's biggest enterprises
- They show changes in business efficiency in a 4-year period, and finally
- They can be used as well as objective basis for efficiency comparison in any enterprise.

Final conclusion of empirical efficiency research for the 400 enterprises in Croatia shows generally insufficient levels of total efficiency of business activities and the tendency is becoming higher. The path of increasing total efficiency of business activities needs to be directed in the sense of strengthening research and development, and after that strengthening profitability and revenue to expenses relation of business activities. Ways to do it are many and different, and should be researched separately.

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Economic Development and Competitiveness of the Baltic Sea Region Economies in Transition

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Abstract

The Baltic Sea region has become one of the most important and fast growing economic regions in Europe due to its favorable location between East and West and dynamic interdependence between transition and integration. The paper is going to give an overview of the comparative evaluation of the competitiveness of the Baltic Sea region economies in transition based on various methodological approaches. The main attention is given to analyzing economic development and international competitiveness of the Baltic States. Factor analysis as a data reduction method is used in order to elaborate generalized indicators of country's competitiveness. The main generalized indicators that explain a country's competitiveness level are the size of economy and the level of economic development. Based on the results of the study, it is possible to conclude that the Baltic Sea region countries have good position among the leading world economies.

Introduction

The development of the Baltic economies in transition is positively influenced by regional integration and economic co-operation between the countries around the Baltic Sea (Baltic rim). These have historical and cultural traditions for developing economic co-operation. The Baltic Sea Region is unique due to the concentration of business activity, high level of economic development, civilization and prosperity, and also due to its non-homogeneity (7;8). The region is divided into the two groups: 1) the developed Western countries, integrated with the EU (Germany, Denmark, Sweden, Finland), 2) the transition countries that are associate members of the EU (Estonia, Latvia, Lithuania, Poland), and two non-associated countries Norway and Russia (the North-East part of Russia).

The paper is going to give an overview of the comparative evaluation of the competitiveness of the Baltic Sea region economies in transition based on various methodological approaches. The main attention is given to analyzing international competitiveness of the Baltic States Estonia, Latvia and Lithuania. These three states started with serious transition processes in 1991 after regaining their independence. Of the former soviet republics only the Baltic States are EU accession candidates after ten years of transition. The development of mutually beneficial economic co-operation with capital abundant countries (such as Germany and the Scandinavian countries) has positively influenced the economic environment of the Baltic States and has created conditions that support their economic restructuring and rise of competitiveness. The Baltic countries competitiveness and economic development are also seriously influenced by the economic and political development of their large neighboring country Russia.

The paper consists of three main parts. The first part of the paper analyzes economic development of the Baltic states. In the second part the methodological approaches for evaluation of country's competitiveness are described, and in the third part the main results of this evaluation are presented.

Economic Development of the Baltic States

After regaining their independence in 1991, the Baltic countries completely lacked macroeconomic policy. The economy was collapsed and it had a legacy of hyperinflation from the Soviet Union. Since that time, all Baltic governments have followed almost similar principles of economic policy which have been directed to solving the following main tasks: 1) liberalization of prices and gradual elimination of all state subsidies; 2) privatization of state owned enterprises; 3) introducing separate currency by means of currency board system (Estonia and

Lithuania) or regular pegs (Latvia); 4) maintaining conservative fiscal policy; 5) implementing a comparatively liberal foreign trade regime.

The essence of the Estonian currency board arrangements consists of the following main rules: 1) the money supply is limited by increases in the foreign exchange reserves of the central bank; 2) the exchange rate of the Estonian currency (*kroon*) is fixed; 3) kroon was pegged to the German mark and, since 2000, to the Euro, with a maximum fluctuation of 3 % in the exchange rate; 4) kroon cannot be devaluated without a legislative change; 5) kroon is the sole legal tender in Estonia.

There are some minor differences between the currency board regimes introduced in Estonia and Lithuania, which find expression not only in anchor currencies, but also in legal coverage of some aspects of currency board operations. All three Baltic States have made use of liberal foreign exchange policy. In 1994, the Baltic states declared the convertibility of their currencies in accordance with the requirements of the IMF (Article 8). Free convertibility of the Baltic States currencies (*kroon, lat* and *litas*) and the liberal foreign exchange policy have secured competitiveness on the foreign exchange markets of these countries. The role of the Baltic states central banks in the money supply has been relatively modest so far.

The currency board regimes in Estonia and Lithuania and the fixed exchange rate regime in Latvia have been central elements in the governments' economic strategies, which provided a rather predictable and stable policy framework and supported the credibility of the governments' policies. Estonian economic and foreign trade policy has been the most liberal. Estonia introduced a foreign trade system without tariffs or quantitative restrictions. Lithuania introduced a relatively extensive system of trade barriers. Latvia has positioned somewhere between Estonia and Lithuania with its trade policy liberalization rate.

The Baltic Sea region countries have a significant role in the foreign trade relations of the Baltic States. The Baltic states have cultural and historical traditions for developing trade relations with the Baltic Sea region countries and this region has been used as a starting point to gain experience and to penetrate into international markets. The development of trade relations within the Baltic Sea region is also important for admittance into the European Union and for establishing an institutional base for integration. The main trade partners for the Baltic States are capital abundant countries around the Baltic Sea: Germany, Sweden and also Finland (Table 1). The share of the Baltic Sea region countries is forming more than 50% of the Baltic States' export and import.

Table 1 THE SHARE OF THE BALTIC SEA REGION COUNTRIES IN EXPORTS AND IMPORT OF THE BALTIC STATES IN 1999 (%)

Baltic Sea Region country	Estonia		Latvia		Lithuania	
	Export	Import	Export	Import	Export	Import
Germany	7.5	9.3	12.8	13.4	16.0	16.5
Sweden	18.8	9.3	6.6	5.4	4.2	3.4
Finland	19.4	22.8	1.5	6.0	1.0	3.1
Denmark	3.9	2.5	5.4	3.0	6.2	3.9
Norway	2.4	1.1	0.8	1.1	1.1	0.7
Poland	0.6	1.9	2.6	4.8	4.5	5.7
Estonia	–	–	5.7	6.7	2.4	1.5
Latvia	8.7	2.2	–	–	12.8	2.0
Lithuania	3.9	1.6	8.3	6.9	–	–
Russia	9.2	13.5	12.4	18.2	7.0	20.1
Total	74.4	64.2	56.1	65.5	55.2	56.9

Source: (2), pp. 16-18

The economies of the Baltic States are seriously influenced by the political and economic situation in Russia. Russia had an important role in these countries' trade relations till the Russian crisis in August 1998, but its share in the Baltic States' export is now declining. For instance, in 1998 the share of Russia in Estonian export was 13.5%, in Latvian export 16.0% and Lithuanian export 16.5%, in 1999 these numbers were 9.2%, 12.4% and 7.0% respectively (2, pp.16-18). The significant changes in geographical trade pattern of the Baltic States' export have also seriously influenced economic development of these countries in recent years.

In the aftermath of the Russian crisis in August 1998, the experience of the three Baltic countries has been similar in many respects: 1) Exports declined driven by the collapse of the Russian and other CIS (the Commonwealth of the Independent States) markets; 2) Economic growth declined significantly (table2); 3) The budgetary positions weakened.

Table 2 SELECTED INDICATORS OF THE BALTIC ECONOMIES IN 1997-1999

Indicator	Estonia			Latvia			Lithuania		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
Consumer price index	11.2	8.2	3.3	8.4	4.7	2.4	8.9	5.1	0.8
Unemployment rate (%)	9.7	9.9	11.7	15.9	14.7	14.0	14.1	13.3	14.2
Labour force participation rate (%)	61.2	60.5	59.2	60.2	59.3	58.4	61.2	61.7	61.9
GDP growth (%)	10.6	4.7	-1.4	8.6	3.6	1.1	7.3	5.1	-3.9
Average monthly gross wages (US $)	257	298	326	207	226	267	195	232	287

Source: (14; 15)

The current accounts adjusted differently in each Baltic country, although imports declined in all the three cases. In Estonia, the recession led from pronounced improvement in the current account to a deficit of about 6 percent of GDP in 1999. This resulted from strengthening in the private sector savings-investment balance of about 13 percent of GDP since 1997 to 1999. In contrast, the current account deficits of Lithuania remained high at around 11 percent of GDP as the deterioration of the fiscal position broadly cancelled any improvements stemming from strengthened private sector saving-investment balances. In Latvia, the current account deficit widened from about 5 percent in 1997 to about 10 percent in both 1998 and 1999 (6).

To sum up, recent years have pointed out the strengths and weaknesses of the Baltic States' economies. From the positive side, the currency board-based monetary system proved its performance efficiency in the economic downfall. In the case of Estonia, for instance, monetary policy framework coped with the sharp changes in the economic environment, but the real sector recovery was slower than expected. The year 2000 showed that the economic growth rate is picking up slowly. Russia's crisis in 1998 also gave lessons to develop more active economic co-operation and better trade relations with the neighboring countries around the Baltic Sea. The Baltic Sea region provided the first experience of restructuring the Baltic States' economies according to western rules. That enables them to be less dependent on the economic and political situation in Russia, to be more open to the EU negotiations and to improve their international competitiveness.

Methodological Approaches for Evaluating Competitiveness

Economics has historically dealt with competition among nations through the notion of "comparative advantage". Why do nations compete? In short, to increase their standard of living. Director of the World Competitiveness Project Stephane Garelli also stresses that the concept "competitiveness" is not very well defined in economic terms (3). The most widely used indicator is a country's per capita Gross Domestic Product, sometimes adjusted to Purchasing Power Parity (PPP). But GDP does not include many items that people would generally consider part of their standard of living. For instance, this is the case with protection of the environment, personal security, education and other attributes of the standard of living. According to Sachs (13), a country can have a high GDP only due to vast natural resources or a good starting point (initial conditions). This does not imply that the country should score highly on competitiveness. A country can have a low GDP growth rate due to fact that it is close to its steady state. This does not mean that the country should receive a low score for competitiveness. Competitiveness correlates well, but not perfectly, with GDP and GDP growth. Competitiveness is a way to use uniform criteria to assess whether a country is doing all it can to promote the highest possible degree of sustained improvements in its population's well being, given the increasing competition in the world markets it faces.

A creative framework for discussions of the concept of "competitiveness" and a set of factors contributing to international competitiveness is offered in the books of Michael Porter (10; 11). M. Porter has worked out an analytical framework for theories of comparative advantage that spans three levels of aggregation: the firm, the industry and the nation. The national environment for the selected industry is characterized with the help of four sets of variables: 1) factor conditions, 2) demand conditions, 3) industry structure and firm strategies, 4) the role of related industries. These interacting determinants are considered to be the main factors that influence a firm's ability to establish and sustain competitive advantage in international markets. In addition, two "external" determinants are introduced: influence of chance and the role of government. These six factors constitute the analytical framework for understanding the competitive position of a nation. According to Porter, the meaningful concept of competitiveness at the national level is productivity defined as the value of the output produced by a unit of labor. At the same time, competitiveness is much more than simply having efficient and low-cost firms. There is also a host of potential externalities between firms and network effects that can yield competitiveness synergies. The quality of government is also an important feature of competitiveness. So are geography and culture. Governments may influence the odds of success for firms, particularly through investments in the infrastructure, including also education.

According to Ailinger (1), the ultimate goal of a state or of its people is to maximize some social welfare function in which incomes, social contributions and environmental preservation are incorporated. This leads to a rather comprehensive definition of competitiveness, with three immediate implications. The first is that low costs are not a goal of economic policy and not even an indicator for long-run competitiveness. The second is that the external balances contribute directly or indirectly to this well-being, but are small relative to consumption. The third is that competitiveness is a dynamic issue, with aspiration levels changing over time, while investment in human capital, technology and information are the means to change the attainable welfare and the level of competitiveness (*Ibid*, pp. 159-169).

Based on the discussed considerations about the concept "competitiveness", and in order to create a comprehensive framework for evaluating the Baltic Sea region countries competitiveness, three methodological approaches are presented in the paper: 1) the World Competitiveness Yearbook (WCY) (18; 19); 2) the Harvard Institute for International Development (HIID) and the United States Agency for International Development (USAID) study of competitiveness in transition economies (includes 25 transitional economies, 5 of them are the Baltic Sea region countries) (12; 13); 3) Factor analysis as a data reduction method that enables to elaborate a) generalized indicators of a country's competitiveness; b) rankings of the countries according to the their international competitiveness level.

There are two groups of indicators used in the WCY methodology and HIID&USAID transition economies studies: 1) numerical information published by multilateral statistical reporting agencies (for instances WDI– The World Development Indicators of the World Bank) (20); 2) survey data of the countries foreign research agencies. It is essential to use both types of data so as to capture competitiveness as it is measured (hard data) and as it perceived (survey data or soft data). The surveys are designed to complement the hard data. "There are some statistics that only become available with lag, and by asking top managers their opinions about these matters, we can supplement the hard data with their up-to-date perceptions about competitiveness" (18, p. 2).

The WCY methodology offers the possibilities to rank and analyze the ability of nations to provide an environment in which enterprises can compete. This information is valuable for a businessman to make investment decisions, while government agencies use it to compare their countries' performance with the competitors and other nations. Theoretical basis of the WCY methodology integrates and describes relationships between the four main dimensions that shape the country's competitiveness environment (18, p. 10-12): 1) Attractiveness vs. Aggressiveness; 2) Proximity vs. Globality; 3) Assets vs. Processes; 4) Individual Risk Taking vs. Social Cohesiveness. These dimensions that shape the country's competitiveness environment also determine their development strategies and participation in international division of labor. In addition to these four dimensions that shape a country's competitiveness environment, also some cultural aspects and a country's value system significantly determine a country's competitiveness level. These aspects are particularly important when analyzing the competitiveness of the Baltic Sea region countries, which have many historical and cultural similarities that support their integration and economic co-operation. Nations do not compete with products and services alone, but also with education and value systems.

According to Garelli (3, p. 12-13), countries go through four distinct phases: 1) Hard work*:* people are totally dedicated to the country and corporate objectives and work many hours (for example Korea); 2) Wealth: people work hard, but they pay a lot of attention to increasing their own incomes (for instance Singapore); 3) Social participation: people are less interested by working hard and more involved in shaping their society (for example, USA and Europe in the late 1960s); 4) Self-achievement: people are more interested in developing their private lives, rather than pursuing societal change (for example, USA and Europe today).

One may assume that a country's value system in the Baltic Sea region is described by the phases two (wealth) and four (self achievement). Presumably, value system of the Baltic economies in transition (Poland, Estonia, Latvia, Lithuania, partly Russia) belongs to the second phase, and value system of the Baltic Sea region developed economies (Germany, Sweden, Finland, Denmark, Norway) to the fourth phase. Technological development (computers, telecommunications, Internet) has also had a profound impact on the competitiveness of countries during the past two decades. High technology and R&D activities are prominently featured in the World Competitiveness Yearbook (18; 19). Most of the Baltic Sea region countries have actively invested in the new technologies to provide local and foreign enterprises with young and qualified labor force that has infotechnological skills. For instance, Estonia as a small Baltic economy in transition has been successful in getting foreign investment due to its rapid technological development, particularly due to quick development of infotechnology.

The Harvard Institute for International Development and the USAID methodology offers the possibility to analyze international competitiveness of economies in transition in order to rank transitional countries according to the competitiveness level. The HIID empirical study for evaluating international competitiveness of economies in transition mainly follows the World Economic Forum's (WEF) annual Global Competitiveness Reports' definition (21): competitiveness is the ability of a national economy to achieve sustained high rates of economic growth. The factors that influence achieving of sustained high rates of economic growth are not expressed only by numerical and statistical information. There are two groups of indicators that are used in order to develop competitiveness rankings of the 25 economies in transition: 1) statistical information; 2) survey data of foreign research institutes located in the countries in transition.

These data are forming an informational background for ranking of countries in transition according to the level of their international competitiveness. The motivation for using both types of data in a study of transition economies is twofold (12, p.3): 1) It allows summarizing a large amount of data in a tractable way. These indicators provide an easy opportunity to capture a concept in the case that a single specific variable cannot; 2) the indicator approach helps to overcome problems of scarcity and quality of the data. Data scarcity is the major obstacle of any work in transition economies. In addition, much of the data suffers from the multitude of reporting biases and measurement problems, often related to the newness of government collection agencies as well as to corruption.

The heuristic model of transition forms a theoretical background for evaluating transitional countries' international competitiveness (12). This model puts emphasis on initial conditions of transition and the ability to develop these conditions in order to improve country's competitiveness. The initial conditions are playing a crucial role in performance of transition and in forming an important framework to evaluate transition processes and to measure international competitiveness. According to Jeffrey Sachs, Clifford Zinnes and Yair Eilat, there are three main types of initial conditions in transition (12; 13): "Fixed" initial conditions are those that are invariant and impossible to change (geography, topography, natural resource endowment, culture, history, climate, etc.), 2) "Hard" initial conditions are primarily those that can be changed but not quickly (the quality of institutions, industrial structure, ownership, public attitudes, composition of economic output, level and quality of human and physical capital stocks, etc.), 3) "Soft" initial conditions primarily refer to government policy such as tax code, including also international relations and agreements.

The third approach for evaluating country's competitiveness used in this paper bases on the factor analysis. Factor analysis as a data reduction method is usually used in order to 1) reduce the number of variables, and 2) detect structure in the relationship between variables (to classify variables). In economic studies, factor analysis is often used for data reduction to identify a small number of factors that explain most of the variance observed in much larger manifested variables.

The factor analysis procedure of the SPSS (Statistical Package for Social Science,) offers a high degree of flexibility. It consists of seven methods of factor extraction (principal components, principal axis factoring, unweighted least squares, generalized least squares, maximum likelihood, alpha factoring and image factoring), five methods of rotation (varimax, equamax, quarimax, direct oblimin, promax), and three methods of computing factor scores (regression, Bartlett, Anderson-Rubin) (9). Principal components method is often preferred as a method for data reduction, while other methods are mostly preferred when the goal is to detect the structure. Rotation procedures enable to modify the structure of the factor matrix and to get a rotated factor matrix that fits better the requirements of interpreting factor structure. After rotation the pattern of a factor matrix is ordinarily much clearer.

The basic model of the factor analysis:

$$X_j = a_{j1}F_1 + a_{j2}F_{j2} + ... + a_{jm}F_m + d_jU_j \qquad (1)$$

X_j – initial variables, j =1, 2, …, n

F_i – generalized indicators or factors, i = 1, 2 , ..., m

a_{ij} –factor loading , correlation between factor F_i and variable X_j (factor matrix – A (a_{ij}))

U_j – specific factor

n – the number of variables, m – the number of factors, (m << n)

Preconditions: 1) The initial variables are normalized and standardized; 2) Factors are non-correlated (orthogonal)

Factor scores also provide additional information for economic interpretation of the generalized competitiveness indicators – factors F_i ($i = 1, 2, …m$). Using factor scores enables to estimate the values of individual case (countries) for the factors F_i. A high positive factor score indicates that the level of this factor is above the cases' (countries') average. A negative factor score indicates that this factor has lower level than the cases' (countries) average. If the factor score is around zero, the factor has reached the average level of the countries (cases).

Competitiveness of the Baltic Economies in Transition

The aim of this part of the paper is to elaborate generalized indicators that enable to rank the Baltic Sea region countries according to their international competitiveness level among the leading world economies paying main attention to the competitiveness of the Baltic states. In order to elaborate the generalized indicators of the Baltic Sea region countries' international competitiveness level, the data of the international and national authorities are used (17; 20; 4; 5). The data have been chosen according to the main data groups of the WCY methodology. The database consists of the data of the 47 WCY countries (18) and additionally of three Baltic states (Estonia, Latvia, Lithuania). Hence, the data of all ten Baltic Sea region countries are included in the database.

The following initial indicators are chosen: GDP (*GDP*), GDP per capita (*GDPPC*), GDP growth (*GDPGR*), total export (*EXP*), total import (*IMP*), share of export to GDP (*EXP/GDP*), share of import to GDP (*IMP/GDP*), FDI flows (*FDI*), FDI flows per capita (*FDIPC*), overall productivity, PPP *(PRODUCTIV)*, real short-term interest rate *(INTEREST)*, population growth *(POPGR)*, labour force growth (*LABFGR*), share of health costs to GDP *(HEALTH)*, density of the road network *(ROAD)*, R&D expenditure per capita *(R&DPC)*, the share of high technology export to GDP *(HTECH)*, internet connections per 1000 people (*INTERNET*), telephone lines per 1000 people (*TELEPH*).

The rotated factor matrix of the country's competitiveness indicators is presented in table 3. Factor F_1 explains 36.6% of the total variation of the initial variables, factor F_2 explains 21.0%, factor F_3 12.0% and factor F_3 7.7%. The total variance of the initial variables explained by the four factors F_i $(i=1,2,3,4)$ is 77.2%. Important stage of using factor analysis for data reduction is the economic interpretation of the new generalized indicators – factors F_i.

The generalized competitiveness indicator – factor F_1 has the most significant factor loadings by the initial variables productivity (*PRODUCTIV*), GDP per capita (*GDPPC*), FDI flows per capita (*FDIPC*), telephone lines per 1000 people (*TELEPH*) and R&D expenditure (*R&DPC*). All these initial variables characterize the level of economic development of a country. In countries with high level of economic development real short-term interest rates are often relatively lower. That fact also explains the negative factor loading between the variable *INTEREST* and factor F_1. Based on these considerations, factor F_1 could be named as the *factor of the level of economic development*. The level of economic development is an important component that influences international competitiveness of a country. But of course, not only economic development determines the level of country's international competitiveness.

Factor F_2 has statistically significant and high factor loadings by the total GDP (*GDP*), FDI flows (*FDI*), export (*EXP*) and import (*IMP*). Hence, factor F_2 could be named as the *factor of size of economy*.

The third factor F_3 has statistically significant and high factor loadings by the share of export and import in GDP (*EXP/GDP* and *IMP/GDP*), and the share of high technology export in GDP *(HTECH)*. This factor is a generalized indicator *of openness of economy*.

The fourth factor could by named as the *factor of population growth*. This factor has statistically significant and high factor loading by population and labour force growth indicators (*POPGR* and *LABFGR*).

Table 3 ROTATED FACTOR MATRIX

Initial variables	F_1	F_2	F_3	F_4
GDP	0.130	0.956**	-0.11	-0.012
GDPPC	0.878**	0.360**	0.146	-0.072
GDPGR	0.178	0.162	0.491**	-0.036
EXP	0.262	0.880**	0.041	-0.053
IMP	0.228	0.960**	0.000	-0.023
EXPGDP	0.062	-0.176	0.936**	-0.001
IMPGDP	0.014	-0.192	0.873**	-0.228
FDI	0.184	0.896**	-0.052	0.037
FDIPC	0.606**	-0.003	0.349**	0.107
PRODUCTIV	0.902**	0.254*	0.000	-0.052
INTEREST	-0.606**	-0.100	-0.268*	0.155
POPGR	-0.165	0.000	-0.030	0.960**
LABFGR	-0.193	-0.056	-0.043	0.941**
HEALTH	0.558**	0.345**	-0.502**	-0.161
ROAD	0.398**	0.074	0.536**	-0.311**
R&DPC	0.777**	0245*	-0.008	-0.204
HTECH	0.051	-0.027	0.915**	0.202
INTERNET	0.520**	0.558**	-0.140	-0.014
TELEPH	0.897**	0.189	0.051	-0.161

Source: author's calculations using statistical package SPSS

Extraction Method: Principal Component Analysis; Rotation Method: Varimax with Kaizer Normalization, rotation converged in 5 iterations;** Significant at the 0.01 level (2-tailed); * Significant at the 0.05 level (2-tailed

Based on the factor scores, it is possible to rank the Baltic Sea region countries among the leading world economies according to the level of economic development (factor F_1), size of their economy (factor F_2), level of openness of economy (factor F_3) and population growth (factor F_4). Table 4 contains the Baltic Sea region countries generalized competitiveness ranks elaborated on the basis of the factor analysis (rank 1 and rank 2) and the WCY rankings 2000 and 2001 (preliminary). The ranks 1 and 2 are calculated on the basis of the factors F_i *(i = 1,2,3,4)* factor scores.

Table 4
INTERNATIONAL COMPETITIVENESS RANKS OF THE BALTIC SEA REGION COUNTRIES ACCORDING TO THE WCY METHODOLOGY (2000 AND 2001) AND THE RESULTS OF USING FACTOR ANALYSIS

Country	WCY rankingss, 2000	WCY rankings, 2001	Facror scores, non weighted	Rank 1	Factor scores, weighted	Rank 2
Germany	8	12	1.194	11	0.470	7
Finland	3	3	0.225	20	0353	11
Sweden	9	8	-0.195	23	0.289	15
Denmark	12	15	-0.198	24	0.265	17
Norway	16	20	0.397	18	0.336	13
Poland	40	47	-2.328	42	–0.507	40
Russia	47	45	-3.362	45	-0.743	46
Estonia	Not included	22	-2.814	43	-0.523	41
Latvia	Not included	Not included	-4.132	46	-0.741	45
Lithuania	Not included	Not included	-2.892	44	-0.534	43

Sources: (20; 21); Author's calculations

Two approaches are used in order to calculate the factor analysis based ranks: It is assumed that four generalized factors F_i have equal impact on forming a generalized indicator of the competitiveness level (rank 1); 2) It is assumed that factors F_i, *(i=1,2,3,4)* have different impact on forming a generalized indicator of the competitiveness level of a country (rank 2). The factor scores are weighted by variances explained by factors F_i *(i = 1,2,3,4)*: the weights are 0.366 for factor F_1; 0.210 for factor F_2; 0.120 for factor F_3; and 0.077 for factor F_4.

The results of using both approaches are similar.

The general competitiveness indicators and rankings of the Baltic Sea region transitional economies and CEE counties based on the HIID methodology are presented in the table 5.

Table 5
INTERNATIONAL COMPETITIVENESS RANKS OF THE BALTIC SEA REGION COUNTRIES IN TRANSITION AND/OR THE EU EASTWARD ENLARGEMENT CANDIDATE COUNTRIES ACCORDING TO THE HIID METHODOLOGY

Country	Gener. rank.	Gener. indic.	Open-ness	Govern-ment	Infra-struct.	Tech-nology	Fin. sect.	Labor	Insti-tutions
Hungary	1	2.027	1	3	1	2	1	3	2
Czech.	2	1.847	3	1	3	1	2	1	3
Poland	3	1.555	4	2	2	3	5	4	1
Estonia	4	1.228	2	4	7	4	4	7	4
Slovenia	5	0.920	7	5	4	5	13	2	5
Lithuania	6	0.774	6	8	5	10	9	5	7
Latvia	7	0.738	5	6	11	8	6	13	6
Slovakia	8	0.702	8	9	12	6	3	6	8
Croatia	9	0.272	12	7	8	7	10	14	14
Bulgaria	10	0.046	10	13	6	9	16	17	9
Romania	12	–0.064	9	19	13	12	8	19	12
Russia	11	0.029	16	11	15	11	7	11	11

Source: (13, p. 19, and pp.29-34)

To sum up, comparing the results of using various methodological approaches in order to evaluate countries' international competitiveness, it is possible to conclude that the Baltic states have good competitive position among the transitional economies and also among the leading world economies. Estonia's biggest competitive advantage is the openness of its economy. According to the HIID methodology, Estonia also has a comparatively good government, well-developed technology and institutions. Lithuania's competitive advantages are good infrastructure and comparatively well-educated labour force. Latvia's advantages are openness of its economy, development of institutions and financial sector and also comparatively good government. Poland's competitive advantages are size of economy, good infrastructure and governments, and high level of technological development. Russian economy is large, but rather closed with not well-developed infrastructure, technology, labour and government. The leading positions among the Baltic Sea region economies in transition belong to Poland and Estonia, and the weakest to Russia.

Concluding Remarks

In order to evaluate international competitiveness of the Baltic Sea region transitional countries and based on the discussions about the concept "competitiveness", three methodological approaches are used in the paper: 1) the World Competitiveness Yearbook methodology; 2) the Harvard Institute for International Development methodology for evaluating competitiveness of transition economies; 3) Factor analysis based methodological approach.

Factor analysis as a data reduction method enables to elaborate generalized indicators of a country's competitiveness and to rank countries according to the their international competitiveness level. As a result, the following generalized factors that characterize the Baltic Sea region countries´ international competitiveness are elaborated: 1) the level of economic development; 2) the size of economy; 3) openness of economy; 4) population growth. The total variance of the initial variables explained by the factors F_i $(i=1,2,3,4)$ is 77.2%. The two first factors (F_1 – size of economy and F_2 – level of economic development) explain more than 50% of variation of initial variables that influence countries' competitiveness.

Based on the results of the analysis, it is possible to conclude that the Baltic Sea region countries have good position among the leading world economies. The best competitive positions among the countries of this region belong to Germany and Finland. Poland and Estonia have the best position among the Baltic Sea region economies in transition. According to the level of international competitiveness, the Baltic Sea region countries could be divided into two rather homogenous groups: 1) the industrialized capital abundant economies (Germany, Finland, Sweden, Norway and Denmark); and 2) the transitional countries with comparatively open economies and cheap labour force (Estonia, Latvia, Lithuania, Poland and Russia).

The results of the study enable us to conclude that the factor analysis based evaluations explain better international competitiveness level of the Baltic Sea region transitional economies than the WCY based evaluations, particularly in the case of a small open economy in transition. For instance, the competitiveness level of Estonia seems to be over evaluated by the WCY evaluations 2001. According to the WCY evaluations, Estonia has the 22nd position among the leading world economies. That also means that Estonia has the best competitive position among the EU accession candidates. Estonia's economy has been very liberal so far and therefore also attractive for FDI, but Estonia's small and open economy is also very sensitive for asymmetric shocks caused by international political and economic environment, and therefore it is difficult to predict stable economic development and high level of competitiveness of this country in the long run.

The evaluations based on the use of factor analysis are also in accordance with the evaluations elaborated according to the Harvard methodology for evaluation of international competitiveness level of 25 transitional economies. Based on both methodological approaches, the HIID and factor analysis based methodologies, it is possible to order the Baltic economies in transition according to their international competitiveness level as follows: Poland, Estonia, Lithuania, Latvia and Russia.

Last but not least, it is possible to assume that the co-operation within the Baltic Sea region countries improves their international competitiveness due to the dynamic interdependence of transition and integration processes also in future.

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Environmentalization of Management and Neo-realism – Imperatives of Sustainable Development in 21st Century

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Abstract

Many countries have accepted sustainable growth as the strategic objective declared by the UN General Assembly in 1987. There is no alternative for this strategic objective in the 21st century. International Chamber of Commerce in Paris proclaimed eco-management for the main instrument of sustainable development. This kind of management requires reversion from neoliberal principles back to economic neo-realism.

OECD documents define globalization as a "process where markets, technologies, means of communication lose their 'national' or 'local' character and acquire a 'universal' character" (1). This is also demonstrated in considering economic development, economic growth. In the context of globalization we often hear of universal, global growth of world economy while local, national economic recessions or crises connected with increasing social and environmental problems are overlooked. On global level, UN agencies since 1972 remind of aggravating state of human environment in various regions as well as worldwide. UN General Assembly of 1987 and UN Conference of Environment and Development in Rio de Janeiro in 1992 both accentuated this ambivalent global situation.

UN document "Our Common Future" of 1987 first used the term "sustainable development". It was defined as a development that allows meeting current needs of humankind without limiting the ability of next generations to meet their future needs (2). UN Conference in Rio de Janeiro in 1982 in a document called "Agenda 21" adopted worldwide recommendations how to secure sustainable development in the world. Sustainable development is in more detail defined in the Environment Law (17/1992) of CSFR: "Sustainable development is such a development of society that allows meeting basic needs of current and future generations while preserving the variety of nature and the natural function of its ecosystems" (4).

Globalization of economy and its impact on national economies, especially in transforming economies of countries in central and Eastern Europe, and the implementation of unrestrained neoliberalism in the economies of these countries including Slovak Republic, increasingly contradicts with the principles of sustainable development. Short-term individual profit-oriented objectives of private enterprises conflict with the long-term, multi-generation interests of population, individual countries and entire society from the aspect of sustainable growth. Sustainable development is thus more a desired vision of far future rather then a social reality (5), despite the fact that there is almost no government in the world that would not declare the necessity of sustainable development.

In the years 1992 – 1999 European Union implemented an environmental program called "Towards Sustainable Development" and it adopted another environmental program "Environment 2010: Our Future, Our Choice" for the subsequent decade 2001 – 2010 (6). In the Slovak Republic a group of experts under the auspices of Slovak Ministry of Environment prepared a document titled as "National Strategy for Sustainable Growth of Slovak Republic" (7).

In spite of international appeals and despite several existing strategies of sustainable growth, the economic and social development of Slovakia in the last decade retains the character of economic recession. It results in a lingering, deepening social and cultural crisis. This is why we cannot speak of sustainable development in the Slovak Republic. The reasons of chronic economic recession in the Slovak Republic with minor growth fluctuation are beyond the scope of this work. The fact that regressive economic and especially financial development of Slovakia is accompanied by lagging behind in solving environmental issues of Slovak society is a serious problem. Even EU agencies pointed to this fact in 2000.

The main principle of sustainable development of society is the saving of inputs into social reproduction process in all branches of economic and social activity. The statistics of the development of material and energy consumption in Slovakia prove the exact opposite: material consumption grows, as well as material and food imports and even waste imports – secondary raw materials, metal scrap and paper. Increasing amounts of timber are extracted and exported from our forests including rough logs. Production of waste has increased and its depositing is inefficient.

The principles of sustainable growth recommend products with long service life, repairable. The principles of profit growth lead usually to the exact opposite in production and sale of products.

Short-term use of products and their cyclic replacement becomes more common. It's frequently caused by their low quality or fashionable variations. This is obviously convenient to producers, importers and vendors: the faster products deteriorate, the more can be produced, imported and sold. Individual profit grows. Under these circumstances, it is illusory to declare or require measures for saving natural resources or materials, because it would result in lower production, lower turnover and lower profit.

However, the possibilities for future generations to use natural resources preserved by current generation decline. More importantly, increasing foreign debt can lead to future situation, where paying off the debt might necessitate further exhaustion of natural resources, thus inhibiting the sustainable growth.

International Chamber of Commerce in Paris (CIC) in 1991 adopted the "Enterprise Charter for Sustainable Development. Fundamentals of Eco-management" (8). Eco-management was described as a crucial, decisive instrument of sustainable development. CIC recommended to its members to implement the fundamentals of eco-management and simultaneously advised to request it from their subcontractors. Integration of eco-management into global management is the first principle. Main objectives include radical savings of material and energy inputs into economic processes and avoiding harm to the social environment. However, the CIC document "Enterprise Charter for Sustainable Development. Fundamentals of Eco-management" was never publicized in the Slovak Republic as a separate material intended for public. Several translations exist in various publications, usually as appendices (9) or commentaries (10). No wonder that Slovak entrepreneurial elite is only marginally interested in implementing eco-management and using its principles for sustainable social development.

In recent years following the adoption of the EU regulation on eco-management and environmental auditing (11) and especially since the adoption of EU standards ISO 14000 and its Slovak translation STN EU ISO 14000 first twenty Slovak companies succeeded in acquiring the international certification based on there standards. Twenty companies represent only a minuscule part of economic subjects in Slovakia that realized the necessity to environmentalize their products, production and management.

Current status of eco-management in Slovak enterprises greatly lags behind the use of environmentally-friendly technologies, products and eco-management in EU countries. For this reason, sustainable development strategy of the Slovak Republic in this millennium will remain only a desired vision, analogous to the vision of restoring the level of economic and social development to pre-1990 status. How to cope with this undesirable situation in the context of sustainable development? This is what the development strategy of Slovak society should indicate. Unfortunately, there is no such strategy at the beginning of third millennium.

Nevertheless, we must face the real situation. We must stop painting everything in bright colors to make everything appear 'alright' when most of Slovak population has a different opinion.

Much has changed in the everyday life in the last years, both improved and worsened. Sometimes the EU institutions have to point at the negative development or non-solving of lingering problems when assessing the readiness of Slovak Republic for the EU.

Manipulation with statistics and comparing of economic figures with neighboring countries is not enough. Officially, no one has yet publicized an analysis of the disastrous situation in Slovakia at the verge of centuries. The reasons are unpleasant and it is difficult to speak or write about them. Not only are they unpleasant, they also are socially undesirable and dangerous. It is not easy to present plain truth to someone. Circumstances are not suitable yet for the small child's courage to say, "the king is naked". This small frank child from a fairy-tale had that courage but adults are generally more cautious. Eradication of the barriers to sustainable development, which is an imperative for each country in 21st century, as well as eco-management as its main instrument, cannot be accomplished by reversing to the pre-1990 status, as some argue. Ten-year experience proves that a decade of "free market economy" and removal of the role of "democratic" state did not solve the problems of Slovak development, did not raise the living standards of decisive part of Slovak population and failed to provide social welfare, cultural development etc. What are the possibilities then?

If the return to the past is impossible, if ultraliberal market economy striving to remove state's influence on life did not meet the expectations of the population, the only solution can be in another, third way of developing society, combining the principles of capitalist market economy with socially- and environmentally-oriented state. This would also allow the existence of mixed public-private enterprises based on experiences from some of the Western European countries (12) based on so-called mixed economy. Its principles have been a taboo in the past as well as in today's social, political and ideological life. All economies of industrially advanced countries have this kind of mixed economy. Pure market economy actually never really existed, only in theories and textbooks (13). How to reach mixed economy, how to find the third way in Slovakia and perhaps others central and eastern European countries, is a topic for expert discussions, not for useless politicking. It is a matter of realism beneficial for the country, European integration and social and economic development of Slovakia that would allow us to enter EU as an equivalent partner and not as a poor neighbor.

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Integrated Competitive Advantage Creation

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Abstract

A competitive advantage in the global market is not a simple individual benefit for a consumer but a complex attributes raising his/her needs satisfaction. Though, it must be multidimensional and company must create an "integrated product" which provides a consumer with world parameters at the same time plus something extra. It is necessary to create a new type of a competitive advantage - an integrated competitive advantage. A company can built its integrated competitive advantage with a new approach of satisfying customer's needs in the following principle: to supply customers with special benefits together with the lowest selling price of a product or to reduce other costs and resources of a customer. The basis for creating integrated competitive advantages must be a process of systematic strategic marketing analysis. The advantage of such an analysis is that it can help to a permanent active competitive advantages creating and facilitates getting ahead of competition.

Introduction

Both the deepening globalisation and the rising saturation of the world market force the firms to intensify their interest in competition problems. Also the competitive advantage has to be comprehended more widely than so far. The success in the world markets consists in finding a set of extraordinary, unique qualities representing a special value for a particular part of the market and providing them in a better way than the competitors.

Integrated Competitive Advantage Substance

Generally the merit of competitive advantage is perceived as a firm ability to produce and sell products and services more valuable than competitive products.[1] A value of a product is given by the degree to which the customer values the whole ability of the product to satisfy his/her needs, which naturally motivates his/her buying behaviour. When deciding the customer investigates and evaluates values of single offers and tries to optimise the total net benefit from the bought product. A rational customer selects the offer bringing him/her the biggest so-called consumer value added. [3] It is a difference between what consumer acquires – total consumer value (a collection of acquired benefits) and what he/she inputs into it while evaluating, acquiring and using the product – total consumer price (a collection of "prices" expended on evaluating, acquiring and using the product). Total consumer value is derived from how consumer perceives and evaluates acquired products together with joined services, a quality of serving personnel and image of the company he/she buys the products from. It is evident that the better the attributes of offer from the view of a consumer are the more valuable they are for him/her. The consumer price depends on buying price, time consumption, invested energy and psychical load with which the customer's effort of evaluating, acquiring and using the product is connected. We should be aware of fact that the consumer perceives all these attributes of a consumer price complexly. The low buying price of product doesn't mean automatically the low consumer price -if the product isn't available and he/she must search it, it often breaks down during usage and mach effort is necessary to put it again to operation. A customer must dedicate a lot of time, energy and psychical power for buying and using it according to his/her ideas, it increases its total consumer price.

A competitive advantage creating means managing both parts of consumer value added because only than it is possible to find an offer configuration and target market service which leads to the biggest consumer value added, i.e. bigger than a competition offers – to competitive advantage. It is possible to acquire it only by finding the way of offering the customers an exceptional consumer value added which the competitors don't provide at all or not with the same parameters.

Today's literature recommends creating a competitive advantage based on single parts of a consumer value added, not on their suitable combination, mutual co-operation and harmonisation. Porter [8] recommends to create two types of competitive advantage, either an advantage of low costs (decreasing total consumer price) or an advantage of differentiation, based on perfecting products or services or personnel or image (increasing total consumer value). This approach is according to our opinion overcome nowadays because it suggests devoting effort to only one part of a consumer value added and in its frame building a competitive advantage on single contributions. We suppose that it is necessary to offer customers the whole collection of contributions and i.e. both those increasing total consumer value and those decreasing their total consumer price. Porter's conception of competitive advantages from its substance eliminates many variants of products and ways of target market serving resulting from synergy between single parts of total consumer value and total consumer price. It then creates a pressure on the development of all company resources and abilities that are necessary for more suitable and more effective satisfaction of customer desires. Also Kotler's conception of three types of competitive advantages [4] – the advantage based on charging of lower price, the advantage based on decreasing other costs of a customer and the advantage based on increasing individual value for a customer by offering individual adaptation of products and services for him/her – is according to our opinion limited. Though he takes into account more aspects of offer beneficial for customer than Porter, he (as Porter) recommends to devote attention to only one part of creating customer value added – either decreasing of total customer price (the advantage based on charging lower price or the advantage based on decreasing other costs of a customer) or increasing total customer value (the advantage of increasing individual value for a customer).

The customers nowadays however demand conceptually quite new ways of satisfying their needs or increasing individual value by offering individually adapted products and services together with the lowest consumer prices. All the time they want more and more perfect products, services and care about the products - often unexpected and thus more attractive, connected with low consumption of resources for their buying and using. For these reasons we suppose that when creating an integrated competitive advantage it is always necessary to build the competitive advantage on more components i.e. on all which can contribute to increasing customer value added, not only to total customer value or total customer price.

We cannot take in a competitive advantage as a simple individual benefit for a consumer but as complex attributes raising his/her need satisfaction. This competitive advantage must be multidimensional and company must create **“integrated product”** which provide a consumer with all world parameters at the same time and something extra. It is necessary to surprise consumers pleasantly with better supply than competitors to gain different and important position in the mind of consumers. It is necessary to create up-to-date new concept of competitive advantage in principle respecting nowadays´ conditions in the world markets - **integrated competitive advantage**. We take into consideration two conception of this advantage – conception of quite new manner of customer need satisfaction or conception of individualisation (perfect product and services accommodating to specific customer needs), but both connected with low total customer price, to rationalise maximally resource´ consumption at customers, distribution channels and producers.

Process of Integrated Competitive Advantage Creation

In contemporary turbulent, global and hypercompetitive environment it is always more difficult to create the competitive advantage on the target market for companies. Dynamically changing market environment forces the companies to create their offer for maintaining their competitiveness so that it fulfil all worlds parameters together and brings to customers all the time something in addition.

This time the success in the market doesn’t consist in individual things but in continual searching and creating the whole collection of unique and extraordinary qualities which represent special value for particular parts of the market and which the company is able to offer better than competitors.[2] Multidimensional comprehended start before competitors – an integrated competitive advantage – can be acquired only by the company which always proves to find always new and surprising ways of creating a bigger customer value added and provide it. This is possible to reach not only through perfect offering expected collection benefits, but above all revealing and satisfying for the moment unknown latent needs, of which satisfying make customers pleasantly surprise and inspired. The bigger the actual consumer value added is in comparison to the expected the bigger is customer satisfaction feeling. [3]

The conception of an integrated competitive advantage asks for quite different actions at its identification. To reach it, we can use analysis of strengths and weaknesses of competitors as a certain base. [7] This process is insufficient for identification of competitive advantage because it is based only on comparing resources and abilities of competitors and it isn’t considered if and to which extent these resources are important for increasing customer satisfaction. At this analysis Kotler [3] admittedly proposes at first to map the current wants of customers, those, which customers let know, to measure their satisfaction and the level of resources and abilities of simple competitors, which are for customer's satisfying necessary. It is evident though, that on this base created competitive advantage is not able to last long, because it doesn’t bring anything surprising for the customers. These days only that company can be successful capable of coming up with new more perfect ways of satisfying customer resting in a whole set of special benefits valuable for the customers. It is necessary to take it into consideration at building identification, better to say at creating an integrated competitive advantage for target markets.

We propose to use as a basis the dynamic conception of strategic marketing analysis (further SMA BU).[6] SMA is a systematic researching of a company external and internal environment resulting in the identification of market opportunities and threats and in the company capability to exploit these opportunities and to eliminate the threats.[7] SMA is constituted by many particular phases (analysis of total environment, customer analysis, market segmentation, competition analysis in market segments, macroenvironment analysis in market segments, estimating of demand and forecasting of sales in market segments, analysis of market segments attraction - see picture 1) which are logically connected and considered as the basis for strategic marketing planning. For identification of integrated competitive advantage, on that basis we can than define certain competitive strategy, it is necessary to take these steps:

General analysis of overall market situation and market development and company position in it

- Overall analysis of marketing macroenvironment and its influence on branch and business unit
- Analysis of overall sice and development of market
- Analysis of overall competition environment and company position in it

Analysis of customers

- Analysis of contemporary ways of customer need satisfying, analysis of customer process of buying and using of product and identification problems connected with it – determining of possibilities of its refining
- Analysis of potential customer wants and preferences of these wants
- Analysis of contemporary resources of, the suplies, the parameters of products and services from simply supliers, and customer satisfaction with them
- Comparison of possibly and contemporary ways of customer need satisfying and identification of all parts (expected and especially latent, surprised) of customer value added increasing

Strategic market segmentation

- by the conception of increasing of customer value added

Analysis of competition and competitivnes of company in market segments

- Identification of competitors
- Analysis of competitor objectives and goals and their objectives and basic and functional strategies (especially marketing and innovative strategies)
- Analysis of those internal competitor and company resources and abilities which are necessary for increasing customer value added – determining of their strenghts and weaknesses and components of integrated competitive advantage

FIG. 1 PROCESS OF INTEGRATED COMPETITIVE ADVANTAGE CREATION

Conclusion

It is shown that in contemporary global and hypercompetitive environment the companies cannot built their competitive advantage and position on simple special benefits for customers but it is necessary to offer them the whole collection of extraordinary benefits as integrated product. It calls for building and creating the integrated competitive advantage on the target markets. These unique benefits should lead to increasing consumer value added and therefore they should relate to both increasing total customer value and also to decreasing total customer price. The single parts of customer value added have to be unique and extraordinary for customers. To reach it at creating integrated competitive advantage it isn’t enough that companies only passively react to wants expressed by the customers but they must necessarily to initialise the changes in customer needs satisfying. That is for better, perfectly and effectively customer serving in future by certain unique way for customer than a competition will. We claim that creating integrated competitive advantage should start from active searching and creating not only those customer wants and desires, which he/she notifies but also from those which are hidden, latent parameters of satisfying of his/her needs. The substance of this process is to build a competitive position, which leads to permanent company prosperity, and grow up.

The basis for creation of integrated competitive advantages must be a process of systematic strategic marketing analysis of business unit, especially its phases “Analysis of overall situation in the market and company position in it”, actively approached “analysis of consumers” leading to revealing not only current, but also latent, often subconscious customer´ wants and desires, “strategic market segmentation” on the basis of preferred concepts of satisfying customer´ wants and desires” and “analysis of competition and own position in target market segments”. The advantage of such a succession of analyses is that it can help to a permanent active multidimensional integrated competitive advantage creating and facilitates getting ahead of competition. The company doesn’t wait for what the market asks but in advance it supplies better and more suitable its needs and wants satisfaction.

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Making FDI Work for Sustainable Growth

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Abstract

This paper considers the role of foreign direct investment (FDI) in sustainable economic growth with focus on the Czech Republic. It is partly a theoretical review of the impact of FDI on host country's economy in terms of sustainable growth and the two studies that are being conducted by Faculty of Business and Management. At the same time, it provides broader economic underpinnings for the specific issues relating to FDI, economic sustainable growth and government policies in attracting FDI.

The impacts of FDI on sustainable economic growth are discussed as well as their links with economic policy of host country. The role of promotion as a key instrument in attracting FDI is discussed in detail and also the reasons of FDI moving into the recipient economy.

The conclusions and recommendations are intended to help policy makers to consider in-depth assessment of the implications of FDI on sustainable growth; and, conversely, make effective decisions on economic development issues.

Introduction

It has thus been widely acknowledged by governments that foreign direct investment (FDI) can play a key role in the economic growth and development process (UNCTAD, 1996). It is also true that under the current turbulent world economy, transition countries should aim for equity inflows (FDI) if they want economic growth to last, after shifting from central planned economy. However, the time series for FDI flows to transition countries, are not yet long enough to draw strong conclusions since the flows started intensively only at the beginning of the 1990s (see Table 1). Therefore, a thorough effort to measure the benefits that transition countries have received from international capital mobility would require more time for better comparison.

In order to understand the impacts of FDI on the economic sustainability of the transition country's economy, there is a need to look at the channels through which the benefits and risks of FDI emerge and what the host countries should do to attract those FDI that could bring long-term benefits, so is economic sustainability.

We will also see if FDI are essentially the consequence of the economical openness of host countries but also of the capacity of the transition countries to stabilize their economic and political environment (Bevan and Estrin, 2000).

Definition of FDI

There has been a significant change in the definitions and measurement of direct investment for the past few decades. Despite the efforts by different researchers and agencies putting forward the idea for uniformity of an FDI definition, still definitions and measurements differ among countries. Among them include the eclectic model, conventional economic theory, oligopolistic theory, monopolistic advantage theory and internal economies of scale. The United Nations has also offered a more flexible definition that does not insist on equity, that is; the foreign investor does not require control only a significant influence. Rutherford (1995) defines foreign direct investment as investment in another country which often takes the form of setting up of local production facilities or the purchase of existing businesses.

The United Nations Conference on Trade and Development (UNCTAD) defines foreign direct investment as an investment involving management control of a resident entity in one economy by an enterprise resident in another economy. According to OECD (1996), an enterprise with direct investment can be defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise. These definitions concurred with the definition used by Czech Republic, during which FDI means ownership by a foreign investor of 10% or more of the equity capital of a firm, which is a conditional on the investor having a lasting interest in the firm and participating in its management. A direct investor needs not own a controlling stake or the largest stake in the firm.

A Conceptual Framework of Foreign Direct Investment

The history of foreign direct investment is relatively short for transition economies (see table1) Foreign direct investment inflows have been growing, although at lower pace than imports of goods. Countries like Czech Republic, Poland and Hungary, which are aspiring to join the EU, have received significant inflows of FDI (see table. 2) after introducing adequate market institutions and legal systems in the second half of the 1990s.

Table 1: FDI INFLOWS BY REGION, 1990-1999 (US$ BILLIONS)

Region	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999***
Developed countries	171	115	118	138	141	208	212	276	468	609
Developing countries	34	43	52	76	100	107	138	172	173	198
Central & Eastern European countries	1	3	5	7	6	15	13	19	20	20
World total	206	160	175	220	247	330	363	478	660	827

**Estimation*

Source: UNCTAD, FDI/TNC database

Table 2: COMPARISON WITH POLAND, HUNGARY, AND SLOVAKIA (USD MIL.)

		1985-1995 (Annual average)	**1996**	**1997**	**1998**	**1999**
Czech Republic	Inward	0.540	1.428	1.300	2.720	5.108
	Outward	0.024	0.153	0.025	0.175	0.197
Poland	Inward	0.768	4.498	4.908	6.365	7.500
	Outward	0.015	0.053	0.045	0.316	0.200
Slovakia	Inward	0.080	0.251	0.206	0.631	0.322
	Outward	0.004	0.052	0.095	0.146	-0.372
Hungary	Inward	1.090	2.275	2.173	2.036	1.944
	Outward	0.012	-0.003	0.431	0.481	0.249

Sources: World Investment Report, 2000

The motives of foreign investment have been explained to be mainly the search for markets, natural resources and cheap assets, and efficiency (Lankes and Venables, 1996). They move to recipient countries to exploit a profit potential that cannot be achieved in home countries (see also Michalet, 2000; Dunning, 1995). Looking at transition countries, the foreign investors have been able to enter the markets of these countries, market their products and have grown to the level that they are now almost monopolizing some sectors. Also, some have been using their new production bases in Czech Republic to penetrate into the regional markets of the former socialist countries.

As we have said, resources are also one of the reasons that have led enterprises to move their operations to former socialist countries. They intend to exploit the availability of a large pool of educated, trainable and relatively low-cost labor, and geographical proximity to Western Europe (Green and McNaughton, 1996), and other inputs such as transportation and communication costs to and from their home headquarters[1]. The conditions in Czech Republic are ideal for them in establishing their corporate networks in the rest of Eastern and Central European markets.

Advocates of capital flow assert that foreign direct investment can assist in updating the inefficient industrial sectors of the former socialist economies (Frydman and Rapaczynski, 1994). According to them this could be achieved through privatization of the former state property to foreign investors. They continue to argue that the industries would be transformed to be able to compete in the global market and firms established through privatization and greenfield investments, could help the former socialist countries to speed up their economic growth (see Blanchard, 1996).

Others claim that foreign direct investment offer enormous benefits to host country's firms and to the economy as well. They argue that foreign direct investment modernize industries in transition economies by allowing them to join the global research and development networks and thus facilitate the transfer of technology (De Gregorio, 1992; Blomstrom, Lipsey and Zejan, 1992) and not to forget about the investment capital that they bring with them (see also Lipsey, 1999). Also, foreign direct investment brings the most needed modern knowledge and managerial skills and techniques (see Blomström, Kokko, and Zejan, 1994; Haddad and Harrison, 1993; De Melo, 1999; Markusen and Venables, 1997; Fabry, 2000).

The impacts of FDI on a host country's growth are expected to be more widespread than those from domestic or state owned firms (see Estrin, 2000). As we have said, they include technology transfer, employment, skills and training, development of new activities such as services linked with FDI. But, the definite impacts of FDI on the output growth's in the host country depend on the spillover effects to domestic firms (Blomström and Kokko, 1998; Blomström, Kokko, Zejan, 2000). FDI leads to increasing returns in domestic productions, and increase in the value-added content of FDI-related productions. Local producers and subcontractors' products are more technology and know-how intensive. But the relationship between inward FDI and growth is not so obvious and automatic.

It is true that FDI is likely to create additional output growth through rising productivity of local factors, e.g. labor, etc. and falling production costs. However, after the start-up period of an investment, characterized by a net inflow of resources into the host country, any foreign investor will eventually expect to repatriate earned profits. Depending on the level of taxation this can cause a significant capital outflow and pressure on the host country's balance of payments (Meier 1995; WTO, 1996).

Critics of the market economy on the other hand argue that foreign investment is the new way of trying to rule the world economically (see also Korten, 1995; Ferrer, 1997; Geyer, 2000; Foster, 2000; Harman, 1996). They claim that foreign investment leads to unequal development, because most of the profits from the host countries are transferred out of the country. Therefore the economic growth difference between the host country and the country from which the foreign investment came from becomes greater than before (see also Kapstein, winter 1998/99).

Foreign direct investment was the US administration's answer to why there will be no Marshall plan for the former socialist countries of Eastern and Central Europe. To assess whether this policy was good or not, we need more time, but as we have said, critics of capital flow have already started to argue that foreign investment assists in the transfer of economic control and wealth to foreign powers[2] (see also Ferrer, 1997; Geyer, 2000; Foster, 2000), eventually resulting in economic decline.

Government Efforts to Attract FDI

Investment incentives

Most of the transition countries have adopted development strategies that will help them harmonize their economies with the global economy. To achieve some of these strategies, these countries have found that they cannot do so without attracting foreign direct investments. One of the tools they found to have more positive impact in attracting investors due to big competition among themselves is the use of incentives.

The packages offered by these countries vary greatly. The competition for FDI is highly intensive, thus, making it difficult for potential host governments like that of Czech Republic to offer less favorable conditions for foreign investment than those offered by other countries such as Hungary, Poland or Estonia. The battle for FDI between transition countries has increased with the hope that by opening their economy more it will increase their chance to join the European common market, especially between Czech Republic, Poland, Hungary and Estonia which are in the first list of possible candidates.

Czech Republic for instance, as from 1999 has been offering an incentives package of corporate tax relief for up to 10 years, import duty free no VAT on new machinery, job training grants that cover up to 50% of the total cost per employee trained or re-trained. Also offered are job creation grants of up to a maximum of CZK 200,000 (approximately USD 6,000) per citizen employed in regions with high unemployment rate, land and designated infrastructure at less-than-commercial prices, etc. (CzechInvest, 2001)

For instance, Ribeiro (2000) argues that once the realities of using investment incentives to compete for foreign direct investment are taken into account, one may be tempted to conclude that the world economy - and the vast majority of individual countries - would be better off with a multilateral agreement that include limitations on the use of investment incentives. He continues to explain that such incentives are no different from any other kind of subsidy program and, as with most other kinds of subsidies, developed countries and the transition countries as well, can out-spend the vast majority of other countries.

Subsidies and tax breaks offered to foreign firms are much more than government's funding of social schemes, for example, education, research and development, etc. (Mallya, 2001). We are of the opinion that sustainable economic growth could be achieved when there is long-term strategy to maintain the country's comparative advantages over others. This requires also more investment in education and research and development[3], as well as subsidizing investments, so far as their long-term position in the local economy is clear.

Transparency

Some researchers have argued that transition countries should rather encourage transparent and predictable rules, provide the necessary infrastructure and avoid macroeconomic extravagancies instead of raising fiscal and other incentives or lowering their labor and environmental standards to attract FDI (see also Reisen, 2001; also Aizenman, and Yi, 1997). However, the result of our research shows that transition countries, especially those aspiring for EU membership, including Czech Republic have already implemented most of these requirements, but still FDI continues to flow to those locations which offer quick returns or more logistical benefits (e.g. Latin America, Asia, etc.). Therefore, we can argue that for sustainable economic growth to be achieved through FDI, the question is not the level of transparency of the host economy that will attract large number of FDI, which will then add value to the host country's economy, but rather, what are the motives of the multinational enterprises[4].

Promotion

Results of our studies show that, most of the government agencies responsible for attracting FDI in the transition economies to date have just been acting as marketing agencies for their countries. Their tasks mainly focused on promoting their countries abroad, provide foreign investors with necessary information regarding the investment climate and conditions, as well as advising them on financial or legal service issues.

Their strategic goals do not differ very much. Some of them though have recently managed to redefine their strategic goals (e.g. CzechInvest), from just been a promotion agency to development focused one. CzechInvest newly created strategic goals for instance, include active influence on the quality of the investment environment in the CR and maximization of the positive economic effects of FDI. This could be considered to be a turnaround from its former main objective of attracting as much FDI as possible. The agencies' participation in defining and realizing the government's industrial policy in most transition countries has been very limited, despite been government institutions and under direct supervision of different ministries. Therefore, involvement of these agencies in policy-making process is inevitable for their objectives to have impact on the sustainable growth of their economies (Ribeiro, 2000).

Under the conditions in which the agencies have been operating the results indicate that there has been an information or coordination failure in the investment process, which has led to these countries attracting insufficient FDI (see fig. 3 for inflows into Czech Republic). We are of the opinion that they might have been attracting wrong quality of FDI, as some of them have left these countries after a short stay. Also the amount reinvested is very small compare to investments returns. This could be argued that, the interests of foreign investors were not in consistence with the economic interests of the transition countries.

As Wells (1999) explains, the administration problems facing promotion agencies derive from three characteristics of investment promotion: it is a public good, it requires skills (the main problem of most of the agencies in transition countries)[5] that bridge the public and private sectors, and performance is difficult to measure. He argues that the country's investment promotion agency should become deeply involved in trying to reduce the bureaucratic red tape that investors face and understand what kinds of services investors expect from the agency.

As we have said earlier, the Czech governments as well as other governments in the economies run most of the promotion agencies directly. This includes funding and making other decisions. Government funding, however, does not necessarily mean that the organization carrying out the activity has to be government owned. It is not strange for government to contract with private parties to provide services for which government pays (Wells, 1999). Therefore, promoting FDI and a transition country's attractiveness will probably require new rules in the coming years.

Foreign Direct Investment Performance

Inflows of FDI into the Czech Republic in 1999 almost doubled from $2.7 billion to $5.1 billion due to turnaround in privatization process. Although in 2000 the total foreign investment in Czech Republic reached $4.6 billion, the figure was less by $1.7 billion when compared to 1999 inflow (see table 3 and 4). This was caused by poor results from the sales of the strategic companies (e.g. Ceská sporitelna, Becherovka, etc), which did not bring much income to the government's coffer. Most of the FDI flows into Czech economy in 2000 went to greenfield projects, such as construction of production buildings, distribution warehouses or other commercial buildings.

TABLE 3: CZECH REPUBLIC FDI INWARD FLOWS IN 1993-2000 (USD MIL.)

Year	Equity capital	Reinvested earnings	Other capital
1993	653.5		
1994	868.5		
1995	2 562.2		
1996	1 428.4		
1997	1 300.4		
1998	2 539.6	180.2	998.1
1999	4 877.0	689.9	757.1
2000*	3 689.5	518.3	387.3

*Preliminary data

Source: Czech National Bank, 2001

Table 4: COUNTRY OF ORIGIN OF SOME MAIN INVESTORS IN CZECH REPUBLIC

Country	Total investment 1990-2000 (mil. CZK)	Total investment during the first quarter of 2001 (mil. CZK)
The Netherlands	232,621.9	10,704.4
Germany	206,912.1	8,235.5
Austria	100,150.3	2,998.5
USA	48,203.6	1,569.2
UK	36,965.6	435.1
Belgium	35,763.7	349.6
France	34,493.2	536.3
Japan	4,737.2	184.9

Source: Lidové Noviny 2001

The Czech sectors to which most of the FDI went in 2000 were financial, commercial and real estate (Lidové Noviny 2001). It is true that the amount of FDI invested in electronics and automotive sectors is increasing, but the trend is not clear, as the global electronics market is experiencing stagnation and some of foreign firms in the sector have recently moved their operations out of the country or cut down planned investments.

Hence, the government needs to focus on attracting those FDI that would ensure long-term economic growth, that is; attracting those FDI that will bring with them high added value to the economy. Such investments include for example research and development, since it has been shown that they create better and long-term working opportunities, as well as increasing knowledge capability and technological competitiveness of the host country[6]. Types of investment like the assembling plants that have mushroomed in different locations could be seen as short-term ventures that can anytime disappear as they appeared[7].

Our studies also tried to look at whether FDI had impact on creation of new firms to allow fair competition and to help reduce the monopolistic position of the former state owned firms. We found out that, they have themselves turned out to monopolize some sectors. It might be that they were attracted just because there are oligopoly rents to be earned in those industries and in this case it would not be in their interest to increase local competition[8] (see also Lall, 1998; Dunning, 1980). It is true that they have helped to stimulate the emergence of a private sector that accounts for a growing share of the workforce in the country and help these local firms to have access to the Western markets. Nevertheless, this has been in harmony with their policies or strategies, as when they leave the country, the local suppliers found themselves in difficult position.

When trying to find if there were foreign firms which entered the market with what Metzner (1996) calls "market-destroying behavior", we found out that some of foreign firms also fall under this category. Some of them acquired local firms through privatization and after sometimes they started to cut down production and increased outsourced inputs manufactured by other domestic firms as well as from neighbor countries. The finding could be argued to be partly consistent to what Bakos (1995) and Bailey (1995) find that foreign investment tends to re-establish and strengthen monopolies and cut resources spent on research and development.

The results of the studies also indicate that among foreign firms which have for instance invested in South Moravia, 93.75 % of their production is exported and 90% of them have pricing policies that focus mainly on gaining market share and maximizing profit. What does this tell us? They are using South Moravia as a production base for their exports, exploiting the well trained Czech labor force, but providing short-term working opportunities before they disappear when the global market for their products changes or when for instance the Czech Republic joins the more competitive EU market (Mallya, 2001).

For those foreign firms which were seeking to acquire and/or exploit intermediate inputs such as certain types of know-how [9], the results show that they were willing to share the equity of their affiliates with the local partners. The main reason was that such knowledge is difficult to describe and often tacit, and its purchase on the market would have been subjected to high transaction costs, or unclear information whether management of local firms would have been prepared to sell it. Thus, how much foreign investors need to know to successfully operate in the Czech Republic is probably a function of the extent of differences in cultural values and behavior between their home country and the Czech Republic.

Therefore, apart from setting up of new plants, most investors have shown a preference for local partnerships, through which they can bypass certain regulations on property ownership, reduce initial costs and take advantage of the knowledge and established market shares of local and non-local partners already present in the domestic and regional markets.

Need for Strategic Change

As we have seen, foreign capital flows, mainly in the form of foreign direct investment play an important role in the on-going economic reform in central and eastern European countries, particularly in the Czech Republic. It is true that FDI will continue to play a significant role in the transition from centrally planned to market-oriented economies, as the governments in these countries have introduced policies, laws and regulations designed to attract inward investment and facilitate structural change. These laws and regulations have continuously been extended and revised, with a view to enhance the climate for FDI in all economic sectors.

The argument by some critics that the commitment of governments to structural transformation has been slow is unfounded, since the pace at which these countries such as Czech Republic introduced the structural changes was more rapid than anticipated. Therefore, this should not be seen as the reason why there have been less inflows of FDI than initially expected. The transition economies are more complex than most of western critics tend to think. Experience has shown that it is not easy to manage an environment that has been under a different kind of management system for decades and rapid changes are not so easy to introduce over night.

It is true that sometimes transition countries were reluctant to accept FDI. But in order to be able to achieve political and social stability (see also Cable, 1995) the authorities had to weigh between giving an advantage to acquire a business been privatized to national operators such as managers, employees or foreign investors. (see also Sinn and Weichenrieder, 1997). Moreover, management buy-out or management-employees buy-out is one of techniques used in privatization. The question is whether those managers/employees were able to transform those firms into effective ones[10] and this is another study (see Aoki and Kim, 1995).

Managing FDI policy effectively in the context of a broader competitiveness strategy is a demanding task. FDI will only be attracted into those countries that have comparative advantages. The government agencies should understand that FDI might enter into their countries, but its benefits are likely to be static and will run out when existing advantages are used up. Thus, to ensure that FDI is sustained over time and enters new activities, it will require policy intervention, both to target investors and to raise the quality of local factors (see Culem, 1988; Green and McNaughton, 1996; Ribeiro, 2000).

The task now should be to create a strategy that suits particular conditions of country like Czech Republic at any particular time, and evolves as the country's needs and its competitive position in the world change. Formulating and implementing an effective strategy requires above all a development vision, coherence and coordination. It also requires the ability to decide on trade-offs between different objectives of development (Ribeiro, 2000).

Therefore, Czech Republic should bear in mind that foreign firms could cause decline in total employment and real income, if their technology transfer is not accompanied by substantial capital investment (see also Batra, 1986). Small economies like that of Czech Republic, however, may require being careful against too much FDI too quickly. Flows of FDI that are too large for the absorptive capacity of the host economy are likely to bring about negative side effects such as the appreciation of the exchange rate, which in turn has a negative impact both on export development and import substitution (Froot and Stein, 1991).

Concluding Remarks

The paper tried to argue that while FDI is certainly not the most important source of production capital in market economies, however, it might play an important role in economic growth in a country like the Czech Republic. We are also of the opinion that openness of host countries like Czech Republic to FDI is not necessarily linked to economic growth (see also Baldwin, Braconier and Forslid, 1998). In order to promote economic growth, government policy needs first focus on supporting growth and this could be achieved through keeping spending and tax rates low for instance.

Further, instead of pursuing a traditional industrial policy, the government approach should be more long-term focused, such as spending on activities like promoting export, tax incentives for research and development relevant for production, support for training and education (see Romer, 1993; Borensztein, De Gregorio, and Lee, 1995), which are the main problems we see facing most of the transition countries including Czech Republic.

We are also convinced that economic growth could be achieved through early membership of the EU for those countries in the first phase of possible EU membership) and with good government strategies to promote economic growth, then the required level of economic growth could be achieved (see Sachs and Warner, 1996). Certainly, there is need to analyze in depth what this might mean both for the countries concerned and for the EU itself (Hare, 1996).

Key words: Foreign direct investment, Sustainable growth, promotion and promotion agency, incentives, and transparency.

Notes

[1] For instance transportation firms from German have not only opened affiliates in Czech Republic, but they are using cheap Czech labor force to do some other duties in German. This has given them competitive edge over their competitors who could not open subsidiaries across the boarder. This has forced the German government to intervene and introduce regulation that requires Czech truck drivers to obtain working permit if they want to operate in German even for a short period).

[2] Under Marshall Plan, most of the enterprises in western countries remained in the hands of local business people, but through FDI and privatization most likely the economic power is going to move to foreign hands. If we take for instance the influence German has over Czech economy (see fig. 2), thus, we could argue that in case of withdraw of German capital the Czech economy will be in big trouble and the results of such move - unpredictable.

[3] Empirical findings so far have found that one of the factors that attract foreign investments is the skill and knowledge processed by the host country. As Drucker (1997) puts it, knowledge has replaced the economist's "land, labor, and capital" as the chief economic resource.

[4] Foreign firms are also known as Multinational Enterprises (MNEs), Transnational Corporations (TNCs), Multinational Corporations (MNCs) or simply Multinationals. All these terminologies may be used in this work to mean one and the same thing unless otherwise specified.

[5] Foreign experts have not been able to provide the necessary base of middle managers and sound administration system necessary to carry out the required reforms. The country needs well-trained local experts, as we believe that the country lacks capable financial and planning work force to carry out government objectives on FDI.

[6] The decision by IBM to invest in Brno could be taken as a positive one to the Czech economy.

[7] Our studies indicate that there are firms which came with big plans and they were provided with all necessary support, but they left within a short period without prior notice, due changes in the market for their products or their customers changed their strategy.

[8] A good example is the Czech Telecom, during which the entry of foreign strategic partner did not bring any cost benefits to its customers. Foreign big supermarkets is another example, because they were able to destroy the small shops in towns and now have monopoly and dictate prices and demand commissions from their suppliers for their products to be displayed in their shops.

[9] There are specific knowledge and tacit technologies, which are owned by countries like Czech Republic, and there was no easy way for foreign firms to obtain them other than going into partnership with local firms.

[10] There are successful stories of local managers who were able to adopt the new way of doing business in market economy environment.

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New Economy in Central Europe

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Abstract

The purpose of this paper is the description of current development towards New Economy within Central Europe region. Overall conclusions supported with findings are based on various statistical resources. Trends of possible future development are proposed at the end of the paper.

When evaluating the overall status of Internet usage, mobile phone communication and e-commerce in countries of Central Europe (CE) it is important to take into account our recent past. Under the state planned economies there were no private banks, no stock markets and credit cards were virtually non-existent. Despite these facts we can observe several bright lights and improvements as countries in this region have moved forward with computerisation and Internet access. On top of this, educated literate scientists and best students from CE already became global citizens.

Conclusions

1. Overall economic stability and sustainable economic development are necessary prerequisites of further e-commerce growth within the region.
2. Overall IT investments are lower than in U.S or European Union (EU), however despite the limited resources CE countries are trying to close the gap.
3. PC and mobile phones penetration and Internet access are significantly lower in CE than in U.S or EU. Increase of these devices penetration would drive further development in field of IT.
4. CE region stayed outside the Internet wave but despite this fact e-commerce is steadily growing, however with much slower pace than it was in the U.S or Western Europe.
5. The mindset change of Internet users is necessary for further growth of e-commerce within the region i.e. shopping habits or trust to virtual brands

Key findings

Main obstacles to e-commerce development

There were four main barriers of e-commerce development in CE identified: i) low internet access, ii) lack of trust in on-line payment, iii) low wages and iv) superstores such as TESCO Plc., IKEA and others that are new phenomenon in the CE region and for many people “it is more social than shopping”[i]

Overall economic situation

Basic reason for low investments to computerisation and digitalisation is lack of resources in developing economies. These countries need to redevelop the infrastructure and industrial capacities with limited resources. Comparison in table1 shows that even CE countries with the highest GDP per capita reach only 20% of Germany’s GDP.

Table 1 GDP FOR SELECTED CENTRAL EUROPEAN COUNTRIES, 2001

COUNTRY	GDP (in billions $)	GDP per capita	Index of GDP/capita vs. Germany
Germany	$2260.4	$27.337	-
Czech Republic	54.6	$5.580	20
Slovak Republic	21.1	$3920	14
Poland	178.9	$4590	16
Hungary	50.9	$5180	19
Estonia	5.5	$3778	14

Source: ING Barings Global Economics 3Q/2001

IT investments

There is no doubt that CE countries invest fewer resources to IT (information technology) in absolute numbers than countries in EU. However, table 2 illustrates their effort to close the gap. For example IT investments per capita of Czech Republic are higher than those of Greece. Even more interesting is comparison of spending as % of GDP. Czech Republic and Estonia spend more than the EU average, followed by Slovakia and Hungary with their investments higher than Greece.

Table 2 IT INVESTMENTS IN CE COUNTRIES

COUNTRY	Per capita (in EUR)	As % of GDP
EU average	457	2.4
Greece	86	0.9
Czech Republic	102	2.8
Slovak Republic	51	2.0
Poland	47	1.1
Hungary	77	2.1
Estonia	74	2.9

Source: EITO Report, 2000

PC users

PC is without any doubt the most common device for Internet access. Despite reasonable growth of PC sales through the whole CE region in recent years there is still significant difference in PC usage between EU and CE countries. While 58% of EU inhabitants claim to use PC the usage of PC in CE reaches approximately half of the usage in EU countries' average. The worst situation is in Slovakia and Poland where only 24% respectively 21% of inhabitants use PC. An increase of PC users is first necessary prerequisite for Internet access rate growth and development towards New Economy.

Table 3 PC USERS IN RESPECTIVE COUNTRIES (in %)

COUNTRY	EU	Czech Republic	Slovakia	Poland	Hungary	Estonia
PC USERS	58	36	24	21	32	41

Source: Net Profit, Datamonitor, Datart Corp., SITA Agency

Fixed telephone lines

Comparison of landline connections shows again significant gap between EU and CE countries. Because most people will continue to access Internet through dial-up connections fixed line access growth and the quality of infrastructure will play crucial role in Internet access growth.

Table 4 FIXED TELEPHONE LINES ACCESS (in %)

COUNTRY	EU	Czech Republic	Slovakia	Poland	Hungary	Estonia
ACCESS	58.5	45.6	35.9	22.8	33.5	34.6

Source: European Commission Report, 1999

Internet access

Despite the outdated telecommunication infrastructure in CE countries, low income levels and lower than EU computer penetration rates the access to Internet is growing, currently reaching approximately 40% of EU average. There are significant differences between Estonians with 33% internet access closely followed by Czech Republic and the rest of CE countries (Hungary, Slovakia, Poland) with Internet access rate around 15%. The dynamics of Internet access growth is higher in countries with lower penetration. Major dynamics was noted in Slovakia (index 166 vs. year 2000).

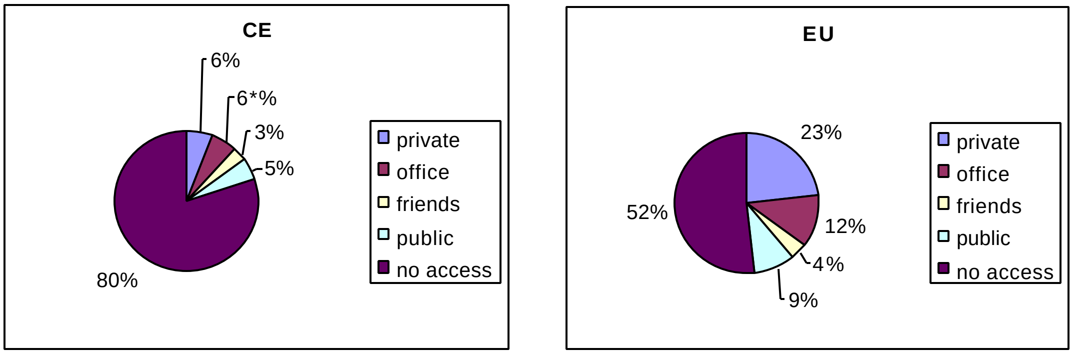
Table 5 INTERNET ACCESS IN CENTRAL EUROPE (% of total population)

COUNTRY	2000	2001	IYA	SOURCE
EU	42	48	114	WSJE/GfK
CE	15	20	125	TN Sofres/ WSJE /GfK
Czech Republic	22	26	118	TN Sofres/GfK
Slovak Republic	9	15	166	TN Sofres/ Markant Agency
Poland	12	16	125	TN Sofres/ WSJE /GfK
Hungary	10	14	140	TN Sofres/ WSJE /GfK
Estonia	24	33	137	eMarketer/TN Sofres

Source: various as noted

Governments of all countries within the region have started projects that should enable Internet access at schools. According the data available Hungary with 80% and Estonia with 65% of schools on-line are leaders in the region while Slovakia is the last with only 10% of schools on-line.[ii]

Private Internet access and access from public places are significantly lower in CE than in EU /picture1/. Lower income and lower PC penetration were identified by eMarketer as major factors of this situation. Thus, CE countries have to support private Internet access, as this seems to be critical for closing the gap between CE and EU countries.



Source: WSJE/ GfK Ad hoc Research World-wide survey, 2001

Fig. 1 COMPARISON OF INTERNET ACCESS IN CE vs. EU

Internet access among different groups

Major difference in Internet access between male and female group is in Poland and Czech Republic, the most balanced usage of Internet is in Estonia.

Table 6 INTERNET USAGE AMONG DIFFERENT GENDERS (in %)

COUNTRY	MALE	FEMALE
Czech	30	21
Poland	20	11
Hungary	19	15
Estonia	35	31

Source: TN Sofres, 2001

Overall trends of Internet usage among different age groups are very similar across the whole CE region. Data in Table 7 only confirm overall difference of Internet access among countries.

Table 7 AGE GROUPS THAT ARE INTERNET USERS (in%)

COUNTRY	<20	20-29	30-39	40-59	60+
Czech	54	45	27	25	2
Poland	43	25	15	9	1
Hungary	58	29	19	10	1
Estonia	73	48	39	27	2

Source: TN Sofres, 2001

Mobile phones penetration

Mobile phones in CE outnumber personal computers four to one and their penetration is still rising. Despite the market is not saturated in any country yet, there are significant differences in penetration between countries /table 8/. While the penetration of mobile phones in Estonia and Czech Republic is close to EU countries and in Hungary slightly behind, it reaches only 40% of EU average in Poland and Slovakia.

Table 8 2001 MOBILE PHONES PENETRATION IN CE

COUNTRY	Czech Republic	Slovakia	Poland	Hungary	Estonia
PENETRATION	54%	28%	26%	43%	61%

Source: TN Sofres, 2001

Similar patterns in usage of mobile phones can be observed across the whole CE region. Majority of mobile phone users use their devices for speaking, sending and receiving SMS messages only. Other services (mobile Internet access e-mail services, m-commerce) are not used often if at all. Mobile phone users claim that following barriers prevent them from other services' usage: i) high price, ii) unreliable connection, and iii) low speed of WAP based applications.

Table 9 MOBILE PHONE USAGE IN CE (in%)

COUNTRY	**SPEAKING**	**SMS**	**E-MAIL**	**INTERNET ACCESS**	**SHOPPING**
Czech	52	46	6	3	1
Poland	24	13	1	-	-
Hungary	33	24	1	-	-
Estonia	59	40	4	1	-

Source: TN Sofres Global Report, 2001

These barriers should be at least partly removed by new generation of mobile phone networks (3G). However, despite high expectations connected to 3G it is important to stress that these are not going to be built in CE region earlier than 2004-6 as there were no licenses for 3G sold yet. On the other hand this gives current operators, who want to bid for new licenses, enough time to prepare business models that will generate enough revenues to cover initial high costs.

E-commerce

E-commerce in CE is slow but rising, however still several years behind the on-line culture of the U.S or EU. J. Schrantz, former investment banker from Minneapolis now owner of Albumcity.cz, says that it is "the life outside the bubble with performance based marketing, slower evolution but more like a real business." [iii]

It is not that big surprise taking into account several factors determining the development of e-commerce. The penetration of PC is still low, home Internet access is uncommon and costly and trust of on-line shops is still in the process of maturing (Jevis, 2001).

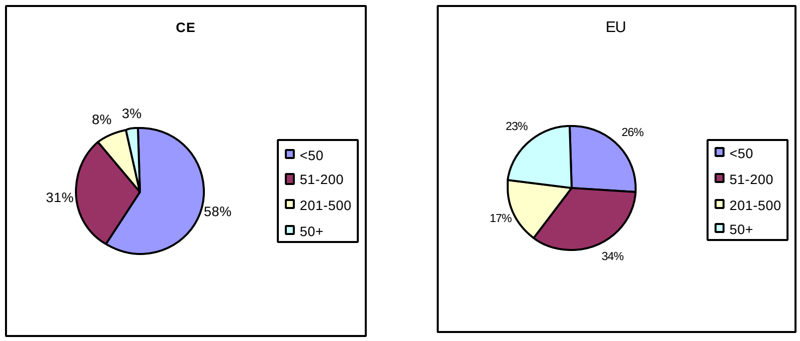
There is dramatic unbalance in online shopping across the whole Europe. 38% of Internet users purchased products over the Internet in EU compared to only 8% in CE. Belgium has most reluctant online shoppers (16%). Still, this is double the average of online shoppers in CE.

Table 10 PURCHASES OVER INTERNET IN THE LAST 6 MONTHS

COUNTRY	**EU**	Belgium	Germany	**CE**	Czech Rep.	Slovakia	Hungary	Poland
% of online shoppers	**38**	16	60	**5**	7	4	8	8

Source: WSJE/ GfK Ad hoc Research World-wide Survey, 2001

Significant difference is also in total spending on Internet purchases between EU and CE e-shoppers (Fig. 2). This difference is driven by these factors: i) overall income disproportion among CE and EU countries ii) higher proportions of vacations, flight tickets or hardware bought online by internet users in EU countries vs. books, CDs and other low costs items bought by CE internet shoppers iii) lack of on-line shops selling higher costs items in CE.



Source: WSJE/ GfK Ad hoc Research World-wide survey, 2001

Fig. 2 COMPARISON OF TOTAL SPENDING ON INTERNET PURCHASES

Barriers to on-line shopping

There are different barriers that prevent Internet users in both CE and EU from on-line shopping. Statements “You don’t know what you get”, “It’s more fun /easier in store“ and “It’s more secure in convenient store”, identified as important reasons for CE internet users by TN Sofres research, propose that the product itself, its quality and delivery is barrier in CE.

According the WSJE/ GfK research internet users in EU identified “credit card security problems” and “no trust to on-line brands” as major barriers that prevent them from on-line shopping. This may suggest that not product itself but rather the transaction and data security is the barrier of on-line shopping within EU.

Despite very slow start of e-commerce in CE region several analysts predict an upcoming boom in this field. An analysis of International Data Corp. predicts e-commerce revenue growth /B-2-B and B-2-C combined/ from $102 million in 2000 to $758 million in the region by the end of 2001. Revenues from B-2-B transactions are expected to reach $650 million and the rest $108 million will be revenues from B-2-C transactions. The fastest growth is expected in major market of CE - Poland with almost 40 million inhabitants where the revenue growth is expected to be tenfold /from $37 million in 2000 to $347 million in 2001/ according to IDC.

What is next?

1. The usage of Internet in CE countries will continue in dynamic growth. Only 8% of the population accessed the web at least once a month in 2000 and IDC Corp. predicts that this figure in 2005 should be 23%. However, penetration of devices and Internet access will be still below the level of EU countries.

2. According to the World Bank’s study conducted by G. Clarke foreign investment has positive impact on Internet access growth. The study suggests that Internet access is more common among enterprises that are at least partly foreign-owned than it is among enterprises that are fully domestically owned. Enterprises within CE that are partly foreign-owned are almost twice as likely to have access to Internet than enterprises with no foreign ownership.

3. The study also suggests that the enterprises that compete with either foreign-owned enterprises or imports are more likely to have Internet access. Finally, the better the infrastructure, the faster Internet access growth which stresses the necessity of steps that improve the performance of fixed line telephone services i.e. privatising of state owned monopolies.

4. The expectations of future development in CE countries during forthcoming wave of mobile Internet are positive. These are based on prerequisites identified by IDC analysts:

i) low fixed-network Internet use will lead to use of mobile networks in the future, ii) low population of respective countries should not have impact on the development of applications and iii) economical integration of the region with EU will lead to wider adoption of e-business applications

5. However these optimistic expectations may be inhibited by these barriers: i) low Internet use may suggest less demand for mobile Internet ii) markets are not large enough to generate large amounts of content – this would reduce appeal to consumers iii) low adoption of e-business applications in the region reduces demand among corporations for mobile e-business.

Final word

Despite the previous text full of statistical data in tables and pictures, there is one thing that has to be taken into the consideration. The data above only count number of PCs, mobile phones penetration and Internet access rate. The problem is that these numbers only measure physical objects. Much more important thing is what people do with their electronic devices. Do they play games or are they searching for knowledge, information and buying things? This is what makes real difference as many thinkers of today expect “shift of the value from ownership of goods to their functionality. “[iv]

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New Management Model of Berlin District Administration

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Abstract

In many OECD countries (GB, USA, New Zealand, Australia), public sector has been experiencing extensive re-structuring processes since 1980s. Modernisation has been oriented on conceptions and strategies of New-Public-Management-Evaluation (NPM) or Public Management (PM). The term of administration reform has become more popular in the 1960s in Germany, as well. Administration reforms are planned changes of organisational, legal, personnel and fiscal structures of administration. The last large discussion on reform of public administration took place in 1970s. However, results of this reform effort were very small. The debate in 1980s concerned de-bureaucratisation, simplification of law, deregulation and privatisation but no exceptional success was reached here, either. After a long silence, this debate of modernisation of state has been experiencing a new positive development since 1990s in Germany, as well. It is oriented on re-evaluation of state roles and re-orientation of arrangement of issues at state and communal institutions. New orientation of administration regarding higher effectiveness, efficiency and convenience for citizens stands in the foreground.

Administration on Crossroad?

In many OECD countries (GB, USA, New Zealand, Australia), public sector has been experiencing extensive re-structuring processes since 1980s. Modernisation has been oriented on conceptions and strategies of New-Public-Management-Evaluation (NPM) or Public Management (PM).

PM can be understood as a connection of public-choice theories, above all the ones of Property-Rights and Principal-Agent-Theory and private economy management concepts. Reduction of state tasks is central to PM application. This concept is oriented on re-evaluation of state tasks and re-organisation of arrangement of issues at state or communal institutions. Firstly, way of organisational reform of state tasks and introduction of market-oriented, customer-oriented public services that are discussed under the word of intra-modernisation, is concerned. Dominating question is: how can the efficiency of state processes be raised? Secondly, re-determination of public tasks (in what quality and in what extent up to the transfer to third party or even complete retraction of public services) stands in the foreground.

NPM comprises following reform application principles:

- general reduction of state activity through task criticism and decrease of the number of activities;
- shift of tasks to the "third sector";
- privatisation;
- market and competition orientation of administrative activities;
- decentralisation of state and administration;
- higher flexibility of financial economy through global budget and result-oriented budgeting;
- introduction of performance components in personnel area;
- reduction of huge regulations and general deregulation and de-bureaucratisation;
- creation and improvement of participation chances of citizens as well as realisation of democratisation measures;
- changing political understanding in sense of concentration to long-term and strategic decisions and advantages.

According to this, NPM can be generally divided into two dimensions:

- Political macro-cosmos, under which questions of external relationship of public administration and its political management is understood. This comprises discussion about core activities of public administration, re-organisation of relationships of the individual administrations or administration levels among one another as well as between public administration and other societal forces.

- Intra-structural micro-cosmos that is characterised by modernisation of internal administration management with replacing old bureaucratic structures with new organisation forms, personnel concepts and management concepts.

Table 1ELEMENTS OF EFFICIENT PUBLIC MANAGEMENT (PM)

Areas of Application	**Measures**
Organisation structures:	Decentralisation, separation, and independence strategies
Processes:	Orientation on result through costs/performance accounting, controlling, output-oriented accounting and effect analyses, separation from politics and service area through clear responsibility demarcation
Personnel:	Organisational Development (OD) through creation of participation, cooperation and group elements, external consulting; personnel development through personnel evaluation, education and training planning, career and utility planning and forming of Corporate Identity (CI)
External relationship:	Forming of customer orientation through Total Quality Management (TQM) and Management by Competition (MbC)

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After a long silence, this debate of modernisation of state has been experiencing a new positive development since 1990s in Germany, as well. It is oriented on re-evaluation of state roles and re-orientation of arrangement of issues at state and communal institutions. New orientation of administration regarding higher effectiveness, efficiency and convenience for citizens stands in the foreground.

Composition of more factors is responsible for this new dynamics:

- public budget deficit worsened by the costs of German unification;
- miserable image of public service;
- growing local debate, in which reluctance to modernisation of public administration is seen as infra-structural disadvantage;
- continuing European integration with the force to keep up with the modernisation potential of concepts followed by other countries already since the beginning of 1980s (e.g. Tilburg);
- existence of an alternative solution to the present form of large organisation in creation of smaller, partially autonomous and self-managing units.

Disadvantageous for Berlin was:

- recreation of legal administration in former eastern part of the city after reunification of both parts;
- associated over-employment of public service;
- structural crisis caused by reduction of industrial places of work;
- eroding of tax incomes;
- reduction of federal help.

Predominating variant of NPM or PM in Germany is the New Management Model (NMM) that was spread by Kommunale Gemeinschaftsstelle für Verwaltungsvereinfachung (KGSt) (Communal Council for Administration Simplification) in 1993. NMM means a referential concept and orientation pattern for present modernisation effort in Germany. With this model, public administrations should be given a set of instruments to reach the goals of efficiency, effectiveness and citizen convenience.

Like PM, NMM is built on intra-modernisation of public administrations with a focus on businesslike elements of administration modernisation such as de-central professional responsibility and responsibility for resources (DPR), budgeting, product catalogue, costs and performance accounting (CPA) and controlling (CT). Importance of personnel, competitive thinking and relationship between politics and administration turned as lower in the past. Consideration of OD measures and participation of employees was underestimated in its importance, as well.

NMM connects the conceptions of organisational division with concepts of contract management. Traditional centralistic over-hierarchical administration organisations with high division of labour should be converted to product-oriented and widely autonomous, de-centrally structured organisation. Pattern is a model of decentralised, autonomous unit within a company. Individual organisational units have a high degree of autonomy regarding budget, organisation and personnel.

System of financial stimulation should take care that a part of surplus incomes/expenses savings remains within the organisation. Organisational units have to set clearly defined goals, prepare and present action plans and plans of usage of resources, develop ways of decentralisation and enable systematic evaluation of their performance through indicators.

Goal of NMM is creation of a businesslike decentralised management and organisational structure. This is characterised by:

- clear responsibility demarcation between politics and administration in form of contract management;
- decentralised personal responsibility for result and for resources associated with central management and controlling field;
- output management in form of product definition, KLR, budgeting and quality management (QM) for creation of direct customer orientation;
- investments in human resources. Administration should become "learning organisation" in order to utilise the innovation potential through personnel development in form of further education (management knowledge, usage of micro-economic instruments, cooperative communicative behaviour), performance stimulations and change of administration culture to a learning administration, in which mistakes are allowed to be made.

New Management Model (NMM) of Berlin Administration - Berlin Enterprise Administration

With the fall of the wall in 1989 and following unification of Germany, the city of Berlin was placed in front of new, more complex tasks that made deep changes necessary. Those particular conditions can be seen in double power acts. On one hand, public service of both "half-cities" became unified and functioning administration had to be created in the eastern part of the city. On the other hand, reform process is a very complex venture by itself and it requires cooperation of all concerned parties. This makes clear that success of administration reform considerably depends on cooperation and motivation of employees of public administration of Berlin.

Because of growing investment in modernisation process since 1990s, Berlin belongs to the most advanced federal countries with regard to the implementation of NMM. Whereas other cities, communes, districts or federal countries have been implementing only partial aspects of NMM such as KLR, budgeting and citizen offices, Berlin has chosen a different approach. The approach in Berlin goes from treasury to complete implementation, i.e. not only stiff factors such as KLR, CT, budgeting but also weak factors such as personnel management (PEM), organisational development (OD), QM, DPR are taken into consideration.

Global goal is to realise transformation of Berlin administration from a bureaucratic organisation to a modern provider of services. Decentralisation of responsibilities and introduction of so-called performance and responsibility centres (PaR) and service centres is closely related with this goal. In sense of new service conception, citizen will be seen as a customer in the future. Another goal is the participation of employees in effective utilisation of scarce resources and independent disposition what should lead to a flexible and fast functionality of the whole administration.

It is clear that administration reform does not follow any short-term savings goal but rather long-term budget consolidation is intended. Long-term budget consolidation can be reached only through synergy of various factors. Important role is played by utilisation of resources under micro-economic points of view and it comprises economic handling with people as well as financial resources.

Another important mean of budget consolidation is the creation of result oriented organisational structure. Such an organisational structure causes reduction of hierarchies what enables the realisation of short decision channels with the result that shift of competence takes place. This means more space for independent decisions and more responsibility for individual employees. Thus, requirement of improved management can be derived that comprises creation of internal management responsible for strategic and operative CT, KLR, PEM and QM and corresponding reporting based on IuK technique.

Goal of the administration reform is transformation of Berlin administration to a modern, economic operating service company oriented on the interests of customers, i.e. citizens of Berlin, as well as of the economy. Successful entrenchment of "enterprise administration" depends mainly on people who provide these services and on the way, how they can provide them. Their motivation and qualification are important factors together with organisation of their cooperation, so that administration reform is realised and citizens of Berlin see the members of administration as their service providers.

Deficits of public sector and possibilities of solutions:

1. Personnel Management (PEM)

- One-sided occupation picture

If one takes into consideration the education of the majority of employees, above all in the field of management positions, considerable majority has juristic education. This reality makes clear that the often-required economic viewpoint of administration activities moves into the background because assumptions considered by lawyers put interest rather on legal viewpoints of realisation of activities. This adherence to law is necessary but not sufficient anymore to cope with new challenges of public administration.

- Lack of management qualities

Prevailing bureaucratic structure of administration with strong order commitment and the postulate of strict adherence to law make management activity become only a hardly distinguishable peripheral phenomenon. Superiors see themselves only as a kind of higher operative employees that keep higher position but do not realise any real controlling and coordination activities in sense of motivation or treatment of employees as seen in modern management theory.

- Bad view of public services

Image of administration and, above all, of the place of work in public service is mostly seen as negative. "Activity in the public office" does not experience any positive assessment either from the outside or from the side of employees. "Thorough culture" of public administration (in comparison to private economy) admired in 1940s has clearly lost on motivation and acquisition effect. The loss of occupational status advantages makes re-orientation in public personnel management inevitable if qualified and motivated personnel should be attracted.

- De-motivating work

Tasks that the employees of public administration have to fulfil are often monotonous, limiting and simple. Strict division of labour and extensive ordering competences of superiors do not leave any possibility of growth and self-realisation. Above all younger employees require more from their activity than only bare realisation of given set of tasks. The position of work in the life of people has shifted away from mere mean of money obtainment to self-realisation at the place of work. Strict division of labour that is characteristic for the administration is not suitable for supporting the motivation of employees and cope with the change " ...from obligation and acceptance values to self-development values..." through strongly limited work content.

- Insufficient utility of personnel resources

Although it is undisputable that biggest amount of expenses must be paid for personnel what must be taken into consideration when making budget, it is noteworthy that there is a unity of opinions in the literature that personnel is the most expensive and the most important resource for survival of organisation and the least utilised one at the same time. If reasonable and above all effective reform of public administration is to be realised, it is not possible to change thinking with respect to the usage of existing but seemingly idle potentials of employee staff.

In order to reduce listed deficits, Berlin human resource management is subject to following principles:

- All employees carry direct responsibility against the public and particularly against the payer of taxes.
- Employees form responsible action. This assumes that Berlin administration supports the employees in optimal utilisation of their creativity and capabilities.
- Personnel management is not a self-purpose concept, rather it serves for growth of effectiveness and efficiency of administration
- Managers are engines of change. They have to realise their management function that is above all a pattern function effectively and fairly towards their employees. Innovation readiness, courage of change and permanent challenge of existing processes and norms are basic assumptions of continuous optimisation process.

PEM means one of the most important strategies, since it means a fundament for further reform elements such as DPR, QM, KLR and budgeting. New PEM comprises various instruments that have already proven useful in the economy or in other administrations.

Elements of new PEM are:

- Performance transparency through objectives;
- Performance-related growth and compensation;
- Suitable evaluation technique;
- Leadership support through qualification and job-rotation;
- Enhancement of competences of employees through job enrichment and job enlargement;
- Improvement of work environment through employee questions, employee-superior talks, performance stimulations and higher work flexibility.

2. Budget System

Cameralistics is oriented on expenses and not costs. Only yearly expenses are recorded without the possibility of depreciation over the years of usage or savings for investments. Building of reserves for growing pension payments is not foreseen what is a reason for budget crisis in the time of decreasing tax income (because budget and pensions are financed from the actual tax incomes).

Furthermore, cameralistics is oriented on input and not output, i.e. it is not result-oriented: resources are assigned to a chapter by title (personal items etc.) and not by performed tasks; therefore those tasks are not quantified (e.g. negative numbers) and there is no check about the effects of a measure. These deficits should be overcome by means of economic instruments such as KLR, budgeting and associated CT and reporting as management information and steering instruments.

Through KLR, costs of administration should be made transparent, cameralistics still remaining a budgeting system with additional accounting entries. Individual goals lie in higher transparency of:

- …used means that must be reached for political and administrative management;
- ...costs of realisation of public activities that are central to result or output oriented management, task criticism and make-or-buy decisions;
- ...real costs of administration taking into consideration calculable costs;
- ...real assets value change recorded by stock-taking of movable assets and calculated costs.

3. Budgeting, Planning, Controlling, Reporting

Management by Objectives assumes that many products that are going to be produced are determined by politics. For each product, median of product costs in all districts is determined. Districts receive these costs based on the planned amount of production and median (product costs), and in addition, they should gain budget for high new investment, as well.

Planning horizon should spread through the period from 1 to 5 years. Within this period, cost centres should dispose of full responsibility for usage of budgets. They can e.g. use surpluses of the individual items for other purposes or take them over to the next budget year. Budgeting is not only an enhancement of cameralistics but also a unique change of direction from cameralistic conception of budget years and resource fixation. Budgeting is a suitable mean to transform stimulation to economic activity and thereby avoid wasting caused by cameralistics (December fever).

CT is a management instrument that comprises functionality of result-oriented planning, analysis, management and controlling. Management by objectives and results of Berlin administration based on growth of efficiency should be supported by a systematic comparison of required state and their actual form. Form of reporting is oriented on the receiver, i.e. it is oriented on the requirements and hierarchic position of receiver. Thus, these economic instruments should directly steer efficiency, effectiveness and need of financial resources of tasks and measures based on budgeting and KLR. Effects of the measures (outcome) must also be included.

4. De-central Professional Responsibility and Responsibility for Resources (Product Management, De-central Structures, Management by Objectives)

Knowledge about what results (output) the administration produces with the disposable resources is usually not sufficiently apparent. Lack of general relationship between the disposable resources (finances and material) and performance output means a weakness of present administration. Goal is to monetarily evaluate performance output (products) of the administration by means of KLR, so that output oriented budget can be created by means of budgeting and reporting technique of PaR.

Decentralised structure means in this case that together with professional responsibility, PaR is also given responsibility for resources. This transfer is mainly related to organisational, personnel, and financial competencies from present cross-section offices. These ones should only realise the function of service units for PaR in the future.

Management by Setting Objectives means that agreement about objectives are made:

- Between offices of district self-administration;
- Between administration and administration;
- Between administration and service provider (within or outside administration);

and that

- PaR can freely operate with the budget within the set objectives and operation rooms;
- Intervention of management should occur only in exceptional cases

5. Quality Management (QM)

Together with internally oriented strategies of change within organisational structures, techniques and persons, enhancing measures of growth of product quality and customer orientation have always been necessary from the view of PM. Here, it is pointed to two central principles: Total-Quality-Management (TQM) and Management-by-Competition (MbC).

Another important element of the implementation of NMM in Berlin administration is represented by QM, related to both above-mentioned principles. For Berlin administration, QM means:

- realistic planning of quality,
- measuring and controlling of quality,
- raising of quality through active influencing and
- minimisation of quality costs.

These goals should be handled with following instruments of quality assurance:

- Surveys of opinions,
- Quality circle,
- Quality costs monitoring,

- Performance comparisons,
- Employee information/visualisation,
- Quality audit and certification,
- Improvement suggestion.

The mentioned instruments are characterised by
- strict orientation on customer interests,
- their relationship to customer acceptance,
- permanent improvement of product, service and information quality, focus on future quality assurance instead of past-oriented quality controlling,
- integration of employees' knowledge of all hierarchical levels,
- Goal-setting of highest possible internal and external transparency through required and reached state of quality.

In first line, quality of performance should be improved. In order to meet the requirements of administration customers (citizen, entrepreneurs, companies, etc.), involvement of employees is planned in the future, as well. Together with customers, employees of administration stand in the centre of particular interest, since they provide services to customers and thus make processes and "produce" quality. In this way they form the image of administration in the public and can contribute to its high credit. Corresponding internal structure of administration is necessary for reaching required quality (e.g. information, communication, structure and process organisation, management, cooperation) that should enable customer-oriented actions of employees.

Quality circles (QC) are the core of QM together with moderators (employees). Within Berlin qualification offensive, many education measures were suggested, in order to make employees, managers and cost centres managers more sensible for this area and for other elements of NMM. Within the qualification offensive, more than 110.000 employees were trained from 1995 to 31.12.1999.

QC are small group activities of using employee potential, in order to evaluate the state of quality and develop improvement measures. Small groups responsibly elaborate improvement measures to identified quality deficits. QC mean an important element of support and strengthening of the participation of employees in Berlin administration.

As to the content, broad spectrum of topics is handled in these circles and they are an instrument of OD. By means of direct participation of employees, problems should be solved but also concepts and individual measures should be created that would contribute to modernisation of administration. In this way, employees can shape their work field by themselves what makes it possible to reach better utilisation of knowledge and creativity of employees as well as identification with results and the associated motivation. Quality circles build an interface between the content of reform (because they are administration reform measure by themselves) and process of realisation (because employees independently find solutions from bottom-up).

Administration on Cross-road?

Reform of Berlin administration has achieved impressive and irreversible progress since beginning of 1990s, particularly in 1994/95. In these years, decisions have been made and changes have been prepared or realised what has considerably changed Berlin administration in comparison to the time of thirty years before. This reform process has not reached its end because not all projects have been finished in the districts so far. Due to the district land reform realised on 01. January 2001, problems have appeared, as well and realisation in senate administration is still missing. In Berlin, there is a whole spectrum of applications of NPM and businesslike-oriented PM focused on internal modernisation of administration. Together with businesslike instruments and quality management, personal management plays a central role, too.

How the administration reform process of Berlin administration will develop in the future, remains in the next years only an exciting question. Based on the intended country-wide implementation of NMM, Berlin administration has the possibility to really enter a comprehensive reform process and stimulate the change of paradigm of administration management.

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Public Works Value Management in Slovakia

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Abstract

There is a double role of the state, typical for the public works procurement:
1. the state as the source and controller of the rules of play and
2. the state in the role of a client with great financial sources on the hand.

But the state is only an administrator, not an owner of these financial resources. There is a great challenge for the Slovak state administration to control the risk of corruption as efficiently, as possible. The great part of the public financial resources is invested in the public works procurement. The author of this article reports about the first results of the analysis of the public works effectiveness evaluation through the state expertise according to the Public works procurement law No. 254/1998. Finally, some proposals for development of the methodology and legislation in this area are formulated.

The current State of the art of Public Works Management in SR

There is a double role of the state typical for the public works procurement:

1. the state as the source and controller of the rules of play and
2. the state in the role of a client with great financial resources on the hand.

In this article we are discussing only the situation in procurement of public works. We are not discussing the procurement of goods and services.

During the research „The assessment of the economical effectiveness of public works" we have stated, that the first legislative step in this area must be continued very soon by next activities [5]. Otherwise, the situation of the economical effectiveness of public works cannot be improved significantly. We have also stated, that the current legislative steps are based on the duty to assess the economical effectiveness of public works twice: in the planning stage and after their realization. It is an important step, because it enables the control of the process. However, the control must be followed by the responsibility of the procurers for active and professional value management of public works.

The lost of public finance begins with incoordination of the programmes and with bad evaluation of the individual projects of these programmes. This planning phase of the investment process opens the greatest space for data manipulation. It is natural, because defining the future facility is based on different assumptions. This opens the space for lobbing for different partial interests by the means of manipulating the data. This lobbing is in the post-communist countries based more on the aggressive power than on rational balancing of partial interests. The results of such approach can be demonstrated through one fresh example, which is only by chance not from SR. The Czech electrical works (CEZ) are afraid, that they cannot sell the same amount of electricity next year, as before. Therefore, they are planning to close three steam-power stations. There are the stations, reconstructed for billions of Czech crowns only few years ago to fit the ecological norms. (in parenthesis are the years of the reconstruction): Hodonín (1996), Chvaletice (1997), Melník (1998) [4].

Beginning with the next year, the electricity market is opening to the competition of CEZ, electricity dealers, and German firms. CEZ will probably loose also some key export contracts with Germany, because of the opposition to the nuclear energy there. These are facts, well known, but ignored in the planning phase of the reconstruction.

The lost of public finance is going on because of the year planning and reallocation of budget resources. So it happens very often, that the started public work suddenly runs off the resources. The classical example of this is the financing of the highways in SR in the last 6 years.

The lost of public finance continues through the procurement and realisation of the public works. The new law on public procurement with its certification of the professionality of public procurers doesn't help till now. According to the vice-chairman of the Public Procurement Authority of SR, Mr. R. Kulman, the number of claims against the public procurers approach is growing up in a very rapid way[1].

For illustration, one example more. The procurer makes an obvious mistake in order to achieve the closing of the public competition. So he produces the „time stress", because of the year allocation of financial resources from the state budget. In the case of „time stress" the procurer can use the direct negotiation with one contractor. For example, SVK - Stredoslovenské vodárne akanalizácie (Water and Sewage Facility of Middle Slovakia) in B. Bystrica are procuring water pipe-line Rimavská Sobota – Chánová, I. part for 110 mil. Sk [3]. They didn't publish the method of the tender assessment. The logical reaction of non-successful tenderers was to claim this approach. The Public Procurement Authority was obliged to stop the public competence for this contract.

According to the Law of public procurement, it was the only possibility for the Authority how to proceed. But you don't need any training to understand, that non-publishing the method of the tender assessment is a grand mistake also if it was unwilling. Such non-professional approach is in our practice nothing illegal, and therefore it cannot be punished. Of course, there are exceptions from this rule: for example the physicians, the bus drivers and so on, if their non-professional work results in wealth damage or death. The managers are not punished for their unprofessionality. You can find a financial manager of unsuccessful private firm next month sitting as a member of board of directors in a big public authority, controlling the great amount of public finances.

I have some experiences as a training administrator, trainer and assessor of persons, candidating as certificated public procurers. From these experiences I know, that unprofessional approach to the public procurement of works is understood only as an equivalent to illegal approach. But the Law on public procurement cannot define the professional approach to public procurement in all detail. The Law on public procurement is regulating only the procurement processes, not for example its preparation, or details on contract preparing, price calculation and so on.

From the analysis of the current state of the art of public works management in SR the following proposition for priorities for further development in this area has resulted.

Priorities for Further Development of Public Works Management in SR

The certificated professionalism of public procurers only cannot help to greater effectiveness of the public works. As we have shown in the example of SVK, the professionalism can help also to block the transparent approach to public procurement, if the public procurer wishes to block it. Therefore, further development of public works management in SR has the priorities as follows:

1. **certification of the professionalism of public procurers** (or their mandators) not only from the point of view of law on public procurement, but also
   a. from the point of view of building economics (for the planning phase of the public work procurement) and
   b. from the point of view of project management for the construction phase of the public work procurement,
2. **consequent punishment of unprofessional approaches,**
3. **coordinated „facility management"** for public buildings, specialized for homogenous groups of these buildings and constructions (administration buildings, schools, hospitals, roads, water and sewage facilities, etc.,
4. **preparing of recommended standard practices** for professional treatment of public works through the whole life-cycle of these works and their results.

To our opinion, the open problem is how to measure and punish the unprofessional treatment of public works procurement.

The Solution Proposal

The main idea of the proposed solution of the problem how to measure and punish the unprofessional treatment of public works procurement is to oblige the Public Procurement Authority, or the High Control Authority of SR to:

1. verify the professionality of the public procurement process in the case of each public work procurement project which didn't reach the planned effects and
2. to punish in a disciplinary way the procurer if his (her) approach was unprofessional in some matter.

What are the possibilities to punish the unprofessional management of public works? I would like to say at first, that we don't need to wait for some new or better Law on public procurement.

The responsibility of the employers of the state for their work is given through the duty to do (her) his job on a professional level. This duty is based on

1. Labour Law,
2. Civil Law,
3. Organizational charter,
4. Internal standards, etc.

According to the Civil Law (§ 420) everybody is responsible for damage, resulting from breaking any legislative norm. The same paragraph is stating that from this responsibility is liberated person, which can demonstrate to do nothing, resulting into the damage. In other words, this person has to demonstrate to treat his duty with professional care (Civil Law, § 420).

What are the possibilities to verify the professionality of the public procurement process? First of all, we have to recognize, that we are not measuring or judging the quality of manager's results, but the quality of manager's work. This means, that the manager can have bad results in bad external conditions. He has „only“ to treat this conditions with the professional care.

The professional care cannot be defined in detail by the law. There are the professional associations, able to define the level, assumptions and conditions of the professional care. Also in management there exists the possibility to verify the level of the professionality of the manager's work. One example is the OECD Standard for Company Management, the other example is the certification of project managers, developed by IPMA[2.] and adopted by the Slovak Project Management Association this year.

The process of defining the professional care in public works management in SR has not to start from zero. In European Union and in USA are existing many very good examples.

For example the Document of the General Planning Committee of France is defining the standard base for assessing investment projects in transport industry [2]. The goal of this standard is to ensure the presentation of effectiveness analysis result as clear and transparently, as possible. The standardized table presentation of results has to support the comparing of several projects and alternatives.

Another example, comming from the USA, is the „standard practice“ for measuring life-cycle costs of buildings and building systems [1].

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Reflections on MNCs, FDI and Sustainable Development in the Slovak Republic

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Abstract

During the 1960s FDI was seen as the motor force behind self-sustaining economic growth. By the mid-1970s though multinational investment was labeled by some theorists as the primary mechanism responsible for core/periphery dependency and underdevelopment. This was reinforced by the environmentalist concept of sustainable development, elaborated by the Brundtland Commission in 1987. The last decade of the 20th century, however, was dominated by the so-called Washington Consensus, promoting market liberalization, free trade, privatization and economic development through private investment. In the Slovak Republic, such strategies have meant divestment of state assets, opening markets to global competition, and joining the international race for FDI. This paper explores the relations between multinationals, FDI and development, with special emphasis on Slovakia. It discusses the issues: What is sustainable development? What must the nation-state do to attract multinational direct investments? And what factors condition the relationship between FDI and sustainable development.

Sustainable Development

It's not unreasonable to argue that popular developmental theory and policy began with W.W. Rostow's lectures at Cambridge University in 1959 on the stages of economic growth [10]. An eloquent speaker, Rostow outlined the transformation of "traditional" society, culture and economy, through a series of steps, into "modern" capitalist urban-industrialized nations. The end-state of the process was self-sustaining economic growth driven by expanding capital investment. In small, developing countries this meant primarily foreign direct investment by multinational corporations—FDI by MNCs. Rostow's vision of modernization dominated Western thinking and policy making throughout the 1960s and early 1970s, until it came under attack by Latin American and African underdevelopment/dependency theorists. These Third World writers saw multinational investment as the primary institutional mechanism responsible for creating wealth in the "North" and poverty in the "South": a geographic structure of core/periphery dependency and an economic process of underdevelopment. A decade later, this critical interpretation was compounded from an environmentalist perspective by the concept of sustainable development, which came out of the 1986 Rio Conference and was elaborated in the 1987 Brundtland Commission report [16]. Not only was foreign direct investment a source of injustice and economic exploitation; it was also at the root of global environmental degradation and life-threatening ecological change. A new approach to economic development, it was argued, was imperative.

The thinking behind sustainable development was not new, however. The late 1960s, a time of intense environmental activism [2], saw the advent of a paradigm known as steady-state economics, which holds that there is no necessary conflict between environmental protection and economic activity. In a steady-state economy, the population and the stock of goods are held constant at levels that are both sufficient for the present and sustainable for the future. The quality of life (satisfaction)is maximized given a constant level of production, while the amount of resource exploitation and processing necessary for that production is minimized. Three key policy measures were proposed to achieve these goals. First, the distribution of wealth was to be made relatively more equal using both a minimum and maximum income level and a maximum wealth level. Second, the population was to be held roughly constant through a system of transferable birth licenses. Third, resource exploitation and hence pollution was to be controlled by depletion quotas [4]. The steady-state economy thus regards production and consumption as directly linked with the surrounding environment, and seeks a constant equilibrium between economic activity and the environment to minimize depletion of the ecosystem. This contrasts sharply with the constantly expanding cycle of production and consumption found in "standard" (liberal, Keynesian, post-Keynesian or neo-liberal) economics, a cycle which encourages "growthmania": the belief that economic growth is a necessary corollary of capitalism, and that growth is the answer to social problems (poverty and unemployment), fiscal problems (debt and deficits), and environmental problems (pollution and depletion). In this standard economic view, environmental degradation may even be disregarded while the activity that caused it is recorded as net current income, and the costs of responding to such degradation may be classified as an addition to GDP [3].

Approximately 20 years after the first appearance of steady-state economics, the World Commission on Environment and Development (the Brundtland Commission) defined sustainable development as development that "meets the needs of the present without compromising the ability of future generations to meet their own needs." Development was seen as limited by the state of technology, by social organization, and by the environment's capacity to absorb the impact of human activity. The Commission recommended, inter alia, urgent population control measures and the achievement of a more equal world food distribution. The latter was to be achieved by increasing production in the developing countries and decreasing it in the developed world. Other proposals included increased environmental protection, increased energy efficiency, a shift from non-renewable to renewable energy sources, the greater use of anti-pollution and efficiency-improving technology, and tighter controls on hazardous waste dumping. To counter urbanization problems, the Commission suggested the encouragement of migration toward smaller towns and cities which would be more closely integrated with surrounding rural areas. The implementation of these policies was expected to require a strengthening of local institutions and improved coordination and cooperation between international institutions. The Commission identified increased growth—albeit more efficient and equitable growth—as a critical element of sustainable development [17].

A comparison between steady-state economics and the Brundtland Commission's conception of sustainable development reveals, if anything, a net decline in the radicalism of the sustainable development agenda over time. Although both positions emphasize such measures as population control, greater distributional equality, and increased government activism, they differ sharply on the question of growth. Whereas steady-state economics rejects growth as incompatible with environmental sustainability, the Commission views it, in modified form, as critical to the achievement of sustainability. The Commission's view in 1987 was therefore more compatible with an increasing cycle of production and consumption than was Daly's steady-state economics, since capitalism cannot sustain a "steady state''—it must expand in order to maintain profits or collapse into depression [1]. The Commission's acceptance of capitalism does not undermine its view of sustainable development, since that view includes positive growth, but it does reduce its strategy to one of incrementalism. Institutions will be strengthened, more efficient technology and practices will be adopted, policy emphases will be changed, but ultimately this position amounts to little more than cleaning up after the capitalist quest for growth. It is an attempt to mitigate the worst effects of our relationship with the environment while refusing to change it.

After little more than a decade, sustainable development, like most public-policy concepts, has become almost unrecognizable. Today there are calls for sustainable communities, sustainable cities, sustainable infrastructure and even sustainable industrialization [8, 14]. In 1991 the World Bank turned the entire idea upside down with its notion of sustainable economic development [15]; a semantic rediscovery of Walt Rostow's self-sustaining economic growth. The mirror image of what the Brundtland Commission had in mind in 1987, quoted above, but now the standard international definition of sustainable development among most economists and public-policy makers. The 1990s were dominated by the end of the Cold War, the supposed collapse of communism and the so-called Washington Consensus. Worked out by the Breton Woods Institutions and subscribed to by the G7 (8) group of wealthy industrialized countries, this latter "North Atlantic" perspective on international economics resulted in the Uruguay Round of the GATT, creation of the World Trade Organization (WTO), and IMF/World Bank conditionality (economic reform and structural adjustment). All of which promote market liberalization, free trade, privatization, "fiscal restraint," and sustainable (economic) development through worldwide private investment flows: primarily FDI. At the practical level, some limits have been applied to neo-liberal globalization, for example, by such measures as the "policy-standards side agreements" of the North American Free Trade Agreement (NAFTA), dealing with the conditions of labor and environmental protection, especially along the US/Mexican border [6]. But these kinds of concessions have normally been honored in the breach. Today, looking at the international concept of sustainable development from the vantage point of the Slovak Republic—despite anti-globalization demonstrations and riots from Seattle, to Austria, to Italy, at the beginning of the new century—sustainable development means public policies that create self-sustaining economic growth, with due regard for incremental environmental protection and politically-acceptable concern for social security and labor remuneration.

Attracting FDI

How does Bratislava go about attracting MNCs to make productive investments in Slovakia? The short macro-scale answer for transitional countries is to adopt an accelerated schedule to divest state assets, open markets to global competition, adopt European Union (EU) "harmonization" standards, and join the international race for FDI. Lengthier authoritative answers are given in standardized form by world-famous economists, such as Paul Krugman and others [9, 12]. The Ministry of Economy of the Slovak Republic invited the Foreign Investment Advisory Service (FIAS), a joint facility of the International Finance Corporation and the World Bank, to visit Slovakia in June 1999. FIAS produced a 53-page report on legal improvements for attracting FDI, which is available on the internet [5]. Innumerable scholarly and private reports are also available; over 330,000 listed by MSN on the World Wide Web during August 2001. With over 20,000 of these entries concerning Slovakia. What more is there to say on the subject?

Relevant answers tend to fit in two categories, (1) statements of national political beliefs and sentiments, and (2) micro- and meso-scale empirical analyses and development planning strategies, policies, programs and projects. The first set of issues—the operational political philosophy of informed Slovaks—is a matter for Slovak leaders, intellectuals and activists. Development planning for foreign direct investment is another thing. Here the problem is to know in infinite detail the economic potentials of Slovakia, its regions, cities and rural places. To know what resources are where, in what grades and quantities, and how they fit into global production and consumption processes. To know the skills, the potentials of the geographically distributed Slovak workforce. And to be able to communicate these strategic facts purposively, in a sensible, understandable way, to the right people and institutions. This requires a vision of the Slovak Republic as a part of the European and international economies. It demands a thoroughly considered and elaborated strategy of national/regional development, which has become an element and then a product of the national political discourse. It then must be informed by contemporary analytical skills and techniques, which will allow Slovaks to understand with precision and in correct detail their local, regional and national comparative economic advantages, and their potential functional linkages to specific business sectors in Central and Eastern Europe, the EU, the North Atlantic community and the world economy. Bratislava must know better than the outside world what Slovakia is capable of economically in the opening decades of the 21st century, and Slovak agencies and businesses must know how to communicate this strategic information to the right people and organizations in Europe and beyond. Most important is to know what these other people want to know, and know how to present it to them in a timely, meaningful fashion. These are daunting tasks, but given the SR's FDI track record there would seem to be no acceptable choice. Solid progress or stagnation are the likely alternatives, and progress in a competitive world requires rigorous skills and hard work, in both the private and public sectors [11].

What are some of the most important tasks involved? A partial list could include the following:

- Develop a thorough understanding of the Slovak Republic's strategic geographic and economic location between the existing EU, the Ukraine, and the Confederation of Independent States (CIS). This "cross-roads" situation has great economic significance and potential, as it has in centuries past, for the country as a whole and for its constituent regions. Businesses, university departments, think tanks and government agencies need to be deeply involved in discovering and specifying its 21st century implications for private investment decisions, development strategies and regional infrastructure plans.
- A comprehensive, nuanced grasp of multinational-regional, continental and global business sectors is absolutely essential, both in terms of life-cycle trends, production processes and distribution and marketing networks. If Slovakia is to take advantage of its potentials, Slovak individuals and organizations must know what the world needs and how to match the two to attract MNCs to consider the SR as a sound business

location. This is “industrial intelligence” of the highest order and importance. It is also the place to employ all the country’s information technology (IT) capabilities.

- Face-to-face contacts and IT systems are at the heart of the next job as well, surveying existing FDI in the country and analyzing it’s strategic business situation, methods and needs. Why did existing firms investment in the SR? (An old question, but always timely and vital to the country’s economic health in the near-term future.) What have been various firms in various industrial sectors experiences in Slovakia: finding plant sites, finding local financing (if necessary) and adequately skilled workers, finding linkages to suppliers and local and export markets, finding help from universities, government and other Slovak partners? How can these experiences be used to frame government policies for the immediate future? On the other hand, how can Slovakia take advantage of its current MNC production and distribution capabilities? The existing internationalized industrial network forms the business milieu for potential investors. It provides the input/output linkages for all future buyers and suppliers. Slovaks and MNCs both need to have an accurate, up-to-date understanding of the existing industrial network to expand its linkages and boundaries.
- The use of official statistics, satellite imagery and geographic information systems (GIS) needs to be taken full advantage of, along with existing cartographic surveys, in order to create a contemporary inventory of industrial sites and natural resource location. For the first time, perhaps, it is possible to “photograph,” analyze and make available on demand (from systematic data sources) a geographic area’s built environment and natural assets. While some such information may be classified for security purposes, most of it can be used by businesses, policy makers and planners to provide a rich picture of the country’s economic potentials, from region to region. Such data bases should, importantly, include region-serving and national infrastructure, as well as existing planned industrial estates (industrial parks).
- Similar information must be available on a localized geographic basis for the SR’s urban-centered labor markets. Where are they? How large and what is the age structure of the labor force? What are the education levels and skill capabilities? What is the match of people to general public infrastructure and training facilities? What is the structure of labor costs? What are the utilization capacities for various occupations and the general levels of unemployment by industrial sector? How is the regional labor market defined, and what would be the journey-to-work/housing-capacity impact of new planned industrial estates?

These kinds of information-gathering and analytical chores could be outlined at greater length and in further detail. But the picture is clear enough. To attract FDI Slovakia has to have a firm grip on its own affairs. And “information” is only the beginning. Information, even organized in state-of-the-art ways, will lead no-where on its own. While some corporate researchers, technocrats and academics are enthralled by its very symmetry and availability, the real action is always elsewhere. It is found in beliefs and action. Political will. Entrepreneurial risk taking. Doing the work on the ground—starting, and then getting it done. Yet. . . all of this must be informed by “true” and pertinent knowledge, or risk brash mistakes and costly failures. Strategic planning is essential to both business and government, and, increasingly, they are doing it along with other actors in civil society, through a hotbed of “public-private partnerships.” Formal and informal organizations which bridge the gap between important actors and stakeholders at different junctures and levels of the development process. Partnership formation and functioning are other aspects of the process of attracting MNCs to the Slovak Republic, but they will be touched on in the next section exploring factors which condition the relationship between FDI and sustainable development.

FDI and Sustainable Development

Foreign investment doesn’t guarantee sustainable development, nor does it necessarily lead to “foreign control” and economic exploitation. A number of important factors condition the relations between the two and their outcomes for the host country and region. In his most recent, troubled essay about MNCs and host-country relations, Raymond Vernon wrote: “. . . [host-country] media regularly report the real or fancied peccadillos of joint ventures in which foreigners have an interest, including an alleged unwillingness to provide advanced technologies, a propensity to repatriate earnings and evade taxes, and a tendency to violate employee rights" [13]. This does not have to be the case, however. Active, positive involvement by host-country—in this case, Slovak—employees, managers and institutions can make an important difference in outcomes. Majority ownership means "control," but control also comes through full engagement in production and management tasks in the office and on the shop floor, and through the active involvement of other businesses and organizations in the firm's industrial milieu. Sustainable development—continuing economic growth with reasonable income shares, social well-being and ecological concern—can be the result of FDI in such an energized, "transactive" environment; where social learning and social linkages are an integral part of the economic process.

At the level of the firm, a good example of such active engagement and networking is CERAM CAB, Inc. of Nove Sady, Slovak Republic [7]. CERAM is primarily a producer of ceramic electrical insulators, which began life as a Czech company and was purchased by Austrian interests in 1991. It employs around 260 people in its rural setting and a broader catchment basin (extending to Bratislava), and profitably exports 90 percent of its output to other European countries, North America and the rest of the world. What is interesting about this SME is the innovative learning approach adopted by its Slovak managers, pointing the way toward sustainable development. Inherited production processes have been greatly improved through process innovation, which won the firm two European awards in 1993 and 1998. Local management has transformed used machinery into a CAM production system, upgrading quality and cutting transaction costs through inventory reduction and OTD. Nove Sady personnel have pioneered software for their computer-aided production system that has become the standard of the entire CERAM European network of plants. Global markets have continued to expand, and reinvestment takes place locally. CERAM CAB's new production techniques and Total Quality Management won it the prestigious national Environmental Protection Award in 1999, which is a symbol of broader community involvement. And Nove Sady personnel have formed an informal partnership with the Faculty of Management of Comenius University, and even the faraway University of Pittsburgh, USA, with staff following advanced management courses and earning jointly awarded post-graduate degrees.

This kind of partnership, which brings together actors from different sectors of society—business, academia, trade organizations, labor, local authorities and government—is a model for promoting sustainable development. Because everyone concerned becomes involved in the innovation and decision-making, varied perspectives and interests are embedded in the strategic planning and implementation process. Such public-private partnerships, pioneered in Pittsburgh, Pennsylvania starting in 1943, are at the heart of the Blair government's two-year old Regional Development Agencies in the United Kingdom, and set the standard for RDAs across the European Union. In organizational terms, partnerships can start at the level of executive committees—rather in the spirit of French "conjunctive planning" during the 1960s—and work out the overall design of strategic plans and decisions. Specialized partnerships can be made largely responsible, as operating agencies, for building and managing industrial estates, like the RIDC (Southwestern Pennsylvania's highly-successful Regional Industrial Development Corporation), and for overall recruitment of MNCs for FDI, such as the Pittsburgh Regional Alliance. Other specialized partnerships can link technical academic research with venture capital, to spin-off new high technology products. This task was begun across the Commonwealth of Pennsylvania by the State-sponsored Ben Franklin Partnership. Partnerships are also suited for many other operating roles, such as environmental protection monitoring and skills training for the labor force. This all builds on the network of linkages which make up the contact and guidance system of firms and sustainable development

In the end, however, many aspects of national development policy must still rest with government. Responsibility for political stability and an appropriate legal environment are matters for informed civic and governmental action, and remain essential to the relations between MNCs, nation-states and sustainable development. The countries laws, especially tax laws, must be enforced in an honest impartial manner. The way in which MNCs remunerate employees, help provide for a realistic social-security net, and reinvest their earnings must be worked out in dialogue between the international companies and government. "One size" doesn't fit all. Different companies, investing in different industrial sectors and different regions of the country need to match the needs and expectations of their host environments. Varied business firms, in different production sectors, have their own requirements as well. Meeting institutional needs and community expectations all becomes part of the strategic conjunctive planning process, where entrepreneurship, facilitation and regulation meet. The Slovak Republic has a special advantage in this regard, because its highly-skilled workforce can support technological advance, yet work within a globally competitive wage structure. Sustainable development through direct foreign investment can be a real possibility in such circumstances.

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Restructuring Transitional Economies
(Managerial aspects)

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Abstract

Objectives: The paper will analyze the transition process in several countries of East –Central Europe and show the differences between them. We will connect these differences to the supply side economics of the market of the countries studied. There are four areas of development:

(a) the restructuring of the ex-socialist companies,
(b) the creation of SMEs,
(c) the entrance of FDIs and
(d) governmental/state economic and industrial policy.

In particular, the managerial implications of restructuring companies will be taken into consideration and analyzed.

The transition process from plan to market economy exhibits very different results for the various countries of East-Central Europe.

These differences have various causes, but the most relevant ones are the modality of the process of restructuring the companies of the previous system into companies, which are able to assume a competitive advantage in the new market environment. There are two main strategies:

a strategy of leadership and selection process of employees
a strategy of indiscriminate reduction of the wage level. Both have
managerial and HRM consequences, which will be discussed.

METHODOLOGY: We will use databases from various sources of IMF, WB, EBRD and the yearbooks of the statistical offices of the countries considered. The data will be elaborated creating graphs and tables. Also some mathematical models will be used, in order to prove the assertions.

Theoretically the transition process from plan to market economy in East-Central Europe can be described by the following graph (Fig.1)

There is a no growth period before transition start, a drop in growth after transition start, reaching a minimum, followed by a growth period characterized by two points: the reaching of the start level (break-even) and the reaching of the point where the wealth lost because of transition is fully regained. This can be considered as the point of transition end.

Now, let's see how countries really behaved. This is shown in the pictures 2 and 3 based an interpolation of the growth index data for 12 transitional countries of East-Central Europe. The growth index is $T_{1989=0}=0$.

The general impression is that of a wide divergence in behaviour between countries, which has been widening in the 11 years of observation. Few countries followed the model curve of Fig. 1, most of them are showing a wavering behaviour which may be sign of indecision in carrying out the transitional task and some of them didn't reach yet a steady and firm growing of GDP. Some of them, after 11 years still didn't reach the transitional minimum (Fig.2)

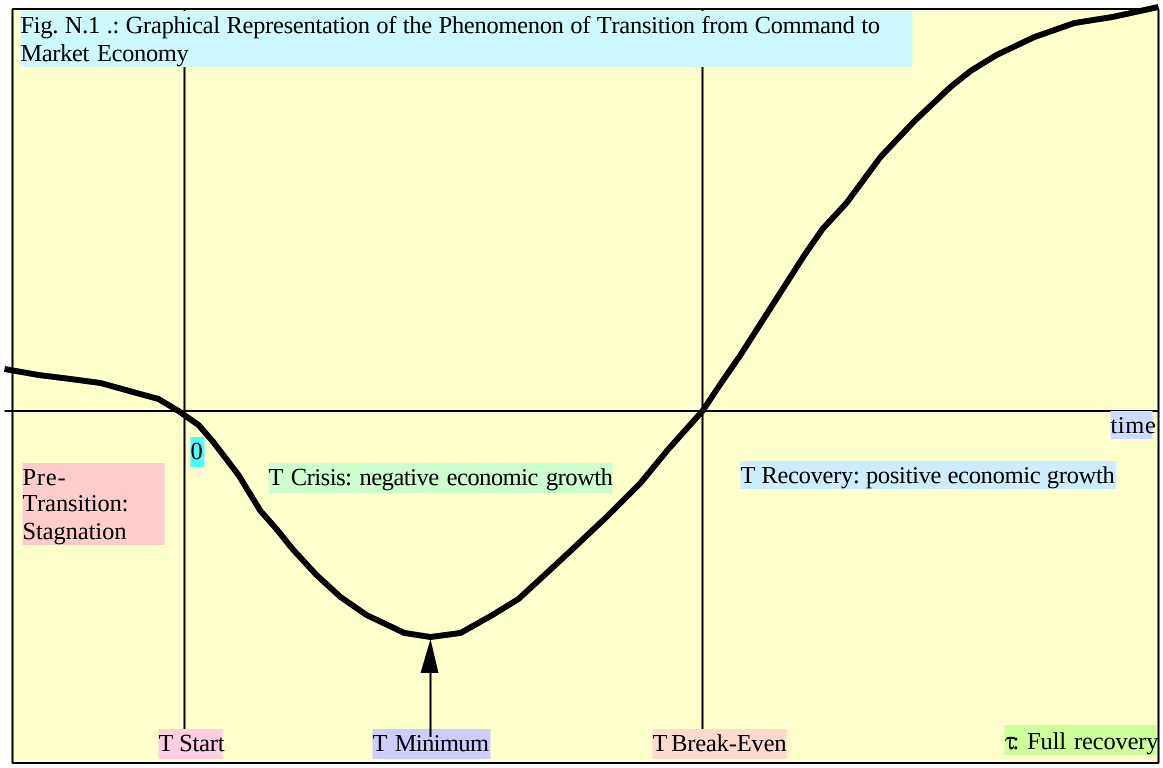
Fig. N.1 .: Graphical Representation of the Phenomenon of Transition from Command to Market Economy
time
0
Pre-Transition: Stagnation
T Crisis: negative economic growth
T Recovery: positive economic growth
T Start
T Minimum
T Break-Even
τ: Full recovery

FIG. 1

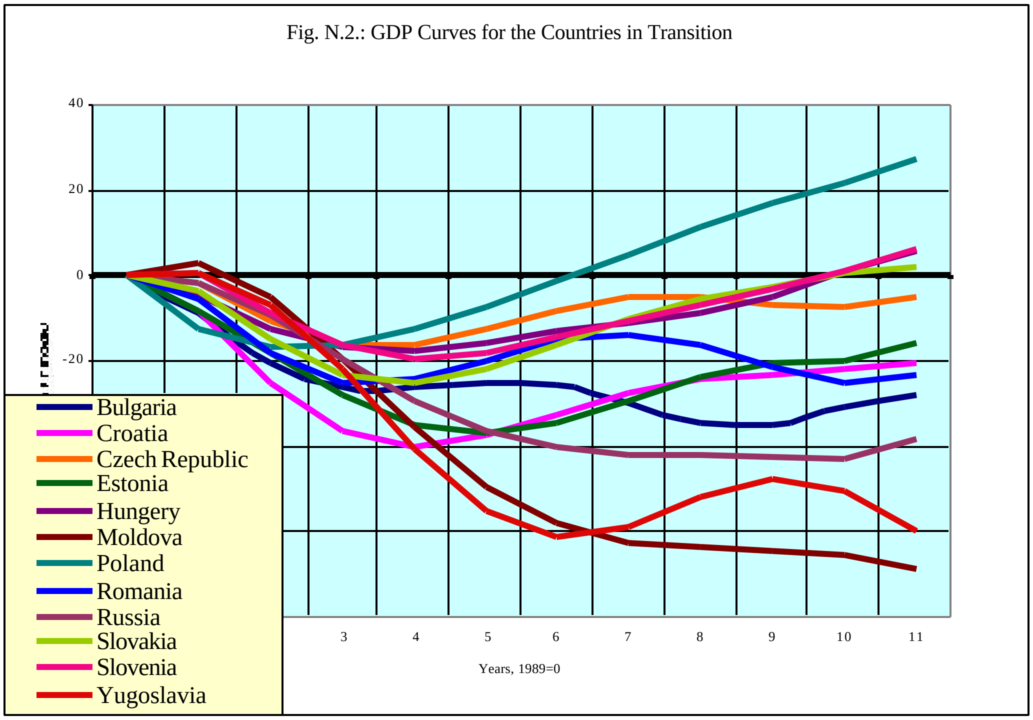

Fig. N.2.: GDP Curves for the Countries in Transition

FIG. 2

Figure 3 is showing the data of the function

$$t = \int_0^X T dx$$

where x is the time variable put =0 at year 1989. From the two pictures we can build Table 1

Table 1: QUALITATIVE CHARACTERISTICS OF TRANSITION FOR VARIOUS COUNTRIES

Country	Year of 1st T min	Year of 2nd T min	Year of T break-even	Year of ? = 0 (Full recovery, end of transition)	Value of T at the 11th year
Poland	2.5	-	6	11	+28
Hungary	3,5	-	9.5	-	+7
Slovenia	4	-	9,5	-	+7
Slovakia	4	-	10	-	+2,5
Czech Republic	4	9.5	-	-	-7
Estonia	5	9.5	-	-	-16
Croatia	4	9,5	-	-	-20
Romania	3,5	10	-	-	-23
Bulgaria	3,5	8,5	-	-	-28
Russia	10	-	-	-	-38
Yugoslavia	6	>10	-	-	-60
Moldova	>11	-	-	-	-68

It is showing a qualitative synthesis of the transitional result of the various countries. On the basis of these data only 1 country could be considered at the end of the transition process and only 4 countries crossed the transition break-even point, reaching the same wealth level as they had at the beginning of the process.

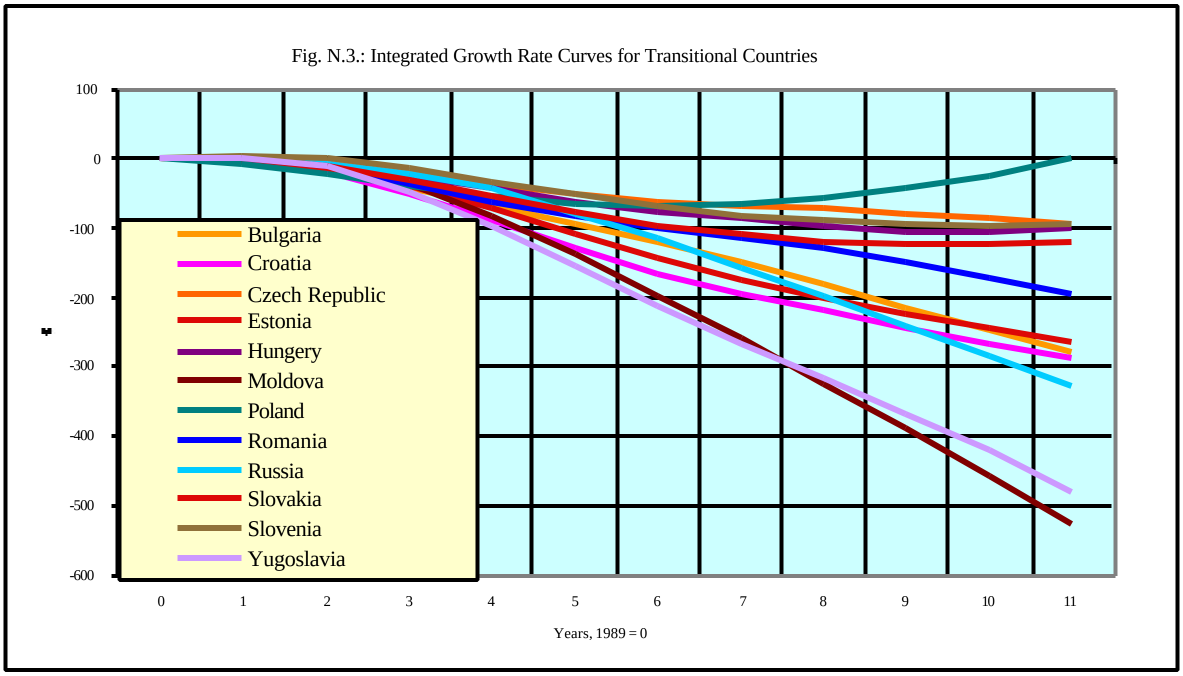

FIG. 3

The difference in behaviour is due to the governmental policies of the various countries but in first place to the development of supply side economics in each country, depending on four main measures:

1. Restructuring of the former socialist companies;
2. Creation of domestic SMEs;
3. Introduction of FDIs;
4. Development of an industrial policy in the country.

Here we will consider only the first of the described measures and its implications: the process of restructuring of the former socialist companies. The aim of it is to improve the performance of them to the point where they start to be competitive on the market.

In order to explain this point we can use a simple analytical algorithm, the long term equilibrium equation of a company:

$$R - H - F - V - U = 0 \qquad (2)$$

Where R is the revenue, H, the cost of the human resource employed, F, the fixed assets (tangible and intangible) invested, V, the direct materials used by the process and U the profit, i.e.: the return for the capital invested in the company by the owners. Usually, in order to judge the performance of the company, we set out the profit U:

$$U = R - H - F - V \qquad (3)$$

Now, let's calculate the relative profit u=U/R. It is given by the expression

$$u = 1 - \left(h^{-1} + f^{-1} + v^{-1}\right) \qquad (4)$$

the value of u depends on the magnitude of the three variables: h=R/H, f=R/F and v=R/V. We can call them productivities of the three factors, as they are the ratios OUTOUT/INPUT of the factors. h, for instance, is the number of USD which an entrepreneur gets as revenue, investing 1 USD in human resource, and f and v have a similar significance[1].

An interesting property of function (4) is that the marginal relative profit u' is

$$u' = h^{-2} + f^{-2} + v^{-2} \qquad (5).$$

And hence for small values of h, f and v is u'>u. This means that if human resource productivity h is small, by a modest improvement of it, it is possible to get a large increment of the relative profit.

Let's consider an example: suppose that in an ex-socialist company h=2, f=4 and v=4. Then u=0, i.e.: the company is in a bad shape, as it doesn't have a profit. If we are able to improve h from 2 to 3, u becomes = 0,167, i.e.: we have an increment of the relative profit u from 0 to 16.7% of the revenue. It is a good result obtained just by an 1 point improvement in human resource productivity, with all other factors being equal.

But how can such productivity increment be obtained?

It is a matter of entrepreneurial strategies and it is possible envisage a large number of different strategies to obtain it. Every entrepreneur can be creative and innovative to that regard, but, of course, some of them are more "at hand" and some intellectually more complex. Those which are easier will become of more general use, because they tend to be copied from one company to the other[2]. One of the easiest moves probably consists of reducing H at R constant, getting the same revenue with less cost for the human resource.

Relevant is the fact that the human resource cost reduction can be obtained by two different strategic sub-moves:

(a) reducing the wages of the whole labour or

(ß) reducing the work-force size.

The ß move is the qualitatively better one, because it may be the first step of a real restructuring of the company.

As a matter of fact, in order to carry it out, the work-force of the company must undergo a selection process: some people must be kept and others fired. In an assumption of management rationality, the managers will keep the ones who are more useful to the restructuring aim[3], sending to the work-force pool those who are less useful to that regard. In order to run this organizational measure, the management of the company must exhibit some leadership skills, as it must convince the employees that the selection is a necessary measure for the survival and successive competitive positioning of the company.

It is not an easy task, especially in an environment, which was and is still permeated with egalitarian culture.

For that reason, I it asks for genuine leadership and entrepreneurial[4] skills. We can call it the Leadership Strategy.

But measure (ß) is only the first step of a larger strategic path, looking for a steady improvement of the competitive position of the company. The profit u materialized by the ß move, must not be depleted, but reinvested in further moves in order to strengthen the position of the company in her competitive environment.

Again, there are many possibilities of how to do it, but there are some simple strategic steps which is possible to imagine and suggest: for example, improvement of the productivity f, by investing in some up-to-date machinery, or in some intangible assets[5]. This successive step may bring to another improvement of u, which may be finally used in order to improve v, the productivity of materials. This can be obtained, for instance, rising the quality of the output or combining output with some services.

These "further" steps taken by a company in order to improve its competitive advantage are not so relevant to the present study. They are indicated only in order to show that step (ß) is to be considered as only the first one of a longer healing process.

Measure (a), reducing the average wage level, is indiscriminative and in this sense it is socially much easier to carry out, as people are all treated in the same way, and nobody is hurt in particular. But has the generic result of depressing wages and lowering the average income of everybody. If it is used by many companies, it has the general outcome of worsening the general income situation of the country. When the wages are to low, the best employees may be tempted to emigrate in more attractive economic environments. Eventually, a lot of companies may get bust, and the employees must look for other jobs at home or abroad. We can call it the indiscriminative strategy.

In both cases workers are expelled from the companies and they go into the work-force market as unemployed, but in case a get unemployed good and bad workers together, whereas in the case ß there is a selection: good workers are kept and worse ones end in the work-force pool and what is most relevant, companies survive.

Key words: Restructuring, transition, HRM Aspects

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[1] We can call h, productivity of the human resource, f, productivity of the investment and v, productivity of the materials used as inputs.

[2] If a manager makes a successful strategic move, he will be widelly copied by others.

[3] Those who permit to keep R at the same level with H smaller.

[4] In the sense of Schumpeter: somebody who dares to do something which is not contemplated by the social environment, either endogenous or exogenous to the company.

[5] Markets, innovation and the like.

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Structural Changes in Economies of Central European Countries

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Abstract

The fall of communistic regimes in Central Europe after 1989 started process of dramatic changes that had impact not only from geopolitical point of view (creation of new countries) but also on overall economic development of respective countries. These are currently on the way from centrally planned economies towards free market or liberal economies. This paper examines and describes significant structural changes in trade balance of central European countries in last decade, their natural orientation towards western European countries.

It identifies possible trends or scenarios of future development as well as evaluates Maastricht criteria fulfilment by CE countries. Conclusions are supported by key findings and scenarios of possible development are proposed at the end of the paper.

Conclusions

1. Germany took over leading role of major trade partner for central European countries from Russia and its share on exports as well as imports of these countries is rising. CE economies rapidly opened up while Eastern European economies' trade turnover stayed the same. Another interesting fact is that except of Slovenia there is no significant second partner from Western Europe in international trade of CE countries. In addition, the Netherlands was one of key investor countries in the region despite its smaller size of its economy.
2. The size of bilateral trade between Czech and Slovak Republic is low and has tendency to decline.
3. There can be observed positive change in the structure of exports and imports among respective CE countries with an increase of exports and imports of machinery &transport equipment that means strengthening the position of these countries in the field with higher than average added value.
4. Food products exports of Poland and Hungary are continuously declining and thus reaching the role these countries are expected to play in the near future. (after joining the EU)
5. Imports of natural resources (natural gas, oil) from Russia stayed at the same level as before the change, which suggests crucial role of Russia in supply of these resources for the whole region.
6. When evaluating economic development of CE countries in term of fulfillment of Maastricht criteria for EMU access it is important to stress following points: i) Poland and Slovakia have problems with high unemployment rate; ii) all CE countries except Czech Republic have higher inflation rate than the one defined by Maastrich criteria; and iii) Budget deficit of CE countries also exceeds the limit and is becoming a problem in the Czech Republic, Poland, and Slovakia. Since some of the reforms (eg, pension reform, bank restructuring) have fiscal consequences and there is an urgent need to build infrastructure, the fiscal deficit could become an issue.

Comparative advantage as driving force of trade structure changes

With the removal of most trade barriers and capital account restrictions, it is natural for small-open economies to pursue their comparative advantage. Central European countries have had the benefit of relatively free trade. As of 1999, the import barriers were substantially lowered in case of Hungary, Poland, and Slovenia, why they remained very low in the Czech Republic and Slovakia (see Table 1).

Table 1 IMPORT BARRIERS

tariff revenues (in percent of imports)	1993	1999
Slovakia	2.3	2.7
Czech Republic	3.5	1.2
Hungary	12	2.4
Poland	15	3.4
Slovenia	7.3	2.6
Russia	12	8.9
Ukraine	1.7*	2.3

(*) Data for Ukraine as of 1994 instead of 1993.
Note: Tariff revenues include all revenues from international trade.
Source: Transition Report 2000, EBRD

The capital account restrictions were gradually removed as well and all Central European countries display much greater forex liberalisation than East European countries (see Table 2).

Table 2 INDEX OF FOREX AND TRADE LIBERALISATION

	1993	1999
Slovakia	4	4.3
Czech Republic	4	4.3
Hungary	4	4.3
Poland	4	4.3
Slovenia	4	4.3
Russia	3	2.3
Ukraine	1	3

Note: Index originally ranged from 1 (the lowest liberalisation) to 4. A change in the index is in units of 0.3.

Source: Transition Report 2000, EBRD

Instead of calculations of the comparative advantage using various data-intensive techniques, one can let the data speak. Under the assumption of high levels of formal education (such as in engineering), high proportions of skilled workers on low incomes and the lack of natural resources, one could have guessed back in 1993 that large amounts of foreign direct investment (if allowed) would flow to Central European countries to labour- and skill-intensive sectors of the economy. This resulted in three tendencies: i) Value-added sectors would grow as proportion of GDP. Currencies could then start to appreciate in real terms and the living standards will increase. Income inequality will increase as well since there will be „winning“ and „losing“ sectors. ii) Not attractive sectors would die out and these goods would be imported. This would cause the trade turnover (as proportion of GDP) to increase. iii) Countries would be more sensitive to cyclical environment of its main trading partners (Western Europe). This could then present a certain cost to the increased living standards and domestic policies should be called upon to smooth the Western European business cycles.

As can be seen, the openness of Central European economies changed dramatically with trade turnover close to 100% of GDP in Slovakia, Czech Republic and approaching the 100% level in Hungary. On the other side, the economies have not opened up in Eastern Europe.

Table 3 OPENNESS OF ECONOMIES

Exports and imports as % of GDP	1993	1999	change
Slovakia	93.2	109.1	15.9
Czech Republic	82.8	104.2	21.4
Hungary	50.4	93.8	43.4
Poland	34.5	43.6	9.1
Slovenia	97.2	92.4	-4.8
Russia	61.7	62.7	1
Ukraine	85.3	82.5	-2.8

Source: Transition Report 2000, EBRD

This means that the business cycles between Western and Central Europe are more and more synchronised allowing smaller problems of adopting the same currency at some stage (optimal currency area argument). Fig.1 plots the widely used German manufacturing IFO index against the export growth rates of Central European countries. Rapid synchronisation of CE exports with the German manufacturing is evident. Table 4 suggests that the greatest correlation is currently in the Czech Republic and Hungary. Both countries have received a fair share of greenfield investment.

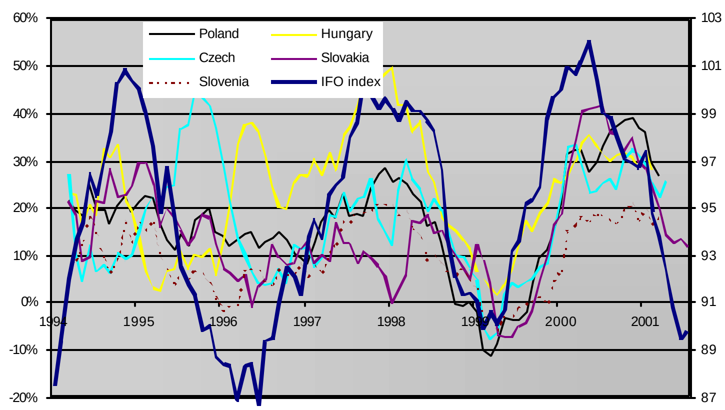

Fig. 1 GERMAN MANUFACTURING IFO INDEX VS. CE EXPORT GROWTH RATES

Note: The export growth rates plotted as 3-month moving average of annual export change in EUR. IFO index plotted on rhs axis.

Table 4 GERMAN MANUFACTURING VS. CE EXPORT GROWTH

	1994-1997	1998-early 2001	Change in correlation
Poland	63.8%	79.7%	15.9%
Czech	-10.6%	78.9%	89.5%
Slovakia	52.5%	62.9%	10.5%
Hungary	20.5%	85.7%	65.1%
Slovenia	81.0%	72.0%	-9.0%

Germany as a prime trade partner for Central Europe

Opening of economies significantly influenced the structure of trade partners of all CE countries. This was driven by two major factors at the same time. CE countries were loosing their position at important Russian market thanks to: i) worsening economic situation that culminated during the crisis in 1997 ii) requirement of mutual payments in hard currencies (DEM or USD), iii) aggressive arising of new (western) competitors that had constrained access to the market before and iv) bad corporate government with resulting low payment discipline. However, this could also be advantage since Russia would have surely imposed softer ‘constraints’ on the quality of CE products and could therefore support slower corporate restructuring in CE countries. Germany became prime trade partner for the whole central Europe and its position is driven by following factors: i) its geographical location close to the CE region (common border with Czech Republic and Poland) ii) huge direct investments of German companies in respective countries, that generate increasing flow of semiproducts and final products between CE subsidiaries and their parent companies located in Germany. iii) bilateral trade and investment relations are not oversensitive to changes of political situation in respective countries as Germans concentrate their attention to the business questions and do not pay too much attention to political nuances.

There is one very interesting fact; cumulative capacity of economies of France, Italy and Great Britain is almost 2 times higher than the one of Germany however their cumulative share on CE exports and imports reaches barely half of the German’s one. Haven’t these countries been able to overcome their mental barrier that prevented them from trade and investments in CE or it is just geographical location of Germany that gives comparative advantage to the Germany? Foreign direct investment data might explain the direction of trade to some extent. Germany was much faster and more willing to invest in CE countries. Table 5 shows that Germany invested 4-times as much as France and UK when adjusted for their respective GDPs. Italy fared very badly compered to other major Western European countries. Table 5 also reveals an astonishing fact about the Netherlands. Netherlands invested almost the same amounts as Germany in both the Czech Republic and Slovakia despite its GDP being only 17% of German GDP. This is probably not just the case of the former Czecho-Slovakia. Looking at available Hungarian FDI data between 1999 –1H2001, the same fact could be found there[i].

Table 5
FOREIGN DIRECT INVESTMENT BY REGION – A CASE OF FORMER CZECHO-SLOVAKIA
HOW MUCH OF US$10,000 OF COUNTRY’S GDP HAS BEEN INVESTED IN CZECHO-SLOVAKIA

	Czechia	Slovakia	Total
Germany	3.3	0.6	3.9
France	0.9	0.1	1.0
Italy	0.2	0.1	0.3
UK	1.1	0.1	1.2
Netherlands	20.2	2.7	22.9
US	0.2	0.0	0.3
Japan	0.0	n/a	n/a

Note: Czech data is cumulative as of 1H2001, Slovak data as of 1Q2001. Cumulative 1993-2000 nominal GDP used.

Czech and Slovak Republic

Development of international trade structure of Czech and Slovak Republic has similar patterns due to the common history and very close relations from previous times. Tables 3 and 4 show significant growth of German share of both republics’ exports as well as imports. Secondly, mutual trade between Czech and Slovak republic is still declining. This is due to: i) interruption of traditional production chains between Czech and Slovak companies ii) arising of the new and substitute producers &products at domestic market and iii) mutual loss of the advantages of internal market (i.e. duties, tax, quotas).

German's share on export of Czech Republic is significantly higher than the one on Slovakian. This may be caused (apart from other reasons such geographic location or amount of direct investments mentioned above) by the fact that semiproducts exported to Czech Republic from Slovakia are used in production and later on exported to Germany as parts of Czech final products.

Table 6 CZECH REPUBLIC - MAJOR EXPORT AND IMPORT PARTNERS

	Exports				Imports			
	1st partner		2nd partner		1st partner		2nd partner	
	Country	%	Country	%	Country	%	Country	%
1993	Germany	26	Slovak Rep.	21.5	Germany	25.4	Slovak Rep.	17.4
2000	Germany	41	Slovak Rep.	12.9	Germany	32.9	Russia	6.3

Source: CESTAT Statistical Bulletin, 2001

Table 7 SLOVAK REPUBLIC – MAJOR EXPORT AND IMPORT PARTNERS

	Exports				Imports			
	1st partner		2nd partner		1st partner		2nd partner	
	Country	%	Country	%	Country	%	Country	%
1993	Czech Rep.	42.4	Germany	15.2	Czech Rep.	35.9	Russia	19.5
2000	Germany	27	Czech Rep.	17.3	Germany	25.3	Russia	16.8

Source: CESTAT Statistical Bulletin, 2001

Hungary

Stable macroeconomics with manageable fiscal and current account deficits, environment open to competition and unproblematic political conditions offered by Hungary attracted high and fast foreign direct investments and these became major driver of trade structure changes. Russian importance as trade partner declined and reaches 1/3 of 1993 share only.

Table 8 HUNGARY - MAJOR EXPORT AND IMPORT PARTNERS

	Exports				Imports			
	1st partner		2nd partner		1st partner		2nd partner	
	Country	%	Country	%	Country	%	Country	%
1993	Germany	26.6	Russia	15.3	Germany	22.2	Russia	21.6
2000	Germany	37.9	Austria	8.9	Germany	26	Russia	7.7

Source: CESTAT Statistical Bulletin, 2001

Poland

While in other CE countries the significant change of trade structure started only in 90-ties, Poland (and to some extend Hungary) is an exception to the rule. Its structural changes started as early as in 80-ies after the different political development. As a result of these differences trade relations of Poland with USSR weakened and to some extend were replaced by its orientation towards Germany and other western European countries.

Tab.9 shows that during last years considerably high trade share of Germany on Polish exports and imports stayed flat in recent years.

Table 9 POLAND - MAJOR EXPORT AND IMPORT PARTNERS

	Exports				Imports			
	1st partner		2nd partner		1st partner		2nd partner	
	Country	**%**	**Country**	**%**	**Country**	**%**	**Country**	**%**
1993	Germany	36.3	Netherlands	5.9	Germany	28	Italy	7.8
2000	Germany	35.2	**Russia**	8.4	Germany	24.2	Russia	9

Source: CESTAT Statistical Bulletin, 2001

Slovenia

The situation of Slovenia is unique compared to the rest of CE countries. It did not have significant trade contacts with Russia and thus it was not hurt by Russian crisis. After the separation from Yugoslavia, Slovenia very quickly oriented itself to western European countries. Slovenia is the only CE country that has another strong EU neighbour (Italy). The trade share of Italy is naturally increasing after some original mutual political conflicts had been removed.

Table 10 SLOVENIA - MAJOR EXPORT AND IMPORT PARTNERS

	Exports				Imports			
	1st partner		2nd partner		1st partner		2nd partner	
	Country	**%**	**Country**	**%**	**Country**	**%**	**Country**	**%**
1993	Germany	29.5	Italy	12.4	Germany	25	Italy	16.2
2000	Germany	27.9	Italy	13.5	Germany	19	Italy	17.1

Source: CESTAT Statistical Bulletin, 2001

Change in the structure of exports and imports

Structural changes of exports and imports of CE countries are also dependent on forces behind them. The tendency of respective economies to change their production structure is driven by: i) an attempt to produce products with higher added value and ii) foreign direct investments that created new capacities and provide local subsidies international marketing channels and thus assured demand for products manufactured in CE.

Looking at structure of exports, "Manufactured goods classified chiefly by materials" was the dominant commodity group exported from all CE countries except Hungary. The outcome of the shift in the exports structure was steadily growing share of machinery and transport equipment on total exports in the whole region, while share of all the other commodity groups on total exports was falling. The shift has different intensity in respective countries. Tab.11 shows that the portion of this commodity group on total exports in Hungary and Slovakia more than doubled in last 7 years, while in Slovenia it grew only slightly. This is due to fact that the structure of Slovenian exports had from the beginning healthy structure.

Table 11 SHARE OF MACHINERY AND TRANSPORT EQUIPMENT ON TOTAL EXPORTS (in %)

Country	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**Index 2000 vs.1994**
Czech Rep.	25.9	30.4	32.7	37.7	41.3	42.4	43.5	143
Slovak Rep.	19	20.4	21.8	28	37.4	39.5	39.4	**207**
Hungary	25.6	25.6	26.3	45.1	52	57	58.8	**229**
Poland	19.8	21.1	23.2	21	28.4	30.3	33.4	168
Slovenia	30.3	31.7	31.4	33.6	36.4	35.5	35.6	116

Source: CESTAT Statistical Bulletin, 2001

The same shift can be observed in the structure of imports within the region. However, the shift was not that strong as it was in the structure of exports. Tab.12 shows that the share of machinery and transport equipment grew most significantly in Hungary while in Czech Republic and Poland it grew only slightly. Growing positive difference between the export and import shares of machinery and transport equipment means growth of added value created in respective countries and this has also positive impact on development of respective industry.

Table 12 SHARE OF MACHINERY AND TRANSPORT EQUIPMENT ON TOTAL IMPORTS (in %)

Country	1994	1995	1996	1997	1998	1999	2000	Index 2000 vs.1994
Czech Rep.	35	37.1	38	38.5	39.4	39.6	39.6	113
Slovak Rep.	27.7	31	33.1	36	40	37.7	35.5	128
Hungary	34.1	30.8	29.5	41.8	46.5	50.2	50.4	**147**
Poland	31.8	33.6	33.8	33.1	36.6	37	34.5	108
Slovenia	28.8	29.9	33.6	36	38.3	38.2	36.4	126

Source: CESTAT Statistical Bulletin, 2001

Food production of Poland and Hungary

Tab.13 suggests another important pattern. We can observe continuous decline of "food and beverages" commodity group share on total exports of Poland and Hungary. In last 7 years it fell nearly 35% in case of Poland and reaches only 1/3 in case of Hungary. Thus the structure of both Poland as well as Hungary converges to the average of their neighbor countries. Major forces behind this dramatic decline of food products exports are: i) quotas posed on food products by EU and ii) loss of comparative advantage of extremely low prices due to overall increase of inputs prices. Thus food products are becoming less attractive for foreign markets.

Table 13 SHARE OF FOOD &BEVERAGES ON TOTAL EXPORTS (in %)

Country	1994	1995	1996	1997	1998	1999	2000	Index 2000 vs.1994
Poland	11.5	9.9	9.9	12.2	10.4	8.9	7.7	**67**
Hungary.	18.5	20.3	16.1	12.8	10.5	8	7.1	**38**

Source: CESTAT Statistical Bulletin, 2001

Russian natural resources imports to CE

Due to instability caused by weakening economy the share of Russian imports from CE declined significantly in last years. However, Russia preserved its position in exports of natural resources to all CE countries. Attempts of CE countries to increase their exports to Russia and thus pay at least part of their natural resources imports failed and partly success of Poland to increase exports turned against Polish companies after the 1997 crisis when these ended up with unpaid receivables.

The dependency on Russian natural resources imports to CE creates high exchange rate risk. This is due to the fact that all payments for natural resources are in USD while majority of CE revenues are in Euro as they come from trade with Eurozone.

Maastricht criteria vs. economic performance of CE countries

Despite the fact that unemployment is not part of Maastricht criteria this issue has been subject of warning statements of EU representatives. Moreover, in case of Poland the situation may get even worse due to the forthcoming transformation of atomised agriculture sector.

Concerning inflation, Slovakia is currently the worst of the group closely followed by one of favourites for early accession – Hungary. However, this is partly due to the late and aggressive price deregulation since core inflation (excluding deregulation and the impact of price of food and fuel) is expected to be at 4.5% at the end of 2001.

Budget deficit of CE countries also exceeds the limit and is becoming a problem in the Czech Republic, Poland, and Slovakia. Since some of the reforms (e.g., pension reform, bank restructuring) have fiscal consequences and there is an urgent need to build infrastructure, the 3% fiscal deficit limit could become an issue.

Debt to GDP ratio doesn't seem to be a problem for any of CE countries according to the official statistics. The reason behind this positive development is strict debt policy of former east block governments with partially released debt policy of Hungary and Poland before 1989. That is why the latter countries have the highest debt to GDP ratios despite the fact that substantial part of Polish debt was abolished. Even though it is reasonable to argue that hidden debt (esp. in the Czech Republic) will increase public debt in the next few years, the countries could meet 60% of GDP criterion.

Table 14 ECONOMICAL INDICATORS OF CE COUNTRIES

Country	Unemployment in (%)	Inflation in (%)	Budget Deficit as % of GDP	Debt to GDP ratio (%)
Czech Republic	8.5	5.8	9.1	19.7
Slovak Republic	18.5	7.7	4	46.6
Hungary	4.8	7.2	3.5	52.7
Poland	17	5.9	4.0	42
Slovenia*	12.2	8.9	-1.4	24.8

Note: Statistics are forecasts for 2001. (*) Slovenia data as of 2000.
Source: Directional Economics, 4Q/2001, Global Economics, 4Q/2001, ING Barings

What is next?

1. Despite recent changes in CE exports and imports and strong position of Germany that thanks to its location and other reasons mentioned above achieved superior position in bilateral trade, the future is not as clear as it seems to be. Now the question is whether other countries will follow the way Germany pioneered, or not.
2. Close look at trade partners of respective CE countries reveals that bilateral trade among these countries is very low. If geographical location is comparative advantage, there are probably other barriers to the trade. One of them is probably very similar structure of the industry that produces variety of supplementary products but a lack of complementary products that could strengthen basis for bilateral trade.
3. Generally, the industry structure of CE countries has successfully undergone positive changes that can continue in case accession process will proceed smoothly. Spontaneous integration of CE economies to EU structures already started. Via FDI and increasing exports and imports CE economies are naturally becoming part of "New Europe" despite official date of EU enlargement even hasn't been announced.
4. Despite significant decline in exports and imports of Hungarian and Polish food products due to reasons mentioned above these countries have good prerequisites and tradition to stay strong in this industry. Moreover, joining EU will remove artificial barriers to their exports and after modernisation, reorganisation and capital influx to agriculture both countries can play important role in this industry in the future.

5. Russia plays and will play even more important role in supplying CE countries with natural resources (oil, natural gas). It will even strengthen its position after new gas pipeline is completed. This means persisting threat of exchange rate risk mentioned above.
   Currently the substitution of Russian natural resources supply is not economically advantageous. In spite of this fact CE countries should consider diversification of their demand in the future. After stabilisation of Russian economy should all CE countries try to cover at least part of their imports by exports to Russia. As Germany has very good position at Russian market part of the export can be incorporated in exports of German companies.
6. As in the case of Ireland and Spain in times of their accession to EU, the level of unemployment could be reduced after more FDI (foreign direct investments) are attracted.
   There are two options of solution of the issue of high inflation. Either candidate countries succeed in reduction of inflation rate within the period of expected entry to Eurozone (approximately 3 years after the EU accession) or the criteria will be adjusted as was the case with debt to GDP ratios of Italy and Belgium (that reached more than double of Maastrich limit).

For all indicators except of unemployment rate, regularly coming election years may have temporary negative effects due to high probability of populist policies of governing parties in respective countries.

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[i] During the time, Netherlands invested EUR$1.1bn compared to EUR0.5bn of German investment into Hungary. Beware of the small sample.

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Sustainable Business Development by Corporate Information Modeling

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Abstract

Global Information Modeling (GIM) produces a logical copy of the enterprise, mirroring the web of logical interrelations among business goals, strategies, critical success factors, processes, functional units, organizational units, and data - without having to quantify them. GIM makes the enterprise transparent and delivers an improved basis for decision-making.

By using fuzzy logic, GIM allows management to model the enterprise in a way resembling the way human beings think, which in response to an inaccurate, unsure, and shifting environment is other than strictly logical. This adjustment in reasoning helps management keep business strategy flexible for rapid implementation of short-lived competitive advantage, thus, making it possible to guarantee sustainable business development.

Global Information Modeling Captures the Unbound

It is at last possible to conceive of a whole enterprise as one unit - despite the ballooning complexity and constant change that characterize the business world at the beginning of the 21st century. A technique known as Global Information Modeling (GIM) produces a logical copy of the enterprise, mirroring the web of logical interrelations among business goals, strategies, critical success factors, processes, functional units, organizational units, and data - without having to quantify them. The closer to the top of an organization's hierarchy, the bigger the radius for GIM - and the bigger its potential to boost cost savings and increase reaction time.

By using fuzzy logic, GIM allows management to model the enterprise in a way resembling the way human beings think, which in response to an inaccurate, unsure, and shifting environment is other than strictly logical. This adjustment in reasoning helps management keep business strategy flexible for rapid implementation of short-lived competitive advantage. It strikes a workable balance between the momentum of an enterprise and the rapid change in the market. GIM makes the enterprise transparent and delivers an improved basis for decision-making. GIM at last harnesses information - one of the last domains examined for chances to gain competitive advantage - to travel the many paths creative information management offers to success.

To maintain both dynamism and flexibility in a business strategy, we must set the long-term rules in a way that allows for continual adaptation to market conditions. To find global solutions in the macroscopic view and simultaneously foresee detailed consequences of any microscopic change has been a major business challenge of the last decade. The inherent logical conflicts have often overtaxed management. A single person cannot take into account both the whole enterprise and multiple related factors at the same time - but a computer can.

GIM is the logical copy of enterprise reality

Global Information Modeling can be the basic technique for information management within an enterprise. The model is a drafting table for enterprise engineering, used to analyze various what-if considerations with emphasis on logical reasoning - not quantification. GIM is the approach that builds flexibility into large and complex systems, especially in a dynamic environment.

The product of Global Information Modeling is the logical copy of enterprise reality. GIM mirrors the logical interrelations among processes, data, and functional, organizational, and geographical units. GIM breaks an enterprise down into component elements while maintaining causal interrelations, functional connections, and data content for each element. Through such decomposition - focusing on input and output - every activity in an enterprise can be viewed in turn as the center of the web: Why does an activity take place? What input does it need from other activities before beginning? How does its output serve other activities? What are the consequences of not completing the activity? Particularly appropriate for GIM's uses are:

- Business objectives and strategies
- Critical success factors and critical assumptions
- Processes, both real and ideal
- Production and consumption relationships among processes
- Data specifying both the processes and their results
- Activities supporting processes such as IT
- Organizational units

GIM opens vistas to the future enterprise

GIM builds a picture of tomorrow's enterprise today. As do managers themselves, it starts with business objectives - see also the Fig.1. It then captures the fuzzy relationships between the objectives and corresponding strategies, as well as those between strategies and corresponding processes. The interrelations between objectives and processes become transparent: each user can see the importance of each process for each objective and assess the resources and services required for each process. In this way, GIM is applicable at all levels - operational, tactical, and strategic. It allows the use of both top-down and bottom-up approaches to refocusing an enterprise or activity. The core of GIM is its single repository for objectives, strategies, processes, data, conditions, limitations, and interrelations on the one hand, and experience, knowledge, and intuition on the other.

Benefits of coordinating tasks become visible

Global Information Modeling can clarify three types of inefficiencies within an enterprise:

- Areas that need increased information technology support
- Processes that can be simplified to reduce information technology support
- Coordinating tasks by middle management that do not add value

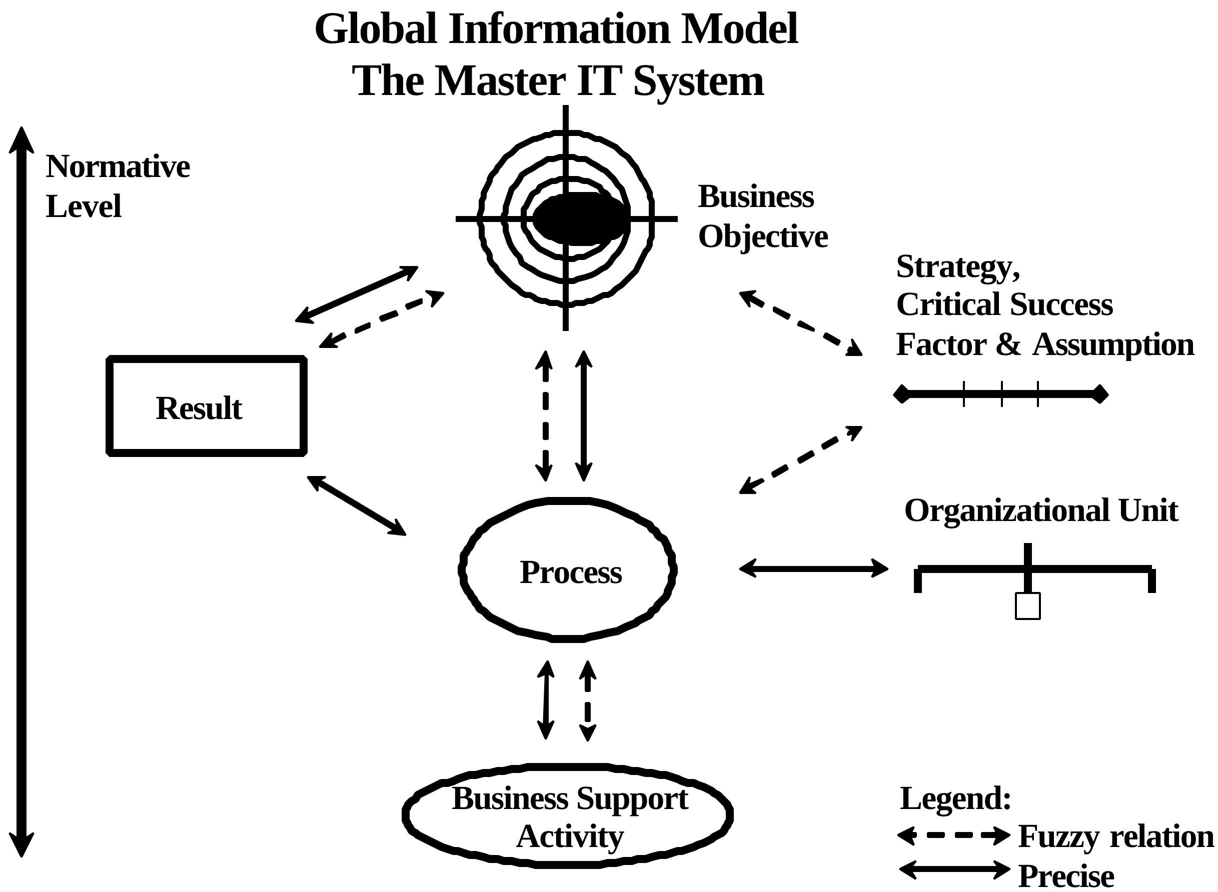
This transparency enables management to reallocate efforts by technology professionals in a consistent manner: Where and why reduce? Where, why, and how optimize? What would be gained? What would be lost? All these questions can be asked and answered for the enterprise or any part of it. GIM gives what-if answers to produce wise decisions.

GIM enables management to ask the right questions

Optimizing the process structure is based on four questions about each process:

- What are the results of the process?
- Who needs the results of this process and for what use?
- Which results are unnecessary?
- What are the prerequisites for getting the needed results?

Prerequisite to maintaining a flexible strategy are the completeness of the relations expressed in the model and the ability to adapt the model quickly to environmental changes. Quantitative rules, controlled separately at several levels, have no effect on this flexibility. Only the qualitative business rules, controlled by the enterprise, can maintain it. These rules are in fact causal, but causality in business cannot be expressed in a mathematical formula as in chemistry or physics. This causality is of the kind *influencing, influenced*, as the famous philosopher Karl Popper explains in his book [3]. Causality among economic factors is often fuzzy - inaccurate and unclear.



S. Janovjak: GIM

Fig.1.: GLOBAL INFORMATION MODELING

Thus, management decisions must in one sense rely on inaccurate data and unclear concepts. Metrics are often fuzzy, using terms like *essential, relevant*, or *probably of a negative influence*. A service like an information system, for example, may be rated in a survey as supporting a process in a way that is *excellent, satisfactory,* or *insufficient*.

Luckily, human beings have the capacity to make decisions in an inaccurate and unclear environment. For example, when parking a car the driver tries to get *close*, but *not too close* to the pavement or adjacent cars, and selects a space only if it is *big enough*. In analyzing economic factors, it is possible to use similar fuzzy logic to describe the causal relations between them, even though the relationships are not quantifiable. However, the relations are logical.

Interrelationships among economic factors are fuzzy

Fuzzy logic can help model inaccurate and unquantifiable kinds of reasoning in order to play with various prototypes, in essence, addressing problems for which there were no tools at all until now. If we assemble many fuzzy elements and describe their interrelations with GIM, we can build a flexible and reliable whole - the very key to competitive advantage. The ascension of fuzzy logic during the next two decades is likely to be as dramatic as the ascension of electronic data processing during the 70s and 80s or the IT development in the last decade.

With the proper implementation of Global Information Modeling, the biggest long-term potential lies in the creative reuse of the model. Reuse saves design time and boosts transparency by means of a common language, definitions and the elimination of redundancies. In addition, the reuse is an approved approach to increase quality of information. At Novartis (previously Ciba-Geigy) almost thirty distinct projects were implemented within a single GIM effort, and the variety of the projects was even more impressive than the number. The projects included an analysis of the adequacy of the IT support; a formal process and data analysis, the implementation of a large software component (MRP II); a study designing an IT architecture; a corporate reengineering project from the IT viewpoint; representation of the divisional mission (Crop Protection); definition of the IT portfolio for the new Novartis (merger of Ciba-Geigy and Sandoz); and a feasibility study for a particular strategic proposal. The projects enabled Novartis to realize significant cost and time savings. Due to the reuse of the model, the implementation time was usually only a fraction of the time needed by a conventional approach: hours instead of days, weeks instead of months.

Gain the competitive response time crucial to success

Especially when the model is kept alive through continual modification, GIM can make the difference in a crisis between death and survival, or between survival and success. Establishing logical infrastructure and entering initial data are time-consuming tasks that require full availability of highly qualified people, which means that performing them only once for the enterprise is a tremendous savings in resources. Building the model in advance guarantees that it is ready immediately when needed, in essence creating the potential for competitive advantage before the challenge hits - leading the enterprise proactively instead of exercising it reactively.

Global Information Modeling thus helps meet the following four major requirements of enterprise steering, which are necessary for sustainable business development:

- Determining an optimal strategy for an enterprise and test it through simulation
- Maintaining response flexibility in the short-, mid-, and long-term
- Focusing all parts of the enterprise on shared business objectives
- Optimizing resources transparently in both a local view and a global view

Planned IT cost reduced by 30 percent

In one example, the IT department of a large service company set up its application portfolio for the coming year, showing staff requirements of about 130 percent of the available personnel. The projected shortfall in resources led to a critical examination using Global Information Modeling. The outcome was a solution that made an increase in staffing unnecessary and indeed clarified ways to reduce staff without loss of effectiveness.

What was the magic formula? GIM made the enterprise transparent. New business objectives and a clarified logical structure pointed to obsolete user requirements. This in turn pointed to unnecessary processes and their owners, making visible the obsolete IT applications or their parts. In the end, the IT portfolio was actually reduced about 30 percent without harming the company or its business objectives. The cost savings amounted to almost three million US dollars.

Investment must be appropriate

The big potential of GIM justifies its implementation, but success is far from guaranteed and has indeed been rare in the business community. The requisite investment of human and monetary resources is quite large and the schedule long. The implementation is successful only when the investment is appropriate. Therefore it is crucial to take into account all factors that influence the size of the investment. The most important influencing factors that relate to the size of the GIM effort are:

- Goals of the effort

- Total content and degree of detail in the model
- Size and complexity of the enterprise
- Position of the implementation team within the organization
- Method, technique, and tool used.

The size of a GIM investment depends on whether the business objectives to examine encompass the whole enterprise or only a part of it. The necessary effort is smaller if the goal is to determine only a strategy and relevant processes, and if the model contains only the structure of the processes and not their necessary resources as well. GIM can handle the organizational restructuring as a by-product of process optimization or have restructuring as its main goal. A Global Information Modeling initiative for a small bank, for example, is fairly simple, because the raw materials, intermediate products, and end products are all money. On the other hand, the GIM initiative for a pharmaceutical enterprise is highly complex, involving expensive research, lengthy product development, high quality requirements in production, and elaborate marketing and sales logistics.

The right method is not sufficient

If management support for the effort is not wholehearted, which is usually the case with a GIM team low on the organizational pyramid, the whole project will probably be unsuccessful, or the application of its results will be very limited. The more highly placed the GIM team is within the enterprise and the greater its aggregate competency, the more straightforward, rapid, and inexpensive the implementation will be. In the ideal case, a member of a company's board would be the godfather of the entire GIM project.

A worthwhile GIM implementation depends on people who can see the big picture, whereby the strengths of IT staff are usually analytical in nature and focused on the detail. (i. e. the IT department will probably not perceive at all the necessity of building a model in advance to insure competitive advantage).

A successful GIM implementation also requires a high level of economic thinking and several levels of domain expertise. In fact, the economic realities of the marketplace and the experience of many employees must be merged into the model.

Learning from costly previous experiences

The importance of the method, technique, and tool chosen for the Global Information Modeling initiative must not be undervalued. If appropriate, they can significantly accelerate the implementation. If inappropriate, they can cause the effort to abort even in its early stages. Professor Dimitris Chorafas provides an illustration of the breadth of that spectrum in his book *Intelligent Multimedia Databases* [1] on the example of "Adequacy of IT":

> *A company which prefers not to be identified started a similar ambitious project. Ten system experts participated but 6 years later - after having spent 60 man-years - the major goals were abandoned. What is now functioning is roughly 10 percent of what Ciba-Geigy did in 3.5 man-years. The difference in cost effectiveness is 3.5 to 600 and reflects a new technology versus the mentality and paleolithic tools of mainframes.*

Such outstanding results are possible only when a suitable method, an excellent tool, and a progressive technique combine in a magical way with experience, creativity, and knowledge. My own method, GIM, has been successfully built on object oriented techniques and the tool is from Ptech Inc. (Boston, USA). Many other techniques and tools are capable of copying an existing global information model, but it is a hard fact of history that those who copy finish at best in second place. However, at that time, the mid of the 90s, and I think even today, Ptech has been the only tool capable of developing a global information model. The Ptech method combined with object oriented techniques offers the model indispensable flexibility, while the mathematics in Ptech guarantee the necessary consistency and integrity.

GIM means flexible strategy

Global Information Modeling supports several different kinds of decision-making. First it facilitates strategy-oriented procedures like:

- Consistent and transparent transposition of business objectives into processes
- Fine-tuning product and market fit for a successful acquisition
- Optimizing company mergers by locating potential conflicts and redundancies
- Setting up critical success factors and behavioral rules for attaining them
- Coordinate management's efforts on all organizational levels to more efficiently reach common objectives, e.g. corporate governance, excellence in change...

GIM means tighter processes

GIM also supports process-oriented decisions like:

- Selecting groups of processes to bundle in single organizational units
- Identifying processes for synergy or simplification based on commonalties
- Evaluating the importance of specific processes to business objectives
- Evaluating processes that are over- or under-supported by IT solutions.

GIM means optimized organization

GIM supports organization-oriented decisions through:

- Analyzing the responsibilities of each organizational unit
- Examining redundancies among organizational units
- Using the transparency of the model to win employees‘ good will for permanent improvement
- Using the transparency to initiate the process of „optimizing in everybody's own interest“.

Finally, GIM supports gaining other possible advantages and results:

- Taking advantage of the high speed of any change
- Control and transparency even at the highest complexity
- Using the transparency to motivate employees by making their contribution visible
- Increasing the employees' loyalty to the company by making the employee/company partnership visible.

Resistance is inevitable

GIM delivers transparency. As a logical consequence, a GIM implementation will be opposed by all who thrive on opacity, especially outdated elements in the enterprise that have learned to hide. Many of these will view their value added as coordination, when actually processes and tasks need merely to be refined to avoid the need for such coordination.

Conclusion

There is no wonder-tool available off the shelf, but every enterprise can build an excellent proprietary tool through a Global Information Modeling (GIM) initiative. The global information model is a logical copy of the corporation, of its relevant elements and rules for their interaction, but without quantification. GIM makes an enterprise transparent and delivers an improved base for decision-making, thus speeding up response time and increasing effectiveness of reaction to change, gaining the enterprise an essential competitive advantage. GIM also enables management to keep business strategy flexible in order to maintain that competitive advantage, thus, making it possible to guarantee sustainable business development

The huge potential of a GIM initiative is the justification for its high resource requirements. The higher in the organizational hierarchy it is initiated the greater the potential of GIM and the wider its radius. Effective Global Information Modeling is the challenge of the beginning of the 21^{st} century for management at all levels.

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Why Central European Companies are not able to Absorb Best Practices Faster?

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Andrej Kopcaj
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Abstract

Utilization of transferred managerial knowledge and methods from West to Central Europe is very poor. There are no signs of quick gap fulfillment between Slovak and European companies after ten years of transformation. Results are so bad, that very often we have heard about "specifics in Slovakia".

Principles of success based on natural laws were applied on described situation. Measurements in more than hundred Czech and Slovak companies were discussed.

It will be shown that probability of success depends on probability of success of knowledge capital and probability of success of social capital.

		entropy
Probability of success of top European companies is	**65 %**	**0,35**
Probability of success of top Slovak companies is	**40 %**	**0,60**
Probability of success of average Slovak company is	**15 %**	**0,85**
In an average Slovak company:		
Probability of success of knowledge capital is	**45 %**	**0,55**
Probability of success of social capital is	**35 %**	**0,65**

Social capital in Slovak companies is more devastated than knowledge capital. Level of social capital limits an absorb capacity of a company. (Fig. 1)

Probability of success (in %) is 1-e (e - entropy). It means 25 % of probability of success is 0,75 entropy, 75 % probability of success is 0,25 entropy. Entropy we can measure. Map of success is the graphic presentation of probability of success. Measurements of entropy are shown. (Fig. 2)

If social capital (people) has entropy between 1 and 0,5 behave like closed (mechanical) system. If social capital (people) has entropy between 0,5 and 0, behave like open (biological) system. Both systems (mechanical and biological) are so different, that we can say: Best practices from top companies (biological system) we can not transfer to our companies (mechanical system) without developing social capital (people).

To develop social capital means to energize them. Efficiency of energizing strategies is in Fig. 3. Comparison in efficiency between stimulation and motivation is shown in Fig. 4.

Conclusion

Utilization of transferred knowledge depends on the level of social capital. It means transferring knowledge without developing people is loosing of money and time. First we have to energize people. Efficiency of energizing strategies is shown.

EQUATION OF SUCCESS

Tomáš Bata

If you WANT and KNOW, everything is possible

		Psychological opinion		
WANT	x	KNOW	⇒	DO
		Anatomical opinion		
RIGHT-BRAIN HEMISPHERE	x	LEFT-BRAIN HEMISPHERE	⇒	HANDS
		Managerial opinion		
PEOPLE´S ENERGIZING	x	KNOWLEDGE OF PROCESSES	⇒	MONEY FOR PRODUCT
		Physical opinion		
ENERGY	x	COEFFICENT OF CHANGING ENERGY TO WORK	⇒	WORK
		Trendy capital opinion		
SOCIAL CAPITAL	x	KNOWLEDGE CAPITAL	⇒	FINANCIAL CAPITAL
		Probabilistic opinion		
PROBABILITY OF SOCIAL CAPITAL SUCCESS	x	PROBABILITY OF KNOWLEDGE CAPITAL SUCCESS	⇒	PROBABILITY OF FINANCIAL SUCCESS
POTENTIAL OF SUCCESS			þ	**SUCCESSFUL PRODUCT**
		Graphic opinion		
		MAP OF SUCCESS		

 Principles and Laws of Spreading Company Welfare 0

Fig. 1
LEVEL OF SOCIAL CAPITAL LIMITS AN ABSORB CAPACITY OF A COMPANY

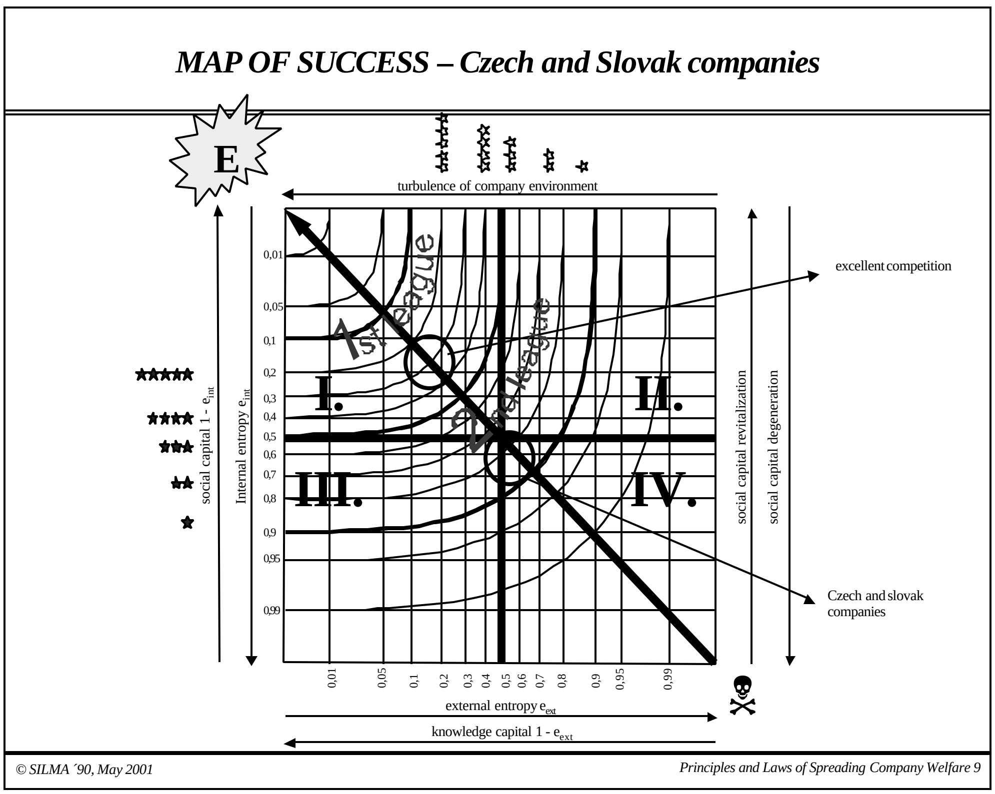

Fig.2
MAP OF SUCCESS - MEASUREMENTS OF ENTROPY

ENERGIZING STRATEGIES

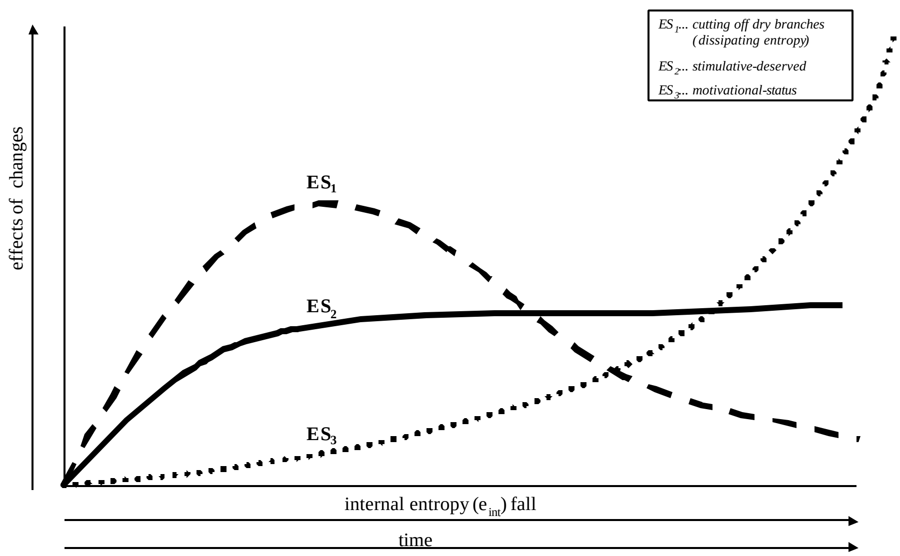

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Fig.3
EFFICIENCY OF ENERGIZING STRATEGIES

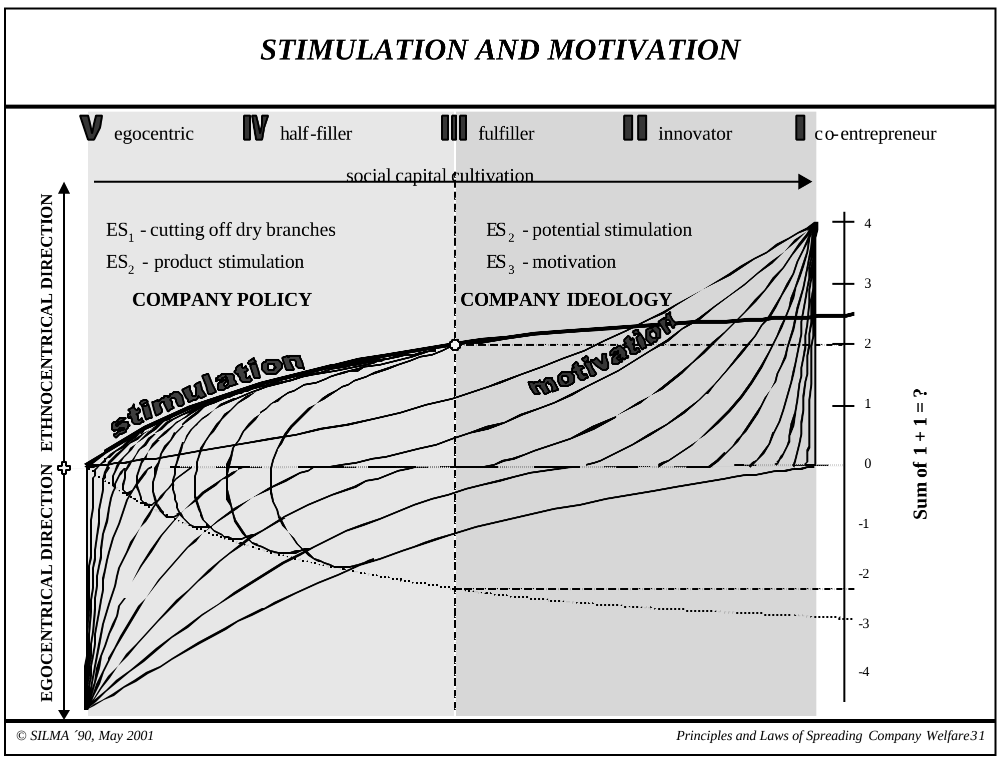

Fig.4
COMPARISON IN EFFICIENCY BETWEEN STIMULATION AND MOTIVATION

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Section 3

Education & E-learning

Education of Public Administration in Central European Universities

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Abstract

The main purpose of this article is to provide an overview of the various university programs and courses in public administration (PA), in – service training, and the extent of Europeanization within the education of PA in Poland, Hungary, the Czech Republic and Slovakia.

Introduction

In order to complete the process of transition to democracy, market economy, and to join the European Union, the nations of Central Europe during the last ten years are attempting with the help of West to achieve greater professionalization of public services. One important instrument for achieving this objective is an introduction and development of new courses and degree programs in Public Administration (PA).

The findings of the study is to attempt to demonstrate the followings: 1. The curriculum in public administration among the various Central European universities is not uniform, and can be classified into three categories: economic and management based, legal tradition, and interdisciplinary/social science orientation. There is significant European influence on these three forms of curricula, but there is an ongoing need to further develop curriculum in accordance with the European tradition. 2. Much progress is being made in development, curriculum and granting of PA degrees by various universities. However, this progress and the stages of development differs among universities in the four countries, and some programs and degrees, are not accredited or at times effectively integrated. 3. There is a recognition that the future prospects for meaningful reform in sustaining European – oriented PA programs is dependent on openness an transparency [7], as well as on the universities themselves in the process of the profesionalization of public servants and students [5]. The scope of this study is limited also because the citizens also need to change their negative attitudes towards public servants [6] and non-participate in corruption [9].

PA Education in Poland

The PA as an academic discipline was re-introduced in Poland in 1990. Today the PA programs leading to BA and MA degrees are offered by:

1. The National School of Public Administration in Warsaw This government-instituted institution offers an MA in PA for officers at the highest levels of state administration.

2. Twelve accredited universities (with the exception of the Catholic University in Lublin and the newly-founded University of Bialystock) offer BA and MA degrees in PA by their Faculties of Law and public Administration and the Faculties of Political Science. The make up of the courses offered by the prior Faculties consists mainly in legal (63%) and economics (11%) orientation, but includes also elective interdisciplinary (17%), social sciences (7%), and other (2%) disciplines. In other words, the Faculties of Law and Public Administration offer degrees in PA whose content and approach is to a great extent a combination of legal and economic theory with little consideration to socio-political environment and practical application. The Political Science Faculties offer, however, more interdisciplinary PA curricula representing legal (15%), interdisciplinary (51%), economics (5%), and social science (26%) disciplines [8, pp. 202-206].

3. Seventeen public and thirty-five private non-accredited universities offer BA degrees in PA with legal (33%) but primarily interdisciplinary orientation (67%). Generally, these schools offer PA majors with a broad range of specializations, such as business administration, central and local government administration, security systems administration, business or administrative law, foreign currency law, European integration etc. [8, pp. 206-210].

4. Training centers and government Ministries are providing the initial training designed to add the skills and qualification as well as in-service training to update the specific skills required within the public service [2, pp. 29-30]. The most important of these training centers are: The Foundation in Support of Local Democracy [3, p. 45], the Civil Society, Development Foundation, Ideal Gmina, Partners Polska, the Boris Foundation, and the Robert Schuman Foundation. In addition, Ministry of Interior and Administration provide in-service training to public administrators at the state, regional and local level [8, pp. 221 – 222].

The European and Comparative Dimension in PA

The integration of European PA courses within the various Polish universities is outstanding, bud uneven [8, pp. 212-219], e.g., in the Faculties of Law and Public Administration only 6% of the PA courses constitute the European area; at the university Faculties of Political Science, European courses in PA total 35%, in private schools Faculties of PA, the European PA constitute 9,2%; and in private schools, Faculties of Political Sciences, it is 17,9% of the total number of courses.

EU or comparative courses in all of the above universities can be classified into:

- the EU as a political-administrative system
- comparative PA courses oriented mainly on Europe, and
- comparative PA courses focusing exclusively on Europe

In addition, the College of Europe in Natolin and the European Centre at the Warsaw University offer post graduate education in European PA studies in French and English.

PA Education in Hungary

From 1990 until the present three important academic institutions influenced the development of PA education in Hungary. Among these, are:

1. Seven accredited university Faculties of Law who were, and are, the dominant in offering MA degrees in PA to a largest number of students. Their philosophy and approach is based on a historical precident that the general and administrative law is the core discipline to which all other fields of study, such as public policy, public management, the various social sciences, and others are subordinated. In this respect, "law curricula generally contains PA only as far as administrative law is concerned – and the core content of legal programs are identical irrespective of whether the student is preparing to become a lawyer, a juror, or public administration professional" (4, pp. 122-124).

2. Four university Faculties other than Law, offer various kinds of MA and PhD degrees: MA's in the fields of Economics and Public Affairs, European Master of PA, Public Service Manager Program (Budapest University of Economics), MA in Public Policy (Eotvos Lorand University in Budapest); PhD in Political Science with some courses in PA, law, economics, and public policy (Central European University, Budapest).

3. College of Public Administration in Budapest offers BA in PA which represents a mixture of PA, management, administrative law and social sciences (4, pp. 125-129).

4. In-service training and staff development in PA by Governmental -Ministries and central agencies is often mandatory and is provided both to the law civil public officials as well as senior managers of central governmental organizations.

The European and Comparative Dimension of PA

In Hungary the EU studies started immediately after 1989-1990, with government support and the universities. Today the EU and the comparative EU courses in PA correspond, rather directly to the overall orientation in PA of the first above listed institutions.

The seven accredited Faculties of Law offer eight core and elective courses with the dominant focus on a *political-administrative* system and comparative PA in several interdisciplinary areas, especially public policy, management, and political science. The College of Public Administration because of the preoccupation with practical issues of the Hungarian national PA, does not have EU component in its BA program.

PA Education in the Czech Republic

The PA education in the Czech Republic is very heterogeneous and difficult to classify. The main reasons for this situation are the lack of program coordination among the universities themselves and the flexible „credit“ system, which allows the students to select PA courses of their choice. In spite of this difficulty, however, the following can been identified as the main contributors to the development of PA [11, pp 48-65]:

1. Five accredited universities who offer MA degrees in PA by various non-Law Faculties: Prague University of Economics (MA's in Public Adm. & Regional Economy, Public Finance, Management of Public Services); Masaryk University, Brno (Public Economics, Regional Development and Administratiion); Pardubice University (Economic Policy and Administration); Institute of Mining Technology, Technical University at Ostrava (Public Economics and Regional Development); and Charles University in Prague (Public and Social Policy).

The above-listed universities in their system of PA education (with the exception of Charles University) use mainly an economics-management content and approach [1, pp. 41-42]. There are two reasons for this non-legal administrative orientation: a response to the demand by both public and private sector for more flexible and practical graduates, and the negative by reaction against way the administrative law was taught ideologically by the Faculties of Law, especially the Faculty of Law of Charles University.

2. University accredited BA degrees in PA offered by: West Bohemian University, Plzen; Ostrava University, Opava School of Pedagogics, Hradec Kralove; Silesian University in Opava; and J.E. Purkyne University, Usti nad Labem. These Schools offer an interesting majors ranging from Public Administration to regional Development, Public Economics to Social Communication to Protection of Municipalities and Citizens.

3. Not approved-government related offerings in PA within MA and BA programs by four other Czech universities who represent mainly the Faculties of Natural and Social Sciences (Charles, Masaryk, Ostrava Universities and the Institute of Mining, and Czech Agricultural University.

4. In-service training and staff development in PA is extensive. All of the Czech universities with MA programs also provide some form of PA in-service training in central, regional and local organizations. However, more comprehensive training for civil service is done by: The Institute for Local Public Administration, The Union of Town and Communities of the Czech Republic, The Civil Society Development Foundation, The National Training Fund, and many other organizations [11, pp. 74-76].

The European an Comparative Dimension in PA

The Czech Republic has a very well developed European curriculum in most of its Master degree programs. The following is a summary of the key representative courses [11, pp, 69-71]: Public Administration and Administrative Law in Europe; Regional Politics of the EU and of the Czech Republic; Regional Structures and Selected European Problems; Regional Policy and Structural Funds of the EU; Systems and Strategies of Territorial Planning in the EU; Regional politics of the EU and of the Czech Republic; Taxation in the EU; International Law and Law of the EU; Economic Policy of the EU; Public Administration Systems in the EU; Regional Geography of Europe; European Union and Euro-Regions Institutional Aspects of Integration.

The faculty of Social Sciences of Charles University, however, is the most important institution pertaining to European issues. It offers MA in European Studies (which was accredited in 2000/2001 academic year) and one year in-service training program for senior civil servants in EU integration in relation to candidate countries.

PA Education in the Slovak Republic

Currently there are only three universities in Slovakia that offer degrees in PA. [10, pp. 248 – 254]. The first, Matej Bel University, Faculty of Economics, offers the most comprehensive MA degree in PA – "Territorial Public Administration and Regional Development". This program is economics and management oriented. The Faculty also offers a minor in PA within its BA program whose concentration is in economics/management studies.

The second, University of Economics, Faculty of the National Economy in Bratislava, grants MA degree in economics/management area with a specialization in PA, and BA in economics/management with a PA component.

The third, University of P. J. Safarik, Faculty of Public Administration and the Institute of Public Administration in Kosice (with a cooperation of the University of Bayreuth, Germany) offers MA primarily in legal studies, with several courses in PA.

Mandated training of public servants at the local, regional, and district level is offered mostly by the Institute of Public Administration (Ministry of the Interior) located in Bratislava, and a great number of state-owned training centers representing various governmental ministries. Special groups, including civil servants, are also trained by profit and non-profit organizations (e.g., the Foundation for Self-Government Training). However, there is no regular training center today, which would provide pre-or in-service training to senior civil servants, and European and comparative topics in PA are uncommon [10, pp, 259-261].

The European and Comparative Dimension in PA

This area is represented by University of Economics, Faculty of the National Economy which offers in its MA degree two courses:

Environmental and Territorial Politics in the EU (required course) and EU Comparative Public Administration (an elective). Presently, the Safarik University in Kosice is offering two courses – European and EU Law and European Policy. This small number EU-oriented courses in Slovakia is caused partly by the lack of EU specialists in university departments involved in PA education [10, pp. 253 – 256].

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Enhancing the Distance Learning Model: Initiatives to Increase the Course Completion Rate For Non-Native Speakers in Slovakia

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Abstract

The article covers the implementation and effectiveness of enhancements to the Distance learning process when courses are delivered in English to non-native speakers at City University/Slovakia. The difficulties that students have in successfully completing regular Distance learning courses are examined and discussed. The article proposes that a hybrid delivery mode called *Enhanced Distance Learning* can significantly reduce the attrition rate. The article describes the adoption of the *Enhanced Distance Learning* delivery mode for courses delivered in English to Slovak students in Bratislava and Trencin, Slovakia.

Introduction

Technology continues to revolutionize the way the world works, communicates, and learns. The field of higher education is no exception, and throughout Central Europe the importance of Distance Learning is becoming increasingly evident. In Slovakia, the majority of university education still takes place in bricks-and-mortar classrooms, with instructors delivering classes to groups of students using the traditional lecture method.

However, the Internet revolution is encouraging all Slovak universities to adopt Distance Learning models as an effective way to reach their students. The models are being adapted to meet local conditions in innovative ways. Terms such as E-Education, E-Learning, and Virtual University recently sounded like science fiction. But today they are fast becoming a part of the reality in Central Europe, and their role in the future will be even larger.

Background

Distance Learning at City University/Slovakia involves individual students taking courses with an assigned instructor. There is no mandatory face-to-face contact. The majority of Distance Learning Students must work to pay tuition, but they follow same program of study as their classroom-based colleagues. Communication between instructors and students is primarily through email. Some instructors use free Internet-based tools such as Blackboard.com to post course materials.

The exclusive language of instruction at City University/Slovakia is English. All course syllabi, assignments, textbooks, and examinations are in English. Over 95% of the students are Slovak; 100% are non-native speakers of English. For some, especially the ethnic Hungarian minority, English is their third language.

The average monthly industrial wage in Slovakia is approximately USD $250.00. This presents certain challenges for delivering U.S.-style university courses. In Slovak homes, the penetration of computers that are connected to the Internet is approximately 5%. For comparison purposes, the rate in the U.S. exceeds 50%. In Slovakia, as in most countries throughout Europe, telephone access is metered and users pay for the duration of all calls. Internet users do not enjoy the unlimited local telephone calls that are commonly found in the U.S.

Students use their own computer if they are fortunate enough to have one. Many Distance Learning students use the computers at their places of employment. City University/Slovakia does maintain PC Labs in Bratislava and Trencin, but these resources are limited. Currently the PC Labs have a combined total of approximately 60 stations, which are shared by over 700 degree-seeking students.

Textbooks are purchased by the university and loaned to students who pay a fee of USD $6.00 per course. Students can use the textbooks for the ten-week duration of a course. Textbooks must be returned before new ones can be checked out.

Picking up textbooks require that students come to Bratislava or Trencin at least at the beginning and end of each academic quarter. Additionally, the course registration process, payment procedures, and the original documents that students need to confirm their legal student status all require them to be physically present in Slovakia.

Problem Identification

Many students experience difficulty in successfully completing Distance Learning courses. These can be categorized into three areas.

First, the educational experience of all students in Slovakia is overwhelmingly from the traditional classroom-based model. The classroom is a familiar environment and provides a reassuring link with the instructor. The schedule of structured classes keeps the attrition rate low. A Distance Learning course is structured radically different from the courses most students are accustomed to, and this lack of structure often causes students to fall behind. Whereas classroom-based courses at City University/Slovakia are organized in cohort groups, Distance Learning students progress through the system individually. Consequently, finding themselves entirely on their own, many Distance Learning Students fall behind and often are not able to successfully complete their courses.

Second, most Distance Learning students are employed. These young adults, most between 20 and 25 years old, are not used to juggling the demands of working and studying at the same time. To receive the social benefits of official student status (such as health insurance, reduced transportation costs), Distance Learning students must take a full load of 15 credits per academic quarter. Because many students rely on their English-language abilities to secure jobs with international companies, their jobs are often demanding, and too frequently they fall behind in completing their Distance Learning Courses.

Third, the demands of successfully completing a Distance Learning course are complicated by the fact that all City University/Slovakia students are non-native speakers. Studying at the university level in a second, or sometimes third, language can exponentially complicate the learning process, especially for quantitative courses like Decision Modeling or Operations Management. With the additional challenges that language can present, Distance Learning students suffer from not having the constant and immediate presence of an instructor that their classroom-based colleagues enjoy.

Enhancing the Distance Learning Process

At City University/Slovakia, academic managers are adopting an E-Learning model that enhances the Distance Learning process. The model is called *Enhanced Distance Learning* (EDL).

EDL is similar to regular Distance Learning, but includes workshops, which help to alleviate the three above-referenced problems. The workshops for each course are scheduled by the instructor, but are normally held in the evenings either weekly or every other week. The workshops are not intended to *replace* the traditional classroom experience, but rather to *enhance* the regular Distance Learning process. The nature and content of the workshops differ with every course and with each instructor; buy may include such topics as:

- course introduction
- discussion of course material
- review of assignments
- exam preparation
- assistance with research assignments
- proctoring of exams

The total number of workshop hours can vary, but is usually a minimum of ten and a maximum of twenty. EDL is an attractive E-Learning model because it deals directly with the difficulties that students have in successfully completing regular Distance Learning courses.

First, the workshops of EDL require face-to-face contact between the student and the instructor. During these workshops, instructors can regularly monitor the progress students are making towards completing course requirements. This not only helps prevent them from falling behind, puts them into contact with other EDL students who are taking the same course. Students benefit from the flexibility that Distance Learning offers, but are provided with enough structure so they do not feel so alone.

Second, the workshops of EDL help students with time management by keeping their course progress on track. If students do fall behind due to pressing work commitments, the EDL instructor can respond to the situation immediately.

Third, the workshops of EDL provides students with more exposure to the instructor, which can alleviate language difficulties. Approximately 50% of the instructors at City University/Slovakia are native speakers of English, and regular meetings are an enormous benefit when non-native speaker students are attempting to decipher the intricacies of quantitative course material.

Conclusion

The EDL model at City University/Slovakia is being adopted with the start of the 2001/2 academic year. While no measurable data is available, it is expected that the enhancements to the Distance Learning process will increase the course completion rate.

Virtual components can certainly replace some of the components of the classroom experience. And once broadband Internet access becomes widely available, these components may offer alternatives to replace the value of face-to-face contact. Students in remote parts of the world can already easily communicate with their colleagues, and various Distance Learning models give them access to instructors that would otherwise not be available to them.

The impact that technology is having on revolutionizing higher education will undoubtedly continue, with development initiatives funded by the U.S. Congress and the European Union accelerating the trends.

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Management Education for the 21st Century

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Abstract

This paper examines what are the expected management education needs in the near future. Includes a brief description of the history of management education beginning from the Managerial Revolution by now. The second part of the paper examines what managers do learn in the training. The third part deals with the changes in the business environment. These changes include economic, political, social, technological, psychological, legislation as well as globalization trends. The fourth part of the paper describes traditional mechanistic model of organization, its advantages and disadvantages, needs for the change to the new model of organization. Typical features of the new model of organization are as the following: flexibility, flat organization, networked, diverse and global or international. The last part of the paper deals with the entrepreneurship as an approach to management. Entrepreneurial new businesses are described as the "engines" of a modern economy growth.

Introduction

There are hundreds of business schools all over the world today that offer education programs in the field of management for potential as well as for existing managers in the companies. Most of these schools operate in the United States, the country that is generally regarded as a traditional basis of management education. The beginning of formal education programs in management is closely related to the period of so-called Managerial Revolution in the mid-forties of last century. The meaning of this term is generally known as a formal separation of management from the ownership of companies. During this time first formal education programs in management were introduced in the United States. After the World War II similar programs were introduced in Western Europe and Japan. In both cases management education was a very effective instrument for rapid development of their economies. This is true particularly in the case of Japan where American training programs for managers were introduced in a large scale after the Second World War. Even today most of Japanese managers are very familiar with such names as Deming or Juran. The same is true in the case of such training programs as TWI (Training within Industry), Statistical Quality Control, Quality Control Circles (QCC), etc. Rapid expansion of management education programs in Japan at that time is regarded as one of the most powerful factors that helped to meet the objectives of the Doubled National Income Plan in the sixties. At that time formal management education programs were introduced and very well accepted also in Europe. They penetrated even the Iron Curtain when introduced in the Institute of Management (Institut rízení) in Prague and later in the Institute of Management (Inštitút riadenia) in Bratislava in former Czechoslovakia. They were shut down after the Warsaw Pact troops invasion in 1968.

After the break down of the Iron Curtain the formal management education programs were soon introduced in all countries of the Central and East European region. Most of them were established in cooperation with American universities. As an example can be used the program at the Faculty of Management Comenius University in Bratislava. This program was established in 1991 in a close cooperation with such American higher education institutions as ILR School of Cornell University, Katz Graduate School of Business, University of Pittsburgh, Wichita State University, Montclair State University, and some others. Another good example are Master of Business Administration (MBA) programs that step-by-step have become an integral part of the program at all major higher education institutions in the region. By now these programs are run usually in cooperation with American partners because of the gap in the legislation of higher education that does not recognize the MBA degree as an official university degree. These countries should overcome this administrative gap as soon as possible. The European Union member countries did so a couple years ago.

What managers do learn?

Management can be seen as a process, science, or profession. Most of management education programs represent a typical Off-The-Job training that integrates all three mentioned perspectives or aspects of management. The curriculum is usually developed according to up-to-date knowledge in the field and teaching methodology always includes case studies. There are some discussions between academics as well as practitioners about the effectiveness of teaching using the case studies but in general this approach is used and well accepted by participants in a majority of programs. But what in reality managers do learn in such training? *They learn how to run an established, more or less successful company that operates in a specific business environment.* But business environment is changing. There are a number of factors that influence changes in the business environment and that will be discussed in the next paragraph. Managers usually do not learn how *to start a new business.* This is true particularly in the case of small and medium-size companies that become real "engines" of economy. For example, during one of my training sessions in former ZTS Martin participants discussed an issue of a growing unemployment rate in the region. My suggestion to one of them was - start your own business. The participant's reply was as the following: "I'm thinking about it for a long period of time. But who can tell me what in reality I should do when starting a new business?"

Changes in the Business Environment

Organizations must change because their environments change. Organizations must change to survive. Managers who are the "change agents" in organizations also should do so. But people hate change even that is the only thing that has brought progress. Managers should learn how to cope with their role of a "change agent". They should learn how to deal with the crisis of change - this means how to deal with the potential dangers and the hidden opportunities that are associated with any change in the organization. The most important factors that influence changes in the business environment are as the following:

- Technological change
- Economic change
- Change in the legal environment
- Social change
- Political change
- Psychological change
- Trends in globalization, and possibly some others

How these changes influence the business environment? Is there some impact on management education? Rapid technological development in the last century has brought the creation of new professions as well as vanishing of some others. Information technology boom has changed the role of managers in the organization - particularly mid-level managers. The general expectation is that all managers are users of personal computers. But reality in many cases is different. It is true particularly in the case of managers who graduated from universities a couple decades ago. Economic and political changes usually go hand in hand with each other. For example the break down of the Iron Curtain and restoration of democracy in the former East-Block countries brings the economy transformation. Managers have to learn how to run their companies in the competitive environment. The economy transformation requires dramatic changes in the role of managers. For example the state owned company's CEO was very surprised with the suggestion to set-up the financial plan for his company. His believe was that there is no need for the financial plan if there is no planned (command) economy any more. After that he asked who is going to give him such a financial plan. He did not look very pleased knowing the answer that he should set up the plan by himself. Because of economic and political changes the legal environment and legislation was changed too. Social changes in the business environment include for example the new work force - university graduates, phenomenon of unemployment, etc. There was such a saying under the command economy system that people pretend that they are working and the state pretends their compensation. This is no true any more. People have changed their attitude what is very important psychological change. The last, but not least are the trends in globalization. Major economies are relying increasingly on foreign customers but they are also relying on foreign suppliers. At the same time cross-ownership of assets between countries is increasing dramatically and foreign subsidiaries provide an increasing share of gross manufacturing output. Foreign subsidiaries contribute in an important way to host countries' innovation system. Globalization means increasing economic interdependency of countries. Country borders will continue to represent barriers to factor mobility. An increasing number of companies have to tackle challenges of cross-border management. Companies are searching for management tools to deal with globalization. Firms who do not succeed in finding the right management tolls in a timely fashion will fail. Put all together we can see a quite clear picture what are the new challenges and requirements for management education at least for the near future.

Traditional and New Model of Organization

We are going to win and the industrial West is going to lose. There is not much you can do about it because the reasons for your failure are within yourselves. Your firms are built on the Taylor model. Even worse, so are your heads. The author of this chilling prophecy is Konosuke Matsushita, the founder of Matsushita Electric, Ltd. Well, the question is if there really is not much we can do about it. As a matter of fact, most of our companies are built on the Taylor model. What is worse, there are some managers who run companies that are built on the traditional model without knowing even who Taylor was. Traditional model of organization was built on the principles of specialization and division of work, specialized individual positions and jobs, formal hierarchy of these positions and jobs, formal rules and standard operating procedures. Under this model boundaries for each department as well as clear boundaries between the organization itself and its environment were set up. Standardized training procedures and a clear chain of command are the typical features of this model. Based on these principles and features we used to call this model bureaucratic model. There are some advantages of the traditional model. They are as the following:

- Predictability and reliability
- Impartiality (depends on the compensation system)
- Expertise
- Clear lines of control, and possibly some other

But there are also some disadvantages of the traditional model of organization. For example, this model is:

- Rigid
- Creates barriers between the organization and the environment
- Almost all advantages can become disadvantages if the environment changes

But unfortunately the environment is changing very frequently. What we can do about it - is change the traditional model for the new one. Based on the changes in the business environment the typical features of the new model of organization should be as the following:

- Flexible
- Flat
- Networked
- Diverse
- Global / International

Flexibility means the capability to satisfy the needs of the customer. Products and services should be tailored according to needs of the customer. This is the way how to get the competitive advantage in the competitive environment. But flexibility means also the ability to deal with the diverse work force and manage unpredictable changes in the external environment.

Flat organizational structure is more flexible. This is the way to respond to changes in the market. Flat organizational structure changes the role of middle managers. There are some opinions that this level of management is not needed any more because of use of information technology. Flat organization is the way to cut the costs and improve productivity (and become more competitive).

Networked organization means building close relationships with suppliers and customers, building coalitions to work together with the key stakeholders and creation of cooperative networks with other companies. Doing so the company can become simultaneously a competitor, a customer as well as partner.

New model of organization should respond also to the growing diversity of the work force, recognize and tolerate the culture of other organization, and of course respond to the globalization trends.

Entrepreneurship as an Approach to Management

The last issue that will be discussed as an integral part of management education for the 21^{st} century is entrepreneurship as an approach to management. Under traditional point of view the entrepreneurship is seen most of all as just small companies and start-ups. Similarly the entrepreneur is seen as a risk taker, founder and innovator. But entrepreneurship can be seen as an approach to management that starts with *opportunity.* But what is an opportunity? It is a desired future state that is different from the present but also a belief that achievement of that state is possible. The opportunity depends on a number of factors. Typical are as the following:

- personal traits and skills
- environment
- access to the required resources
- timing

During the training courses managers can learn what are the basic managerial skills that can be developed and improved. They include technical, communication, interpersonal, and conceptual skills. Related to this there are the personal traits of a manager: capacity to create stability, understanding the big picture, risk reduction, measurable results during the time frame of senior management, orientation toward the internal, high capacity to work within structure and existing rules of the game, etc. But entrepreneurs are expected to possess some other personal traits like risk management, attention to detail, long time perspective, and endurance. Entrepreneurs should be able to identify and evaluate the opportunity in the environment, to overcome the competitive barriers and to get the access to the resources. The opportunity is a "window". But windows close. That is the reason why timing is an important factor that the opportunity depends on.

Successful entrepreneurship comes from individual entrepreneurs. If the enterprise and entrepreneurial new businesses "are the engines" of the growth in a modern economy, so there is a good reason to support it. There is a good reason to stress the entrepreneurship as an integral part of management education for the 21st century.

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New Directions in European Education/ Business Partnerships

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Abstract

Within the Framework of the Socrates Programme, preparatory courses for pedagogical and Educational institutions for primary and Secondary school students over the next decades have been organised. The Millennium Challenge: New Directions for European School/Business Partnership took in Rotterdam. The course was intended for Teachers and Principals of Basic and Middle Schools and for workers drawn from the Ministries of Education from 16 countries the course familiarised participants with new abilities and knowledge, which students must cope with, should they want to pot these successfully into practise. The course was also devoted to the progressively increasing demands, which are paced by the education process on teachers.

Changes occurring in the structures of the economies of the developed countries at the current time are, in turn, provoking changes in the requirements made on their educational systems. Whole new professions are arising, and the extent and purview of the uses of information technologies are dramatically increasing. The employment markets require ever-greater flexibility of employees and creates pressures for their re-qualification. Obviously, the European Union is reacting to these general structural changes in the economies within its bounds, in all areas of its activities. This was, for instance, the animus of the origin of the Socrates/Comenius project. It is one of the EU projects oriented on the domain of education, and that specifically on the lower levels of the educational systems – i.e. from the kindergarten up to, and including, middle/secondary schools.

Last year, the specialist course “The Millennium Challenge: New Directions for European School/Business Partnerships” took place in Rotterdam. The course was intended for teachers and school principals from the Primary and Secondary School sectors, as well as for workers in State (Educational) Administrations. 24 participants hailing from 16 countries made their ways to Rotterdam – Vlaardingen. The following countries were represented: Belgium, Bulgaria, the Czech Republic, France, Holland, Ireland/Eire, Italy, Germany, Poland, Portugal, Romania, Greece, Northern Ireland, Sweden, Great Britain and Austria. The aims of the course were to inform participants as to which skills and knowledge bases students would have to master, to successfully find placements in the labour markets (of the future), should they so desire. The course also devoted itself to the growing demands placed on teachers in the education process.

Developments in the whole of Europe are bringing with themselves new requirements being made of education. Political, economical, social and technological changes debouching themselves as rapid and radical changes in the conditions prevailing on the employment markets. Many professions and employment opportunities now exist, for which people need to be equipped with wide-ranging knowledge and experience. New skills are required, both in traditional, as well as newly arisen fields of activities. Developments in international contacts coupled to developments in communications technologies are causing the ever-greater internationalisation of all aspects of life.

Changes in the system of education are, to a marked extent, determined by what is happening in the world on a global scale. In view of the tempo of change, it is hardly surprising that planned changes in the domain of education are often shown up to be insufficient. The world, where both political and economic processes are complicated and undergoing rapid change, places heightened demands on the level of people’s knowledge and their ability to communicate. Current working conditions require flexible people, with new adaptability to the working environment, and the employment market is creating demands that schools be supple as to the content and aims of education provision. Long established professions are disappearing and are being replaced by new ones. Borders between various types of work are disintegrating and dissolving. We are the witnesses of a rapid growth in the volume of the market between European member states which, in turn, evokes increased needs for language skills among workers and their ability to be able to respect those political, cultural and religious customs and beliefs prevalent in the lifestyles of people from differing parts of the world. The role of educational systems is to accommodate those requirements placed, not only on Basic Schools, but also on the higher levels of the educational systems.

These types of changes mean that institutions and organisations within the educational system must be supple and capable of change, so as to be able to provide young people with the necessary education and to equip them with the skills and capabilities to adapt themselves to change. Young people in Europe have an ever-greater tendency to remain within the educational system for a relatively longer period of time. This fact, of itself, means that schools are responsible not only for the professional preparation of student, but equally, for their preparation from a societal point-of-view. Students should be equipped with the ability to communicate with other people, the skill (or intuition) as to, during the course of the discussions held, to formulate and to defend their own opinions.

The question, as to what knowledge schools should include in their curriculum, is becoming ever more complicated. That, which young people today are learning, comes from many sources. Teachers cannot be expected to know the complete extent of the extant knowledge, and which students require. Schools are compelled to alter teaching styles. The function of a teacher is changing. Their role is no longer simply providing students with a set of basic knowledge bases. The teaching process is becoming ever more interactive. The teacher must take into consideration the requirements and questions posed by their students and try to provide them not only with explanations of the problem under consideration, but also support, stimulation and direction in the learning process. One of the main tasks of schools remains the handing down of (one's country's) cultural heritage, (its) traditions and accrued knowledge pool to future generations. Nevertheless, a significant role in the education process is centered on the utilisation of the possibilities offered through the rapidly developing domain of information technologies. These technologies act as the intermediaries of the newest flows of information regarding subject matters studied and have a very strong influence and attract the attention of the youth of today. To them (the teachers), are left the necessity of elaborating enormous flows of information, of sorting that information, orienting oneself in them and how to make practical use of them.

At the end of the course, the participants, in conjunction with the teacher-trainers attempted to compile, collate and summarise the general requirements made on the educational system and to suggest a possible (ideal) structure of an educational establishment, which might be capable of fulfilling these given goals.

The main or key tendencies impinging on the framework of the productive activities of societies were summarised as follows:

- Developments in technology allow new opportunities of setting just what sort of work should be done, as well as how and where it might be done;
- New organisational structures are arising within whose frameworks all those functions relating to a given activity are assured by other economic entities (sub-contracting and outsourcing), as is the growing utilisation of independent specialists;
- General interest in the environment is steadily growing, and questions regarding the ecological aspects of manufacturing and production are becoming critical issues;
- (Mutually) Cooperating subjects or entities, employees and customers have an ever greater interest in the reciprocal respecting of one another's needs and their incorporated values;
- Enterprises and commercial organisations are feeling an increasing need to maintain and uphold the public's faith in the legitimacy of their operations and commercial links.
- Similar trends influencing the individual worker may be summarised as follows:
- The effects of permanent changes which require that the worker constantly renew and upgrade their skills and knowledge base by means of life-long education;
- A worker may expect several changes in the orientation of their individual careers, and during the course of their career path, they may be led to perform duties or to engage in professions which previously never existed;
- The number of working positions requiring higher levels of qualification are continually growing, and in corresponding contrast, the possibilities of performing manual, low qualified work are diminishing;

- The process is under way in which there is a movement away from the need for qualifications oriented to manual dexterity in the direction of those qualifications in which the comprehension of the functioning and functions of complicated machinery are stressed;
- There is an increase in the extent of (personal) responsibility within the framework of the performance of one's duties, since there is a lesser dependence on management levels within organisations;
- Professions are ceasing to be oriented on routine activities, and rather, greater emphasis is being placed upon coordination activities and communications within a team made up of workers drawn from various professions;
- A decrease in places in manufacturing matched by a corresponding increase in those in the service industries.

From the above-mentioned associations, flow the requirements which are placed upon the educational system and whose consequences equally determine certain recommendations which can be made regarding the organisation of educational institutions:

- Schools should be more differentiated and specialised, so as to be able to afford students and parents the opportunity of a greater range in choice;
- Educational establishments should be independent, and financed from more sources;
- Schools should be subject to a quality assurance system grounded on a generally agreed schema as to the description of the term quality. This system should be in compliance with the State's policies regarding the future developments in school systems and this should replace the traditional function of Schools Inspectors;
- Teacher assignment placements should be filled by a wide spectrum of teachers and other specialists;
- Educational establishments should be professionally led by a pedagogue, but the performance of administrative direction should be entrusted to a professional manager;
- Schools should be able to dispose of a core team of professional teachers employed full-time and backed up by a team of assistants and advisors teaching on a part-time basis.

This course offered its participants a number of issues (to think about) and inspirations to fire their effectuation in the scholastic process. It provided them with a priceless opportunity to compare their personal experiences with those of their colleagues from other countries and to familiarise themselves with their opinions as to the solution of mutual problems encountered in their everyday pedagogical practices.

The Potential of the Education to Promote Economic Growth and to Attract FDI: The Case of Estonia

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Abstract

The aim of the current paper is to analyze the linkages of economic growth and education, and education and FDI. In this paper we:

- **analyze the education-growth and education-FDI linkages in the framework of growth theories;**
- **bring out more general economic *pro et contra* arguments concerning investments into education;**
- **bring out some empirical works about education, economic growth and FDI;**
- **analyze the to date educational policy of Estonian government.**

As a result we can say that there are many direct and indirect ways education can affect the economic growth and FDI. Many empirical works yield controversial and different scale results in studies about the impact of education on economic processes. Even the human development index of Estonia and our position in World Competitiveness Report are high, the more precise and critical analysis must be done about the future perspectives. The education policy of Estonian government seems sometimes quite unstable.

Introduction

Due to the size and geographical location Estonia is in a pretty unique situation. Small size of the country can be seen as an advantage and disadvantage simultaneously. From one side, it has accelerated the processes taken place in the economy and in the whole society. At the same time the limited availability of human and financial resources can slow the restructuring and economic growth down.

What we are talking here is the in economic theory very good known concept of restricted resources. If in earlier economic theories the main resources of production have been seen as land, capital and labor force then nowadays the economists are talking about more and more broad spectrum of production factors.

Transition process has forced Central and Eastern European countries to choose between opening their markets or continuing in autarky. As it has shown in the case of Estonia the absolute openness to both foreign trade as FDI had its positive effects on increase in productivity and overall competitiveness of Estonian domestic and foreign owned firms. Inward FDI influence the economic development in different ways. Relatively high level of inward FDI into Estonia has been taken place during our economic transition process.

The investments into industry (i.e. capital accumulation) can basically originate from domestic savings but in small countries like Estonia, domestic savings are often insufficient, therefore FDI are more important. The role of FDI on economic development has many sides starting from simple capital multiplier and ending with the complicated relationships through networking. For example, from the experience of Slovenia (see also Rojec, Damijan, Majcen 2000) we can see, that foreign subsidiaries have often many advantages over domestic firms, i.e. they have many activities which impact on increase in productivity is empirically hardly measurable.

- they have a clear corporate governance with “responsible owners”,
- they have clear company strategy and resources for the realization of this strategy;
- they have undergone major (post-acquisition) restructuring with introduction of new production programs;
- they are part of a MNEs network what gives them access to parent company ownership specific advantages, including access to foreign markets.

In last decade the importance of human capital and technology have been seen as crucial factors for economic development. The main argument behind this is the argument of increasing returns on scale of human capital. In this paper we will concentrate us on the education capital as one type of human capital, which can accelerate economic growth. Of cause we could look for knowledge-effects caused by FDI, while one method of attracting knowledge, financial and other resources necessary for the changes in economic structure and promoting economic growth is to attract foreign investors. Anyway, because of space limitations the spillover effects of FDI are not treated in this paper.

Next we will concentrate on analysis of the education-growth and education-FDI linkages in the framework of growth theories. Then we will bring out more general economic *pro et contra* arguments concerning investments into education. Thirdly, we will bring out some empirical works about education, economic growth and FDI. At least we will shortly analyze the current situation of educational level in Estonia and make some comments about the to date educational policy of Estonian government.

Education, economic growth and FDI: theoretical considerations

The motivation behind investments in public education is not only to achieve economic growth, but it can be broadly divided:

- economic (growth, productivity, allocation of resources etc.);
- social (public services as one part of consumption, balancing regional disparities etc.);
- other (developing common sense, increasing the sense of responsibility, reduction of pollution, more efficient use of natural resources etc.).

In some extent all of these could be seen from some angle as generators of economic growth. More precisely, the education influences directly economic growth in many ways (see also Fig.1):

1. educational services as one source of value added and consumption (1);
2. education as production factor (human capital) (2);
3. education as creators of amenity, which attracts other production factors (3);
4. education as factor that increases the productivity of other production factors (with the same amount of inputs can be produced more and attracts other factors) (4, 4').

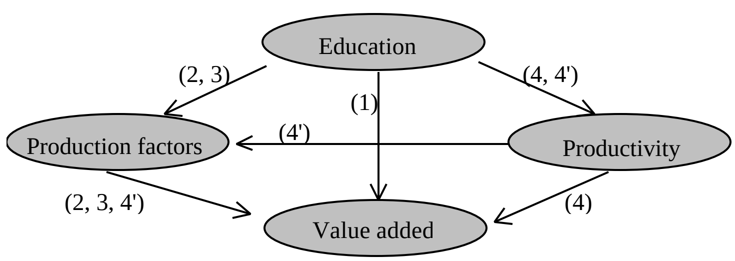


Fig.1 THE IMPACT OF EDUCATION ON ECONOMIC GROWTH

The ways the higher education can attract FDI is very closely related to its ability to generate economic growth. More precise approach about this is given with the Fig.2. First at all, higher average level of education reduces production costs, creates amenity and so develops preconditions for concentration of the production. All this can lead to economic growth and through this give additional impulses for developing education systems.

We can distinguish following ways to increase the effectiveness in production (decrease production costs):

A. Direct increase in efficiency:

- ability to reduce the number of processes, especially non-value adding processes (so to say higher level of learning by doing);
- ability to synchronize the transformation, information, measurement and co-ordination functions;

B. Ability to reduce opportunity costs:

- ability to improve the processing quality and environmental working conditions around the process;
- ability to reduce direct investments into alternative sources of human capital;

C. Technology transfer implications, higher flexibility etc. (propensity to use more advanced technologies, propensity to apply alternative or radically new technologies, potential for innovations etc.).

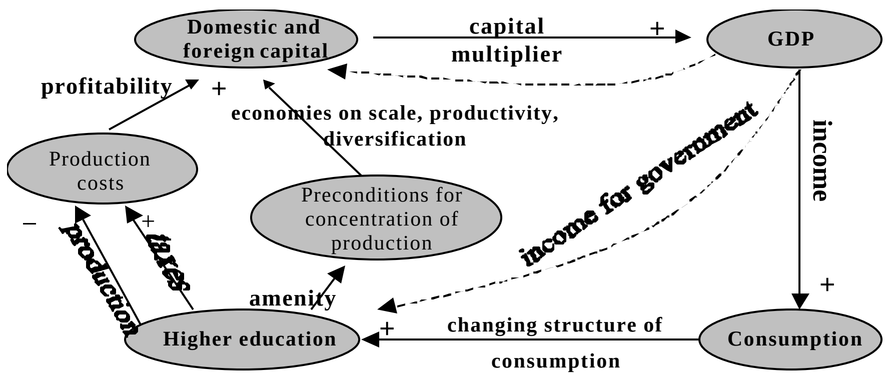


Fig.2. RELATIONSHIPS BETWEEN HIGHER EDUCATION AND CAPITAL MOVEMENT

If we would take into account broader impacts of higher average level of education, e.g. add to the previous analysis the foreign trade sector, labor market and direct impacts on GDP, then the picture would be even more complicated (see Fig.3).

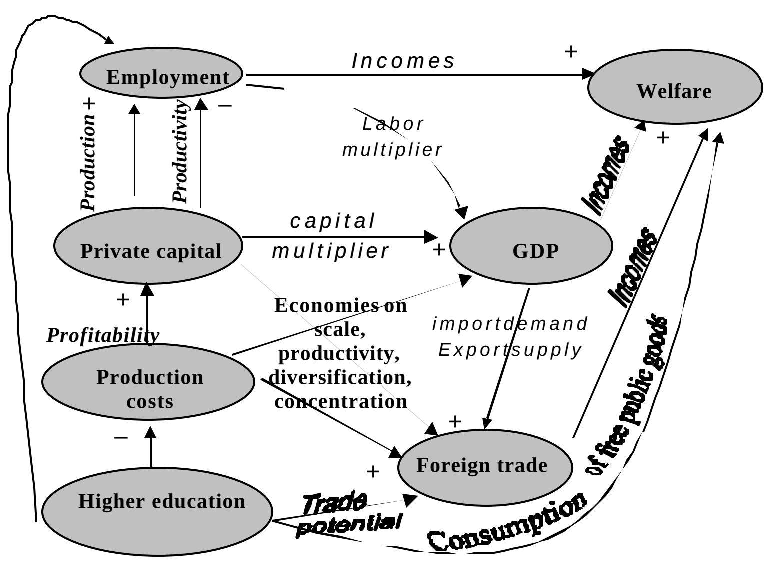


Fig.3. RELATIONSHIPS BETWEEN HIGHER EDUCATION, CAPITAL ACCUMULATION, EMPLOYMENT, FOREIGN TRADE AND GDP

The important factor on both figures is also the changing structure of consumption. It doesn't only mean that on higher level of incomes the demand on education services will rise. It also means that the demand on other products will become more sophisticated and "demanding", and that the higher proportion of import goods will be consumed. All this can shift the production structure in favor of the products with the higher value added.

All this seams to be very positive and therefore the only conclusions we could made from this is to throw more resources into development of education. Still it has some obstacles and hazards, which must be mentioned.

- The structure of education must correspond to the demand on it. Otherwise, high level of education "in numbers" will not automatically lead to better economic performance.
- Efficiency of government spending. All the public investments need not to turn into public capital (corruption, inefficiency, administration etc.).
- Flight of well educated people.
- Investment into education is mostly long run investment. Certainly, it is possible to get some good results in the schooling of more elementary skills needing workers, but overall higher quality of education requires long term planning, preparation and implementation.
- Public investments are often used as the instruments of regional policies. Therefore it can occur that the higher investments are made to the regions with lower productivity. The fact is that higher investments into education of less developed regions do not lead to jump-ups of their productivity in short-run. As a result the higher investments on the country level do not correlate with overall increase in productivity.

Even so, there is a risk to make a failure in planning the structure of educational spending, the education has become to one of the natural parts of social way of thinking. The representatives of western economies are anticipating that the level of education in transition countries corresponds to the level of education in their countries. What is important in the case of transition economies is the marketability of education services, and stability in planning and implementation of education policy.

Earlier empirical works

The impacts of education on economic growth can be analysed using three approaches (Böhme, Laaser, Sichelschmidt, Soltwedel 1998). Aggregate production function with additional (capital) inputs (availability of educated labor force shifts up the production function). Costs of location – theories of von Thünen, Weber, Christaller and Lösch. Competition of locations with factors of location and as a policy instrument in regional competition for mobile capital. New trade theories (e.g. Krugman: agglomeration of production is the consequence of balancing between returns on scale and transportation costs) – costs and their effects on location of production. There are many studies about public economic growth and human capital (mostly measured as the level of education). But the results of them are not so clear. For example Hamilton and Monteagudo 1998 have found that investments into equity are influencing economic growth more than the rate of secondary education having people in labor force. But even authors themselves are critical about their results. The reason could be just in procyclical nature of investments into equity and countercyclical nature of education investments. For additional results look for the Table 1.

Mostly the researches do not take into consideration the causality problems. In the case of developing countries the causality problems can be greater than in the case of developed countries. In developed countries there is higher probability, that economic decline does not involve essential decline in public investments into education, because there exists so to say "a socially minimal necessary level of investments". In the case of developing and transition countries less social goals may dominate and these countries have always a problem of “too many goals and too little finances”. At the same time the effectiveness of investments can be greater for developing countries, especially, if the investments are managed efficient.

It must be mentioned that on the average level developed and more developed countries differ in the sense, that the first group is investing in education facilities hoping to attract more foreign direct investment (and through this generating an additional economic growth). More developed countries must invest in order to respond to the higher demand on social services and to avoid an outflow of investments to the “cheaper” countries. So they invest to avoid an economic recession and unemployment problems. Also they invest in generation of new base for competitiveness.

Here must be additionally discussed two additional factors, which were already mentioned in the theoretical part of the paper. Firstly, does higher education lead to higher ability to learn by doing (there is again no clear answer on this question)? Secondly, are the higher level of education and the higher level of technology complementary? When Benhabib and Spiegel (Benhabib, Spiegel 1994) found that education and learning by doing are complementary, then Bartel and Sicherman (Bartel, Sicherman 1995) found them not to be complementary. The results of last study can be explained by fact, that the authors concentrated themselves on technologically fast developing sectors, where mostly the training and schooling on the firm level is high. Therefore it seems reasonable, that in fast developing industries the differences of more and less educated workers are diminishing.

Table 1
EMPIRICAL WORKS ABOUT EDUCATION-FDI AND EDUCATION-GROWTH RELATIONSHIPS

Research	**Country/region**	**The impact of education on FDI**	**Results**
Anh and Meyer (1999)	Vietnam (1988-1993)	Positive	FDI is depending from human capital both in cities as in countryside.
Borensztein; De Gregorio; Lee (1998)	Investments of 12 Singapore' firms to China	Positive	The productivity of foreign owned firms is higher than productivity of domestic owned firms when there exists some minimal necessary level of human capital (education).
Baffes and Shah (1992) (see Kessides 1993)	26 countries	Positive	Human capital is one factor, which most strongly influences economic growth.
Hamilton and Monteagudo (1998)	98 countries (1960-1970 and 1975-1985)	Negative	The level of education has negative impact on economic growth, as the initially lower level of GDP causes higher level of GDP growth.
Barro (1999)	Ca 100 countries (1965-1975, 1975-1985 and 1985-1990)	Positive	There exists a positive relationship between men's secondary and higher education and economic growth (still, the negative impact on domestic investments was found). At the same time the primary education of men has negative impact on economic growth and the variables describing the women's level of education were statistically insignificant. Initially lower level of GDP can be associated with higher rate of GDP growth. The lengthen in life expectancy has positive impact on economic growth as well on domestic investments.
Martin, Rogers, (2000)	4 different groups: 90 European regions, 24 industrial countries, OECD maid and 72 non-industrial countries	Positive	For regions of Europe the regression was unreliable. In the case of OECD, industrial countries and developing countries the was found a positive impact of primary education on economic growth.

The second question can be answered using the work of Temple and Voth (Temple, Voth 1998,). They found that in the process of increasing of education level in the country, the industrialization would take place. In the absence of educated workforce it is the implementation of more developed technologies and more complicated equipment more costly compared to implementation of traditional production facilities.

Current state of the labor force, education level and FDI in Estonia

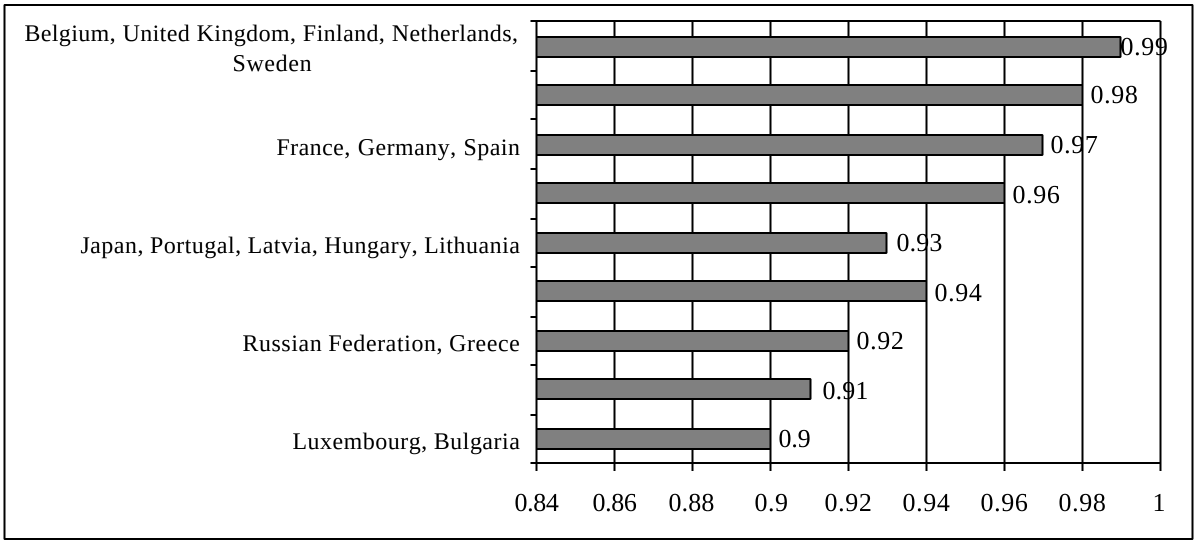
If we would talk about labor force, then the three most important headwords we have to think about are amount, costs and skills of the labor. In the case of Estonia the most important constraint for mass-production is the amount of labor force. Equally, the problem of increasing labor costs is rising over time. Estonia has still an advantage in comparison to Finland and Sweden, but compared to the other Baltic countries and Russia, the disadvantage is increasing. In the beginning of the transition processes the Estonian wages jumped up, but the productivity couldn't follow this increase. If we look at the compensation per employee and unit labor costs figures (see Table 2) we can see that from 1995 unit labor costs are growing more slowly than the compensation per employee. This means that the higher productivity is in some extent compensating the increase in labor costs.

Table 2
CHANGES IN COMPENSATION PER EMPLOYEE AND UNIT LABOR COSTS

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Estonia										
Nominal compensation per employee	:	53.8	40.5	23.3	19.7	13.6	7.1	11.1	10.4	10.1
Real compensation per employee (GDP deflator)	:	10.0	6.6	-0.5	8.0	4.4	3.1	1.9	5.5	5.5
Nominal unit labor costs	:	53.5	27.6	16.8	8.7	7.2	3.8	4.0	4.2	4.1
Real unit labor costs	:	9.8	-3.2	-5.8	-2.0	-1.6	0.0	-4.7	-0.4	-0.1
Latvia										
Nominal compensation per employee	138.3	54.3	23.9	24.2	15.2	7.0	11.1	4.3	4.3	4.4
Real compensation per employee (GDP deflator)	38.9	11.5	6.8	6.6	8.1	1.4	9.0	-0.6	1.8	1.6
Nominal unit labor costs	160.6	37.7	20.6	17.0	8.1	3.6	10.5	-1.3	-0.2	-0.1
Real unit labor costs	51.9	-0.4	4.0	0.4	1.4	-1.8	8.4	-6.0	-2.6	-2.7
Lithuania										
Nominal compensation per employee	:	67.7	61.5	29.4	24.1	19.9	7.6	4.8	2.6	3.8
Real compensation per employee (GDP deflator)	:	3.7	17.0	3.4	9.6	12.4	4.1	3.4	0.5	0.7
Nominal unit labor costs	:	75.1	53.4	24.7	16.4	13.2	11.6	-1.5	-1.5	0.1
Real unit labor costs	:	8.3	11.1	-0.3	2.8	6.1	8.0	-2.8	-3.5	-3.0
Czech Republic										
Nominal compensation per employee	3.8	19.1	19.3	16.4	7.2	8.2	8.7	5.4	5.7	6.3
Real compensation per employee (GDP deflator)	-14.2	5.1	8.3	7.6	-1.0	-2.8	7.7	1.7	1.4	1.7
Nominal unit labor costs	3.5	17.8	13.5	11.3	7.6	9.1	7.3	1.7	1.7	2.2
Real unit labor costs	-14.5	3.9	2.9	2.8	-0.7	-2.1	6.2	-2.0	-2.5	-2.2
Hungary										
Nominal compensation per employee	23.1	17.9	21.5	20.2	20.8	13.9	6.1	7.6	8.6	6.0
Real compensation per employee (GDP deflator)	1.5	-1.4	-4.1	-0.8	2.0	1.1	-2.2	0.8	0.6	-0.2
Nominal unit labor costs	16.1	12.3	17.4	17.6	15.5	10.2	4.7	3.2	4.8	2.0
Real unit labor costs	-4.3	-6.1	-7.3	-3.0	-2.5	-2.2	-3.5	-3.3	-2.9	-3.9

Source: Employment in Europe 2001

If we look at the education index released by UNDP, which is calculated using the data of literacy and the years of attending the school, then we could say that Estonia has compared to average level of EU relatively moderate (Fig.4). Still, it is compared to other transition countries on good position.



Source: Human Development Report 2001

Fig.4. EDUCATION INDEX

Remarkable is that if we take GDP per capita in (PPP US$), 1999 and education index 1999, then we could see that the correlation between these indicators are different in different groups of countries (see Table 3). It seems to be tendency that if we compare the countries with different level of development, then it is clear tendency for the higher positive correlation between the level of education and the level of GDP. But this doesn't hold in the case of peak-countries of every "development-group". More precisely, if in the case of poorer EU (and transition) countries it is easier to observe the positive correlation between higher level of *per capita* GDP then in the case of richer EU (and transition) countries this correlation is not so obvious. Estonia is one example of that – even the development level in GDP *per capita* terms isn't so high, the level of education is comparatively high.

Table 3
CORRELATION BETWEEN GDP PER CAPITA IN (PPP US$) AND EDUCATION INDEX (1999)

Region	Correlation coefficient
EU(14), excl. Luxembourg	0.653
EU(14)+6Transition countries	0.750
7 richer EU countries (Ireland, Denmark, Belgium, Austria, Netherlands, Germany, Finland)	-0.381
6 richer transition countries (Slovenia, Czech Republic, Hungary, Slovakia, Poland, Estonia)	-0.218

Source: Human Development Report 2001

But what is the structure of Estonian education system compared to some other countries. As we can see the Estonian education system is more similar to one in North-Europe (see Table 4). Compared to South-European countries, where many people have just basic or primary education, has Estonia a clear performance.

So we could anticipate that such a position compared to other European countries will make our long-run growth perspectives more optimistic. Still there are some negative aspects that in first moment can't be seen in table 4, namely, the structure of education. For example some economists are arguing, that Estonia has to high ratio of people technical and vocational education. One of the indicators of this the high unemployment rate of people who have secondary or vocational education (about of half from unemployed people have education level 3 on the basis International Standard Classification of Education (ISCED)). This is actually not the question of amount but the question of the quality and structure of technical education and its narrow specialization. Compared to the system of other European countries we do not have such a good co-operation with the employers.

Table 4
THE RATIO OF THE PEOPLE WITH DIFFERENT LEVEL OF EDUCATION WITHIN THE AGE GROUP (%)

	Basic education (ISCED 1)	Primary education (ISCED 2)	Secondary and vocational education (ISCED 3)	Technical-secondary education (ISCED 5)	Higher education and more (ISCED 6/7)
Greece	36,6	10,6	29,4	8,9	14,5
Portugal	61,6	15,0	11,7	3,4	8,3
Spain	30,2	28,3	17,8	7,5	16,3
Netherlands	9,3	24,0	41,8	0,0	25,0
Germany	0,1	15,3	60,7	9,5	14,4
Denmark	0,0	24,0	52,9	6,3	16,8
Estonia	0,0	11,4	45,9	24,0	18,7
Lithuania	3,5	15,0	37,9	25,5	18,1
Poland	0,0	18,0	67,9	3,4	10,7
Slovenia	2,7	20,8	62,7	7,0	6,8

Source: ILO, 1998

Estonian government has for short time decided to put more emphasis on higher industrial and vocational education, but from other side their will reduced finances in some fields of higher education. Next years we can anticipate that most of the energy on the level of Ministry of Education will go on the working out and implementing the concept of higher technical and practical education.

If we would now look at the flows of FDI we could see that from the beginning of 1990s the foreign capital inflow became more and more important for Estonian economy (see Fig.5). In 1998 FDI increased for short run sharply mainly because of the Sweden banks, which took over Estonian banks. Estonia has been one of the most successful transformation countries in FDI per capita terms (we can compare Estonia with Hungary and the Czech Republic). For example, per capita FDI flows to Lithuania and Latvia in the 1990s have been in average two times lower than in the case of Estonia.

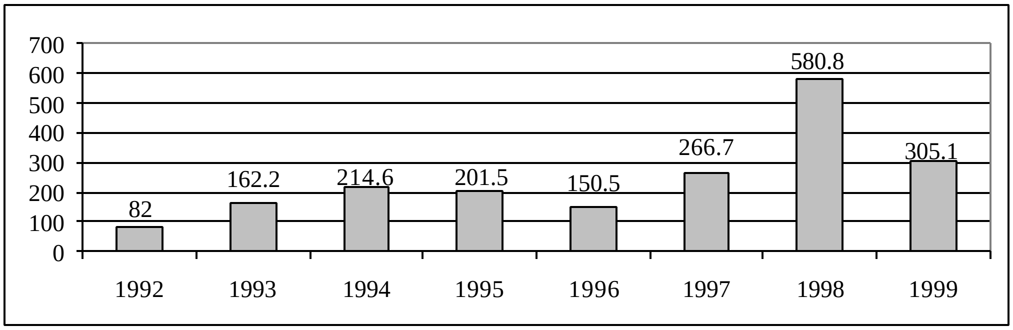


Fig. 5. FDI INTO ESTONIA 1992-1999 (MILLIONS OF USD) (ESTONIAN BALANCE OF PAYMENTS 2000)

As it can be seen from the survey provided by European Bank of Reconstruction and Development (EBRD) the cheap labor was not a very important factor attracting investment, but cheap skilled labor is the second most important factor on average. The most important factor was the access to an attractive host market. This holds not only in the case of CEE and Baltic States, but also in the case of other countries. (How do foreign … 2001.)

Similarly to most transition countries for specific job skills the labor market is still quite thin in Estonia. For example the hiring the IT and financial staff is constrained by lack of people and by relatively high wage costs. Mostly the investors must have no great difficulties for hiring skilled staff in many other sectors. So, the problem for both domestic and foreign investors is the same – the lack of specific labor.

Conclusions

The education is recognized as one of the most important factors influencing economic growth and attracting FDI. The main ways the level of education is affecting economic growth and attracting FDI are the factors associated with productivity (efficiency) and other production factors. Still some linkages can be brought are related to foreign trade, changing structure of consumption and development of technology.

Anyway the empirical works (especially econometric ones) do not give a clear answer about the impact of education on economic growth. Still for attracting FDI cheap skilled labor-force is one of most important factors.

The per capita GDP level of Estonia is much lower than in European Union. Still, the average level of education is in Estonia better than in some South-European countries. Still the structure of public education is still favoring the vocational and special-technical education with quite narrow specialization.

The importance of education is recognized by Estonian governmental institutions and it is decided to place more emphasis on higher level of technical and vocational education

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Section 4

MNCs, Mrgers & Acquisitions, Financial Markets & Entrepreneurship

Barriers to Small Family Business Development: Case of the Czech Republic

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Abstract

This paper presents the results of research in the field of small family-run businesses in the Czech Republic. The paper is divided into two parts. The first part deals with the results of a qualitative research on a randomly selected sample of small family-run businesses in the Czech Republic while the second part deals with proposals and recommendations for small family-run businesses in the Czech Republic. The sample of small family-run businesses was, in line with the results of the pilot study, selected from both private individuals and legal entities comprising small family-run businesses in the Czech Republic. The final number of small businesses analysed was 83 and the data related to those businesses was collected, between 1998 and 2000, from both secondary and primary resources the resulting information being gathered by applying some of the 'data mining' principles. The data was further processed using the MS EXCELâ program, with the information professionally assessed before processing. That stage was considered a pioneering study in the Czech Republic as its approach was diametrically opposed to previously published studies. The results of the research were analysed and presented in two different forms –graphically and in tables.

1. Introduction

The issue of family-run businesses has been very high on the agenda in the developed market economies. Family firms are an independent subject of university courses and the area is targeted by many research programmes. It is, therefore, rather unfortunate that, in the Czech Republic, family businesses are largely ignored [22]. Throughout the world, small family-owned firms form a recognised part of the business world. Spain [1], [2], [3], Great Britain and Norway are typical examples of EU countries where family firms have a dominant position in the segment of small businesses with up to ten employees. Small family companies play an important role overseas, in the USA and Canada, where, again, they dominate in the "up to ten employees" segment. This paper does not purport to explore all the aspects of small family business. Instead, it sets out to do some pioneering work in this area, presenting the basic characteristics of small family businesses in the Czech Republic today.

2. Formulating the Research Objectives and Establishing the Research Methods and Techniques

The fundamental problem of the research to be undertaken is how to define and then analyze small family firms in the Czech Republic. Family companies have no statutory obligation to make it publicly known they are established and run on a family basis. Bearing this in mind, the research objectives were set out as follows:

- **acquiring and analyzing information on small family businesses in the Czech Republic and abroad** with the aim of analyzing the basic structure of small family firms,
- **carrying out research into small family firms in the Czech Republic** provided the research will be undertaken using a qualitative method and will cover the whole Czech Republic,
  - using different data gathering techniques about small family businesses (databases, newspapers, magazines, case studies, interviews, etc.),
  - using "**manual data mining"** techniques applied to the collected documents about companies,
  - processing and evaluating the acquired company data using the MS EXCEL® software,
- **establishing the determinants having a positive or negative impact on the development of small family businesses in the Czech republic.**

The paper presents a combination of primary and secondary research. While the primary research concentrated on small family companies throughout the Czech Republic, the secondary research involved the study of specialized magazines, research reports and books published during the last five years. The methods and information sources used in the secondary research are referred to in literature as empirical [10]. The methodology applied in the primary research was based on the principles published in the works by Zikmund [24] and Kerlinger [16] which describe both the quantitative and qualitative research. The primary research was carried out using the qualitative method. The acquisition of data on small family businesses from the available resources (commercial databases such as ABACUS MONITORING and ALBERTINA, recorded interviews, case studies, etc.) was based on using the new "data mining" techniques described in literature [25]. The acquired family business data was then processed using a traditional tool which, in this particular case, was the MS EXCEL® software[26]. The fact that the data was binomial meant that it was difficult to apply some traditional methods. As a result, only selected parts of descriptive statistics were used for the data processing. The basic qualitative approach methods employed in the research included observation, interviews and document analysis techniques.

3. Discussion of the Research Outcome

It was found there had been no similar type of research carried out in the Czech Republic in the period following the year 1989 and the research performed as part of the post-doctoral theses is a truly pioneering work not only in the Czech Republic but, as the results of the secondary research suggest, in Eastern Europe as a whole representing a seminal piece of research work which sets out to establish the determinants of the development of small family firms. In addition, during discussions with Czech and foreign experts [1] it was revealed that carrying out such research is highly desirable not only from the scientific viewpoint but also to meet the requirements of the business world itself. As a result of numerous consultations and attempts to obtain information it was decided to include in the research only businesses that are small in accordance with the European Union definition. The initial company classification was then based on the company classification as defined in the Trades Licensing Act [28] and the Commercial Code [27].

<u>a) Private Individuals – Sole Traders</u>

These include a large number of businesses classified as the MICRO [2] category. As these entities represent a significant segment of the small family firm group they **have been included in the research**.

<u>b) Legal Entities – Unlimited Partnerships, Limited Partnerships, Limited Liability Companies, Co-operatives, Joint Stock Companies</u>

Companies from within this group **have been included in the research** but only those that can be classified as being in the SMALL category.

3.1 Carrying out a Pilot Study

In 1998 a pilot study was made within which 5 small family companies from all over the Czech Republic were randomly selected. The reason for carrying out the pilot study was to establish the basic directions for the primary research to be undertaken using the qualitative approach. The pilot study included determining the main groups of factors (determinants) affecting the development of small family companies. It was also helpful in establishing what basic data (small company identification) can be obtained by applying the qualitative approach and using data mining techniques. The pilot study outputs included small family firm identification elements as well as the basic groups of determinants shown in the following tables. The classification into the basic group of determinants and company identification elements has been preserved throughout the primary research and is presented below.

Tab. 1 ESTABLISHING THE BASIC GROUPS OF DETERMINANTS IN THE PILOT STUDY

Group designation	Group name
A.	Company identification
B.	External determinants
C.	Internal determinants
D.	Company financial management determinants
E.	Succession determinants (handing over control to the successor)

Tab. 2 ESTABLISHING THE SMALL FAMILY FIRM IDENTIFICATION ELEMENTS

A. Company identification	
Identifier designation	**Identifier name**
IF1	Year of establishing the company
IF2	Legal status of the company
IF3	Number of employees
IF4	Business sector
IF5	Turnover in the previous year
IF6	Type of family relationships

3.2 Acquiring Data in the Primary Research

In the Czech Republic there is no legal obligation to make it publicly known that a company is run by a family. This made it difficult to identify family firms and to carry out the primary research. All the materials about family firms from the whole Czech Republic had been gradually collected since 1998. The following table shows a recapitulation of all the small family firms and a contribution represented by the individual information sources to the examined sample of small family businesses.

Tab. 3 RECAPITULATION OF THE ANALYZED COMPANIES CLASSIFIED BY INFORMATION SOURCES

Information source / Number of companies	Directly from SFF		Case studies	Databases	Total
	Interview	Written			
Number of all SFF identified	30	73	37	68	208
Total number of SFF in the examined sample	28	15	26	14	83

As can be seen in the table above the research involved a total of 208 small family businesses from the whole Czech Republic identified as such from all types of information sources. For the purposes of further processing in the MS EXCEL® environment the mined data was evaluated using the following key: if the phenomenon exists in the examined firm: then 1, if the phenomenon does not exist in the examined firm: then 0. The total number of companies included in the analysed sample about which company related material used for data mining had been acquired was 83[3].

3.3 Evaluating the Acquired Data

The proportion of the companies established in 1991 (25.3%) was the highest, followed by 1990 (15.6%) and 1993 (13.2%). In 14.4% the attempts to discover the year the company was established failed. In the examined sample, the largest segment is taken up by private individuals (sole traders) representing 75.9 % followed by legal entities making up the remaining 24.1 %. Of the legal entities, limited liability companies occur most frequently. Unlimited partnerships represent a fraction of a per cent and the sample also includes a small joint stock company. In accordance with the research objectives the highest proportion is made up of micro companies with a number of employees from 1 to 9 (54.2 %), small firms with a number of employees of up to 99 (31.3 %) and only one company ranked as medium-sized. However, in 13.2 % of companies it was impossible to determine the number of employees from the data analysed. The classification of companies by business sectors – manufacturing, services, construction and retail – shows an even distribution in the examined sample, except for construction. There, the number of companies showed a clear deviation and a test had to be made for outlier deviations. The turnover data for the past period is only presented for illustration as the number of companies where no data could be obtained reached 74.6 %. In theory it is possible to distinguish a large number of family relationship types. For the purposes of the research a certain simplification was made which specified seven basic family relationships that can be identified in family businesses [5], [7], [8]. The largest distribution was represented by the relationship: father, or mother + daughter or son (53%). This was followed by the husband + wife relationship (16.8 %). The number of companies where no family relationship could be identified was relatively small, only 3.6 %. To verify whether the proposed research was correct, the examined sample of small family businesses was compared to a sample of small and medium-sized businesses from the whole Czech Republic in two categories; in the category of small and medium-sized business classification by business sector and in the category of small and medium-sized business classification by the legal status of the company. The small and medium-sized business data used in the comparison was taken from the resources provided by the Czech Ministry of Industry and Trade. The results of the comparison between the examined sample of small family firms and the sample of all the small and medium-sized businesses in the Czech Republic by the „sector“ category are shown in the table below.

Tab. 4 COMPARING THE EXAMINED SAMPLE OF COMPANIES WITH THE SAMPLE OF ALL THE COMPANIES IN THE CZECH REPUBLIC – IN THE BUSINESS SECTOR CATEGORY

Business sector	**SFF in CR [%]**	**SFF in the examined sample [%]**	**Absolute deviation ½?½**
Manufacturing	24.291	30.120	5.829
Services	28.481	31.325	2.844
Construction	13.325	6.024	7.301
Retail	33.900	32.530	1.37

The distribution in per cent of the different companies by business sectors and absolute deviations between the samples in the individual sectors were established. The above table clearly shows that the construction firm distribution in per cent is quite low in the examined sample (6.024%). This may point to a possible outlier. To determine the extreme value (deviation) in the distribution of firms by sector that distorts the examined sample one can use some of the methods applied in statistics, such as the Grubbs test [10]. After passing the values into the formula we receive a result of 1.729. The permissible interval at the significance level $\alpha = 0.05$ b $\notin < 0,\ 1.689 >$. From the above it follows that the value of 6.024 in the examined sample for the construction sector is an outlier (outside the interval) and has to be excluded from the examined sample. As a result all the data related to construction sector companies were eliminated from the examined sample of companies. The total number of firms in the examined sample was narrowed down to 78. The conclusions presented below in the post-doctoral theses will only be applicable to the manufacturing, services and retail sectors. When the construction sector is excluded from comparison it is possible to determine the standard deviation of both samples, that is of all the companies in the Czech Republic and the examined sample s = 1.854. The results of comparing the examined sample of small family businesses against the sample of all the small and medium-sized companies in the Czech Republic by the “legal status of the company” category are presented in the following table.

Tab. 5 COMPARING THE EXAMINED SAMPLE OF COMPANIES WITH THE SAMPLE OF ALL THE COMPANIES IN THE CZECH REPUBLIC – IN THE LEGAL STATUS OF THE COMPANY CATEGORY

Legal status of the company	SFF in CR [%]	SFF in the examined sample [%]	Absolute deviation ½?½
Private individuals	84.886	75.903	8.983
Legal entities	15.113	24.097	8.984

It is obvious that the absolute deviations are greater than when comparing the two samples by the "business sector" category. These comparisons should be understood as being only supplementary.

3.4 Establishing the Determinants of the Small Family Business Development

The terminology that follows, which is not commonly published and is related to company growth, was introduced for the next part of the paper. The concept of growth can be understood both in the quantitative and in the qualitative sense. In literature [34], [45], [46] the concept of company growth is commonly used in the quantitative sense, meaning an increase in the company turnover, assets, number of employees, etc. In the text below, the notion of qualitative growth should be understood to mean the notion of company development. In each of the four groups determinants were established that were subject to an analysis in the examined sample of companies. These determinants affect, in a negative or a positive way, the development of a small family business. To determine the significance of the individual determinants within each group they have been arranged in a descending order in each group. For each group of determinants the following basic characteristics of descriptive statistics were calculated: standard deviation, median, upper and lower quartile. The table below shows the sorted determinants within each group, including the basic statistical characteristics.

Tab. 6 DETERMINANTS IN EACH GROUP SORTED BY THEIR FREQUENCY

	External determinants	**Freq.**	**Rel. freq. [%]**		
DE4	Problems with customers / delayed payments, non-payers	37	18.592965	Stand. dev. S	11.333414
DE2	Stiff competition	36	18.090452	Upper quartile	26.5
DE8	Low availability of bank loans	32	16.080402	Median	14
DE7	Adverse economic situation in the country	21	10.552764	Lower quartile	9.5
DE5	Problems with legislature	18	9.0452261		
DE6	Low business ethics / corruption	14	7.0351759		
DE9	Insufficient support to small companies by the state	11	5.5276382		
DE10	High tax burden	10	5.0251256		
DE1	Low market demand	9	4.5226131		
DE11	Problems with suppliers	6	3.0150754		
DE3	Excessive state bureaucracy	5	2.5125628		
		n =199	100		
	Internal determinants	**Freq.**	**Rel. freq. [%]**		

DI5	Problems with employees	26	12.745098	Stand. dev. S	5.6255719
DI1	Conflicts in family and working relationships	20	9.8039216	Upper quartile	14
DI3	Insufficient qualifications of the owner(s)	17	8.3333333	Median	12
DI4	Problems with management / administration / inf. systems	15	7.3529412	Lower quartile	8
DI2	No motivation system in place	14	6.8627451		
DI8	Family and business finances not separated	14	6.8627451		
DI13	Merging of family and business relationships	14	6.8627451		
DI17	The firm will not grow	13	6.372549		
DI6	Short term goals of the business owner(s)	12	5.8823529		
DI10	Bad communication: owner – empl. owner – family	12	5.8823529		
DI9	No delegation of authorities	9	4.4117647		
DI7	Unclear competences within the family	9	4.4117647		
DI12	Impossible to extend production / business	8	3.9215686		
DI14	Generation gap problems	7	3.4313725		
DI11	Pressures by other relatives (envy)	6	2.9411765		
DI16	Positive motivation to growth	6	2.9411765		
DI15	Family exploitation	2	0.9803922		
		n = 204	100		
	Financial management determinants	**Freq.**	**Rel. freq. [%]**		
DF1	Shortage of capital	20	22.727273	Stand. dev. S	6.8007353
DF4	Financing from own resources	20	22.727273	Upper quartile	18.5
DF5	Financing from external resources	18	20.454545	Median	8.5
DF8	Using the resources: problems with financing the operation	10	11.363636	Lower quartile	5.75
DF6	Financing from family resources	7	7.9545455		
DF2	High debts of the business	6	6.8181818		
DF7	Using the resources: problems with investment financing	5	5.6818182		
DF3	Shortcomings in financial management	2	2.2727273		
		N = 88	100		
	Succession determinants	**Freq.**	**Rel. freq. [%]**		
DN2	Succession is not and will not be, in the immediate future, on the agenda	29	52.727273	Stand. dev. S	9.1406247
DN4	Succession: to son	11	20	Upper quartile	8
DN1	Children not interested in the company	5	9.0909091	Median	4
DN3	Succession: to daughter	4	7.2727273	Lower quartile	2.5
DN6	Succession: to an outside person	3	5.4545455		
DN7	Company will be sold	2	3.6363636		
DN5	Succession: to other family members	1	1.8181818		
		N =55	100		

3.5 Basic Discussion of the Results

If we study the determinants sorted by their frequency in each group it can be seen that the upper and lower quartile clearly divide the data in each of the groups. The upper quartile separates the data with the highest statistical significance within the group, the lower quartile separates the data with the least statistical significance. The quartile range then determines the area of data that occurs most frequently within the group. If we sum up the above conclusions we arrive at the classification of the determinants by their significance within the individual groups. The classification of the determinants is shown in the table below.

Tab. 7 CLASSIFICATION OF DETERMINANTS WITHIN EACH GROUP BY THEIR SIGNIFICANCE

Determinant classification	**Determinant group B. External**	**Determinant group C. Internal**	**Determinant group D. Financial management**	**Determinant group E. Succession**	**Note**
Most significant (decisive) determinants	DE4, DE2, DE8	DI5, DI1, DI3, DI4, **DI2, DI8, DI13**	DF1, DF4	DN2, DN4	The determinants in bold letters are at a boundary between groups
Significant determinants	DE7, DE5, DE6, DE9, DE10	DI17, DI6, DI10, DI9, DI7, **DI12**	DF5, DF8, DF6, DF2	DN1, DN3, DN6	The determinants in bold letters are at a boundary between groups
Least significant (immaterial) determinants	DE1, DE11, DE3	DI14, DI11, DI16, DI15	DF7, DF3	DN7, DN5	

The following text presents a more detailed discussion of the individual determinants.

1. **The external determinant group.** The most significant positions in this group are taken up by determinants DE4, DE2 and DE8, that is ***"Problems with customers"*** (delayed payments/non-payers), ***"Stiff competition"*** and ***"Low availability of bank loans"***. These **decisive determinants** are roughly the same as with the other small and medium-sized companies [4], [6]. Determinant DE8 "Low availability of bank loans" matches the determinants in group D. Financial management of the company. In this group, financing from external resources is only classified as a significant determinant. Small family firms used to be financed from external resources, including mainly bank loans, at the beginning of the 1990s. Then when the major changes were introduced in the banking sector the availability of bank loans to small family firms began to vanish. Currently, financing from the company's, or the family's, own resources prevails. The whole group of external determinants contains only determinants that pose barriers to the further development of small family businesses. There are no determinants contained herein that would promote the further development of small family companies.

2**. The internal determinant group.** The decisive position in this group is held by determinants DI5, DI1, DI3 and DI4, that is ***"Problems with employees"***, ***"Conflicts in family and business relationships"***, ***"Insufficient qualifications of the owner"*** and ***"Problems with management/ administration/ information systems"***. Determinant DI1 is a typical feature for small family firms [9], [11], [12], the other determinants are the same as the determinants for small and medium-sized companies. The next three determinants are on the boundary between the most significant (decisive) and the significant. They include determinants DI2, DI8 and DI13, that is ***"No motivation system in place"***, ***"Family and business finances not separated"*** and ***"Merging of family and business relationships".*** The internal determinant group contains a single positive determinant DI16 **"Positive motivation to growth"**, this, however, occurs in the section of the **least significant (immaterial)** determinants.

3. **The financial management determinant group**. The decisive determinants in this group include determinants DF1 and DF4, that is **”Shortage of capital”** and **”Financing from own resources”**. It is interesting to notice that the most significant determinants in this group are related to the providing of resources instead of the allocating of resources [14], [15]. Determinant DF8 ***”Using the resources: problems with financing the operation”*** is represented only as significant and determinants DF7 and DF3, that is **“Using the resources: problems with investment financing ”** and **“Shortcomings in financial management”** are only represented as the least significant. It can be stated that today when the small family firms are financed, to a large extent, from their own resources and when they experience a shortage of capital they are forced to spend the capital very economically, so much so that they do not actually perceive a shortage in this area. There is, however, always the family at hand to help the firm should it get into financial difficulties. There was no determinant found in this group affecting in a positive way small family business growth.

4. **The succession determinant group.** There are only two decisive determinants identified in this group - DN2 and DN4, that is ***”Succession is not and will not be, in the immediate future, on the agenda“*** and ***”Succession: to son”***, [17], [20], [21]. The remaining determinants are only represented as significant or least significant. It can be stated that small Czech family firms are too young to be preoccupied with the succession issue. If any of the analyzed companies addressed the problem then the clearly prevailing solution is handing over the management to the son.

3.6 Verification of the research result

The results of the research were tested by selecting three small family firms from Brno and its surroundings at random. Their owners were presented with unsorted determinants in the groups and asked to determine the order of importance of the individual determinants in each group. The results of this verification roughly match the results of the research, the differences in all the groups of determinants being only minimal.

4. Conclusion

The practical contribution that this research has made can be summed up by the following points:

- the research provided a general overview of the determinants of the development of small family firms in the Czech Republic,
- the research presented a new, previously unpublished, view of the barriers to the further development of small family businesses,
- the results of the research are applicable to the business environment in the Czech Republic,
- the results of the research are applicable on an international level.

The importance of the research can be seen in several areas, including in particular:

- designing untraditional procedures of data mining and their use in establishing the determinants of the small family firm growth,
- creating the necessary expert capacity at the PF VUT in Brno in the area of small family businesses,
- possibility of publishing this research in foreign reviewed magazines.

The contribution for science rests mainly in verifying a new procedure of data mining in the area of small family firms and establishing the determinants of their development. The continuation of the research in the future is necessary [23] and it can be expected that the research activities of the author will concentrate on this particular area.

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[1] Consultations were mostly held in the “European Council for Small Business” where the author of the paper is active in the executive.

[2] According to the EU company classification.

[3] All the company related information collected from the above mentioned sources has been systematically archived.

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Due Diligence for Small and Medium Companies

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Abstract

Realisation of company evaluation strongly depends on information that was collected about the evaluated company. This information obtainment and company analysis is called due diligence. Characteristics of due diligence for small and medium companies differ from bigger and big companies particularly in dependency of company on persons. Entrepreneurial personality of the owner is an important factor of small and medium companies that can't be underestimated. At first, criteria of differentiation of small and medium companies are defined. Consequently, characteristics of company analysis are discussed with respect to the areas of organisation and structure, accounting, and financing, personnel, production, purchase, marketing and sale, company infrastructure.

Introduction

At first, small and medium companies handled in this contribution are defined, consequently, due diligence is discussed as an important instrument of information obtainment for evaluation of small and medium companies. Through a comprehensive analysis, broad insight into the situation of concerned company will be provided.

Characteristics of Small and Medium Companies

Within this work, exclusively small and medium enterprises (further also called "SME") are examined.

Principally, qualitative or quantitative criteria as well as connection of qualitative and quantitative features can be used for the demarcation.

Qualitative demarcation features have the advantage of easy and unique assignment. By means of qualitative features, SME-typical features can be better shown. The most important qualitative features of SME are shortly examined in the following discussion:

Relationship of these companies to persons belongs to the first important feature of SME. Here, central position of the owner in the company must be mentioned on first place.

Unity of management and ownership, associated with the connection of economic existence of owner with the existence of company, is a peculiarity of a medium company.

Personal relationship also means that company depends on the owner or entrepreneurs in a considerable extent.

Typical medium entrepreneur takes over various or even all management tasks in a company.

Another characteristics of a small and medium company is that, together with the entrepreneur, other family members have some relationship to the company based on active cooperation.

Another important criterion is the independence of small and medium companies, i.e. small and medium companies do not belong to any concern and there is no dependency on other companies.

For the discussed topic, approach to the definition of SME is relatively broad.

Company is considered small or medium if

- ownership and management are in the hands of one person and
- there is no legal and economic dependency (above all no dependency on concerns).

Analysis of a Small or Medium Company

In order to be able to evaluate a SME company thoroughly and in the right way, evaluator must obtain a comprehensive insight into the state of the considered company.

"Comprehensive company analysis is a starting point for the company evaluation. Under company analysis, specific technique of obtaining economic relevant information about company and its environment is understood. "Due diligence" as an alternative aspect means thorough verification by means of a systematic and detailed intelligence and analysis of data of the concerned company, its environment and development. Due diligence is an analysis that precedes sale of a company.

The objective of company analysis is to identify and objectively evaluate resources and potentials of the company as thoroughly as possible, so that information asymmetry between buyer and seller is minimised. Another goal of the analysis is to make potential risks in the analysed company visible because such risks could lead to higher costs after the realisation of take-over.

With help of data obtained within due diligence or company analysis, "general picture of a company, its strengths and weaknesses, but also its opportunities and threats" can be created.

In the literature, this technique is understood under the acronym of "SWOT-Analysis".

The importance of this systematic research shows that following statement: "With regard to company evaluation, thoroughly realised company analysis can be of higher importance than usage of the right evaluation method itself."

Therefore, information obtainment phase is important, since seller will usually not willingly point to existing weaknesses of a company. Nevertheless, he will approve the company analysis because potential buyer would require distrust-based purchase price allowances otherwise, based on the asymmetric information distribution. Regarding SME it must be particularly verified if a company is viable without present entrepreneur.

Another goal of due diligence verification is the search of points at which guaranty problems can occur.

As a rule, company analyses are realised by an expert third subject. Question catalogues or checklists that should be adjusted to specific situation of evaluated company can be recommended for data intelligence realised within company analysis. Advantages of checklists are:

➢ Safety that no important aspect is overlooked.
➢ Time savings
➢ Disclosure of shortcomings and bottlenecks of problem areas
➢ Simplification of an apprehensible depiction
➢ Possibility of permanent actualisation and adjustment.

In the literature, it is often differentiated between financial/tax due diligence, legal/environmental due diligence and business/commercial due diligence what leads to splitting of company analysis into various research fields that can be better supervised. Internal areas of analysis of SME will be handled individually. Areas like markets/competition and company environment will be excluded from further research.

Analysis of Internal Area

In this section, analysis of company will be performed with respect to existing and future expected strengths and weaknesses. Following company areas will be evaluated in detail:

• Organisation and structure
• Accounting and financing
• Personnel
• Production
• Purchase

• Marketing and Sale
• Company infrastructure.

Organisation and Structure

Organisational structure could be taken into consideration as the first step of the analysis of structure and organisation of a company. On this background, it must be found out if legal form selected at take-over of company could lead to complications. Here, possible opposite or non-uniform opinions concerning the transaction represented by family members with smaller shares who could only be persuaded after long negotiations must be taken into consideration. Question if all corporate stock payments are paid must also be answered, since buyer is responsible for all payable receivables together with the seller.

Another important aspect of analysis concerns internal structure or organisation of a company. At first, organisational form must be identified. The smaller the company, the lower the probability of clear organisational form, since everybody "has to help everywhere". At the same time, it is very important to identify employees that have managerial influence either in formal or informal organisational structure marked by personal relationships and thereby take care of continuous functioning of a company.

Organisational form can provide information about the way of management of present owner. Strongly hierarchical organisational form with various management or hierarchy levels means rather autocratic management style. Competencies and size of responsibility areas of individual employees point to the way of company management, as well. It stands here: the less is delegated, the more autocratic the management style is. Flat hierarchies and direct contact of management and employees with large delegation of tasks could be advantageous for the company because in this way, fast and flexible reaction to changed situation and customer wishes - understood as competitive advantage - could be easier to reach. Furthermore, it should be verified if assignment of tasks is economically reasonable, if there is over-employment of individual areas and competencies are clear. In addition, it should be determined if reorganisation could increase efficiency or decrease costs.

Third area concerns existing, long-term agreements with external persons or companies. Here, focus is at first placed on the agreements with family members. These agreements could relate to loans, usage of private property of family member, usage of company property by a family member or licence agreements with respect to existing patents and rights. Question of existing silent shares or special promises of old-age treatment of family members or existing owner must be answered within this concept.

In addition, future influence of all agreements with long-term character such as agreements with outsourcing companies or leasing organisations (transportation) must be examined. Especially, it should be identified if and in what extent the agreements can be denounced.

Accounting and Financing

Detailed examination of asset, financial and revenue situation of company in the past as well as at present and - if possible - also in the future is the subject of financial/tax due diligence. In this conception, financial statements of past business years are analysed and it is verified if individual balance sheet items have been utilised according to their reason and kind of application and if profit or cash-flow has not been distorted by unusual or strange circumstances. With respect to SME, deterioration by private consumption of company owner that has been made taxable can be mentioned. It must also be taken into consideration at revenue analysis, "if company has manipulated income by means of a planned company transaction or if expenses have been shifted, so that it is possible to reach higher revenue." Strategy of seller to make results "nicer", followed shortly before the sale of a company must lead to researches at which it must be explained if for instance:

- research and development expenses decrease,
- investments are decreasing,
- maintenance expenses are lower,

- level of supply has become lower than it would be reasonable,
- sales costs have inadequately decreased (e.g. because of lower fair or promotion costs).

But criteria usual for external financial statement analysis such as structure of tangible assets, financing structure and term of foreign capital must be verified, as well. Indicators that can be built as "economic relevant information concentrates" or "highly compressed measuring variables" in form of absolute, relational, division and index numbers are particularly suitable for such quantitative analyses. Here, it must be found out if central variables were relatively constant in the past or if stability violations could be spotted. In such a case, central determination factors must be examined.

Research of tax situation of past fiscal years is central to tax-oriented company analysis. Methodically, tax due diligence is the same as business tax audit as to the analysis of past fiscal years, at which possible surcharges must be identified for concerned kinds of taxes. Regarding SME, focus of the analysis should be placed on tax calculation and related risks as well as on applied balance and evaluation principles. Under tax viewpoints, eventual loss transfers are of importance if they can be accounted with corresponding profits of the future because in this way income would increase. On the other hand, it must also be verified to what extent the present management is responsible for subsidisation of tax reserves. It is necessary to perform accurate examination of arising risks for fiscal years of the past, for that external verification is still possible.

Regarding future effects of the take-over, analysis of tax aspects primarily serves for evaluation of tax minimising take-over construction.

In this context, existing relationships with credit institutions must be examined and it must be found out if accounting data is objective. Primary goal is the determination of actual state of liquidity. This can be particularly recommended at SME based on their low equity capital, since low liquidity can lead to difficulties anytime. Within the negotiations with potential capital providers, it could be useful to point to eventually existing equity capital weaknesses of a company, in order to reduce the shortcomings by means of acquired capital and show profound knowledge about the company at the same time.

Intangible goods rights in form of economic protection rights, author rights or intellectual property mean a particular problem area, especially if non-balanced, self-created rights of acquired company are concerned. Therefore, special list must be created within company analysis, in which such intangible goods rights, that are in the hands of entrepreneur, individual or more family members but are given to the entrepreneur at disposal for usage, would be recorded. For the evaluation of these rights, licence analogy is often used where appropriate licence fee is capitalised.

Personnel

With regard to purchase decision, overview of all present and future personnel costs is of special importance. Such an overview can be created in the simplest way with organisational chart of a company and information about personnel costs (structured according to functional fields). Following questions can stand in the foreground here:
- How many employees are there?
- How long have they been employed in company?
- What conditions do their employment contracts assume?
- Is cooperative decision-making institutionalised?
- What is the compensation like?
- What additional services have been promised (old-age treatment, etc.)?
- What is the age structure?
- How qualified are they?

From this information, personnel expenses can be relatively reliably derived. In the second step, personnel structure should be analysed with the objective to find out if places of work can be kept in present form under future general conditions and strategies.

Under financial points of view, future obligations of the company to employees regarding old-age treatment are of importance. From the existing agreements, estimation of the size of future burden should be derived, since it could be "enormous". Particular attention must be paid to treatment promises to managers, i.e. present owners.

Advantages or utility for the company brought by employees should be examined, too. Ideally, individual employee should perform tasks corresponding to his abilities, in order to produce optimal work results.

On the background of the requirements of economic change, success of small and medium companies increasingly depends on investments concerning knowledge. "On the way from industrial society to knowledge-based economy, human capital equipment of employees and thereby qualification level in company becomes a central factor of competitive abilities." Hence, research should be focused on the fact, if a sufficiently qualified personnel is available in companies or if qualified work force must be restructured for future challenges. Furthermore, measures such as utilisation of further education offers by employees must be taken into consideration as future investment because even if employees are already qualified, their knowledge-related capital can still be extended.

Thus, the area of personnel recruitment gains on importance. Particularly with regard to SME, problems with recruitment of qualified employees are often mentioned.

Employees, motivation and engagement for company interests are central to future development of a company.

Low motivation of management also influences other employees and should be properly considered within company analysis. In this sense, together with usual data, illness rate and fluctuation rate or lack of flexibility concerning overtimes at bottleneck situations must be evaluated within the analysis as an indicator of low motivation or lack of personnel management.

On this background, it must also be identified, what attitude employees have with respect to change of ownership and management of a company. This concerns mainly employees in managerial functions. In this respect, entrepreneur must be aware of the danger that success potentials will be damaged after the change of owner, since e.g. employees of the same generation as the present owner similarly leave the company shortly after take-over. Close relationship to the old owner can lead to considerable decrease of motivation due to a disappointment about his withdrawal.

This is the more dangerous for a company; the more important the person of individual employee is in company. In this respect, analysis of personnel area may prove certain promises of the seller necessary in which he guarantees that particular employees remain available at least for a certain period of time.

Production

At first, evaluator must gain overview of the extent and structure of production or service programme. Here, position of products in product life-cycle must be identified, so that it is possible to assess future necessary investment and des-investment possibilities. Age structure analysis of product programme can thus bring valuable information about future competitive ability of a company. Regarding the research of future product planning, attention must be paid to decreasing orders inflow/state of orders that could point to the fact that product has become obsolete. Particularly at SME that often depend on a few products or even on one single product, development (possibilities) concerning a diversification of risk minimisation must be examined in high detail.

From this reason, maintenance of product development through the activities of R&D area means a necessary basis for long-term success and maintenance of competitive position. Company should be able to produce innovation also in the future. In this respect, distance of marketing department to customers and production development is of special importance because products can be successful on the market only if the market side can identify needs, and the development and production department can utilise them.

With respect to the ownership relationships of production equipment, it must be disclosed, if individual machines and production equipment are leased or belong to the property of the company or present company owner. Picture of the state of production-technical equipment can be obtainment in the best way by visiting the company. In this respect, it must also be found out, to what extent production equipment supports flexibility of SME or decreases it based on inflexible machines. Therefore, technically capable advisor, that could answer questions concerning obsolete or non-actual technique, should be eventually invited. Because if simpler or more worthwhile production techniques existed, resources necessary for purchase of modern equipment in production area would have to be taken into consideration. Such an investment level can often exist in companies where present entrepreneur does not want to withdraw yet but is afraid of investment with pay back period in the future.

Should finalisation of products be based on foreign know-how, it must be determined, to what extent e.g. existing licence agreements are at disposal to the company after take-over.

Purchase

In this section, techniques of purchase of necessary goods within a company are discussed, rather than conditions on purchase markets. It can be considered central that information about new trends and methods exists and is used at first in large companies and, only after certain time period, it is utilised in SME. Particularly purchase marketing could be such a case based on late knowledge about its importance in theory and practice. Thus, systematic market processing on the purchase side will exist in very few cases in SME.

At the analysis of the state of purchase activities in the acquired company, following questions can be posed in this context:

- Is there any section responsible for purchase or is purchase realised quasi "incidentally"?
- Is there any structured technique within purchase activities?
- Are the employees in the department qualified?
- Are the purchase policies and purchase principles determined?
- Is there market information about entrenched suppliers?
- Can the purchase (and logistics) process be optimised?
- Is purchase as a company function so integrated that coordinated and efficient cooperation with other functions is guaranteed?

Purchase department should also be able to provide information necessary as a basis for make-or-buy decision. Thus, potential suppliers and their production programme, quality, contact person etc. must be known without time delays.

If the examined company does not own any functioning purchase management, various problems such as delivery unwillingness of suppliers, production breaks due to decreased quantity, bad quality of supplied parts and associated problems on the sales market or simply too high production costs, could arise. This must also be taken into consideration of risk, together with costs of creation of non-existing or only partially existing purchase function in a company. Furthermore, with respect to the dependency on a little amount of suppliers or even only one supplier, company should be able to overcome this disadvantage expressed in non-worthwhile purchase conditions, through certain purchase strategies.

Marketing and Sale

"Good marketing means much more than just a good advertisement. It requires permanent satisfaction of wishes and needs of customers and endeavour to direct the company according to these wishes and needs. Of course, marketing needs to have a possibility to be able to realise wishes and needs of customers. For example, sale must receive feedback from trade or from tradespersons. Often, old company owner has the opinion that "products can be somehow sold by themselves". Thus, state of marketing can be characterised as dissatisfactory in high portion of companies examined within this research. If evaluator or entrepreneur experienced such a state, it would cost time and money to redirect the company for the time of take-over to customer orientation.

Another danger for the future of a company can lie in a situation, in which the company has been living for long time from one successful product "and introduction of successor products has been neglected". This can lead to a problem that after a change of demand for this concrete successful product, new products would have to be developed at first. This would be associated with negative consequences for future revenues based on development costs and time need. This statement also stands for existing dependency on one or a few customers. In such a case, either stronger acquisition activities or enlargement of production programme are necessary.

Company Infrastructure

Buildings and other assets of a company have to be analysed, as well, so that it is possible to find out, to what extent the investment need of maintenance reaches and what effects this will have on the financial structure. For example, in a company with many foreign-service employees in sale or service, transportation department should undergo concrete examination, too. Here, factors such as age and state of vehicles plays as important role as the question of structure of ownership relationships (leasing or ownership). For orientation, list of existing land, buildings and production equipment with information about the age, state or value would be useful.

With regard to rapidly advancing development in the area of information technologies, important field of research grows in the equipment of company with database applications. Examination of equipment of various company areas should be realised with respect to the situation and strategies of a company. Thus, in a trade company with a huge warehouse, research could be mainly oriented on the quality of supply chain management and purchase system. Furthermore, it should be examined, if separated solutions are concerned regarding the equipment or if company has efficient network in all areas. If individual software or hardware solutions prevail instead of a standardised database system, attention must be paid to future compatibility and resulting continual costs (e.g. based on long-term agreements). This must be postulated particularly with regard to rising importance of the Internet, since new possibilities of communication (video telephones, video conferences), transfer of payments or purchase and negotiation (e-commerce) become still more useful for SME, as well.

Intensity of problem awareness of the selling subject determined by means of questioning can be an indicator of the way of taking these developments into consideration. If there were any danger for company processes in this area, necessary modernisation measures would have to be considered in the revenue estimation.

Insurance situation of a company could be another area that should be considered with respect to company infrastructure. Comparison of existing insurance policies should be realised here and those identified policies should be consequently tested on existing risks.

Conclusion

Obtainment of information about company is an important question for company evaluation that could even have higher influence on the value of company than the used evaluation method. Within this work, internal information from the areas of organisation and structure, accounting and financing, personnel, production, sale, purchase and company infrastructure of SME have been discussed. Each one of these areas brings important data that is of importance for the evaluation of future revenue potential of a company.

Together with internal areas, areas of analysis of markets/competition and analysis of company environment should be realised within company evaluation. Only sum of those analyses can provide the evaluator with information that is necessary for derivation of future-oriented company development.

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Open Questions of Common Currency

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Abstract

The presented research paper and solutions of this paper were a part of the „Theory of price relativity: monetary stability or price stability“. This theory is partially included in monographies already published before, which forms also a part of the solutions of this research program. It was turned out that the aim of monetary policy is not only the price stability, or especially to ensure certain quantitative level of dynamics of the money supply, bat it is more important to ensure the monetary stability. But for such monetary stability it is necessary to admit some price dynamics – inflation. This regulated inflation could be an important instrument for monetary stabilisation and therefore a certain important aim of monetary policy. These macroeconomic metrological points of view, was till the present time not put into practice, but in the near future it could be an important criterion of economic policy.

Undoubted aim of monetary policy in national and international perspective is the stability of currency. Although this postulate is generally recognised, the criteria of monetary stability are not sufficiently generalised with regard to unified implementation of these criteria in national and international levels. Henceforth we will outline in our presentation possible solution of theoretical questions of principal understanding of currency stability and its evaluation according to generally valid and pragmatically implementable basic criterion of evaluation of achieved level of monetary balance and stability.

Primary framework of banking market within EU, with common European central bank and common monetary as well as banking policy, has been first of all Rome Agreement supplemented by first and second banking regulation. These legal documents, that were bases of common currency building, have been extended a lot by the European Agreements establishing association between EU and countries of Central and Eastern Europe. These have also created conditions for banks of these countries to operate and provide services within EU.

This so far very long way of western European integration to monetary union has been and still is related to three crucial questions that are still very actual. When, who (how many countries) and under what conditions will be allowed to join EU and at the same time get the possibility to incorporate to EMU.

Convergent criteria are considered as macro-economic criteria, which fulfilment is a condition of entering particular EU countries to the third phase of monetary union. These criteria are well known: inflation rate, state debt to GDP ratio, state budget deficit to GDP ratio, interest rates range and so called "normal" range of foreign exchange rates. The last criterion is often and mostly doubted. Convergent criteria created before the end of 1992 are still valid (even after European Council meeting in Madrid in December 1995) however their primary right (related to EMU) has been shifted to secondary law of EC i.e. to particular orders. Although fulfilment of convergent criteria is a legal condition for entering EU, it is not the only condition. There are also other especially political criteria (e.g. implementation of democracy principles in the executive structures of legal state) as well as the way of fulfilling the Maastricht agreement text interpretation.

Also interpretation of Maastricht agreement considering the convergent criteria and their implementation is considered as legal part of approaching monetary union. This is related mostly the legal interpretation of following criteria: state debt to GDP ratio, state budget deficit to GDP ratio and also "normal exchange rate ranges.

Criteria related to state debt and state budget deficit are criticised mostly because they can be interpreted very loosely. If Euro is about to be the basic anchor of EMS II and ERM II it is necessary to know exact and clear definition of common currency Euro in several aspects. It will be necessary to clearly define the relation of Euro as a legal descendent of ECU in fulfilling contracts and agreements elaborated in ECU. This problem influences also banks in countries that are and can also longer be out of EU.

We would like to prepare also Slovak koruna in such way that it won’t be necessary to rely on solving legally unclear question but that economic criteria of common currency determination and setting conditions of its implementation would be so clear, that they will be able to apply without bigger problems not only in EU member countries but will be basic guidelines also for approximation of transformation of national currencies of non EU countries to Euro. However the problem of determining criteria of common currency will occur also in broader world globalisation monetary circumstances.

Monetary Stability as Recognised Aim of Monetary Policy

Basic aim of monetary policy also within EMU is maintaining stability of common currency. Fulfilling certain monetary criteria is and will be the assumption of achieving such aim also in particular member countries "ins" as well as "pre-ins". Stable currency should however be also generally valid objective criterion also in globalisation tendencies of world economy. In this area opinions of currency professionals both theoreticians as well as practitioners are the same.

Following questions remain open:

- Are so far formulated Maastricht convergent criteria sufficient as general criteria of considering monetary stability or is it necessary to look for other?
- Which other criteria of monetary stability assessment would be effective and how could they be identified?
- What degree of monetary stability disturbance by the individual countries in transition to the single currency would be tolerable?

We will try to give at least brief answers to these questions:

The convergence criteria are, above all, pragmatically determined criteria. However, they are not yet empirically verified as sufficient to assess the monetary stability and a tolerable degree of its disturbance. The convergence criteria as yet do not have a character of criteria included in a legal system. Their implementation gives more alternatives of interpretation (Denmark is often given as an example). Therefore, particularly on a theoretical level, other possible and more objective currency criteria are being searched. A thesis is meanwhile stated that the currency criteria should, by a clear method, enable us to determine the currency as a economic value, both as a national currency unit (foreign exchange) and a common currency unit (e.g. Euro), or other currency unit used in a certain economic integration group.

The European Monetary System (EMS) was based on a so-called non-national currency unit - ECU (European Currency Unit), an exchange rate mechanism and a credit mechanism. ECU was considered the cardinal component of the EMS. It was not determined as a currency unit. It was quantified as an ECU value. This value was given by a so-called currency basket. It was determined by the "basket" of currencies of the EU member countries, which were represented in it by a certain ratio.

Moreover, it became obvious that even the foreign exchange rate mechanism based on intervention sales and purchases of national currencies of the member countries by the central banks on national foreign exchange markets is not a sufficient instrument to provide monetary stability. Although it is declared that the EMS central banks are obliged to maintain a stable exchange rate of the national currency, the mutual exchange rates of the member countries should be sustained in a certain range (between so-called upper and lower intervention point). On exceeding the approved range between the lower and upper intervention point the central banks are obliged to intervene on the domestic foreign exchange markets so as to increase the supply of the stronger currency and decrease the demand for the weaker one. The foreign exchange interventions were to be performed in order to maintain bilateral mutual exchange rates of the national currencies. It is this index that indicates that a certain currency is developing in a different direction than other currencies.

However, an objective of the EMS is also to "catch up" with currencies of the countries of so-called strong economic triangle: EC, USA and Japan. After the EC agreement in Maastricht five years ago (9th October, 1992) on EU establishment, the area that gave rise to the European economic and monetary union was created. The completion of these European integration processes should result in creation of a single common currency, which will no longer be ECU, but Euro. However, this gives rise to a multitude of questions that will also be related to implementation of single banking legal standards in the whole European banking system attached to ECU and transforming to Euro.

Theoretically open questions of the single currency

If we speak about the single European currency, national currencies, certain monetary system, we somehow evade the question whether it is still possible and effective to define the currency as a certain economic value unit by simpler, but unified means. That means, in general, to define the currency as an economic value and, according to such a generally valid criterion, to determine not only national currencies, but also the common currency as an economic value unit. This means to create a currency system that would be based on a common economic value unit in a systemic interconnection of national currencies in a particular economic group. This also includes finishing the creation of the single currency, Euro, in terms of providing currency function of an account unit in the EMS.

Euro should be a stable currency. But the generally valid criteria of assessing stability of the common currency, Euro, are not unequivocally specified, both themselves and in terms of assessing stability level of the national currencies of the community countries.

From the currency development history we know that in a certain period a monetary unit in general was determined by a weight unit, specifically weight of gold. However, the weight of gold was different for every foreign exchange, as so-called national form of money. Thus, specific foreign currencies as economic value units were determined usually by different weight of gold. The foreign exchange unit was specified in individual countries as a national monetary unit, namely in weight units - usually gold.

Historically, a shift in understanding of a monetary unit occurred. It became a foreign exchange unit, which was named currency. And thus, establishment of criteria of determining a currency as an economic value unit became the quintessence of the problem. This unit had been, in fact, different already when the foreign currencies functioned as national forms of money, and this resulted in a question of determining the foreign exchange parity (i.e. mutual substitutability of specific foreign currencies functioning as economic value units in an economic practice), mainly in the foreign exchange.

In solving the parity questions, which were very up-to-date particularly in exchange of goods between the economies of individual countries, the Brettonwood currency system, in which the foreign currencies as currency units were indeed determined equally by gold weight units (usually in grams of pure gold), but on the other hand differently by the amount of this weight.

After demonetization of gold and abolishment of exchangeability of foreign exchange for, the open questions of establishment of generally valid criteria for determining the currency as an economic value unit by other means than gold emerged even more urgently. However, such generally valid criteria, based on which the currency could be defined as an economic value unit, regardlessly of which currency is concerned (whether USD, DEM, SKK or others), are still missing.

However, in the practice, there is no need to determine the currency as an economic value unit. The pragmatic issues concerning establishment of a certain exchange determining system are being predominantly addressed. These include mainly the pragmatic means of determining the exchange rates, particularly by a method originated from the currency basket, or in determining the exchange rates from the development of mutual relations of demand and supply of foreign exchange on a foreign exchange market. However, this brings a considerable element of uncertainty into the whole problem.

Open questions of monetary stability assessment

The objective of the monetary policy, both on national and international level, is definitely to provide a stable currency. However, there is no generally valid criterion of monetary stability assessment either. Namely, the stable currency criterion in international relations is, in practice, replaced by quite a vague criterion of exchange rate stability. Thus, in fact, even the absence of a generally valid criterion of stable currency assessment in foreign relations is replaced by criteria of exchange rate stability, and, in regard to internal economy, first of all by a criterion of achieved inflation rate, of course in wider economic perspectives.

Hence, along with monetary stability assessment, pragmatic questions are in fact presented and solved: if and how (by what means) to maintain a fixed foreign exchange rate, or to introduce floating, and if the latter has some limits and constraints. Thus, the practice also creates pragmatic means to provide exchange in international practice, such as the "currency snake", "currency range", "currency grid" and others.

In these terms, it is necessary to realise an open question, whether it is possible to establish generally valid and unified criteria of monetary stability assessment, or if it is necessary to establish extra criteria to assess external and internal monetary stability, which is: can a generally valid criterion of monetary stability assessment, which is interpreted uniformly as a program objective of the monetary policy, be substituted by criteria of providing the exchange rate stability inside the "normal" ranges, as well as by a relatively vague criterion of "low" inflation rate, or vice versa. Can these criteria replace the generally valid criteria of monetary stability assessment?

These questions will, in our opinion, further emerge also in specifying the common currency, Euro, as well as individual national currencies that would like and would be able to converge to a single currency. A pragmatic substitution of the monetary stability criterion by an exchange rate criterion brings about certain risk that the convergence of national currencies into a common currency, Euro, will be accompanied by mistrust even on behalf of the EU member countries.

Solving the quoted questions would make the convergence process of individual currencies to a single currency more transparent. This would make it possible to increase the transparency of the economic convergence criteria as currency criteria, which are connected with assessment of attained monetary stability level. The current three currency convergence criteria that are bound to the interest rate movement, inflation rate and exchange rate movement are to be considered pragmatic preliminary criteria, which are not to be referred to as generally valid criteria of monetary stability level assessment, as these criteria only allow assessment of the implementation level of preliminary goals of the monetary policy.

According to the mentioned facts, we can, first of all, summarise the open theoretical questions of the single currency that will still need to be answered:

- How can we define the generally valid criteria to determine the currency (both national as well as common) as an economic value unit?
- How can we define the monetary stability as a program objective of the monetary policy by other means than by establishing the preliminary currency goals?
- How can we determine the generally valid criteria of monetary stability assessment (national as well as common)?
- How to determine a generally valid criterion of currency parity assessment as an essential starting point of determining the exchange rates?
- How to determine a criterion of assessment of monetary-acceptable inflation rate?

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Private Equity as a Driver for Growth in Central and Eastern Europe

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Abstract

Venture Capital and Private Equity have become a main driver of financing in mature capital markets. Making its way from the US to the UK in a first step, it is now widely used all over Europe and has rapidly found acceptance as an interesting alternative to debt financing.

Both equity instruments allow the investor to participate in the shareholding of the company, which results in a more active involvement in the day to day business or at least the main decisions.

Private equity provides equity capital to enterprises not quoted on a stock market. Private equity can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a company's balance sheet. It can also resolve ownership and management issues – a succession in family-owned companies, or the buyout or buy-in of a business by experienced managers may be achieved using private equity. Private equity in this paper refers to investments in the "Old Economy".

Venture capital is, strictly speaking, a subset of private equity and refers to equity investments made for the launch and early development of a business. Among different countries, there are variations in what is meant by venture capital and private equity. During the last years, the term venture capital is generally used for early stage investments, especially in the technology industry. Venture capital in this paper refers to investments in the "New Economy". For this paper we will stick to this definition.

European private equity

The European venture capital industry can trace its roots back 50 years but growth started in earnest in the 1980s. It now provides the European private corporate sector with permanent access to professional sources of growth capital.

Key European market data

- Since the emergence of private equity in Europe in the early '80s, a cumulative total of more than €125 billion of capital has been raised for investment in Europe's most promising growth companies
- In 1999, €25.1 billion was invested in over 11,000 investments, in the first 6 month of 2000 13.5 billion was invested in 4.630 companies
- 41% of all investments are to provide expansion finance
- Venture-backed MBOs and MBIs are contributing significantly to Europe's corporate restructuring effort and helping to create new entrepreneurial businesses
- Technology investments account for 26% of the total amount invested and the amount invested in the technology sectors increased by 94% in 1999
- The amount of capital committed to start-up deals increased by 89% in 1999.
- Private equity and venture capital contribute to the rapid growth of companies. A survey of venture-backed companies showed that over the 4 year period 1991-1995, venture-backed companies':
  - ☐ Sales rose on average by 35% annually, twice as fast as the top 500 European companies
  - ☐ Employment increased by an average of 15% per year versus only 2% for the top European companies

- Investment in plant, property and capital equipment grew by an average of 25% annually
- R&D expenditure represented on average 8.6% of total sales compared to 1.3% for the top European companies
- Exports rose on average by 30% per year
- Private equity investors are active partners providing more than finance. According to managers of investee companies, the three main contributions made by venture capital investors, other than finance, were financial advice, assistance on corporate strategy and acting as a sounding board for ideas
- 81% of managers surveyed in the above study believed that their company would not have existed or would have grown less rapidly without venture capital

Since the opening of former communist countries in the early 90, these countries have experienced a lot of interest of both direct foreign investment (FDI) or investments via private equity or venture capital funds.

The last years have shown that investments in the technology sector have almost levelled to western standards, both in pricing as well as quality of the ventures. It seems, the CEE region jumped over some market stages by adopting the lessons learned from the western neighbours.

We feel that the difference between the new economy in the CEE region and its western counterparts became almost negligible and is more driven by stock prices and peer group evaluation than anything else. Venture capital does a lot for the CEE region in respect to growth, but the impact of venture capital does not differ from its influence in western hemispheres.

The same is only partially true for the old economy, where evaluation patterns differ substantially from comparable companies in the west. It is obviously far easier for new and emerging ventures to mimic the recent trends in the west than for bricks and mortar businesses to change the actual patterns. For this paper we will focus on the old economy, especially on SMU's and the impact of the private equity investment.

Introduction

Over the course of the last four years, making the case for investing in private equity in Central Europe has sometimes been difficult. Returns on local equity markets have been volatile and have often fallen short of expectations. Returns have also suffered from contagion effects from events in other emerging markets.

The fundamentals are now changing. The Central European states of the Czech Republic, Hungary and Poland are entering a period of rapid, sustained growth in GDP. Inflation is down sharply from the double-digit rates of only a few years ago. Prospects for membership in the EU are already contributing to convergence in inflation and interest rates towards West European levels. Membership in NATO and OECD and the existence of strong, healthy democracies are sharply reducing country risk premiums, a development that is unique to Central Europe among emerging markets.

In addition, emerging market contagion effects are working in reverse. Most of Southeast Asia is experiencing strong economic growth again and GDP in Russia and Ukraine is finally rising. Although still sizeable, some of the economic instability that has characterised Russia and the other successor states of the former Soviet Union has diminished. Finally, the U.S. economy appears to be slowing and U.S. equity valuations are adjusting to more realistic levels. For these reasons, Central Europe promises to provide some of the most attractive investment opportunities among emerging markets in the coming years.

This paper will make the case for investing in Central European equities, in particular, private equity. In the medium-term, this asset class is projected to outperform other classes not only in the region but also in comparison with other emerging markets. The paper will first assess prospects for strong GDP growth in the region and for the convergence of inflation and interest rates towards EU levels. It will then evaluate prospects for equity markets in the region prior to EU accession. It will conclude with a discussion of the advantages of making private equity investments in the region.

The paper will concentrate on the Central European states of Poland, Hungary and the Czech Republic, the leading countries in the transition process. While the analysis also applies to other countries in transition, in particular Slovakia, Slovenia and the Baltic states, because of the size of the three Central European economies and the importance of their equity markets, the focus is on these three countries.

Economic rationale behind CEE convergence

The CEE countries are undoubtedly going down the convergence way towards the European Union. The economies of the CEE countries have experienced so far one of their most dynamic period in history and will continue going through a period of great convergence towards their western counterparts. This is where the biggest excitement for private equity investors entering the region comes from, as the gap between the EU and CEE countries' economies is still significant, thus offering a reasonable upside as this gap narrows in the future.

The CEE economies have more or less gone through privatisation and restructuring and are now entering a period of rapid sustained growth. The Inflation is under control and with the gradual price liberalisation seen in the region there are no threats of turbulence. Steady decline in unemployment in the region is supported mainly by direct investments and "greenfield projects". With the strong inflow of foreign investments into the region coupled with incomes from tourism sector, the mounting C/A deficit poses a manageable challenge to the national banks of Eastern European countries. The external (current account) convertibility in some CEE currencies have been restricted before, but the full convertibility of those has been arranged according to IMF regulations already, even though in some countries the internal convertibility remains limited for local citizens. Some of the CEE currencies remain pegged (those of the Baltic countries) and some are freely convertible (CZK, SKK, HUF). But most of the currencies in the CEE should experience a stable period over the course of the next decade, marking the region as safe in terms of FX risk for foreign investors in general.

All the macroeconomic fundamentals create a sound environment for GDP growth and wealth creation – a solid base for all investors in general.

Table 1: CEE MACROECONOMIC FUNDAMENTALS + FORECASTS

Poland	**1998**	**1999**	**2000**	**2001F**	**2002F**
GDP growth [%, y-o-y]	4.8	4.1	4.1	3.5	4.3
GDP [USD, bn]	158.4	155.2	158.9	184.0	194.2
CPI-inflation, [%, avg.]	11.8	7.3	10.1	6.6	5.9
Unemployment rate [%]	9.9	12.0	14.0	15.5	15.8
C/A deficit [% GDP]	-4.3	-7.5	-6.2	-5.5	-5.0
FX reserves [USD, bn]	28.3	27.3	26.8	27.2	27.8
Exchange rate PLN / USD [eop]	3.50	4.15	4.14	4.50	4.10

Source: WdB London

Hungary	**1998**	**1999**	**2000**	**2001F**	**2002F**
GDP growth [%, y-o-y]	4.9	4.5	5.2	4.8	5.2
GDP [USD, bn]	47.0	48.2	47.1	52.5	60.1
CPI-inflation, [%, avg.]	14.3	10.0	9.8	9.1	6.5
Unemployment rate [%]	7.8	7.0	6.4	6.3	5.8
C/A deficit [% GDP]	-4.9	-4.3	-3.2	-3.8	-4.1
FX reserves [USD, bn]	9.3	10.7	11.3	11.4	11.5
Exchange rate HUF / USD [eop]	219.0	252.5	284.7	292.5	260.2

Source: WdB London

Czech Republic	1998	1999	2000	2001F	2002F
GDP growth [%, y-o-y]	-1.2	-0.4	2.9	3.4	3.9
GDP [USD, bn]	56.9	54.8	51.2	54.5	63.0
CPI-inflation, [%, avg.]	10.7	2.1	3.9	4.4	4.0
Unemployment rate [%]	6.1	8.6	9.0	8.0	7.5
C/A deficit [% GDP]	-2.3	-2.9	-4.6	-5.4	-5.0
FX reserves [USD, bn]	12.6	12.8	13.1	14.6	16.2
Exchange rate CZK / USD [eop]	29.9	36.0	37.8	39.0	35.5

Source: WdB London

Equity valuation assumptions and characteristics

The private equity market has experienced a strong growth during last 10 years with the cumulative average growth rate at 40%. Demand for these instruments has been driven mainly by a history of superior private equity returns and distributions. A number of new institutions opening private equity/venture capital funds has been steadily increasing, building a broader portfolio of financial products. Pension and other long-term funds have increased their percentage allocations in the private equity funds, viewing them as a mean of deploying excess capital. As such, private equity investments have gradually started appearing on the radar screen of investors from Western Europe too. Investors seem to intend to reduce the number of managerial levels, having their investment managers tightened closer to the actual investments.

In the CEE region, we could have clearly seen a sectoral approach to private equity investment. While most of the investors rushed to invest to the “fancy” technology area across the borders, other areas remained virtually untouched as of yet. This obviously caused huge differences in the equity valuations across the sectors in the CEE markets. Especially in the area of internet and technology investments, similar valuations could have been seen as those in the US and Western Europe. The valuations in the technology sector have first gone through the roof and since early 1999 started declining. With the US equity valuation declining to more realistic levels, funds investing in the CEE region start broadening their investment horizon and start looking on other sectors too. The rationale behind is that technology and telecommunication sectors no longer provide such rosy upside potentials in terms of the old “sky-high” valuations. However, the US and Western European equity valuations remain the basic assumptions for valuations of the respective sectors in the CEE countries. The threat of economic recession in those countries would obviously affect not only the CEE economies and their growth, but also their respective equity valuations.

CEE private equity/venture capital markets

Overall, the private equity market in general (not only in the CEE region) is characterised by lower level of transparency and higher information imbalance than other parts of the capital markets. The non-existence of standardised investment tools and secondary markets creates a potential liquidity problem, should the private equity investor wish to exit the investment prematurely. It also burdens the information base that is generally available on private equity deals to outsiders. The private equity/venture capital market in contrast to the capital market is not regulated by an official body. This virtually removes any possibility for market supervision, performance presentation and disclosure standards. As most of the private equity/venture capital deals are intended to last for a period of several years, with no secondary markets available, questions can be raised on how to value the private equity portfolio before an actual exit is achieved.

A typical private equity fund investing in the CEE region is looking for the IRR of approximately 30% pa, which implies slight risk premium of roughly 5-10% for the location of the investment in the Emerging Markets area.

The highest demand has traditionally been for investments in the information technology, telecommunication, internet, chemical, service and manufacturing industries in this respective order. As mentioned above, the focus is expected to shift slightly towards the “old economy” sectors for the reason of global equity valuation change. Several segments, for example military and tobacco industries, have always remained outside the radar screen of private equity investors and this is projected not to change, as the main investors (mainly multinational non-private organisations) should hardly change their investment mandate in the "social" respect.

In the case of MBOs and MBIs financed by the private equity investor a strict management commitment is obviously sought. The empirical evidence shows that such management team had all co-invest their 1-year income in the initial phase. In later stages, even higher participation has been quite common.

Average intended investment period sought by private equity investors in the CEE has been 6 years with the range of 4-8 years, very seldom more or less. It is worth to mention that so far very little (almost none) private equity investments have reached their intended maturity in the CEE region. Nevertheless, some investments have been exited by trade sales to strategic investors, but most of them prematurely. Crucial point, thus for every private equity investor is the mean of exiting the investment. This topic is more discussed on other places later in the article.

The process of private equity investing in the CEE countries requires perhaps even deeper attention, as several of the investment patterns not necessarily automatically work in the region, compared to the situation in Western Europe and the USA. There are certain specifics in the private equity Investment Cycle typical in the CEE region:

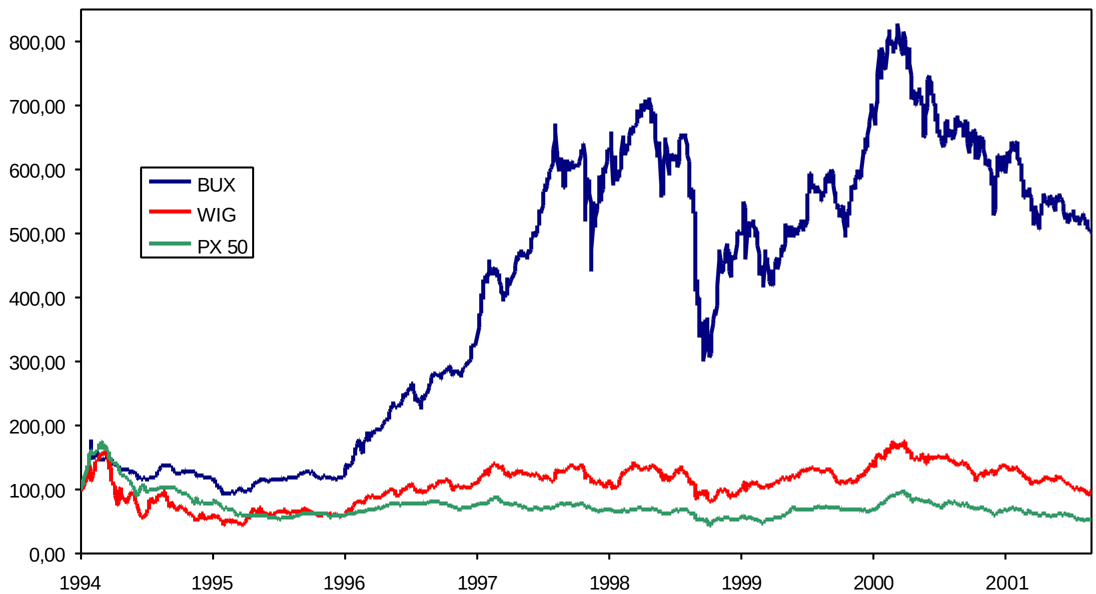
- Fund Raising – predominant investors in private equity/venture capital funds investing in the CEE region are governmental organisations and multinational non-private banks (EBRD, EIB, World Bank etc.) unlike in the USA and the UK, where the main contributors are companies from private sector like banks, pension funds and insurance companies accompanied by private individuals.
- Origination & Documentation – as a result of smaller potential market size in the CEE countries, some burdens are placed on private equity fund investment managers in terms of the size and structure of potential deals, as there usually are limited numbers of potential sizeable deals. The potential dealsize is a hurdle, as an average private equity fund operating in the CEE region is looking for single investment of $4-8m and it may be sometimes difficult to find suitable investment opportunity, compared to more mature and larger Western European and US markets. The lower level of corporate governance also makes it rare situation for a small and medium developing company to have an acceptable financial audit from a reputable international company (the so called big 5). As private equity funds can hardly make any investment without a thorough due diligence on the target company, the non-existence of the basic reliable financial audit poses a serious complication from time and financial point of view.
- Investment Structure – this is where there are almost no differences in comparing private equity investments in the CEE region and its western peers.
- Investment Transaction – itself also contains only minor differences to the process in Western Europe and the USA.
- Monitoring & Control – requires perhaps the biggest personal involvement of the investment managers of the private equity/venture capital funds. Since the corporate governance and business culture usually do not reach the levels seen in western countries, some of the highest valued contributions of private equity investors are the new financial and business advice and the creation of corporate strategy. Nevertheless, the private equity investor's role has mainly been limited to the supervisory board membership in the investee company.
- Exit – with very weak local equity capital markets in the CEE, the main hope for the investors must have been company trade sales to a strategic partner or some version of management buyout. Potential capital market listing has to be approached cautiously and with the view to list the investee company in the broader pan-European capital markets platform should this be suitable (Neuer Markt in Germany, Easdaq, LSE Seaq etc.). Strategic investors trade sales are therefore more appropriate and enable to search for the investor on world-wide reach basis.

Among the private equity/venture capital companies investing in the CEE region, the main players are: Advent International, GE Capital, Warburg Pincus, Dresdner Kleinwort Benson Private Equity, RZB Private Equity, Bancroft UK, Renaissance Partners, EPIC, CSFB Private Equity etc.

EU/CEE equity markets outlook, impact on CEE private equity

In early 1991 in Hungary, 1992 in Poland and 1994 in the Czech Republic, equity capital markets were born. Many investors rushed into the CEE region to take advantage of new, fast developing markets, which offered attractive investment opportunities in terms of very low asset valuations. Major US and European Asset Management firms contested to open dedicated CEE equity funds to attract investors. In the early stages all the CEE capital markets performed really well and most of the investors booked hefty gains in their portfolios. However, the lack of corporate governance, slow structural reforms and huge political influence over the transforming Eastern European economies caused that many of the investors burned their fingers. The devastating effect had a special magnitude in the smaller markets (for example: foreign investment restrictions imposed in Slovenia, privatisation scandals in Slovakia etc.) or during the Russian crisis in 1998.

Looking back at the equity markets performance in major CEE countries (Fig. 1) implies that of the three main capital markets, only that of Hungary actually produced any sensible return. The Polish and Czech market are below their initial values of 1994. The return figures would be diluted even further if the benchmark was to be the USD (as at most of the foreign investors is), because of the crawling peg of the Hungarian Forint and Polish Zloty and gradual depreciation of CZK for most of the concerned period.



Source: Reuters

Fig. 1: CEE EQUITY MARKETS PERFORMANCE [RE-BASED AS OF 3/JAN/1994 TO 100 POINTS]

The CAGR for the $7^{2/3}$ years was 23.6% for the Hungarian market, -0.42% for the Polish market and –7.83% for the Czech market respectively. This implies, the typical USD-benchmarked foreign portfolio investor investing into CEE & Russian equities would be hardly posting any sensible returns on the portfolio, but perhaps breaking even in the best case.

With the poor performance of the CEE equity capital markets, their sizes and trading volumes are on the decline as well, especially in the last 2 years, as it can be seen from Tables 3-5:

Table 3: EQUITY MARKET CAPITALISATION IN MAJOR CEE COUNTRIES [USD, BN]

Country	1995	1996	1997	1998	1999	2000
Hungary	2.4	5.6	15.0	14.0	16.4	11.9
Poland	4.5	8.3	12.5	18.6	29.4	31.4
Czech Republic	18.0	19.7	14.3	13.9	13.3	11.7

Source: Bratislava Stock Exchange

Table 4: EQUITY MARKET CAPITALISATION IN MAJOR CEE COUNTRIES [% OF GDP]

Country	1995	1996	1997	1998	1999	2000
Hungary	6.0%	12.9%	36.6%	29.9%	36.1%	28.3%
Poland	2.7%	5.3%	9.3%	13.2%	20.0%	21,1%
Czech Republic	34.7%	34.3%	29.7%	23.1%	26.1%	23.6%

Source: Bratislava Stock Exchange

Table 5: EQUITY TRADING VOLUMES ON MAJOR CEE MARKETS [USD, MIL]

Country	1995	1996	1997	1998	1999	2000
Hungary	348.5	1,606.3	7,684.7	16,104.2	14,847.9	12,247.6
Poland	2,800.0	5,500.0	7,900.0	8,750.0	10,820.0	20,406.5
Czech Republic	4,674.1	9,145.6	7,810.0	5,337.2	4,705.3	6,985.6

Source: Bratislava Stock Exchange

Originally it seemed to be a brilliant idea to exit venture capital investments via equity capital markets, as most of the CEE markets did well. Unfortunately, because of the above mentioned facts, the performance and thus the importance of the local equity capital markets is declining. As a response to the weakening CEE markets during the last 2-3 years, some of the companies from the CEE region (mainly the early stage ones) sought listings and IPOs directly on the Western European and US bourses. Examples of that include Hungarian Graphisoft (Neuer Markt), Polish Netia (Nasdaq, LSE), Russian MTS (NYSE) and Golden Telecom (Nasdaq) etc. With an increasing number of CEE companies seeking listing on specialised, sector-based stock exchanges abroad rather than on the local exchanges the role of the CEE capital markets is likely to deteriorate further. Several Western European Stock Exchanges started to specialise on sectors; Deutsche Boerse XETRA formed the so-called Neuer Markt which specialises on IT and technology issues, several European banks formed EASDAQ – another technology and new issues stock exchange which was recently acquired by Nasdaq – the US version of such a specialised market. As the trading platforms in the western countries specialise, special segments will be established for the old economy stocks, new economy stocks, or start-up companies. The recent consolidation and merger activities (LSE + Deutsche Boerse, Nasdaq + Easdaq) seem to indicate that in the future there will be a pan-European platform with special segments for trading respective industry sector based shares. As with many other things in life – size does matter – and the smaller markets (especially those of the CEE) will face a difficult challenge to survive. And with diminishing number of instruments – shares to trade – with prevailing lack of new issues and finishing privatisation activities, their survival will be a major hurdle. At the end of the day the CEE stock exchanges will have to give up and integrate into broader pan-European market structure, enabling investors to enter all the European markets at once.

Obviously, as local CEE equity markets cease to exist, the crucial way to exit for private equity investors from their investments will have to be strategic trade sales. Another alternative for them will be to approach these pan-European markets and divest their investments via IPOs. But one thing is almost certain already: the local CEE markets neither have the strength, nor the investors base to serve as a stable exit vehicle for the mounting and maturing private equity investments in the region.

Outlook for private equity investments into CEE markets

The outlook for private equity/venture capital investments in the CEE region has to be considered in the light of:

- The European integration process – as the CEE countries converge towards the EU, not only their political systems will equalize with the EU standards, but also their economies will grow to match the levels of their western counterparts. With ill-functional or almost non-functional equity capital markets, one of the best opportunities for investors to bet on this convergence play seems to be the private equity business.
- Increased financial valuations in the CEE – in certain sectors (such as the new economy), asset valuations in the CEE have already leveled out to the western rank. Nevertheless, a big gap in asset valuation remains in the field of old economy. This disparity has been caused partly by sky-high valuations in the new economy sector, partly by the difficulty to restructure the old economy to adapt to market practices and be competitive. It is this valuation gap that creates the upside potential for investors to profit on supplies of finance for the growth.
- Globalization and ownership centralization – as in the other parts of the world, also in the CEE, huge interest from (mainly foreign) strategic investors can be seen to take over the smaller CEE peers and to integrate them. The strong strategic investor can not only help restructure the target company, but also create savings from the economies of scale and finally, the target company profits from being a part of large conglomerate. This process started in the CEE already in early 90s, since the privatization program began. Gradually we are witnessing a shift more towards the corporate sphere, where domestic and foreign companies integrate local CEE companies in order to maximize the synergy effects (e.g. Hungarian MOL and Slovakian Slovnaft). Private equity investors can view these globalization and integration trends as a favorable way to exit their investment.

Private equity investment in the CEE offers opportunity whereby investors could both take advantage of very low asset valuation and look forward to rapidly developing economies. Private equity investments enable investors to more directly interact with the investee company, supervise their investments and avoid any potential problems with weak corporate governance or entrepreneurial culture, such as portfolio investors often have to face in the CEE region. Thus, private equity seems to be the best proxy to the economic growth potential of the region while maintaining certain investment protection degree. Especially in the light of the diminishing importance of the CEE equity capital markets, private equity investments in the CEE seem to be poised for take-off. Have you got your seatbelts fastened?

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Requirements and Calculation Elements of Real Estate Investment Calculus

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Abstract

Requirements on real estate oriented investment calculus are derived from the particularities of real estate as an economic good. As a rule, real estate is characterised by very long operating life. Whereas, with respect to machines, only residual revenue can be reached at the end of their utility, continual increases of values have been observed for land and soil. Taxation and particularly tax advantages regarding real estate are of higher importance than with respect to other investment objects. Therefore, planning period for real estate investment calculation should be sufficiently long. As for the monetary dimension of real estate investment, it must be differentiated between direct and indirect payments. To direct payments belong investment expenses, expenses continual in periods, incomes continual in periods and income from sale at the end of the utility period. To indirect payments belongs usage of income surpluses, balance of expense surpluses, and income and estate taxes.

General Requirements on Investment Calculus for Real Estate

Investment calculus is oriented at development of decision models of preparation and funding of investment decisions. By means of methods of investment calculus, decision criteria of decision maker are formalised within the evaluation method and thereby made operational for evaluation of decisions possibilities. Here, at first, periodic payments are generated within dynamic methods based on estimated flow of payments, that are consequently aggregated to final values by means of techniques of financial mathematics or through full financial planning. Consideration of the period of time of the concerned payment affected by different handling of interest effects under various methods is of special importance in this respect. Values calculated in this way should be understood in coherence with decision rules associated with method defined and used according to the preferences of decision maker. Through the comparison of resulting values of different alternatives, most worthwhile alternative can be determined under defined general conditions.

Thus, main goal of investment calculus is to provide the user with mathematically well-founded information of economic attractiveness of a plan. Here, it can be differentiated between the evaluation of absolute and relative advantageousness. Within the evaluation of absolute advantageousness, individual investment plan is evaluated with respect to the question if realisation of examined plan leads to improvement of starting situation and if it is reasonable from pure economic reasoning to realise or leave the investment. In comparison to the absolute advantageousness, relative advantageousness should make clear which one of at least two mutually excluding investment alternatives leads to a final value that is considered better by the decision maker. Alternative investments can be related to alternative investment objects as well as alternative financing forms of the same investment object. This implies that requirement associated with the method of investment calculus is that it should provide a statement about absolute advantageousness of investment plan as well as a comparison with alternative investment possibilities through relative advantageousness.

In order to be able to assess absolute or negative advantageousness of investment, investment plan must be reduced to monetary dimension at first, i.e. individual incomes and expenses. More or less long-term employment of financial resources in an investment object is associated with each investment. With respect to this, resulting outflow of resources and eventually necessary additional capital requirements lie more or less in the future. However, investor can't be indifferent if certain payment occurs in a year or in ten years. This preference of time creates another requirement on investment calculus: it must take into consideration time aspects of a payment in a suitable form.

In order to be able to provide suitable decision basis for the investor, investment calculus must depict all information relevant to the analysis of advantageousness and general conditions such as financing or taxation. On the other hand, it is of special interest for investor that present methods show data that enters investment calculation, technique of calculation and the premises in a thorough and transparent way. Problem field strained with partially contradicting requirements is handled in a different way by various methods of investment calculation.

Special Requirements on Investment Calculus for Real Estate

Special requirements on investment calculus for real estate are derived from particularities of real estate as economic good. In comparison to machinery, real estate is characterised by a very long operating life period; however, economic utility of some types of real estate lies deeply under this period. The value of real estate consists of the value of used land and soil and the value of building. Whereas at machines, only residual revenue can be reached at the end of their utility time, value development of real estate is principally different. At least, continual increase of the value of land and soil could be observed in the past. Furthermore, under corresponding development of economic general conditions, value of building could experience increase, as well. In practice, real estate investments are often motivated by expected value increase potentials.

Furthermore, taxation and particularly tax advantages are of higher importance at real estate investment than at other investment objects. Based on long capital employment period, high value of income from sale of real estate, and importance of tax influence, planning period for real estate oriented investment should be sufficiently long. Despite their uncertainty, period-specific and differentiated prognoses about payments associated with real estate investment should be made.

Calculation Elements of Investment Analysis of Real Estate

With respect to monetary dimension of real estate investment, it must be differentiated between direct payments, i.e. payments directly caused by investment, and indirect payments, i.e. payments resulting as consequences. Basically, it is assumed that payments occur always at the end of year. To direct payments belong investment expenses, continual expenses in periods, continual incomes in the periods and income from sale at the end of the utility time. To indirect payments belong usage of income surpluses, balance of expense surpluses, and income and estate taxes. In the following discussion, direct and indirect payments are examined in more detail.

Direct Payments

Investment Expense

For the determination of investment expense concerning real estate, it must be differentiated if investor buys or builds the object by himself. Differentiation into obtainment expenses and construction expenses is closely related to this situation. These expenses can differ from obtainment or construction costs that build the basis for tax-deductible depreciation and are determined according to tax rules. To obtainment expenses belong:

- Purchase price
- Land obtainment tax
- Expenses for visits (travelling costs, diets)
- Provision for agent
- Notary and estate register fees
- Expenses for obtainment and processing of financing
- Interests for financing in advance and during the time of investment

Under tax viewpoints, differentiation of obtainment costs to land and soil and buildings is of high importance. At the time of realisation of investment calculation for real estate, purchase price at least should be determined with sufficient accuracy. Further expenses can be taken into consideration in form of a percentage surcharge to the purchase price. Together with 3,5 % of land obtainment tax, 1 to 7 % are used for agent provision (depending on the kind of usage and size of object) and 1 to 2 % are considered for notary fees. If construction plan is independently realised, construction expenses occur. As a result of relatively long construction period of real estate, construction expenses should be assessed by building engineers. There are various possibilities of determination of construction costs:

- Assessment can be realised on the basis of average calculation values per measure unit (e.g. cubic meter of gross room space, square meter of gross floor space or square meter of usable space). This simplified technique is often used at first determination of costs.
- Furthermore, costs can be determined by means of cost normative for facilities. This is a usual technique of accurate estimation of construction costs in practice.
- Another differentiation technique determines costs by means of cost normative for individual elements of construction. Used cost normative is oriented at empirical values. Information about normative can be obtained from checklists, databases or other statistics. Older normative should be adjusted to actual costs level using indexation.

Interests for financing in advance or in the meantime, occurring during the time of construction should be included into investment expenses. Their determination should be oriented at time development of usage of financing resources. In the practice, average usage of 50% of total financing volume is often taken into consideration with respect to calculation of construction interests. This technique is based on the assumption of linear development of costs. Close-to-reality results can be obtained if ideal cost development and corresponding financing need is assumed at the determination of construction interests.

Financing plays important role with regard to investment in real estate, as well. Capital costs of foreign financing comprise interests that have to be paid for loans as well as insurance contributions if capital life insurance is integrated into financing of real estate. Problem lies in the fact that planning period on which the investment calculation is based spreads over interest fixation term of a loan. In this case, prognosis about the interest rate of additional financing is necessary; here, calculations could be oriented at average effective interest rate for mortgage loans of last ten years or assume that prolongation at the present effective interest rate is possible.

In case of (partial) equity financing, capital costs consist of interests that investor could get for a long-term alternative investment, e.g. security with fixed interest rate, and that he did not gain because of realising real estate investment. Corresponding information about opportunity costs can be taken from economic newspapers or bank information. If planning period for real estate investment exceeds the duration of alternatively possible capital investment, assumption about additional financing possibility is necessary. Here, average yield of last ten years of securities with fixed interest rate or one-year fixed monetary deposits could be used.

Continual Income

With respect to real estate, continual income comprises yearly rental fees, portion of secondary costs as well as other revenues from renting of parking and advertisement places. Business and living room rental conditions are subject to generally same determinations; however, there are additional regulations for living room rent. At business rent, rent interest rate is typically a (monthly, quarterly or yearly) fixed amount. Rent interests are usual at middle-term and long-term rent agreements. Gradual rent agreements, value ensuring clauses (called also index clauses), reservation clauses and spread clauses are used:

- Gradual rent agreements stipulate the amount by which rent will increase in certain time frame.
- Value ensuring clauses use development of officially determined life standard costs indexes as calculation basis for rent increases.

- Reservation clauses trigger no automatic change of rent interest in association with official life standard costs indexes, rather, new negotiations concerning rent are realised.
- Spread clauses integrate rent interest increase to comparable value measure.

Since, rent prognosis for living room rent conditions and business rent conditions is seen as difficult, only extrapolation of rent development observed in the past taking into consideration features of considered real estate object, is realised. Together with rent mirroring, market observations of big real estate agents and agent associations as well as publications in professional magazines, are suitable as information sources.

Continuous Expenses

Regarding continuous expenses, it should be differentiated between taxable and non-taxable parts. At living room rent conditions, taxation of secondary costs is limited by §§ 4 and 10 MHG to operating costs in sense of § 27 II. BV or Appendix 3 to II. BV; renter has to bear maintenance and administration costs. At business rent conditions, special agreement has to be made about taxable secondary costs. Usually, tenant bears the operating costs, in some cases even administration costs. Assumptions have to be made in investment calculation about individual components of secondary costs. Administration costs are personnel and material costs that arise for foreign and own services within building and land administration. Determination of administration costs should be adjusted by inflation in time; average growth rate of life standard costs of last years can serve as index. The size of maintenance costs is primarily dependent on quality of building, usage intensity and revision intervals. Maintenance costs are differentiated according to DIN 31051 into inspection, revision and repairing costs. Periodically arising costs for inspection and revision should be determined from empirical values and adjusted for inflation analogously to administration costs. Non-periodic repairing costs should be included with respect to their probable time occurrence into the investment calculation.

Income from Sale

When selling real estate at the end of the planning horizon, investor reaches an income from sale. This economic problem can be generally solved by means of mathematical models of utility time and time of replacement. Of course, there is no research about optimal utility time or optimal point of sale of real estate. Used planning horizon of investor should be oriented at his expectation concerning required duration of investment. This becomes a problem when a very long time period is expected, since prognosis accuracy decreases with growing time distance. Here, it is recommended to choose a shorter planning horizon of 15 to 20 years, assume sale of real estate and set prognosis period to 50 years. Orientation help for the prognosis of value development of real estate is provided by analysis of their development in the past. It can be shown that land and soil prices have increased stronger on average than the price index of life standard costs. Although buildings are subject to age-based depreciation in opposition to land and soil, values of buildings have been increasing in the past, as well. Of course, it must be taken into consideration that value development of real estate is not the same for various market segments and places. In practice, income from sale from real estate is often simply determined by raising investment expense based on developments observed in the past (extrapolation). Here, indicators of real estate prices or land prices published by Federal Office of Statistics can be taken into consideration. Another possibility of determination of income from sale is determination of the value of facility at the end of planning period by means of standard technique of facility value determination. Determination of future income from sale of real estate certainly means one of the most difficult problems of investment calculus. Since advantageousness of real estate investment depends on value increase or decrease of the object, prognoses have to be realised with special attention in order to avoid the danger that investor "calculates himself rich".

Indirect Payments

Together with direct payments, indirect payments also have to be included into investment calculus. These comprise utilisation of income surpluses or balance of expense surpluses as well as tax effects of investment plan.

Utilisation of Income Surpluses

When income surpluses arise in the individual years of planning period, question can be posed, how these surpluses should be used and how the usage should be dealt with in investment calculus. Following alternatives can be considered:

- Reinvestment of free resources into financial deposits, e.g. securities, fixed money
- Reinvestment of free resources into observed object, e.g. improvement of substance
- Reinvestment of free resources into other real estate objects
- Loan instalment to decrease interest

Financing of Expense Surpluses

Assumptions are necessary, how surplus of expenses, e.g. caused by planned modernisation, will be financed. Balancing is possible to be made in two ways:

- Taking a loan
- Decreasing investment by selling financial deposit or real estate object

Consideration of Taxes

Since taxation influences absolute and relative advantageousness of considered investment plan, real estate investment calculations have to take into consideration tax effects of investment. Following kinds of taxes come into consideration with respect to a rented real estate from investor's point of view:

- Corporate tax/income tax, church tax and solidarity surcharge
- Business income and business capital tax - land tax
- Heritage and accession tax - land obtainment tax
- Turnover tax

Consideration of taxes within real estate investment calculus is seen as difficult from several reasons:

1. In order to be able to determine existing tax burden, calculation of total income and assets, which real estate is only a part of, has to be performed excluding land. Thus, assumptions about development of those both components have to be made what leads to an increase of complexity of calculation.
2. Rules concerning obtainment costs, construction costs, obtainment-related construction expenses, maintenance expenses, additional construction costs and depreciation, etc. as well as directions of substance taxation related to real estate are complicated.
3. Prognosis of tax burden is made more difficult by unpredictability of changes within tax law creation and interpretation.

Mentioned examinations imply that theoretically accurate decision model can be developed for present tax conditions but determination of included data is difficult and uncertain. But even if it were possible to reliably obtain necessary information, practical dilemma would arise: model would be so complex that ordinary investor could not understand it anymore. Contradiction between exactness, data uncertainty and comprehensiveness can only be solved by making simplified assumptions about tax sphere of investor.

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Responsiveness and Copying Of Slovak Enterprises with External Changes (Internal Conditions of Competitive Advantage Uprise)

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Abstract

Adaptability is basic assumption of a survival. Successful enterprises will be these only, which manage to react quickly and flexibly toward changes of external surroundings. Competitive advantage will be captured by these enterprises only, which manage to receive their business environment sensitively and to copy with its changes. The paper contents the results of own original research considering nearly 300 Slovak enterprises. It presents in what scale these enterprises dispose a potential for using the changes in external business environment in favour of competitive advantage uprise. The basic idea of paper is pictured in a process from information to competitive advantage: information (on external changes) ? reaction (flexibility and time) ? generation innovation competence (internal changing) ? competitive advantage.

Traditional approach toward competitive advantage identification imposes vigour for internal analysis of an enterprise. It searches and evaluates quantity and quality of resources, especially those, which are registered by any formal method, e. g. machines, equipment, finance and human resources and deals with mental relations in a less scale, which get tangible, human and financial resources in an activity, e. g. management system and corporate culture. Tangible resources and intangible linkages between them should cooperate, and then their interplay creates a competitive advantage. Resources and linkages have in addition to particular, matter-of-fact parameters (quantity and quality) general attributes too, which are responsiveness and copying with changes in business environment.

1. Goal, entity and methods of research

Research goal was to recognise in what scale Slovak enterprises know actual situation and future evolution of their business environment, how react flexibly and quickly toward external changes and after all, in what extent they accomplish to reconceive external opportunities into competitive advantage by that they change themselves within. Internal conditions research of competitive advantage uprise was realised with package of 350 firms in area of Slovakia by questionnaire method. It was executed by fourth class students of Business Management Faculty of University of Economics in Bratislava in a period of October and November 2000. One interviewer evaluated the only enterprise, which visited face-to-face. Choice of firm was free, neither size, no industry limits were set. For support of credibility every question was completed by detailed commentary. After discarding duplicities and inaccuracies the analysed file has got 285 enterprises from 16 industries. The file was embedded in database of Access 97. Results are interpreted as enterprises proportion in % from whole file for which is typical evaluated parameter, or they are expressed in five point scale.

2. Internal conditions of competitive advantage uprise

Formal assumptions for competitive advantage are favourable external and internal conditions [1]. A possibility of competitive advantage creation depends on a size, variability and complexity of external change and on an ability to react to these changes and use them effectively. It means to act sooner, more flexibly, more quickly and more sophistically in comparison with rivals. An enterprise must dispose with one resource which are information, one capability which is flexibility and with an ability to change internally to be prepared within for external change using more effectively than its competitors. Research conception is based on hypothetical existence of a process which begins with acquirement of information and finishes with competitive advantage uprise.

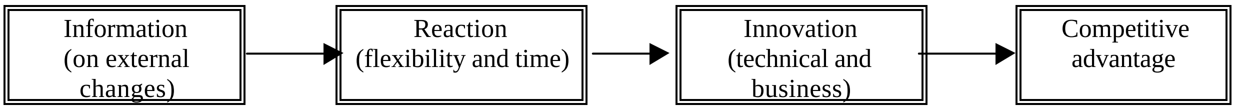

Fig. 1 INFORMATION - REACTION - INNOVATION - COMPETITIVE ADVANTAGE CHAIN

Competitive advantage is being manifested without and its consequence is higher profit rate or higher profit potential than competitive firms achieve. Second-rare earning signalises, that an enterprise has competitive disadvantage, average profit rate is a mark of competitive equality. Till over average profit is consequence of competitive advantage although temporary only and extraordinal profit rate is a proof of a sustainable competitive advantage. As it is apparent of table 1 one fourths of firms have competitive advantage according to earning criterion only, nearly half of them equal themselves their rivals only and 28 % has competitive disadvantage. It is discernible, that competitive advantage is not massive appearance.

Tab. 1 ECONOMIC RESULT

Level	Proportion of enterprises (%)
1. extraordinal	6
2. above standard	19
3. standard	47
4. under standard	9
5. balanced	4
6. modest loss	9
7. striking loss	6

3. Informability about external environment

Responsiveness for external environment was measured through quantity and reliability of information, which enterprises dispose or manage to find out them about their attendance and future in three till five years. Research results are quoted in fig. 2. At attendance from necessary amount of 100 % information the enterprises dispose with 73,02 % information in average for whole file and their average estimated reliability is 76,39 %. Intersection (product) of either data is result of 55,78 %, which can be interpreted, that enterprises receive entirely for a certainty present state of their external environment in few more only, than there is half of all necessary information. Enterprises have got to disposal 52,56 % information in average for whole file about their future evolution in three till five years, which medial estimated reliability is 54,6 %. Intersection of either data is result of 28,7 %. It means that enterprises have got absolutely reliable ideas on level being few higher, than there is one fourths of all necessary information. On base of simplified reflection it can be assumed, that roughly 50 % undoubted and reliable information about present state introduce standard firm from researched file in a situation, when its competitive advantage is a result in equal rate nearly either an occasion or meaningful activity. A reference sample of other similar research although lacks, it can be given out with a big probability, that 50 % undoubtedly information is not enough for gaining a competitive advantage.

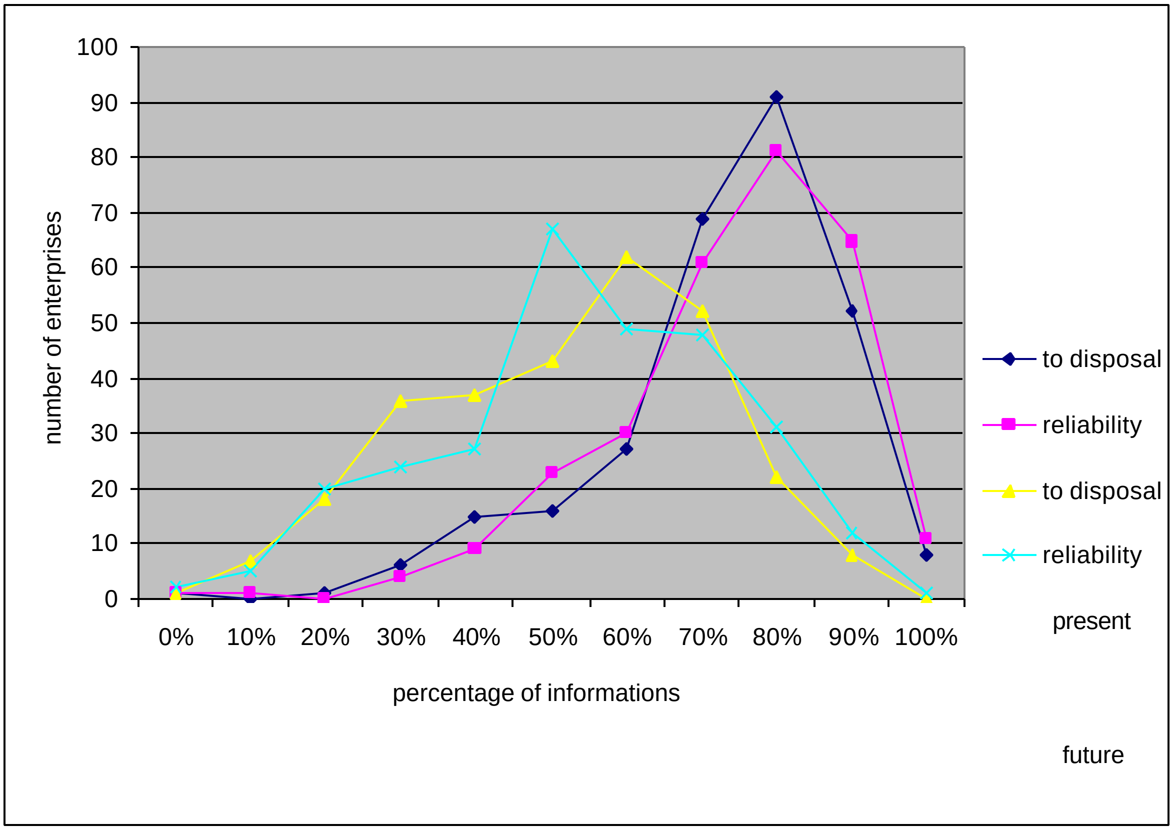

Fig. 2
INFORMABILITY OF ENTERPRISES ABOUT PRESENT AND FUTURE STATE OF EXTERNAL ENVIRONMENT

4. A flexibility of a reaction toward external changes

In according to data in table 2 nearly two thirds of enterprises dispose with lower degrees of managerial flexibility (4 % and 61 %), which hardly give them a hope to gain a competitive advantage. Approximately one third of enterprises appear higher degrees of managerial flexibility (17 % and 18 %), which are an assumption for competitive advantage creation. The only strategic flexibility can be considered as a conditions or a guarantee for long term sustainable competitive advantage.

Tab. 2 MANAGERIAL FLEXIBILITY [2]

Degree of flexibility	Share (%)
Stead-state	4
Operational	61
Structural	17
Strategic	18

Tab. 3 SYSTEMIC FLEXIBILITY [3]

Item	Degree of systemic flexibility and its occurrence in enterprises (%)						
	extreme high 5 points	high 4 points	average 3 points	under-average 2 points	low 1 points	none 0 points	mean points
Technology	7,7	44,6	32,3	8,36	6,0	1,05	3,36
Structure	6,0	36,5	43,9	8,36	4,9	0,35	3,29
Corporate Culture	4,6	28,1	51,9	8,36	6,3	0,7	3,14

Degrees of systemic flexibility, which were measured through a flexibility of technology, organisation structure and corporate culture, are quoted in table 3. Between average values of individual items there are not vivid differences. A suspicion from overvaluation invokes corporate culture. Systemic flexibility is full valuable, when its individual items are balanced and approximately on one level consequently. It is visible from table 3, unnegligible unsteadiness occurs in the first three degrees and this weakens a complementarity of competitive advantage.

5. Internal change potential and its reconceiving into a competitive advantage

In this manner as external environment alternates and a change is an opportunity for gaining a competitive advantage, internal environment should alternate too in order to originate harmony between an external and internal change was converted into a competitive advantage. An ability of enterprise internally to change was measured through a potential for technical innovation creation as a sum of personal and technological resources, which give a possibility to make use of external technical changes and opportunities in extent from 0 % to 100 %. Another measure was a potential for business innovation creation (business strategy originality, new competitive method, new value chain configuration, area for potential business distinction), which means an ability to difference from a competition in extent from 0 % till 100 %. In average for whole file the enterprises manage to make use of external technical changes on 65,33 % and to difference from a competition on 59,4 %. At last a degree of external conditions using and an ability to reconceive them into a competitive advantage was measured. Its average value for whole file is equaled 59,16 %. Histograms of potentials are pictured in fig. 3.

Important there is a comparison of economic result as a real proof of a competitive advantage existence and degree of making use of external condition and their reconceiving into a competitive advantage, which are a belief, whether a scheme burdened by a certain subjectiveness of interviewer and asked person too. Differences between a reality and a belief, which are quoted in table 4, can be probably explained by wrong understanding of competitive advantage. Competitive advantage as a comprehensive phenomenon is often replaced with its components, e. g. cheap labour force or geographical area, which do not manage to create a complete competitive advantage and hence over average profit, if they are isolated and uncomplimentary. Relatively high (modest over average) potentials for creation of technical and business innovation are not unambiguous guarantee fot competitive advantage uprise.

6. Conclusion

A standard enterprise from research file is from point of view of general internal assumptions able to achieve a competitive equality merely. Average or modest over average, over half values prevail in all quoted general parameters. This finding should be a serious warning for Slovak enterprises.

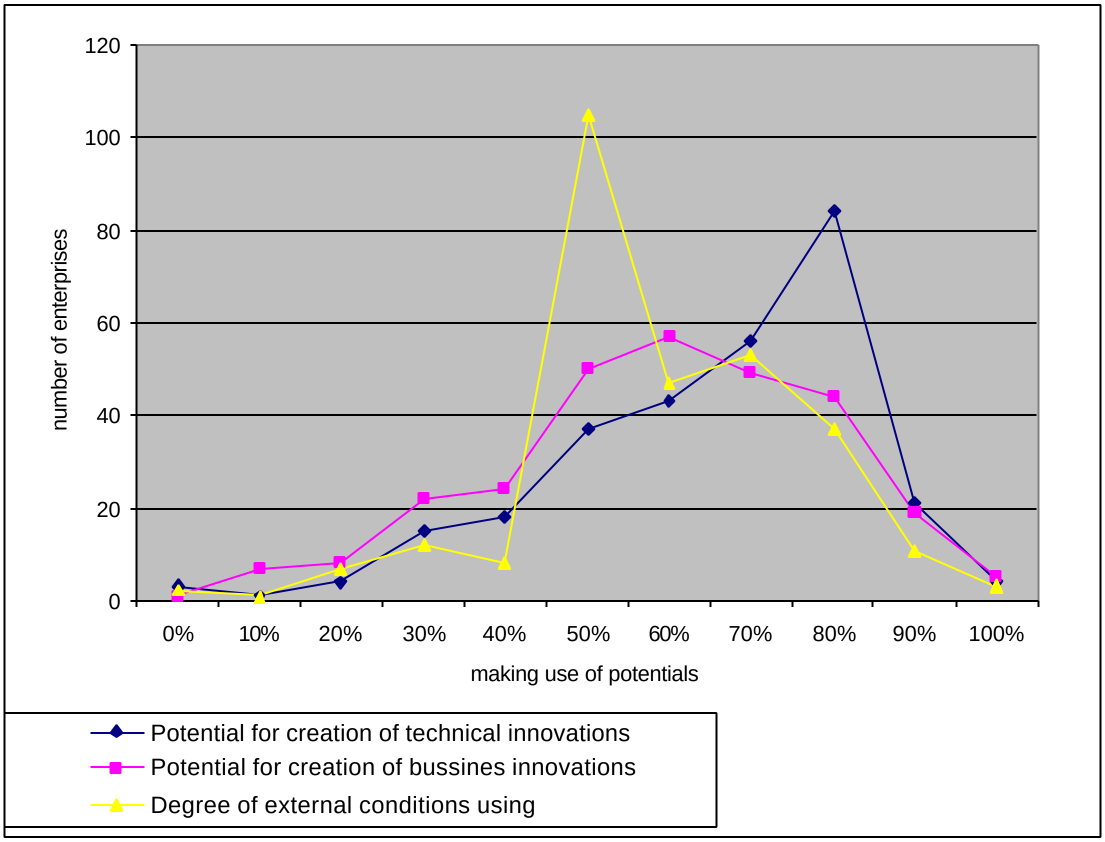

Fig. 3 INNOVATION POTENTIALS

TAB. 4 IMAGINARY AND REAL COMPETITIVE ADVANTAGE
(In this table there are quoted proportions of enterprises from research file, which reach some of competitiveness degrees)

Measuring scale of competitiveness	Belief: Making use of external conditions for competitive advantage uprise	Reality: Economic result	Commentary and difference
Competitive disadvantage 0 - 40 %	10,55 %	under average and worst 28 %	overvaluation in 17,45 %
Competitive equality 50 %	36,7 %	average 47 %	undervaluation in 10,3 %
Competitive advantage 60 - 80 %	47,8 %	over average 19 %	overvaluation in 28,8 %
Extraordinary competitive advantage 80 - 100 %	4,85 %	exceptional 6 %	undervaluation in 1,15 %

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Shares as Securities and Issues of Acquisitions in Capital Market Connected Therewith

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Abstract

The article contains the basic legal information related to securities, particularly the shares, classification thereof, specific properties connected with a golden share, the relationship between the holders of the share and the share itself, joint ownership of shares. Further, it deals with specification of the financial market, the capital market, the basic principles of trading with securities, dealer with securities, broker, agreements on securities, options, futures, order for trade, repo operations. Last but not lease, it deals with division of stock exchanges, the basic types of exchange speculations, public offer for sale of shares, and the position of the Office for Financial Market.

1. The financial market, the capital market, and the securities represent a category affecting, in a material way, the operation of the market economy.

2. The securities are traditionally understood as specific type of property (they represent a property value), and as such they represent the object of legal relations. The very term of „securities“ did not emerge historically as a general term identifying certain property values, on the contrary, the first individual types of securities existed, and subsequently, common characteristics were found. The security as the institute of private law is characteristic by the connection of absolute and commitment (or any other) rights in a single property value, as a separate object of legal relations. The provisions of the Law on Securities (Law No. 600/1992 Coll., as amended, hereinafter referred to as „LS“) do not contain any legal definition of the security, but only a list of types of securities, in the text of the provision of §1 of LS. The security may be understood, in my legal opinion, as certain material substrate, where the subjective law is incorporated (embodied). The fate of such law is irreversibly connected with the material substrate, most often with the instrument.

The basic function of the securities is:

a) transferring function, following from the fact that by transferring the instrument or a record in the statutory register, the rights connected therewith are transferred, too, unless the law stipulates otherwise. In certain forms of certificates, a written declaration of the parties´s will is required, either contained directly in the instrument or in a separate form.

b) guarantee function, following from the fact that the instrument or the record thereof guarantees to the security holder the existence of the right stated in the instrument or in the record thereof, and thus the transferee need not require any other evidence on existence of the given right. This function enhances the legal certainty of the securities in legal relations. Certain modification of the given function is represented by the possibility for the liable person to apply absolute objections to the security holder, i.e. objections against the security as such, as well as the possibility of raising relative objections which are connected with mutual relations connected with the security.

c) legitimate function, following from the fact that the certificate or a records in the statutory register serves as legitimation (authorisation) to exercise the right connected with the certificate or the records. The legitimate function of the security is applied both to the liable person (to such person it is exercised by that the debtor is entitled to refuse fulfilment to anyone who fails to submit the certificate, or fails to prove that he/she is a person listed in the statutory register) and to the entitled person (to such person, the given function is exercised particularly in that the liable person is obliged to fulfil to the entitled person until and unless an evidence is provided that the person furnishing the instrument or the person listed in the statutory records is not the entitled person).

The provisions of the LS divide the securities:

a) according to the form thereof (the provision of §3 of LS) to registered securities (rectapapers), securities to the order (ordrepapers), bearer securities (au porteur papers),

As the criterion for the division is traditionally the manner in which the security may be transferred, and thus the way of determining the person holding the rights connected with the security, i.e. the owner thereof, the legal problem lies in the fact that such division of securities applies also to the securities issued in the book-entry form, even if they do not differ either in the technique of transfer thereof or in the manner of identification of the security holder. From the theoretical aspect, it would be more correct to consider the book-entry securities as a form of securities rather than the type thereof.

b) according to the appearance thereof (the provision of §1(2) of the LS) to:

b1) Security in materialized form. The subjective right is incorporated in the written declaration of the issuer's will – in the instrument. The bearer security in materialized form is characteristic by that the security does not contain the name of its holder, but only the notification „to the bearer ", „for the bearer", „to the holder ", „for the holder", as in case of absence of such notification, the instrument would not represent a security (except for checks). The holder of the instrument is deemed to be the owner thereof, and the rights connected with the bearer security may be exercised only by the person furnishing the instrument. For the security in materialized form to the order is typical that the first person entitled from the security is expressly stated therein, and the rights connected with such security may be exercised only by the person submitting the same and on whose name the instrument was issued or to whom the continuous order of endorsements belongs, unless the law stipulates otherwise. Such person is then considered as a holder of the security, unless the law stipulates otherwise. The rights following from the security to the order may be exercised by the holder thereof, which, however, shall not always apply, as e.g. in case of registered shares, the shareholder's rights connected with such shares may be exercised by a person listed in the register of shareholders. Based on the text of the provision of §18 of LS, transfer of a security in materialized form to the order requires, inter alia, endorsement. Typical for a registered security in materialized form is that the name of the entitled person who is at the same time the holder thereof is stated in the text of the instrument. Only such person is legitimate for exercising the rights connected with the registered security.

b2) Book-entry security (this is a case when the security as the medium of the subjective right is replaced by the entry in the statutory register. (A paradox from the linguistic aspect is the very name of the „book-entry security", because there exists no security at all. It is a certain fiction).

c) according to the other criteria to:

- securities negotiable in public, securities not negotiable in public, securities negotiable with restrictions, non-negotiable securities,

- causal securities (these are such securities where the economic reason is stated), abstract securities (securities, where no economic reasons is stated),

- constitutive securities (issue thereof is a prerequisite for occurrence of the rights connected with the securities), declaratory securities (embodying the right which existed even prior to the issue thereof),

- domestic securities (securities, the issuer of which is a resident, the provision of §2(g) of the Foreign Exchange Control Law No. 202/1995 Coll., as amended), foreign securities (the issuer of such securities is a foreign resident, the provision of §2(h) of the Foreign Exchange Control Law),

- public securities (e.g. government bonds, bonds issued by the National Bank of Slovakia), private securities (the securities which are not public securities),

- securities replaceable (the securities of the same type, issued by the same person in the same form, with pertaining same rights - the provision of §2(1) of LS), securities non-replaceable (the securities which are not replaceable),

- securities issued in a collective form (i.e. issuing replaceable securities, according to the provision of §77(3) of LS, collective issuance of securities means the issue thereof in the aggregate number of no less than 1,000 pcs, while the other statutory conditions must be satisfied, too), securities issued on individual basis (it means the issue on non-replaceable securities).

3. The provision of §1(a) of LS contemplates shares as one of the type of securities. The shares issued by a joint-stock company are, according to the Decision of the Constitutional Court of the Slovak Republic (PL ÚS 38/95 dated April 03, 1996, published in the Collection of Awards and Resolutions of the Constitutional Court of the Slovak Republic under No. 135/1996), understood to be securities with embodied materialized right for certain fulfilments. It is a special type of securities with pertaining shareholder's rights and liabilities. The Commercial Code (Law No. 513/1991 Coll., as amended) uses, in accordance with the above decision, the term „share“ in a triple meaning, i.e. the share as a part of the registered stock capital of a joint-stock company, the share as a security with pertaining shareholder's rights, and the share as the identification of the shareholder's set of liabilities.

According to the type of shares, the shares are divided, according to the relevant provisions of the Commercial Code, into: registered shares (au nom, the provision of §156 of the Commercial Code), bearer shares (au porteur, the provision of §156 Of the Commercial Code), employees shares (the provision of §158 Of the Commercial Code), priority shares (the provision of §159 Of the Commercial Code), collective shares (the provision of §157(2) Of the Commercial Code).

I would like to only briefly mention that fact that while the relevant provisions of the LS qualify the identification of the bearer securities or registered securities as the classification according to the form of the security, the legal theory and judicial practice, in case of the Commercial Code and classification of registered shares and bearer shares, prefers to understand this division according to the type.

In the legal theory, one may find the opinion according to which a special type of shares is represented by the so-called golden share (i.e. the share with pertaining special voting rights in the General Assembly of the joint-stock company). According to the legal opinion of the Constitutional Court of the Slovak Republic, such special rights do not result from any special character of shares, but they are granted as special rights in relation to the person holding the same /PL ÚS 38/95, the Award of the Constitutional Court of the Slovak Republic dated April 03, 1996, published in the Collection of Awards and Resolutions of the Slovak Republic under No. 4/96/. In the said judicial decision, a legal opinion was expressed according to which it does not represent any new type of shares, but the existing form of shares (the given case involved registered ordinary shares), providing to its holders special rights pertaining with them which differ from the rights of the other holders of the same type of shares, and therefore, the Court considered the shares as being discriminating.

The provision of §155(2) of the Commercial Code provides for the requirements for the shares. The share must contain the business name (the provision of §8 *et seq*. of the Commercial Code) and the seat of the company (the provision of §2(3) of the Commercial Code), the number of the share and the nominal value thereof, information whether it is a registered share or bearer share, in case of a registered share it shall contain the name of the shareholder, the amount of the registered stock capital, and the number of all shares in the company at the time of issue of the share, the date of issue, and signatures of two members of the Board of Directors authorised to sign for the company. I believe that this statutory provision on the requirements for the shares may be applied in full only by share certificates. If the shares are issued in the book-entry form, it is necessary to apply the provision of §155(2) of the Commercial Code in connection with the text of the provision §4 of LS, according to which the requirements for securities are stipulated in the law, and the provisions of the special law on requirements for securities shall not apply, provided it is excluded by the nature of the book-entry security. The following legal problem is closely related to the above mentioned. The share may be issued only after establishment of the company, i.e. after incorporation thereof in the Commercial Register, and may be issued only after the nominal value thereof has been paid-up in full. Prior to the establishment of the company, the shareholder may receive a receipt confirming payment of part of the nominal value, and after incorporation of the company in the Commercial Register, the company shall exchange such receipt for an interim certificate and after paying-up the total nominal value of the share (the provision of §168(2) (3) of the Commercial Code). Pursuant to the provision of §5(1) of LS, the security is issued at the moment of satisfying all statutory requirements and when it becomes a property, in the manner stipulated by the law, of the first holder, unless a special regulations stipulates otherwise. As the text of the Commercial Code does not deviate from the quoted provisions, the stipulations thereof applicable for the issue of shares may be considered as supplemented and made more precise, and it is logical that also the other conditions specified in the text of the provisions of the

Commercial Code must be satisfied, too. If the date of issue is to be shown in the share, and if all shares are printed in advance, it means that it is necessary to determine in advance the moment of the issue of shares, which seems to be rather problematic. The above may be closed by stating that the date of issue of the shares is appropriate and applicable for those securities which are issued on individual basis, but the application thereof to the collectively issued securities is complicated. Collective issue of replaceable securities is stipulated in the text of the provision of §77 of LS, and the provision of §76 of LS stipulates additional requirements for securities, supplementing the text of the provision of §4 of LS. However, the difference in determination of the moment of issue is not provided for, and thus stating the date of issue, as stipulated in the text of the provision of §155(2) of the Commercial Code, seems to be hardly realizable.

In respect of identification of the holder of the shares I may state that while the text of the provision of §157(2) of the Commercial Code provides for the „holder of a collective share ", the provision of §158(4) of the Commercial Code for a „holder of an employees share ", the provision §161(1)(a) of the Commercial Code contains the term „the person who owned ..... the shares", the provision of §161(3) of the Commercial Code for „.the sole holder ... of the shares", of §7 and §8(3) of LS provide for a „holder of security". From the above examples it is clear that in the Commercial Code, the most frequent term used in connection with the relation between the holder of the share and the share is the term „holder of the share", and for the given relation, in the context of the provisions of LS, the most frequently used words are the „holder of the security". By applying the method of grammatical interpretation of the legal norm, i.e. that the words, expressions and terms used in the text of the legal norm should be understood in such meaning which they have in the general base of the official language, unless there exist any legally relevant reasons (given by a special statutory interpretation of a certain term different from that which arises from the general base of the official language) in order that any other different meaning of the contents thereof be adopted as the basis for interpretation thereof. The Commercial Code does not provide for any special interpretation of the terms stated in the text of the provisions of §158, §159, §161 of the Commercial Code, and based on the grammatical interpretation of the term „holder of the share", we may speak about the holder of the share or the holder of the security. The legal conclusion in the preceding sentence may be supported also by the legal statement of the Commission of Human Rights in case of the complaints 3039/67, 5479/72, 8588/79, 8589/79, which considered the relation between the holder of the share and the shares as the ownership relations, as well as the decision of the Constitutional Court of the Slovak Republic (PL ÚS 33/95, Resolution of the Constitutional Court of the Slovak Republic dated November 29, 1995, case No.: II. ÚS 136/95, published in the Collection of Awards and Resolutions of the Constitutional Court of the Slovak Republic under No. 33/95), according to which the „coupon holder" is the owner thereof. Based on the above mentioned it may be stated that the relation between the shareholder and the share may be considered as the ownership relation. The contents of the ownership title to the shares are represented by the rights stipulated in the provisions of the Commercial Code, specifically the right to participate in control of the joint-stock company (e.g. the provision of §155 of the Commercial Code), to share in the profit of the joint-stock company (e.g. the provision of §155, §178 of the Commercial Code), the right to share in the liquidation assets of the joint-stock company (the provision of §155 of the Commercial Code in conjunction with the provision of §179(3) of the Commercial Code). As a matter of complex information it is stated that the provisions of the Commercial Code do not provide for the ownership relation between the holder of the shares and the share on complex basis, and therefore pursuant to the provision of §1(2) of the Commercial Code, also the relevant provisions of the Civil Code (Law No. 40/1964 Coll., as amended) must be applied to the given relation.

The share has its nominal value which must be specified in the company's Articles of Association, in the form of a whole positive number (the provision of §157(1) of the Commercial Code). Pursuant to the provision of §6(1) of LS, the nominal value of a security is the financial amount which is stated in the face thereof. I am of the opinion that such definition may be used only for a security in the form of a written instrument because the book-entry security is issued in the form which cannot show the nominal value of the security. Based on analogy it may be stated that the nominal value of a book-entry security represents the amount stated in the issuer's register and in the account held in the statutory register. The sum of the nominal values of the shares must correspond to the amount of the company's registered stock capital. The price of the security means the price of the security determined and published by the organizer of the public market in the procedure specified in the stock exchange rules. The issue price of the security means the cash amount for which the security is issued by the issuer (the provision of §6(2) (3) of LS). The actual value of the security means the price thereof determined according to the rules set out in the text of the provision of §6a) of LS.

The share may be in the joint ownership of several persons, and the provisions of the Commercial Code do not allow any of the joint holders to exercise the rights connected with the share without agreement with the other joint holders. If such agreement among the joint holders exists and is valid, then there is no reason for any of the joint owners to exercise the rights connected therewith, while a solution would be designation of a common proxy. The provisions of the Civil Code on joint ownership must be analogically applied to the mutual relations among the joint holders of a security. If the book-entry securities are in the ownership of several persons, the Securities Center of the Slovak Republic, a.s. shall register, in the account of each of the joint holders the names of the other joint holders, the amount of their shares, the name of the person authorised to exercise the rights connected with the share, and the scope of such authorisation (the provisions of §59(c)(3) and §59(d) of LS.

4. The term „capital market“ is frequently used in the legal system of the Slovak Republic, however, it is not defined therein, and therefore the specification thereof is based on economic science. The economic interpretation of this term is not unified, however, in spite of differences; it may be understood as one of the segments of the financial market. The financial market must be understood as institutionally organized purchase and sale, motivated by money, the basic task of which is to create a mediating mechanism between financial investors and the persons interested in temporary free funds. From the above mentioned it is clear that the basic mark of the financial market is the existence of financial surplus on the side of the surplus entity and deficiency of funds on the side of the deficit entity. The function of the financial market is first of all the possibility of re-distribution of any free funds from the surplus entity to the deficiency one, and allocation thereof in places where the use thereof is most effective (this is accomplished by accumulation of funds, i.e. mobilization from available resources, allocation thereof – placement of funds, re-distribution thereof, selection of viable and prospective entities, speeding-up dissolution of non-prospective and non-viable entities, stimulating the pricing which is modified by demand and offer). In order to fulfil such function, there exist many institution and instruments of the financial market. The financial market may be understood as a system of institutions and instruments of the financial market, ensuring circulation of money and capital in all forms between various economic entities, based on demand and offer. Operations in the financial market are performed directly (i.e. by issue of governmental bonds and purchase thereof directly by investors), indirectly (via dealers, e.g. stock exchanges, banks, etc.), while the basic effort of the investor is to maximize the yields, maximize the liquidity and minimize the risk. It is impossible to achieve such ideal state because the individual criteria exclude each other. Therefore, the investors´ effort is aimed at achievement of a status of optimum ratio among the quoted criteria. The essence of investing in the financial market represents abandonment of today's certain value in favour of uncertain future value.

The financial market is divided, according to dependence on the characteristics of marketable funds and the term of maturity of claims and needs of the groups, into the financial market (this is the market determined for circulation of short-term financial documents, whose the term of maturity does not exceed one year, e.g. notes, checks), capital market (the system of instruments and institutions ensuring circulation of medium- and long-term capital between economic entities via various forms of securities), foreign-exchange market (it deals with foreign-exchange denominated in various currency), market of precious metals including trade with gold, silver, platinum and other precious metals, and the insurance market dealing with insurance and reinsurance. The capital market is divided into primary market (dealing with new issues, both the issue itself and acquisition thereof by the fist investor) and the secondary market dealing with already issued securities, and thus changing the holders of securities. The instruments of the capital market are mainly the securities (particularly shares, bonds, units). The operation of the capital market is not entirely left to free development. Regulation of the capital market means direction thereof, which has legal and non-legal character. The non-legal regulation is represented by a system of ethical rules, being observed by the engaged entities on voluntary basis. Observation thereof is in the interest of the given entities, while otherwise the voluntary observation of such rules would be virtually nil. In the countries with advanced capital markets like U.S.A., United Kingdom, the so-called self- regulatory organisations have great importance, including especially association of dealers with securities, etc. The task of these organisations is to create authoritative rules binding for their members, violation of which is subject to penalty. Creation of ethic rules based on being observed on voluntary basis is not sufficient in respect of the capital market, and therefore there exists a legal regulation of the capital market. The above is supported also by the fact that the capital market stands and falls on credibility of the entities operating therein, first of all the investors. The legal regulation of the capital market may be divided to preliminary one (it includes particularly restrictions for performing certain activities in the capital market, thus affecting the structure of the capital market. The above shall allow entry to the capital market by a person satisfying certain conditions, thus assuring professionalism of the capital market, however, this measure limits the competing milieu of the capital market), subsequent one (this includes control of observance of the rules and conditions determined for the capital market), and continuous one (affecting behaviour of entities having achieved access to the capital market).

5. Trading with securities means, according to the provision of §8(1) of LS, a business the object of which is purchase or sale of securities, or procurement of purchase or sale of securities. Trading with securities does not include organisation of the market with securities. In purchase and sale of a security, the dealer with securities concludes, in his own name and on his own account, two purchase contracts: one with the person from whom he purchases the security or who sells the security, and the other one with the person for whom the security is purchased or on behalf of whom the security is sold. In procurement of purchase or sale of a security, the dealer with securities enters with the person for whom the purchase or sale of securities is procured into a commissioning agreement, a mandate agreement, and an agreement on mediation of purchase or sale of the security. Subsequently, the dealer with securities shall enter with the person from whom the security is purchased or who sells the security into a purchase contract according to the type of the contract concluded between the dealer and the person for whom the purchase or sale is procured, either in his own name or on behalf of such person (cf. the text below). Public trading with securities means trading with securities in the stock exchange (it is a public market), and the natural or legal person may buy or sell securities negotiable in public only in the public market according to the provisions of the LS. The holder of the security negotiable in the public market cannot be changed in any way other that by a deal concluded in such market, save for deals with securities performed by the National Bank of Slovakia in order to direct the money market according to special legal regulations, and save for free-of-charge transfer and conveyance of a security. Purchase or sale of a security may be procured only by the person holding a license for such activity according to the relevant provisions of the LS, and according to the provision of §8(4) of LS, the contract on procurement of purchase or sale of a security must be made in writing. According to the provision of §45 of LS, deals with securities may be performed only by a legal entity established in a legal form of the joint-stock company with the minimum registered stock capital in the amount of SKK 5,000,000, holding a license for such activity granted upon a written application by the Office for Financial Market (hereinafter referred to as „Office“). It is stated for information only that the new bill on securities stipulates the minimum registered stock capital in the amount of SKK 35,000,000, SKK 6,000,000, and SKK 2,500,000 depending on provided investment services and disposal of the funds or investment tools of the client. A dealer with securities may be, according to the provision of §45a) of LS, also a branch office of a foreign legal entity which must satisfy also additional statutory conditions. In relation to the investors, the text of the provision of §48 of LS is interesting, stipulating withdrawal of the license for trading with securities in cases specified therein. Even if the legal regulations do not stipulate it expressly, I am of the opinion that from the nature of the matter it follows that the dealer with securities is authorised to complete any concluded deal, as otherwise he could not be released, in relation to his clients, from the liability for e.g. any delay, even if on the other hand it is indisputable that the legal person is no more authorised to perform such activity in case of withdrawal of the license for trading with securities.

From the text of the provision of §49 of LS it follows that the dealer with securities performs professional trading activities according to the provisions of LS always via a natural person holding a license granted by the Office (hereinafter referred to as the „broker“). The broker acts on behalf of the dealer with securities, even in case the broker is in any relation with the dealer other than employment. The broker may act only for one dealer with securities. The broker may but is not obliged to perform the activity specified in the preceding text via an agent who may be only a natural person, who is of good character, is fully capable to do legal acts, and the agent shall act only according to the broker's instructions.

6. As mentioned above, trading with securities is the activity stipulated in the text of the provision of §8(1) of LS, which is closely connected with the legislation applicable for contracts on securities, as stipulated in the text of the provision of §13 et seq. of LS. Contracts on securities are divided into a contract on securities (including a contract on transfer of securities for consideration, named also a contract on purchase of securities, and it is subject, save for special regime provided in the provision of LS, to the provisions on purchase contract according to the Commercial Code), a contract on free-of-charge transfer of securities, which is subject to the legal regime of a deed of donation in the Civil Code, an agreement on procurement of purchase or sale of securities (commissioning agreement, mandate agreement, agreement on procurements of purchase and sale of securities), an agreement on custody, management, and deposit of securities, pledge over securities. A valid contract of purchase of securities shall require, in addition to general requirements, also specification of the transferred securities and the purchase price thereof (unless the contract either meets such requirements or unless such requirements are specified with certainty later, such contract shall not exist). Without specification of the purchase price, the given contract is valid in case the parties express their wish to conclude the contract without such specification, and it is interesting that such expression of the will does not require a written form, and thus proving the existence thereof is problematic. Even in such case the buyer is liable to pay the purchase price, and determination of the amount thereof is stipulated in the text of the provision of §13(2) of LS. If no purchase price is paid, the case would represent a free-of-charge transfer of securities. In the contract on transfer of securities, whether for a consideration or free-of-charge, the rights and liabilities may be bound to the condition precedent, i.e. expression of a will by either of the parties that it insists on the concluded contract (option right), or the condition precedent, i.e. expiry of the period between the execution of the contract and performance of the contract (futures). The option deal means a contracts with agreed right of option for a consideration. In case of agreeing on the option right in an executed contract, the buyer or the seller shall have the right but not the obligation to purchase or sell securities which are the object of the contract, for the price specified in the contract. If the option right belongs to the buyer, i.e. purchase (call option), the person entitled to the agreed option (option holder) shall have the right to purchase, within the determined period, the security to which the option applies, for the specific price, from the person with whom the option right was agreed (option seller), however, he shall have no obligation to purchase the securities. In case the option is held by the seller, i.e. option for sale (put option), the option holder has the right to sell, within the determined period, the securities to which the option applies, for the specific price, however, he has no obligation to sell the securities. The option right may be agreed in such manner that it may be exercised any time during a specific period (American way), or so that it may be exercised only on a specific date (European way). The position enjoyed by the option holder is called a long position, as this person has the right to elect exercise of his right, and the position of the option seller is identified as close or short position, as it depends on a decision of the option holder. Options are divided into option for shares, indices, foreign exchange, etc., while the most frequent ones are the options for shares. Two groups of option deals are differentiated, namely speculative and hedging ones. The aim of the former is to achieve profit, where small investors buy options in the market without being interested in the purchase of shares, and their objective is to make profit from changes in the prices for shares. The aim of hedging deals is to reduce the risk of trading with shares. They are used especially for protection of the portfolio against losses incurred by fall in prices of shares. In that case, the investor abandons, on voluntary basis, certain part of his revenues in order to minimize the risk. The positions of call options and the price of shares move in the same direction. The ratio of the number of shares which must be observed per one option in order to protect the share against the floating price thereof is described as the hedging ratio which is changed in each material change in the price of the share. The hedging bears no risk only in case of small changes in prices of shares, because the possibility of severe changes in prices of shares which cannot be included in hedging results in the high risk rate of this form of option deals.

The basic option strategies are:

- sale of call option (the sale of call), when the investor expects a falling price of the shares, and if the price of the shares falls to zero, the investor shall earn only the premium, i.e. a consideration for realization of the option, however, if the price of the shares starts to rise, the risk of loss is unlimited),

- sale of put option (the sale of a put, when the investor expects a rising price of the shares. The investor achieves profit when the price of the share remains the same or when it rises, however, he bears unlimited risk in case of falling price of the shares),

- buying of call option (call option buying, where the investor expects rising prices of the shares, and he need not pay the full price for buying the call option, as he only pays a premium for taking the position. If the prices of the shares rise, he shall make profit also as a holder of the shares, but his profit shall be reduced by the amount of the paid premium. The risk of loss depends on the amount of the premium, which is advantageous as compared with possession of the shares, as in case of possession of the shares, the investor loses his total initial investment),

- buying of put option (put option buying, which is an alternative of sale of shares, and it is applied in case of estimated fall of prices. The difference lies in that as compared with the put option buying, the investor abandons a part of profit due to limiting a loss connected with rise of the prices of shares. The amount of the limited loss is equal to the amount of the paid premium),

- buying of straddle (straddle, accounting for deviations in the price to the positive and negative direction from the realization price, being the price paid by the party in the option in exercising his right, and it is specified in advance by the stock exchange),

- buying of butterfly (butterfly, estimating that the prices of shares in the future shall neither rise not fall too much. He incurs a limited loss, small initial investment and profit, even if the limited one is higher than the possible risk),

- buying of condor (it is a combination of the strategy of positive and negative price spread in high fluctuation of the prices of shares upwards and downwards, as compared with the realization price thereof).

A future means a contract on sale of securities, under which the transfer of securities is to be effected after execution of the contract within the period longer than 15 days. Both option deals and futures may be concluded only for those securities which are negotiable in the public market. Unless the seller transfers the security to the buyer within the agreed period or unless such period is agreed within 15 days of execution of the contract, or if the buyer fails to pay the purchase price remains outstanding, the contract shall be deemed to be materially violated with the consequences described in the text the provision § 345 of the Commercial Code. However, such consequences need not occur when the contract provide, in given cases, for some other applicable solutions. What concerns the very transfer of the security, in case of a security in materialized form, the obligation of transfer is accomplished by delivery thereof to the transferee (transfer of a security in materialized form issued to the order shall require endorsement and a written form of the contract). In case of transfer of a book-entry security, the obligation is fulfilled by registration of the right by the Securities Centre of SR, a.s., upon the instruction for registration of transfer of the book-entry security, provided the transferred security corresponds to the contract. The instruction for such registration means making a record in the statutory register according to the provision of §1(2) of LS, by debiting the transferor's account and crediting the transferee's account, and effecting both records as of the same date. In case the purchase or sale of the book-entry security was procured by a dealer with securities, such instruction shall be given by such person without undue delay (the provision of §23 of LS). Both in the case of a book-entry security and in case of transfer of a security in materialized form, the legal prerequisite of transfer is a valid contract. Even if the law does not expressly require a written form for transfer of a book-entry security, it may be recommended in order to achieve legal certainty.

The first of the forms of contracts on procurements of purchase and sale of securities is a commissioning agreement on procurement of purchase and sale of security. According to the provision of §28 of LS, the agent agrees in such agreement that it shall arrange, in his own name, for the principal and on principal's account, purchase or sale of securities, or that the agent shall perform activities in order to achieve such aim, and the principal agrees to pay a consideration. The provisions of LS contain specific requirements for the given type of agreement, but otherwise the provisions of the Commercial Code on purchase contract shall apply. If the principal instructs the agent to procure sale of a security, the agent may require that in case of a security in materialized form, such security be delivered by the principal, or in case of a book-entry security, suspension of the right to deal with such security be registered in the Centre. The provisions of LS do not describe the procedure of transferring a security in materialized form issued to order under the commissioning agreement. Such transfer could be effected by endorsement to the agent, and to agree, in the commissioning agreement, on a return transfer, should the intended sale not be realised (however such procedure is not in accordance with the text of the provision of §32(1) LS), or execution of a Power-of-Attorney for the agent to execute the endorsement (in usual conditions, such procedure is problematic from the aspect of future evidence of continuous list of endorsements, representing the basis for proving the ownership title to the security, or the necessity of permanent attachment of the Power-of-Attorney). The fact that the above solution is not practical leads to the idea that a part of the agent's authorisation to execute the endorsement may be directly the principal's signature in the place specified in the endorsement, and the additional text of the endorsement would be filled-in by the agent (however, there is a problem that in case of sale of securities by an agent, blank endorsement will most probably not be accepted due to the type of the transferred security). A contract on sale of securities may be concluded; where the principal shall agree in the commissioning agreement that he shall execute the necessary endorsement. I am of the opinion that neither of the above solutions is ideal and the above mentioned case deserves a separate legislation, however, I consider as the least controversial solution to be the one of executing the endorsement by the agent under properly granted Power-of-Attorney. The prepared bill on securities does not resolve the above problem. The securities in materialized form delivered to the agent for sale are in the ownership of the principal, until they are acquired by a third person. The security in a materialized form procured by the agent for the principal shall be transferred to principal's property on the date of delivery thereof by the agent, and the agent is liable to act in this way without undue delay after payment by the principal of the price for the purchased securities, and the consideration. The liability described in the previous sentence shall apply to the agent, provided he is liable to deposit the securities for the principal. Even if the provision of LS does not expressly provide for transfer of book-entry securities to the principal's property, in view of the character of the book-entry securities, analogy with the procedure described above is out-of-question, and the securities have to be transferred from the account or to the account of the principal. The agent is authorised to file the instruction for registration of transfer, and such authorisation shall be proved by the commissioning agreement or by the instruction for procurement of purchase and sale of the security.

Additional forms of the procurement contract include a mandate agreement, agreement on mediation of purchase and sale securities, and in both the above types, the text of the provision of §33(3) of LS refers to the legal regime of the relevant provisions of the Commercial Code. Under the mandate agreement on procurement of purchase and sale of securities, the agent agrees to purchase or sell, on behalf of the principal and on his account, the securities according to the principal's instructions, or that the agent shall perform activities in order to achieve such aim and the principal agrees to pay a consideration therefor. Under the agreement on mediation of purchase and sale of securities, the agent agrees to develop activities aimed at providing occasion for the principal to sell or buy securities, and the principal agrees to pay a consideration therefor. Under another type of contract – agreement on deposit of securities, the depositor agrees to take over a security to be deposited in a separate deposit (deposit of a security in materialized form of a single principal, separately from the securities in materialized form of any other principals, and the depositor is liable to deliver to the principal the same security in materialized form) or to a collective deposit (collective deposit of the principal's replaceable security with replaceable securities of any other principals, and the depositor is liable to deliver to the principal a replaceable security, and the principal is not entitled to receive the same security deposited by him) and the principal agrees to pay a consideration therefor. This is a type of contract for consideration, and if the parties agree of performing the given legal act free-of-charge, they shall be deemed to have concluded an innominate agreement. Only for information I state that in case of collective deposit there is a problem of who is the holder of the deposited securities, as the current legislation does not provide for solution of such problem. The prepared bill on securities shall resolve the problem in that the replaceable securities in collective deposit shall represent a joint property of the principals, and the share of the principals shall correspond to the ratio of the aggregate nominal value of the replaceable securities deposited by him in the collective deposit to the aggregate nominal value of all replaceable securities in the collective deposit.

Under the agreement on management of securities, the manager agrees that he shall perform, during the existence of the agreement, all legal acts required for preservation of the rights connected with certain securities, and the holder of security agrees to pay a consideration thereof. The manager may only be a dealer with securities holding such right from the license to act as a deal with securities. From the wording „...all legal acts..“ it is sometimes derived that it is not possible to agree on certain legal acts only, and that it is not possible to exclude some legal acts. In practice, such procedure is rather frequent, and therefore it may be considered as admissible, which is indirectly proved by the text of the provision of §36(3) of LS. In case of a different legal opinion, the legal conclusion is execution of an innominate agreement according to the provision of §269 of the Commercial Code, and not the agreement on management of securities. The agreement on deposit of securities contains the depositor's obligation to take over a security in materialized form for deposit and management, and the principal agrees to pay a consideration therefor. The depositor may only be a dealer with securities, holding such right according to the license to act as a dealer with securities.

The dealer trades in the stock exchange not only on his own account but also on the accounts of his clients – investors, because only the dealer may enter the stock exchange. The investor may request the dealer to trade with securities in his name on the investor's account, and such deals shall be performed according to the investor's orders. The most frequent order is the market order – (the order to buy or sell certain number of securities for the best price), day order (valid one day, and if the dealer with securities fails to realize such order on that day, it shall be null and void without further action), limit order (determining the limit price of the security, and the dealer with securities cannot realize the deal beyond the stated limit), the order “good till cancelled” (which shall apply unless and until cancelled by the investor), the order „fill or kill“ (it is immediately valid, and if the dealer with securities fails to realize it immediately, it shall be automatically null and void), the order “on the books” (which means that the investor shall determine the price for which he wishes to buy securities and the dealer with securities may realize purchases only for the determined or lower price), the order “stop loss” (when the investor determines the minimum price of the security. If the price falls to or under the determined price, the dealer with securities starts selling the securities). Operations with securities are related to the repo operations. These represent situations when the security holder transfers the security to another person providing funds to the holder, and such person agrees to re-transfer the securities to the original holder upon request or within a determined period, against payment of the agreed amount. The repo operation always involve a mixed contract, as it represents sale of securities with agreed right of re-purchase for a consideration (the seller re-buys the securities for the price lower than the price for which they were sold) and at the same time a loan operation (the lender provides to the borrower funds, and the borrower agrees to repay the loan within the agreed period or within the period specified by the borrower. Repayment of the loan is secured by security transfer of securities). In the legislation of the Slovak Republic, the repo operations are not specifically stipulated, however, according to the essence thereof, they are closed to loans secured by security transfer of securities.

The stock exchange forms an inseparable part of the capital market. Modern stock exchanges go back to the year 1608 and the establishment of the Amsterdam stock exchange. According to the type of commodity, stock exchanges are divided into monetary ones (matching demand and offer of capital), commodity ones (trading with commodities represented by samples), service ones (services mean e.g. contracts on operation of ships, aircraft, etc.). The stock exchange is the organizer of the public market (the provision of §50 of LS, §1 of the Law No. 330/2000 Coll., hereinafter referred to as the „Stock Exchange Law“), it is authorised to organize, in the determined place and in determined time, demand and offer of securities, to perform the activities according to the Stock Exchange Law, to make deals with options, deals with other similar financial instruments, and to perform the activities connected therewith according to the Stock Exchange Law. The procedure in organizing demand and offer of securities, and the terms of trading in the stock exchange are stipulated in the stock exchange rules (the provision of §15 of the Stock Exchange Law). An exchange deal means purchase and sale of a security in the stock exchange in the time and in the place determined by the stock exchange rules. Only the members of the stock exchange may trade therein (a legal person authorised to deal with securities, which has been granted a license by the stock exchange to trade in the stock exchange) and the National Bank of Slovakia. In the exchange deal, all parties therein have equal rights; all of them must have available, at the same time, equal information important for development of prices of securities. The parties in the exchange deal must not conclude any exchange deals aimed to detriment of third persons, particularly any exchange deals the purpose of which is to achieve such price of a security which does not correspond to the current demand and offer in respect of the given security. The stock exchange organizes trade with securities in the market of listed securities, and in the free market of the stock exchange; acceptance of a security to the relevant market is subject to satisfaction of special conditions of the issuer and the security (this shall not apply for governmental bonds). In the stock exchange, foreign securities may be traded, too, provided they fulfil additional statutory conditions. A security negotiable in public is such security which has been accepted to the market of listed securities of the stock exchange, upon an application filed by the issuer of the security, which shall contain a listed prospectus of the security (the provisions of §71 of LS, §21 of the Stock Exchange Law). To the free market, the stock exchange is authorised to accept any security even without an application. The security accepted to the market of listed securities of the stock exchange must not be accepted to the free market of any other stock exchange, however, such security may be accepted to the market of listed securities of several stock exchanges (the provision of §23(7) of the Stock Exchange Law). I find the wording of the provision of §23(7) of the Stock Exchange Law as ambiguous because it is not clear whether it may occur at the same time (i.e. simultaneous acceptance of the security to the listed markets of securities of several stock exchanges) or whether it may occur subsequently (i.e. the security has been accepted to the listed market of securities of a stock exchange, and subsequently it shall be accepted to another listed market of securities).

The wish expressed by the issuer, addressing uncertain group of person unidentified in advance for the purpose of announcement of conditions applicable for acquisition of shares issued by the issuer represents a public offer. In the public offer of sale of shares, the shares are offered directly to the public or are sold to an agent who shall subsequently offer them to the public. The public offer of shares has the character of sale for a fixed price (the issuer shall announce the number of shares and the fixed price). The issue is successful in case of excess demand for shares, which means that the demand exceeds the offer, the price for the shares is too low, which means loss for the issuer, a for the investor it means the opportunity of quickly selling the shares and earning a profit from the differences in prices), tender (this is a public tender where only the lowest price is specified and the investor bids a higher price), auction where shares are sold in the form of auction, and they are acquired by the investor with the highest bid. The basis in speculative exchange deals is the investor's effort to find securities which are not evaluated accurately, their actual value differing from the market one. There exist speculations for rise in prices (a la hausse, when the investor seeks for the moment when the security is undervaluated and the actual value is higher than its market price. In such case, the securities should be purchased and then sold for higher price) and speculation for drop in prices (a la baisse, which means sale of a security at the moment when it is overvaluated).

The issuer must not, in promotion of the issue of its securities, use any untrue or misleading information, or hide any facts important for making a decision on acquisition of securities, e.g. offering any benefits reliability of which cannot be ensured by the issuer, state any false information on its economic situation, etc. The dealer with securities is liable to execute the order of its clients with due diligence, and must not prefer any deal on its own account. Important protection for investors and operations performed in the stock exchange is provided by the text of the provision of § 79(3) of LS, according to which any person participating in the activities of the Centre, the organizer of public market, the dealer with securities, as well as the organizer of the public market, the dealer with securities, the broker and their employees, and the Centre's employees are liable to keep confidential all information obtained in their positions and which are important for development of the financial market or affect the interests of individual participants.

The legal position of the Office is stipulated particularly in the provisions of the Law No. 329/2000 Coll. (hereinafter referred to as the “Law on Office“). The Office is a governmental authority for capital market and insurance business, it is a budgetary organisation. It performs governmental supervision, *inter alia,* over the capital market, it decides on the rights and legally protected interests and liabilities of legal entities and natural persons in respect of capital market, it co-operates with the Ministry of Finance of the Slovak Republic in creating and executing the financial policy, particularly in preparation of the analysis of development of the capital market, in preparation of the concept of development of the capital market, in preparation of generally valid legal regulations in capital market and in the extent stipulated in the Law on Office, it co-operates with foreign supervising authorities responsible for capital market. According to the provision of §28(2) of the Stock Exchange Law, the Office performs governmental supervision over the stock exchange, the members of the stock exchange, the authorised person and over persons accounting and settling exchange deals. The Office may control compliance with the Stock Exchange Law and other generally valid legal regulations, control compliance with the conditions of licenses for organisation of the public market, control exchange deals, etc. The means of remedy, if any, include particularly measures for remedy of defects, fines, limitation or suspension of the license for organisation of the public market, withdrawal of such license, etc. If the Office finds out that the stock exchange violates, in a material way, the provisions of the Stock Exchange Law or the stock exchange rules, and losses are threatening (threatening loss is sufficient, and not occurrence thereof, and the law does not provide further details on what a loss is), it may but is not obliged to withdraw the licenses granted to the Board of Directors of the stock exchange and the General Manager, as stated in the provisions of §9(1), §12(3) of the Stock Exchange Law, and at the same time it shall appoint an authorised person who shall act on behalf of the stock exchange and shall be responsible for management thereof until election of new members of the Board of Directors of the stock exchange and appointment of a new General Manager of the stock exchange. In relation to public property, the Office performs governmental supervision over trading with securities, the issuer of a security negotiable in public, the Centre, the organizer of the public market, the dealer with securities, the broker, and the operator of a printing house of securities. The object of the said governmental supervision is compliance with the mandatory conditions set out in the licenses, as enumerated in the law (the provision of §83(1)(a) of LS) and compliance with the provisions of LS and special laws, in the extent arising therefrom, as well as those legal regulations and measures which have been published by the Ministry of Finance of the Slovak Republic. In performing governmental supervision, the Office imposes measures for remedy and fines.

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The Financing of Small and Medium-sized Enterprises in the Context of the Czech Economy

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Abstract

Small and medium-sized enterprises (SMEs) represent a significant potential for every economy. However, they often suffer from less trust by potential investors and thereby incur problems with the financing of their entrepreneurial activities. This contribution is concerned with the availability of individual financing sources for SMEs in the Czech Republic, and the exploitation of such resources. It is equally oriented to the analysis of the costs of individual financial resources as one of the significant factors influencing the competitive ability of enterprises.

This contribution contains the attitude of (Czech) managers of enterprises to the question of the financing of their enterprises, the results of which were ascertained on the basis of a questionnaire-based research study conducted in December, 2000.

Small and Medium-sized Enterprises (further only SMEs) represent a significant potential for every economy. In the Czech Republic, their share of GDP creation is near-on fifty percent.

In various countries the definition and delimitation of SMEs is related to differently sized firms. In the Czech Republic, the definition of SMEs is established according to the criteria in use in the area of the European Union: "Small and Medium-sized Enterprises are defined as those enterprises, which have less than 250 employees, (and whose) annual turnover does not exceed forty million Euros, or else, whose overall equity does not exceed forty million Euros."

The question of both short-term and long-term financing is one of those problems, which has to be resolved by the management of all enterprises. With small and medium-sized enterprises, the situation is often complicated by a worsened access to the sources of financing, caused especially by the greater risk to which potential investors prepared to provide such resources are exposed. This increased risk is linked to a usually minor market share, frequently with only limited or regional reach, a greater volatility in their profitability, occasionally even with the brief historical existence of the firm, and such like. In the face of the increased level of risk confronted by the investor, then requires a commensurately greater return on his investment. For it to be rational to acquire more expensive (financial) resources then, the return on investment from the conduction of business with the assets, which were acquired with these money, must be higher than is the price of these resources. Concurrently, the enterprise must watch over its liquidity, so as not to lose its suppliers while at the same time being able, given the conditions prevailing on concrete markets, to provide credit to its customers.

In December 2000, the Faculty of Management and Economics of the Tomas Bata University in Zlín carried out a questionnaire-based research study of SMEs. 109 firms of up to 250 employees were approached. One of the many areas, with which the research questionnaire concerned itself, was the problem faced in the financing of SMEs. The questionnaire was so constructed as to contain "open" questions, "closed" questions as well as evaluative scaled or rated questions.

In view of the fact that enterprises of the dimensions of 1 – 250 employees have markedly differentiated characteristics, certain questions contained in the questionnaire-based research study were evaluated on the basis of their being divided into the following groups:

1. Enterprises up to 10 employees (micro-enterprises). In total, there were 10 such enterprises, with an average of 6 employees.
2. Enterprises with 11 – 50 employees. 40 such enterprises were approached, with an average of 22 employees.
3. Enterprises with 51 – 250 employees, which still met the criteria set for medium-sized businesses for the purposes of being able to use the business support services. 59 such enterprises were approached, thus this was the most numerous group. They had an average of 112 employees.

Replies to the question, as to what sources of financing for their business activities the firms use are contained in Table 1. The bracketed figures represent the percentage share such resources make up in the individual groupings of enterprises.

Table 1: SME FINANCING RESOURCES AND SOURCES

Resource/Source Type:	Number of Employees:			
	1-10	11 – 50	51 – 250	Total
Own Stake	7 [70%]	29 [73%]	32 [54%]	68 [62%]
Loans From Friends/Family	1 [10%]	8 [20%]	2 [3%]	11 [10%]
Profits + Depreciation	8 [80%]	28 [70%]	49 [83%]	85 [78%]
Leasing	4 [40%]	18 [45%]	38 [66%]	60 [55%]
Entry of a Partner	0 [0%]	2 [5%]	2 [3%]	4 [4%]
Bank Loans	0 [0%]	24 [60%]	42 [71%]	66 [61%]
Tacit (Sleeping) Partner	0 [0%]	1 [2,5%]	1 [2%]	2 [2%]
Venture Capital	0 [0%]	1 [2,5%]	0 [0%]	1 [1%]
Dotations, SME Support Scheme	0 [0%]	3 [8%]	11 [19%]	14 [13%]
Other	0 [0%]	1 [2,5%]	2 [3%]	3 [3%]

Generally speaking, (Czech) enterprises tend to prefer financing through the assistance of internal (70 % of firms), rather than external resources. Of these internal resources, they tend to use profits and depreciation the most as a resource. These enterprises on average invested one third of their after-tax profits into the renewal and expansion of their assets. Of course, a significant percentage of financing efforts concern the depositing of one's own (financial) resources, (but currently, every tenth firm operates with money invested by friends and family of the entrepreneur).

Risk capital is used by only one of the respondents, while a further 3 enterprises are preparing to make use of this source of financing in the future. One third of respondents will not use this method of financing because they do not have a suitable project planned, a further third of the respondent enterprises feel that this form of financing is not acceptable to the owners of the enterprise in question. The rest of the enterprises either do not know of this form of financing, or else lack sufficient information and knowledge about this form of financing and its providers. Table 2 presents information as to the number of applications received by the risk capital fund (as one of those institutions founded by the government to assist SMEs), as well as the actual number of projects that have received investments. The low percentage of real risk capital investor entry to enterprises is also a consequence of the conditions required prior to their entry:

- The enterprise must have a capable management team, which will turn the project into reality, and which manages the activities of the enterprise.
- The enterprise must have (a) demonstrable and sustainable competitive advantage(s).
- Investors require the real possibility of a profitable exit from the enterprise.
- The enterprise must be either manufacturing or service-orientated.
- The entrepreneurial orientation must demonstrate growth characteristics.

Table 2: APPLICATIONS FOR RESOURCES TO THE RISK CAPITAL FUND

Year:	No. of Applications:	No. of Projects Invested Into:
1996	136	3
1997	165	4
1998	163	3
1999	104	0
2000 (I.-III. Quarter)	101	0

[Source: The Risk Capital Fund]

Concurrently, it tends to be true that these enterprises are poorly informed about risk capital; and that in the main, interests in risk capital acquisitions are shown by firms, which were unsuccessful in raising capital elsewhere, e.g. applications for a bank loan. Further, these are often owners who do not wish to allow someone else entry into their enterprise, and who could thereby influence the running of the enterprise. The advantage of this form of financing however lies in the fact that the enterprise need not pay back the debt nor interest, since the investor seeks the valorisation of their investment through the advantageous sale of their share only after a certain period of time (several years as a rule). However, for having had to undertake the risk, they require an adequately high level of return on their investment. And for this reason, such an investor invests his money only into such projects with perspectively high returns.

Two thirds of the enterprises make use of bank loans to finance themselves. The share of bank loan utilisation per individual group of enterprise – and their averaged interest rates over the years 1999-2000, are presented in Table 3. No micro-enterprise use a bank for financing purposes; as far as the other enterprises are concerned, they predominately use medium-term loans, then come short-term loans, and least of all used are long-term loans. The enterprises, when questioned, replied that in the case of readily accessible loans for their enterprise, they would (on average) require the following structuring of their loans portfolios: 31 % short-term, 42 % medium-term, and 28 % long-term. The last line in Table 3 shows, for ease of comparison, interest rates charged on newly provided loans in the Czech Republic. Were we to compare those interest rates, which, on average, enterprises in the Czech Republic are charged on their loans, and the conditions of such loans set for the SME, there is a clear tendency for the interest burden of the latter to be the greater. This reality is dependent upon the greater riskiness of the business dealings of SMEs. Currently, however, it tends to be true that banks sometimes refuse such enterprises a priori, without bothering to balance the relation of risk to price for such loans [2]. This is also confirmed by the replies regarding the problems associated with the acquisition of loans (Picture 1).

Table 3: SHARE OF INDIVIDUAL TYPES OF LOAN ON ENTERPRISES' OVERALL LOAN PORTFOLIOS AND AVERAGED INTEREST RATES LEVELS CHARGED

	Short-term Loans		**Medium-term Loans**		**Long-term Loans**	
No. of Employees	**1999**	**2000**	**1999**	**2000**	**1999**	**2000**
1-10 loans use aprox. 0 % enterprises	-	-	-	-	-	-
11-50 loans use aprox. 33 % enterprises	36.8 % *(12.9 % p.a.)*	33.4 % *(10.3 % p.a.)*	54.5 % *(12.7 % p.a.)*	52.5 % *(14.1 % p.a.)*	8.7 % *(19.5 % p.a.)*	12.3 % *(19 % p.a.)*
51-250 loans use aprox. 58% enterprises	36.5 % *(10.7 % p.a.)*	33.5 % *(9.2 % p.a.)*	44.5 % *(11.5 % p.a.)*	46.5 % *(9.8 % p.a.)*	19.0 % *(10.7% p.a.)*	20.0 % *(11.0 % p.a.)*
Averaged Interest Rates on New Loans in the Czech Republic	*8.377 % p.a.*	*6.619 % p.a.*	*9.153 % p.a.*	*8.119 % p.a.*	*10.191 % p.a.*	*7.713 % p.a.*

Fig. 1 shows the main reasons for the problems faced by SMEs in acquiring bank loans; 23 % of respondents replied that they had no such problems.

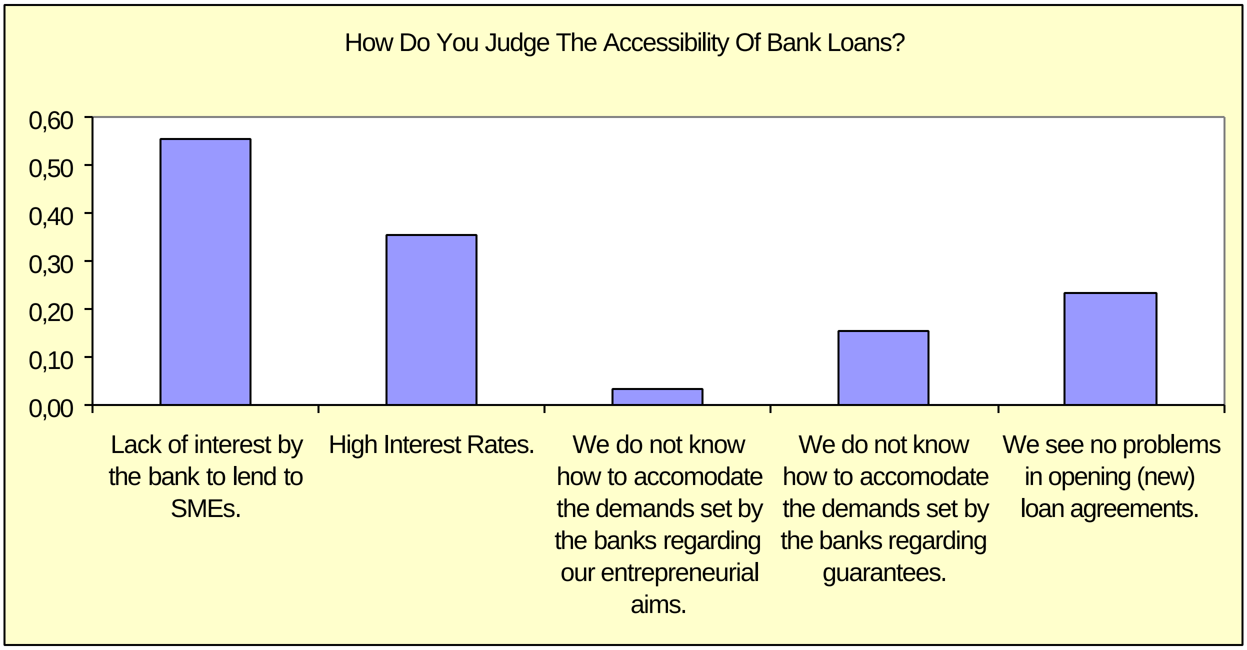

Fig. 1: BANK LOAN ACCESSIBILITY FOR SMES

The banking market has recently seen the first welcome steps made by the banking sector in an effort to alleviate the situation. One of the biggest Czech bank - Ceská sporitelna a.s., decided in spring of this year to support small and medium-sized entrepreneurs by offering advantageous preferential loans. The interest rate for such loans was set at 3 % below the prevailing market rate.

More than one third of the enterprises questioned had interested themselves at some time in the past in financing through foreign exchange denominated loans, and fully one fifth had made use of such loans.

The leasing method of financing is a favourite with SMEs, and is usually more accessible than are bank loans (however this is normally more expensive) – more than half of the respondents questioned in the questionnaire-based research study were using this method at the time of being questioned. Leasing had been used at some time by some 85 % of the enterprises questioned. However, only one fourth used leasing to finance machinery and equipment (the balance being used to finance automobiles).

The acquisition of assets in the form of leasing agreements is increasing year-by-year throughout the Czech economy. The use of leasing arrangements is influenced by the extent and price of bank loans for enterprises.

Should enterprises be able to choose the source of financing for their investment goals, most often they would select the following order: profits + depreciation; CZK denominated bank loans; leasing; other (further) capital injections by the owner(s) of the enterprise; ForEx denominated bank loans; a silent/tacit partner; and last of all venture capital.

Factors, which influenced the creation of the financial structure of the enterprise were ranked as follows by respondents (from most to least important):

1. Capital costs (the price, which it would be necessary to pay in the form of interest or a share in the profits)
2. The accessibility of resources.
3. The asset structure of the enterprise.
4. A negative attitude to risk, which is associated with the indebtedness of the enterprise.
5. Fears by the owner(s) as to the dilution of their equity share(s).
6. The average figures for indebtedness prevailing in their branch.

On the basis of these results, it is possible to say that these enterprises are neglectful as to the average figure for indebtedness in their branch. Various studies by economists have, however, shown that it is just these branch average indebtedness figures which offer the possibility of an approximation of an optimal financial structure. Bowen – Daley - Huber [1] discovered that the branch average indebtedness figure is stable over time, and that enterprises have a tendency to approach such ratios, as if indeed they were optimal. These economists suggested that the ratio of the book value) of debt to market value of the equity per branch be taken as a valid measure for the optimalisation of indebtedness.

SMEs are very often to a great extent dependent on the financing by their short-term obligations. This results from the fact that they face greater difficulties and accessibility to other sources of financing, and that these tend to more expensive in the light of their increased risk-exposure. The possibility of using supplier credit however, depends both upon their standing and the competition (for such credit) from their supplier entities. On the other hand, they may be able to gain money from the sale of their products earlier than the invoice payment period granted – for instance, by offering discount or through the use of factoring and forfaiting companies. So as to speed up payments from their customers, 56 % of the enterprises approached used discounts; in the payment of their own obligations almost half of those SMEs questioned made use of these terms. It was not demonstrated however, that the practice of offering discounts had a greater influence on the payment levels or rates for bad outstanding debt or for doubtful debt (i.e. outstanding unpaid debts in excess of the agreed-upon payment period); nor any correlation between the use of discounts by the enterprise and the level of its own outstanding obligations in excess of such agreed-upon payment periods. Only 10 % of the enterprises approached took advantage of the services provided by factoring companies.

Almost all of these enterprises systematically track incomes and expenditures, and these short-term cash flows are planned by 80 % of these enterprises.

Only one third of these enterprises replied that they did not suffer from an insufficiency of money, for half of these enterprises this lack represented a braking factor on the expansion of their business activities. 27 % of these enterprises indicated that they even face problems with sufficiently financing normal operational activities.

Should these enterprises have cash in hand, 65 % of them priorities the paying down of their debts, a quarter let the funds lie in their current accounts, a quarter deposit them in fixed-term accounts, and only a fifth of these enterprises purchases other forms of assets (they could choose more than one answer).

Fig. 2 expresses the future aims of these enterprises. In view of the great number of enterprises that wish to increase production or else to expand the enterprise’s activities without increasing the number of employees, it must be evident, that they will have to invest into better and more efficient technologies, alternatively to better organise working practices and thereby to increase the productivity of their working practices. This however, ordinarily requires the acquisition of long-term financing resources.

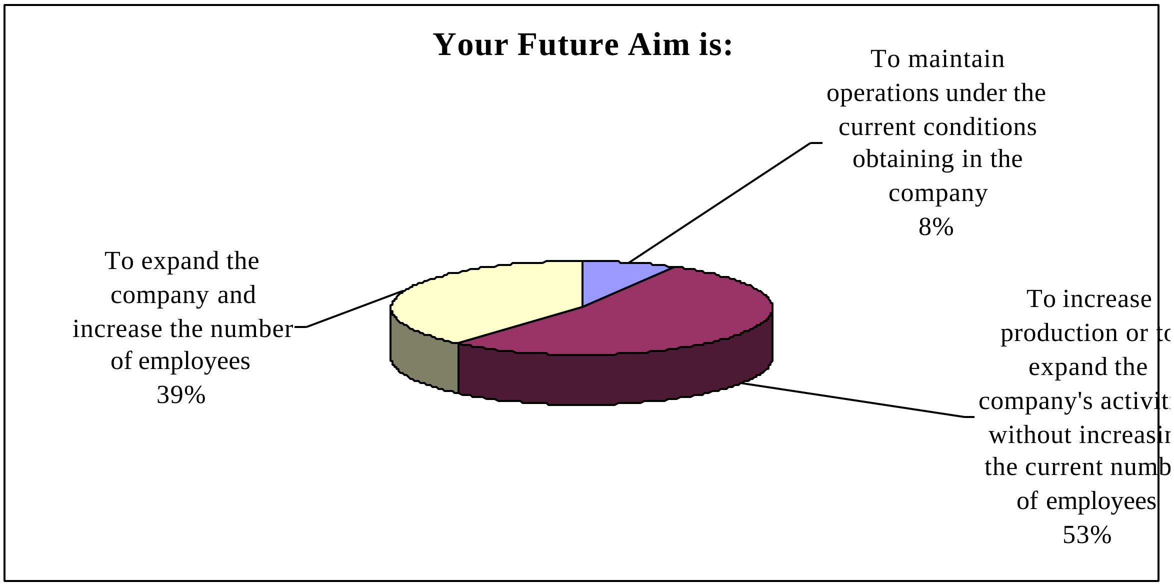

Fig. 2: FUTURE AIMS OF THE ENTERPRISES

Within the framework of the research study it was discovered that enterprises which use financial planning as a management tool (43 % of the respondent enterprises had financial plans exceeding 1 year), indebt themselves more than do those enterprises which do not use financial planning. Those, who avoid debt, do not compare the costs of alternative sources of financing, and limit their financing activities to using undistributed profits and their own money. Here, the management orient their management activities to short-term goals – managing on a "day-to-day" basis. Borrowed money is overly uncertain, and the future unpredictable or unforeseeable.

Support Programmes for SME Activities

Governments of different countries are coming up with varied forms of subventions, support and assistance programmes and dotations - not only with a regard to the numbers employed by and the GDP share attributable to the small and medium entrepreneurial sector, but equally with a view to current globalisation trends and the attendant increases in competition on individual markets. These governments are trying through the above-mentioned tools to improve the current position of their domestic enterprises and at the same time, to protect their domestic economies.

Through the assistance provided by support for small and medium entrepreneurial activities, the State is attempting to equalise or balance out differences in the access to resources between small and large-scale enterprises. The State thus prefers small enterprises to the detriment of or at the expense of their larger colleagues, since small and medium-sized enterprises represent dynamically growing firms with potential future success. Developments in the resources made available for the support for SMEs over the period 1996-2001 in the Czech Republic are presented below in Table 4.

Table 4: DEVELOPMENTS IN RESOURCES (PROVIDED) IN SUPPORT OF SMES OVER THE PERIOD OF 1996-2001 IN THE CZECH REPUBLIC

Level of Financial Resources (Provided) for the Support of Enterprise (mil. CZK)	
1996	1000
1997	1200
1998	825
1999	1900
2000	1950
2001	1600

Source: *www.mpo.cz*

Support for SMEs in the Czech Republic for the period 2001 - 2004 has been announced in the form of a combination of 17 across-the-board and regional programmes. These programmes are within the competencies of:

- *The Ministry of Industry and Trade*, which plans to disburse some 1,3 billion CZK during the course of 2001.
- *The Ministry of Regional Development*, which plans to disburse some 0,3 billion CZK over the course of 2001.

Recipients may be small enterprises, in which the number of full-time employees must not exceed 50 persons, or medium-sized enterprises, where the number of full-time employees must not exceed 250 persons. Sales for the previous closed accounting period must not exceed 1,450 million CZK, and the asset state at the end of this period must not exceed 980 million CZK.

One may discover more details of the programmes offered in support of entrepreneurial activities directly from the materials supplied from these institutions (both printed and electronic – to be found on their web-pages).

The level of resources available for support is limited. This is the result of certain programmes closing down or coming to their end during the course of the year. These programmes are set out in the National Programme, which is in turn supported by resources directly from the Czech Republic's State Budget in conjunction with resources from the Phare Fund. According to the reactions of small and medium entrepreneurial activities, the government is concentrated only on the offering of support programmes, and there lacks co-ordination between the individual programmes themselves.

The greatest inadequacy, which entrepreneurs emphasise, is the paltry recompense and replacement of imperfections in the legal system by these short-term programmes, while the conditions essential for the successful development of business activities are still to be improved, such as are a top-quality legal environment, an (honourable) payment moral climate, a lower tax burden, and the smooth functioning of the State's administrative functions.

Table 5 shows the number of enterprises in each group according to the breakdown of the number of employees, and which use some of the support programmes for part-financing their activities. (In brackets is always shown the percentile share by group).

Table 5: UTILISATION OF PROGRAMMES (DOMESTIC OR FOREIGN) FOR THE SUPPORT OF SMES

Use of Programmes:	**Number of Employees in the Enterprise**			
	Up to 10	**11 – 50**	**51 – 250**	**Total:**
Yes	0 [0%]	5 [12.5%]	12 [20%]	**17 [16%]**
No	9 [90%]	18 [45%]	33 [56%]	**60 [54%]**
No Response	1 [10%]	17 [42.5%]	14 [24%]	**32 [30%]**

The programme used most frequently by these enterprises was the TRH programme. The aim of this programme is the increasing of the competitive abilities of SMEs on the domestic and foreign markets. Support is provided in the form of:

- Contributions toward the repayment of interests charged on bank loans for tangible and intangible investment assets, in the form of reimbursements for up to 5 % of the interest.
- Contributions of up to 50% of the costs incurred in gaining certification in line with norms set for ISO 9000, ISO 14000, EMAS, and for gaining the CNS TEST norms compliance trademark.

Do these enterprises wish to be informed at all about the programmes offered? Table 6 holds the answers.

Table 6: INTEREST EXPRESSED IN INFORMATION REGARDING PROGRAMMES IN SUPPORT OF SMES

	Number of Employees in the Enterprise:			
	Up to 10	**11 – 50**	**51 – 250**	**Total:**
Yes	6 [60%]	19 [48%]	18 [31%]	**43 [38%]**
Not Interested	2 [20%]	4 [10%]	3 [5%]	**9 [9%]**
No, we have enough information already	2 [20%]	15 [37%]	27 [45%]	**44 [41%]**
No Response	0 [0%]	2 [5%]	11 [19%]	**13 [12%]**

On the basis of these responses it is possible to note a trend, which is marked as follows: The more employees an enterprise has, the better informed it is, and there is not such a demand for such information as there is from smaller enterprises. The greatest percentile share of enterprises that utilise support programmes for SMEs is just that group where the number of employees lies between 51-250 employees. It is logical, in view of their opportunities for greater specialisation of their employees. For small enterprises, it is possible to recommend the use of the services provided by specialised workplaces – Regional Development Agencies, Chambers of Commerce, Universities, and such like.

The most frequent response as to the reason why these enterprises had yet to use these support programmes was that they had not interested themselves in such possibilities to date, or that their applications had been turned down, in some cases that they did not consider these programmes as necessary to the enterprise.

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The Restructuring of the Banking Sector in the Conditions of the EU and Integrating Requirements for the Slovak Banking

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Abstract

A long-term preparation of the Slovak banking for the entry into the EU will need a crucial change of the approach to the Slovak banking. The banking will be seen not only from a closer regional or national point of view, but from a broader perspective of the globalising European banking. Not only banks operating at present on the particular domestic market will be necessary to consider as a potential competitor in the future, but it will be necessary to take account also multinational competitiveness.

The ongoing privatisation in the three largest Slovak banks is only the first step towards the transformation of the Slovak banking to the conditions of the EU, which should be realised within the years 1999-2001. This stage should be followed by another one, the subject of which would be the elaboration of the long-term plan of the restructuring of banks in Slovakia in the period 2005 - 2008. On the basis of the analysis of the current state and world-wide trends, this long-term restructuring programme should identify an optimum structure and the organisation of the banking sector so that the banking belongs to the strongest sectors in Slovakia's economics.

The large fundamental reorganisation of the banking sector in the world took place in the 1990´s. The well-known American banks approached their large re-organisation. The European universal banks responded to the ongoing changes in American banks so that they emphasised their long-term relations towards the domestic clientele. Many universal banks in Europe were in need of restructuring. The necessity of restructuring was initiated by a large number of classified credits, by non-profitable products and services as well as by managers unable to react to the changing environment. Banks changed their strategy and realised many changes so as to remain competitive on the market. The acquisitions and mergers in the banking sector led to the reduction in the number of banks. Since 1990, the number of banks in America has decreased from 15 thousand to 10 thousand. The banks have become even larger due to the ongoing acquisitions and mergers. At that time, large groups of multi-financial banking conglomerations emerged.

The European banks as well as their American colleagues followed the slogan ”the bigger is the better”, which resulted in the acquisition strategies and the average value of assets increased in the ten largest banks. Only 4 or 5 banks out of 20 focused on the retail banking and the field of the medium enterprise and offering financial services for individuals. These services were provided outside their country. Some of the banks focused on the wholesale banking and, of course, their commercial activities and their activities in the field of the investment banking were integrated more difficulty.

The banks had to adapt to many changes and react to the strengthened competitiveness. They had to improve their operation on the market and their profitability. Their success depends on the result of the domestic restructuring and on focusing on the traditional banking. The wholesale banking and dealing with securities absorbed a large number of innovations. Transactions related to syndicated loans, subscribing of securities, insurance and acquisitions, advisory services became very important for the banks. Of course, the mentioned activities were influenced by requirements for uniform currency.

A qualitatively new space for the restructuring of the banking sector has been created by the establishment of the EMU, not only in the member states, but also in the countries of Central and Eastern Europe, and therefore, the future development of the banking in the Slovak Republic will be determined by determining global trends to a greater extent and more essentially.

New Trends of the Globalisation of the Banking Sector within the Conditions of the European Monetary Union

The most important trends of the development of the banking sector in which the consequences of the globalisations are manifested are as follows:

1. The trend, which lies in the increasing complexity and mediateness of the connection between the money flow and the sphere of the real economy, and in a relative increase and the separation of the monetary sphere in relation to real economic processes.

In the functioning of money as a general equivalent, beside the passive discharge of the function of a mediator of the exchange and the supply of transaction needs, their active role is markedly extending as well, in which the money releases from the immediate influence of the ”world of real goods” and from the principles of the circulation of the goods, and is orientated on the profit making increasingly.

2. The trend, which is based on developing the interchangeability of the function of money servicing the circulation of goods on one hand and of loan and moneyed capital. The differences between both the functions are being settled or they are overlapping under the influence of the interchangeability.

Beside banks as ”classic” subjects of the market motivated allocation of disposable funds, there appear other new subjects which weaken the original dominant position of banks and cause the globalisation of existing and emerging markets.

3. Securisation trend, i.e. the increase of the number of financial means allocated by means of the market of securities to the detriment of granting bank credits.

4. The trend of desintermediation, which lies in the fact that banks as a classic mediator of the offered and required financial means have been being increasingly superseded by institutional investors. It results e.g. in the fact that long-term investments are not orientated on bank deposits but on life insurance companies with a marked tax allowance. Large industrial firms have often emancipated themselves to the extent that they have been searching for the possibilities of financing their growth on the foreign markets independently.

In the connection with the desintermediation, it is necessary to point to another sphere of the banking activity - mediatory services, which are being slowly superseded. It is a traditional payment system which has been connected with the banks on the basis of their monopoly to deal with ready money so far and which is being superseded from all sides by various cashless systems developed e.g. by large companies closely connected with the consumer market. As a consequence of this, an always greater part of the financial flows connected with the settlement of payments are declining from the banks and are going on outside the banks.

5. An extraordinarily important trend is a large-scale penetration and a fast innovation of computing and telecommunication technologies in the field of banking and finances. It represents a material basis of other new trends in the development of the character of banking institutions, their internal structure, the changes in distribution channels and providing products and services but also in the character of the competitiveness, employment, new problems and risks.

6. Another trend which causes extraordinary demands on the adaptation of the banking sector is the gradation of the global interdependence and the competitiveness on national, regional and world markets and financial markets.

Banks and financial institutions are connected to networks linking on-line countries and continents, and by means of electric impulses, they can become active participants of globalising financial operations and processes. On one hand, the bank is given the access to an incomparably broader global operation space, within which it can offer its products and services, however, on the other hand it means that the bank as well is forced to open the sphere of its up-to-now operation not only to other banks but also to other financial mediators more and more. As a consequence of this, the global competitive fight for the repartition of the existing markets and for occupying the positions on emerging markets is sharpening very intensively.

In the banking sector, we can observe several differences, which can be together named as an asymmetric effect of the competitiveness. In fact it means that the entry into the banking is easier than the entry of the banks into non-financial sectors. The largest competitive pressures on banks can be monitored outside the banking sector, but new competitors have as a rule another cost structure, do not need a branch network, have lower fixed costs and follow traditional banking practices. Department stores and firms which deal with various parts of the banking process or particular products and services on the basis of new information technologies etc. are becoming new competitors.

7. At present, the trend of the faster reduction of entrance barriers in comparison with removing exit barriers is characteristic for the banking sector. It leads to the relative growth of the excessive capacity of banking sector, which is manifested by the excessive capital, the large number of banks, overextended infrastructure and excessive technology. The excess of the volume of capital is caused by the transfer of traditional banking operation to non-banking subjects.

Following the mentioned changes, the banking sector is in need of the deep restructuring and consolidation as a whole. The moving force of this trend is reaching the inevitable economic capacity (income yield, profitability) on the basis of which it would be possible to compete not only with domestic banks and non-banking subjects, but also with domestic banks and foreign banks and non-banking subjects on globalising money and financial markets. It is possible to realise the process of restructuring in the light of wide range of adaptation processes and measures. Also the ”natural mortality” of banks, which went bankrupt due to the strong competitiveness, but mostly due to the accelerated process of mergers and acquisitions i.e. merging and taking over of banks in order to make the financial institutions stronger and more competitive, can be considered for example as the solution.

The aim of mergers and acquisitions is not only to make the final banking institution quantitatively sizeable, but mostly to set conditions enabling to take cost reducing measures, the identification and using of savings and gaining income, which conform to the future requirements of strengthening global competitiveness. Horizontal mergers are an example, in which the saving in the common accounting, in the financial management, in the financial control etc. becomes the main argument. Another reason for mergers and acquisitions is the usage of excessive funds - many acquisitions are financed just due to this reason, Deutsche Bank can be an example - the bank in order to ensure the growth and due to the reason of excessive funds always acquires new companies. Furthermore, it is the drawing claims to tax allowances (after having been incorporated in the firm, tax losses are gradually being dissolved). It is conditioned that the firm must not liquidate purchased assets, because the tax allowance is applied only to them.

The banking universalisation on the basis of the convergence and the integration of the commercial banking, investment banking, insurance and other financial services belongs to other important fields of an efficient structural adaptation. A sort of ”a financial supermarket” is a result of these activities.

Opinions supporting the creation of banking-financial conglomerates and ”financial supermarkets” are, however, opposed by opinions, in which the future of the banking and finances lies in a high specialisation of the supply combined with the mastering of information and telecommunication technologies.

The contradiction between the universality and the specialisation in the future of the banking is only seeming however. Rational possibilities of both the tendencies are conditioned by the character and the features of modern information and telecommunication technologies. The information and telecommunication technologies dramatically change the efficiency sensitivity of the range of assets and of the rationalisation of organisation structures and distributing channels. It means not only the transition to the so-called direct banking (phone banking, home banking), by means of linked computers, but also to the network banking, functioning through the internet and in perspective, also through other communication media. Also extreme opinions appear saying that these could take over the role of banks, and therefore there is no need to reform the banks but to get rid of them gradually.

The analysis of both the basic tendencies of restructuring shows that not even within the European Monetary Union, the development will not proceed only in the way of mergers and acquisitions and of the establishment of giant universal banks, but an important role will be played by the creation of various types of universal financial groups, based on the interoperation of specialised and co-operating middle and small banking and non-banking subjects. This other tendency in special should be a challenge for a quick elaboration of the strategy, the adaptation restructuring of Slovak banks in the light of the process of entering the European Union.

Integration Requirements for the Slovak Banking

In the recent development of the transformation of Slovakia (even though the attempt to follow the development trends in the developed countries) in the first stage of the transformation of the banking sector already, despite partial positive results, a common standard of the structure and operation of banks in more developed European countries and also the inevitable level of competitiveness which will be required not only by deepening current relations with abroad, but mostly by its integration in the European banking has not been reached.

From this, it is possible to identify which requirements will be imposed on Slovak banking by its integration when preparing the entry into the European Union. We consider several world development trends, which are going to influence the system problems of restructuring of Slovak banks. In these terms, it will be possible to expect especially:

- a marked strengthening of the pressure of foreign competitiveness, in Slovak conditions, the competitiveness of Czech banks and in case of the approximation of Slovakia to CEFTA also of other countries in the process of transformation, in particular the CEFTA states,
- competitive factors will further support an objective process of restructuring of the banking sector by means of various forms of mergers and acquisitions, the tendencies of the increase of the capital participation of stronger European banks, their participation in the increase of the capital of Slovak banks,
- the growth of financial innovations, in the field of investment banking and the combination of connecting banking and insurance products as an up-to-date element of the connection of banking-financial subjects,
- the growth of the importance of the banking based on the private property,
- the provision of a wide range of banking services aimed at particular market segments with respect to decreasing the bank costs and strengthening the marketing orientation of banking activities,
- the increase of the technological progress, of the importance of a wide range of information, which will obviously require highly qualified employees and the intellectualisation of the basis of the banking management,
- a marked strengthening of the specialisation of banks, based on a) the increase of the qualification and professionalism of the decreased number of bank employees and b) a wider division and specialisation of banking activities,
- the strengthening of marketing approaches to the management of banks,
- the effort aimed at the reducing of costs, conditioned mainly by a marked specialisation of banks, and the narrowing of the range of banking activities on the basis of the specialisation of bank products in one bank subject will function as a priority objective of these changes. This, however, will not probably influence the overall decrease of the range of these products by the whole banking sector.

The realised privatisation of the two key Slovak banks – VÚB, a.s. and Slovenská sporitelna, a.s. in particular is considered an inevitable condition of being included within these trends, and only then, it will be possible to contemplate a possible strategy of the joining of the Slovak banking the European Union in more detail. It is also necessary to realise that in the year 2005, any protective measures resulting from the association agreement should be completed, and that means that it is necessary to succeed in the revitalisation process in all banks and only then, the conditions for real speculations over the participation of the banks in the European Union will be created.

A long-term preparation of the Slovak banking for the entry into the EU will need a crucial change of the approach to the Slovak banking. The banking will be seen not only from a closer regional or national point of view, but from a broader perspective of the globalising European banking. Not only banks operating at present on the particular domestic market will be necessary to consider as a potential competitor in the future, but it will be necessary to take account also multinational competitiveness. Nowadays already, from the strategy of multinational banks operating in the world, it may be seen that if a particular market provides interesting and suitable opportunities, it forces the banks to extend their activities. A larger entry of foreign banks on the domestic market will have to be taken into consideration. It is proved by the experience of the preparation of Slovenia's joining the EU.

In closing, it may be stated that the ongoing privatisation in the three largest Slovak banks is only the first step towards the transformation of the Slovak banking to the conditions of the EU, which should be realised within the years 1999-2001. This stage should be followed by another one, the subject of which would be the elaboration of the long-term plan of the restructuring of banks in Slovakia in the period 2005 - 2008. On the basis of the analysis of the current state and world-wide trends, this long-term restructuring programme should identify an optimum structure and the organisation of the banking sector so that the banking belongs to the strongest sectors in Slovakia’s economics.

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Vulnerability Index – Guessing the Probability of a Currency Crisis Central European Experience

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Abstract

The recent years have witnessed a dramatic increase in the participation of foreign investors in both emerging-market equity and fixed-income investments. While the rewards in investing in emerging markets are great, so are the risks. A number of currency crises shook investors' confidence in emerging countries. We ask whether some of the crises could be anticipated by looking at economic fundamentals. We have constructed a weighted "vulnerability" index to signal just that – do economic fundamentals justify a higher probability of a currency crisis occurring in a given country? It is computed as a weighted average of macroeconomic indicators such as the real exchange rate, the export growth rate, the ratio of M2 to official international reserves, real domestic credit growth, financing gap, etc. The higher the value, the higher the model-implied probability of a currency crisis. However, the index is not a direct measure of probability. The index explains some of the currency pressures in Central European countries.

Motivation

The recent years have witnessed a dramatic increase in the participation of foreign investors in both emerging-market equity and fixed-income investments. While the rewards in investing in emerging markets are great, so are the risks. A number of currency crises shook investors' confidence in emerging countries. We ask whether some of the crises could be anticipated by looking at economic fundamentals. We have constructed a weighted "vulnerability" index to signal just that – do economic fundamentals justify a higher probability of a currency crisis occurring in a given country?

Introduction

In the majority of cases, currency crisis in emerging markets are preceded by a number of economic problems that warn of the need for an eventual corrective adjustment of exchange rates. Crisis-prone currencies typically display a number of classic symptoms that warn of an impending speculative attack. These symptoms include excessive real appreciation of the currency, weak domestic economic growth, rising unemployment, an adverse terms-of-trade shock, a deteriorating current account balance, excessive domestic credit expansion, banking-system difficulties, unsustainably large government budget deficits, overly expansionary monetary policies, a high ratio of M2 to reserves, foreign-exchange reserve losses, falling asset prices, etc. [3]. The economics research has not traditionally focused on the issue of currency collapses and it has been only for the past few years that the researchers began collecting the evidence. This could be one reason why many currency turmoils were not anticipated by market players since in most cases the interest-rate differentials failed to widen several months before the crises [3]. The past experience suggests that there seems to be some threshold point in the minds of market players beyond which the country starts to be very vulnerable to the currency crisis and the foreign exchange traders suddenly are concerned with the country's deteriorating fundamentals.

In fact, the interest rate differentials sometimes moved in the *opposite* direction as they should have. Let us assume that interest rate parity holds, i.e. interest rate differential between the two currencies is equal to the *expected* exchange rate change. In case of a fixed exchange rate regime, the longer the regime is in place untouched, the higher the belief it will stay so since investors often extrapolate the favourable history into the future. Interest rates converge as the capital flows drive the differential closer to zero. In case of bad economic policy[1], the productivity differentials might not be so favourable for the emerging country to offset the rising real appreciation of the currency. In such a scenario, interest rate differential would actually get *smaller* as the probability of exchange rate pressures *mounts*.

With the efforts to seek higher returns, the investments in emerging countries became fashionable in the 1990s. Portfolio managers have often put money into countries that had not been researched deeply enough. As Calvo (1995) argues the marginal gain from gathering new information declines as diversification opportunities rise. In other words, *diversification breeds ignorance* [3]. Then the attack on such a currency supports a sudden effort on the side of market players to brush on fundaments and foreign exchange contagion could take its toll on other vulnerable countries.

The numerous research studies have found that the single best predictor of a future strong currency correction is the real exchange rate [1,3]. Real effective exchange rate is the trade-weighted nominal exchange rate adjusted for the difference in domestic and foreign inflation. Another useful indicator includes international reserves, the ratio of money supply to foreign reserves, M2 multiplier, and so on (see Table 1). However, some of the indicators were more consistent at pin-pointing the crisis as the others. Table 2 ranks the macro indicators by their noise – e.g., real exchange rate is much less nosier than M2 multiplier. This is an important criterion as well since the false signals could precipitate an otherwise healthy emerging country into crisis on a self-fulfilling prophesy. Therefore, currency vulnerability models should, as much as possible, prevent giving false signals to market participants.

Table 1: LEADING INDICATORS OF CURRENCY CRISES – GOOD SIGNALS

	Actual Good Signals/Possible Good Signals
Real Exchange Rate	25
International Reserves	22
M2/Reserves	21
M2 Multiplier	20
Banking Crisis	19
Terms of Trade	19
Exports	17
Stock Prices	17
Output	16
Excess M1 balances	16
Bank Deposits	16
Real Interest Rate	15
Domestic Credit/GDP	14
Lending Rate/Deposit Rate	13
Real Interest-Rate Differential	11
Imports	9

Source: Kaminsky, Lizondon and Reinhard (1998)

The methodology – the Indicators

IMF in its May 1998 World Economic Outlook report constructed a vulnerability index for six Asian and four Latin American countries using a weighted average of three variables: real exchange rate, the real domestic credit growth, and M2/Foreign Reserves ratio [1]. The deviations from their three-year mean levels were inputted into the model. We have tried to extend the pool of variables mainly suggested by Tables 1 and 2. We assigned the weights to the variables below so as to be proportional to the ratio of good signals statistics in Table 1 to the bad signal one in Table 2, where available – see Table 3.

Table 2: LEADING INDICATORS OF CURRENCY CRISES – BAD SIGNALS

	Actual Bad Signals/Possible Bad Signals
Real Exchange Rate	5
Banking Crisis	6
Exports	7
Stock Prices	8
Output	8
Excess M1 Balances	8
Domestic Credit/GDP	9
M2/Reserves	10
Real Interest Rate	11
Real Interest-Rate Differential	11
Imports	11
International Reserves	12
M2 Multiplier	12
Terms of Trade	15
Bank Deposits	19
Lending Rate/Deposit Rate	22

Source: Kaminsky, Lizondon and Reinhard (1998)

Table 3: MODEL INPUTS WITH THEIR WEIGHTS

	Weight
Real Exchange Rate	25.6%
Exports	12.4%
M2/Official Reserves	10.7%
Dollarization Ratio*	10.2%
Monthly Import Cover	9.4%
Trade Deficit	8.3%
Domestic Credit	8.0%
Cost of External Financing*	7.7%
Financing Gap*	7.7%
Total	100.0%

Note: (*) The indicator does not appear in some form in Tables 1&2 and its weight is given arbitrarily.

Real Effective Exchange Rate

The strength of the currency is the single best indicator. In the previous version of our model applied to Slovakia only (see Toth (1999)), we took real effective exchange rate (REER) adjusted by producer prices using 9 foreign countries covering 80% of Slovak exports. We arbitrarily picked January 1995 period as base period due to the external stability. In the current model, we choose to de-trend REER and we assign the 'overvaluation/undervaluation' meaning to the difference between REER and the trend. The advantage of the approach is that a base period does not have to be chosen and we - at least indirectly - account for some real sustainable appreciation of the emerging currency due to the higher productivity growth[2]. Another possibly better but more data intensive approach would be to compute real exchange rate on the basis of unit-labour costs.

Banking Crisis
The previous version of the model had the ratio of classified 'bad' loans to total local currency loans as an indicator of a probability of a banking crisis. However, we chose to omit the variable as the numbers have not been reliable in Slovakia (and probably in other Central European countries). Strong political constituencies have had vested interests in state banks and banking supervision and the data has probably not been immune to these stakes.

Exports
Export growth signals the ability of the economy to repay its foreign liabilities. Due to the earlier data availability (current account data are usually released with a quarter delay), we take merchandise exports adjusted by producer prices to get a proxy for real export growth. We take the 3-month moving average.

M2 to Official Reserves Ratio
The indicator suggests what part of the domestic money supply is backed by the foreign currency. Should the monetary authorities relax monetary policy and the economy would not be able to attract higher inflows of foreign reserves due to higher growth, the ratio would send a worrying signal.

Dollarisation Ratio
Dollarisation Ratio points to the proportion of foreign currency deposits to total deposits and thus could indirectly signal the distrust in domestic currency.

Monthly Import Cover
Monthly Import Cover could be a better indicator than imports in case of a flood of foreign direct investments that boom both technological imports as well as the foreign reserves. We take the ratio of the latest reserves data to the average of the last three months of import data.

Trade Deficit
We use the 3-month moving average of trade deficit to expected GDP ratio. Should trade deficit/GDP be bigger than the ability of the country to pay (proxied by the potential GDP growth) for an infinite period, the country would not be able to repay the debt as the repayments would exceed output at some point in the future. It is however possible to get a noisy signal from trade deficit since heavy corporate restructuring based on inward foreign direct investment usually means a booming trade deficit.

Domestic Credit
This indicator could show the overheating of the economy caused by monetary policy. We adjust domestic credit growth by producer prices to get a proxy for real domestic credit growth.

Cost of External Financing
We take the spreads on benchmark sovereign (if available) eurobonds. Raising money abroad at favourable cost should decrease the country's vulnerability in the short-term.

Financing Gap
Basic balance is usually interpreted as that part of the current account deficit that is not covered with foreign direct investment and therefore, the country has to attract the funds (in the amount of basic balance) to cover the gap in more volatile portfolio or debt inflows. In addition, the country has to repay (or revolve) the principals of foreign debt falling due. We therefore define the financing gap as the 3-month moving average of the basic balance and debt service (required inflows would have negative signs).

We define the vulnerability index as the weighted average of these standardised macroeconomic indicators. The higher the value, the higher the probability of a currency crisis occuring. The index is however not a direct probability measures. The level of zero implies a certain ‘equilibrium’ value of macroeconomic indicators chosen *ex-ante*. No political variables are present in the model.

Small Sample Issues

We standardised the variables by taking differences from their mean and dividing them by their respective standard deviations. In trying to assign equilibrium to zero value, we sometimes ignored historical means due to short sample data issue and imposed more ‘equilibrium’ values. In addition, since some variables could have extreme values at certain times (eg, the level of reserves was extremely small in Slovakia in 1993 and m2/reserves standardised statistics showed the value of 30), we adjusted the standardisation using the following rationale. The values around mean (eg, roughly the first 20% of values nearest mean) should provide little information content on vulnerability while the extreme value contribution should be limited as well. We confined extreme signal (eg, roughly the last 10% of values) at 2 (in previously mentioned Slovak case, we then used 2 instead of 30) using the following transformation function (see Fig. 1).

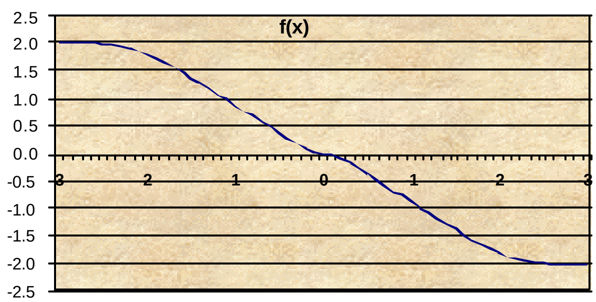

Fig. 1: TRANSFORMATION FUNCTION OF STANDARDISED VALUES X

Note: On the horizontal axis, x means the standardised value (i.e., in units of standard deviation).

The first derivative of the transformation function is then presented in Fig. 2.

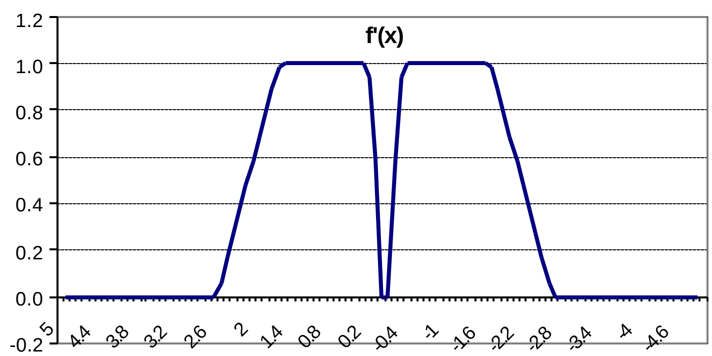

Fig. 2: THE DERIVATIVE OF TRANSFORMATION FUNCTION

Note: The values between (-0.25,0.25)[3] in the units of a standard deviation represent the area where the information content of the value is arbitrarily lowered to suggest that it is ‘normal’ to see fluctuations inside such a narrow interval around a perceived equilibrium. Outside the interval (-1.64,1.64)[4] the information content of the value is lowered again not to have one indicator imposing too much weight on the overall index (say, an extreme value is perceivable on one indicator due to one-off events or structural changes). Outside interval (-2.2) the transformation value is set to equal 2 or –2. An example favouring such a transformation would include the case of a sharp devaluation in Turkey in 2001. The real exchange rate was so undervalued (and hence it would have sent such a strong positive signal if transformation function had not been used) that could offset the negative signals of all other variables with the resulting vulnerability index deep in negative territory suggesting almost no probability of a continued currency crisis (which would not be a reasonable thing to expect in Turkish case in 2001). Intervals were chosen arbitrarily.

Empirical Results – Central Europe

Figures 3-6 plot the resulting vulnerability indices for Central European countries along with the monthly variances of the daily changes of their local currency to EUR (with a one month shift). Neither the weights in Table 3, nor the transformation function was chosen by regression, hence, the following results could be considered as out-of-sample. Since immediately after the crisis, the exchange rate substantially weakens, the reader should not be surprised with the fall of the index on the month of the crisis or just after.

Slovak experience in Fig.3 suggests that the index performed well and signalled the first devaluation in mid-1993, May 1997 crisis, October 1998 floating of koruna, and May 1999 currency turmoil. Slovakia had fixed exchange rate regime will October 1999 (therefore, the attack on koruna in May 1997 is not revealed by volatility).

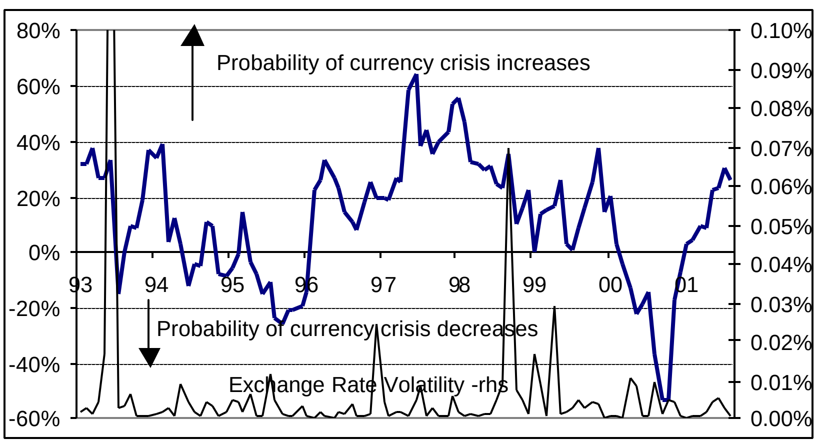

Fig. 3: SLOVAK EXPERIENCE

In the Czech example (Fig. 4) the indicator correctly pin-pointed the May 1997. The trend of the index (rather than the level itself) also located the second currency pressures in 1998.

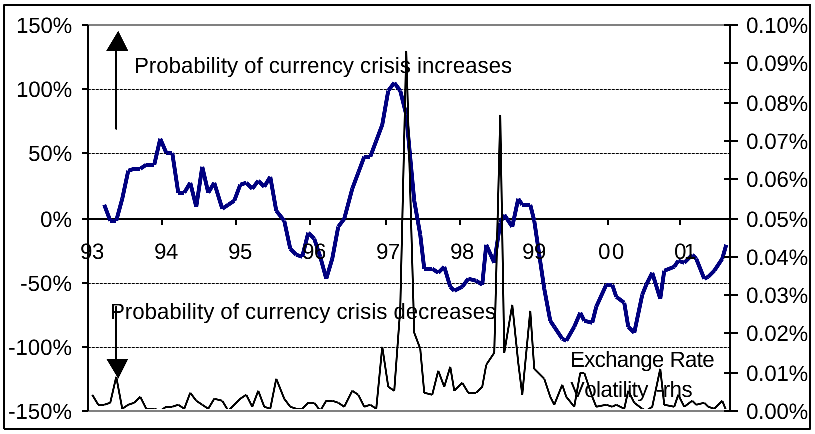

Fig. 4: CZECH EXPERIENCE

In Hungarian case, the index performed reasonably satisfyingly though the absolute level of zero does not indicate 'equilibrium' situation.

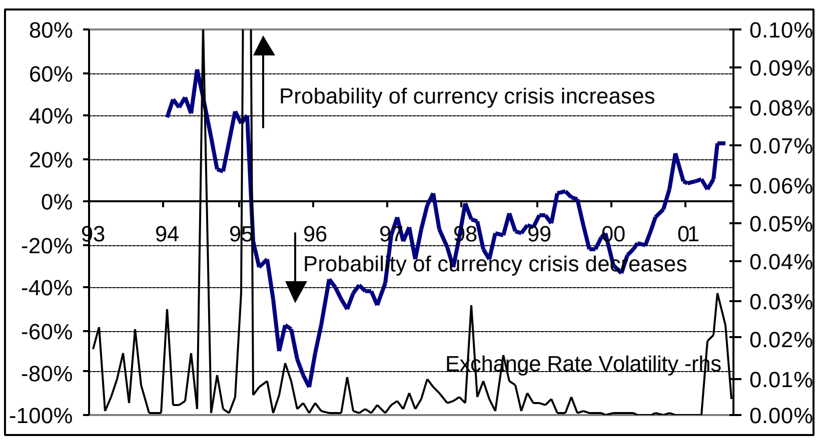

Fig. 5: HUNGARIAN EXPERIENCE

Polish results have been mixed especially in 1997 though the signal about the recent crisis appeared to be very reliable.

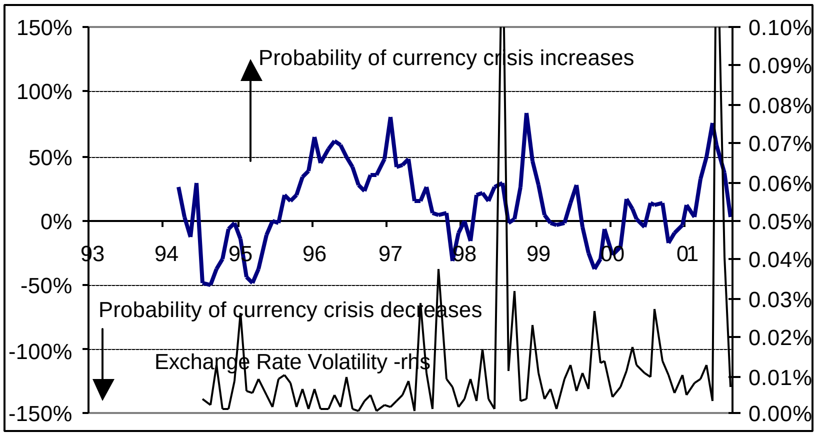

Fig. 6: POLISH EXPERIENCE

Conclusion

The vulnerability index has been successful at signalling some of the Central European currency distresses, especially since the nature of the experiment was out-of-sample. This means that similar phenomena have been at work in Central Europe than in other emerging countries. Due to the problems estimating 'equilibrium' values, both the trend and the absolute value of the index have explanatory power.

Further Research

It might be informative to let the regression choose the weights and see the implied in-sample suggested weights. Transformation function could be adjusted as well according to the data. REER as the most important variable with almost 26% weight could be computed using the unit-labour costs. In addition, one could think about bringing in a new political variable signalling the probability of a government collapse or plainly the time before the elections. In addition, statistical analysis could be used to transform the index to a probability measure and thus allowing cross-country comparisons.

Notes

* I would like to thank Alexander Chudik at ING Bank for tremendous help with the data.

[1] Such as mismanagement of investments with the state's influence on banks, the lack of good corporate governance, or elections-induced fiscal extravaganzas.

[2] Balassa-Samuelson argument suggests that assuming convergence, the converging country is bound to have higher inflation as well as higher productivity growth. We assume the trend represents a linear proxy of the long-run sustainable real appreciation of a currency due to the higher productivity differential.

[3] Corresponding to 20% density under normal distribution.

[4] Corresponding to 90% density under normal distribution.

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Section 5

Information Technology, E-business & E-governance

E-Banking as an Important Part of Electronic Commerce

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Abstract

The conditions of e-banking in the Czech Republic are analyzed in this paper. The level of e-banking in Czech financial companies is compared with today's global trends in the information technology. Challenges and possibilities of financial e-services - particularly e-banking are described. E-banking is sought not just as internetbanking, possibly homebanking, but also as phonebanking and GSM banking. Using these new technologies gives an organization the ability to better monitor transaction intensive activities - such as the ordering, the processing etc., and provides customers with higher quality level of the customer services. E-banking allows clients to access virtually almost all types of financial services in any time and in any place. We all, the members of global information society live and work in cyberspace in the age of information. New delivery channels and new products have emerged using IT. Application of logistics methods offers a new opportunity for organizations seeking to improve their corporate efficiency.

Introduction

Networking and telecommunication set up new conditions for global economic development. Revolution in business practices, economic restructalization, deregulation (institution deregulation, privatization, and price liberalization), and deindustrialization has yet started. The beginning century is characterized not only by power of information technology but also by differences between traditional, real economics of products and financial, virtual economics of financial products. There is an immense money transfer in the frame of global economics each day, financial transaction are considerable multiple in comparison with volume of product market. Predominance of global financial processes over investment in real economics could cause serious changes in a global frame.

The Development and the Advantages of E-banking

E-banking involves use of IT to enhance communications and transactions with all of an organization's stakeholders - customers, suppliers, government regulators, financial institutions, managers, employees and the public at large. Internet reformulates traditional modes of business. There are at least three critical challenges in competitive environment that companies have to face: demand risk - fewer customers want to buy our products, innovation risk – innovation often easy leads to imitation that could lead to oversupply, and inefficiency risk – lower cost of distribution - disintermediation means the elimination of intermediaries such as brokers, dealers etc. - and lower cost of communication with customers. The Internet services, particularly WWW service could reduce these risks. Advantages of e-banking:

- the speed of information transfer and the increasing speed of economic transaction,
- the time compression of business cycles,
- the influence of interactivity,
- the power and effectiveness of networks,
- opportunities for globalization.

The Application of Logistical Principles in Banking

The development of information technology has caused the new development of logistics as well. The using of the logistical principles in the banking industry is needed. This subject matter has not been so far adequately discussed. There is a considerable development in the fields of logistics and information technology. The shifts in behavior of clients change processes of their product choices and the advertising efficiency is decreased. The interchangeability of products and the price competition are leading for seeking of new effective methods as logistics to keep company competitive on the market. Business relationships are turbulently changing, driven by the increasingly important forces of speed, forces of globalization, and communication. Only by a fusion of resources in the logistic chain can the competitive advantage be maintained. The application off information technology for logistic procurement can open wide market opportunities, and replace inefficient paper-based systems. The reorganization of the logistic chain in banking is badly needed. Logistics as conventional tools of management of material flow can be applied to a model of the bank. First of all flow of information within and outside the bank has to be analyzed. Know how of the bank is a determinant. Workflow as well as webflow has to be defined e.g. movement of policy of insurance, evidence of trade processes etc. The simulation models could be used for solving different problems.

The Development of the E-commerce

The future form of Internet is unpredictable. The rapid development of IT is enormous. There is an estimation of the future development B to C (sometimes marked as e-commerce) and B to B (sometimes marked as e-business) in Fig. 1. We are also discussing e-culture (B to B, C to B, C to B, B to C...).

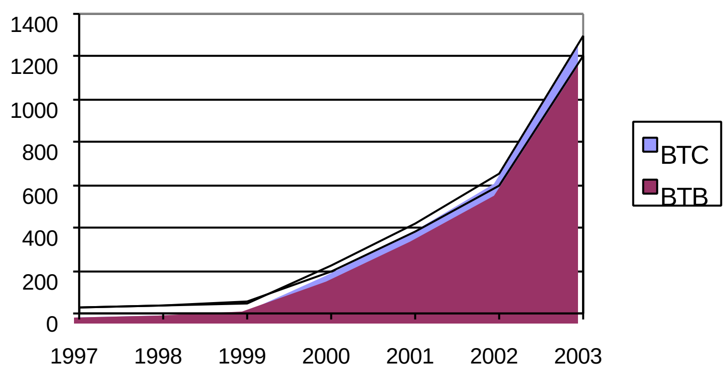

Fig. 1. EXPECTATIONS BTB AND BTC IN MILLIARD USD
Source: Forester Research in New Media Magazine

It’s also supposed that percentage of consumer banking – see Fig. 2 – is going to growth rapidly.

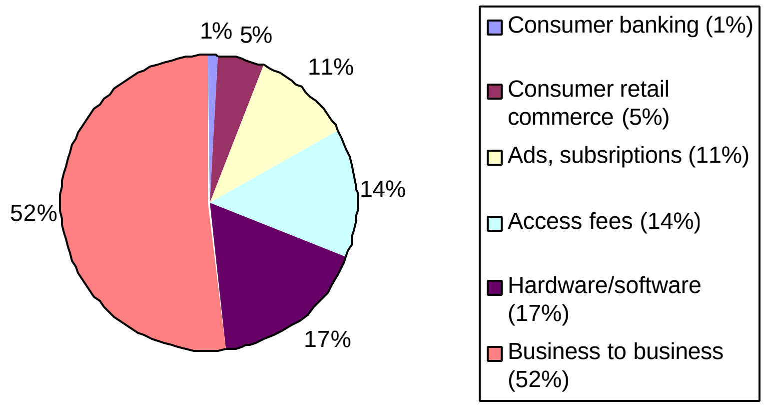

Fig. 2 STRUCTURE OF ELECTRONIC COMMERCE ESTIMATED FOR 2001
Source: Pricewaterhouse Coopers

E-banking in the Czech Republic

E-shops' revenues in the fourth quarter of the year 2000 reached 77 million CZK, the aggregate sales 2000 more than 185 million CZK. The first bank on Czech market providing internetbanking - in 1998 - was Expandia banka - now eBanka, following by Union banka – name of service I-banka, next CSOB, Citibank, Živnobanka - name of service Netbanka. At the beginning of April 2001 have started to offer internet services Komercní banka - name of service „mojebanka“ and Bank Austria Credianstalt - name of service - online banking. Till the end of this year offering of internetbanking is intended by GE Capital Bank. Using phonebanking could be cheaper – minus cost of running Internet– free call numbers are often used – and it is more comfortable for client who need to be mobile. Komercní banka offers product Expresní linka, Ceská sporitelna - Sporotel, CSOB - Linka 24, Živnobanka - Telebanka, GE CB - Telefon Banka, Bank Austria Credianstalt (BA/CA)– Nonstopkonto. For using GSM banking – clients have to pay for SMS – is necessary to have SIM toolkit - a banking application for mobile phone. The client has to select an active or passive control. Today GSM banking in Czech Republic is provided by six banks, mostly free of charge. Providers - IPB, eBanka, CSOB – Mobil 24, Union Banka, GE Capital Bank, and CS. The term e-banking represents internetbanking as well as phonebanking and GSM banking.

The share of the internetbanking market in the Czech Republic:

eBanka	52 %
CSOB/IP	19 %
Komercní banka	17 %
Ceská sporitelna	14 %

The share of the GSM banking market in the Czech Republic:

Ceská sporitelna	31 %
GE Capital Bank	24 %
eBanka	22 %
CSOB/IP	18 %

It is supposed that most people will be connected on Internet by mobile phones than by computers till the end year 2004. Tab. 1 shows number of users (in %) using computers at home, Internet at home, and mobile phones. Tab. 2 describes how often users are on Internet - March 2001.

Table 1 NUMBER OF USERS IN CZECH REPUBLIC

Year	**computer at home (%)**	**Internet at home (%)**	**using mobile phone (%)**
1996	23	-	-
1997	24	2	8
1998	25	5	14
1999	27	9	22
spring 2000	32	10	31
autumn 2000	36	15	53
spring 2000	41	17	66

Source: DEMA, AMR, Taylor Nelson Sofres

Table 2 NUMBER OF INTERNET USERS IN MARCH 2001 IN CZECH REPUBLIC

month	1 955 121
average a week	963 984
average a workday	361 756
average a rest day	192 927

Source: Acron

Major advantages for clients using electronic banking (source Markent, spring 2001):

- cushioness – 78% of users treat it as an important factor
- low charge – 64%
- fast money transfer – 62%
- easy to monitor transaction – 37%

Major disadvantages of electronic banking for potential clients (source TNS, summer 2001):

- the client does not have internet account in his/her bank – 38% of users treat it as an important factor
- off-line banking is sufficient – 26 %
- doubts about security assurance – 21 %

The largest European bank offering on-line services is Nordea – 2.4 million customers, the largest internet bank is Egg - 1.2 million customers and only a tenth of transactions in comparison with Nordea.

Conclusion

This paper is focused on the analysis of the major changes in banking. The rapid development of new technologies has caused a break in all aspects of financial services. Companies in a short time utilize new chances created by progress in the field of telecommunication. Particularly financial services on Czech market have been considerably changed during last years. It can be concluded that e-banking will further develop and will contribute to a further improvement in the field of human activities.

Key words: e-banking, internetbanking, financial services, e-commerce, logistics

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E-Commerce Strategies and Net-integration

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Abstract

Maybe it is too early to tell whether e-commerce produces sustainable competitive advantage. Observation and research indicate that e-commerce is producing clearly discernible changes in competitive environment. Some companies that had been leaders in some industries have already lost significant ground to upstart e-commerce companies. On the other hand, in some other industries e-commerce produces hardly any effect in the current industry structure. Since, what happened to one or few companies may happen again to others, we show in this article some aspects of e-commerce strategies and how they tie to information technologies.

Introduction

The information technology infrastructure that supports electronic business (e-business) services must be flexible enough to absorb new technologies and changes in the business model. To create an overall e-infrastructure blueprint, companies must identify functional components, adopt open standards, plan for scalability and security.

There would be a need to innovate. To do that, the infrastructure should be flexible enough to put in new applications. It should also be scalable to accommodate unpredictable demands such as customers' requests at different times.

Companies should also create value networks with their partners. Another critical issue is the need to be smart in managing e-business networks.

The Internet has become infused in the business. Every change we make in general now either includes e-business or considers e-business and how it affects our overall operations.

With the rush to the web and the perceived need to get your business online many people are unwittingly taking bad decisions over the way in which their e-commerce strategies are implemented.

One problem with a subject still so new - in relative terms - is the fast-changing nature of the market and the real risk that everything that one has invested in will become out-of-date or unworkable in a very short time. Therefore it is considered quite essential to get as much of the planning right as possible so that any future changes are more cosmetic rather than radical. In other words it might be easy to change the look and feel of your web site and add new features but it may be harder to suddenly change (once again) your distribution, ordering, planning and crucial internal infrastructure systems just as easily.

When e-commerce started, its customers were pleased to be rid of the sales person at the store; they were free to browse the shopping area at their own pace without the pushy sales person. Some nervous customers would call when they were ready to make the purchase, preferring to give their credit card number on the phone while talking with a real person rather than entering it on their computer keyboard. Now, few customers hesitate before paying over the Web. Several customers, however, do miss the sales person with the friendly advice and the answers to questions about the product.

The most difficult part of e-commerce is making the customer visit your site once and then making the customer return. A creative marketing staff can create the differentiation needed by your business.

E-commerce customers demand immediate response and expect personalized service. Addressing the needs of the customers places new demands on the organization. Many organizations have adopted communication channels on the Web. E-mail and chat are the two most popular communication channels on the Web, though the telephone is still a favorite. These customer demands do impact an organization's staffing decisions. More and more organizations are also turning toward Customer Relationship Management (CRM) software to better manage their customers' needs.

Outsourcing as an e-commerce strategy

Outsourcing is a good idea and a often implemented strategy. What are the benefits of outsourcing? One of the approaches to answer this question is to analyze the issues that can impact the decision of outsourcing:

Volume of transactions

The organization's estimate of the volume of transactions per day at the e-commerce site will have a big impact on its decision to outsource. A large volume of transactions requires higher investment in both the equipment and the people. Rather than taking on the responsibility of running the whole business in-house, organizations might choose to outsource certain parts.

Cost

Apart from the responsibility of running all the operations of the e-commerce business in-house, organizations might discover that the cost of outsourcing is actually lower.

Hardware investments

An important consideration is the required investment in hardware. As business grows, and as faster and better equipment is made available, the systems need to be constantly upgraded. Organizations could choose to use a vendor that provides the hardware and upgrades it when needed for a certain charge.

However, there are several vendors that offer hosting services but require the hardware to be provided. Even if hardware investment is an important consideration, the other services that are part of the package offered by the vendor should be carefully evaluated.

In-house technology know-how

Quite simply, if the technology know-how is not available in-house, organizations should choose to outsource. In some cases, it is less expensive than hiring an in-house technical team.

Security

Security of the e-commerce system is one of the most important issues that can make or break an e-commerce enterprise. Apart from the security of customers' information, including their credit card information, the security of the Web site is just as important. For example, if the online Web store is not accessible for a considerable length of time, it is equivalent to a customer arriving during regular working hours to shop at a brick and mortar store, only to find it shut. The denial of service attacks on several large Web sites in early 2000 reminded users of how vulnerable e-commerce businesses are to attacks by hackers.

Complexity of the application

The more complex the application, the more complex it is to build and maintain the system. Organizations could choose to outsource the creation of parts of the system or the entire system to a software development house. The decision should be based on cost and in-house technology know-how.

Back end, real-time transaction processing

This is also related to the complexity of the application. Each order placed on the Web site might be hooked up at the back end to database systems, managing the inventory and shipping, which work in tandem to complete the transaction. Outsourcing this back end processing could be an important issue to consider.

Community services

As part of its customer relationship strategies, an organization might choose to provide certain community services that allow its customers to interact with customer representatives and other customers. Managing these services can become an overhead in terms of finding and keeping the right people to run it. It might make better business sense to simply outsource this to a company that specializes in running such services.

Customer service

If the existing business processes already include customer service, it might be simple enough to extend that to the e-commerce side of the business. However, there are some issues that must be considered. For example, is access to customer service limited to e-mail, or will 24x7 service be provided? These considerations might lead the organization toward the option of outsourcing.

Order management, fulfillment, returns, shipping, and inventory management

This relates to the business processes that complete a transaction for each customer. Most of these operations can be outsourced, leaving the organization to manage the front end used by the customer to place the order.

Product catalog development and maintenance

If the organization has a very large catalog of products, or one that changes constantly, managing the catalog and keeping it up-to-date can be an enormous task. Similarly, if the organization has a customizable product, where users can choose different components or specifications for different parts to build the final product, catalog maintenance could sap internal resources. Some organizations prefer to leave this up to a vendor to update and maintain.

Multiple currencies

E-commerce has raised some debate about business across international borders. If the site accepts orders from international customers, the organization needs to deal with issues such as foreign exchange rates, import and export laws. The Web site also needs to be equipped to handle transactions in foreign currencies. Some of these issues could become cumbersome to manage in-house.

The decision to outsource is not a simple one. The issues listed above that need to be considered to make the decision all lead finally to the same questions: “Which option makes the most business sense?” and “Does taking on all of the operations minimize the focus on the organization's key competencies?”

In the highly competitive e-commerce world, it is critical to keep abreast of developments in the general market place and determine design aspects (both look and feel as well as functionality) that would be beneficial to the e-commerce offering:

- Skills in analysis of current product and category performance
- Marketing skills in seeking out and monitoring additional Web marketing opportunities
- Margin analysis in order to establish pricing for new products to be implemented on the e-commerce site
- Knowledge about industry and competitors.

Use of the existing communication networks

Almost all people are social. Maybe, except few computer specialists. Social scientists say that each person has a network of eight to fifteen people in their close network of friends, family, and closest associates. A person's broader network may consist of hundreds of people, depending on their position in society. Network marketers use and understand this power of human networks. People on the internet develop networks of relationships. They collect favorite http and e-mail addresses. Some special programs exploit such networks. It is important to learn to place the message into existing communications between people and thus multiply its dispersion. The medium that carries the marketing message must be easy to transfer and replicate: e-mail, website, graphics, software downloads. Digital format makes copying simple. From a marketing point of view, the message must be simple so it can be transmitted early and without degradation. To spread as fast as possible the transmission method must be rapidly scalable from small to very large.

Executives seeking competitive advantage from e-commerce must think about how their company might change its processes to serve customers more effectively.

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ICT, Changes of Mobility and Changes of Processes

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Abstract

Development of information and communication technologies ICT has an impact on the processes in the companies, in the institutions and in the communication systems creates the changes of modal split. Information and communication technologies are the part and also tools for marketing activities. The proposed paper will be dedicated to the problems of impact of ICT on the changes of mobility, possibilities and perspectives and on the changes of processes – case study for public administration.

Adequate analyse of the development impacts of communication infrastructure and services in the spatial dimension or the level of communication serviceability will be probably to resonate in the solution of behaviour of the subjects in the process of its planning and building, application and evaluation.

Nowadays the problem of sustainable development occurs in many discussions, debates, studies, research works etc. Reasons, for which is necessary to attend to enquiries of sustainability (for example: transport growth) and possible solutions (for example: using of new technologies, information and communication technologies /next only ICT/, products and services) are mentioned.

Why just ICT?

ICT nowadays enable to change using practices and substitute them by new ones, which are based on using of ICT, on information and data networks etc. They also make possible to obtain more information quickly, effectively, and comfortably and to adapt this obtaining to requests of individual subjects.

In the process of location of firms, or households, an affection of expenses, yield, income, innovation process, and profit occurs on one side, and on the other side, these subjects affect their surroundings, i.e. they affect location decisions of other subjects and the development of the region in accordance with natural living conditions.

From this point of view, our economic future calls for information and communication technologies that create new conditions for business or job opportunities. According to various studies, these technologies are the third most important factor in the decision making process of the firms about locating their activities. It means that the technologies determine the quality of the territory from the aspect of the location of economic activities, together with traffic channels and ease of access to the market [1]. At the same time the importance of information and communication technologies will be growing in accordance with the further development of the high-developed mobile society [2,4].

Besides the technological development, the following factors are important from the aspect of the observation of the demand for the communication:

- the space ones – centres; regional centres are more efficient, innovative, economically more developed, which is also connected with a higher level of the communication infrastructure, and with higher requirements on this infrastructure,
- the institutional and economic ones that now include, especially the integration processes within the regions (development of the cross-boarder cooperation), decreasing the use of subsidy tools of the regional policy, and deregulation of many branches and activities,
- the social-psychological ones that reflect and include the problems of life-style, employment, income groups, housing type, and so on. From the aspect of the demand for the communication, they are important and they influence the type and the volume of required products, networks, etc.

What is possible classification of ICT services like?

There is no fixed classification for ICT services. Their definition results from combination of definition of telecommunication services and information services, i.e.:

- Telecommunication services are such services, whose providing consists completely or mainly in information transfer through telecommunication equipment,
- Information services indicate utilisable capacity of information transfer and information processing, which is provided to a customer by service operator.

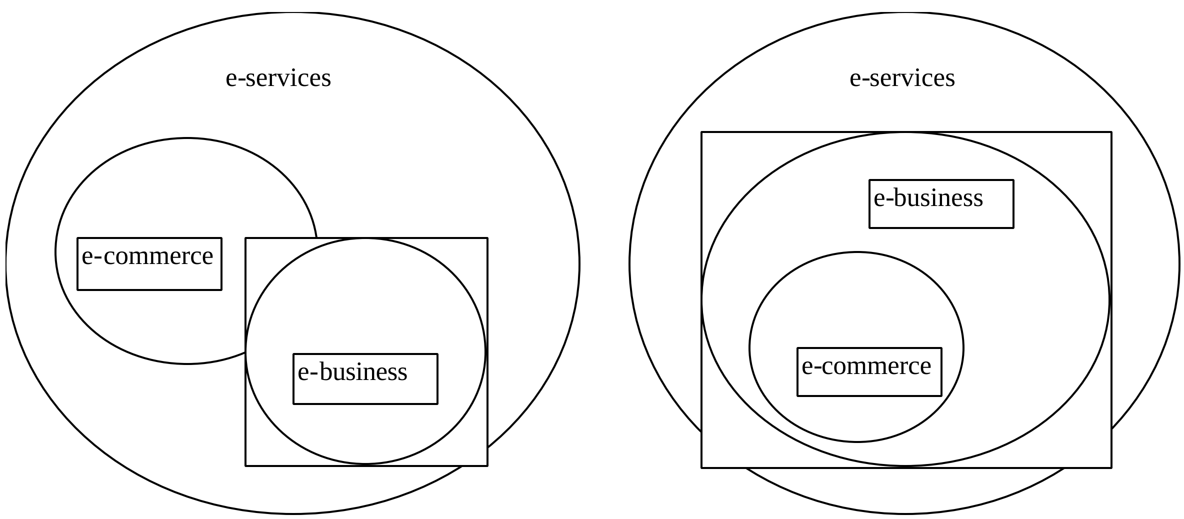
Applications alternatively multimedia applications are very often used indication (for ICT) too. It comes out from definition ETSI ETR 197, where these services are characterised as interactive, in which information exchange consists of at least two information types [3]. According to ETSI document SCR6 they are EII services or e-commerce type services:

- tele-learning
- tele-working
- tele-medicine
- tele-cooperation
- tele-shopping
- video on demand etc.

By ITU specification ICT services are divided to two groups:

- Interactive (conversation, etc.)
- Distributive (with or without the possibility of service management)..

Some relations among the following terms: e-services, e-business and e-commerce are displayed in the picture 1 and 2. It is evident from the pictures that there isn't so far incorporate looking at the problem of e-services.



a) structure and relations of e-services, e-business and e-commerce by www.pcrevue.sk

b) relation among the e-terms by Compaq

Fig. 1

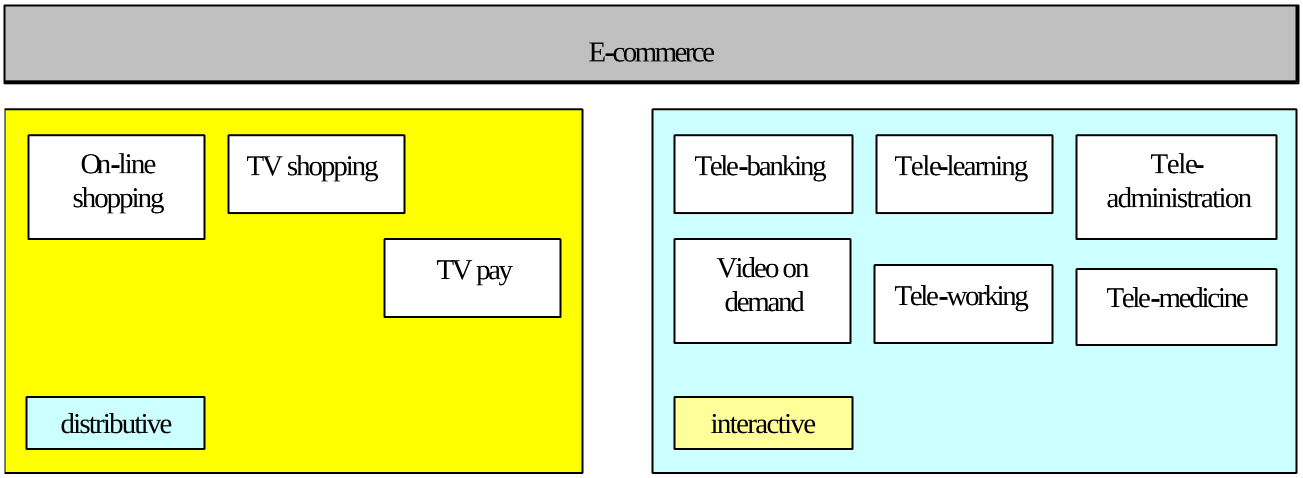


Fig. 2

What are potential effects in transport?

Single ICT services are more or less connected with solving problems of transport.

In this regard these services are mentioned the most often:

- tele-working,
- e-commerce

The wider application of tele-working service is linked with solving of staff problems as for its transport to and from work, elimination of morning traffic jam etc. These demands on transport are eliminated, though on the other hand new demands on transport originate. These new demands on transport - induced transport or derivate demand on transport – are linked to:

- providing of transport services in connection with e-business and particularly with e-commerce,
- providing of transport services, which are connected with other activities, processes than with employment itself. These are often interconnected directly with travelling to and from work.

We can say that changes of mobility, flows, tendency and time occur.

One of the important assumptions for transport sustainability is the creation of conditions for synergy effects of the ICT and transport systems and networks.

Nowadays global trends indicate network model of development, which is more based on complementarities [2] than on hierarchical relations and this affects elements of exchange and mobility within the territory and so it also affects design of communication service of the qualified territory.

We will define synergy in the communication service of territory as a result of co-operation of some communication subsystems and their elements, which together create an effect, which is greater than the sum of the effects of the individual subsystems.

The synergy in development of network represents higher degree of cohesion in the process of territory service, which is characterised by means of:

- interconnectivity, i. e. network-oriented synergy, which correspond to horizontal cohesion among various subsystems and their availability,

- intermodality, i. e. transport-oriented synergy, which reflects, that transportation process consists of sequential utilisation of various means of transport,
- interoperability, i. e. institutional-oriented synergy, which specifies operating and technical integration and co-ordination, which enable real interconnectivity and also intermodality on different levels for operators and users.

What are possibilities for changes of processes in institutions?

Significant moment in application of ICT in business and institutions is realisation of processes, which are passing in these subjects, in exercising of technological possibilities and in realisation of own application.

The external synergy is just a demonstration of making full use of the communication infrastructure and services in public administration. The synergy effects reside in changes of technological processes in public administration resulting in quality increasing of public administration and cost reduction at subjects functioning in the region.

Schematic representation of possibility of information flow mediation is listed in fig.3, where using of individual subsystems of communication service is possible to understand parallel and also in series [5]. Parallel various subjects use different manners of communication for purpose of acquirement of required information or documents, in series subject (citizen) utilises different manners of communication for realisation of individual advancing steps in obtaining required information or document.

Conclusion

The objective of our research in this field is to understand better the economic, technological and social aspects of e-services and their impacts on the transport, mobility and processes. The identification of relationships between them can help shape future policy and strategies.

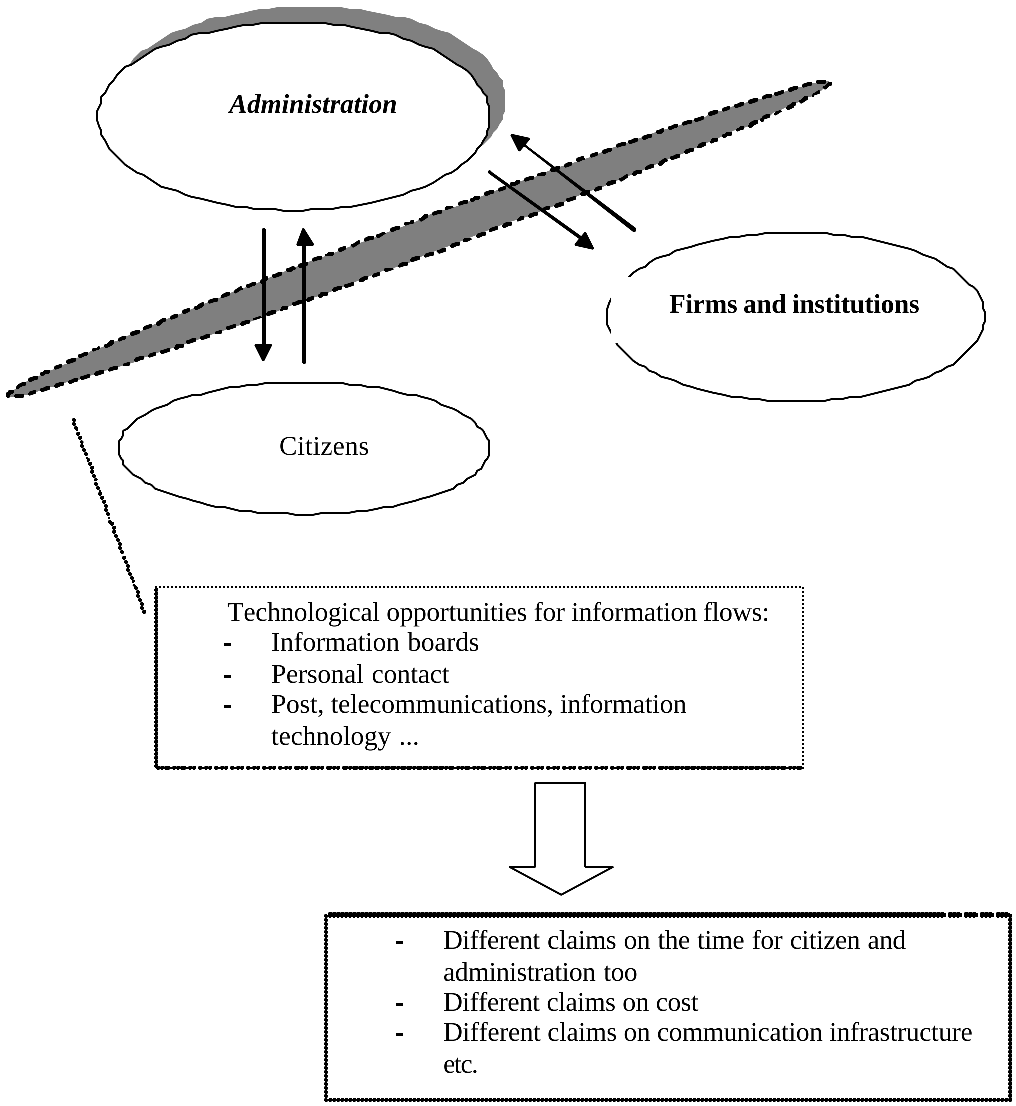

Administration
Firms and institutions
Citizens
Technological opportunities for information flows:
- Information boards
- Personal contact
- Post, telecommunications, information technology ...
- Different claims on the time for citizen and administration too
- Different claims on cost
- Different claims on communication infrastructure etc.

Fig. 3

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The Management of Strategic Global Relationship Knowledge: A Virtual Perspective

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Abstract

Globalization has arrived in the world but not in many of the world's organizations. There is little doubt that to be viable during next century, globalization and the rise of virtual organization are two of the most powerful forces affecting businesses. The increasing rate of change has put more pressures on firms to react quickly. Even before forces of global competition became clearly visible, there was a trend toward more flexible organizations, forms that are difficult to capture with a traditional organization chart. These flexible organizations, along with their associated strategic partners, have increasingly focused alliances of firms, functions and processes. New tools such as the Internet virtual reality, used in support of new global industrial initiatives, can only be implemented effectively through the sharing of knowledge. Computer networks will play an important role in the development of new organizational forms and virtual organizations. This paper analyses the management of strategic global relationship knowledge from a virtual perspective.

The first section of the paper is briefly describes virtual organizations that can be used to facilitate the transfer of knowledge among relational partners. The second section illustrates five models of virtual organizations where as, the third section develops a virtual management perspective that is beneficial when attempting to stimulate knowledge exchange. The final section of the paper describes implications of virtual management in global organizations.

"Different skills will be needed to interact within global community. Not surprisingly, the continual change in technology and competitive environment will present new opportunities and imperatives in the "wonderland" of virtual organizations. Virtual organizations are much like Chesire Cat (Alice in Wonderland). You my or may not seen them, but you know they exist."

(Jonson, Heimann and O'Neill, 2001)

Introduction

In today's hypercompetitive, global marketplace, many organizations are forming strategic relationships in order to compete effectively. One of the primary goals in these strategic relationships is to share/gain information and knowledge through these relationships. Many of these strategic relationships are conceived as a means to increase both the efficiency and effectiveness of those involved in these strategic relationships (34, 15). Inter-organizational relationships (i.e. strategic alliances) have become one of the most frequently used means of entering or expanding in the global marketplace. There are a number of reasons given for forming these global strategic arrangements, such as: 1) gaining access to new markets; 2) enhancing market position in existing markets; 3) augmenting existing product lines with relationship partner's products; 4) entering new market segments/domains by allowing partners to selectively incorporate existing products into their lines; 5) accelerating the rate of international expansion; 6) reducing cost/risk of participating in international markets; and 7) lowering costs to gain/maintain competitive advantage (31). The primary type of interorganizational relationship used by global organizations, the strategic alliance, has enabled many global organizations to obtain significant advantages. Therefore, it is anticipated that managing these and other types of interorganizational relationships effectively will become increasingly integral to managing global strategic operations.

The Virtual Organization Concept

A virtual organization is "a collection of business units in which people and work processes from the business units interact intensively in order to perform work which benefits all" (13, p. 158). Although virtual organizations have become a relatively widespread business approach to structuring business, the underlying concepts of linking competencies across business units or organizations have existed for some time. These business linkages enable organizations to more tightly coordinate the transactions and activities across a value chain. Virtual relity, virtual space, virtual organizations, virtual teams; "virtual" is today's organizational buzzword. (19)

Virtual organizations enable organizational and/or individual core competencies to be brought together when needed and disbanded when no longer required. These new firms mirror the fluidity of the global markets, creating and disbanding resources as dictated by the marketplace. Global location, technical, workforce and market expertise advantages can be heightened through the use of the virtual organizational structure (9).

The rationale for forming a virtual organization varies for the different entities involved in each relationship. One primary rationale for creating virtual organizations has been the ability to bring key players from a variety of organizations together in order to pursue a specific global market opportunity. Virtual organizations are able to generate new products more quickly, decrease the risk of pursuing a new opportunity, increase "apparent" organizational size, and decrease cycle times by relying on the core competencies of the membership. Characteristics of virtual organizations are continuing to evolve. However, some characteristics that have been identified include (13):

- a web of companies each contributing resources
- virtually vertically integrated
- linked through inter-enterprise business and production systems
- aimed at reduced business cycle time
- aimed at one-stop shopping.

These characteristics are closely aligned with assessing all strategic activities across the entire global value chain in order to "virtually vertically integrate" across a "web of companies". It would appear that creating a virtual organization to generate a product or service more effectively can take one of two forms: 1) removing inefficient transaction costs from the value chain, such as reducing time to market; and 2) adding value to existing activities in the value chain enhancing the overall value of the product or service.

Virtual Global Organizational Models

Virtual global strategic organizations involve interorganizational relationships that exist in a variety of forms. These relationships can be based on existing relationships among firms and often reflect prior competitive or cooperative interactions (17). In addition to these interorganizational strategic relationships, firms must have an economic incentive for participation. Strategic needs, desire for performance enhancements, or an attempt to foster innovation can drive these incentives. Nike was one of the first organizations that took advantage of advanced communication and logistic technology to create a global network of organizations to produce athletic shoes instead of keeping all the work inside the organization (21)

Five identifiable models of virtual global strategic organizations begin to emerge from the existing literature (see Fig. 1). These models share common elements of coordination through the use of IT and communication technologies, and the performance of work across time and space.

	Location	**Work Cycle**	**Culture**	**Organizational Relationships**	**Virtual Management Issues**
Shared Partnership (Model 1)	Often co-located, a spin-off approach	Often highly synchronized activities	Typically homogeneous cultures, although distinctive	Typically strong preexisting relationships	Challenge of adapting existing relationships into virtual management
Core/Satellite (Model 2)	Typically not co-located unless performing physical job functions	Often highly synchronized activities	Less emphasis on culture, more use of contracting relationship	Existing relationships have been established	Ongoing assessment of old/new partners in constellation
Virtual Value Chain (Model 3)	Typically not co-located	Highly synchronized across adjoining members of the value chain	Some emphasis on culture across adjoining members, but more contractual	Often existing relationships limited to adjoining members only	Identifying alternative partners for expanding value chain globally
Integrated Firm (Model 4)	Often co-located or located in close proximity	Often highly synchronized with coordinated scheduling	Higher emphasis on culture as a competitive advantage	Strong existing relationships among at least some members	Initiating offensive, defensive, and existing strategies
Electronic Market (Model 5)	Rarely co-located	Highly responsive, but not necessarily highly coordinated	Similar service oriented cultures, but not necessary	In many cases few existing relationships	Auditing and exit strategies; competitive response

Fig. 1: VIRTUAL ORGANIZATIONAL MODEL CHARACTERISTICS

Model I: Shared Partnership

The first model is a shared global partnership with each partner bringing nearly equal amounts of commitment to the virtual organization. This shared partnership requires a compatibility of partner goals and values (11) and evolves from existing relationships that are strong between partnering organizations. A specific shared global partnership is likely to occur when several organizations wish to undertake a global strategic project, where the group of organizations, is aggregate, possess the necessary skills and resources agree to work together for either the duration of the project or for some extended period. In this design, organizations form alliances or consortia to bring complementary strategic expertise together in meeting complex global market opportunities. The interorganizational relationships in the virtual model can provide additional value to participating firms. They also create some interdependencies and provide an opportunity for cooperation between the strategic functions in these organizations. Economic incentives include the opportunity to share costs and risks while sharing resources likely to generate valuable output. This model is often found in co-located, spin-off situations, where multiple firms share resources to develop new products or processes, working in close coordination. The work is often highly synchronized in the design and development stages. The shared partnership model is evident in the coalescing of expertise and sharing of risks among IBM, Sun, and Hewlett Packard on the development of the Internet programming language JAVA.

Model II: Core/Satellite

The second model reflects a core global organization maintaining relationships with satellite strategic organizations. The core global organization calls on advertising agencies, wholesalers, retailers and the like, from a variety of organizations to respond more effectively to market opportunities (3, 16). In many cases these are organizations based around similar industries located in different countries each providing strategic competency or expertise. In this model, a core firm provides the impetus to form the global network of organizations (30) and this firm typically defines the work synchronicity, calling on satellite firm strategic capabilities as needed.

These organizations do not need to be co-located and frequently are located in different countries. The global relational culture can be either convergent or divergent, but the core firm(s) plays a dominant role in establishing the culture. Core firms typically take an active role in coordinating activities, providing economic advantages. Examples of this are numerous, including most industries where the core company has leverage and transfer-pricing and risk/cost sharing, become key issues, including governmental defense contractors and some consultancy companies. An alternative core/satellite model is the production and sale of consumer products through loosely coupled manufacturers, distributors and retailers in different countries. Ford and its global suppliers have formed this type of virtual relationship, as they share new product development ideas for new car development as was evidenced in the development of the "Asia Ford." This co-development reduces cycle time and lowers development costs. Another example of this type of virtual relationship is used by global information organization, Reuters, which utilizes this model in software development, bringing in satellite partners as required for specific projects. This provides a "best breed" approach to partners and maintains Reuters firmly in control of project specifications.

Model III: Virtual Value Chain

The final three models are based on the value or global supply chain model. The first of the three is a coordinated set of transactions among companies serving an end customer in a number of different countries with information technology supporting the development of the end product or service. This model is utilized on both a project basis, as in large construction projects in developing countries, and on a more permanent basis, as with WalMart and international suppliers.

The work is synchronized across adjoining virtual organizational member firms to generate the end product. Essentially goods or services are sold at each transaction point in a number of countries. Location can be remote across many members of the chain, but often those adjoining firms are closely located even when the suppliers have to put in facilities in a number of different countries. In the case of international construction projects, the general contractor often drives culture, and in many cases the use of contractual requirements is a surrogate for establishing inter-firm cultural relationships. Relationships have often been well established, but on a project-by-project basis, the virtual model provides additional support for the relationship between subcontractors from different countries who do not have a common board or a joint working relationship. When this occurs, the relationship is coordinated by the general contractor who establishes the virtual cultural relationship. Participants anticipate economic incentives through improved coordination, a smoothing of demand, and opportunities to increase global market access. Benetton, the French sportswear marketer, utilizes a global virtual value chain in coordinating the production and shipments of garments and materials of its virtual global production and channel of distribution system. The virtual value chain passes through a number of suppliers generating textiles, designing and manufacturing clothing, and providing distribution services to retailing establishments.

Model IV: Integrated Firm

The fourth model takes a more integrated view of the global supply chain. This vertical integration results in autonomous units utilizing technology to coordinate efforts between functions and countries at the same time. A group of companies conduct related businesses as parts of a vertical set of processes to produce a good or service. This concept incorporates a continuing set of global strategic relationships (4).

In this type of global virtual relationship, the companies agree to function as a single vertically integrated firm throughout the world. This network of companies is frequently located in different countries participate across a strategic value chain to deliver a product or service to an ultimate consumer generating a virtual value chain (7). The contact between companies across the specific production activities is more fully coordinated than in the prior models. Culture and work synchronicity are more important dimensions, and in many cases one of the relationship member operations provides a unique geographic location to the needs of the integrated value chain (e.g. suppliers locating in the same countries as strategic members of the value chain). Existing strategic relationships among the organizations following this model are typically well developed, which leads participants to identify the value of improved coordination, including the economic leverage of economies of scale and market access to a number of foreign markets. This model might also be extended to include value constellations (20) with firms supplying each of the companies in the value chain. Many of the Korean chaebols are examples of this global model of virtual organizations. This model is utilized by Kone Elevators, a Finnish elevator manufacturer, to integrate the work of its affiliated companies throughout the world. This provides sharing of market information, design specifications, and coordination of manufacturing to maintain a competitive advantage at both local market and global system levels.

Model V: Electronic Market

The final global virtual strategic relational model is that of an electronic market, with the technology itself serving as a key component in creating the market among the virtual global strategic organizational partners. Individual firms operate within the electronic market using the technology as an intermediary to interact with end customers. The establishment of an electronic market (6) allows firms to compete in global markets while allowing customers to select from a variety of potential providers. In some cases, the electronic market is open and other strategic relationship members serve as intermediaries. An example of an open market is the wine market and digital newspapers on the World Wide Web, with multiple vendors competing for worldwide business.

Existing relationships between countries are less typical in this model. Participants have economic incentives of increased foreign market access and potential for compelling cost savings in inventory, physical location, and distribution costs. Examples include amazon.com connecting with book dealers and end customers worldwide, or virtual banking establishments coordinating the lending functions and electronic payments among on-line retailers, payment authorizers and the end consumer in a number of countries. In addition to bookstores such as Amazon and banks, electronic markets have established worldwide capabilities for auctioning of goods as diverse as furniture and computers to high-end antiques and personal services (e.g. eBay on-line auction).

Virtual Management of Global Strategic Relationships

Strategic relationships and the management of these relationships can be characterized as "virtual" as a significant amount of activity between relationship partners occurs outside their organizational domains and therefore, occurs in non face-to-face contexts. Given the difficulty of managing the entire domain of potential global strategic relationships in this virtual mode, a basic philosophy of global interorganizational management should be developed. This management orientation, more than likely, will have to go beyond the command and control model that is frequently used within organizations and focus on cooperation as the basis for the interaction.

The coordination among strategic partners in a virtual relationship becomes a critical dimension in achieving the desired results of increased value-added to the global relational network (23, 12). More virtual relationships must develop a mechanism for structuring and coordinating work/employees while at the same time being exceptionally flexible and open to change while alleviating managers and employees anxiety that results from lack of formal structure (1). These virtual relationships/ organizations will develop a culture and identity of their own apart and distinct from that of the two parent organizations (1). What is needed is a decision process that can be used to determine the virtual management requirements associated with the different virtual models. In order to manage these global organizations virtually, an assessment of the "degree of virtualness" between global partners is necessary.

The establishment of virtual management has been characterized as effectively coalescing key "players" from internal and external sources and from a variety of organizations to capitalize on a market opportunity (9). The appropriate infrastructure for virtually managing strategic relationships will be dependent on the geographical distance, work-cycle synchronicity, and cultural differences between relational partners (Palmer & Speier, forthcoming). Frequent contact and "hand-holding" can occur in relationships with low geographic distance facilitating rich relationships. These strategic relationships can be managed differently from those where high richness is desired yet partners are geographically disparate . Organizational culture is one of most important factors that lead to successful virtual organization. It's an adaptive technologically advanced non-hierarchical organization is more likely to succeed with virtual teams than a highly-structured, control –oriented organization (5) Similarly, a high degree of work cycle synchronicity implies high interdependence and low ambiguity regarding work activities. In contrast, low synchronicity involves increased ambiguity resulting in additional time and communication between partners. Finally, the cultural dimensions assess the degree to which relational partners share values and beliefs (29). The greater the cultural convergence, the easier it is to develop trust, mutual understanding, and foster a rich relationship.

Seven steps addressing virtual management of global strategic relationships is presented in this section. Each of the steps will be discussed separately to highlight their importance in developing a virtual management philosophy to global strategic relationships.

Step One: Development of Relational Characteristics/Criteria

The first step in developing a global virtual management orientation is to identify the characteristics of the domain(s) of the potential relationships. As the domain (i.e., internal, organization-to-organization, organization-to-individual) changes the degree of virtualness between partners also can change based upon the geographical distance, work-cycle synchronicity, and culture between the focal organization and the relational partner (22). If relational partners are working in the same location, at the same time, and have convergent culture, the management system does not have to be modified to accommodate the virtual nature of the relationship (14). Whereas the need for a sophisticated virtual management philosophy is imperative, when the relationship partners work in geographically disparate locations, at different times, and have dissimilar cultures. The more dissimilar the context of the relationship the more virtual the management system must become to accommo date the complexities of these diverse strategic relationships. As the domain of the relationship changes the degree of virtualness of the management will also have to be modified. Each domain and dimension of the domain impacts the degree of virtualness of the management philosophy (27,29).

Step Two: Identification of Alternative Relational Partners

While the domain of relationships may be broad, organizations may strategically decide to focus on one set of strategic relational opportunities over others. For example, developing an organization-to-organization relationship may be deemed most important to gain global competitive advantage in the market place. Therefore, rather than examining all potential relational partners in the full domain of relationships, one domain may be assessed to identify key strategic partners. In this phase of global virtual management, one must identify the significant characteristics of potential relational partners. These variables will vary by the domain of the relationship and therefore a set of selection criteria needs to be established for each potential relational configuration.

The criteria to select global relationship partners reflect the domain of the relationship. For example, when forming organization-to-organization relationships, a three-step assessment of macro-environment, industry level analysis, and company level characteristics consistent with competitive analysis (24, 25, 26) might be most appropriate. The analysis may start at any level, but all three levels should be considered. Furthermore, the depth of analysis at each of the three levels may vary according to the importance of that level to the relationship, the difficulty in obtaining accurate information, and the perceived magnitude of importance of the relational decision relative to the focal organization (28). Utilizing this process, the unique attributes of the potential relational partners can be assessed and the distinctive competencies of the resulting relationship can be determined (23). The combination of characteristics found in the relationship determines how the relationship can strategically outperform competitors (32) and facilitates the determination of a global virtual management strategy.

Step Three: Comparative Assessment of Relational Partners

This stage of global virtual management development focuses on the direct comparison between potential strategic relationship partners on the criteria established in the preceding step. The goal of this stage is to develop a discriminate analysis among the potential relationship partners and to determine when there is a significant difference between potential partners. The result of this analysis may be a ranking of the potential candidates or a classification system that identifies highly attractive to unacceptable candidates. In this step, the degree of virtualness (location, work-cycle synchronicity, and culture) should be determined to establish the management philosophy most appropriate for the global virtual model in place. The linkage between the virtual partners can also be analyzed to ascertain the necessary activities for maintaining the strategic relationship over time and the degree of relational richness may become a critical dimension in the ultimate selection of relational partners.

Step Four: Initiating Relationship Strategies

The primary objective of this virtual management stage is to identify the motivation for forming the relationship. There are a number of reasons that could provide the impetus for establishing a long-term global strategic relationship. Most frequently, relationships are proactive, offensive strategies (e.g., increasing economies of scale, increasing power relative to a competitor, expanding distribution) to improve competitive position in the marketplace. Following this orientation, the focal organization implements a relational strategy to improve effectiveness and efficiency in their operations maintaining a relative advantage over competitive rivals.

While offensive motivations for forming relationships dominate the rationale for entering relationships, there are a number of defensive or reactive reasons to form a relationship. The primary defensive motivation is to affect a stronger competitors' market position or competitive advantage. Examples of defensive strategies include: 1) reducing the power of one member of a channel-of-distribution by forming a coalition; 2) entering a market through a relationship to test new products to avoid a negative impact on primary markets; and 3) reducing government influence on new product testing and introduction. Overall, the defensive motivation for forming relationships recognizes the difficulty of meeting the business challenges in hyper-competition markets.

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Step Five: Managing Relationships Over Time

The virtual management of relationships must take into account the original assessment of the global strategic relationship and how that relationship may change over time. The initial assessment of what was needed to have a successful strategic relationship might have been assessed incorrectly or perspectives on the goals of the relationship have changed over time. Developing a management auditing process could enable assessment of relationship changes over time.

The relationship auditing process should include the following steps: 1) assessing the initial goal of the relationship and the commitments made during the formation of the relationship; 2) analyzing change in the external environment which could impact the value/benefit of the relationship; 3) evaluating the configural advantage of the relationship relative to future competitive positioning and market opportunities; 4) determining the explicit cost of maintaining the relationship; 5) determining an appropriate set of exiting strategies. The audit process should be periodic, systematic, and independently undertaken to provide objective data on the present "value" of the relationship.

Step Six: Response to Reaction from Potential Relational Partners and Competitors

Existing strategic relationships create potential opportunity cost associated with the development of future relationships. By virtue of having existing global strategic relationships, potential other strategic partners may be precluded from entering into relationships with the focal organization. Therefore, assessing potential relationship constraints should be undertaken to determine the sustainable competitive value to existing relationship relative to other configurations that could be formed in the market place. Similarly, competitors' reactions to the formation of a relationship should be monitored to determine their strategic reaction, (10).

Step Seven: Exit Strategies from Relationships

There may be a number of reasons for terminating a relationship: 1) the relationship did not reach predetermined goals...was not successful; 2) growing differences between relational partners...changing goals; 3) breach of explicit and/or implicit relationship agreement...relational incompatibilities; 4) changes in the market place (consumer/competitor) that makes formation of another relationship more attractive...heightened opportunity cost; 5) internal problems in focal organization that necessitate dissolution of relationship...change in strategy, ownership or financial problems; and 6) the original goal(s) of the partnership have been met...successful completion of the intent of the relationship. The motivation to exit the relationship may also be based on the inability to manage the strategic relationship effectively and may be the sole impetus for leaving relationships.

There are a number of termination strategies that need to be evaluated when exiting a relationship. Several alternative strategies have a proactive exit orientation, such as termination by acquisition, substitution of new member(s), and selling the intangible rights of the relationship to a third party. However, many terminating relationships occur in a negative context. The unplanned, unfriendly dissolution of a strategic relationship can have a significant impact on business exchange. Mutually derived benefits for partnering organizations can be disrupted due to uncertainty associated with the dissolution of the relationship. Trust relative to the ability to perform after the termination of the relationship becomes a significant issue for both relationship partners to address (12).

Summary/Conclusions

Assessing and implementing virtual organizational models and virtual management provides an organization a template for increasing the control and viability of its global operations. Each virtual model is likely to require greater emphasis to certain facets of the virtual management process and less emphasis on others. This emphasis will be related to the degree to which existing relationships exist and the power distribution (e.g., shared partnership vs. core/ satellite) between organizational partners.

Relationships necessitate an inter-organizational management perspective and one that is capable of delineating the differences between the various types of global relationships. By recognizing that there are differing types of relationships and that the management of these relationships needs to be adjusted over time, marketers can better maintain control and reach the goals established for the relationship. Strategic relations provide a great opportunity for globalization of strategic strategies. But without a means to effectively manage these relations, the ultimate impact of these strategic alliances will not fulfill the expectations of those involved in the relationships.

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Web-Based Support for e-Government

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Abstract

This paper presents main ideas, basic architecture and possible impact of the WEBOCRAT system, which is being developed within the EU-funded project Webocracy ("Web Technologies Supporting Direct Participation in Democratic Processes") on the quality of services provided by a public administration institution.

1. Introduction

The Webocracy project responds to an urgent need for establishment of efficient systems providing effective and secure user-friendly tools, working methods, and support mechanisms to ensure the efficient exchange of information between citizens and the administrations [3]. This project addresses the problem of providing new types of communication flows and services from public administration institutions to citizens, and improves the access of citizens to public administration (PA) services and information. The new types of services will increase the efficiency, transparency and accountability of PA institutions and will have impact on their policies toward citizens.

In [9] a three-phase strategy, for implementing e-democracy consisting of initiation, infusion and customisation phases, has been proposed. E-government and e-politics are there identified as elements of *e-democracy*. *e-Government* informs citizens about their representatives and how they may be contacted. It also improves government efficiency by enabling citizens to make transactions online. *E-politics* is the use of Web technology to improve the effectiveness of political decision-making supporting participation of citizens in this process.

The first, *initiation phase*, starts with establishment of a portal that conveniently links citizens to (all levels of) government. Next, *infusion phase*, means restructuring the organisation in order to accommodate innovation. And, finally, *customisation phase* of e-democracy system implements a one-to-one relationship between citizen and government.

The WEBOCRAT system focuses on support of infusion and mainly customisation phases by various specialised modules. Customisation will enable citizens to finely focus on personally critical issues.

Our approach is focussed on the concept of *strong democracy* [2]. Unlike quick democracy that wants to speed up the decision-making processes, strong democracy wants to slow them down by involving people in discussion and deliberation processes [1]. One of the main novelties of our approach is the knowledge-based support [6]. Information of all kinds produced by various modules or segments of these documents is linked to a shared ontology representing a domain of public administration (local government). Such ontology serves as a means for structuring and organising knowledge. The advantage of clear structuring is more powerful search and retrieval engine, and more user-friendly content presentation [5].

In this paper, current status of the Webocracy project is presented. First, a hierarchy of criteria which are being considered at the design of the WEBOCRAT system are introduced in section 0. As next, rough architecture of WEBOCRAT system as it has been proposed is described in section 0. Moreover, pilot applications defined by local authorities who are user partners of the Webocracy project are briefly described in section 0. Finally, section 0 provides a summary of the main conclusions of this paper.

2. Motivation

The proposal of the WEBOCRAT architecture is based on a set of criteria in order to guarantee its quality. Two kinds of criteria have been considered:

- User requirements
- General criteria

The former represent necessary conditions – minimal functionality which should be provided by the system in order to support users to comply with tasks they face during their activities (these requirements are defined in [4] and [8]). They define services, which should be offered by the final system. The latter represents additional requirements, which, although not expressed in an explicit way, increase the chance of the final system to be adopted by users (e.g. user-friendliness, speed, etc.). All considered criteria are depicted in FIG. 1.

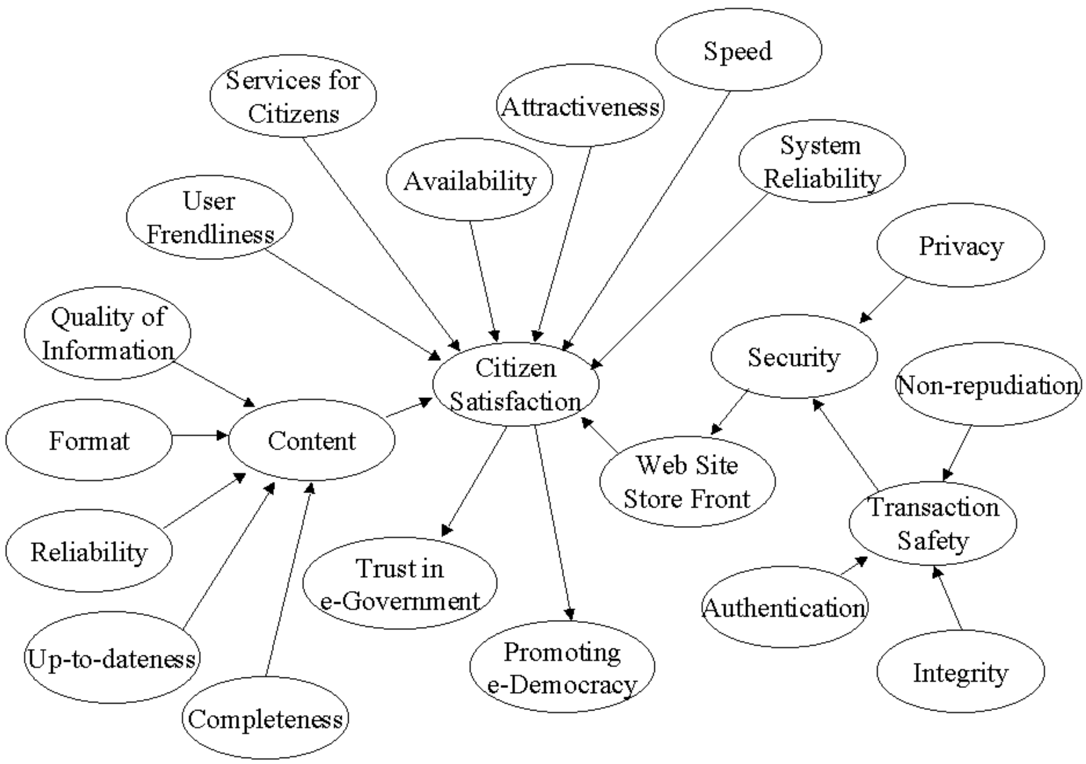

Fig. 1: A COMPREHENSIVE MODEL OF E-GOVERNMENT CONSTITUENCY SATISFACTION

The criteria form a hierarchical structure resulting in satisfaction of citizens. If this is achieved, it can imply trust of citizens in e-government and simultaneously it can have effect on promoting e-democracy.

"Trust" (psychological status of involved parties who are willing to pursue further interactions to achieve a planned goal) should be developed among citizens, elected representatives, and public administration institutions on-line. The trust in e-government should be a "knowledge-based trust", i.e. grounded in the knowledge of the other party and procedures it uses. In addition to this trust between involved parties, it is necessary to have trust in the used infrastructure and e-government environment.

Adoption of a system, which is focused on meeting the above-mentioned criteria, brings different kinds of benefits:

Benefits to local government (LG):

- Decrease of the costs of creating, processing, distributing, storing, and retrieving information
- Support of “reengineering” of intra-organisational and inter-organisational processes. By changing the processes the productivity of LGs, administrators, councillors can increase significantly.
- Improved citizen service
- Improved image, increased flexibility, expediting access to information
- Improved knowledge management, decision making in LGs
- Support of organisational learning

Benefits to citizens:

- Access to information and LG services (24 hours a day, all year round) from almost any location (anytime, anyplace)
- Increased speed of services
- New quality of services
- New types of services, customisation of services

Benefits to society:

- Increased transparency of PA
- Improved services for citizens, entrepreneurs and other user groups will result in fostering of local economic development

3. Architecture of the WEBOCRAT system

Basic scheme of the proposed WEBOCRAT system is depicted in

FIG. 2. The system is based on knowledge modelling technology. Ontological knowledge models are employed in order to index all the information present in the system. Therefore first layer - *knowledge models* are depicted in the core of the scheme on

FIG. 2.

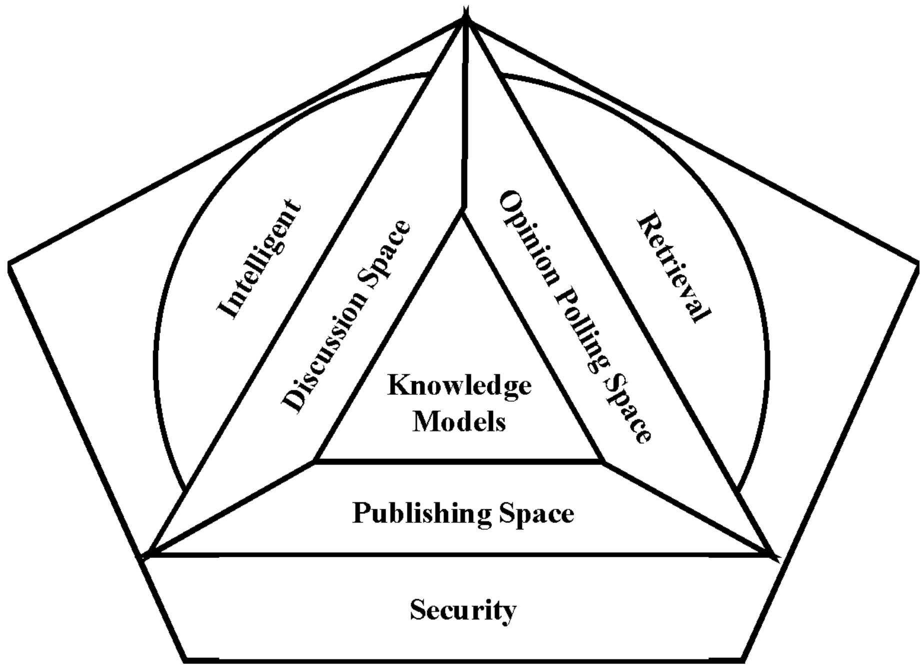

Fig. 2 THE PRINCIPAL SCHEME OF THE WEBOCRAT SYSTEM

From the technical point of view, the system will be based on results achieved within the EU-funded KnowWeb project (ESPRIT project 29065, 1998-2001) focused on organising information using domain specific knowledge models [6]. These models play the role of domain specific indexes (with own internal structure). Their employment enables precise annotation of information based on its content, which results in efficient and powerful information retrieval capability [4].

The second layer is represented by *publishing*, *discussion* and *opinion polling spaces* providing means for storing, updating and managing (in principle three slightly different types of) documents and their relations among themselves, as well as their relations to the knowledge model in the WEBOCRAT system.

The *Discussion Forum* (DF) module will support intelligent communication processes between public authorities, citizens and their elected representatives. DF will be responsible for documents in *discussion space*.

The *Web Content Management* (WCM) module will support publication of documents on the Internet, i.e. it will be responsible for documents in the *publishing space*.

The *Opinion Polling Room* (OPR) will enable electronic opinion polling featuring also with support for authentication and voter's privacy. OPR will be responsible for documents in the *opinion polling space*.

The third layer is composed from two retrieval-focused modules supporting retrieval capabilities that need only read access to the three above-mentioned spaces as well as to the knowledge model. The *Information Desk* (ID) will retrieve relevant documents of different types that are stored in the system.

The *Reporter/Summary* (REP) module will provide means for calculation of a variety of statistics as well as some more sophisticated approaches based on, e.g. data mining techniques. Moreover, this module will provide also alerting functionality, which has been required by our user partners in [4].

Alerting means, that as part of the registration process, registered users should be able to indicate interest in specific topics (linked to the knowledge model) and request email to alert them to new items relating to these topics. They should also be able to restrict the number of alerts received, either by requesting only a specified number of the most relevant to their selected topics in a given time period (day/week/month), or by requesting a digest email (one per day/week/month) including all the relevant items.

User registered in the system as an individual entity (i.e. not anonymous user) is provided with a personal access page ensuring him/her an individual access to the system. This page is built in an automatic way and can contain several parts. Some of them can be general and the other are person specific.

The former can serve as a starting point for browsing all published documents accessible to the user, all conferences he/she is allowed to participate in, all running polls for which he/she is eligible, using search facilities of the system, read hot information, etc. The latter parts are devoted to user's personal newsletter, links to documents and conferences topics of which match the user's area of interest.

The personal access page hides division of the system into modules. Terms 'publishing space', 'discussion space', and 'opinion polling space' do not confuse users. The personal access page enables user to access all functionality of the system that he/she is allowed to access in a uniform and coherent way.

4. Pilot applications

The first trials will be devoted to basic features of discussion, publishing and polling spaces. The second trials will involve all features on knowledge modelling technology, alerting and personalisation.

The two trial phases will provide the context for all implementation and evaluation activities. In each phase, each of the user partners will conduct trials concurrently. Wolverhampton City Council (WCC) is responsible for the design, specification and evaluation of the trials in the UK. The Local Authority Kosice - City ward Tahanovce (LATA) and The Local Authority Kosice - City ward Dargovskych hrdinov (LAFU) are responsible for pilot applications and trials in Slovak Republic.

The first trial in WCC would make use of all three available modules (DF, WCM, OPR) and involves partner agencies and citizens. It has the advantage of taking place in small, local areas and addressing local issues, which makes things easier for marketing purposes and promoting local usage. As the issues are ones which are of direct interest to local citizens and partner agencies, it is hoped for a higher than average response.

First trial in LATA will make use of WCM and OPR modules. LATA wants to focus their pilot application on web publishing and content management, in order to effectively inform citizens and all other users. This is one of the form how to access information as defined in valid law of the National Parliament of the Slovak Republic number 211/2000 of the Code of Laws, The Free Information Access Law. They want to make the matters of public administration clearer and easier for the citizens and support them by expressing their opinions.

In LAFU the trial will be focused on a special use of discussion forum plus OPR for evaluation purposes. At present state no citizen can check on the processing status of his/her document(s) submitted to the Local Authority. User knows just the processing deadline, which is 30 days after document entry date. The proposed WEBOCRAT pilot application should enable the user to check the processing status of his/her submitted document(s). After positive authorization any citizen will be able to see how his/her document has been handled. Moreover, the WEBOCRAT system will enable easy electronic submission of documents to the Local Authority.

5. Conclusions

In this paper the main ideas of the Webocracy project and basic motivation for the design of the WEBOCRAT system as well as its coarse architecture have been presented.

The Knowledge Module [7] represents the core of the system on which the other components are built. This system will provide automatic routing of messages from citizens to the appropriate person within the PA; tracking of processing citizens requests/complaints within PA; tools for easy access to PA information and to competitive tendering; discussion forums involving citizens and government representatives (DF); on-line opinion polling on defined issues of public interest (OPR); tools for publication of documents on the Internet, browsing and navigation (WCM); tools for identification, authentication and security built into the system (Security module); intelligent retrieval (ID), calculation of summary statistics, alerting services (REP) and convenient access to information based on individual needs (personalized User Web-interface).

The WEBOCRAT system will bring PA closer to citizens, making it more accessible and easier to understand. The system will encourage more participation in democracy as well as making administration more efficient. This proposition should be approved by various pilot applications, which have been designed by user partners of the Webocracy project. First trials of these pilot applications have been also sketched here.

Acknowledgements

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Section 6

Management Strategies, HRM & Knowledge Management

Borrowing Strengths from one's Allies - a Successful Competition Strategy

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Abstract

Traditional competitive strategies of Slovak firms involve making tough choices on three dimensions: which customers to focus on, which products to offer, and which activities to perform, well known as "the who-what-how" framework. New environment in integrating Europe and globalisation of industries have a great influence on change of approaches in strategy creation process. Traditional effort to win a battle on markets as individual firm is gradually replaced by effort to compete with support from allies as strategic partners. One of the conditions for creating strategic alliances is to be attractive for strategic partners. Results of realised research project indicate assumptions for creation of strategic alliances in Slovak industries.

The development of the theory and practice of strategic management in Slovakia has been dramatic within the last decade. While at the beginning of the transition period the hunger for all fields of modern management theory was generally dominant, there is need to select different approaches and adapt theories adequate to changing situation in business environment in this period of growth.

This situation is a logical result of interruption in managerial theory development during the four decades in twenty century. While highly developed countries started with strategic management in the 1960's, the first steps in strategic management were done in central European countries only at beginning of the 1990's. The first information about theory and practice of strategic management came from basic literature sources, from educational courses assigned to executives and from strategic management courses in the business schools. Early literature sources include Ansoff's (1965) Corporate Strategy [1], Andrew's (1965) The Concept of Corporate Strategy [2] and Porter's (1980) Competitive strategy [3]. These early works described contingency perspective, resource-based framework emphasising internal strengths and weaknesses and industrial organisation economics.

Strategic management has traditionally focused on business concepts that affect firm performance. The field of strategic management is eclectic in nature, with emphasis on firms' internal strengths and weaknesses relative to their external opportunities and threats. Methodologically, the early theories emphasise the normative aspect of business knowledge and are chiefly interested in identifying and developing the "best practices" that are useful for managers.

Using a structural analysis approach, managers prefer an analytical framework that can be used in understanding the structure of an industry. Structural analysis focuses on competition beyond a firm's immediate and existing rivals. Porter's Five Forces Model enables to specify the various aspects of an industry structure, provides a useful analytic tool to assess an industry's attractiveness and facilitates competitor analysis. The ability for a firm to gain competitive advantage rests mainly on how well it positions and differentiates itself in an industry. The collective effects of the five forces determine the ability of firms in an industry to make profits. The five forces embody the rules of competition that determine industry attractiveness, and help determine a competitive strategy.

Strategy management theory also developed the concept of "strategic groups." Porter [3] defines strategic group as a group of firms in the same industry following the same or similar strategies. This concept disagrees with the assumption that industry members differ only in market share and, hence, suggests that the presence of strategic group in an industry poses a significant effect on the industry's performance. The concept of strategic groups is closely linked to mobility barriers, which insulate firms in a strategic group from entry by members of another group through means such as scale economies, product differentiation, or distribution network. Mobility barriers represent crucial factors, in addition to industry-wide factors, in accounting for intra-industry differences in firm performance. In this regard, industry is no longer viewed as a homogeneous unit to the extent that the concept of strategic groups exposes the "structure within industries".

While the strategic group concept represented the first way from industry level analysis, another approaches focus on competitive dynamics. The essence of this stream is an explicit recognition that firms' strategies are dynamic. Actions initiated by one firm may trigger a series of actions among the competing firms. The new competitive landscape in many industries gives rise to relentless pace of competition, emphasising flexibility, speed, and innovation in response to the fast-changing environment. The term "hypercompetition" used to describe the condition of rapidly escalating competition, characterises many industries. The increased interest in competitive dynamics research signifies the strategy researchers' acute awareness of the new competitive landscape in the environment.

The competitor action-reaction provides another point of view on competition dynamics. This way of thinking about business competition explicates the interactive, dynamic nature of firm competition. The competitive theory, also with theory of strategic group, demonstrates the field's ability to integrate economically based arguments with management theories and concepts, such as information processing, to create a unique body of research with a strong focus on the firm and competitive interaction.

While competition strategies emphasise industry-level phenomena, strategic management is concerned with firm-level strategies. Application of the competition theories brought new and important focus to the strategic management. However, building on the early work of Ansoff and others, there remained some missing pieces of the puzzle. Research has shown that some firms perform better than others in the same industry and/or within the same strategic group. This suggests that firm-level phenomena are important. Furthermore, the competitive landscape for many industries began to change, particularly with the development of global markets, as opposed to domestic markets. Foreign firms entered domestic markets and, in some cases, armed with new ideas and strategies, began to capture significant market shares.

Rapid changes in environment during last decades created the new competitive landscape. One of the most important changes in many industries is the increased level of globalisation. As firms compete in the global market, the competitive resources and positions of firms become more complex. Hence, it is more difficult for strategic management researchers to examine research questions using a single theoretical framework. Increasingly, researchers are integrating multiple theoretical frameworks to explain complex international strategic issues. The sustainability of competitive resources obtained from the global market may represent a different dimension for firm competition. These resources can be obtained from global level learning by means of foreign subsidiaries or through strategic alliances.

Co-operative strategies, especially network strategy on an international scale, continue to shape the trajectory, nature and pattern of business competition. Challenging issues such as international alliance partner selection and acquisition of new knowledge or technology are likely to capture the attention of many strategic management researchers in the near future. Related to the issue of globalisation is the importance of the institutional context of international research. In a similar vein, firm strategies, organisation structures, and governance mechanisms successfully pursued and implemented in a particular institutional context may not achieve the same outcomes in another institutional context. The universality of specific competitive advantages will be increasingly called into question. Certainly, more research is required that accounts for the institutional differences among geographic or cultural environments.

In recent years, we have witnessed a surge of alliances among major corporations throughout the world. These inter-firm relationships involve partners from various parts of the world and cover a range of functions and activities. They often tend to be strategic, formed in direct response to major strategic challenges faced by the partner firms.

The primary driver of strategic alliances is the emergence of intense global competition, which has rendered simple but time-tested strategies, a staple of major corporations, less effective. Firms must constantly innovate to forge ahead of equally innovative rivals throughout the world. They must develop new capabilities in a number of areas, ranging from technology development to manufacturing processes, from plant economies to marketing and distribution, and do so quickly.

The strategic alliance links specific faces of the businesses of two or more firms. At its core, this link is a trading partnership that enhances the effectiveness of the competitive strategies of the participating firms by providing for the mutually beneficial trade of technologies, skills, or products based upon them. The alliance can take a variety of forms, ranging from an arm's-length contracts to a joint venture. Sufficient characteristics of the strategic alliances are:

- The two or more firms that unite to pursue a set of agreed goals remain independent subsequent to the formulation of the alliance.
- The partner firms share benefits of the alliance and control over the performance of assigned task – perhaps the most distinctive characteristic of alliances and the one that makes them so difficult to manage.
- The partner firms contribute on a continuing basis on one or mo re key strategic areas, e.g. technology, products, and so forth. [4]

Strategic alliances are not a new idea. Already during the fourth century B.C. ancient Chinese war strategists advised to borrow strengths from an alliance. Sun Tzu in his work The Art of War emphasised first and foremost the importance of avoiding bloody conflicts as much as possible. Therefore, the biggest form of victory is to conquer by strategy. To win a battle by fighting is not the best strategy; to conquer the enemy without having to resort to war is the highest, most admirable form of generalship. The next best form of generalship is to conquer the enemy with an alliance – by borrowing strengths from the alliance [5].

During the transition process of the economy, Slovak firms go through a difficult period of finding and creating their strategies. Many of them successfully based their strategy on principles of strategic alliances. Borrowing the forces from strategic alliances is one of the best ways of strategy for companies from developing economy with a relative small home market, but with strong core competencies and competitive potential for competing in integrating Europe and global markets.

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Communication in Slovak Organizations in Relation to Power Distance Dimension of Slovak National Culture

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Abstract

This article outlines the results of a survey that focuses on communication and feedback practices within Slovak organizations. The survey was based on a sample of 512 questionnaires that addressed all levels of management in Slovak companies in a variety of industries and businesses with different financial and capital ownership structures. The primary goal of the survey was to link communication practices and feedback style to Hofstede's power distance dimension thereby portraying the communication style in corporations conducting business in Slovakia. It focuses on demonstrating differences in communication and feedback within the companies involved with regard to such factors as gender, age, span of control, managerial position, tenure and form of ownership.

Long gone are the days when organizations solely relied on domestic sources of labor. With the currently intensifying movement of organizations and labor forces across borders, the presence of culturally diverse workforce phenomenon in companies is stronger than ever. This fact represents two critical aspects of the current labor market and business environment – on the one hand there are individuals whose movement in search of work opportunities is more flexible and thus their employment possibilities are beyond national boundaries. On the other, the corporations need to re-think their approach to management when entering a new country, whether via joint-venture, merger or acquisition. Regardless of the form of ownership, entrance into a new labor market and the implementation of foreign management practices and styles imposes several challenges on foreign managers, challenges stemming mainly from cultural differences.

Every individual (as a member of a specific national culture) has a set of attitudes and beliefs created in the process of family upbringing, education and work experiences and which contribute to the formation of a set of filters through which the person sees various management situations in the work environment. Such filters generally represent national cultural values, of greater importance to most individuals than those of an organization. This is the case simply as a result of the "childhood rooted" origins of national cultural values. Thus, we can view organizational cultures as being formed on the platform of nationally shared values and beliefs.

Geographically extensive research on individual dimensions of national cultures has been performed. The area of Central and Eastern Europe however, has been historically excluded from the attention of a complex study. The transformation economies of this geographical area, with their "post - big brother is watching" national culture specifications present a new challenge to western management practices. For multinational companies expanding their activities into this region, it is necessary to adapt to the unique aspects of the local culture in order to manage the local human resource reservoir effectively.

Five Dimensions of National Culture

Organizational culture is a categorizing principle of employee opinions and understandings of their work, their approach to it and the way in which they anticipate to be treated. National culture entails that a specific way of behaving on the part of a superior is preferred to another. If management practices are inconsistent with these deeply held values, employees are very likely to feel dissatisfied, distracted and under appreciated. On the other hand, employees are more likely to be focused on their performance if not distracted by the management's requirements to behave in ways that are inconsistent with their own values.

The science of social anthropology has developed a theory that all societies, in today's world mostly represented by individual nations or geographically grouped countries, face similar problems. What makes one culture diverse from the other are the reactions of individual cultures to these problems.

This concept has become the foundation for the research of Dutch academic Geert Hofstede, who has identified five main areas, or dimensions, representing similar problems that each national culture faces, and in reaction to which, they differ.

The first national cultural dimension is *collectivism/individualism*, depicting the relationship between the individual and the group in a society. Individualism implies a loosely bound social network in which people focus primarily on taking care of themselves and their families. Members of individualistic cultures place more importance on individual self-respect and encourage and honor individual achievements in organizations. In contrast, collectivism is characterized by firm social networks in which people strongly distinguish between their own groups (departments, divisions or even organizations) and other groups. Members of collectivist cultures are expected to look after their co-members protect them and give them security in exchange for their loyalty. People from collectivist cultures place importance on fitting in harmoniously and in "saving face".

The next dimension is *masculinity/femininity*, which assesses the social implications of having been born as a boy or a girl in a culture. The dominant values in masculine cultures put stress on assertiveness and acquisition of money while not overly emphasizing concern for people and relationships. Men's and women's roles in this type of culture are more rigidly predefined. Men are expected to be assertive, women to be nurturing. Possessions are important and performance is what counts. Achievement is admired and celebrated within organizations. Cultures that are characterized by femininity, stress relationships and concern for others. Quality of life is important and people and environment are emphasized.

The *uncertainty avoidance* dimension relates to the control of aggression and the expression of emotions. It represents the extent to which people are threatened by uncertain, unknown or unstructured situations and thus epitomizes the degree to which they try to avoid risk taking and perilous situations. In countries with a high uncertainty-avoidance index, clarity of plans, policies and rules is stressed. Reliance on clear and well-defined procedures reduces uncertainty and discomfort with the unknown.

A dimension *of long term vs. short-term* orientation in life refers to a country's time orientation. This dimension has been added to Hofstede's original four dimensions in order to capture the values primarily relevant in Asian countries. Long-term oriented cultures are distinguished by patience, respect for elders and ancestors and a sense of compliance and duty toward the larger good. In organizations it reflects long-term employment practices and lengthy but precise problem solving.

The last of Hofstede's dimensions is *power distance*, which is the spotlight of our study with a major focus on organizational communication as the key paradigm in internal distribution of power.

Power distance

Power distance measures the extent to which less powerful members of organizations accept an unequal distribution of power. In other words, it provides answers to questions of the following nature: To what extent do employees acknowledge that their superior has more power than they have? Is the manager correct because he or she is the boss (high power distance) or are the superiors correct in their decisions when they know the proper answer (low power distance)? Do the employees perform a particular task simply because their employer wants them to do it that way (high power distance) or because they believe it is the best way to do it (low power distance)?

Power distance is small in countries where superiors and subordinates work closely together and consult one another. They consider each other as more or less equal even if there is a difference in authority, pay or even in education level. The hierarchical system changes, depending on the circumstances. Structures are flat with a decentralized organization and with a small number of supervisors. Within such a company the degree for unequal treatment is reduced to a low level. There is interdependence between employer and employee. As a result of a low power distance, the salary range is narrower between the top and bottom of the company. Subordinates expect to be consulted during the decision-making process.

In contrast, in countries with a high power distance index the relation between manager and subordinate is strictly defined and dependent on the decisions of the superior. In companies with higher power distance indices that also have a very centralized organization, subordinates expect to be told what to do from their superiors because they consider each other as unequal. Inequalities are normally expected and superiors see privileges as desirable. There is a large tendency towards centralization and the salary range is wide. People express positive emotions to superiors and negative emotions to subordinates. Superiors and subordinates deem bypassing to be insubordination (in low power distance countries, employees circumvent the boss frequently in order to get the work done). Employees are seen as afraid of disagreeing with their employers and employers are viewed as autocratic or paternalistic.

The power distance index informs us about dependence relationships in a country. In small power distance index countries there is limited dependence on the part of subordinates upon their managers and a preference for consultation. The emotional distance between them is relatively small; subordinates will quite readily approach and contradict their bosses. In large power distance countries, there is a considerable dependence of subordinates on managers. Subordinates respond by either preferring such dependence or rejecting it entirely, which in psychology is known as counter-dependence[1].

In organizations, power distance influences the amount of formal hierarchy, the degree of centralization and the amount of participation in decision-making. Participation is an important sub-dimension of power distance. The efficacy of participation in high power distance cultures is doubtful. Employees in high power distance cultures are likely to view participatory management with fear, distrust and disrespect because participation is not consistent with the national culture. Managers who encourage participation are likely to be seen as weak and incompetent.

Power distance in relation to organizational communication

All of the above mentioned aspects of power distance contribute to the style of communication in organizations.

It is only obvious that, in organizations built on the platform of low power distance, communication is more informal and straightforward, relying on discussions and participatory decision-making. Employees do not fear to discuss or even oppose their manager on work-related issues. Such communication could be classified as open and dialogue-based. Feedback is mutually exchanged. Communication is based on consensus, involving participatory decisions. Subordinates expect frequent feedback from their superiors and superiors are expected to possess quality feedback skills. Communication is more intensive on vertical levels, corresponding with naturally more flat organizational structures.

In organizations of high power distance, more formal ways of communication are expected. Superiors give orders that only those placed above in the hierarchy of the organization are to discuss. Their decisions are automatically accepted. The attitude of a “yes man” is preferred and expected. Communication flow is more horizontally-oriented. Those with (legitimate) power are viewed as the carriers of knowledge; decision-making is often autocratic which only implies close reserved communication.

The research findings

The presented research focuses on one aspect of power distance: communication and feedback. It is the first and the most crucial skill that managers use, especially when they face a foreign business setting. Communication, both formal and informal, influences the quality of work done, the attitudes of employees, their engagement in work as well as the way managers and the workplace are perceived. Whether communication is open or closed is an indicator of the relationship between managers and subordinates. The ability to provide constructive feedback is also an indicator. As such, they can depict the state of power distance in a certain cultural setting. Although there are more indicators that can portray power distance in a particular culture, we have focused on communication as it plays a significant role and indirectly reflects other aspects of power distance such as respect, tendencies to accept orders without questioning them, a willingness to actively participate in discussions etc.

The primary aim of the survey is to describe the style of communication in Slovak companies. If the communication is open then organization is of a low power distance, and vice versa. Simultaneously we examine whether the communication differs in any way in relation to gender, age, span of control, managerial position, tenure, and type of ownership.

We have addressed managers form both Slovak companies and companies with foreign ownership as we wanted to examine whether the style of communication differs in respect to the form of ownership.

As attitudes and preferences toward working in a small vs. large company or toward foreign vs. domestic companies may vary, we have decided to include all types of companies throughout all regions of Slovakia.

The total number of questionnaires sent was 718. They were sent to 52 companies with a final count of returned, filled-out questionnaires amounting to 512 from 35 organizations. This represents a 71.31 % return rate on individual participants and 67.3% on the companies. The enterprises actively involved in the research cumulatively employ 11,765 people. We consider this sample more than sufficient for analysis.

To examine the style of communication, we have created a questionnaire that is comprised of three parts. The first section is about the demographics of the respondents, asking their gender, position in the company (top, middle, low level management), type of ownership (Slovak or with foreign capital investments); tenure (1 year, 2-5 years, 6-12 years, 13+ years), the number of employees in the company as well as the number of direct subordinates. We have also asked the respondents to identify their age by choosing one of the following categories (less than 30 years of age, 31-45, and 45+).

The demographic characteristics of the respondent group were as follows. There were 115 (22.55%) top managers, 205 (40.2%) middle managers, and 190 (37.25%) line managers. The group consisted of 390 (76.32%) male respondents and 121 (23.86%) female. Out of the sample, 64 (12.52%) were younger than 30, 190 (37.18%) were from the group 31 – 45 years of age, and 257 (50.3%) people were older than 45. There were 432 respondents from Slovak companies and 72 from those with capital investments from abroad. The most frequent number of direct subordinates was four, indicating a rather narrow span of control. The extreme numbers of direct subordinates, however, ranged from 1 to 135. There were 511 respondents who identified their tenure, out of which 33 (6.46%) have worked less than one year for a company, 101 (19.77%) who work 2-5 years with the company, 123 (24.07%) who work 6-12 years with the company, and 254 (49.71%) who work longer than 13 years with the company.

The second part of the questionnaire consists of 30 statements evaluated on a 1-5 Lickert scale, where 1 indicates the least acceptance of the statement and 5 indicates that the respondent fully agrees with the statement. There are various statements from different areas that evaluate the attitudes of managers towards their work, their managerial style, and communication style. For the purpose of this paper those statements are analyzed that deal with communication and feedback. The third part of the paper consists of questions where the respondents are asked to evaluate statements qualitatively, indicating the responses that are the closest to what they think about the statement. There is also space available for their own individual responses. For the purpose of this study all relevant parts of the questionnaire have been statistically analyzed.

From the second part, we extracted the following statements (all of them with a scale raging from 1 representing the statement “never” to 5 representing “always”):

8. I have troubles getting feedback from my subordinates.
12. In case my subordinates do not agree with me, they express it openly.
13. I have difficulties finding out whether my subordinates agree with my decisions.
19. I regularly evaluate work performance of my subordinates.
23. I can express criticism of my superiors without any problems.
24. I can discuss serious problems with my superiors at any time.
30. My superiors keep important information for themselves.

These seven statements are to be divided into two subgroups – one referring to the relationship towards the manager’s subordinates (statements number 8, 12, 13, and 19; Table 1) and the second looking at the relationship towards the manager’s superiors (statements number 23, 24, and 30; Table 2)

The following tables give average and median values for each of the statements. It also gives more detailed elaboration, comparing gender, age and position within a company in relation to the questions:

Table 1 COMMUNICATION TOWARDS SUBORDINATES

Question number	**8**	**12**	**13**	**19**
Average	2.16	3.73	2.21	3.88
Mode	2	4	2	4
Median	2	4	2	4
Gender				
Male	2.1	3.7	2.22	3.9
Female	2.34	3.84	2.17	3.81
Position in the hierarchy				
Top management	2.1	3.75	2.24	3.87
Middle management	2.21	3.69	2.23	3.81
Line management	2.13	3.77	2.14	3.97
Age				
under 30	2.11	3.74	2.15	3.75
31-45	2.17	3.72	2.20	3.86
45 and older	2.15	3.74	2.23	3.93
Tenure				
1 year	1.97	3.77	1.97	3.98
2-5 years	2.14	3.74	2.16	3.86
6-12 years	2.24	3.73	2.23	3.66
13 and more	2.14	3.73	2.26	3.99
Ownership				
Slovak	2.19	3.72	2.23	3.87
Foreign	1.96	3.78	2.07	3.89

As can be inferred from the table the managers do not perceive their subordinates as reluctant to provide feedback or general opinions on manager’s actions. The average response was 2.16, meaning “almost never.” Here the responses were very close and do not show statistically significant differences. The only group where we could see differences in receiving feedback from the employees was in the male/female category, where women indicated slightly more problematic access to feedback (2.34 on average) than men (2.1 on average). Also, the availability of feedback was slightly better in international companies (1.96) when compared to those that are purely Slovak (2.19).

This is also supported by question #13 in which managers were asked to evaluate the feedback of their subordinates in estimating whether they can tell how much their subordinates comply with their decisions. Here the average answer was 2.21, standing for “almost never” and very close to the responses in question # 8. As the table demonstrates, the responses do not vary significantly across age, tenure or managerial position. Responses, however, show a slight tendency toward more open communication in foreign settings. What is interesting, but not very surprising, is the fact that top managers indicated the most problems when finding out what their subordinates think of their actions, middle managers less and line the least.

Question #12 states that, when subordinates do not agree with their supervisor, they can express so. Here the average response was 3.73, standing for “almost always” and again the values do not deviate across managerial positions, age or tenure. However, when compared across gender, women indicate to be slightly more accepting of criticism (with value 3.84 against 3.7 for men). A similar situation occurs again when comparing Slovak to foreign companies, where foreign companies tend to be more supportive of negative feedback and criticism.

The last question of this subgroup was question #19, measuring whether managers regularly evaluate work of their subordinates. The average response here was 3.88, meaning “almost always.” As with other responses, the values do not differ significantly across various categories.

Table 2 COMMUNICATION TOWARDS SUPERIORS

Question number	23	24	30
Average	3.25	4.39	2.92
Median	3	5	3
Mode	3	5	3
Gender			
Male	3.23	4.37	2.91
Female	3.34	4.48	2.95
Position in the hierarchy			
Top management	3.27	4.32	2.68
Middle management	3.27	4.3	2.88
Line management	3.22	4.56	3.1
Age			
under 30	3.3	4.39	2.81
31-45	3.19	4.38	2.91
45 and older	3.29	4.4	2.96
Tenure			
1 year	3.48	4.76	2.85
2-5 years	3.45	4.48	2.8
6-12 years	3.15	4.24	2.91
13 and more	3.19	4.39	2.98
Ownership			
Slovak	3.19	4.34	3
Foreign	3.58	4.66	2.48

The second set of questions deals with the relationship of the managers towards their superiors. In question #23 the respondents evaluated the extent they can freely express criticism of their superiors. Here the average response was 3.25, with both mode and median at value of 3. The response “sometimes” seems to be rather neutral, with the most extreme value of 3.58 in the subcategory of foreign companies. Statement #24 asks whether the manager can consult serious problems with his/her superiors. Here the average value is 4.39, meaning “almost always.” Both the median and the mode are of the value 5, or “always”. This might suggest a rather discussion-supportive environment. The last statement was to examine the trust relationship between managers and their superiors when asking to indicate whether their superiors keep important information for themselves. The results here were 2.29 in average, with median and mode values 3.

When looking at these three statements across different categories, the most significant shift toward open communication is in the foreign companies. This suggests that foreign management practices do influence the style of communication at the workplace. They are more supportive of both asking and providing feedback as well as of asking and sharing information with others.

The second significant category was among the employees whose tenure is shorter than one year. Their interest in accepting feedback, communicating with subordinates and superiors might stem from the fact that they are new to the environment and are learning how to work efficiently and effectively.

An interesting point is drawn when comparing questions #12 with the question # 23, which have essentially the same content, except that question # 12 is directed to the openness of communication towards subordinates and question # 23 towards superiors. The statistics show that communication is more open toward subordinates (mode and median of value of 4, meaning almost always) than to superiors (mode and median of value of 3).

Conclusions

Communication style, in general, among the examined responses, seems to be open and supportive and therefore tends toward a low power-distance index in the companies involved in the survey. Communication flow is easy, both in formal and informal ways of communication.

When compared across the four questions, several interesting conclusions can be drawn. Managers who have the shortest tenure (up to 1 year) show the most open feedback-welcome communication style. They not only initiate communication while encouraging their peers to comment on their performance but are also willing to provide others with feedback. This might be due to their insecurity with the new work environment as well as due to their efforts in getting to know their work, their position, and in learning the rules of the new workplace.

Also, when comparing Slovak and foreign companies, communication tends to be slightly more open in international companies, possibly, because of different managerial styles and practices implemented from abroad, mostly from companies that support a "Western" managerial style. When compared with Slovak companies, the managers from foreign companies indicated fewer difficulties in getting feedback from their employees and fewer problems finding out what their subordinate really thought. There seems to be more discussions between managers and employees.

Young managers under the age of 30, indicate the most open, easy-going communication style with regard to their subordinates.

Another interesting conclusion can be drawn when communication between subordinates and superiors are compared. While managers indicate a willingness to discuss issues with their subordinates in an open, easy-going manner, their approach toward their superiors is slightly more reserved. This may be due to several factors. (1) They may overestimate the "ideal" style of communication toward their subordinates and thus consider it to be better than it is in reality. Unfortunately, the shortcoming of this study is that it does not examine the attitudes of all employees in the companies and looks only at those at the managerial level. (2) The second reason why there are discrepancies might be that communication in general is still rather respectful towards higher authority. This may suggest that there is still room for improvement in the area of open, assertive communication.

Based on our questionnaire and its analysis, communication should be considered generally open, thus leading us to conclude that the workplace environment in the Slovak cultural setting is of low power distance.

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Enhancing the Performance of Organizations by Competency Based Management

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Abstract

This paper brings information on some results of the research, which was made at the Department of management CU, Bratislava. The aim of the research was to collect information on recent developments in the theory and practice of Competency based management in the USA and Great Britain, to compare it with the situation in Slovakia and to draw conclusions and recommendations for further development of the theory and practice in Slovakia.
The paper concentrates at following questions:

- **What is the "competency" or "competence"?**
- **Identification of needed competencies.**
- **Core competencies.**
- **Organizational structure and core managerial competencies.**
- **Core competencies of organization.**
- **Comparison of the situation in the USA and Great Britain with the situation in the Slovak republic and some conclusions.**

Introduction

In recent years in the USA, Great Britain and in some other countries there has been a very intensive discussion on competencies and on competency based management. Many articles and many books were published on these problems. This was the reason why we, at our Department of management made some research into these problems. The aim of our research or exploration is formulated in the Abstract of this paper. In this short paper we would like to touch some basic questions of the competency based management. We are preparing now a book, in which these problems will be described and explained in much more details.

1. What is to be understood under the notion of "competency"?

In the literature published in the USA and Great Britain we can find two similar expressions: "competency" and "competence". Some authors make a distinction between these expressions. According to some authors the expression "competency" (plural: "competencies" is connected with the behavioral approach while the expression "competence (plural: "competences") is connected with the approach of minimal standards. However, in the practice many organizations don't make any difference between these expressions. There are some differences in the literature published in the USA and in Great Britain. In the USA they use the term "competency" ("competencies"), while in Great Britain is common the term "competence" ("competences").

There are many definitions of "competency" or "competence". The most popular is the definition formulated by Parry (1996). According to Parry "a competency is a cluster of related knowledge, skills and attitudes (K, S, A) that affects a major part of one's job (a role or responsibility), that correlate with performance on the job, that can be measured against well-accepted standards, and that can be improved via training and development".

Developing the competencies of individuals and the competency of the organization as a whole requires according to Lawler ((1994) different approaches to organization design, to work design and human resource management in the areas of selection, career development, pay and overall competency management. According to new views traditional job descriptions are not flexible enough for a changing world. The answer is the competency approach.

2. Identification of needed competencies

The most difficult and most complex is the decision how to identify the competencies, that are needed for successful job performance. There are many approaches to this problem. Here is not place enough to describe different approaches and different views to this problem. The book Competency based management which we prepare to publish will contain the characteristics of different approaches to the problem of how to identify needed competencies, and the overview of competencies formulated in the studies from 10 organizations in the USA and also the different views on the problem who has to identify the competencies and for which employees is it necessary to formulate the competencies.

3. Core competencies

In the literature on competency based management very big attention is being paid to "core competencies". Studies made by Prahalad and Hamel and mainly now classic article published in Harvard Business Review "The Core Competencies of the Corporation" (1990) were major factors in sustaining the great interest in competency approaches. Researchers and officials were challenged to identify core competencies of managers that would reinforce collective learning in the organization. Burack, Hochwater and Matys (1997) formulated a General Core Competency Model, which contains three different groups of general competencies: (1) general mobility skills and knowledge, (2) general managerial core competencies and (3) detailed, job specific competencies. There are also, other different approaches, but all of them stress the need to formulate core competencies for managers.

Christoper Barlett and Sumantra Goshal (1997) came to the conclusion that it is necessary to abolish the myth of a "generic" manager and to strive to define new management roles and management competencies for these new roles and tasks. Based on research in 20 big European, American and Asian corporations they designed a transformation model of management roles and tasks for operating-level managers, senior level managers and top level managers.

The changing role of operating -level managers is the transition from "operational implementers to aggressive entrepreneurs".

The changing role of senior-level managers is the transition from "administrative controllers to supportive coaches".

The role of top-level managers is changing "from resource allocators to institutional leaders".

For managers of different levels the model defines also primary value added and key activities and tasks.

Alfred, Snow and Miles (1996) inquired core competencies from the aspect of the development of organization structures. According to their meaning "organization structure dictates core managerial competencies", "different organization structures require a different mix of managerial competencies" and "organization structures dictate how careers are managed".. In the article "Characteristics of Managerial Careers in the 21st Century " they explain which core competencies were , are and will be important in traditional organizations (functional, divisional and matrix structures) and in modern contemporary and future organizations (network organizations and cellular organizations).

According to Alfred, Snow and Miles traditional organizations were heavy users of a limited set of human capabilities, primarily technical knowledge and skills.

In functional organizations "managers pursued the bulk of their careers within a technical specialty and typically did not exercise full commercial and governance competencies until they reached the top of the management hierarchy".

In divisional structures, that emerged after the First World War some managers could gain also some interdisciplinary experiences and to utilize their knowledge in positions of general management.

In matrix structures, that emerged in the end of fifties and the beginning of sixties managers gained and developed their competencies in their home functions as well as in commercial and other fields, when they were temporarily assigned to program and project teams.

In network structures, which were developed in 1970th and broadly used in the end of 20th century was generally expected, that most of managers would have and use technical, commercial and other competencies which in traditional organizations were required only from top managers.

According to Alfred, Snow and Miles characteristic for the 21st century will be the transition from network structures to cellular structures.

A cellular organization can be briefly described as follows:

- Is made of cells (self-managing teams), autonomous business units,
- common knowledge and information are shared by all the cells in a manner, akin to human DNA,
- organization functions not as an employer but as a facilitating mechanism,
- an agreed set of norms promote full self-governance,
- careers in such an organization may not involve managerial hierarchies at all.

Alfred, Snow and Miles developed five categories of knowledge, skills and other attributes: that individuals must have for success in the 21st century organizations: (1) knowledge based technical specialty, (2) cross-functional and international experience, (3) collaborative leadership, (4) self-management skills and (5) personal traits such as flexibility, integrity and trustworthiness.

4. Core competencies of an organization

Concept of core competencies is being used not only for identification, development and exploiting of competencies of individuals (managers and operatives), but also for identification, creating and exploiting the competency of a firm as a whole. In the literature we can find many different definitions or characteristics of core competencies of an organization.

According to Irvin and Michaels (1989) core skills are “the critical capabilities that an organization as a whole has - as distinct from the capabilities of the individuals in the organization”.

Prahalad and Hamel see the core competences of the corporation in the competitive advantage from a capability, which lies behind the products that serve the markets. Prahalad´s and Hamel´s definition of core competencies of organization is aimed at production capabilities of a firm. According to Mahen Tampoe (1994) a core competence of the organization can be defined as: “a technical or management subsystem, which integrates diverse technologies, processes, resources and know-how to deliver products and services which confer sustainable and unique competitive advantage and added value to the organization”.

The identification, development and exploitation of core competencies of the organization is a separate problem, but it is in a very close connection with the individual competencies of managers and other employees.

Individual managerial competencies create a substantial part of a core competency of the organization as a whole.

5. Comparison of the situation in the USA and Great Britain with the situation in the Slovak Republic

Based on analysis and comparison of the situation we came to these conclusions and recommendations:

a) In our Slovak terminology we don’t have adequate notion to the notions of “competency” or “competence”. The expressions “kompetencia”, “kompetencie” that are broadly used in Slovakia mean something else as the expressions “competency” or “competence” in English. In our language the expressions “kompetencia”, means the **right** to make decisions. However, a manager can have the right to make decisions, but he may not be “competent” to make these decisions, because of lack of needed knowledge, skills and attitudes.

Not even other expressions that are used in Slovakia, such as “kvalifikácia” (qualification), “schopnost” (capability) or “odborná spôsobilost” (professional proficiency) don’t have the same meaning as the expressions “competency” or “competence”. Therefore our recommendation is to use expressions “kompetentnost” (plural: “kompetentnosti”) which will have the same meaning as the expressions “competency/competence)” as they have been defined by Parry (a cluster of knowledge, skills and attitudes).

b) From the survey, that we made in some firms in Slovakia and from other sources we know, that the vast majority of enterprises pay some attention to management development. Many firms use for this purpose especially regular performance assessments and by this occasion assign to managers and other employees the tasks in the field of gaining new needed knowledge and improving their skills. But in comparison with the published results of surveys from the firms in the USA, the firms in Slovakia don’t have such complex systems of competency based management as have many firms in the USA. Deficiencies in the competency of managers have the consequences in bad performance and bad economic results of firms. Statistical data show that many firms in Slovakia are not profitable. There may be, of course, some “objective” reasons for that, but we can say that bad results of many firms are due to incompetent management. It is necessary to add, that not even the theory of competency based management exists in Slovakia. Only a few managers, who attended lectures and took courses at some management development institutions, are familiar with the conception of competency based management. Very rich knowledge that was gained in this field in the USA and Great Britain, for the broad community of managers and management specialists is not available in Slovakia. Therefore we recommend to launch a discussion on competency based management with the aim to evoke the interest of the theory and practice to competency based management in order that our organizations can better fulfill their mission and as far as the firms are concerned, that they by their high competency could better compete at domestic and international markets.

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High Performance, Remuneration and Trust

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Abstract

The paper examines the concept of high performance in selected Slovak companies in relation to different remuneration systems introduced. It has been identified that Slovak companies do not apply a system approach towards rewarding high performance. The findings show relevant differences between age groups of managers in charge of rewarding high performers and their perceptions of high performance. It becomes obvious that younger employees not only welcome reward systems recognizing high performance, but also precisely set the value of their extraordinary contributions to the overall outcomes of the team, plant or company. Due to absence of the system rewards for high performers, there should be other grounds evoking high performance. Trust in employer's fairness is one of those.

In our research we examined the attributes attached to high performance, characteristics of high performers, remuneration systems recognizing high performance as well as motivation leading to high performance. Moreover, we analyzed the high-performance-friendly environment and the importance of trust in it.

1 Theory

1.1 High Performance – What does it mean?

As managerial styles change, organizations need to look carefully at the business of motivating all their employees. The process for improving performance should be tailored both to the organization and to the individual.

First we look at the aims of managing motivation for performance improvement and explore how the process works. Managing motivation for performance improvement (MMPI) deals with the use of power and leadership, whatever the culture of the country or the organization. The process takes into account both individual differences found among managers and collective differences among organizations.

1.2 Individual characteristics: motives and competencies

All managers will have noticed the difference between what pushes them to act and what triggers action in a colleague. This acknowledgement is a prerequisite to any change in ways to foster achievement.

The motor of action is each individual’s social motivation. Associated with every manager’s culture, education, training and know-how, this social motivation underlies all their competencies, whatever their stage of development. Hay/McBer has developed a method that enables organizations to decode internal motivation based on the research carried out by David McClelland.

1.3 Three Social Motives

Three social motives can be determined and evaluated for each individual that condition that individual’s behaviors and competencies. The combination of the drive for achievement, the desire to maintain friendly relationships with others and the power drive, or desire to be influential over, one’s environment result in different professional attitudes, depending on the degree of intensity of each.

By imagining a number of thoughts and acts in specific situations, which are then screened through a precise decoding method, the process results in a personal motivation profile. The main characteristics of the profile attached to each dominant motivation are as follows. The *drive for achievement* expresses itself through:

- A tendency to take reasonable risks;
- The desire to take sole responsibility for results, that is, not to be involved in processes in which chance has an important role to play;
- The need to know quickly whether one's work was correctly done or not;
- A permanent concern for personal improvement;
- A genuine interest in innovation and efficiency (how to do things better, faster, differently) [5, p.133].

Many managers believe that they and their subordinates fall into this category simply because of the fact that in the culture of the industrial corporations, performance is the key value. However, cultural atmosphere needs to be disassociated for actual behaviors. Superior performance can be achieved for motives other than a high achievement drive. These motives are internal, that is deep-rooted and not necessarily detectable at first glance.

Certain people are more concerned than others with the need to establish, maintain or re-establish *friendly relationships* with others. This need results in:

- A greater receptivity to factor affecting relationships at work;
- The ability to establish and to maintain convivial and friendly relationships;
- The fear of losing these relationships [5, p. 134].

1.4 The will to influence

The word *power* often has negative connotations in our European culture. This term seems solidly linked with the idea of coercion of others, and calls political power to mind, which is no longer highly regarded. But in terms of competencies, *the will to influence* and to be powerful manifests itself through:

- The desire to impress others through action or through words;
- Attempts to influence others to improve one's prestige (personal power) or for the common good (socialized power);
- Concern for one's reputation;
- A capacity spontaneously to offer support and advice.

The need for definitions of personal motives is because managers who have a strong achievement drive do not lead their team in the same way as those who are highly motivated by an affiliation need or by a power drive.

Personal motives orient and direct professional behavior. They translate into strong and weak points in terms of competencies. If a person fears other people's reactions but has the will to influence, that person will not use her or his competencies in the same way as a colleague facing the same professional environment with no fear of rejection and a strong focus on his or her field.

If someone's primary objective in life, which may be subconscious but is always personal, is to establish friendly relations with others, all efforts will instinctively be directed towards the achievement of that goal. A power or achievement drive may also motivate that person but to a lesser extent. The competencies put to use at work will be greater in those fields in which someone instinctively feels at ease.

1.5 Performance Measurement

The measurement of performance is an organization which is at the core of any system of performance management. This is because, in order to evaluate and improve anything in life, we have to know from where we are starting, and how we are progressing as time passes. The importance of good performance measurement is illustrated by the logical model that

- *Success* depends on achievement of performance target,
- *Targets* are set against established performance standards,
- *Standards* are defined on the basis of *measured performance*.

The measurement of performance is, therefore, the foundation upon which performance management is built. If the foundation is flawed, the whole structure is suspect.

Precisely what should be measured in any individual organization depends upon the nature of the organization's business, and on the jobs of the people within it. What is important is to identify the considerations that should guide management in deciding what should be measured, how it should be measured and how standards of performance and targets for achievement should be assessed.

To do this you need to start with the recognition that the performance standards and targets set in any organization are the product of a complex range of forces on the business.

To identify the important guidelines for performance measurement, it is necessary to consider those aspects of an organization's business which will have a great impact on its performance measurement system. These are:

- *The market* in which the organization operates,
- Specific *corporate challenges* for the individual organization,
- Identification of the *right population* for consistent measurement systems,
- The involvement of *people* as a key business asset.

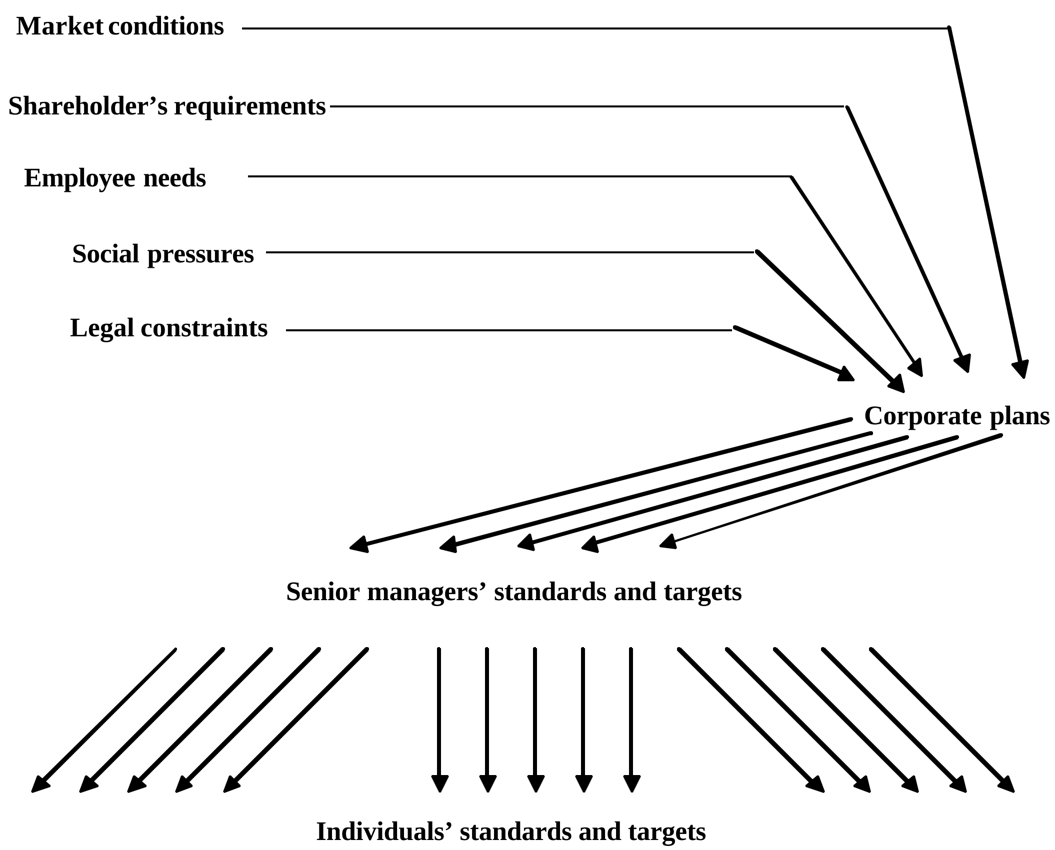

FIG.1.: FORCES ACTING ON PERFORMANCE STANDARDS [6, P.27].

These subjects have to be considered in order to avoid the naïve view that Management by Objectives simply requires a manager to clarify what needs to be done in order to be able to get on and do it. In a business organization it would be fatal to set the goals without establishing measurements.

Communications will recur as a key element in establishing the best performance standards for the measurement of your business and for establishing a data set that can be used for analysis and targeting.

In building a data set, remember the key guideline to observe in developing performance standards: to be of maximum use they have to be measurable *over time*, so that change can be evaluated and analyzed. The time should be spent addressing the question of what are the best and most relevant definitions for the measurement of a business. It must be kept in mind that standards can and should be developed, modified or changed as business needs demand and the vital role of feedback should not be overlooked. But it should never be forgotten that large or frequent changes to the performance standards being measured will undermine the value of the very data set you are trying to improve.

1.6 People Sensitivity

It is not merely a by-product of good performance measurement that employees should feel that they own the systems of measurement and the standards by which they are measured. The best performance systems are developed from the outset with sensitivity to employees' needs and expectations. It is difficult to conceive of an organization whose performance does not depend on the quality of the staff that make it work. People may not be given a value on the balance sheet but they are as important an asset as the capital equipment that they use in their work. The manufacturing equipment, cars etc. – all the things that do have a balance sheet value can have their functions precisely defined. Their performance standards are defined in their specifications. In people's flexibility lies a danger which should be recognized in the development of a performance measurement system. The danger is the virus that infects most systems from time to time – moving goalposts. This disease is caused by an organization having to respond to its environment; its symptoms are standards and targets that change too frequently. If it is not treated it can be fatal to effective performance management.

Any performance measurement system must allow management the flexibility to revise standards and targets. It is obvious that the markets in which managers operate do not evolve to the schedules of their appraisal systems. Managers must be capable of responding to change, and this will inevitably involve revision of the standards and targets to which they work. If they are having to react to change, so too must their subordinates.

Perhaps the most pressing is the discussion how string the link should be in the appraisal discussion between performance improvement, career development and the pay reward. Some eminent personnel professionals would agree that these three elements should be kept entirely separate as each may infringe negatively on the other elements. Others would argue that if one believes the level of performance should be a major factor in determining the level of career and monetary rewards, then the link should not be seen as too remote.

The linking of performance with pay requires consideration of the need for and value of performance rating. Certainly rating performance either numerically or descriptively can be a sensitive issue. Equally, however, to forgo the use of performance ratings can severely weaken the link between performance and the level of pay increase that is awarded.

In this regard it is useful to express each performance rating in terms of the level of overall achievement made against the pre-agreed objectives. Thus one such definition can read "The individual has met the objectives and requirements of the job, consistently performing in a thoroughly professional manner" while another could read "The individual has not met many of the objectives or requirements of the job and needs to be helped to improve performance or to move to a more appropriate position" [6]. Again the level of expertise is all-important, since managers need to be able to link the level of achievement against the objectives with the most appropriate performance rating and, most important, to explain the rationale.

A further issue often voiced is how a performance management system can be justified in terms of the fair and consistent application of standards of performance rating and pay award. Certainly, no system can guarantee this, least of all a non-performance-based system that applies a common standard of reward irrespective of individual contribution – often the end result of collective bargaining agreements!

1.7 HAY Position Evaluation Method

The HAY Guide Chart Profile Method (developed by HAY Management Consultants GmbH) is based on the view that every job in an organization exists in order to achieve results. This requires a certain form, type and level of know-how, which – utilized in a thinking process – leads to actions that have a certain impact on identifiable results.

The HAY method therefore uses, as factors, which reflect the essential content of all jobs, the criteria:

- Know-how;
- Problem solving;
- Accountability.

By analyzing job requirements on the basis of these criteria it is possible:

- To establish a ranking order of jobs;
- To quantify job contents;
- To determine job requirement profiles for a quantitative personnel-planning process;
- To review the delegation levels of organizational structures.
- Consequently, the application of HAY Guide Chart Profile Method clearly extend beyond the scope of conventional job and performance rating methods, especially for exempt and top managerial functions.

The HAY Guide Chart Profile Method is an analytical method for evaluating jobs according to a total of 8 dimensions, which are assigned to three main criteria:

A Know-how with the dimensions of
A1 Technical/specialized know-how
A2 Management know-how
A3 Human relations skills

B Problem Solving with the dimensions of
B1 Thinking environment
B2 Thinking challenge

C Accountability with the dimensions of
C1 Freedom to act
C2 Job impact on end results
C3 Magnitude (area of impact)

2 Research

2.1 Methodology

In the research, we used a questionnaire with two parts: demographic data and the high-performance related questions. The questionnaire was anonymous, however the recipient company was identified.

2.2 Questionnaire

The questionnaire in addition to demographic data comprised the following questions (Part II):

1. Which of the given remuneration systems do you take for transparent?

- The one which is known to the managers.
- The one which is known to a number of employees.
- The one which is publicized ex-post (i.e. after the outstanding achievements have been identified).

- The one which is familiar to all the employees.
- Others – please, specify:

2. Does your remuneration scheme support your high-performers? Y/N

3. If Y, which of the following reward systems is preferred?
- Financial
- Non-financial (please, specify)
- Combined (financial + non-financial)

4. What forms of a non-financial reward system are applied if your employer uses it?

5. Which out of the following characterizes the high performer best?
- The employee with qualitatively outstanding performance.
- The employee with quantitatively outstanding performance
- The employee with new ideas and initiative
- The employee with extraordinary traits
- Others (specify):

6. If the financial reward system is preferred, what percentage of the monthly salary should reward the high performance? Please, specify.

7. Does the applied reward system motivate sufficiently?
- Yes
- No

8. Based on your experience, which of the following motivating factors leads to high performance most frequently?
- Financial reward
- Non-financial reward
- Higher power status
- Relief from routine duties
- Others (specify):

9. Have you ever experienced colleagues' negative attitudes towards hogh performing employees in your organization?
- Yes
- No

2.3 Analysis

We approached three large Slovak companies (A, B, C) in manufacturing. The questionnaires were filled in by HR officers and representatives of top and middle managements. We sent out 80 questionnaires and 96 per cent out of which were sent back filled-in. As a Control Sample an institution of public administration was introduced. Forty questionnaires were submitted to the public administration institution (D) and 72 per cent out of responses were valid.

The age of the respondents proved to be relevant for the analysis and we present the survey in Table1.

TABLE 1

Age	A	B	C	D
up to 30	14%	7%	17%	14%
31-40	29%	46%	33%	27%
41-50	14%	40%	25%	46%
50+	43%	7%	25%	13%

As comes from the Table 1, the oldest respondents were from A. Due to the company policy, this is likely to be evoked by the need for experienced personnel who have to work in the given field for a number of years. On the other hand, the respondents of C were the youngest. B obviously prefers young people for managerial positions, however, some years of experience are a must. This interpretation was supported by the answers to the question: “How long have you worked in this position?”

The answers to the question No. 1 (Part II) are introduced in the Table 2.

TABLE 2

Which of the given remuneration systems do you take for transparent?	A	B	C	D
The one which is known to the managers.	-	-	-	-
The one which is known to a number of employees.	-	7%	7%	-
The one which is publicized ex-post (i.e. after the outstanding achievements have been identified).	-	-	-	4.5%
The one which is familiar to all the employees.	100%	93%	93%	91%
Others – please, specify.	-	-	-	4%

Here we tried to categorize respondents according to their perception of what constitutes a transparent reward system. Only in A the respondents unanimously defined the system as the one with which all employees are familiarized. In the two others, the answers are identical in percent shares. The reason why here the respondents took for transparent the system with which just some employees are familiarized is that the respondents coming from these two companies are on higher hierarchical positions and they presented the view of the senior officers, while the respondents in A represented middle management. This proves the formerly identified gap between top managerial positions and the rest in Slovak companies.

In D, the reward system concurrently taken for transparent is the one with which all the employees are familiarized.

It has been interesting to find out how the answers to the question if the current reward system motivates the employees to higher performance differed. While the respondents of two companies took their reward systems for more motivating in bigger numbers, in C the numbers of those who took it for motivating and non-motivating were equal. It is obvious that the views of the employees of their reward systems’ motivating function towards higher performance is controversial and divides employees into two groups. In spite of the distrust of a reward system and its motivating role, more respondents than those who agreed with the motivating role of a reward system answered the question which tried to identify which reward would be most motivating. It is clear that even those who distrust the motivating role of their current reward system are quite sure about the motivating power of a particular reward form. The Table 3 presents the distribution of the answers in the view of different forms as well as separate companies.

There is obvious distrust expressed in the current reward system in D. Just 9 per cent out of the replies considered their reward system as sufficiently motivating. The number of the replies taking the reward system for motivating had its impact on the number of the answers to the following question.

TABLE 3

If Y, which of the following reward systems is preferred?	A	B	C	D
Financial.	29%	34%	50%	9%
Non – financial (please, specify).	14%	-	-	-
Combined (financial + non financial).	57%	33%	8%	14%
Not answered.	-	33%	42%	77%

The purely financial reward is preferred by the respondents of C where almost a half of them identified this reward form as most motivating. On the other hand, almost a half of the respondents did not answer the question at all. In A the least number of respondents chose financial reward as most motivating and the majority of respondents took the combined form of the reward for the most motivating. What was actually meant by the combined reward were expensive trainings for A employees which are widely provided. Such a reward was introduced exclusively by A.

In C and B the question remained unanswered in a large number of questionnaires. While the question was linked to the positive answer to the question No. 3 (Part II). However, it is obvious also from other researches in Slovak companies that the financial reward is taken for the basic motivator for high performance. But, if the employees experienced themselves other forms (training in this case), in the comparison with the financial reward they valued the opportunity of further development higher.

In D, 50 per cent of the replies preferred purely financial rewards and almost 50 per cent combined rewards.

It was interesting to learn what performer the respondents take for the high performer. Table 4 introduces the replies.

TABLE 4

Which out of the following characterized the high performer best?	A	B	C	D
The employee with qualitatively outstanding performance.	28%	7%	42%	40%
The employee with quantitatively outstanding performance.	-	7%	8%	8%
The employee with new ideas and initiative.	29%	52%	42%	44%
The employee with extraordinary traits.	14%	7%	8%	8%
Others (specify):	29%	27%	-	-

The respondents chose each of the offered characteristics. Qualitatively higher performance was preferred by the respondents from C, on the other hand it was just scarcely chosen by the respondents from B. In A, the respondents chose evenly each characteristic of the high performer. However, no respondent took for a high performance the one with quantitatively higher parameters. The most preferred characteristic denoted the employee with new ideas and initiative.

In D, the reply to the question No. 5 was identical with the answers from the manufacturing sector.

In addition, the performer with qualitatively higher performance was also recognized by 50 per cent of respondents.

When the respondents were asked to identify the percentage of the monthly salary that would reward a high performer, those who replied, categorized the percentage into two levels: up to 10 per cent and 11 percent through 120 per cent. Vast majority of respondents from A ignored the question. It is clear that the question was irrelevant for those who preferred non-financial reward as the motivator. (See Table 5).

TABLE 5

If the financial reward system is preferred, what percentage of the monthly salary should reward the high performance? Please, specify.	A	B	C	D
0 – 10%	7%	40%	-	59%
10 – 120%	-	60%	58%	41%
Not specified	39%	-	42%	-

Here the correlation of the age and high percentage of the salary as a premium is evident. The percentage of 100 up to 120 per cent of the monthly salary was preferred by younger respondents, while the older ones suggested the reward reaching up to 10 per cent of the monthly salary. The answers if the reward system motivates sufficiently are presented in the Table 6.

TABLE 6

Does the applied reward system motivate sufficiently?	A	B	C	D
Yes	-	27%	25%	9%
No	71%	73%	67%	91%
No answered	29%	-	8%	-

In D, 59 per cent out of respondents introduced the bonus of 0 – 9 per cent of a monthly salary, while 36 per cent preferred 10 to 20 per cent out of a monthly salary.

The opinions if there is a need for rewarding high performance with regard to motivation coincide in all the three companies in their negative views. Approximately three fourths of all respondents claim that such reward itself does not motivate towards higher performance. We can derive that the respondents accept the reward ex-post, i.e. when work has been completed; however, the reward is not taken for a motivating factor leading to the high performance in the future. Such views oppose strictly the answers to the following question (Table 7. Based on your experience, which of the following motivating factors leads to high performance most frequently? – financial reward, non-financial reward, higher power status, relief from routine duties or others.).

TABLE 7

Based on your experience, which of the following motivating factors leads to high performance most frequently?	A	B	C	D
Financial reward	100%	100%	100%	91%
Non-financial reward	-	33.3%	-	18%
Higher power status	42.8%	6.6%	-	8%
Relief from routine duties	-	-	-	9%
Others:	-	-	-	5%

The answers vary extremely. It is obvious that the answers generalize the experience of a particular company. All respondents, however, emphasized the financial reward. As we stated above, B and A employees added also “higher power status”. The respondents of B are the only group which included also “non-financial reward”. The respondents exclusively come from the group of senior managers and the answers are based on their personal experience. The examples covered mobile telephones, company cars or provision of fuel.

In D, 91 per cent out of the respondents claimed that their current reward systems do not motivate towards high performance.

This answer reflects the situation where the public administration institutions remunerate their employees strictly according to the pre-set tariffs.

As comes from the further question if the respondents trusted their institutions, majority answered positively. It proves that in spite of non-motivating, even de-motivating affect of a reward system, trust in one's employer is sufficient for high-quality or extraordinary performance.

The last question looks for the answers to the question on the negative attitudes of colleagues in the case of a high performer. The Table 8.

TABLE 8

Have you ever experienced colleagues' negative attitudes towards high performing employees in your organization?	A	B	C	D
Yes	43%	53%	67%	46%
No	57%	47%	33%	54%

The majority of positive answers in B and C (53 per cent and 67 per cent respectively) shows the experience with negative reactions of colleagues if an employee performs extraordinarily. The respondents are younger and obviously more sensitive to the relations at workplace. The lower percentage of a positive answer in A correlates with the older age of the respondents there.

In D, 54 per cent out of the respondents experienced negative attitudes of co-workers in the case of high performance; the rest of the respondents had never faced hostile attitudes.

3 Conclusion

Based on the above results we can summarize that there is no system approach towards the concept of high performance in the Slovak companies. As a consequence reward systems applied do not identify high performers.

The answers to the request for defining "high performer" were obviously of subjective nature.

We can conclude that there is a tendency to reward an outstanding performance ex-post (once it is over). This leads to a problem in setting the level of the reward. In addition, it is demotivating in the view of the future performances.

The view of younger and older (over 51) respondents diametrically differ in their views what constitutes high performance. Primarily the young respondents are familiar with the reward systems applied abroad which recognizes high performance and it comes from their replies that they expect their high performance to be rewarded as well. Moreover, it is clear that they are aware of the price of their high performance. The younger respondents mostly introduced the 100 per cent bonus (out of salary) in the case of high performance.

The older respondents took high performance for part of a standard and if recognized they would expect the bonus representing extra 15 per cent of the monthly salary.

The public administration institutions cannot actually motivate their employees by the financial reward systems because the financial means are strictly planned and the limited budgets do not allow for any other use of them. The rigid budget is spent regardless the employees' performance.

Key words: *high performance, remuneration system, high-performance-friendly environment, trust*

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How to Improve Understanding and Commitment of Personnel Specialists to Ongoing Strategic and Operational Business Activities

(An Approach for Business Sustainable Development)

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Abstract

Instead of asking "What is the information that matter and how do we most effectively manage it" companies (and other organizations) start asking "What are the relationships that matter and how can technology most effectively support them?"...it` s relationship – the formal and informal networks of people that really govern how the organization runs and how value is created. (Michael Schrage)

Training an approach for sustainable development

Training is no longer optional. In an environment of constant change, only organizations which help employees grow and develop can keep their customers satisfied, stay ahead of the competition and make the best use of resources. Offices and factories are full of people who are creative, dynamic and efficient in their leisure time yet never get a chance to flourish at work. Training, as effective employers have long known, is the key to tapping into their skills, releasing their potential and adding maximum value.

The idea of continual learning – an organization renewing its knowledge and skills in an ongoing framework of personal and organizational growth – is a powerful model. It can bring excitement, energy and real empowerment to people. This is a highly skilled process. It calls for the subtle awareness of self and others.

Among the core challenges of today's world:

- managers need to be able to build and coach high-performance teams, empower others, influence decision-making and drive through change
- trainers require the psychological and business awareness to maximize the impact of their interventions
- personnel professionals must ensure they are up-to-date with the latest employment law issues and are able to contribute to the business strategy, through developing and implementing appropriate personnel policies, reward strategies and recruitment and selection decisions, in a continuously changing environment

Natural talent is obviously important in all these areas, but it is well-planned training initiatives which give practitioners a chance to find out what has worked elsewhere, try out fresh techniques, obtain honest feedback and learn from their mistakes. Improved performance should then feed through directly into business results.

Recognise and develop potential-personal power, the most valuable professional asset

For personnel specialists and training and development professionals these times of change provide opportunities to demonstrate new skills, skills of influencing, advising and enabling learning.

In influencing – and in building relationships – there are three sources of personal power: Skill, Preparation and Attitude. All of them are interrelated and interdependent.

As a personnel specialists and training and development professionals, your long-term success is increasingly dependent on your ability to build long-term relationships.

In general the philosophy is comprised of beliefs and values. Your philosophy and approach should be based upon these beliefs:

- that long-term success in increasingly dependent on your ability to build strong, lasting relationships
- that there are three levels of relationship: Competitive, Cooperative, and Collaborative, and that these theree levels are based upon the degree to which needs are aligned
- that needs can be so aligned that they are actually interdependent, and that the meeting of interdependent needs is the basis for the strongest and most enduring relationships
- that relationships can be strengthened and elevated through the negotiating process
- that long-term relationships require a convergence of ethics and pragmatics, so that the answer to the question, „What is smart?“ is always the same as the answer to the question, „What is right?“

Principles are fundamental truths that support your philosophy and guide your behavior. People change and circumstances change. But, because they are fundamental truths-unless your philosophy changes-your principles do not change.

There are 15 of the most important principles of our approach-the principles intended to guide you in (1) building strong, lasting client and customer relationships, and (2) ensuring optimal results from the solutions you provide to your employees.

These are:

- There are there levels of negotiation-and relationship: collaborative, cooperative, and competitive.
- Negotiation is the application of power to meet needs. If you have no needs, you will be unwilling to negotiate: if you have no power, you will be unable to negotiate.
- There are seven sources of power in negotiation: Skill, Preparation, Attitude, Insight, Legitimacy, Relationship, Need/Solution.
- Personal power you bring to a situation: core power you develop and apply within that situation.
- Insight is the power to see into a situation-beyond the obvious.
- Legitimacy helps bridge the gap between possibility and certainty.
- Relationships are comprised of four factors; trust, rapport, respect, and value.
- Need/ Solution is the primary source of power in negotiation and the reason for all employee-to-employee, employee-employer as wwel as business-to-business relationships.
- The power of Need-Solution is drive by two forces: Options, and Investment-Commitment.
- Options- and the reduction of options-are based upon positive differentiation.
- Investment-Commitment is required for partnership: mutual commitment requires mutual investment.
- When you recognize a tactic-as a tactic- the effectiveness of that tactic is dramatically reduced.
- There are three rules for managing tactics: 1. Prevention, 2. Recognition, 3. Counteraction
- A counteraction must defeat or neutralize a tactic without defeating the employee using the tactic.
- There are five ways to attend in negotiation: (1) listen, (2) ask, (3) acknowledge, (4) support, and (5) provide rationale.

Negotiation is an integral part of client or customer's buying process- as well as selling process- and it must be understood in that context. Virtually companies conduct the same eight-stage buying process when making major purchasing decisions. The graphic below represents these eight stages of the buying process overlaid with negotiation as it occurs within-and often drives-the buying process.

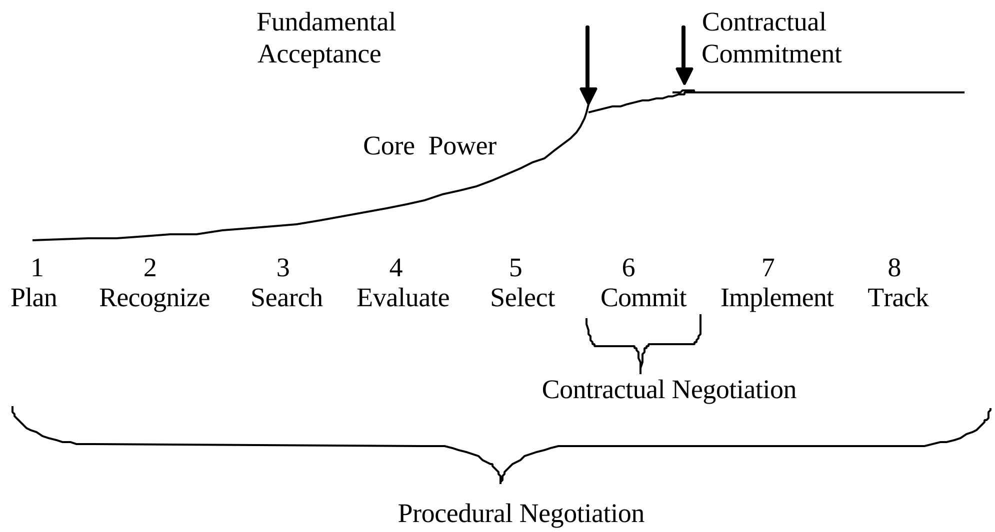

FIG. 1 EIGHT-STAGE BUYING/ NEGOTIATION PROCESS

Negotiation is the application of power to meet needs, and power is applied differently at each of the three levels of negotiation. At the Competitive level, power is simply exercised: at the Cooperative level power is balanced, which sometimes requires restraint on the part of one or both parties: and at the Collaborative level power is shared.

Because negotiation is the application of power to meet needs, if you have no needs, you will be unwilling to negotiate and, if you have no power, you will be unable to negotiate.

In every negotiation there are seven sources of power. Of these seven sources, three represent personal power: Skill, Preparation, and Attitude. These tree sources of personal power are used to develop and apply the four sources of core power: Insight, Legitimacy, Relationship, and Need/ Solution.

Your core power in any negotiating situation or relationship is dependent upon the perception of the key players within that situation or relationship. You may have great insight into your customer's goals, problems, and needs. Your organization may have a strong reputation in your field. And you may have the best solution for solving your customer's problems and meeting your customer's needs. But if the key players in the customer organization do not know of your reputation, have not benefited from your insight, and do not recognize the superiority of your solution, you gain little core power from these assets.

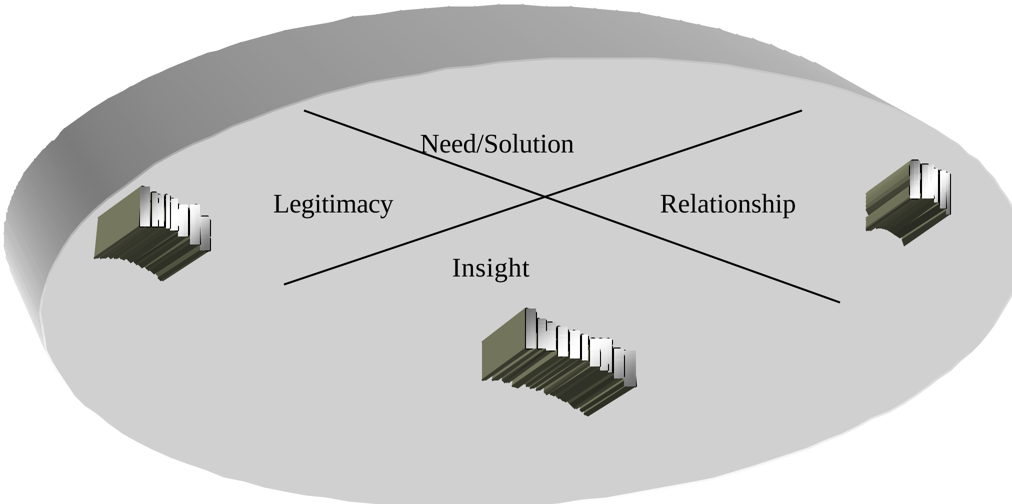

Fig. 2 SOURCES OF POWER

The interrelationship of the four core sources of power is key. The power of Insight, for example, assists you in developing the power of Legitimacy: the power of Legitimacy helps you develop the power of Relationship: and the greater your power of Relationship, the more Insight and Legitimacy you will be able to develop. Insight, Legitimacy, and Relationship power combine to support the primary source of power: Need/ Solution.

Your core power is based on your employee's or client's perception. Perception can be influenced, and you can develop core power.

Through the implementation of a power-building strategy during the buying process-prior to contractual negotiation-you can develop the power you need:

- to avoid entering into negotiations for which you are not prepared,
- to increase the probability that when you do negotiate, it will be at the Cooperative or Collaborative levels, rather than at the Competitive level and
- to ensure that your need-as well as your customer`s needs-will be met at what-ever level the negotiation takes place.

New opportunities for skills – leverage your sales, support, and service team

The approach to negotiation is multifaceted and multidimensional. It is an approach, not just for business-to-business negotiation, but for building strong, lasting relationships in every area of your activities as personnel specialist or/ and training and development professional.

In this complex, highly competitive, and rapidly changing environment, maintaining strong relationships is (a) increasingly important and (b) increasingly difficult. Collaboration among members of the sales, support, and service team is required.

Through collaboration with other members of your team you are able to develop multiple channels of information-and insight-sustain multiple relationships at multiple levels in each client or customer organization, create multiple layers of legitimacy through the combined reputation and expertise of the team members, and apply multiple resources toward the development of your solutions.

The approach will increase the effectiveness of your interpersonal communication-that is, your communication with others. It will also increase the effectiveness of your intrapersonal communication-your communication with your-self.

Thinking is essentially intrapersonal communication. Your power of Preparation, your power of Attitude, and the application of your power of Skill are all dependent upon how effectively you communicate with yourself.

Conclusion

Our personal lives are not about selling, supporting, or servicing in the sense that our professional lives may be. We are, though, selling ideas, beliefs, and values, and our personal lives are clearly about relationships. Our personal lives are also about goals, problems, and needs.

As each of us has experienced in our own personal life, building strong, lasting relationships frequently requires more than goodwill-it requires real skill. It is through skillful communication that relationships are initiated, developed, and strengthened. And it is through skillful communication that trust, rapport, respect, and value are established and enhanced.

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Human Resources Management of a Company under Current Conditions

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Abstract

The article deals with the changes in the conception of human resources management of a company in current market environment. The first part characterises the traditional conception of the personnel management common in domestic companies and briefly describes its main tasks. The directions the HR management should follow at present and especially in the future are presented in the second part. The following scopes are mentioned above all: creation of flexible organisation structures, improving selection and recruitment of employees, aiming at the continuous development of the employees' potential and lifetime education, selection of appropriate means of motivation and removing bureaucratic barriers. Theoretical considerations are completed by a comparison with a practical attitude. Taking the transformation of Czech Savings Bank (Ceská sporitelna a.s.) as an example, the practical progress of changes is illustrated, which took place after a foreign owner had taken over a traditionally managed Czech company.

The current market environment in which our companies operate is being globalised step by step and it's obvious that this trend is going to continue. The main outlines of this trend are according to Peters [2] especially:

- the strengthening competition pressure of both domestic and foreign companies
- growing demands of the customers
- technical revolution
- changes (mostly unpredictable), which became more or less regular and whose rate increases

If a company wants to be successful under these conditions, new demands arise in almost all fields. Of course, this concerns also the company staff and personnel management.

1. The main tasks of the personnel management in a company – traditional approach

Generally, these tasks may be conceived as follows:

- creating of a dynamic balance between the working tasks requirements on the one hand and human resources being used by the company on the other hand considering the number and working abilities of the employees and their qualification structure;
- optimal usage of these resources from the point of view of the working hours and abilities – employees' potential [1].Especially the personnel clerks, partially also the line managers participate in fulfilling these tasks. Although the fulfilment of such tasks has not been always easy (for many reasons), even under the conditions of isolated and relatively stable economics, many companies managed to cope with them satisfactorily. Modern methods of personnel management have been introduced in prospering companies, especially selecting people for the key positions, systems of education and staff abilities' development and systems of motivation. Under the current conditions of the open economics, globalisation, intensive competition and considerable dynamics of changes, some classical approaches and so far „successful templates" which were suitable for stable companies have failed and it is necessary to change the attitude.

2. Changes in the attitudes towards the HR management

Under the current conditions, as described above, the companies' employees – its human capital – become the limited factor of success and the quality characteristics of this capital and its potential come out/arise/protrude... The main tasks in general, as described in part no. 1, are still valid but the considerable dynamics of changes in environment and the requirements for employees need a different attitude. In such situation, the company should focus especially on the changes in the following areas:

- creating of flexible organisation structure which would encourage activity and interest of people
- improving the quality of employees' recruitment
- stress on continual development of employees' potential
- motivation instruments
- removing of bureaucratic barriers [2].

Successful application of these recommendations enables the full usage of employees' potential and should lead to a substantial change in their motivation. There is no doubt about the rationality of these recommendations. Unfortunately, many companies accept them only at the theoretical or proclamation level, and practically carry on in rationalisation by dismissing the staff while still proclaiming that employees are their most significant resource. Practical procedure of the changes in a traditionally managed Czech company after a foreign owner take-over is illustrated on the example of Czech Savings Bank.

3. Human resources in the process of transformation of Czech Savings Bank

Czech Savings Bank (Ceská sporitelna) was in the period of centrally planned economics and institution specialised on the service to the individuals in the area of deposits and loans. Its task was above all to gather the citizens' savings that would flow to the State Central Bank and whose further use was practically business of the Ministry of Finance. The Savings Bank had a monopoly position in this area and was directed by a state plan. Considering these conditions, Czech Savings Bank didn't operate as a business but more as an office administrating withdrawal of funds on behalf of the state. The nature of personnel and the personnel policy corresponded with these tasks: the main requirements for staff were accuracy, strict following of regulations and obedience, which means perfect performance according to given procedures, initiative was not desirable. Also the company culture was more close to a bureaucratic institution than a financial institution. After the political change in 1989, a change of Czech Savings Bank starts gradually and proceeds till today. The period of this transformation can be divided into 3 stages.

Stage I. 1990 – 1994

After the transition period in the beginning of the 90's, in 1992 the state owned company was transformed into a joint stock company with a majority share or the state, and changes in the scope of the service provided began. The strategic target of the top management at this time was the transformation of the Savings Bank into a universal bank that would be able to provide the full scope of financial products both to individuals and to companies. The company achieved with respect to that time's macroeconomic conditions 5 milliards CZK average annual profit after taxation in the first half of this period. The basic strategy was an expansion both in the field of buildings and equipment and HR. At that time (see chart figure 1) the number of employees almost tripled. There was a multistage organisation structure with regional divisions in the individual districts; the number of business-points in the Czech Republic was 2168.

Stage II. 1995 – 1999

At this stage the consequences of wrong credits and certain „megalomania" of that time's top-management, especially concerning the investments into buildings and equipment, began to show in the economic results. The company's profit dropped significantly and the Savings Bank was in "red figures" since 1998. This caused the change of strategy from expansion to maintaining the market share and to efforts to make the individual activities more efficient. This affected the HR field by decreasing the number of employees, which was carried out by suppressing some activities, natural leavings and flattening of the organisation structure. During the first phase in 1995, one management level was left out – the regional divisions and district subsidiaries became directly subordinate to headquarters. During the next phase in 1999, the district subsidiaries were united and 33 organisation units were created of 78 and the number of business points was reduced to 876 by 1999. Thus the number of employees was reduced almost by a quarter to 15277.

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Number of employee	7403	10820	14500	17171	19851	19460	19319	17522	16580	15277	14500	12500

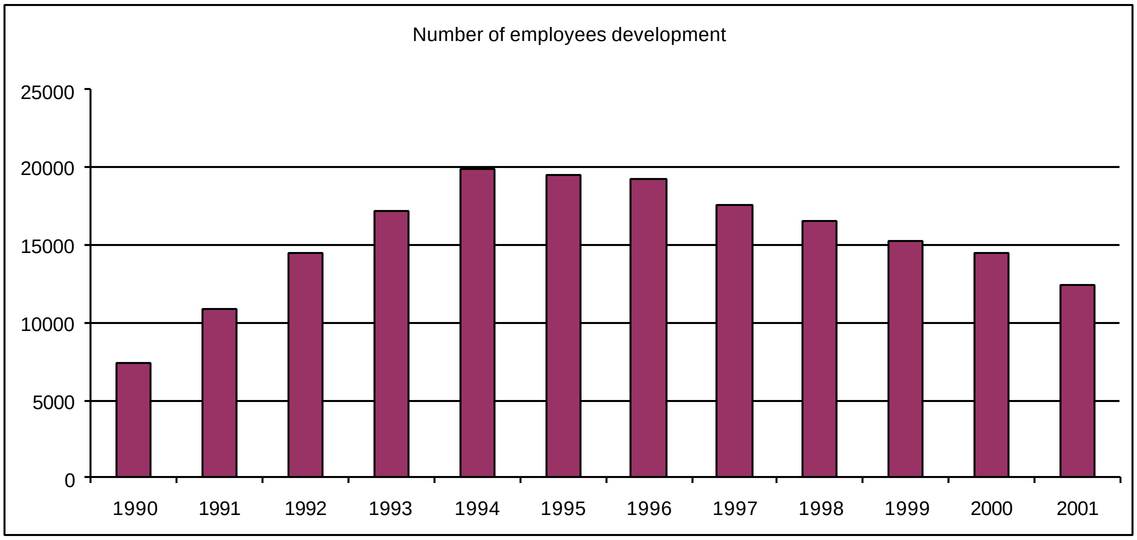

Fig. 1 NUMBER OF EMPLOYEES DEVELOPMENT

Stage III. 2000 – present

In the middle of 2000 a major share in the company was purchased by the Austrian Erste Bank Sparkassen, which overtook the exercise of owner's rights after the purchasing price was settled and immediately started making pressure on the quality of services and profitability. The main task is rationalising of the company by applying common methods such as centralising of activities, reengineering, outsourcing, and abolishing of non-productive activities. The basic organisation structure of the district subsidiaries does not change but its inner structure is being significantly reduced. The number of employees has dropped to 14.500 and should continually decrease to the final amount of about 9000. The ways and methods of personnel work have been changing during the last decade. While in the first stage, the stage of extensive development, the staff recruitment for ensuring new activities, education system creation an its realisation were the key tasks, in the II. stage a gradual reduction of the staff started to be necessary. In this phase the staff reduction was carried out slowly mainly by means of natural leavings and the average reduction was approximately 5 % per year. The situation changed dramatically after the foreign partner's joining; the reduction in the first year was almost 14 % and further 28 % are needed to achieve the final status.

Conclusion

Classical attitudes towards the development of HRM are applied in prospering and stable companies in the Czech Republic. Since the mid-90ies, the position of many companies has changed; there are pressures to increase efficiency, which results in efforts to rationalise the company. This process usually goes together with more or less fierce reduction of the staff. The current situation in the Czech Savings Bank is a typical example of this approach. Although the rationality (especially economical) of the rationalising is obvious, it may have its own difficulties. The dismissing of employees should be managed and carried out by the personnel departments the way that unnecessary losses of both knowledge and potential of competent employees are avoided. In the Czech Savings Bank, the reduction of staff is actually carried out by an administrative decision of the headquarters and it concerns determined positions in subsidiaries. I assume that there is a possible risk of loss of both knowledge and potential of some leaving employees. It may be decreased perhaps only by individual approach of the heads of the district subsidiaries, which depends on their personal characteristics and attitudes. The judgement whether and to what extent the transformation of the Savings Bank as a complex and its human resources is successful will be possible after the transformation's end – based on the development of the company's market position and its economic results.

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Intercultural Communication

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Abstract

Communication skills are skills without which we cannot imagine not only effective managerial work, but also work of the other workers in an organisation.

In this time more and more organisations realise that effective interpersonal communication is very important for organisational success. Effective interpersonal competencies (therefore also communication skills) become one of the most important criteria in candidate selection for managerial positions.

The entry of globalisation and the rise of the diverse work environment make the requirement for effective intercultural communication event more important.

It is also important to realise, that we can learn these skills, we can learn to communicate effectively with other people, with people from other cultural environment, we can increase the effectiveness of the interpersonal communication.

The purpose of this article is to focus attention to the need of effective interpersonal skills and possibility to develop these skills.

The entry of globalisation, the rise of the diverse work environment not only in terms of sex, education or age but also in sense of cultural values, attitudes, ways of behaviour and communication request an adaptation of all the employees of the organisation to these changes as well as to the new requirements that this new environment carries with it.

The very first step to the effective communication with people from other cultural conditions is to perceive what the culture means and how it determines the behaviour and thinking of people.

Culture is a system of communally shared symbols, opinions, attitudes, values, expectations and standards that are reflected in behaviour of individuals [1].

Culture is a way of life developed and manifested by a certain group of people and passed from one generation to the next [2].

The culture is formed and influenced by the policy system, religion, language, work, expectations etc. This does not mean that all the members of a certain culture possess identical values, ways of thinking, acting or communicating but there is no doubt that their culture strongly influences their personalities. In communication process this is reflected in a selection of words and symbols, mode of expressing, selection of themes and ways appropriate for communication, extent of time that the partners are willing to dedicate to a discussion, in using non-verbal symbols that accompany the communication process - gestures, movements, eye contact, vocal characteristics of an individual, dynamics of the speech or expression of emotions. These non-verbal symbols can acquire a totally different meaning.

The opinions of people are also very specific and can be accepted in different ways. The most important opinions are those that define our priorities and are reflected in individuals' behaviour. The values and roles that one holds are transmitted into his opinions that are determined by the culture he comes from and appear in interpersonal interactions, i.e. in interpersonal communication.

A human is constantly influenced by set of impulses and finds himself in various situations. But the perception of these impulses and situations differs for each individual. It is also determined by factors such as personal characteristics, experience, interests, expectations but in a significant measure also by the special characteristics of the country or society the individual comes from.

Due to this influence the perception process is a selective process. This means that the same situation can be perceived differently by different individuals, it can be interpreted with different meanings and the individuals can lay stress upon different facts. What an individual from one culture feels as desirable and positive, an individual from other culture can feel as not desirable and negative. This is the reason why it is important to dedicate so much attention to the partner's specific perception of reality.

The expressions of emotions that we can see during the reciprocal discussions are strongly influenced by the culture. We interpret our emotions mainly from the point of our experiences and opinions. But the culture can also suppress some expressions (for example during the negotiation Japanese business men common don't express the emotions during the negotiation with Japanese businessmen) or it can also support them (for example the open expressing of emotions in Italy).

It has to be also carefully reconsidered when using humorous examples during the discussion (an Englishman will laugh on different jokes than an Arab…)

It is also important to realise one's need regarding the appropriate distance from the partner during the discussion. Not only the personal characteristics are important here but also the different customs of a certain country. The lack of understanding of the need of a bigger distance of people from different cultures leads to a so-called ***proxemic dance***, where one of the partners is trying to come nearer to the other, while the second partner desires bigger distance and so he is forced to step back. This situation causes the source of unpleasant feelings in both partners and is negatively reflected in communication process.

Each culture has also its own perception of time, its own concept of the time importance. The time may be effectively used or only let to pass along. In some cultures the being on time is appreciated, in others people are more benevolent to keeping the exact times and deadlines. One culture expects apologies in case you would be late, other cultures don't require it (in Anglo cultures, for example, it is not needed to apologise if you are not late more than 5 minutes but after this limit the apologies are expected. In Sweden even 5 minutes of delay is perceived as inapt. On the other hand the Spanish do not care much about being always in time).

Not even the continues stress and hurry or a full diary are in all the cultures accepted positively - as an evidence of a manager's success.

We also should focus our attention to the social behaviour and ethics in the interaction with people from different culture environment. The appropriation of the formal as well as the informal rules of behaviour in a given culture determines noticeably the success of the mutual discussions. People from different cultures differentiate one from another by their visions of the world, ways of solving problems, value importance, customs, modes of using the space or their need to be a part of the society, etc.

The communication process with people from other cultures has some weak points. The biggest source of problems is the process of coding and decoding the information. It is important when coding the information that the transmitter uses such kind of codes that the receiver knows and understands. The transmitter has to be conscious of the possible ways of the perception and understanding of various codes. The risk of a misunderstanding of the sent message can be decreased by an immediate feedback. The effectiveness of the interpersonal communication can be increased also by using the direct communication because it allows feeling also the non-verbal signals of the both partners. In this way the information obtained from the words are completed with the information obtained for example from:

- face expression – express understanding, surprise, worries, indifference...
- eyes – express interest, relation to the partner...
- attitude – express mutual relationship, interest, personal involvement...
- tone of voice or fluency of speech – express worries, fear, conviction, etc.

The direct communication allows to specify or to correct the information already in the very first sign of the mutual misunderstanding.

Knowing the culture where a man lives allows predicting the behaviour of this individual. The misunderstanding of the cultural particularities can lead to a total mutual misunderstanding of people. The organisations hiring workers from various cultures are very frequently facing the problems that have the origin in the interpersonal interactions. The way how to cope with these problems is one of the means of one's personal growth and development.

The mutual interaction of the personalities and their cultural environment they come from can be illustrated as follows:

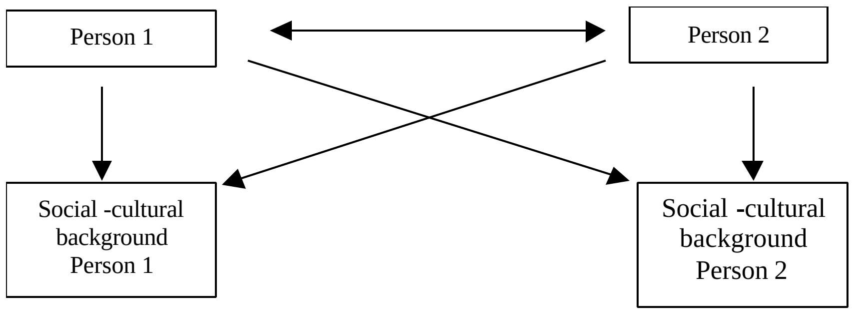

Fig.1 MODEL OF MUTUAL COMMUNICATION AND CULTURE APPEAL

In such context the partners know each other not only as unique personalities, but also as personalities with specific social and cultural background, background with different cultural paradigms.

The way to the effective intercultural communication is the approach so-called ***reflexive communication***. The mutual understanding supports the communication process based on a reflexive approach. This is the process that helps better understanding. It is based on the acceptation of paradigms of other cultures, on the clarification of meanings. The reflexive communication does not primary focuses on problem solving but it concentrates on problem understanding. For this aim reflexive questions evoking new ways of thinking and acting are used - for example: "What do you think - how would the situation develop...?"

The attitude of an individual supporting the reflexive communication is most of all based on the effort for the collaboration and it supports the free expression of ideas, the equality of partners. The experts' position or the position of higher status is suppressed and this allows more relaxation, openness and equality.

The reflexive communication requires skills in active listening, in providing the verbal as well as the non-verbal feedback, in asking questions - where open questions leave enough space for expressing an idea, for having own view of the problem and lead to further discussion. Via these factors it is possible to get more information. It is important to know to use the ***paraphrase*** that gives us an information about how the information was accepted and understood - for example: "According to what I have just heard...", ***clarification*** - of the heard, reflection of emotions and meanings - the ability to express emotional mood - for example: "It seems to me that you don't feel quite comfortable, if...", ***empathy*** - the ability to see the facts from the point of the view of the other person, ***summarisation*** - the brief summary of facts and emotions that have been expressed.

There is need to learn the effective interpersonal communication in culturally diverse environment. It is needed to develop the skills that can support this process. The way how to acquire this ability is to choose the right training program. The training programs have to focus not only on the perfection of language skills but also on the improvement of presentation, adequate using of non-verbal signals, providing feedback, increasing sensitivity towards others, development of empathy, etc. Such training program is suitable not only for managers, but also for students in different business schools.

To conclude, here are some recommendations how to make more effective the interpersonal communication with people from other cultural environment:

- to acquaint with cultural customs of the given country - by different means such as literature, discussions with people that have visited the given country;
- to adopt the language - it often helps to gain the respect;
- to acquaint with the history, policy, religion or customers of the given country;
- to eliminate the stereotype in negotiations, ethnocentrism - the tendency to consider the mother culture solutions of problems as the best, parochialism - the assumption that the problem solutions from the point of view of the mother culture is the only right;

- development of skills such as active listening, mutual acceptation and respect, empathy, tolerance, flexibility, clear and open communication, congruency of verbal and non verbal information;
- an ability of listening to the partner, patience;
- an acceptation of differences and respect to the partner;
- an ability of ambiguity tolerance and flexibility;
- a clear formulation of an idea and its distinct expression;
- an appropriate speed of speech

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Interpersonal Conflicts at Work: A New Phenomenon Called »Mobbing«?

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Abstract

Troubles at the work place are well known, as well as strain caused by stressful work. But nowadays, and that is what is new about it, emotional strain has increased significantly. The number of employees who retire untimely because of psychical stress has doubled in only ten years according to official statistics. With the term "Mobbing", in the Anglo-Saxon states known as Interpersonal Conflicts, Bossing, Bullying or Harassment, a collective noun became established for all kinds of negative behaviour at the working place. Viewing as a whole Mobbing creates tremendous costs, which affects and risks the economic success of companies considerably in the end. Therefore it follows the necessity for Human Resources to deal with the phenomenon and to pay more attention to Interpersonal Conflicts. Harassment at the job is no longer tolerable, and this not only because of economic or political reasons.

A large part of a person's life is spent on the job or in a professional setting. One isn't alone or isolated, but in more or less periodical or constant contact with one's work environment - co-workers, subordinates, employees, superiors, customers, and so on. Each of them contributes his own aims, interests, and values. The different ways of thinking and behaviour create a high potential for conflicts. Troubles at the work place are well known, as well as strain caused by stressful work. But nowadays, and that is what is new about it, emotional strain has increased significantly. The number of employees who retire untimely because of psychical stress has doubled in only ten years according to official statistics. On the one hand causal psychical stress could arise because of the actual job, but on the other hand because of stress or psychosocial conflicts with co-workers or superiors, which spreads throughout the workplace. With the term "Mobbing", in the Anglo-Saxon states known as -Interpersonal Conflicts-, -Bossing-, -Bullying-, or -Harassment-, a collective noun became established for all kinds of negative behaviour at the working place. Only by the creation of the homogenous word "Mobbing" it was possible that experiences and problems in the social area of the companies could be obtained by experts. In the first place the phenomenon of Interpersonal Conflicts proves to be a psychological problem. The term "Mobbing" as a form of harassment at the job exists only since a few years. Historically the phenomenon dates far back, but because of the Swedish scientist 'Heinz Leymann' this very serious problem was officially described and published. Originally the term "Mobbing" was only used by 'Konrad Lorenz' for defining animal behaviour. Leymann used this term for similar incidents in the work place. He started his research about direct and indirect assaults at the work place at the end of the 1970's in Sweden. In the middle of the 1980's he published the first report in which he used the term "Mobbing". Then, in the beginning of the 1990's, he published his first book where he combined all scientific cognitions. Therefore it is owed to Leymann that a public discussion about Mobbing got started at all. First of all his reports and publications about harassment at the job and psychological violence in the professional life have been shown interest only in the states of Northern Europe, but eventually attention was drawn to the subject of Interpersonal Conflicts in the states of Middle Europe, even if there was a temporary delay. Favoured by publications, urgent descriptions of cases, public discussions and training by consultants, the general public cautiously began to deal with the phenomenon. This wave was supported because trade unions and federations became interested as well. So far the little research about Mobbing, recognized initially in Sweden and partly also in Austria, predominantly dealt with the sociological, psychological and medical view of Mobbing. They are related mainly to the clinical picture of the victims and the spreading of the phenomenon in companies. Among other things parameters were established to find out which kind of Mobbing activities were bothering the employees and especially to what extent. But still a different analysis about the consequences of Mobbing in social and economic categories is missing - and still there is no consideration of the subject matter in Business Management. Only in Sweden research is intended for the next years. The goal of the research is to find out whether any specific organisational conditions favour the development of Mobbing or affects its course. Dealing with the subject matter is very complex and its consideration is being complicated by the fact that the primary insurmountable difficulties are caused by the companies and their representatives who are not willing to discuss the problem. And the few, who do give details, even if grudgingly, do this only under the so-called ‘seal of secrecy’. The public discussion of Mobbing is also prevented when the concerned persons do not wish to talk about it, in spite of guaranteed anonymity. Presenting to Human Resources the comparison of theory and practice is very important, because the necessary steps for intervention or prevention have to be practicable. Urgent needed effective researches requires not only a confrontation with the concerned persons, victims, offenders, companies, advisory boards, self-help-groups, trade unions or health insurance companies, but also a detailed consideration and analysis or evaluation of the theoretical references. As it is shown, the subject matter is handled only superficially by commercial reference books, where the subject matter of Interpersonal Conflicts is described only partially and in a simplified or vague way. The phenomenon of Mobbing is often hard to understand and its far-reaching impact is mostly underestimated. The confrontation caused a lot of misunderstandings. In many cases nobody took note that the phenomenon is a social process, but instead hasty conflicts, quarrels, slanders or duress in everyday work life were wrongly called “Mobbing”, without considering the facts. Mobbing is existential harassment. Indeed, single actions still do not represent Mobbing at all. Only the repetition of harassing activities over a long period, causing physical or psychical affliction, can be designated as “Mobbing”. Mobbing always involves a process and therefore it can be shown in models of phases. Mobbing means stress - and stress causes illness. And Mobbing causes not only direct health consequences for the concerned persons, but also for the companies, where Mobbing takes place, should expect high financial costs. Therefore it is necessary to prepare companies to recognize Mobbing in order to prevent it or to intervene if it is already occurring. There are numerous opportunities that can be effective. Nevertheless Mobbing causes not only negative effects in motivation and productivity, but can also cause frequent calling in sick and absenteeism. The cooperative working environment is especially strained because of the negative interpersonal relationships. This can be disastrous because good cooperation is the elementary assumption of each successful group or for teamwork. The positive effects of synergy, which rise because of the influences of the group-members, and which are especially important for the companies, as increase in the group- and team orientation are showing, are being prevented because of Interpersonal Conflicts. The general view became focused because of public discussions and thus the way was paved for scientific research of the phenomenon. One can see the start for the solution of the Interpersonal Conflicts since the end of the 1980's and the beginning of the 1990's. Scientists, physicians, health insurance companies and various employers have started to deal with the subject matter "Mobbing”. Also the European press has already taken up the problem, even though the international (and especially the US-American) coverage ignores the problem up to now. Just in the era of the ‘Shareholder Value’ the interests of the employees are less important. Subsequently this is astonishing, because dealing with the complex phenomenon it concerns Business Science as well as other scientific fields, as there are Pedagogy, Sociology or Psychology. Therefore the central objective exists in the representation of Mobbing as a complex and multi-layered problem, which concerns all social fields and structures and which should be an object of scientific research in the future. Meanwhile the first points in internal Human Resources can be recognized, which are dealing in a systematic and scientific way with hostilities at the job. Considerably this is a blatant call for action, because a social mechanism of ousting has been observed up to now. This is being influenced because of people's fear to be concerned for themselves. In view of the increasing readiness of the society for violence this is not astonishing, really. Mobbing can be found in all professions and lines of business, and evenly distributed between the sexes. Dealing with the subject matter has been strongly influenced from the whole spectrum of defence mechanisms and polarization, along with victim accusation and stigmatization until ousting or denying. Viewing as a whole Mobbing creates tremendous costs, which affects and risks the economic success of companies considerably in the end. Therefore it follows the necessity for Human Resources to deal with the phenomenon and to pay more attention to Interpersonal Conflicts. Harassment at the job is no longer tolerable, not only because of economic or political reasons. The phenomenon “Mobbing” must be studied for a better understanding - and this causes the basis for the basic statements - and especially for effective opportunities of treatment.

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Managing the Corporate Culture

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Abstract

Every organization has a corporate culture, whether it shapes it systematically or not. Corporate Culture effects how employees and managers access each other, problems, customers, and deal with suppliers, react to competition and how they perform various activities now and in future. If an organization wants to achieve its goals, it should actively manage its corporate culture. The corporate culture should be aligned with the overall direction of the company. The two important expressions of corporate guidance - strategy and planned culture - must be well matched and supportive, because strategy and culture support, complement and reinforce each other. The process of corporate culture management has four main phases: assessment and diagnosis, development, implementation, and evaluation and control. The primarily responsibility for corporate culture management has CEO and secondary top level management. The shaping of corporate culture should hit the whole organization and be relevant to all levels of employees.

Every Organization has a Corporate Culture

Every organization has a corporate culture, whether it shapes it systematically or not. The corporate culture is similar to the personality of an individual, it is present, and provides reason, tendency and base for behavior and actions. Just like the personality influences the behavior of a person, the shared values and ideology influence the behavioral patterns, opinions and actions inside the organization. Culture effects how employees and managers access each other, problems, customers and deal with suppliers, react to competition and how they perform various activities now and in future. Bajzikova and Sajgalikova [1] define corporate culture as „a set of credo's, values, and norms, which are shared inside a society and which substantially affects the behavior of its members. This set has been built by collective experience of successful problem solving by the society during a longer time period. This set is transferred as relevant to new society members." Culture is part of the company’s substance, it is an integral part of it and influences it regardless the organization is concerned with it or not. Corporate culture simply develops, because if any group of people works and lives together for a time, it creates and shares specific opinions and values about what's wrong and what's right. Corporate culture, despite of its strong influence, is intangible. It can not be seen like machines and technology, it is not readable as the P&L statement and it is not measurable so simply as the market share. The corporate culture can be pictured after Oden [2] – Tab.1 on two levels - the upper level is outwardly observable, the lower level is hidden from view and resides in people's minds. These two levels of culture are easily distinguished, but nearly impossible to separate. The hidden aspect of the culture is the substantive portion of culture, the part that truly influences peoples' behavior. The hidden level of culture usually can be inferred by observing the behavior of organizational members, especially those at the top.

Table 1 OBSERVABLE AND HIDDEN LEVELS OF CULTURE

OBSERVABLE LEVEL **Readily observable, but hard to interpret**	**Behaviors and Artifacts**	Includes anecdotes, art, ceremonies, heroes, habits, communication, jargon, language, management practices, myths, norms, physical arrangements, rituals, stories, symbols, and traditions
HIDDEN LEVEL **Not directly observable – can be inferred from how people justify what they do**	**Values, Beliefs, and Assumptions**	Includes assumptions, beliefs, cognitive processes, commitment, consensus, ethics, feelings, ideologies, mind-set, philosophy, principles, purpose, sentiments, thinking, understanding, values, vision, worldview

The Corporate Culture should be managed

The importance of the corporate culture impact on the organization implies, that if an organization wants to effectively achieve its goals, it should deal with its corporate culture and manage it actively. A number of researches, e.g. Peters and Waterman [3], Deal and Kennedy [4], which studied companies, which achieve above average results over a long period of time, showed that the most successful companies have built a certain system of values. This value system is well rooted in these organizations, it is well communicated and understood. Simply, these organizations have built corporate culture.

Referring to the management of corporate culture, managers often put themselves into two extreme positions. One group says, that corporate culture can not be in its fundamental changed similarly to the personality of an individual. They say, that it is better for a corporation to choose a strategy, which is in line with existing culture. The second very optimistic group says, that management of the corporate culture is quite a simple process, it is only needed to know and use existing tools. As usually, the truth is somewhere in the middle. It is possible to shape the corporate culture as human's personality, but it is a very difficult process. In some cases the change of corporate culture is a question of company survival, especially in today's dynamically developing external and internal business environment.

Corporate Strategy and Corporate Culture must be well matched and supportive

If an organization wants to function successfully, it should have a clear idea, what it wants to achieve in its environment. This idea is usually defined it the corporate strategy. The corporate strategy is by Papula [5] purposeful management of the future of the company toward settled goals, by solid, but at the same time widely determined ways, which enable reaction to changing external and internal environment. The corporate strategy is defined in following documents:

Mission statement, which specifies, in which business the company wants to be and how to succeed in this business. The mission statement names the game the company is going to play.

Strategic goals are derived from the company mission. They represent major milestones of the strategic plans in achieving the mission. These objectives are one-time goals that should be clear and measurable.

Strategic Plans or Strategies outline how strategic objectives will be achieved. Strategies can include positioning the firm for growth through new products or new markets, global expansion, technological innovation, quality performance, or cost-price leadership. Porter [6] states three types of generic strategies: cost minimization, differentiation and focus.

If an organization is to be successful, the two important expressions of corporate guidance (strategy and planned culture) must be well matched and supportive (i.e. their development and implementation must be integrated). The interplay between the corporate culture and the organizational strategy is of great importance. Culture and strategy support, complement and reinforce each other.

Normally, the development of relations with the external environment (strategy) should come first. Although the organization lacks complete control over its internal environment (culture), it has even less control over the external environment (competitors, economy, technology, etc.). Therefore, the company must first adapt itself to the external environment by developing its strategy. Then it must develop a planned culture that is consistent with its strategy. By understanding their organizations from a cultural viewpoint, high-level managers can and must strive to create a culture that facilitates rather than hinders achievement of the mission and strategic plans.

It is important to mention, that the values of key employees as a part of corporate culture influence the strategic decisions concerning the corporate strategy. The creation of long-term strategy, as a very complex decision, is often influenced by the philosophy and values of the decision-maker. The corporate culture could filtrate the ideas of top executives and limit the strategic alternatives they are willing to consider. It is needed to realize and manage the influence of corporate culture on the strategic decisions. New definition of corporate culture may remove the old taboos, which could needlessly limit strategic decision making in the past. This definition is important especially when organization faces strategic decisions, which could imply significant differences from the previous strategy.

The Process of Corporate Culture Management

The organization has from its heart corporate culture, which influences itself significantly. If organization wants to achieve its goals effectively, it needs to align its corporate culture with its overall direction. The company should systematically manage its culture. The process of corporate culture management is part of the strategic management, the primary responsibility for this is on the CEO. However, the CEO should not do it only himself, especially in big companies. A steering committee, focused and responsible for the corporate culture management, should be established. The name of this committee might be Cultural Management Council (CMC). Members of this team should be high-level managers, key decision-makers as well as CEO. The CMC should elect its leader - Cultural Manager (CM). CM might be even a full-time position, mostly in cases, when organization only starts to manage its corporate culture or needs an important change in it. The management of corporate culture should be a process with main attributes like: contingency, compactness and internal harmony. The process of corporate culture management has four main phases: assessment and diagnosis of existing corporate culture, development of corporate culture, implementation, evaluation and control.

Assessment and Diagnosis of existing Corporate Culture

Some managers think that if there is a clear strategic direction of the company, only the development and implementation of corporate culture should be done. This is quite premature, firstly it is needed to determine, what the current corporate culture is. The CMC is responsible for the identification and diagnosis of the current corporate culture. This phase could be done internally by organizational members or externally by consultants or combined. The culture assessment has several objectives:

- To explore all aspects of organizational functioning in order to identify the values, beliefs, and assumptions currently held by organization’s employees
- To identify the personality and beliefs of the strategic leader
- To identify the strength and history of the existing culture
- To identify how well the culture is understood
- To identify major opportunities for cultural improvement
- To identify possible barriers to cultural implementation program

- To promote cultural awareness

The corporate culture could be analyzed by a variety of techniques, e.g. personal and confidential interviews with a cross section of employees, group interviews, written surveys. It is recommended to use more or all of these techniques.

These surveys should answer questions like:

- Is there cooperation among employees
- Do employees feel recognized and rewarded
- Do employees feel the have a say in how the work is done
- Do employees feel free of unnecessary policies and procedures
- Do employees feel challenged by the work they do

The analysis of corporate culture should also answer, how, if ever, the company has built and shaped its culture until now and willingness and readiness to do it in future. This is needed to prepare a good plan for implementation. The following questions are useful in conducting the analysis:

- Has the company shaped its culture systematically in the past
- Are the present cultural implementation efforts succeeding
- Why are the cultural implementation efforts succeeding or failing
- Has the organization taken advantage of all opportunities
- Can the organization overcome obstacles

The corporate culture must be consistent with and support the corporate mission, objectives and strategies. To accomplish this, the corporate strategy must be analyzed and determine the implication for the corporate culture. Four often used aspects of corporate strategy with their implications toward corporate culture are:

- Growth vs. retrenchment
- Aggressive versus conservative
- Time of market entrance-exit
- Low cost versus differentiation

The analysis of corporate culture should also consider the influence of continuously changing and developing external and internal environment of companies. The most important influences of external environment are: political, legislative, economic, technological, social, cultural, customers and suppliers. The main internal influences are: product portfolio, rules and procedures, organizational structure and employees.

Development of Corporate Culture

After careful analysis and evaluation of current culture and conducting external and internal analysis, the next step is development of corporate culture. The development of corporate culture should by done by Cultural Management Council, led by Cultural Manager. Cultural Manager is responsible for preparation of drafts of the vision, core values, and guiding principles. The CEO should be member of the CMC council and participate in this process. The creation of these documents should be an interactive process. A necessary input to developing the vision, core values, and guiding principles of the organization is the mission statement from the strategic planning effort. If a corporate mission statement is not available, the CMC should take steps to have one developed before proceeding. The mission and vision should definitely be consistent and supportive, but they will not be exactly alike, since they serve two different purposes. A mission states what a company intends to do, to achieve, in the external environment on a one-time basis. A vision states what a company intends that its internal (cultural) environment should be or should become on a continuing basis. Normally the mission should be developed first, with the vision of what the organization should be like to achieve the mission being developed second. Because the mission is directly linked to the customers and external environment, it makes sense for the vision to be based on the mission. It is extremely important that the organization’s mission and vision be consistent and mutually supportive. The corporate culture is defined in following documents:

Vision: states, what a company intends that its internal (cultural) environment should be or should become on a continuing basis. A vision is a picture of a preferred future state, a description of what the organization would be like some years from now. Vision is more philosophy about how to play the game. Vision should be simple enough and short enough that it can be easily understood and remembered by all hands in order to provide the motivating force that is needed. The four most persuasive reasons for having a vision are: inspiration, unobtrusive control, focus, and integration.

Core Values: are the organization’s essential and enduring tenets – a small set of general values, not to be compromised for financial gain or short-term expedience and not to be confused with specific practices, which are included in the guiding principles. Only a few values can be truly core – values so fundamental and deeply held that they will never change and will never be compromised. Core values are perhaps the most difficult element to define, but they are also one of the most important.

Guiding Principles: describe how the vision and core values will be achieved. They establish the professional standards for the work done inside the organization. They specify the relationship between people in the organization – on all levels. In short, they outline how all members of the organization will behave to achieve the core values, the vision – and the mission. The principles establish the professional standards for the work done inside the organization. Without clear standards, the organization may suffer inconsistent efforts because people do not know to what level they should strive. The Principles establish a clear level of quality and excellence that every employee can understand and aspire to maintain.

Before implementation, the results of cultural planning must be tested. The testing has three purposes: to determine, if all employees understand the vision, values and principles, second, to determine if all employees accept and are willing to carry out the vision, values and principles, and third, to determine, if there are any recommendations for improvement. There are more ways, how to test them, one of them are in-depth discussions in focus groups, consisting of valid cross section of the company’s employees. The CMC members act as facilitators for the group discussions.

Implementation and Shaping the Corporate Culture

To put the developed corporate culture in the life of organization, the implementation is needed. The primarily responsibility for implementation is on the CEO, the secondary on high-level executives together with Cultural Management Council. The implementation of culture often fails. It is not unusual for a team of senior managers discussing these issues and becoming excited about a set of new values that they proclaim are the way forward. After the workshop any commitment to the new values and to change can be easily lost once managers return to the daily grid and they become caught up again in immediate problems and difficulties. Their behavior does not change and so the culture remains largely untouched. The behavior of top management and the way, how it enforces the cultural values into corporate praxis is very important example for all employees. The successful implementations of corporate culture have usually four common characteristics. First of all, they should be trustworthy. They should come from a credible source, like the CEO. The implementation of culture, which seems to be insincere, or which contradicts the basic organizational values would be probably rejected as company propaganda. Second, the successful implementation of corporate culture should be dramatic. They should naturally be interesting, not boring. Third, the successful implementations should hit the whole organization and be relevant to all levels of employees. The middle-level management, supervisors and all other employees should be involved in the process of implementation. Last, the successful implementations must be easy to remember and to believe. The corporate culture should have clear relevance to the performance of all employees, e.g. it should indicate, which behavior is expected in specific situations.

The implementation of corporate culture is conducted through managerial areas, as listed in Tichy’s Tab.2. [7]. Some examples, how to use managerial areas to shape the corporate culture are following.

Shaping of subcultures might support different parts of organization. Different subculture is suitable for research and development, which is long-term oriented, innovative, and producing ideas. Another kind of subculture is needed in production, which is more costs and efficiency focused. The company should support subcultures consistent with the departmental orientation. Simultaneously, these subcultures should not be too strong and act again each other, because then the individual departments do not sufficiently identify themselves with the company as whole.

The human resource management is also an important corporate culture shaping tool. Especially Japanese companies use very skillfully human resource management for shaping and reinforcement of corporate culture. In the human resource area the important tools are: selection of new employees, socialization, development and evaluation of employees, and rewarding. In the selection process, the technical skills as well as fit of the individual with corporate culture should be taken into account on all positions, not only managerial. The corporate culture could be also shaped by development and socialization of workers. It is reasonable to invest into training activities, which learn not only the needed skills, but also imprint on employees the organizational values. Evaluation and rewarding of employees should also enforce the developed corporate culture. The evaluation criteria should be settled to identify people, who support dominant organizational values and are identified with them. This people should be rewarded and promoted.

The corporate culture is transferred and expressed among employees in various ways, among them are: symbols, language, histories, activities. The well-known symbols are the symbols of key-executives, which communicate importance and status. These symbols are: dressing, office positioning, artworks in offices, company car, driver, assistant, reserved parking place. One aspect of corporate culture is also shared interpretation of these symbols.

Companies might use many language forms for creation of culture. Some companies and professions have own jargon and slang. This specific language might be technical, but it could have also political sense. One form of cultural communication is also humor. Company can use the kind of humor, which squibs competition or employee, who does not act in line with company norms.

Other often used form to communicate cultural values are organizational stories, myths or legends. The main actors in these stories are usually leaders, founders or key-executives of the company. These stories describe important moments from the company history, which have implication to current set of corporate values. The organizational stories have a message or lesson, they illustrate, how the basic values influenced concrete behavior of organizational member. Usually they are interesting and catching.

Similarly the top executives could develop new jargon or rituals, or promote old ones, or introduce new activities and rewards with fresh symbolic sense.

Another form of cultural transmission are activities. Activities might be annual conferences or Christmas parties, which communicate, that all employees are important for the company. Next forms are rituals, which often imply equalization activities, like team-sport competitions. Farewell parties are also a ritual, which should help employee safely leave the company and ensure him, that his contribution would not be forgotten.

Evaluation and Control

The last phase of Corporate Culture Management process is evaluation and control. The control should look backward, to the history; it should provide feed-back to previous phases, evaluate the current situation and identify differences from expected state. This control should be also forward oriented, it should monitor the development of external and internal environment and provide signals and information for potential corrections of existing corporate culture. As the whole corporate culture management is primary responsibility of CEO, he is also responsible for the control. The Cultural Management Council should execute the control. The control should reach the whole organization and all employee levels.

Table 2

Managerial areas ↓	Mission and Strategy	Tasks	Prescribed Networks	People	Processes	Emergent Networks
Technical System						
Political System						
Cultural System	Managing influence of values and philosophy on mission and strategy Developing culture aligned with mission and strategy	Use of symbolic events to reinforce culture Role modeling by key people Clarifying and defining values	Developing managerial style aligned with technical and political structures Development of subcultures to support roles (production subculture, R&D subculture, etc.) Integration of subcultures to create company culture	Utilizing cultural leadership skills Matching values of people with organizational culture	Selection of people to build or reinforce culture Development (specialization) to mold organizational cutlure Management of rewards to shape and reinforce the culture Management of information and planning systems to shape and reinforce the culture	Fostering friendship and affective networks, coalitions, and cliques to shape and reinforce the culture

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Personality and Competencies of Crisis Managers

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Abstract

The solutions of crisis situations are accompanied by many specific traits. Some of them are typical for all crisis situations, some of them denote the one singular form of crisis only. A crisis of the technical or social system is a condition, with two possible ways out from – the run of system or its radical change leading to the renewal of system functions. Contemporary opinions about the solution of crisis situation concur those crisis produces new dimensions in the organization scene. The demands for people readiness at particular positions and for decision-making process are rising. Therefore the demands on crisis managers are rising too proportionally with the intricacy of the situation. The crisis situations are special in work, time and information stress. In this article several approaches to a content of manager's competencies and specified crisis manager's activities, their functions, tasks and roles are presented. In this paper we try to define the traits, qualities and skills, which are necessary to develop to effective solution of crisis situations in the organization.

1 Functions, Roles and Personal Dispositions of Crisis Manager

The term *crisis management* appeared not long ago but it is used more and more frequently. The collocation formerly used by President J. F. Kennedy to express the process of solving of the Cuban crisis moved gradually from the political-security sector to economy and management of public administration, for example by solving the consequences of natural, technological and ecological disasters. The solving of various crises in various areas of human activities expects the subject of management to gain a lot of specific knowledge, skills and other dispositions. These can vary according to character, range and sector in which the crisis is manifested. Real life brings particular requirements on practical solution of the cases we considered to be crises or critical situations in various spheres of social life. Only the social praxis brings up the urgent task to be prepared for solving of such problems, which are indicated by endangering of human life, safety and property. The opinions on what the various types of crises have in common and what is specific for them develop gradually. It is not our goal to present the typology of crises here, but we think it is necessary to distinguish primarily the following crises:

- crises caused by unexpected accidents, technological and natural disasters with consequences on organizations, municipalities or whole regions,
- crises as consequence of acute endangering of security of the state, its citizens, its political and economical system, function of infrastructure, most often by political terrorism and military menace,
- crises in social systems caused by disrespecting or underestimating basic human needs, civic and political rights and arranged and generally accepted norms, or crises caused by failure of functions of particular system,
- crises caused by mismanaging risk of the enterprise in economical subjects (enterprises, firms), e.g.lost of liquidity, market, competition ability, failure of relation with supplier, crises in cooperating firms.

Some authors explain crises as not managed risk, as a certain stage in development of risk factors [9]. The existence of risk does not necessarily have to develop into a crisis. Vice versa, not every crisis has to announce itself by manifest risk factors. We can agree with Casserlay, "risk is the volatility of potential outcomes" [1]. So, to accept a risk also can mean an opportunity. However, not every crisis announces by perceived risk factors. Here we do not solve these questions, because this article engages crises, which do not have their source in an enterprise.

Every crisis, regardless to its cause, specifically influences living, behavior and decision making of people. The crisis situation directly influences all managing processes. Apart from other so that:

- it endangers life of people and their property,

- it evokes feeling of insecurity and fear in the organization and its surrounding,
- it endangers function of particular systems in organization,
- it evokes need of urgent solution,
- it can start unexpected human behavior, panic, chaos,
- it demands restriction of certain needs of people who take part in solving the crisis or which are befallen by it, demands on co-operation of working teams rise,
- the demand for information inside the organization and also from public rises and other [6].

The crisis situation influences quality and effectiveness of decision-making processes of a manager. Long-lasting work in strenuous conditions restricts human awareness, increases the risk of wrong perception of the information and its misinterpretation. For the defining necessary skills and competencies for crisis manager, it is important to know what is expected from by the following elements of internal and external environment:

a) levels of management,
b) authorities of state administration on particular level,
c) executive subjects of the organization,
d) co-operating organizations,
e) directly befallen public,
f) general public, media, society.

That means that the crisis manager solving a crisis situation has above all these roles:

1. He decides about sources, tasks, particular measures, he solves arising problems quickly with the objective to eliminate the consequences of the crisis and to restart the function of the organization.

2. He ensures the function of crisis information system, enables effective exchange of information inside the organization, between the co-operating elements and between management and public.

3. He directs activity of all who take part in solving the crisis; decisively eliminates negative social phenomena, is responsible consistent and decisive leader and coordinator.

There are lots of opinions on what are the competencies of the manager. The term itself can have various meanings: competency as a set of qualities, abilities to do something, as a qualification or as a set of responsibility and authority. In connection with management we talk about manager competencies as about personal characteristics of executive managers. We must of course mention that these personal characteristics are meaningful only if managers' range of authority is strictly restricted. Then we can define competencies of a manager as *a set of knowledge, abilities, skills and experience together with physical and psychical readiness to use these qualities for effective executing of particular tasks according to given authority and general expectations.*

Because the activities of a crisis manager develop from general functions of management, we think it is suitable to specify basic abilities of crisis manager by general demands on work of headmasters. On the other hand, we accept that an important role will be played by the outputs of theoretical elaboration of the crisis management, codified social needs and demands of responsible authority of civic administration, expressed by laws, regulations, directives and other norms, including international agreements. An important source is also the experience of crisis managers and crisis crew. It is necessary to accept the needs and expectations of subjects befallen by the crisis and its consequences.

2 Possible Approaches to Identification of Crucial Abilities of Crisis Manager

At the present there are more approaches and opinions about managers' competencies. Some authors come out of goals, content and tasks on particular levels of managing. Typical example is a model presented in most of management manuals distinguishing conceptual, social and technical abilities and skills [2]. The content of these abilities depends on whether the author prefers functional or adjective approach. Lately we can see a diverting from traditional approach to the demands on managers' personality. The competencies to reach particular objectives on quality level of pre-set standard are preferred more than personal qualities needed for the function and role of a manager. As an example we can use the effort of The Institute of Management in Great Britain and Czech consulting firm Inventa Consulting to create the European standards of manager and professional competencies. The main goal was the creation of an effective instrument for evaluation of manger competencies. A competence is understood as *readiness of manager to attain performance with his subordinate structures according to defined standard* [4].

In case of crisis solving it is complicated to set precisely the expected result standard of the crisis management but understanding the competencies on two levels (functional and personal), as in the Table 1, is more apposite. *Functional competencies* are set of glib abilities focused on tasks of managed object. *Personal competencies* denote the ability of managing subject to keep himself on such professional readiness and in such physical and psychical condition (fitness) so that he can realize his goals and tasks effectively.

Table 1 TWO LEVELS OF MANAGER COMPETENCIES

Manager Competencies	
Functional Competencies	***Personal Competencies***
Creating of strategy, goals assessment	Self-knowledge, self-evaluation
Managing of operations	Professional development
Managing of information	Physical condition
Managing of human and other resources	Mental condition

Especially personal competencies, in connection with some kind of retreat from usage of psychological methods of manager evaluation, are underestimated. There exist lot of particular experiences and professional studies, which prove that often the reason of managers' failure is not professional incapability, but failure of his proven managing methods (especially in crisis). He is not psychically ready to manage this change. For the manager is not enough to manage competencies demanded by functions and roles on particular levels of management (e.g. conceptual, social, professional, technical etc.), but he also has to be able to manage himself, physically and psychically manage all demands of the stress situation. In Eberspächer´s opinions, *physical and mental condition* is part of personal competence [3]. Then we can define this condition for crisis manager as *ability of organism to cope with roles and tasks resulting from need of effective solution of crisis adequately to the situation*

From this point of view, it is interesting to compare the already mentioned opinions, with the opinions and experiences of chosen subjects of crisis management in SR. Faculty of Special Engineering of Žilina University organized in June 2001 an international scientific conference "The Crisis Situation Solution in Specific Conditions", in which took part more than two hundred professionals concerned with crisis management in various spheres and levels of management in enterprises and state administration. We expected that their opinions and experiences would bring a lot of stimuli for the improvement of content, forms and method of the crisis manager' training in FSI ŽU. We asked them for co-operation by choosing a set of most important abilities, skills and competencies. Their task was to answer two questions. The first one was focused on the most important activities of crisis manager in particular stages of solving of crisis situation and the second one on decisive knowledge, abilities and skills needed for effective solving of crisis situations.

1.Describe 5 the most important activities of crisis manager in your opinion

- in the stage of crisis planning
- in the stage of solving of acute crisis in organization (or other particular environment)
- in the stage of removing of consequences of crisis.

Write, which knowledge, abilities and skills are, in your opinion, the most important for effective crisis manager.

The above mentioned questions were given to 180 participants of the conference, among which were officers from Department of Economy, Home Office, Defense, heads of regional and district offices, heads of

Departments of Civil protection, Fire protection and of Environment, as well as managers of private enterprises, state and non-state rescue organizations. Following answers are the most frequent:

Most important activities of crisis manager

A) In the stage of crisis planning:

collecting of information about potential risks, analyzing of risk and crisis sources, investigating of probability of occurrence and rate of negative influence of particular factors,

analyzing of previous crises and experiences according to their solution, formation of prognosis,

workout of crisis plans, checkout of their realization on lower levels, control of preparation of preventive measures,

processing of directives, methodics, examination of current crisis plans, their realization, preparation of alternative solutions,

choosing of people to crisis crew, selection of cooperating elements, training of people, scenarios, exercises, screening of readiness,

collecting of information about important and useful sources and means and others.

Almost all participants agreed on the most important activities, although the state administration officers put on the first place the importance of processing of directives and methodic, while mangers and rescuers preferred preparation of crisis managers, emphasizing especially training with simulations.

B) In the stage of solving of acute crisis:

managing and coordination of work of particular subjects by realization of crisis plans,

permanent monitoring and evaluation of the situation, control and assessment of possibilities, prediction of how the situation will develop, specifying of tasks and of their order,

objective, brief and timely information of particular elements of crisis management and co-operating elements, true and sensible communication with public and media,

reinforcement of psychological endurance of members of crisis crews and members of rescue forces,

organization of not planned preventive and rescue activities as well as activities for ensuring life and property of befallen subjects (resources, evacuation, medical help) and others.

C) In the stage of removing of consequences of crisis:

estimation and verifying of consequences and damages, evaluation of own possibilities,

setting of order of activities and measures, managing of organization and co-ordination of rescue, localizing and liquidation operations, organization of co-operation with helping subjects and services,

evaluation of importance of particular operations to distinguish important tasks from less important,

monitoring of operations, evaluation of experiences, preparation of impulses for actualization of crisis plans,

managing of restoration of security systems in organization and its surrounding, measures against plundering,

ensuring of professional, material, medical and psychological service for consequences removing people,

being in permanent contact with public, giving actual information about goals, tasks and general situation,

taking measures against secondary consequences of crisis (epidemic, famine, other catastrophes, social conflicts) and others.

There were accented: co-ordination of all elements on rescue operations, monitoring the situation, prompt reaction on unexpected situation and permanent and objective communication with public in this part answers.

Most important knowledge, abilities and skills of crisis manager

The answers to this part of questionnaire correspond with all what was already said about the activities of crisis manager:

ability to lead people in demanding situations, direct control and help them,

ability to decide in non-standard situations, ability to recognize what is most suitable in particular situation, independence, decisiveness, responsibility,

psychical endurance, psychical ability to solve unexpected problems promptly, ability to stand up long-lasting physical and psychical stress,

professional competence, professional and technical knowledge, knowledge of specific problems of crisis management,

ability to observe and experience the environment and its changes, ability of quick orientation in demanding situation, predict its development and consequences,

ability to organize and co-ordinate tasks and activities of members of crisis crew, executive and co-operating elements and helping services,

knowledge of prepared information systems of crisis management, particular database systems and ability to use them correctly,

knowledge of laws, decries, regulations and other norms which restrict responsibility, tasks, activities and their relations in case of crisis ability to use them by co-ordination of particular subjects of crisis management and rescue forces,

communicative skills, ability to listen, understand the information and signals, know how to negotiate, influence, persuade, keep feedback, clearly and briefly formulate decisions and orders, seriously, briefly and quickly inform public,

Have experiences with solving of nonstandard situations from job with crisis crew, from solving previous crisis or other.

Even though the participants of the survey agreed on the list of competencies, there are differences in priority they give to them. It shows Table 2. Important is that both groups prefer competence for leadership in demanding situations, ability to decide independently according to analysis of permanently changing situation. Natural is professional knowledge, knowledge of methods, principles and techniques of solving of crisis situations. However, there are clear differences in order of some preferences for competencies.

Table.2 PREFERRED ABILITIES IN THE VIEW OF SPHERE OF CRISIS MANAGERS' ACTIVITIES

State Administrators		Private Enterprises Managers	
Professionally-technical knowledge and skills	17%	Psychical endurance and readiness	22%
Leadership	15%	Decide in non-standard situations	15%
Ability to organize and co-ordinate	15%	Recognize and analyze the environment	15%
Ability to use database	15%	Leadership	15%
Recognize and analyze the environment	12%	Professionally-technical knowledge and skills	13%
Other	26%	Other	20%

Managers and employees of state administration prefer – except of leadership – also professional, organizational and technical competences. It is also clear, that this group, unlike managers of enterprises, strongly prefers knowledge of laws, regulations, directives and methodics. That depicts habits and style of work of these employees, but also their need of general co-ordination of more subjects (what should be ensured especially by laws and norms). On the other hand, managers of enterprises and rescue subjects clearly have more experience with the solving of real crisis, industrial accidents, floods, fires, snow calamities, which were in last few years in Central Europe more than usual. We can see this also in the demands on psychical endurance and readiness to solve unexpected problems and stand up long-lasting physical and psychical stress.

Personal interviews with many managers, which have their own experience with the solving of crisis situations, indicate other problems, which were not in the answers. It means problems with information of public and with no readiness of people to react on warning signals. Last years experiences indicate also no readiness of crisis crews to react correctly on, sometimes illogical, behavior of affected citizens. Old and incompatible information systems complicate the co-operation of particular executive elements of crisis crew.

According to previous experiences and to this survey, it is possible to propose kind of system of manager competencies, which accepts demands and specialties of a crisis manager. We consider as reasonable to accept the division in functional and personal.

The content of the functional competencies can be expressed in the following way:

Planning abilities:

ability to analyze information about potential risks and about development of crisis factors,

ability to set aim and main tasks with preference of saving lives,

predict the development of the crisis, decide about sources,

ability to coordinate work on preparation of crisis plans,

knowledge of demanded techniques and methods,

Abilities to evaluate and realize:

monitor fulfilling of tasks, evaluate potential risks and their consequences,

examine the balance between tasks and needs and development, react according to changes,

set tasks, stimulate their fulfillment,

co-ordinate important information sources.

Social competencies:

a) Leadership

get the people for fulfillment of tasks, order, stimulate, motivate, evaluate,

take care about their professional, physical and psychical readiness,

create team and coordinate their activities, monitor their enthusiasm, know to asses need of rest and exchange,

manage more styles of leadership according to need and situation

solve potential conflicts.

b) Communicative skills

monitor, observe what is going on an describe the situation correctly,

monitor communication, listen actively, ask for actual information, know to distinguish important and less important,

ability to communicate with people living in befallen area,

persuade, formulate decisions clearly,

be able to inform the public about the situation, goals and tasks of crisis management activity briefly, truly and seriously.

Conclusion

The mentioned opinions and conclusions from the survey indicate that training of crisis managers should be demanding according to the demands of tasks they will be given by solving of the crisis situation. The training of crisis managers, who will coordinate activities of executive teams from various posts, including the leading post, is a matter of general need. Experiences show us that the training by learning a big amount of professional and manager's knowledge is not always enough. It is clear that we have to look for some prepositions for the role of the effective manager in demanding situations in his physical and psychical condition. The balance between tasks and possibilities of managers is rising in the crisis situations. Manager cannot succumb to outer demands. He must control them effectively. The role of his mental condition (fitness) and skills is more important.

Especially the mental condition should be given more attendance, what is confirmed also by the statements of managers. We must not underestimate those activities, which help the psychical regeneration of organism. Experiences from long-lasting managing of process of anti-flood measures confirm that exchange of crisis crew

members is necessary, eventually it is possible to exchange individuals, but the coordination of particular activities must be kept up. There are experiences about serious psychical breakdown, if the needs of psychical regeneration were not respected.

During the preparation and crisis planning it is necessary to accept these facts. Therefore crucial specific traits must be the base of education and development of crisis managers.

Key words: Crisis, crisis manager, competency, abilities, skills

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Rational Expectation Theory in New Millennium

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Abstract

The new modern macroeconomics worked out by J. M. Keynes is used as a part of economics to formulate a suitable economic policy to find solution to state intervention into modern production of goods using for satisfaction of peoples needs by all labor force and raw materials.

We tried to present opinions of some leading macroeconomists in last two centuries to work out new economic policy to contribute to renew economic equilibrium.

The motivation for a rational expectation approach in macroeconomics in new millennium.

One of the most conspicuous features of macroeconomics fluctuations in the close association between the fluctuations in output and prices over the business cycle. In statistical terms, there is a marked positive correlation between aggregate production and the rate of change in the aggregate price level. The relationship between output and inflation is a not a new phenomenon, although it has shifted over time as expectations of inflation have changed. It has appeared with few exceptions in business cycle as far back as data on business cycles exist. It was observed and studied by American economists Irving Fisher, A. C. Pigou or J. M. Keynes: many other economic theorists in the early part of 20th century. It received even wider notice after being embodied in a simple econometric equation by A. W. Phillips in 1958. The price-output correlation is usually given a top billing in the "aggregate supply" chapters of modern macroeconomic textbooks – the term "aggregate supply" itself connoting a positive association between prices and output. And, of course, particular realizations of the correlation have always been major news events; the recent downside realization – the worldwide recession and the decline in the inflation rate – is certainly no exception.

Many macroeconomic policy recommendations have been based on the price-output correlation. In the 1920s business cycle theorists drew conclusions about stabilization policy from it. Examining data for the United States, Irving Fisher argued that fluctuations in economic activity could be reduced by a macroeconomic policy that simply stabilized the aggregate price level. Noting similar correlation in the United Kingdom, Pigou (1927) argued for a policy of preventing prices from rising in booms and falling in depressions and thereby "loosing industrial fluctuations." And in his tract Monetary reform J. M. Keynes /1923/ also argued for a policy of price stabilization citing Fisher's evidence in the United States. The causal assumption implicit in such policy recommendations clearly is that price fluctuations are the direct cause of production and employment fluctuations.

Although based on the same Phillips-curve–type correlation, policy recommendations in more recent times have been quite different.

In the 1960's many macroeconomists argued that a policy of price stabilization, or a low inflation target, would disrupt production and increase unemployment. Price stabilization proposals have been revived in recent years, but the conclusion that too much price stabilization would reduce output stability is still held by many economists. Given such wide differences in policy recommendation all erasing from the same statistical correlation, the need for a clear and quantifiable theory to explain and understand this correlation seems obvious.

The development in the early 1970's of rational expectation models in macroeconomics – the subject of this paper – was largely in response to such a need. Of course, economic theories of the Philips curve had already been the subject of an intensive research effort when rational expectation models were introduced, but there were still some problems with this research. Consider, for example the research of Edmund Phelps /1967/ and Milton Friedman /1968/, which showed that there is an important distinction between the long-run and the short-run output – inflation relationship. This distinction is due to expectations. According to the Phels-Friedman theory, these stimulating effects associated with a steady rice in prices these movements and adjust their behavior accordingly. The theory is elegant, logically consistent, and indeed empirically accurate in its predictions for the long-run inflation – output correlation. The problems with the theory are in its description of the short-run correlation between inflation and output, where it relies on adaptive expectations to explain why firms and workers would be slow to adjust their expectations to business cycle conditions.

The adaptive expectation assumption might be a reasonable description of how expectations adjust after a major unprecedented development, but it seems particularly inappropriate as an explanation of a phenomenon that has been observed regularly as part of economic fluctuations for hundred years. To the extent that business cycles are recurrent phenomena, the assumption that people form expectation adaptively, learning from scratch about the dynamics of each business cycle as if it were a unique event, does not seem appropriate. Almost all applications of economic theory are based on the assumption that individual beliefs are influenced by experience. There is no reason why macroeconomic application would be different.

Prof. J. A. Schumpeter was born in 1883 and died 1950. His teaching is very popular especially in this new millennium; many economists are trying to apply his basic ideas in the modern capitalistic market economy. In this connection they speak about Schumpeter's contribution to Business cycle theory. In this sense is Schumpeter one of the leading creators of modern macro-economy not omitting the place of J. M. Keynes.

Speaking about modern macro-economy we mean that has begun with monetary and business cycle theory: and Schumpeter laid the foundation of this new phenomenon by his famous work: "Theory of economic development" published in 1912: there are here not only internal relations between the variables, but even external shocks. Schumpeter stressed an innovation activity of the entrepreneurs, which accounts for "the wave movement" in economic life. This idea is a vital part of dynamic theory which was evolving on the Continent in the first decade of 20th century.

Schumpeter's theory of innovation – new production function of the entrepreneur was a stabile factor that pumps intermittent flows of investment into the economic system. With respect to Schumpeter's cycle theory we should direct our attention to following matters:

a) Should be this theory classified as exogenous or endogenous?
b) What is the upper turning point?
c) The three cycle schema.

It is exogenous in the respect that it places primary emphasis upon changes in the data. Yet it is endogenous in the respect that it runs in terms of an interherent in the inner nature of a dynamic economy whose impelling force – innovation cycle after cycle renews the wave-like movement. The business cycle is regarded as the ebb and flow of innovation together with the repercussions flowing therefrom. It is a nature of a dynamic economy; but it is exogenous in the sense that innovation is a change in the basic data.

Exogenous theories place primary emphasis upon changes in the data, endogenous theories upon the lagged reactions of the economic structure /with a system of internal relationships/ to changes in the data. Expansion is brought about by innovation activity. Innovation in Schumpeter's view is an historic and irreversible change in the way of doing things: it is a change in the production function. We may simply define innovation as the setting up of a new production function. Innovation wells up in a great tidal wave, and then recedes. So business cycle is nothing more than the ebb and flow of innovation; an economy which experience innovations necessarily display wave-like movements.

Innovation involves capital investment which appears a masse at intervals. Innovation activity tends to come in "clusters" in "bunches", because of the herd-like action of followers in the wake of successful innovation. It is an endogenous process determined by the inner nature of a dynamic economy.

Endogenous theories place primary emphasis upon the lagged reactions of the economic structure to changes in the data.

It is sometimes said that there is a tendency in business cycle literature to stress the role of exogenous factors as the cause of causes of expansion: Expansion is brought about, in Schumpeter's view by innovation activity. An innovation is defined as a fundamental change in the data; it is not a matter of varying the quantities of the factors. This means only new technique, or the new products or new markets.

Whenever a few success innovators appear a host of others follow. This is the basis of "the wave-like movement" of economic life. The expansion proceeds by "rushes" because of the herd-like movement of others, trying to use the opportunity. The central drawing force is the appearance of new entrepreneurs. There is also the endogenous process of adaptation to this driving force. Under the impulse of innovational activity, the economic system draws away from the neighborhood of equilibrium. But the farther it moves away from equilibrium the stronger is the fall back to equilibrium. In the downward readjustment the economy is likely to "overshoot"; again the economy is pulled back toward offers a favorable climate for renewed surge for innovation. Schumpeter is saying that "the only cause of the depression is prosperity."

This means that the depression is nothing more than the economic system's reaction to the distortions of the boom: it is an adaptation to the situation into which the boom brings the system. We must understand that innovations inject disturbances into system; these disturbances cannot be currently and smoothly absorbed. They disrupt the existing system and enforce a distinct and often painful process of adaptation. The boom development is discontinuous and has to be absorbed – to reach again equilibrium. The system is struggling for new equilibrium. And we should hold to this process.

The final result must be a new equilibrium position. The incentive to produce more and more products will not crease before this condition is arrived at, nor before price falls as a result of the growing supply.

The entrepreneurs are carried out new combinations; they get profit. This profit is the surplus, to which no liability corresponds. These individuals have done nothing but employ existing goods to greater effect: they have carried out new combinations and are entrepreneurs in our sense. The commercial combinations is the choice of a new cheaper source of supply for means of production, perhaps a raw material may be cited. The other example can be the search for new markets in which an article has not yet been made familiar. At the same time the above covers the case of the production of a completely new good-these individuals have absolute control over the means of production. At the moment when the combination is completed and the products come to existence their value is determined. The value of the new products must be compared with the value of those products which the same means of production have been producing so far in the normal circular flow. The successful carrying out of new combinations also result in a value surplus in non-exchanging economy: surplus value in development is special form of profit – it is a social phenomenon. The new combination yields a certain surplus; and it is a gain for an entrepreneurs, introducing this new combination. Many are repeating the same combination and the source for profit is diffusing. The former new combination is now prevailing in society and production is awaiting entrepreneurs trying to introduce a new combination. And this process is perpetual process – we call it the development.

It is true that many Schumpeter's ideas are controversial: many don't agree with his arguments. But Schumpeter has still many supporters and followers: three are trying to introduce his economic scale theory to explain recessions in modern market economy.

In this period they are introducing the state intervention into economy in order to decrease unemployment.

Conclusions: The theory of rational expectation is closely connected to business cycle theory of Schumpeter, nevertheless it was formulated one hundred years ago. Both theories are popular in 21st century: it supports the final goal of economists to decrease high unemployment in modern market economies.

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Some Facts about Human Resource Management in Selected Regions of Slovakia

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Abstract

The new economic conditions which started to develop after 1989 require new methods and a new approach to human resource management because a key to the prosperity of individual companies or to the whole society is just in the human factor, in its rational and economical employment and, in its formation and motivation as well as in the special care about it. The contribution submitted is aimed at several important aspects of the human resource management in our country.
The first aspect is the orientation of human resource departments in modern entrepreneurial entities. The second problem is planning personnel activities, the analysis of job vacancies associated with recruiting and a choice of labour. The third aspect is the choice of employees and the relatively complicated present situation existing in this field and having impact on our economic conditins. The fourth aspect is the mutual interaconnection of problems associated with the evaluation, remuneration and motivation of employees. One of the discussed problems which need to be solved is nowadays also the corporate culture development.

Human Resource Department in the Modern Company

The orientation of human resource departments in modern entrepreneurial entities results from the fact that they

- participate in increasing the company´s effectiveness and contribute to the growth of profit and to a good name of the company,
- enter into contacts with out-of-company institutions,
- are a source of information for top executives and other employees,
- offer services of the mercantile character.

The most important aspect in the orientation of human resource departments in the contemporary companies is their participation in the enhancement of the companies´ effectiveness by fulfiling all functions of the human resource management. In establishing contacts with out-of-company institutions, it is necessary to take into account the searching for such organizations that can be useful for the own company. The contacts should be made with

a) human resource departments in the other institutions – the comparison of methods and activities,
b) organizations ensuring qualification/re-qualification services,
c) organizations ensuring professional/expertise services,
d) organizations offering professional/consultation services,
e) institutions, to which are offered services by their own human resource departments.

The fact that human resource departments are a source of information for managing and managed workers is obvious from the name and assignments of the human resource management. The provision of services of the mercantile character comprises such a human resource activity in relation to out-of-company entities which ensures a share of the human resource department of the own company in the profit gained from the provided paid services. In our conditions this field should be viewed critically because the minimum attention is paid to it in practice. The bigger companies try to enter into contacts with schools and other educational institutions and the relatively extended is the sphere where services of the human resource departments are provided inside the companies as information centres.

Planning of Human Resource Activities in the Company

It is undoubtful that the mission of the human resource planning is in ensuring the right number and composition of employees who fulfil given tasks and are nominated in the correct positions. In this way the human resource planning can be splitted into several interconnected components such as:

a) planning of manpower requirements,
b) planning of the recruitment and choice of labour,
c) planning of the reduction in the number of employees (retirement and dismissal),
d) planning of the allocation of employees,
e) planning of the education of employees,
f) planning of the remuneration and productivity of labour,
g) planning of the personal development.

As for the above-indicated structure and extent the insufficient attention has been paid in our economic practice. The planning of manpower requirements in our country does not always create a link with all fields of the company planning. Without any information and planning data concerned with marketing, production, investments, organization, etc. it is impossible to plan manpower demands in the entrepreneurial entity because without clarifying the plan of the demands of employees and their coverage the planning also in other company spheres would be doubtful.

This problem is closely associated with the analysis of job activities or job positions. The standard answer to the question by whom the above-mentioned field in entrepreneurial entities is implemented does not exist because it depends on the particular conditions, their extent, orientation, organizational structure, etc. However, it can be generally said that this field is safeguarded by the human resource department itself, personnel administrators or external professional co-workers, all of which play a major role in it. At present the planning of human resource activities in our economic system is given an appropriate attention in connection with the analysis of job positions and job activities.

Process of the Choice of Employees

As regards the choice of employees, our enterprises try to achieve such a state in which they would have at their disposal a lot of information data about applicants and their claims. Only in this way can be the employees adequately included in the working process. The goal of the selective process is to choose, hire and place such applicants who are the most convenient from the aspect of accomplishing their stipulated assignments and objectives.

The process of the choice of new employees in companies (besides those belonging to the top management) is usually organized after accomplishing certain principles as follows:

1. The personnel administrator will briefly interview the candidate for a job to obtain the primary information on his professional and personal qualities in order that he could be the most suitably placed in the vacant post. The candidate will submit his documents and the above-indicated administrator will make the primary classification of all candidates.
2. After considering all information data the personnel administrator will specify the convenient job position on the basis of the job vacancies. If the applicant will show his interest in the job at the particular department, the administrator will notify the executive of it and will acquaint him with all information concerned with the applicant.
3. The personnel administrator will fill in “a Proposal for the job placement“ of the applicant and the executive of the company will discuss with him the rights and duties in the offered position.
4. If the executive will agree to admit the applicant to the designated job position, he will sign a Proposal for the job placement and the applicant will come back to the human resource department. Then the administrator of the department will have an entrance interview with him.

5. If the executive will express his consent on the basis of the information obtained from the personnel administrator and on the basis of the applicant´s agreement to take up the designated job position, then the personnel administrator will send the applicant to the entrance medical examination. In some cases the applicant is obliged to undergo also the entrance psychological examination including: performance examinations aimed to find out the level and structure of the intellectual capacity, extent and ability of the concentration, etc., personal questionnaires oriented to the applicants´ character and dispositions.
6. If the applicant is competent to hold an office due to the fulfilment of medical, professional and psychological requirements, the personnel administrator will enable him to get through the entrance training directed at the fire protection, health security and protection at work, products quality and at the environmental training.
7. The applicant´s contract of employment will be concluded with the executive of the human resource department.

Besides the above-indicated choice of new employees which is oriented negatively it is also necessary to make a choice of persons for managerial functions. This choice is oriented positively, that is to say to searching for right people capable of fulfiling their obligations. The choice is usually made from among existing employees in the company when their advancement or shifting is necessary.

In the process of searching for candidates and their inclusion in the database of manpower reserves one should have at disposal the results obtained from the regular job evaluation and from the database of the personal information, as well as the results of psychological examinations and informative materials provided by executives and the results obtained during the adaptation process of newly-admitted employees.

Every post needs the elaboration of a set of requirements comprising general claims, the level of identification with the company, its strategy and philosophy, interest in work and in the labour performance, perspectives in the position in question, demographic requirements (educational level and degree, knowledge, skills, qualification, professional experience, language requirements), health and psychical requirements to achieve the successful job performance.

The choice of manpower reserves is the optimization process of relations between the requirements for the successful job position on the one hand and the professional and personal dispositions of people on the other. Nevertheless, one should take into account also the evolutional and perspective feasibilities of people – the ability to guide them and organize their work, communicativeness, decision-making, open thinking, team work, ability to raise the level of labour skills, etc.

The candidates who are able to meet the stipulated requirements and have interest to hold a prominent post are incorporated into a plan for the preparation of manpower reserves. If the employee completed successfuly the preparative programme and if the post, for which he was suggested, is free, he can undertake his function. As far as the choice of employees is concerned, very good results concerned with the elaboration of methods for the evaluation of selected employees have been achieved in our economic practice. In the economic practice also various competition systems have been often used.

Evaluation, Remuneration and Motivation of Employees in Practice

The job evaluation has been already applied in our companies as a part of the personnel work as well as a part of the corporate culture. At the defned period of time the executives in the particular company are obliged to evaluate not only the performance of employees and set assignments for the period to come but also to estimate the developmental abilities of employees, their contribution to the fulfilment of the organization´s objectives and the extent of their identification, or to specify some motivation factors. On the other hand, they should realize that employees have the right to receive the feedback information on how the executive evaluates their work, which are the weak points in their activity and where he finds their reserves. The major role in the informal as well as formal evaluation has a direct superior of employees being subjected to his appraisal. The evaluation process is carried out in accordance with internal guidelines.

The most frequently used criteria for the evaluation of the manager in our economic system have been drawn up to find out whether he

- has the conceptual idea about objectives of his department and is able also to realize them,
- can discern essential and critical problems and solve them efficiently,
- gives an analysis of the potential alternatives of solutions (their advantages and disadvantages) in submitting them to his superior or in asking him for help in solving some problems,
- can solve some critical situations effectively,
- gives a proposal for the implementation of new ideas and improves labour methods and procedures with respect to the reality and contribution,
- conducts working sessions and meetings purposefully and creatively,
- presents his superior the complete, reliable and prompt information regarding the situation and problems occurring during the implementation of various assignments,
- shapes good labour relations with other departments in the company,
- serves an example of industry, fidelity and interest in the company,
- is responsible, conscientious and thorough,
- behaves reasonably and deliberately in stressed situations,
- has an informal authority or is respected by subordinate employees,
- gives clear and complete instructions and explanations in setting some assignments to his co-workers,
- is systematically monitoring the working results of cow-workers with the aim to secure their systematic control,
- maintains and consolidates the discipline in problem-solving related to the field of technology and the safety at work,
- stimulates subordinates and can appreciate their contribution and work,
- can create such an atmosphere at his department that the labour relations of his employees are friendly and co-operative (open communication and informativeness),
- takes care of the professional growth of his co-workers,
- involves his co-workers in the solution of problems encountered in the field of decision-making and initiatively employs their contribution,
- improves the dynamism of his managerial work.

Criteria for the evaluation of officers in charge are:

- application of the professional knowledge and experience at work,
- special activity in further professional advancement – self-improvement,
- independence and initiative in accomplishing the appointed tasks and in solving labour problems,
- overall labour performance – implementation of assignments at a required range, quality and deadline,
- ability to adapt rapidly to new working procedures,
- participation of personal elements at work and in the fulfilment of assignments.

The most important component of the whole evaluation process in our economic system is considered an interview with the employee. The starting point in it are last achievements which serve as a basis for future tasks formulated after the mutual agreement.The fundamental problem of the guidance of people is that they can be forced to do necessary things but cannot be forced to do them if they do not want to. The motivation effect of the interview depends mainly on the fact how both participants were prepared for it, how it proceeded and what significance they ascribed to it.

In our economic conditions some recommendations for the evaluation of employees have been time-tested as follows:

1. The job evaluation should be done regularly, once a year to a minimum. In view of the effective functioning of the job evaluation system it is significant to determine the optimum intervals of job evaluations.
2. It is necessary to link up the results of the job evaluation to the remuneration system. In our economic practice a very often applied wage system which permits the differentiation of wages for individual employees within individual wage categories exists.
3. The relevance of the job evaluation should be shifted from the assessment of criteria to the evaluation of objectives and functions which were fulfiled in the previous period. The objectives should be divided according to the hierarchy of employees in the organization.
4. Before the valuation interview employees should undergo the self-valuation. In accordance with the practice of a lot of firms the efficiuency of traditional valuation systems is insufficient.
5. It is important to create a large factual and temporal space for assessors.
6. It is necessary to prepare assessors at all managerial levels and to accomplish a briefing for persons subjected to evaluation always before the job evaluation. The briefing aimed at the preparation of assessors in seminars should preceded the proper job evaluation.
7. The results of the job evaluation should be introduced into the information system of the human resource development. For the effective management of people it is inevitable that the results obtained from the job evaluation, such as future functions and objectives, requirements for improvement of the labour performance, the plan of the professional development and plans for the appraisal of employees, were reflected in the information system of the human resource development. The employee expects that conclusions accepted in the valuation interview will be introduced into practice. If this fails, the motivation of the employee will diminish and the conclusions which he promised to fulfil in the next period he will cease to respect. Of course, this will be projected also in the reduction of his labour performance.

In our economic conditions the classical wage system of the remuneration of employees on the basis of the job evaluation and performance has been employed. In monitoring and evaluating the remuneration system in practice some drawbacks occurred and led to certain proposals and measures for its improvement. In other words, if there exists an effort to create such a system which would sufficiently stimulate employees the usefulness of the following principles should be considered:

1. It is necessary to consistently differentiate wages of the “best“ and “worst“ employees. It is also vital to monitor the development of the differentiation of wages regularly and to follow whether it does not lead to levelling.
2. It is necessary to plan criteria for the salary advancement. Due to gradual wage adjustments carried out on the basis of the predetermined criteria the entrepreneurial subject will achieve the higher effect in the motivation of employees than it is in the case of the nonrecurring, even more profound wage adjustment.
3. From the motivation point of view it is also significant and essential to set up real objectives for a longer period for the purpose of their fulfilment. If employees do not succeed in the task fulfilment, their initial enthusiasm and motivation level fall down, employees feel the unsatisfaction and frustration.
4. The higher motivation of employees is achievable, if employees have the possibility to be involved in the shaping of objectives and functions during the job planning, and also in their implementation. One of the ways how to solve this problem is to pay more attention to the management technics according to defined objectives.
5. Another important principle is the principle of participation. The possibility to participate in the management and decision-making process follows from the necessity of the self-realization, recognition and from the feeling that the accomplishment of the firm´s objectives will help also the fulfilment of the personal objectives of empoloyees.

6. The last, even though very important principle is that the wage system of the particular company should not be only fair and equitable but also correctly explained to its employees.

What should be added in conclusion? As one might see, there are many problems in the above-indicated field of managing human resources. With regard to the potential extent and content of the contribution submitted it is impossible to analyze them in more detail, although most of them would deserve it.

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Strategic Aspects of Organizational Culture of Czech Companies

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Abstract

The paper presents the results of the research into organizational culture which was carried out at the Brno University of Technology, Faculty of Business and Management within the institutional research project MS 265100018 "Research of strategic management in Czech companies". Respondents of the research were representatives of top and middle management working in 54 Czech manufacturing companies. The organizational culture was thoroughly looked at on the level of organization values and strategic aspects of behaviour of companies. Research outcomes bring information which could be useful for the management training, further education of managers and also for further research in this area.

Organizational culture, currently quite a frequent concept in the literature on management, has been the focus of research of scholars and practitioners from about the end of the 1970s and the beginning of the 1980s, when several studies strongly calling attention to the influence and the role of 'soft' factors in the management and success of an organization were published [2], [5]. Although both researchers and practitioners are almost without doubt as to the influence of the content and the power of organizational culture on the efficiency of an organization, there has not been such a consensus about the definition of this complex and elusive phenomenon itself. Consequently, the research into the organizational culture remains rather complicated from the methodological point of view.

In their attempt at delimiting the term 'organizational (corporate) culture', some authors for instance emphasize that "culture is the commonly held and relatively stable beliefs, attitudes, and values that exist within organization", ... "that provides the decision-making and problem-solving processes of organization and ... influences the goals, means, and manner of actions" [6, p. 238] or that "the culture perspective has focused on the basic values, beliefs, and assumptions that are present in organisations, the patterns of behavior that result from these shared meanings, and the symbols that express the links between assumptions, values, and behavior to an organization's members" [3, p. 27].

Despite the lack of a unanimous agreement about a precise definition of organizational culture, it is nowadays generally acknowledged that an organization's culture is manifested through certain external symbols and behaviour, with some underlying, less visible aspects of culture such as the norms of behaviour existing in the culture and the beliefs and values more-or-less shared in the organization. They in turn significantly influence the behaviour of the organization's members and the decision-making and problem-solving processes of the company and become an important determiner of the efficiency of the organization [1].

If organizational values together with basic beliefs are seen to constitute the core of organizational culture, then finding out what they are has an important and practical value for managers: it indicates to them whether the dominant content of the culture in their company corresponds to the organizational strategy and whether it supports its implementation. If the company does not have an explicit definition of its strategy, as the case is with many Czech companies, then the values which are shared in the company implicitly determine its 'strategic' behaviour – its basic direction. The research into organizational culture on the level of organizational values is therefore very topical in the present period, when intentional efforts to transform the Czech economy are being made.

The aim of the research

The aim of the research was to delimit the content of the organizational culture of Czech manufacturing companies on the level of values which are shared in the organization with view to the anticipated impact on strategic behaviour of the company.

Methodology

The research was based on a questionnaire consisting of 39 organizational values, each of them formulated as a brief statement. Using a scale from 1 to 9, the respondents' task was to evaluate the level to which the individual values are considered in their companies as important. However, they were asked not to state which values they considered important themselves – they were supposed to act as 'observers' in their own companies. The scale reflected the rising importance of values: 1 was used to denote a marginal importance of the values in a company, 9 was used to denote a high importance.

The sources for the preparation of the sample of organizational values were the previous foreign researches into organizational values, primarily Quinn and Rohrbaugh's Competing values model [1] and the researches into the typical Czech features of organizational culture carried out by Ivan Nový and his team [5].

Sample

The research was carried out in 54 Czech manufacturing companies in several industrial areas. Table 1 shows the composition of the sample under investigation from the point of view of their size and field of business.

Table 1. COMPANIES INVESTIGATED

Average annual number of employees

	Number of companies	- 50	51-299	300-500	501-1000	1001 -
Total	54	8	22	10	7	7
Mining and quarrying	1			1		
Manufacture of food products, beverages and tobacco	4		2	2		
Manufacture of textiles and textile products	5	1	2	1	1	
Manufacture of leather and leather products	1			1		
Manufacture of wood and wood products	2		2			
Manufacture of pulp, paper and paper products	1		1			
Manufacture of chemicals, chemical products and man-made fibres	3	1	1	1		
Manufacture of rubber and plastic products	4		1	1	1	1
Manufacture of other non-metallic mineral products	1				1	
Manufacture of basic metals and fabricated metal products	2			1		1
Manufacture of machinery and equipment n.e.c.	16	1	8	1	3	3
Manufacture of electrical and optical equipment	4		1	1		2
Manufacture of transport equipment	1				1	
Manufacturing n.e.c.	3	2	1			

Building industry	6	3	3			

As the organizational culture was researched on the level of organizational values and with respect to the strategic behaviour of the company, which is primarily defined by the opinions and the behaviour of management, the research was carried out on the representatives of the top and the middle management. The number of such respondents varied in relation to the size of the company: the questionnaires were filled out by 2 - 3 managers of companies with less than 50 employees, by 4 - 8 managers of companies with 51 to 1000 employees, and by 8 and more managers of companies with more than 1000 employees. The total number of respondents was 336. Out of this number, there were 269 men and 67 women, 205 members of top management and 130 members of middle management (1 respondent failed to indicate his position).

Owing to the sensitive character of the research topic, all the respondents from each company filled out the questionnaires at the same time in the presence of the researcher.

Data processing

The data obtained on the basis of the values questionnaire were statistically processed using the methods of factor analysis and cluster analysis. The numbers of respondents perceiving the culture in their company in the given manner were eventually ascertained for the individual clusters documenting the typical contents of organizational culture of Czech manufacturing companies on the level of organizational values.

Results

Content components of organizational culture

Using factor analysis to process the data, four relatively consistent factors were extracted. These factors represent the content components of organizational culture as revealed through the use of a selected set of values. Table 2 shows the results of the factor analysis.

Table 2. THE RESULTS OF FACTOR ANALYSIS

VALUES	**Factor 1**	**Factor 2**	**Factor 3**	**Factor 4**
To respect the company hierarchy and procedures	0,197	0,045	0,115	**0,674**
To experiment, to try new things	0,064	0,196	**0,528**	***-0,347***
To provide employees with the opportunity of professional development and growth	0,257	**0,570**	***0,301***	-0,137
To beat the competitors in the market	-0,010	-0,079	**0,598**	0,119
To have clear “rules of the game“ in the company	**0,469**	0,185	0,103	***0,333***
To compete with one another	0,042	0,113	**0,465**	0,108
To fulfil obligations	**0,515**	0,060	0,158	0,006
To have high goals	0,158	-0,012	**0,674**	-0,077
To take care about the social atmosphere and relations	-0,009	**0,758**	0,051	0,031
To be precise and faultless	**0,563**	-0,209	0,278	0,028
To work in a mutual collaboration	**0,575**	0,288	0,079	-0,109
To have organizational norms and rules in written form	-0,021	0,093	0,035	**0,716**
To expand in the markets	-0,021	0,121	**0,606**	0,022
To provide employees with the opportunity to participate in decision-making	0,183	**0,497**	0,180	-0,274
To be directed towards performance and success	0,254	0,022	**0,584**	-0,117
To behave in a responsible manner to the region and the city	-0,159	**0,490**	0,088	0,273
To have the latest, top technologies	0,013	0,185	***0,323***	-0,007
To use standard and established procedures	-0,091	0,123	-0,205	**0,643**
To respect each individual	***0,338***	**0,631**	-0,025	-0,107
To be the best	***0,302***	-0,083	**0,704**	-0,140
To comply with rules	0,234	-0,010	-0,005	**0,654**
To share a comradely spirit with colleagues	***0,368***	**0,511**	-0,132	-0,020
To be able to improvise	0,009	0,168	0,058	-0,266
Not to risk, to use the tested	-0,046	-0,023	***-0,320***	**0,475**
To pass on knowledge and experience to one another	**0,640**	***0,332***	0,066	-0,150
To achieve maximum results	***0,309***	-0,161	**0,643**	-0,042
To behave morally	***0,377***	**0,484**	0,027	-0,022
To pay regard to details and perfection	**0,604**	-0,069	0,189	0,028
To develop new and original products	-0,034	0,152	**0,551**	-0,175
To cooperate in a mutual way	**0,665**	0,285	0,009	-0,082
To build certainty and stability	***0,326***	***0,321***	0,206	0,038
To be creative in solving problems	***0,320***	0,252	0,168	***-0,429***
To pay regard to precision and punctuality	**0,659**	-0,056	-0,002	0,245
To respect agreed procedures	**0,498**	0,093	0,066	**0,462**
To be tolerant to mistakes	-0,141	**0,478**	-0,082	0,020
To keep on learning new things	0,279	***0,382***	***0,390***	-0,290
To arrive at agreements	0,290	***0,332***	0,020	0,213
To take care about the company environment and the employee‘s satisfaction	0,152	**0,689**	0,073	-0,059
To be responsible towards the environment	-0,002	**0,461**	0,169	0,255

Factor No. 1 includes primarily values directed to the order within the company (to take care about precision and punctuality, to have clear "rules of the game" in the company, to respect agreed procedures), mutual cooperation (to work in mutual collaboration, to cooperate in a mutual way, to pass on knowledge and experience), quality (to be precise and faultless, to take care about details and perfection) and reliability.

Factor No. 2 loads primarily on the values concerning the support and care directed at the employees inside the company (care about relations and the social atmosphere within the firm, about the employees and their growth and development, etc.) but also outside the company, i.e. on the support of the region and the concern for the environment.

Factor No. 3 is characterized by its orientation to competitiveness, victory (to be the best, to beat the competitors in the market, to expand in the market) and results (to achieve maximum results, to be directed towards performance and success, ...) in connection with innovative attitudes (to experiment, to try new things, to develop new and original products).

Factor No. 4 loads on the values of a 'bureaucratic' character – to have organizational norms in written form, to respect the company hierarchy and procedures, to use standard and established procedures, to comply with rules, to respect agreed procedures, not to risk, to use the tested.

Table 2 indicates that some values load on more than one factor – either with opposite polarities or with the same polarities but in different contexts. Factors Nos. 3 and 4 are partially contradictory – the values of 'to experiment, to try new things', 'not to risk, to use tested' have different polarities. Similarly, the value 'to be creative in solving problems' has a positive polarity for factor No. 1 and a negative polarity for factor No. 4. On the other hand, factors Nos. 1 and 2 include some identical values (albeit to a different extent) with identical polarities. This is the case primarily with the values concerning interpersonal behaviour and the value of moral behaviour; for factor No. 1, however, this occurs in the context of a good operation of the company and the reliability towards customers, and for factor No. 2 in connection with the care about the social atmosphere and relations. Similarly, factors Nos. 2 and 3 load on the values of 'to provide employees with the opportunity of professional development and growth' and 'to keep on learning new things'. As regards factor No. 2, however, this occurs as a reflection of the customer care, while for factor No. 3, which loads on the given values to a lesser extent, this concerns the development of employees and constant learning as a way of attaining the best results possible, innovating and winning in the market.

Empirical types of organizational culture

The empirical types of organizational culture of Czech manufacturing companies (on the level of organizational values) were ascertained by means of the hierarchical cluster analysis. It employed the 'Within group linkage' method on the squares of Euclid distances of factor polarities from the factor analysis. The results of the analysis are provided in Table 3.

Table 3. THE SCORES OF INDIVIDUAL FACTORS FOR THE PARTICULAR CLUSTERS

	cluster 1	**cluster 2**	**cluster 3**	**cluster 4**	**cluster 5**
factor 1 (orientation to order, cooperation, quality and reliability)	0,700	0,420	-0,115	-0,438	-1,266
factor 2 (orientation to care and support)	- 0,209	1,127	-1,183	0,136	0,415
factor 3 (orientation to results and victory in the market and innovations)	- 0,136	0,579	0,604	-1,044	0,818
factor 4 (orientation to traditional procedures and 'bureaucratic' management)	- 0,724	0,420	0,742	0,295	- 0,913

Cluster No. 1 is characterized by a high level of the factor of order, quality and cooperation. The factor of competitiveness and orientation towards results and innovation is on a medium level and the factor of control, stability and bureaucracy is on a low level. As a result, this refers to **a type of corporate culture which places the highest significance upon the constructive cooperation of employees in order to ensure smooth operation, reliability and fulfilment of obligations of the company.** Companies with this type of culture are likely not to operate on the basis of aggressiveness and rivalry but want to acquire their position in the market through their respectability and reliability. People and relations, as well as the victory over competitors and the expansion in markets, are neither unimportant nor primarily important for them. They place the reliable operation of the company and the quality of production, which can be attained through order and cooperation, above all.

Cluster No. 2 can be described as a constellation of higher levels of all factors with the factor No. 2 being strongly dominant. Factor No. 2 is directed towards support and care. **Everything is thus considered as important and the care about people and the support of the region are primary.** However, if everything in the company is considered important, then it appears that, to a certain extent, inconsistent values are held in the company. This is because factors Nos. 3 and 4 and Factors Nos. 1 and 4 are partially contradictory.

Cluster No. 3 is characterised by a high level of the factor of competitiveness and orientation towards results and innovation. At the same time, the factor of control, stability and bureaucracy retains a high level, while the factor of order, quality and cooperation is on the medium level and the factor of care and support is on a low level. Taking into account the fact that the contents of factors No. 3 (competitiveness, orientation towards results and innovation) and No. 4 (stability, control, standard procedures and bureaucracy) are partially contradictory, it seems that the members of this cluster **also hold partially contrary and inconsistent organizational values, with the lowest importance ascribed to people and their development and support.**

Cluster No. 4 is characterized by a less marked **prevalence of the levels of factors No. 4, i.e. the factor of control, stability and bureaucracy and the factor of care and support** (with a slightly higher and medium levels). The members of this cluster ascribe a lower importance to the values of order, quality and cooperation and very low importance to competitiveness, orientation towards results and innovation.

Cluster No. 5 is characterized by a marked recognition of the values of competitiveness and orientation towards results and innovation (factor No. 3). At the same time, there is a high orientation towards support and care (factor No. 2) and a very low level of both the factor of order, quality and cooperation and the factor of control, stability and bureaucracy. This probably refers to **a type of culture which is strongly directed towards results. It provides people with freedom and the opportunity to be creative in attaining the results, and considers them to be an important value and source of success.**

The numbers of respondents perceiving the culture in their company in the given manner were eventually ascertained for the individual clusters documenting the typical contents of organizational culture of Czech manufacturing companies on the level of organizational values. The results are provided in Table 4.

Table 4. THE NUMBERS OF RESPONDENTS PERCEIVING THEIR ORGANIZATION'S CULTURE IN HARMONY WITH INDIVIDUAL TYPES.

company No.	cluster 1	cluster 2	cluster 3	cluster 4	cluster 5
1		1	4	1	
2	2		1		1
3		4	1	3	
4	1	1			
5	1	2	1	2	
6	1	3	2	3	1
7	3		1		
8	1	1		4	
9	1		3	2	
10	2		1		3
11	1		1	1	
12	4	4		1	
13	2	4	5	1	
14		1	1	3	2
15		2	1	1	3
16		2	1	2	1
17	1	3	2	2	1
18	2	3	1	1	
19		3	1		4
20	3	1		1	
21				1	
22	6			1	
23	1		1	1	
24	1			2	5
25	3				1
26	3			2	
27	1			1	
28			1	2	
29	3		1	1	
30	2	3	2	2	
31	2			1	
32	1	2			
33	3	1			
34	1	1		2	2
35	2				
36	2		1	3	
37	5	2	14		
38		1		2	
39	1	2		4	2
40	1		1	6	
41	1			2	
42			4	2	

43	1		1	9	
44	3				
45	1				
46	2		4		
47	3	5	1	1	
48				4	
49		5	1	3	
50	2			4	
51	2				
52	5				
53	1		1	2	
54	2				1
$\sum$	86	57	56	86	26

Disregarding the companies represented by a single respondent, Table 4 shows that a complete or substantial agreement about the way respondents perceive the contents of the organizational culture on the level of shared values occurred in the case of 6 companies (Nos. 22, 25, 35, 44, 51, 52). On the other hand, some companies have their representatives scattered into as many as 5 clusters. However, the figures cannot be easily compared with one another because the companies were of different sizes and, consequently, the numbers of respondents were different, too.

It therefore seems that in the case of companies, whose respondents exhibited a uniform opinion, certain values are really shared and the organizational culture is likely to be strong. On the other hand, the companies whose representatives showed a wide range of replies are likely to have a weak and diffuse culture or lack a dominant, unifying culture – as a result, the respondents from such companies could have responded in harmony with the subcultures of individual company divisions whose members they are.

Nevertheless, there is the question of why some clusters include contradictory values; in other words, it is apparent from the typical constellations of respondents' answers that such values are held whose contents are contradictory. One of the causes could be seen in the respondents' attitudes towards filling out the forms – if they completed them carelessly, then such a situation could come up as a result. However, the people administering the questionnaires, who were present at the filling-out, attest that such careless attitude on the part of respondents was very rare. Another possible cause to explain such results is that the culture in the respective companies really is inconsistent and internally contradictory from the point of view of shared values. The question however remains of the extent to which such a culture can actually be functional.

Conclusion

The research into organizational values of Czech manufacturing companies, which was carried out with view to the possible influence on the 'strategic behaviour of companies', has revealed that only a few companies have a strong culture with clear-cut values. On the level of analysis of the present study it appears that a majority of the companies have weak and diffuse cultures with some companies likely to hold values that are contradictory and inconsistent as regards their content. The presented research aims to be an introduction into the issue as the subject is extremely complex to deal with from the methodological point of view.

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The Concept of Determination

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Abstract

The concept emphasises the process character of the human (work-) behaviour. On one hand the comparisons have effect on level of physical experience process; here the influence of satisfaction of motive and the value of reward are meant. On the other hand learning processes have effect on the self-conception and the experiences. The conception of workmanship determinants does not raise the demand to completely explain human behaviour in enterprises in its complexity. As a synthesis disposition is relatively suitable for showing points for an influence on human workmanship. On consideration of personal controlling now one falls back to these behavioural-scientific perceptions for analysing possibilities and problems of steering and controlling human workmanship through personnel controlling. In economy success depends on efficiency and quality. And performance consequences have to be seen as a result of skills and wanting, influenced by expectations, requirements and satisfaction.

The efficiency of human work in economy

For enabling the employees in enterprises to achieve work efficiency, appropriate working conditions and resources have to be placed at their disposal, they have to be qualified and motivated for their respective occupation. The motivation is a key factor, which determines the human work efficiency in enterprises. Taylor examined the connection between the execution of certain occupations and the work efficiency within the scope of his scientific management. Proceeding from the hypothesis that for every occupation there is a best possible way of performance. Taylor tried to find the optimal way of performance through time- and motion studies. All other employees were then accordingly schooled and trained, for applying the found rational way of performance. A sufficient motivation of the employees should result in form of the remuneration by following the idea of the homo oeconomicus. Taylor's work is a first, very technocratic starting point of maximisation of work efficiency. Following his training as an engineer, a rational, through division of labour and labour optimisation marked way of thinking is in his foreground. The results of the examinations by Mayo, Roethlisberger and Dickson between 1927 and 1932 in the Hawthorne Works of the General Electric Company show that the human work efficiency is also determined by social factors. The paradigm of the Human-Relations-Starts regards the social relations and the social conditions as decisive for the labour contentment, which again essentially also determine the work efficiency. In the fifties there was a paradigm-change to human resource management which sees the human as ”complex man” and has a differentiated point of view with the analysis of human work efficiency. The term ”complex man” reflects a pragmatic human picture; it supersedes the ”homo oeconomicus” as well as the ”social man” [2]. So the work efficiency depends on the environment and on the person. Behavioural sciences attribute the aim for targets of a person on the construct of the motivation and examine influx orders on the labour motivation and it's influence on work efficiency. The motivation has been tried to be explained in several attempts and models. The theories of motivation in the main are all based on Maslow's Pyramid of needs. You deliberately have to forego a detailed discussion of single theories, as these have only been partially and not entirely empirically validated. It seems hard imaginable to empirically execute the reflection of the complete hierarchy of needs of a person on an enterprise. For such a project not only psychologists and economists have to work close but also a representative number of persons within a (larger) enterprise have to be found, as well as an enterprise itself which would afford an extensive insight. The herewith connected impediment would not only be unreasonable but also unacceptable, as it would falsify the results. To add to this, the individual projection with the thereby connected situate transfer of focus point. A simplifying statement of the work efficiency of the employees would be an interpretation of the work efficiency as contribution to gaining enterprise targets. This starting point is too instrumental and linear causal, as it does not consider that human behaviour and therefore also the work efficiency is process determined through many influence facts. Resulting from this basic problem, Lattmann describes the work efficiency as ”the extent, to which he (annotation of the author: the employees) fulfils the tasks given due to his behaviour” [4]. The process theories of motivation with its basic model of the Valenz-instrumentality-expectation-theory by Victor H. Vroom proceed from the fact that behaviour is not only realised through the factors of asset factors and the socialisation, but which has situatively perceived and evaluated, individual use of the behaviour in the meaning of a means-purpose-relation a basic behaviour control. The VIE-theory is attributed to the three factors valence, instrumentality and expectations. The valence of a behaviour is for simplifying reasons classed a positive or negative. The valence on first level denotes the value of a result of action, the valence of second level signifies the value of action consequences. The instrumentality then exists when the result of behaviour leads to the achievement of desired targets. The expectation specifies the subjective experienced probability with which an action leads to the desired result [1]. An empirical examination by Vroom about the connection between work efficiency and work contentment disproved the assumption of representatives of Human-Relations, that with the increase of the work contentment the work efficiency increases, too. He noted a correlation of solely +0.14 which is not to be classed as significant. The noted dispersion of +0.86 to –0.31 in Vroom’s examination is an indicator for the different possibilities of relation between work efficiency and work contentment. The examination also proves that there is no connection possible between work efficiency and work contentment [6]. The process theories of motivation aim at the question which motives induce humans to a certain way of behaviour. Here a further representation of the different process theories is renounced as the essential aspects of these theories are included in the following conception of determinants of workmanship. The conception of determinants of workmanship offers the advantage to describe the complexity of the factors on the work efficiency and to offer a synthesis of essential explication starts.

The determinants wanting and skills

It has to be stressed the necessity of a conception of the synthesis of the different theories of motivation as the complete analysis seems to be more suitable for recording the complex and interdependent connections of the determinants of work efficiency. It is emphasised that one hand the employee has to have the necessary qualification for being able to realise his work, but on the other hand at the same time the readiness to use the qualification potential for the realisation of his work. Berthel summarises these components in the terms of skills and desires and defines these as performance-necessary qualification. The conception commences with the starting point of structure of motive which is divided in the fields of motives and attitudes. By motive a (rating-) disposition is meant which goes in coherence behaviour readiness, wanting to reach respectively to avoid positive respectively negative (target) conditions. Within the scope of internal company incentive organisation two possibilities arise to extrinsically motivate the employees. By the term of attitude, a general, objectionable, judging and deducted from experience and temporally stable disposition in the meaning of a perception is meant. As a third variable stand norms as well as valences. While norms steer the individual behaviour through general action expectations and strengthen them through sanctions, valences as individual assessment of values are also decisively involved in the control of behaviour. Valences represent the assumed advantage of target achievement of one’s own behaviour. The expectation of effort comes into being when each person sees his performance as result of the intensity of his employment and not explained by extern factors. The expectation of consequence reflects the assumption of the consequences of one’s own behaviour. Crux is the question for the instrumentality, whether the anticipated behaviour with sufficient probability will lead to the intended success. The intensity of employment is the product of these three factors. Attention has to be paid to the implicit hypothesis that none of the three variables can be equal zero if behaviour of workmanship is to be achieved. Furthermore a distortion of the variables of employment intensity may arise. So for example the assessment of a target can lead to a misjudgement of own performance faculty. In the meaning of Atkinson’s risk-choice-model, performance-motivated behaviour is to be explained as difference from the success searching and failure avoiding tendencies. The product from norms and valences with the expectation of effort and expectation of consequence is regarded in a different way by a success-motivated person as by a failure-motivated person. While success-orientated persons preferably choose tasks of middle degree of difficulty, failure-motivated persons show a preference of simple or difficult tasks [1]. Through perceptions one gains information about the environment and therefore can gather experiences which can serve as selection criteria for decisions over selection of possibilities of behaviour. By the process of perception individual filter-, selection- and structuring processes are to be taken notice of. An individual self-conception develops though the perception of the own person and is relatively stable set about assumptions regarding the performance-history, -presence and –future. The socialisation is also influenced through factors of personality. Factors of personality correlate with the behaviour in certain situations. The factors determining ”wanting” to performance influence the employment intensity which falls into the field of ”skills” and beside the factors suitability, work knowledge and working conditions determine the performance behaviour. By suitability the sum of personal features is meant which qualify humans for certain occupations. As qualification features are to be named the knowledge of a person, his intellectual and physical skills as well as his personality features which in each case limit the performance ability of person in individual markedness in it's synergy. The work knowledge is to be understood as a meta-knowledge about the practical realisation of work assignments. With this it is meant that one does not only have to dispose of the theoretical skills for the execution of an assignment but also have the skills to realise the theoretical knowledge to practice and thereby behave according to the social conditions and other factors. For example a scientist has to lead a research project. Despite professional qualifications he does not posses the ability to lead his team for which reason the work is ineffective and the targets are not reached. The degree of the performance effort in actual fact in dependency of individual performance maximum below set conditions Berthels names degree of activation. The enterprise is interested in a high degree of activation due to economical reasons, whereas the employee partially holds back possible performance reserves due to strategically and individual aspects. The interdependence to motive structure of the individual becomes clear. In this field the factors of the internal company incentive structurisation are to implement which are said to posses a motivation-supporting effect. In this connection the enterprises have financial and non-monetary incentive factors at their disposal which are to positively enlarge the performance behaviour of the employees. The working conditions are fundamentally determined through the ergonomically, organisatorically and technological design of the place of work. An optimal place of work makes an appropriate interindividual, optimal performance realisation of the performance intention.

The consequences of performance

The power consequences are firstly subsummarised under the term of reward. Intrinsic rewards are for example success experiences through the performance behaviour. Behaviour processes are intrinsically motivated when these are in it's origin and/or it's effect in the signified system self founded. The reward and other internal company incentives are extrinsic rewards. It is spoken of extrinsic motivation with behaviour when this is influenced by external and not in the person himself lying factors [3]. Every expectation has a certain level of demand which describes type and extent of the expectations. It is equal with a concrete objective of a person whose achievement leads to satisfaction and whose failure leads to dissatisfaction. In so far the level of demand is decisive for the self-judgement of achieved behaviour results. Persons compare the occurrence of reward as well his own effort expectations as well as his expectations of consequence with the perceived descended effects [1]. The level of requirement of a person is not static as it is adjusted to the reality through perceived misbalances regarding demand and performance. One explains and judges his own behaviour and concludes inferences for future behaviour. Important for workmanship behaviour at the place of work are also attribution-theoretical perceptions. Reason explications of a result of behaviour provoke larger changes in expectations as attributions on non-stable factors. Furthermore effort attributions are stronger than coincidence attributions in their effect on behaviour [5]. Satisfaction in work is an emotional condition which occurs when the consequences (rewards) of a certain behaviour correspond to (or surpass) the preserved expectations and level of requirement.

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The Development's Strategy of Knowledge Management in the Learning Organisations

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Abstract

The contribution offers new impulses for a creating strategy of the development in the learning organisations in the conditions of the starting to the knowledge management and new, knowledgeable, informational, net economics. The accent is laid on the (re)definition of the knowledge-management (KM), on the creative, knowledge in the people's heads, inventions, innovations and people's leading.

1. The essence, attributions, goals KM and a creating company strategy

The strategy in the profit and non-profit organisations should be map processes and knowledges in the essence from these main areas (1):

- to analyse an environment of the organisation and to accomplish a synthesis of knowledges,
- to name and to take apart strong and weak aspects in the organisation,
- clearly to lick into shape specifically advantages,
- to (re)definite a mission and a vision,
- to formulate 5 –7 top strategic company-goals,
- to appoint priority strategic operations.

For a creation long-time company's strategy shall/must to carry a responsibility hers top management. In the first time is for top management in the learning organisations main deep to perceive a progressive curve of the transformation data, massages, informations to the knowledges and wisdom. By the change selected informations on the knowledges it's going about understanding rules.

The top of the manipulation with the knowledges of the leaders and managers are an understanding, a practical implementation and a realisation the main principles of the management and an operation of the learning organisations in the entry to the 3.millennium.

From an aspect of KM will more and more to prefer knowledges which are laid in people's heads-leaders, managers, teachers, planners, designers, technologists, but also all another creative employees. It goes about a most valuable immaterial property, intellectual capital, a significant part of the knowledges assets, with we must abroad most to husband.

The knowledges are in a rule dual: the knowledges consigned in PC, on the Internet and it goes after about the knowledges, which dispose live people.

A definition of the knowledges – they are the winning transformed informations, the positive and sage values, which dispose at first real personalities. In the examined area of the KM are they at first leaders, managers (mainly CEO, CIO, CKO).

These subjects of the KM understand the knowledges and principles; they agree with their contents, they prove to link, to combine, to multiplicate and creatively to use in the praxis.

Between the typical attributes of the knowledges and goals of the KM we can put on these:

- a selecting main positive values from date informations,
- a understanding of the contents of the informations, rules, principles, laws,
- a elevation of the synergetic and a multiplicate effect of the joining and combining the relevant informations and the knowledges to the top of the knowledge's pyramid which represent the wisdom,

- a quality of thinking and behaving of the leaders and managers primary determine a personnel culture, humbleness, humility, awe, morality, ethics, practical respecting all kinds of the active lows and examples action,
- knowledges and sage KM have to keep an eye on a final intention, as a growth life level of the citizens, employees, a raising the prosperity and safety of the organisations, regions, states, continents.

2. The (re)definition of the knowledge management and its strategic goals

A new definition of the knowledge management – KM is a synergy of the permanent processes a planning, decision-making, organising, work with the people, informations and knowledges, controlling and evaluation, which apply on a creativity, inventions, innovations, on an appreciation knowledges.

This effect heads to a creation psychical/clergyman treasury, growth and global wisdom, to the creation innovative and new products and services. Typical process are pre-productions stages (1), which shall be spectacularly managing and sagely to lead people.

The primary factors of development are creative people, inventions, inovations, which lead to the top added value and to the finalisation of the products and services.

Like this we can to come to *strategic goals of the company as one whole* – in the growth of the global competitive ability, long-time prosperity, in the increasing profitability (ROI), profit, cash flow, salaries, payments whether profit shares.

- Between basic strategic tactical goals and roles in the area of the KM belong to:
- how quickly to increase effectivity and quality of the processes data, informations transformation on the knowledges and ale wisdom in the processes decision-making, implementation, practical realisation,
- how quickly to increase effectivity and quality of education, breeding research and development, marketing subprocesses, development of positive creativity employees and in the concrete learning organisation XYZ.

The crucial role has CEO in the company in aspect of motivation of creativity. Concreating of these processes shall to appear in rules of the intraorganized management (2).

3. Examples in area of KM in the world

The significant mission of the leaders and managers in the world on the millennium – break contain new managerial manifesto (3). It is a document of Sloan School of advanced management – Massachusetts Institute of technology. People shall to be capital the number one also in 21. century.

Microsoft - the biggest software producer on the world have new software-strategy based on the co-operation with others SW producers. New knowledge strategy named NET. New services *HailStorm* impersonated practise of the KM, knowledge combination and functions (e-mail, immediate massages etc.).

IBM – Institute for the knowledge management. The manager L. PRUSAK in the year 1999 said that all in the life and business is a game of probability. As well as human resource management increases a probability of the employees holding, a good service for customer increase probability of the repeated shopping, the knowledge management means increasing probability, that the knowledges brings an innovation. It means a profit’s growth…

Schwedishman – KARL ERIK SVEIBY (together with Japanman - Ikudžiro NONAKA are leaders in area of KM) said – *I know to read EINSTEIN´S equation and can her to repeat as a parrot, but also don’t understand hers. It isn’t for me knowledge, as long as do not to apply to do something, until don’t change my capacity to hold (4)*.

Alfa and omega in the KM in these intentions is – to create objective mechanisms of a measurement, evaluation and appreciation real creative people. Those people, which represent the positive creativity and are the most valuable source of proceeding human civilisation in just started 3. Millennium.

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The Link between Human Resource Management and Company Performance

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Abstract

There seems to be a wide spread agreement that human resources are the main source of competitive advantage in a modern company. Therefore the traditional personnel function is transforming into human resource management (HRM) which becomes a part of strategic management and integrates HRM activities to fit business needs. In this paper we analyze the transformation of personnel function in Slovenian companies which had to change their behavior due to the transition to market economy and increased competitive pressures. Based on our data we may conclude that Slovenian companies use many different personnel models and that transformation into HRM occurred mostly in those companies which place greater emphasis on people-related goals when they formulate business strategy. However, the positive effect of this transformation on company performance could not be established yet.

1. Introduction

An increasingly competitive and changing business environment forces companies around the world to continuously search for new sources of competitiveness. Globalisation and information technology just add pressures to the need to constantly reinvent ways to compete. Since financial resources and technology are now relatively easier to obtain than in the past, many regard people (their knowledge and creativity) as the key force behind company success. Consequently, human resource management (HRM) as a means of acquiring and retaining critical talent becomes an important element of strategic management. The main purpose is to develop employee capabilities and to assure high levels of employee motivation in order to achieve business goals.

The competitive situation is even more complex for companies in transitional countries. On their way to an open-market economy they have to solve some major problems regarding many inefficiencies which were allowed by previous socio-economic systems. Also, companies had to gain new and much more demanding markets in the midst of ownership transformation, with slowly developing capital and labour markets, and a fair amount of political turmoil. In order to succeed, transitional companies had to examine various sources of competitiveness, including the way they manage their human resources. In this paper we will look whether companies adjusted to this new business situation by introducing human resource management (HRM) as a model of personnel function. We will use the term “personnel function” as a generic term for all activities related to the management of employees, regardless of the particular model used (traditional personnel management or human resource management). At first we will discuss why HRM is a potential source of competitive advantage and as such important to Slovenian companies. Then we will look at the research findings regarding some models of personnel function used by Slovenian companies. We will examine whether the transformation of personnel function into HRM is affected by the way companies formulate their strategic goals and whether more advanced personnel models can be also linked to company performance. At the end we offer some concluding remarks and discuss future research prospects.

2. HRM as a Source of Competitive Advantage

There is an increasing amount of evidence that today human resources are one of the most important sources of competitive advantage [10]. Wright, McMahan and Williams [14] use the theoretical concept from the resource-based view of the firm to argue that HR meet the criteria for sustained competitive advantage. HR certainly add value - their supply and demand are not homogenous in terms of knowledge, skills and abilities which leads to variance in individuals' contributions to the firm's creation of value. The whole utility analysis research provides support for this argument and also provides methods for estimating the value. Job complexity and changing environment demand high skills, but high-quality human resources are rare since skills and abilities are normally distributed in the population and those firms which have high-quality HR are gaining this capital at the expense of others. HR are also very hard to imitate due to their unique history, casual ambiguity and social complexity which makes it difficult to identify exactly the source of competitive advantage and to duplicate both relevant components of HR pool and circumstances under which these resources function. Also, HR mobility is not perfect due to transaction costs which occur when moving from one employment situation to another. HR are non-substitutable since they are one of the few firm resources which have the potential to not become obsolete and to be transferable across a variety of technologies, products and markets. Although there may be some substitutes in the short run (such as automation), so far there is no good replacement for human knowledge and creativity in the long run.

But we must also remember that HR are only a potential source of sustained competitive advantage. Because human resources are characterized by casual ambiguity, social complexity and unique historical conditions, firms may not successfully develop human resources as sustained competitive advantage simply by imitating the HR practices of firms which have done so. An integrated approach to HRM, which tailors practices to fit particular company and its employees, is more effective. As MacDuffy [6] has stated the use of appropriate HRM strategies and bundles of consistent HRM practices yields better results than simply introducing a particular HR best practice. So far this contingency (or strategic fit) approach has gained some more empirical support than the universal, best practices approach advocated by Pfeffer [10].

In order to achieve competitiveness through people we need both, highly skilled and capable workforce, and high levels of motivation. The strategic component of HRM becomes very important: effective HRM practices are business driven [4], and there is a reciprocal relationship between business and HRM strategy [5]. In other words, HRM has to become an integral part of strategic management. Milkovich and Boudreau [8] have proposed a diagnostic model in which HRM strategy and activities have to be designed in congruence with both external environment (e.g. demographic trends, economic conditions, government regulations) and internal conditions pertaining to organisational factors (e.g. financial conditions, technology, strategy, organisation design, job design) and to employee characteristics (e.g. demographics, performance, values, attitudes and opinions). All of these factors determine HRM objectives and HRM activities to reach these objectives. Included in their model is a constant evaluation of HRM effectiveness in terms of reaching HR and business objectives. HRM is also taking on multiple roles, Ulrich [12] for example distinguishes between the roles of a strategic partner, an administrative expert, an employee champion and a change agent. All of these roles are related to achieving company goals and increasing its competitiveness.

3. Models of Personnel Function

When discussing HRM we must distinguish two levels – conceptual and practical. Since HRM is a fairly young concept which was introduced in the US in the mid 80s, it is not surprising that its conceptual base has not been fully developed yet. But overall we may argue, that HRM as a concept is now widely accepted. On the other hand, research shows that the practice of personnel function has not changed with the same pace as theoretical developments did. Companies today use various models of personnel function and HRM is just one of them. For example, Monks [9] has researched Irish companies and she found four distinctive models which include a development component of personnel function. Each model adds complexity by increasing the level of professional activities and strategic orientation:

- in a **traditional/administrative** model personnel function is perceived as a typical support function with a focus on administrative matters and record keeping,
- in a **traditional/industrial relations** model the focus lies on negotiating rules and agreements with trade unions, and employee relations are strongly emphasized,
- the third model is called **innovative/professional**, and the role of personnel managers (departments) is to develop appropriate models for staffing, employee training and development, and compensation, based on recent knowledge and developments in the field of personnel management,

- the fourth model is described as **innovative/sophisticated** and is actually the model that can be associated with true human resource management as defined by Manoney and Deckop [7], where HRM is perceived as more strategic, towards a top management oriented set of integrated activities regarding HRM issues, the main objective being to improve company performance and achieve strategic goals.

When we analyse the link between HRM and company performance we should first of all make a clear distinction between various models of personnel function companies might use. We may talk about HRM only when there is a strategic orientation and the link between personnel function and business strategy is established.

4. Models of Personnel Function in Slovenian Companies and their Effect on Company Performance

In Slovenian companies we may expect a great variety of personnel models since during the transition to a market economy companies were forced to change the way they operate. Among those previously described models, only the industrial relations model may not be as relevant due to a very different tradition of trade union/management relationships during the system of socialist self-management, when trade unions played a marginal role since due to social ownership and company management by worker's council there was supposedly no inherent conflict between managers and workers (the tradition of collective bargaining did not exist). We will use our research data to show which models are actually used by Slovenian companies and whether HRM has already been widely accepted as the most effective way to manage human resources. We will further examine whether this kind of transformation of personnel function shows positive effects with regard to company performance.

4.1. Methodology

We have obtained the data for our analysis as a part of an extensive project conducted by a group of researchers at the Faculty of Economics in Ljubljana: "Behavior of Slovenian Enterprises and Financial Institutions during the Period of Transition to a Market Economy". Till now we have collected complete data sets for 42 companies which will be used in our analysis. These are large and medium size companies (more than 200 employees) which were socially owned and had to go through the privatization process. The questionnaire regarding personnel function in the year of 1997 was filled in by the personnel department manager, and the questions pertaining to company strategic gaols were answered by the general manager. The performance data were collected from company business reports for 1998 and 1999.

At the outset we looked at three theoretical models of personnel function (see Table 1). We have followed previously described models and built on complexity and strategic orientation.

Table 1: MODELS OF PERSONNEL FUNCTION

Traditional	**Innovative**	
Administrative	**Professional**	**HRM (stratigic)**
• personnel strategy does not exist • few formal personnel programs and activities • centralized decision making reagrding personnel (most decisions made by general manager) • the head of personnel department does not have an important role in designing company business strategy • the head of personnel department is not reporting to the genaral manager but rather to a manager at a lower position • the tasks within personnel department are mostly administrative in nature	• personnel strategy may exist but is not put in writing • many formal personnel programs and activities • centralized decision making reagrding personnel (most decisions made by general manager and personnel manager) • the head of personnel department has a medium important role in designing company business strategy • the head of personnel department is not reporting to the genaral manager but rather to a manager responsible for general affairs • the tasks within personnel department are mostly professional in nature	• written personnel strategy • many formal personnel programs and activities • decentralized decision making reagrding personnel • the head of personnel department has an important role in designing company business strategy • the head of personnel department is reporting directly to the genaral manager • the tasks within personnel department are mostly professional in nature

Finding the existing personnel models is only one part of our research. We also wanted to check whether the transformation of personnel function depends on the overall emphasis a company places on its people related business goals. Thus our first proposition stems from the previously mentioned strategic HRM literature arguing that HRM has to be a part of a strategic process and included in the process of formulating a business strategy.

Proposition 1: Companies which place higher importance on people related strategic goals have better transformed their personnel function into human resource management model.

Then the next important issue arises, whether the transformation into HRM can be linked to company performance. Wright and McMahen [14] believe that it is the fit between business strategy and HRM that acts as a vehicle to achieve maximum organizational performance. Although a lot of research was conducted in recent years [2],[3], there is still no clear explanation of how HR is actually linked to company performance. The simple linear model proposed by Becker et al. [1] suggests that business and strategic initiatives are the basis for designing HRM systems, thus affecting employee skills and motivation as well as job design and work structures. These systems result in creativity, productivity and discretionary efforts that lead to improved organizational performance.

Proposition 2: Companies with a better developed HRM function also achieve better performance.

Using the available data we first construed a list of 18 dependent variables (see table A.1 in the Appendix). For these variables we have performed factor analysis in order to see whether some typical personnel models could be depicted. We have used the principal components analysis which is a typical data reduction technique. In order to obtain more comprehensive results we also performed the varimax rotation method. In the next step we used the components which have explained the largest proportions of variance as composed variables which represented typical models of personnel function in Slovenian companies. Then we tested them against two sets of independent variables in order to test our two propositions (see table A.2 in the Appendix). The first set of variable was related to the importance of personnel related business goals such as increased knowledge, productivity, labor cost control, innovation and quality of work-life. The second set were performance variables, such as share of export in sales, return on sales, return on assets, return on equity and value added. At this stage of research we then performed a simple bivariate correlation analysis since more cases would be needed for a more complex structural model.

4.2. Results

The results have shown that Slovenian companies indeed use many models of personnel function (see table 2).

Table 2:
EIGENVALUES, PERCENTAGE OF TOTAL VARIATIONS AND
CUMULATIVE VARIATON FOR MAJOR COMPONENTS (C)

		% of variance	
C	Eigenvalue	Component (C)	Cumulative
1	3,439	19,105	19,105
2	2,106	11,702	30,807
3	1,984	11,022	41,829
4	1,658	9,209	51,038
5	1,542	8,567	59,604
6	1,349	7,494	67,099
7	1,229	6,828	73,927
8	0,915	5,084	79,011
9	0,678	3,768	82,779
10	0,615	3,416	86,195
11	0,575	3,192	89,378
12	0,408	2,265	91,652
13	0,388	2,158	93,810
14	0,347	1,929	95,739
15	0,288	1,599	97,338
16	0,235	1,304	98,642
17	0,156	0,868	99,510
18	0,088	0,490	100,00

Source: Questionnaire analysis

After we examined the percentages of explained variance and the line in scree diagram have decided to make further analysis using the first three components. Each one explains more than 10% of total variance and their cumulative is 42%. Using the principal component method and the varimax rotation we have obtained weights pertaining to dependent variables and thus the basis to explain the five models (table 3). Weights range from –1 to +1 and the higher the value the more important is the weight in explaining the component.

Table 3: WEIGHTS FOR THE FIRST THREE COMPONENTS

LABEL	WEIGHTS OF THE FIRST THREE COMPONENTS		
	C1	C2	C3
DEC_EMP	0,108	0,256	-0,096
DEC_LINE	0,073	-0,083	-0,155
DEC_ TOP	-0,201	0,023	-0,851
DEC_PERS	-0,010	0,253	0,865
TRAIN_INTR	0,617	0,323	-0,196
PLAN_SUC	-0,050	-0,041	0,192
PLAN_CAR	0,671	-0,173	0,190
PERF_APP	0,715	0,122	0,014
RED_SICK	0,433	0,175	-0,188
PERFPAY_IND	0,819	-0,108	0,029
PERFPAY_GR	0,047	-0,071	-0,080
PERFPAY_CO	0,041	0,083	0,198
MEETINGS	0,063	0,080	0,054
IND_MEET	-0,016	-0,081	-0,225
INFL_STRAT	0,131	0,849	0,162
PERS_SUP	0,090	0,902	0,026
PERS_STR	0,635	0,178	0,163
TASKS_STR	0,427	0,123	0,157

Source: Questionnaire analysis

Based on these results and some additional qualitative analysis we derived the following three models of personnel function in Slovenian companies. Models are listed in rank order related to total amount of variance explained:

- The first model (C1) can be labeled as "HRM" in which strategic orientation is present as well as many programs aiming at increasing employee capabilities and motivation are used. The decision making process regarding personnel issues is decentralized and responsibilities are shared by HR and line managers.
- The second model (C2) can be labeled as "quasi-HRM", since there is the perception of the importance of personnel function in a strategic sense and in the decision making process about personnel issues. On the other hand, there seem to be only few (some of them legally required) programs or activities to materialize this importance.
- The third model (C3) can be labeled "low-power personnel", with very limited personnel activities and very low involvement of a general manager in a decision making process who seems to rely on personnel manager's judgement performing routine tasks. This model resembles to the administrative HRM.

Based on our research we may conclude that there is a lot of variation among Slovenian companies regarding the way they execute their personnel function. Some have already successfully transformed it to human resource management while others are lacking either strategic orientation or professional effectiveness. The reasons may be different competitive pressures, management philosophy and awareness regarding the importance of human resources as a source of competitive advantage.

With regard to our first proposition we found some support since only the first model, labeled human resource management, is positively linked to the goals of productivity and innovation (see Table 4). On the other hand, the low-power personnel model is negatively linked to the goal of increasing knowledge. We can argue that the importance of people-related goals regarding the formulation of a business strategy increases the probability of a successful transformation of personnel function into HRM. With regard to the second proposition there is no clear support (see Table 4) since the only significant link is between the first two models and the share of exports. There may be several reasons for these results. First of all, our sample is at this moment too small in order to allow controls for some factors such as industry and size which may have a strong impact on business results. Then we should also take into account that the transformation of personnel function has a lagging effect on performance since today's activities usually do not have an immediate effect on results. The third reason could be related to unreliable measures of performance since the accounting data can be manipulated to some extent (e.g. profit can be hidden for the taxation purposes). Nevertheless, these initial findings will help us design our future research. We plan to increase the number of cases as well as include improved performance measures over a longer period of time.

Table 4: CORRELATION MATRIX

Variable	HRM	Quasi-HRM	Low-power Personnel
KNOW	0,247 0,115	-0,114 0,472	*-0,284 0,069
PROD	0,283 *0,069	0,146 0,357	-0,300 0,850
L_COSTS	0,222 0,157	0,126 0,427	0,133 0,400
QWL	0,045 0,779	-0,056 0,723	0,080 0,614
INNOV	**0,306 0,049	-0,094 0,552	-0,115 0,468
EX_S98	**0,330 0,033	**0,441 0,004	0,066 0,677
EX_S99	*0,291 0,062	**0,468 0,004	0,059 0,712
ROS98	-0,097 0,543	0,160 0,312	-0,232 0,140
ROS99	-0,021 0,896	0,000 0,998	-0,041 0,796
ROE98	0,181 0,253	0,014 0,932	-0,211 0,180
ROE99	0,147 0,353	-0,103 0,517	-0,091 0,566
ROA98	0,035 0,825	0,184 0,245	-0,207 0,188
ROA99	0,108 0,495	0,064 0,688	-0,069 0,662
VA98	0,199 0,206	0,003 0,983	0,123 0,439
VA99	0,230 0,143	-0,049 0,759	0,112 0,478

Legend:
*** probability less than 0,01.
** probability between 0,01 and 0,05.
* probability between 0,05 and 0,10.

5. Conclusions

Most of Slovenian companies are in the position which requires effective responses to increasing competitive pressures, including the transformation of personnel function into human resource management. Our results have shown, however, that this transformation has been conducted with a limited success. Some of the reasons that HRM is not more developed can be found both in the history of personnel development as well as in the problems pertaining to the transition to an open-market economy. Under the previous system of socialist self-management personnel function was treated mostly as an administrative and not a managerial one. Hence managers as well as personnel staff lack the knowledge and experience to deal with current HRM challenges. Responsibilities are not clear and personnel departments are often poorly organised. Also, the whole HRM discipline is not well developed both as an academic as well as a professional field. Only recently, HRM has become a part of the curriculum in business schools and there are only few university level programs which specialise in HRM. Another reason pertains to the company management. The process of privatisation in Slovenia is slower than in some other transitional economies and for many years management have focused (and to some extent also employees) on finding the best way to privatise. This often meant that other areas have been heavily neglected. Also, many companies have not managed to clearly define their business strategy and therefore they used ad hoc actions to increase competitiveness. This short term orientation also stems from the fact that problems of labour inefficiency in Slovenian companies surfaced with a full force at the very beginning of the transition period. The main reasons were overemployment and relatively high salaries and other labour costs compared to productivity. Consequently, we could observe an interesting paradox. Turning towards more competitive markets would require strategic behaviour where human resource development plays an important role. In reality, most companies used mostly low-cost strategies, where main HRM concerns were downsizing and lowering of total labour costs [11]. Another problem area is also labour legislation and accompanying new institutions in Slovenian industrial relations, such as collective bargaining. We can find a mix of Western European approaches, mostly influenced by the German system of industrial relations. This of course means that legislation offers little flexibility to company management when HR issues are concerned (this is especially evident with respect to employee termination and compensation) and thus weakens HR as a potential source of competitiveness.

There is no doubt that HRM is an important means for Slovenian companies through which they could increase their competitiveness and internationalisation. Based on our former discussion we may conclude, that Slovenian companies still have a lot of reserves with respect to turning HRM into a source of a competitive advantage. Since we have found some evidence that the awareness of the importance of people-related goals increases the prospects for a successful transformation of the traditional personnel function, a lot of emphasis should be placed into increasing the HRM knowledge base, especially for managers who have a key role in the process of formulating a business strategy. With regard to the link between HRM and company performance some further research is needed in order to show which elements have the most impact and offer some possible explanations for the positive link. The research should combine two issues: to depict the stage of development of personnel function (e.g. various models used by companies) and to find reliable measures of performance over a longer period of time.

Appendix

Table A.1: DEPENDENT VARIABLES (18)

Label	Description
DEC_EMP	Relative influence of employees on personnel decisions
DEC_LINE	Relative influence of line managers on personnel decisions
DEC_ TOP	Relative influence of general manager on personnel decisions
DEC_PERS	Relative influence of personnel on personnel decisions
TRAIN_INTR	Do you have a formal program of training for new employees?
PLAN_SUC	Do you have a formal program of succession planning?
PLAN_CAR	Do you have a formal program of career plannning?
PERF_APP	Do you have a formal program of performance appraisal?
RED_SICK	Do you have a formal program for the reduction of sick leave hours?
PERFPAY_IND	Do you have variable pay based on individual performance?
PERFPAY_GR	Do you have variable pay based on group performance
PERFPAY_CO	Do you have variable pay based on company performance?
MEETINGS	Do you use informative group meetings as a means of communication with employees?
IND_MEET	Do you use individual meetings as a means of communication with employees?
INFL_STRAT	Influence of personnel manager on business strategy formulation.
PERS_SUP	Superior to personnel manager.
PERS_STR	Do you have a written personnel strategy?
TASKS_STR	Strategic component of personnel tasks.

Table A.2: INDEPENDENT VARIABLES (15)

Label	Description
KNOW	How important is the goal of increasing knowledge when you formulate your strategy?
PROD	How important is the goal of increasing productivity when you formulate your strategy?
L_COSTS	How important is the goal of decreasing labor costs when you formulate your strategy?
QWL	How important is the goal of improving the quality of working life of your employees when you formulate your strategy?
INNOV	How important is the goal of innovation when you formulate your strategy?
EX_S98	Share of export in sales in 1998.
EX_S99	Share of export in sales in 1999.
ROS98	Return on sales in 1998.
ROS99	Return on sales in 1999.
ROE98	Return on equity in 1998.
ROE99	Return on equity in 1999.
ROA98	Return on assets in 1998.
ROA99	Return on assets in 1999.
VA98	Value added in 1998.
VA99	Value added in 1999.

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The Position of Learning Organizations in Logistics Chains

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Abstract

In my research paper, I pay special attention to those aspects of learning organizations in the logistics management which are either neglected or only slightly perceived in our enterprises. It involves, especially, a consequential intention of achieving the efficiency of IS/IT in entrepreneurial subjects and its observation and assessment as well as focusing on the so-called "soft" factors determining the successful realization of information strategy, namely the human factor.

Solving the problems related to the agreement of users in leaving organizations, there are efforts to ensure that certain applications meet the demands of individual users as far as their characteristics and their working style are concerned. The users of analytic orientation accept the knowledge strategy without problems while the workers with heuristic approach need certain time to get accustomed to the proposed knowledge strategy.

Of course, in this respect, the education of the users achieved so far is of great importance, which holds also for their training and motivation to use the system of information processes organization and information management as well as the ability of further development of information. Humans as components of learning organizations are able to perceive the advantages as well as the disadvantages of information management.

1. Introduction

Logistics has all premises to become an important and full-valuable partaker of corporate strategy formulation and the strategic planning process. Preliminarily, it is necessary to assume and clarify the concurrencies of basic terms, such as mission, information strategy, strategy and planning, including the hierarchic nature of strategic planning. At the same time, it is also necessary to devote attention to the comprehensive insight of the broad scale of opportunities and difficulties that await logistics professionals in the 21. Century, called the century of "information" or "knowledge".

One of the most noteworthy tendencies in the latest years is the rapid globalization of markets. This tendency is not expressed only in renowned brands as Coca-Cola, it is also perceptible in such diverse markets, as in those of computers, communication devices, cars or consumer electronics. However, globalization is not reduced only to finished goods markets; similar transformation took place also in services, either in banking and retailing or in satellite broadcasting. In these tendencies, information seems to be an important source of effectiveness and competitive ability of companies. Though, in the reality, the insufficient standard of information management, or information systems and technologies, is being proved, inadequate to their strategic significancy. It is obvious that the company management and, at the same time, the logistics management do not pay sufficient attention to corporate information strategy. Information strategy not only forms an integral part of the whole corporate strategy; in the present turbulent business environment and the positions of companies in the logistic chain, it is also essential for the constantly sustainable development of a company. This is why we are forced to pay enormous attention to information strategy when providing resources for entrepreneurial processes.

Information strategy is neither a data base, nor a discussion concerning hardware or software to be purchased. Information strategy of a company is a permanent and unceasing process, whose four continuously repeating steps are the following:

Corporate strategy – searching answer to the question Why?

- Information system – searching answer to the question What?
- Information technology – searching answer to the question How?
- Information management – searching answers to the questions Who? Where? When? For how much?

The creation of corporate information strategy and, consequently, of the logistic chain is a continuous dialogue of the company management as well as of all other business subjects in the chain, who, along with IS/IT experts, search for answers to the following questions:

How can IS/IT add values to our services or products, open new business opportunities and increase our competitive ability?

- Who should be in charge of the development and operation of IS/IT in companies joined into a chain and how?
- How much money has to be spent on the development and operation of IS/IT inside the chain?
- What should be the organization of the resources for the development and operation of IS/IT and what are the possibilities of the evaluation of their effectiveness?
- How to train and motivate the employees in companies to use IS/IT more efficiently?

When outlining the information strategy, it is necessary to discuss questions related to information technologies, especially the problems connected with the strategy of creating information infrastructure of companies inside the chain, because the information infrastructure forms the environment for the development of IS/IT in companies. Its standard is determined by its individual components, which are the following.

- sufficiently powerful and advanced hardware,
- suitable and advanced software,
- proper data sources,
- employees with computer skills.

2. Attitudes towards the information strategy of logistics management

The information strategy of a logistic chain consisting of a large scale of business subjects cannot become a doctrine, according to which the companies will proceed to the use of IS/IT in a uniform way; it is a manifold mix of various objective and, mostly, also subjective impacts. The bearers of the subjective impacts are logistics managers, who, within the framework of their attitudes towards IS/IT, shape the entrepreneurial atmosphere in the material flows management and approaches to IS/IT.

Information technologies in the present form of highly powerful computers and networks have very short service lives, which means that the theories dealing with IS/IT management are still in the stage of development, unlike, for instance, the other managerial disciplines, such as production, finance, accountancy etc., whose fundamentals were set already at the beginning of the last century. Moreover, the paradigm of the so-called “hard” management factors is applied quite forcefully in this sphere, which is proper to the basic principles of contemporary information technologies. Hard factors are the result of rational and technocratic ideas and, largely, of the material nature. They are the factors which can be designed, formally outlined, implemented to the chain and dictated. These factors include, especially, the organizational structure, the relationship between competence and responsibility, planning systems, operations management and control, procedure and processes in information systems, intracompany management rules etc.

Soft management factors are related to the human element and the social relationships within the company and, consequently, within the chain. They are informal and ambiguous. They cannot be dictated or formally outlined. Their change is a long-term problem because they are strongly linked to the human factor and they are rather persistent. Soft factors include, for instance, the management style, qualification and skills, sharing the values within the chain and, consequently, in the company, teamwork, inventive leadership, the action of the logistics management etc. It is the soft factors that strongly influence the way IS/IT will be accepted and managed in the chain as well as in the companies because new information technologies bring dramatic changes to logistic processes and logistic organizational structures and people are able to change the established practice only with great difficulties.

When discussing the relization of IS/IT, logistics managers have to solve the dilemma of the so-called magic triangle of:

- IS/IT quality,
- IS/IT costs,
- The time factor.

Quality as well as time, which is still becoming more critical element of the present logistics approach to entrepreneurship, always cost something and finding the right “well-balanced” compromise solution concerning quality, price and time is the real managerial art, depending on the intensity of perception of the strategic importance of IS/IT not only for the company, but also for the chain. The remarkable tendency of the logistics manager to focus on one of the peaks of the magic triangle encodes the future destiny of information strategy. The rapidity of implementation is important, above all, for the earliest realization of the expected revenues. On the other hand, any precipitate implementation or development represent just a source of errors, which, in addition, multiply within the chain and reduce considerably the quality of IS/IT. For every IS/IT application, there exist certain “optimum” development and implementation periods and every attempt to shorten these periods represents a progressive cost increase.

Parsons[1] characterizes, in general, the following possible policies of approach towards IS/IT management:

- central planning – the information strategy is fully integrated with business strategy and it is directed by the top level IS department, which enables better understanding of the company’s opportunities and needs as well as effective purchasing and optimal allocation of resources. However, it requires the direct involvement of top managers and it is less flexible related to IS/IT development; it also often faces the aversion of the lower management,
- leading role – the information strategy is shaped on the background of the real understanding of the leading role of IS/IT in the competitive ability of a company; it uses the latest technologies but, at the same time, it draws significant costs. IS/IT applications are often risky and require support from the top management,
- free market – the users know best what information they need, which enables selective application of the progressive information technologies; nevertheless, the IS/IT department itself has to face the competition of external firms and it has little support from the top management. This is the cause of wasting sources and the inhibitor of the development of integrated IS,
- monopoly – IS/IT applications are realized by a single department for all users. This method enables to satisfy all users soon, even with limited resources, and the IS/IT costs can be controlled easily. In this case, the users are not satisfied with the applications in all situations as well as the applications do not always reflect the competitive ability needs of the chain,
- limited resources – a way of IS/IT management in which expenditures are given in advance and the decisions concerning the applications portfolio are met by finance managers. The main criterion for the evaluation of applications is the rate of return,
- inevitable evil – IS/IT are applied only when required by regulations or when there is no alternative solution to the problems. The applications have to prove high rates of return. This approach is always applied under cautious managements, which is the cause of demoralization or even retirement of qualified employees, leading definitely to the loss of the competitive ability of companies.

Of course, the above-mentioned theoretical approaches to IS/IT management are not applied in companies and chains in their pure shape uniformly in all elements of the chain; they can be used differentially with various applications of IS/IT and, above of, they change in time in accordance with the changes of the company, the chain and its internal as well as external environment.

3. Profits of IS/IT in logistics management

It is the sense of information strategy in logistics management to make the expenditures on IS/IT bring the greatest profit possible and to make the logistic concept effective. The problem of information strategy represents, to a considerable extent, the matter of expectations of the people as the final recipients and evaluators of the profit. The realization of information strategy through certain applications of IS/IT should be profitable to for the company. The fact who expects certain kinds of profits is, of course, a complex problem, which should be further analysed. Focusing on the business sphere, we can identify four categories of subjects and their expectations of profit:

- owners – IS/IT should constantly valorize their possession invested in the company,
- managers – IS/IT should enable the possibility of leading the firm successfully so that the results required would be achieved with minimum resources in their charge,
- employees – IS/IT should offer better working environment, higher social status and stronger feeling of belonging to the company
- customers, in final consequence – they should realize the above-mentioned aspects when getting products and services of higher added value for affordable prices [Supply Chain Management].

This portfolio of profit recipients should be fully respected when creating information strategy of a company or a chain and, similarly, balanced proportions of quality, expenditures and time should be searched for, which holds also for balanced profits for all partakers of the information system.

If we design the information strategy of a company or a chain, we have to set specific goals to be reached by applying IS/IT. These goals are formulated in various indicators. To observe the fruitfulness of fulfilling the goals set by the corresponding information strategy in the logistics management, it is also necessary to determine the metrics of the goals achievement. The indicators in question can be the following:

- financial (measured with currency units) and nonfinancial (measured with other physical units – e.g. count, time etc.),
- quantitative (measurable with cardinal scales) and qualitative (measurable with ordinal scales or with logical values “achieved – not achieved”),
- direct (in which the direct causal relation to the goal achieved can be proved) and indirect (in which some representative indicators with causal relation to the observed goal have to be determined),
- short-term (appearing in the course of six months after implementing IS/IT) and long-term (appearing later, sometimes even in several years).

In connection with the measurable and unmeasurable indicators of profit, hard (tangible) and soft (intangible) indicators are often discussed. The intangible indicators involve:

- improvement of the company’s goodwill (can be evaluated in various researches),
- satisfaction of customers (can be evaluated in various researches and, in the long-term periods, approves itself by the increase in the number of customers),
- increase in customer’s loyalty (can be evaluated by the number of repeated orders from existing customers),
- flexibility of logistic services, creativity in assuming new products, services, processes or structures (can be evaluated e.g. by the number of modifications for customers),
- reactions to newly appearing needs of the market (can be evaluated by the time needed to launch a new product or service in the market),
- improvement of the working environment (can be evaluated in various questionnaires or inquiries and, in long term periods, leads to the stabilization of the labor force, or growing interest in working),
- increasing the qualification of employees (can be evaluated in various questionnaires or in a wide range of systems of qualification evaluation used in personal management),
- adding value to products or services (can be evaluated by the willingness of the customers to pay more for the product, by the increase in the number of customers or by both).

Whatever is the character of the goal or of its indicator, under the information strategy, it is always necessary not only to determine the required “number”, but also to ensure (plan) its regular observation and assessment from the personal and organizational point of view so that we could state that the information strategy realization brought desirable change to the company or the chain element.

Conclusion

In our paper, we intentionally passed away the whole broad field of formalized approaches towards the creation of information strategies in the logistics management, which are described in detail in methodics of various consulting companies and, of course, in the scientific literature as well. We focused exactly on those implications of information strategies in logistics that are ignored or only slightly perceived in our companies. These are especially the consequential focus on reaching the effectiveness of IS/IT in the entrepreneurship, its observation, assessment and the so-called “soft factors” determining the fruitfulness of the information strategy realizations, namely the human factor.

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Section 7

Production, Quality, Marketing & International Trade

Advertising of Slovakia as a Tourism Destination in the Process of Globalisation

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Abstract

Slovak Republic with its natural and cultural – historical potential, by which it disposes, occurs, within globalisation tendencies, as one of the perspective destination areas of tourism.

Tourist industry is one of economical sectors, which can become an important contribution to visualising Slovakia in an integrated European environment. It does not only represent a source of income but moreover it creates new job opportunities and participates in an image of the country in a very important way. The government has stated in its program declaration, that it will support expansion of tourism as one of the priorities of its economic policy. Consequently several proceedings mostly related to advertising of Slovakia as a potential tourism destination were realised.

Approval of Slovakian tourism agency statute took an important part in the proceeding sequence, which helps Slovakia in being visualised as a tourism destination.

Tourism represents a cross-sectional industry while the whole amount of other industries participates in its realization (e.g. transport, culture, building industry, health service, manufacture industries, agriculture...). It is a branch of service sector, which represents striking major – over a half or over two thirds – share in economics of developed countries. Even within services generally - the sector showing high dynamics, tourism is one of the fast growing ones. World Tourism Organization's (WTO) prognosis, World Tourism Council's (WTTC) prognosis, prognosis of specialized institutions and experts coincide in its following dynamic world growth. Average world growth of tourism from a year to year is forecasted to be 2.5 - 2.8% [1]. This is in accordance with the growth of free time, pensions, traffic development, and growth of education level as well as changes of lifestyle.

Word Tourism Organization expects 6.1 billion journeys abroad for tourism purposes in year 2020. Foreign tourists will spend more than 2 billion USD on travelling. This represents an average annual growth of journeys abroad to be 4.3% and their expenditures 6.7%. It is more than an annual growth of world economics, which is assumed to be 3% [2].

According to World Tourist Organization, development of tourism in the beginning of 21st century will be influenced by several trends:

- Deepening globalisation and dependable prosperity of destination cities
- Using new distribution technologies for supply and distributions of products
- Destinations are able to compete successfully only if they focus on their image as an assumption of diversification and expansion of their attractiveness
- Growing preferences of tourism participants towards comfort, simplification and acceleration of travelling process, adventure, health, ecology, recognition and culture, fun and entertainment
- Tendency to gain an Asian tourist will be dominant all over the world.

National tourism is an important part of population's consumption as well as a form of its regeneration and building up health. At the same time it extends general knowledge and changing of experience, it enables social contacts and influences level of public satisfaction.

The external environment of tourism consists of economic, social, technologic and ecological environment. Inflation and purchasing power of Slovak crown, internal convertibility and exchange rate, living costs, economic growth and unemployment, loans accessibility and foreign investment, privatization, entrepreneurial condition and taxing are the most influential factors of economic environment.

Slovakia as a country of destination entered the international market of tourism by origin of Slovak Republic. Although many of tourism centers were notable in international consequence, Slovakia used to be an unknown country for many tourism participants. Slovakian government endorsed statute of Slovak Tourism Agency (SACR) and Department of Economy of Slovak Republic has assigned it its contributory organization effective since 1st September 1995. It is aimed to provide marketing and state advertising of Slovak tourism abroad.

SACR provides official participation of Slovak republic at international exhibitions and trade fairs of tourism, where it enables all Slovak subjects of active foreign tourism to take part. It has provided participation of Slovakia at 20 fair trades - the most important for Slovakia, in adjoining countries and the other fair trades in Europe (Brno, Prague, Budapest, Warsaw, Krakow, Vienna, Moscow, Kiev, Riga, Berlin, Leipzig, Cologne, Munich, Stuttgart, Milan, Geneva, Gothenburg, London), in three other continents (Toronto, Dubai, Singapore) and at four national fare trades with international relevance: Slovakiatour Bratislava, Expotour Žilina, Hotel Banska Bystrica, Nostalgia Bratislava, 10th Danube exchange Bratislava.

Besides representation at specialized exhibitions and trade fairs of tourism, SACR provides presentations and workshops of tourism subjects in form of bipartite undertakings or as a part of middle-European cooperation in tourism at home as well as abroad. Presentations and workshops in Stuttgart, Brussels, Copenhagen, Prague, Tokyo, Osaka, Mexico, Kiev, Minsk, Vilnius, Riga, on ferry Polonia, in Warsaw, Paris, Zagreb, Ljubljana and Bratislava were realized this way. Series of presentations and workshops of Slovakian spa in German towns: Chemnitz, Leipzig, Magdeburg, Postupim and Berlin were extremely successful.

SACR cooperates with national and foreign medias actively. First of all there is an organization of press conferences in country and abroad, which is linked to presentation of a specific region or important undertaking of tourism in Slovakia. Press conferences and presentations of regions in Bratislava, Prague and Budapest have already become a tradition. Apart from them, there were press conferences in Vienna, Warsaw, Berlin, Stuttgart, and London. In Slovakia, they took place in Piestany, Jasna, Banska Bystrica, Roznava and High Tatras.

Constantly maintainable development of tourism in Slovakia is aimed to stabilize its position in national economy structure and form assumptions for its effective and long-term development as a factor of economic, social and cultural development of society. The main criteria of tourism development is optimal satisfying of particular segments` needs by differentiated goods while using labor, capital and Slovakian natural and cultural potential effectively.

Strategic aims of Slovakian tourism are based on strengths and weaknesses of domestic as well as international tourism market. The strategy supposes reaching the following middle-term aims (within 5 years):

- Increasing competitiveness of our tourism in European context
- Recovery of dynamics of foreign exchange growth, while the rate would be exceeding European average growth rate
- Recovery of dynamics of national tourism growth
- Growth of “overnight” tourism from abroad
- Improvement of visitors` structure in term of economic contributions
- Capture of determining development trends of world tourism
- The most perspective forms of tourism are preferred to be developed
- Keeping up with Check and Hungarian services` quality growth rate
- Realize cross-border cooperation in tourism aimed to coordinate activities in particular regions
- Maintenance of natural and cultural development potential and its possible all year use

Reaching of aims has to be supported by many government remedies in tourism, because leeway in performance is caused by leeway in creating conditions for development of tourism in Slovakia.

According to evaluation of supply of the country and its equipment, consideration of long-term tendencies in tourism demand and globalization tendencies, it is necessary to develop the following forms of tourism:

- Summer recreation in mountains, including supply of mountain tourism and many spare time activities
- Winter mountain sports, particularly downhill skiing and other sports, fun and relaxing activities

- Town and cultural tourism, including cognitive tourism focused on history and culture and congressional tourism. According to conditions in our country, presence, mentality of markets and perspective of these forms, it is our future product.
- Balneal and health tourism in its traditional form, which is necessary to be maintained and at the same time develop health tourism (relax, fitness, prevention, beautifying), which begins to grow all over the world
- Rustic tourism and agro tourism could also have substantial importance in some regions

Alignment of tourism development in particular countries is disparate and modified by multiple laws and other enactments. Multi-parliament conference about tourism, which took place in Haag on 10th – 14th April 1989, accepted declaration, where national parliaments were recommended to take specific part in creating national politics of tourism, to contract legislation of Union and accept tourism law code if needed.

There is an amount of other legal documents of European Union focused on development of member states cooperation, creation of incorporate politics of tourism in Union and other partial areas (e.g. creation of sequence of member states cooperation, acquiring statistical data, designing a Union plan to support tourism etc.).

Mission of tourism law approximation in means of developing cooperation between member states of European Union and Slovak Republic is basically stated in article 89 of European Agreement about practice affiliation (alleviation of business in tourism, increase of information flow through international nets, consigning know-how by professional practice, participation of Slovakia and Slovakian tourism subjects in European and international organizations, organizing common actions). Decision of European Council accepted on 10th April is important, too. It encodes Union politics in tourism and declares that tourism is one of the economics departments, which contributes to harmonic development of economic activities within Union and extending of European integration. This decision has also assigned business committee of European Commission to design directive project concerning tourism.

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Agent–Based Strategic Business Cycles

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Abstract

This paper examines endogenous strategic business cycles with agent – based simulations of economic development. We show existence of equilibrium for the model and analyze the dynamics of the equilibrium trajectories generated in the model. Because of the non - linearity generated by strategic interaction of agents in the model , we find that complex and chaotic equilibrium dynamics are possible in this model for a broader range of preferences. Market thickness determines how big an impact each agent's bid for the good has on determining the overall price. Thick market equilibrium can be Pareto superior to thin market equilibrium and thick market equilibrium are less susceptible to endogenous fluctuations. Strategic interactions complicate economic dynamics.

Many asset pricing puzzles can be explained when agents can choose consumption and labor optimally in response to more technology shocks. Hence the agents want to smooth consumption extremely , making consumption very unresponsive to shocks. Results provide an alternative to the technology – based explanation for the fact that business cycles became an important economic phenomenon.

JEL: C72, C73, D51, L16

Architectures and implementations of many agent systems differ so widely that interoperability is not possible. System and user resources have to be protected from use by other users and by remote applications using local resources. Early simulations of growth cycles hypothesis adopted an augmented production function approach and in these studies mostly cross – sectional in nature.

In such causality tests, the cycles variable is said to cause in the forecast for the cycles variable improves when the lagged economics variables are included.

Industrialization has other important consequences, however, beyond the direct enlargement of markets in response to scale economics and the more important effects was the reorganization of industry forced by scale economies and the emergence of oligopoly, and the concentration of wealth in the hands of entrepreneurs.

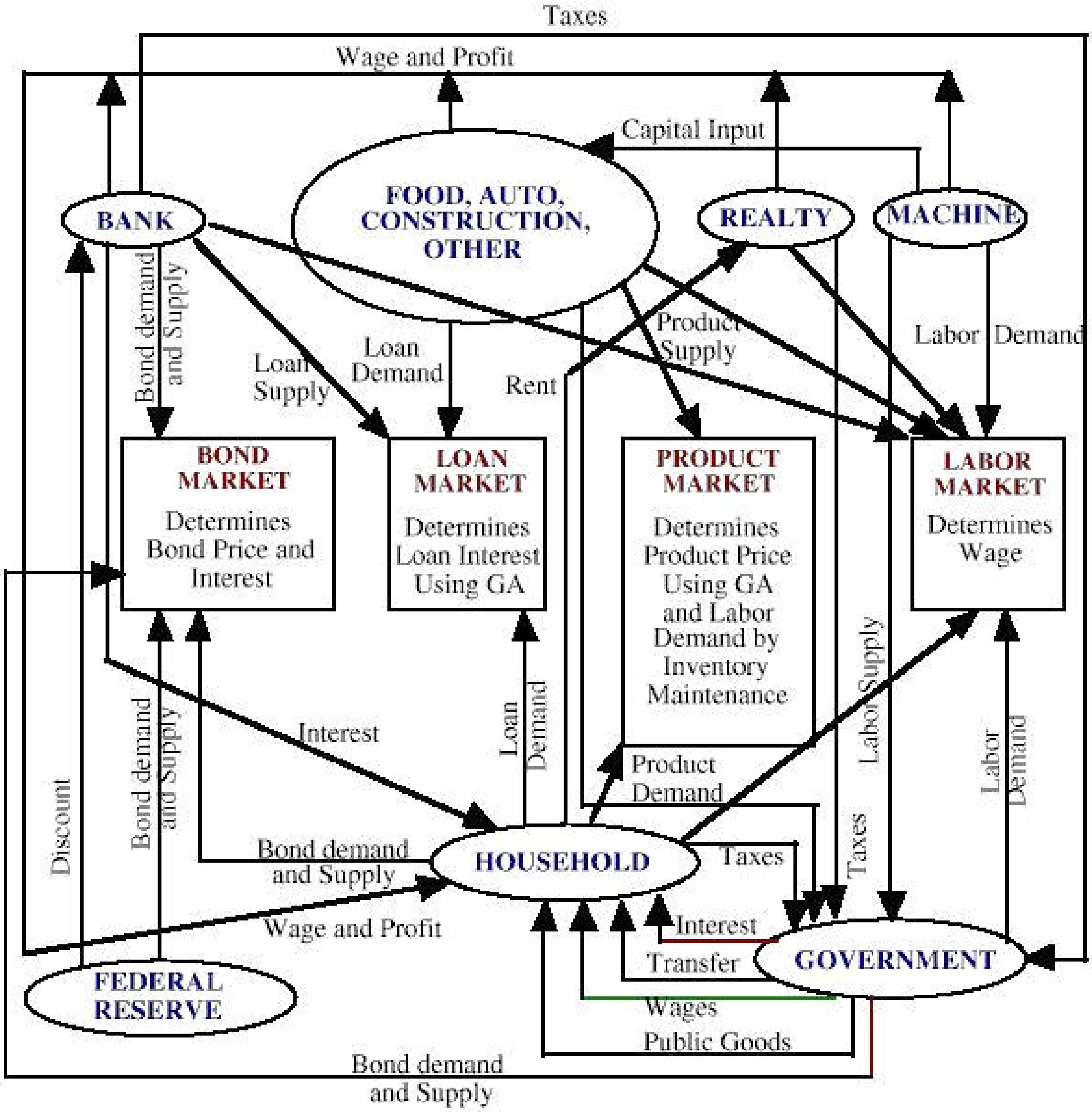
These two effects changed the way that business was done by magnifying the importance of strategic interactions among agents relative to the norms of competitive behavior. There are a number of reasons to suspect a priori, that competitive markets might play a role in generating business cycles. The strategic behavior of agents make adjustments in their own net trades in response to the actions of other agents. Market thickness determine how big an impact each agent's bid for the good has on determining the overall price. The market equilibrium can be Pareto superior to thin market equilibrium and less susceptible to endogenous fluctuations.

The strategic effects of market thickness from that of variations in the value of money, which are the source of fluctuations in competitive overlapping generations economies.

The possibility of monitoring has been investigated in three-layer hierarchies and we want analyze the problem of collusion in hierarchical relationship (Kessler, 2000). There are three risk-neutral agents a principal P, a supervisor S, and manager A. The agent is a productive unit and produces output $x = q + e$ that is determined by a random productivity parameter q and the agents effort e. The agent's utility is $u_A = t - y\,(e)$ and his reservation utility is denoted while the output x publicity observable both q and e are private information of the agent.

In each period, agents may trade a single perishable good and money, which can be stored from one period to the next. Agents are endowed with amounts of the good in each period and

agent endowment is $w = [w_1, w_2]$. The consumption of agent at time t will be denoted $\left[x_{it}^{t}, x_{it}^{t+1}\right]$ for *i=1,….,n*. Utility is additive separable $u\left(x_t^t, x_t^{t+1}\right) = U\left(x_t^t\right) + V\left(x_t^{t+1}\right)$. Trade takes place at trading posts in which agents offer some amount *q* of the good for sale, and make money bids *b* for purchase of a share of offering and savings *m*.



This agent's strategy set is then $S_t = \{(q_t, b_t, m_t) \in R^s | w \geq q_t > 0\}$. Each agent is allocated a share of the amount of money bid in the proportion: $B_t^s = \sum_{i=1}^{n} b_{it}^s$ for *s=t,t+1* and $Q_t^s = \sum_{i=1}^{n} q_{it}^s$ for *s=t,t+1*.

If the budget constraints are satisfied, the trading mechanism:

$$x_t^t = w_1 - q_t^t + \frac{Q_t}{B_t} b_t^t \text{ and } x_t^{t+1} = w_2 - q_t^{t+1} + \frac{Q_{t+1}}{B_{t+1}} b_t^{t+1}.$$

Next for example we are shoving hierarchy of agent´s using genetic algorithm (GA) learning classifier system (Basu, et. al. 1998) for solution macroeconomic problems via the aggregation of the agents microeconomic actions – model ASPEN. The present paper has studied collusion in a simple agency model with hierarchy of risk, learning and as result macroeconomic stability for example for Household, Federal Reserve and Government or production and services, a various markets and global level of hierarchy.

Now, a typical agent's given the bids and offers of all other agents is determined as the solution to the problem of market game of agents are indeterminate at Nash equilibrium.

Define $p_n^t = \frac{\hat{B}_t^n - m}{\hat{Q}^n}$ and suppose that $\{p_t^n\}_{n=1}^{\infty}$ is a sequence of interior Nash equilibrium prices for the n –fold replication of the market game.

The marginal rate of substitution at the endowment is $\frac{U'(w_1)}{V'(w_2)} < 1.$

However, in the offer – constrained market game, there is a restriction on the amount of the good offered for sale and this agents prefer thick markets, because the game is non – cooperative, so there is no way for any agent to increase the offers of other agents. The agent's own offer is optimal in the sense that any change in the offer can also be achieved by a corresponding change in the bid.

In this situation, if the backward dynamics exhibit cycles which are stable under iterations of the dynamics, these cycles will also be perfect foresight equilibrium under the forward dynamics, which examine how agents in a dynamic economy might go about learning the rational expectations equilibrium.

It will be useful to define functions, the backward dynamics as $q_t = j(q_{t+1})$, mapping j satisfies $v_1[j(q)] = v_2(q)$. We get the condition:

$$R_2(w_2 + \hat{q}) > \frac{(w_2 + \hat{q})(\tilde{Q} - 2\hat{q})}{\hat{q}(\tilde{Q} - \hat{q})} + \frac{(w_2 + \hat{q})}{\hat{q}}\left[\frac{2\hat{q} + \hat{Q}}{\hat{Q} + \hat{q}} + R_1(w_1 - \hat{q})\frac{\hat{q}}{w_1 - \hat{q}}\right]$$

If agents may have different offers, $\hat{Q}$ can remain positive as $\tilde{Q} \to 0$ since for any agent *i*, we have $\hat{Q}_i = \breve{Q}_i + q_{i2} - q_{i1}$. Hence, by choosing agent *is* offers appropriately, in the type economy with *n>1*, since $\hat{Q} = (n-1)q_1 + nq_2$ and $\tilde{Q} = nq_1 + (n-1)q_2$.

Suppose the economy by adding agents, but simultaneously reduce individual offers such that *Q* remains unchanged, is essence keeping the market thin. Prices will remain positive since although bids and offer are shrinking, aggregate bids and offers remain positive and finite. It is, therefore, the thinness of the market, not the number of agents, which determines if complex dynamics persist. The condition also makes it particularly easy to calculate bifurcation diagrams since it is known for such orbits that the critical point of the mapping is attracted to this orbit.

Accordingly the agents participation and incentive constrains must hold for all possible signals in economy separately. The agent´s uncertainty and risk facilitates punishments when agent is detected shirking which in turn greatly improve incentives to provide the correct effort. The Kuhn-Tucker conditions are:

$$\frac{\partial L}{\partial e_h} = q - (l_2 + l_3) y'(e_h) \le 0,$$

$$e_h = 0 \text{ and } e_h \frac{\partial L}{\partial e_h} = 0 \; e_h \frac{\partial L}{\partial e_h} = 0$$

$$\frac{\partial L}{\partial \tilde{t}_h} = -q + (l_2 + l_3) \leq 0$$

$$\tilde{t}_h \geq 0 \text{ and } \tilde{t}_h \frac{\partial L}{\partial \tilde{t}_h} = 0$$

$$\frac{\partial L}{\partial e_l} = 1 - q - l_1 y'(e_l) + l_3 y'(e_l - \Delta q) \leq 0$$

$$e_l \geq 0 \text{ and } e_l \frac{\partial L}{\partial e_l} = 0$$

$$\frac{\partial L}{\partial \tilde{t}_l^{\,N}} = -(1-q)pa + l_1 pa - l_3 p(1-a) \leq 0$$

$$\tilde{t}_l^{\,N} \geq 0 \text{ and } \tilde{t}_l^{\,N} \frac{\partial L}{\partial \tilde{t}_l^{\,N}} = 0$$

$$\frac{\partial L}{\partial \tilde{t}_l^{\,0}} = -(1-q)(1-p) + l_1(1-p) - l_3(1-p) \leq 0$$

$$\tilde{t}_l^{\,0} \geq 0 \text{ and } \tilde{t}_l^{\,0} \frac{\partial L}{\partial \tilde{t}_l^{\,0}} = 0,$$

plus the constrains.

Let (t_l, x_l) and (t_h, x_h) be the contract designed for an agent who claims to be a type q_l and q_h respectively. Denoting $e_i = x_i - q_i$, $i \in \{l, h\}$, the participation constraints:

$$t_i - y(e_i) \geq \overline{U}, \quad i \in \{l, h\},$$

with compensation utility $\overline{U}$.

Let t_l^r and w^r denote the compensation for the agent and supervisor on the report $r \in \{O, N, S\}$.

This line of reasoning suggest who faces an agency problem which consist of moral hazard and a hidden-information component should rationally prefer to monitor the agent's action rather than to audit his reported information.

Compensation and leisure are complements in the preferences of the agents budget constrains and consider a economy populated by agents. Total wealth of agents is divided between money and physical capital. Agents competitively decide on consumption, labor supply, wealth accumulation and portfolio compensation. The decision problem faced by agent is

$$\max \int_0^\infty U(c,l) e^{-dt} dt$$

subject to the flow budget constraint

$$\dot{c} + n\dot{x} + \dot{k} = f(k,l) + s - (n+p)m - nk - cn(m)$$

where

c – per capita consumption,

l – labor effort,

m – per capita real money balances,

k – per capita capital stock,

f(.,.) – per capita output,

s – per capita government transfers,

n – population growth rate,

p - inflation rate.

$u(.)$ - liquidity cost per unit of consumption,

d - rate of time preferences,

t – time.

But when agents do not have detailed knowledge of relevant relations for rational expectations equilibrium or Nash equilibrium, they can easily arrive learning methods.

Nonparametric recursive estimators as kernel, orthogonal series, spline, wavelets, neural networks estimators are implemented by putting

$$H_{l(n)} = \left\{ q(x) = \sum_{j=1}^{k(n)} b_j f\left(g_0 + g_j' x\right) : |b| + |g| \le b_n < \infty \right\} \text{, with}$$

$$b_n \to \infty, \quad k(n) \to \infty \quad \text{as} \quad n \to \infty.$$

The procedure introduced the possibility that agents do know not fixed bounded set. Heuristically, the feedback present in learning systems introduces memory of the arbitrarily distant pass. A change of belief, according to the suggested interpretation, is not necessarily a result of acquiring new knowledge. A belief space is a measurable space each point of which is associated with a probability measure on the space.

For each event E and real number p

$$B^p(E) = \{ w | t(w)(E) \ge p \}$$

is the event that the probability ascribed by the agent to E is at least p and we call $B^p(E)$ the event that the agent is certain of E.

Obviously in equilibrium the agent will choose the loans and effort to solve the following optimization problem:

$$\text{B(S,L):} \quad \max_{l,d,e} \quad U(c_1, c_2, e),$$

$$\text{subject to} \quad (l,d) \in L(S),$$

$$c_1 = w + s_1 + l,$$

$$c_2 = \max[s_2 - d, \min(s_2, l)].$$

The agent may approach a bank and secure a loan agreement (l,d) and the amount l represents the loan received by first period with $l<0$ corresponding to saving. The agent then promises to replay the amount d in the second period and $d<0$ corresponds to withdrawal of savings and the contract taking form of sharing rule $S = (s_1, s_2(.))$.

We avoid overlapping generations and assume that agents are infinitely lived. We assume that that markets are complete, so agents can trade securities with payoffs that are contingent on the state of the economy at all dates. The rational expectations equilibrium with growth cycles exists. We show that that the equilibrium is stable under a natural learning rule. The equilibrium is possible in the sense that it makes only modest information processing demands on the agents. When agents expect growth to be slow, the return are low and little investment take place. But if agents expect fast growth,, all activities oriented on this goal.

The agent’s preferences are represented by an utility function $U(c_1, c_2, e)$ where $c_t \geq 0$ is consumption expenditures in period t and $e \geq 0$ represents the total effort expended. Let w be the agent´s initial wealth, if the agent accepts the contract S. and given the bankruptcy protection level l and agent with contract S and aggregate debts d, which the agent incentives could be affected by buying or selling shares in the firm. This is likely to be the case of credit markets are sufficiently sophisticated to allow for risky borrowing with an adequate level of bankruptcy protection (Bized, et al. 1999). If the agent is a manager running a publicly traded firm, the agents incentives could be affected hierarchies in new economy and consideration of arbitrary contingent contracts in the presence of bankruptcy protection. If credit markets need not disrupt efficiency in agency environment.

Strategic interactions complicate economic dynamics. One possibility which suggest itself is to endow agents which some technology for converting leisure into input, while requiring that production decision must be made prior to the opening of bidding, nevertheless cyclic behavior remains a possibility in some examples.

A related question concerns the role of expectations, the offer decision is to specify offers as functions of expected future prices, possibly in the context in which agents are trying to learn.

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Benchmarking - Tool of the Firm Prosperity

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Abstract

The article describes the Benchmarking importance as an internal firm audit to identify weaknesses and to determine performance gap using the comparison with the best company achieving excellent performance. It is very important not only to find problems here, but also to look for the methods eliminating these problems and closing the performance gap. This way of firm performance improvement can be utilize as a competitive advantage.

What is Benchmarking

Benchmarking[3] is a continuous, systematic process for evaluating the products, services, and work processes of organizations that are recognized as representing best practices for the purpose of organizational improvement. Benchmarking is the process of measuring your operations against similar operations for the purpose of improving your business processes. The purpose of benchmarking is to improve products and processes to better meet customer needs. The linkage of the business process to customer needs is critical to effective benchmarking.

Benchmarking as an audit function means improving the audit process and audit products (reports, etc.) to meet the needs of internal audit customers (primarily senior management and the audit committee). For implementation benchmarking we must have a thorough understanding of:

- The critical business processes,
- The critical success factors for fulfilling customer needs,
- The best measurements will provide this information.

Types of Benchmarking

There are identified three levels of benchmarking here:

- company benchmarking,
- sectoral benchmarking,
- benchmarking of framework conditions.

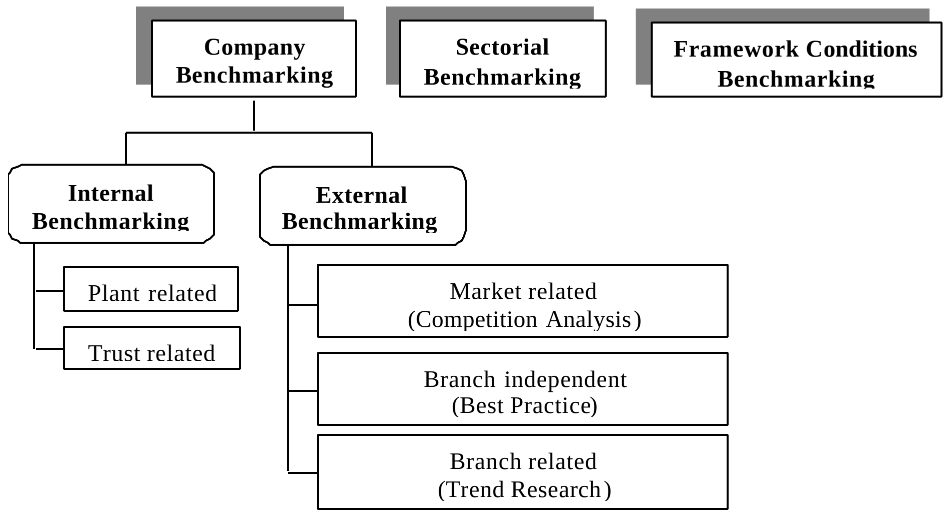

Fig.1 TYPES OF BENCHMARKING

The company benchmarking has achieved the main number of benchmarking activities, where internal practices, processes and their performance are compared with others. Mainly bigger companies used benchmarking to identify and implement best practices. Small and medium sized companies are hindered by the lack of time, money and methodological skills to make use of benchmarking.

Sectoral benchmarking covers performance indicators of a specific industrial branch like automotive industry, wood and furniture, chemical, electronic or banking industry as well as small and medium sized business. Useful sources of general data are the national official of statistics and the industrial associations of the specific sector.

Benchmarking of framework conditions relates to competitiveness indicators of countries or regions regarding infrastructure, taxation, education, policy regulations etc. A typical source of such information is the OECD, the Worldbank and the national official of statistics.

Why is It Important for Company Utilizing "Best Practices"

The answer to this question is very simple. Nobody is perfect in everything. It is described in next figure.

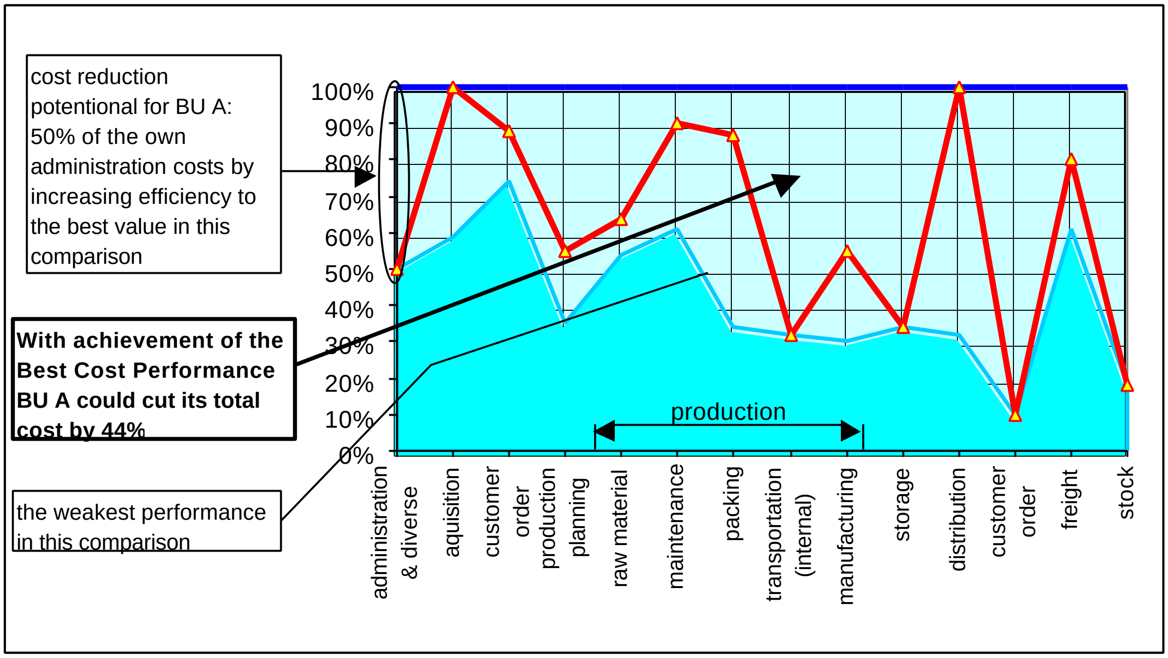

Fig. 2 COMPARISON BUSINESS UNIT A WITH THE OTHERS

From the Fig. 2 it is clear, that business unit A has best performance in 2 categories, but there are several categories, where his performance achieves the weakest value in this comparison.. It means entertainment could improve something.

Benchmarking Steps

There are many versions of Benchmarking Steps used by very successful organizations. AT&T has 12, Xerox uses 10, Alcoa has 6, and others recommend 7 or 8 steps. The software program Benchmarking, based on the work of James Harrington in business process improvement, uses an 18-step process. All current models use the same steps. The differences between them are that some of the steps are divided into multiple steps.

The simplest framework is recommended by GOAL/QPC. It has six steps (keyed to the Deming Cycle of continuous improvement):

1. *Plan* (Plan)
2. *Research* (Plan)
3. *Observe* (Do)
4. Analyze (Do)
5. *Adapt* (Check)
6. Improve (Act)

Benchmarking is not a one-time project. It is a continuous improvement strategy and a change management process. Once begun, the entity should continue to benchmark against "best practices" in order to continuously improve.

Step 1: Plan

The first step in the benchmarking process is to plan. A Benchmark Team provides insight into key customer needs and the processes in the organization that address those needs. When a customer need is identified, the processes that directly fulfill that need become critical processes. We only benchmark critical processes.

The Benchmarking Team needs to:

- understand the critical processes and how they are measured,
- decide what kind of data is needed and how data will be collected.,
- identify all team members and find a sponsor.

A key step in the planning process is using flow charts so that the Team first understands their own critical processes. The Team needs to understand the process and how it is measured, both in their own terms and in the customer's terms. The kinds of measurements (or metrics) chosen have to be useful to compare performance with a benchmark partner. If the metric chosen uses information that could be sensitive to either partner, it is not a good measure. There is a Golden Rule of Benchmarking:

Do not ask your benchmarking partner to tell you things you are not willing to reveal about your own operation.

The output of the planning process should be:

- An identified customer class.
- Identified customers' needs.
- A targeted critical process related to fulfilling customers' needs.
- A linkage between the purpose of the benchmarking study and organizational objectives.
- A sponsor and a benchmarking team.
- A data collection plan.

Step 2: Research

The purpose of research is to:

- establish the metrics to be used.,
- identify the benchmark candidat,.
- collect public data.

Before collecting a lot of data about others, a benchmarking team needs to collect baseline data about its own processes. Collecting this data will refine the measurement process and help develop the final set of metrics to be used in the benchmarking effort. Use TQM tools or other analytical tools to observe and analyze your own process. The Benchmarking Team can use this internal review as benchmarking practice prior to the site visit with the benchmarking partner.

Identifying potential benchmarking partners is another step in the research phase. It is always best to develop a list of three to five potential benchmarking partners for cooperative benchmarking. Some potential partners may not be interested, not have the time, or not wish to share information. Although benchmarking practice stresses using the "best in class" for our benchmark, often that has to be tempered with other factors, such as cooperation, costs, time, location, and already established relationships.

Step 3: Observe

Eventually the Benchmarking Team must go to the source of the data and visit the benchmarking partner. The Team will have already prepared itself by:

- establishing a benchmarking agreement with a partner organization,
- establishing a data collection plan and method,
- becoming experts in the measurement of their own system,
- preparing themselves by absorbing and cataloging all relevant public information.

To save embarrassment, it would be helpful if the Benchmarking Team reviewed the common sense principles found in the Benchmarking Code of Conduct or similar document. This list of "correct behavior" will ensure that benchmarking efforts are not derailed over a breach of etiquette.

Step 4: Analyze

Analysis of the collected data usually takes several steps:

- summarize and interpret the data,
- analyze the gap between your process and your partner's process,
- project where future gaps will be,
- analyze things that were not on the agenda,
- develop key findings into new operational goals.

Analyzing the benchmark performance "Gap" can be done as a snapshot or as a trend over a period of time. Either method (or both) may be appropriate for the process being studied. When cost, productivity or quality is the metric under study, sometimes it is useful to look at the historical trend as well as the current gap. Projecting future performance levels of your productivity and the benchmark partner's, given the current rate of improvement for each, creates what we call the "Z Chart" of productivity improvement required to attain parity with your benchmark partner.

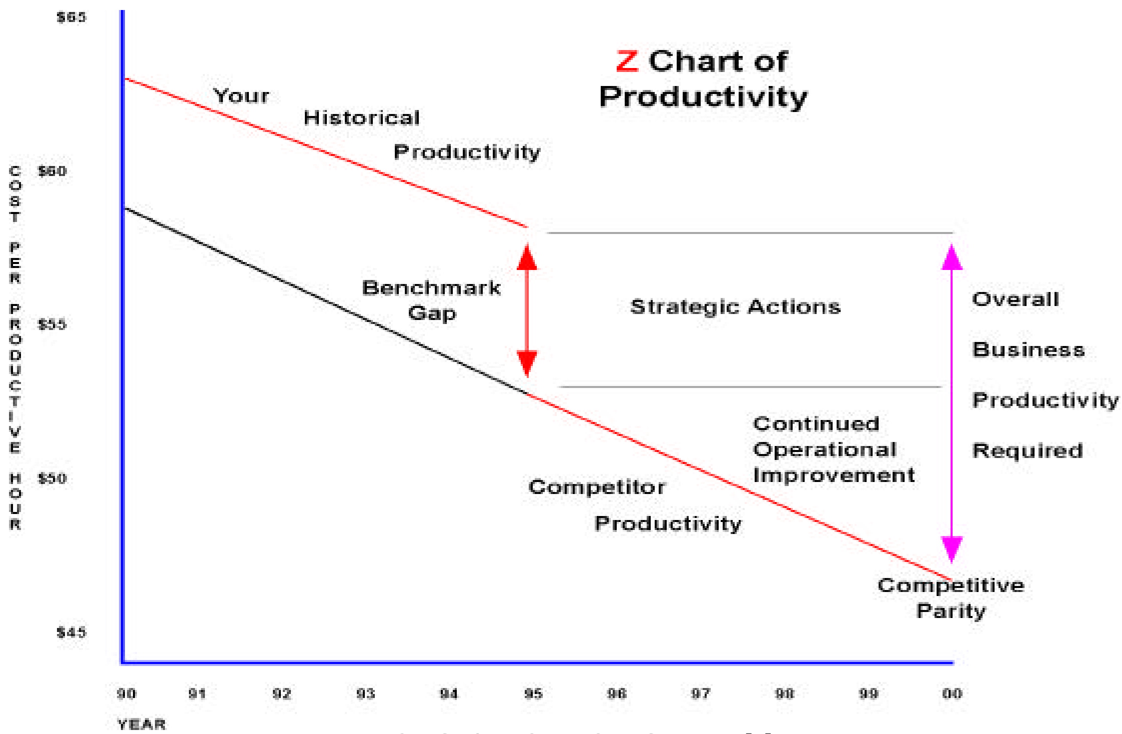

Fig. 3 Z CHART OF PRODUCTIVITY [2]

By reducing the problem to metrics through analysis, it is easy to get lost in the numbers. Part of our analysis is to step back and look for things the numbers are not telling us. We also must be alert to qualitative data and observations.

Step 5: Adapt

As a process improvement technique, benchmarking requires the same change management framework that all improvements need. The key change management techniques used are:

- communicate the benchmark findings widely,
- involve a broad cross-functional team of employees,
- translate the findings to a few core principles,
- work down from principles to strategies to action plans.

Benchmarking is about improving processes. Each process has a process "owner," and process owners and other stakeholders need to have a voice in the changes recommended. Before developing strategies, it is important to communicate with all who might be involved in the change.

Step 6: Improve

The key implementation strategy is to choose solutions to benchmark findings that also contain an element of continuous improvement. Another implementation strategy is to move the benchmarking out from specialized work groups to include all employees and all processes that may need it. Finally, there should be an improvement to the benchmarking process itself -- to establish "best practices" in benchmarking.

To accomplish the goal of bringing benchmarking activities to all critical processes of the organization means that all employees may eventually need benchmark training. Process owners are key people to train in benchmarking principles so that they can also own the benchmarking process. Once they feel ownership and control, benchmarking becomes another quality management tool.

The final step in any benchmarking activity is to complete the Deming Cycle of continuous improvement; that is, to plan for the next benchmarking project. Lessons learned in the benchmarking activity become the source for continuous improvement of the benchmarking process. These lessons should be documented and used as the basis for the new planning cycle.

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Communication in the International Marketing Mix

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Abstract

Each firm is functioning in the unique operative microenvironment, has unique competencies and applies the unique strategy. Therefore the generalisation of conditions for the communication mix is highly challenging. The international communication mix can be tailored to individual market conditions. Standardisation of the international publicity brings about, above all, lower costs and a shorter period for its preparation and implementation.

The international communication mix (Table 1) must be formulated in agreement with internal as well as external strategic objectives of the firm. The existence of a wide range of instruments and communication techniques calls for the firm's critical decisions about their significant and effective application in implementing selected marketing strategies. Since each firm is known to act in the unique operative microenvironment, to have unique competencies, and to apply unique strategies, the recommended communication mix cannot be generalised easily. The only orientation element, even though very simplified, can be the distinction between communication pull-oriented strategies of the manufacturers of mass-consumption goods and communication push-oriented strategies of the manufacturers of industrial products (Fig. 1).

The international communication mix can be, more or less, adjusted according to individual market conditions. The priority of the standardised international promotion lies especially in lower costs and a shorter period for its preparation and implementation. Personalization and the mix adaptation to individual international markets meet, on the contrary, requirements of the cultural diversification which is very often of the language character (impossibility of translating and applying simple advertising texts), and also requirements of some media to gain an access to local markets. The cultural aspect based on national customs and on the educational level of potential consumers shows itself also in the approaches to personal selling, to the forms of social relations, and to advertising. A choice of the different means of communication and of different symbols (a man or a woman, colours, etc.) and a change in the advertising situations are only some examples to demonstrate consequences of the adaptation of advertising to local conditions.

An important aspect of the international adaptation of the communication mix are also legal directions which regulate an advertising in the particular country and are very different in individual markets. There are many countries in which the comparative advertising is inadmissible due to the competition, use of superlatives and foreign expressions, misuse of children as advertising models, application of pornography, and sex-based advertising situations.

The up-to-date international-communication form is *direct marketing* comprising a variety of other forms (mailing, telemarketing, Internet). The direct marketing is a communication instrument allowing selectivity and capillarity of the information transfer, personalization of promotional undertakings and their interactivity in the real time. It belongs to the most effective forms of communication, with the readily measurable effects of individual undertakings (Fig. 2).

It is reasonable to assume that in the international marketing just this form of communication will be more consistently applied, namely:

- due to accessibility and collective employment of the respective media at an international level (telephone, computer networks),
- in connection with a growing market diversification and necessity for an individual communication with consumers,
- in identifying new market segments (database marketing), because of the purchase comfort (direct supply of products also in geographically heavy-accessible regions, etc.).

In the international communication of firms an extraordinary attention is being paid to *branding.* The brand of each firm is more and more closely linked up to the firm's mission and culture and to the publicised consumers' life style. The market globalisation gives rise to an accelerated globalisation of the firm's brands and symbols, the brand image of the firm representing a large assortment of its products available in international markets. Consumers will gradually recognise the values symbolised by the firm's brand and will transfer their attitudes into decisions on the purchase of individual products. The international firm's brand is very important in the marketing strategy. In a lot of firms it will develop from the communication mix element into the commercial product which can be sold in the market or granted under licences, and which has its own communication strategies, distribution, etc. Thus the international credit of the firm's brand will become an international commercial article.

The promotion of products implemented by means of the firm's uniform brand leads to the reduction of marketing costs and, at the international level, to the more facilitated communication in international markets (on the assumption that it will be internationally accepted, recognised and associated with global cultural values).

Table 1 COMMUNICATION MIX

Publicity	**Sales promotion**	**Public relations**	**Personal selling**	**Other forms**
Classical paid forms of the impersonal presentation of goods and services	Short-term stimuli for encouraging the purchase	Social activities directed at preservation, improvement or protection of the firm′s image or brand	Oral presentation in the conversation with potential customers to realise selling	Non-traditional forms of communication
Advertising, press, broadcasting, TV, external packaging, mailing, catalogues, posters, leaflets, advertising, boards, symbols, emblems, films	Fairs, exhibitions, presentations, samples, coupons, reductions, presents	Articles in the press, seminars, sponsoring, publications, social contacts, hobbies, clubs	Sales negotiation, fairs, stimulating programmes	Direct marketing, telemarketing, networking, internet, advertising

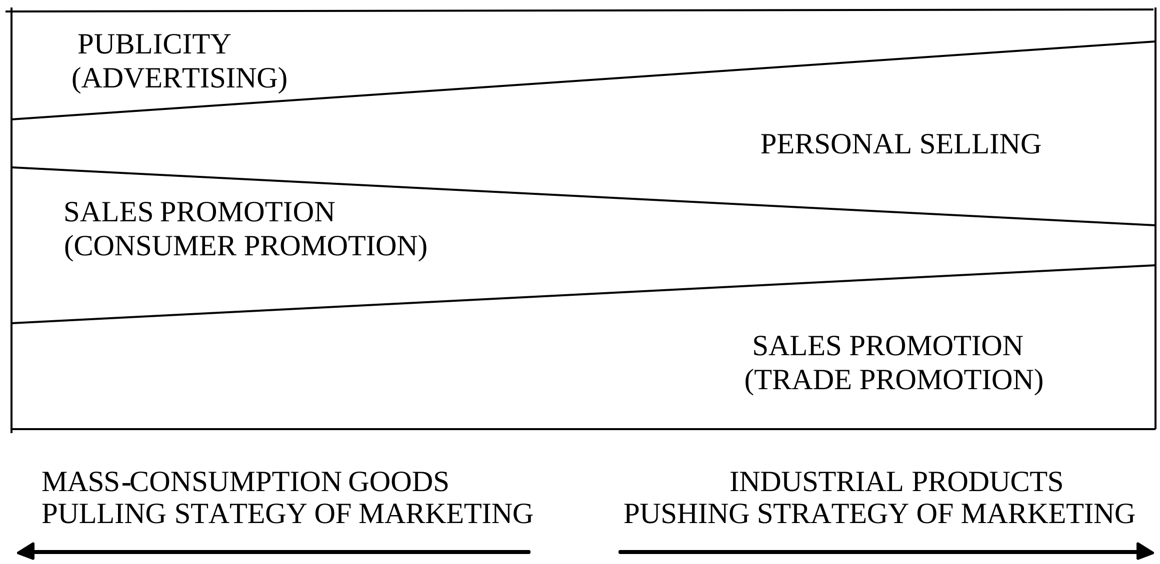

Fig. 1
RELATIVE SIGNIFICANCE OF CLASSICAL MARKETING COMMUNICATION INSTRUMENTS

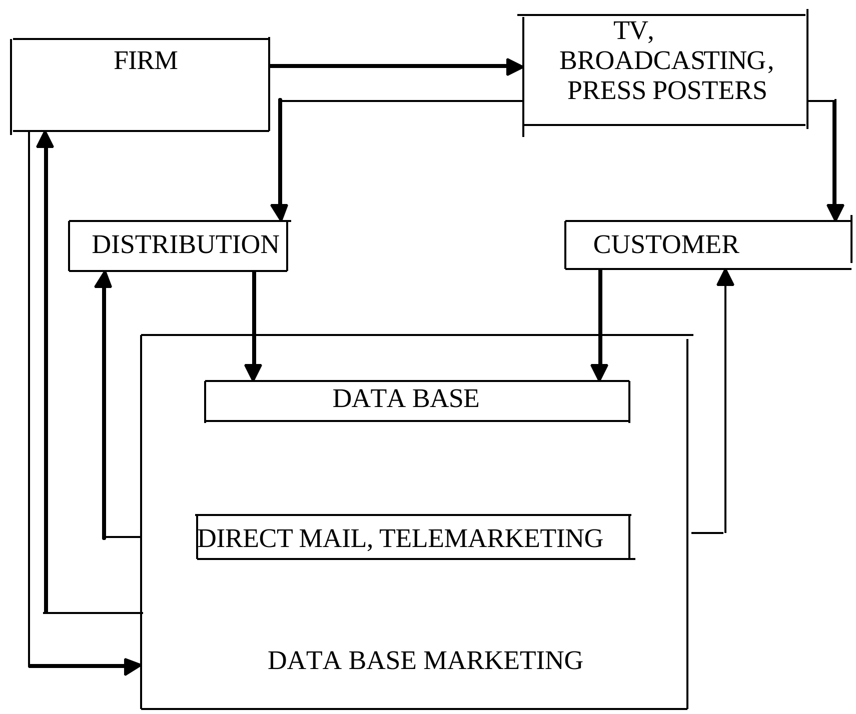

Fig. 2
MECHANISM FOR THE IDENTIFICATION OF POTENTIAL SEGMENTS IN THE DIRECT MARKETING

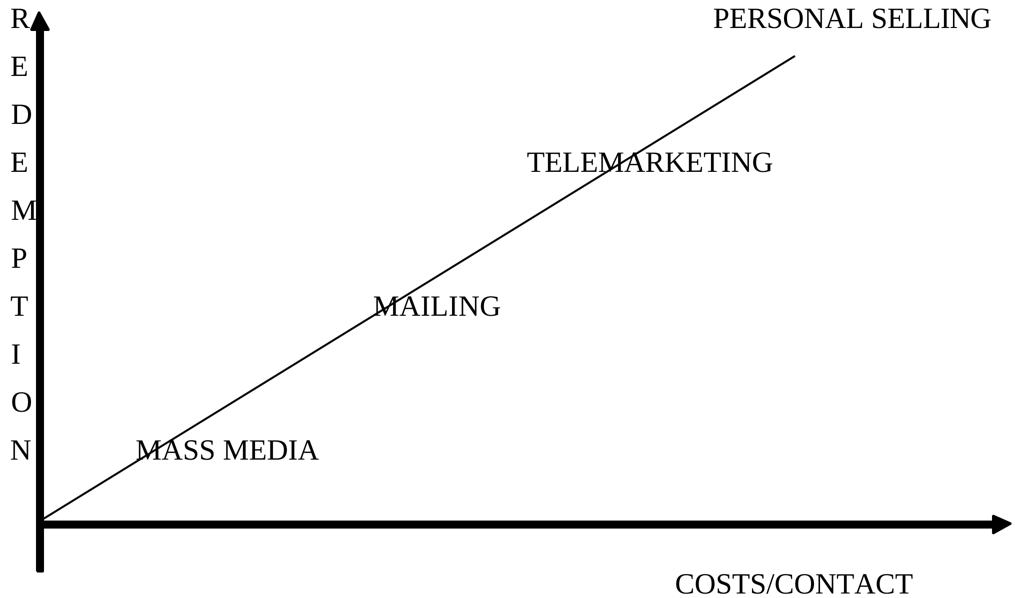

Fig. 3
COSTS AND REDEMPTION OF INDIVIDUAL FORMS OF THE MARKETING COMMUNICATION

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Customer Satisfaction from the point of the Modern Marketing Philosophy (Total Customer Satisfaction)

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Abstract

The paper deals with the question of the application of the modern marketing philosophy – Total Customer Satisfaction. The knowledge is based upon the results of the theoretical analysis and pre-research performed within the framework of the partial tasks of the Institutional research of the strategic management in the Czech companies, which is focused on the role of the company culture and organization in connection to the strategic management. The essence of the article is the characterization of the customer satisfaction from the point of modern marketing philosophy.

People involved both in theory and practice constantly seek the universal methods upon which could be based the competitive advantage of companies in today dynamic environment. The fundaments of this seeking resembles seeking for Perpetum mobile. We all know that in social sciences it is not always easy to find any universal model, which would operate irrespective of time and environment, in which the companies operate. Nevertheless, we still try to find such model in spite of the price that it would work only for certain period of time or for certain field, environment etc. Last time comes into the foreground of many practitioners – but also theoretical and research people interested in management marketing – good-old (new) way, the way of orientation to customer. Why just the customer and his/her satisfaction should be that universal instruction? In this contribution we will try to find and explain certain features of modern marketing philosophy which we can see on the basis of analysis of various theoretical opinions and practical experience of our authors and authors from abroad.

Customer is the most important part of all endeavor of the company, all activities of the company are conditioned by the fact whether the company has customers who are willing and able to buy the results of the endeavor of the company. Already many years ago Peter Drucker found-out that the main task of the company is „forming of customers". At existing competitive environment is harder and harder to form the customers, to acquire them and to keep them. That's why are being searched methods how to be in this field as effective as possible. As notes Piercy [1995], "One of the most frequented and certainly one of the most up-to-date pressures on management in all types of companies is to focus on customer needs – to be led by customers, to be oriented to market, to take care of customers etc." However, too many companies are sure that the care for customers is the task of only marketing or sales departments. However, how noted Drucker [1954]: „Marketing is so basic that cannot be considered a separate function. It is whole business seen from the point of view of its final results, from the customer ´s point of view." This definition calls our attention to the fact that the basic mistake is when we separate marketing from other activities in the company, when we understand is as certain department of the company. Substantial is that marketing is the philosophy of the approach to market– method of thinking, the objective of which is by the means of integration and co-ordination of various marketing tools to find-out, to call and to satisfy the customer needs at target markets, which are the moving powers of all activities of the company with the tasks of long-period success in the form of the maximization of the profit.

Problems, which we can today identify, come out from the antagonism of essential fundaments of the marketing philosophy and its application. There exist views that there is a discrepancy between theoretical layout of marketing and its practical applications. Carson and Gilmore [1998] notify of the fact that also marketing professionals (practitioners and theoreticians) should think over the re-interpretation of the product in relation to the customers. Marketing theories many times do not have anything to say to practitioners and, consequently, they are losing their market, customers. They document it by the announcement of practitioner [Grant, 1996] : "Of one thing I am certain, it will pay the marketing professionals to examine themselves and their role with the same rigour and objectivity that they would apply to any product that has been around more or less unchallenged and unchanged for about forty years.“ Topically expresses to this question Harris [2000], who sees the solution to this problem in defining of organizational barriers. He proves it by the synthesis of existing research regarding the obstacles of market organization via analysis of organizational features, which influence the expansion of market orientation in companies. Current research in this field he sees in four main themes:

1. significant amount of theories are concentrated to analyses of philosophical basis of market orientation, mainly those which became known as “marketing concepts“ [f.e. Kotler and Levy, 1969; McNamra, 1972; Hirschman, 1983; Webster, 1994]
2. part of studies aim at operationalization of market orientation [f.e. Kohli and Jaworski, 1990; Narver and Slater, 1990; Deng and Dart, 1994; Cadogan and Diamantopoulos, 1995]
3. in relation to continuation of operationalization the existing trend is the study of relations between market orientation and effectiveness in various national contexts [f.e. Pitt et al., 1996; Selnes et al., 1996) and different environmental conditions (f. e. Slater and Narver, 1994; Greenley, 1995]
4. coming research see mainly in aiming at identification of potential barriers of development of market orientation [we can seek in Felton, 1959;, Lear, 1963;, Messikkomer, 1987; Jaworski and Kohli, 1993; Harris, 1996; Harris, 1998]

In spite of the fact that these observations are very suggestive, the stage of considerations of our marketing theoreticians and practitioners is unfortunately influenced by short period of time for getting of such advanced experience and knowledge. This possibility came into the existence only after the year 1989, when our borders as well as economy were opened to the whole world. By that is influenced the level of the research in this field. Due to this it is necessary to turn the attention – more intensely – to all problems which can help our companies to compete in hard competitive environment. After short experience it is clear that not all theories and experience can be applied - without prejudice - in our environment, but only in experience and performed research it is possible to find the engaging points.

Our companies by the means of their managers have the similar opinion what is the world trend about the fact that existing marketing theory has its limitations in the practical application, but our observations and first results have notified us that original problem is to be searched mainly in misunderstanding of the basic philosophy of marketing. Companies usually have experience with application of certain out of context torn out methods and marketing tools without the understanding of the basic fundaments of marketing.

The objective of this thesis is not the examination of causes of attitudes to marketing theory, but the effort to sketch the main features of the modern marketing philosophy-TCS.

Theoretical perspective of the marketing philosophy TCS

The basic principle of TCS philosophy is the orientation to customer and satisfaction of his needs. What can we imagine under these words from the point of the company? All marketing activities of the company are controlled from the perspective of customer. This includes the learning about the expectations and needs of the customers (perception of what the customer really wants and needs, not what the management thinks that the customer wants and needs). Production of products and services provided by the company should be formed on the basis of the learning of these expectations and needs with respect to the optimization of the ratio of the consumer value and consumer price. Satisfaction of the customer depends upon his feelings of delight or disappointment resulting from the comparison of consumer effectiveness (consumer advantage) with effectiveness expected (Kotler, 1998). In case there is a difference between expected and percepted value, then the customer is dissatisfied. Many companies endeavor for the high customer satisfaction with the target to win his loyalty to products, services and the company as such. Starting point of TCS philosophy is the declaration that highly satisfied customers are not usually interested in changing of the existing product for more sophisticated product of another company. High level of satisfaction or joy from using of the product establish in the customer the emotional relation to brandname and loyalty to company. Rate of expectation of customer is conditioned by many factors: promises of the company, past experience, personal and situational factors, communication, quality of the offer of competitors, culture, messages between customers etc.

Recognition of the satisfaction of the customer is very complicated, but essentially needed for the implementation of the described philosophy into the company life.

One of the models of customer satisfaction is the model ECSI (Fig.1), which was formed in only last couple of years with the purpose to obtain the useful information about the customer behavior as the completing measurement of European economy. European Customer Satisfaction Index (ECSI) provides macro-economical indicators and statistical results regarding the satisfaction percepted by the customer and measurement of quality of goods and services in series of important industrial fields. The advantage of the use of the model we can see mainly in the fact how the European customer evaluates products and services, which he buys and uses. Moreover, it enables to quantify the value, which the customer attaches to such products and on the basis of it to control the improvement of the quality. Companies can use the data from the index for the evaluation of the customer's loyalty, for identification of the potential barriers of the entering of the market, for predication of ROI and also for delimitation of fields in which the customer's expectation are not being satisfied. As ECSI covers both domestic and imported products, it is also very useful for comparison of quality of European products with the international competitors. What are the limits of ECSI? ECSI is macro indicator enabling to perform comparison between companies, sectors and countries. It is not micro indicator, which would enable the organization the detail position of own indicators enabling the re-definition of the situation and strategy. [3]

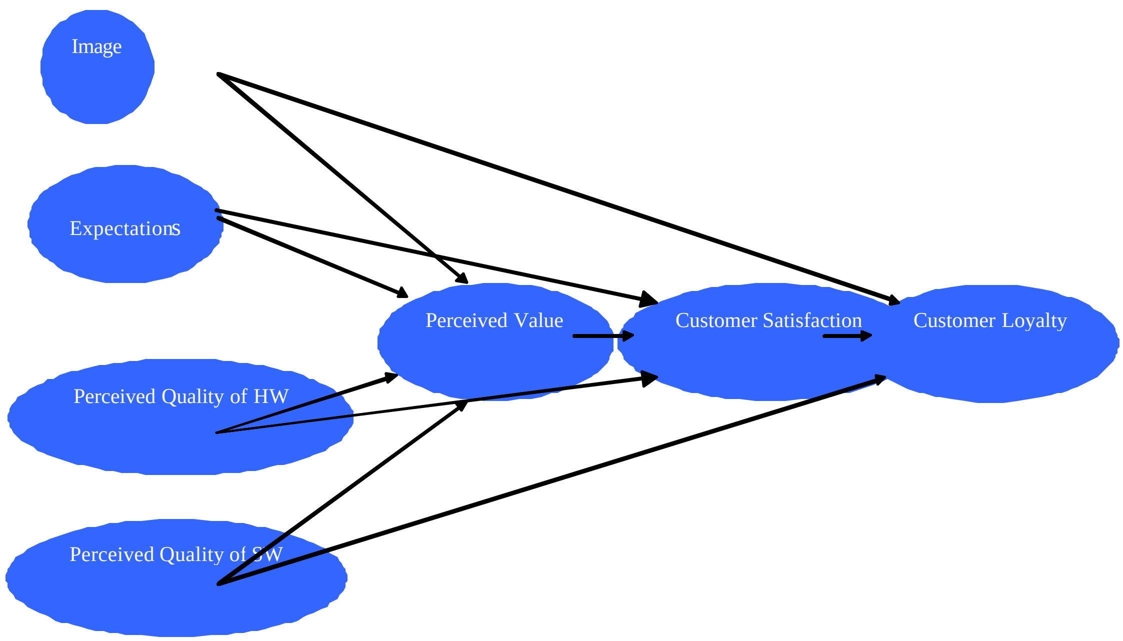

Fig. 1: EUROPEAN CUSTOMER SATISFACTION MODEL -ECSI

Model ECSI is closely connected with the model of American Customer Satisfaction Index (ACSI). Model ACSI is the set of causal adjustments which lead the customer expectations, perceived quality and expected value for the satisfaction of the customer and then to the results in the form of the customer loyalty (measured by price tolerance and customer retention) in spite of customer complaints. (see Fig.2)

For most of the companies is the returning customer the main contributor to the profit of the company. Therefore, the customer who stays with the company is the guarantee of the probability of the repeated purchase, and by that the main indicator of the financial efficiency. In comparison with ECSI is ACSI considered as very strong econometrical model inside the real world of business application. It is the tool, which centers the business activities on the customer as the economic contribution and offers the benefit in the form of unique strategic weapon for achieving of the competitive advantage and forming of shareholder value. [4]

Both models use mutual public results of researchers. ECSI has been established in the way so as to be compatible with ACSI, because Europe is on the common world market and needs to be able to compare its results with other countries.

Within the searching of the global competitive advantage joined together in year 1989 14 leading European corporations and established the European Foundation for Quality Management (EFQM). In year 1993 this organization already had 300 corporations and universities. Today it covers around 550 member organizations. Within the framework of the main objective of the organization to advance the complex management of quality (TQM) was the customer satisfaction positioned into the model of Business Excellence - EFQM model (see.Fig.3), as one of the most important factors leading to the success. Within the framework of this model is the orientation to customer implemented into the framework of micro environment where the customer satisfaction is conditioned by the management of the company, control and development of human resources, strategy and planning in the company, sources and quality of process control. This model notifies us of the complexity of the individual factors, which influence the successful operation of the company.

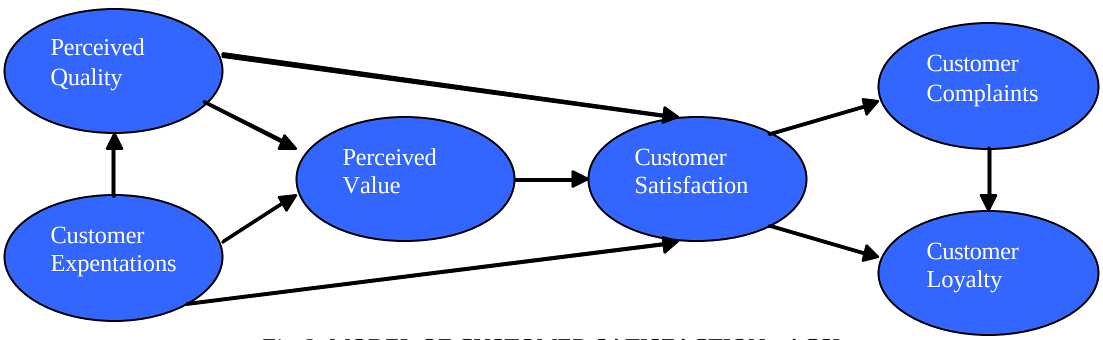

Fig. 2: MODEL OF CUSTOMER SATISFACTION - ACSI

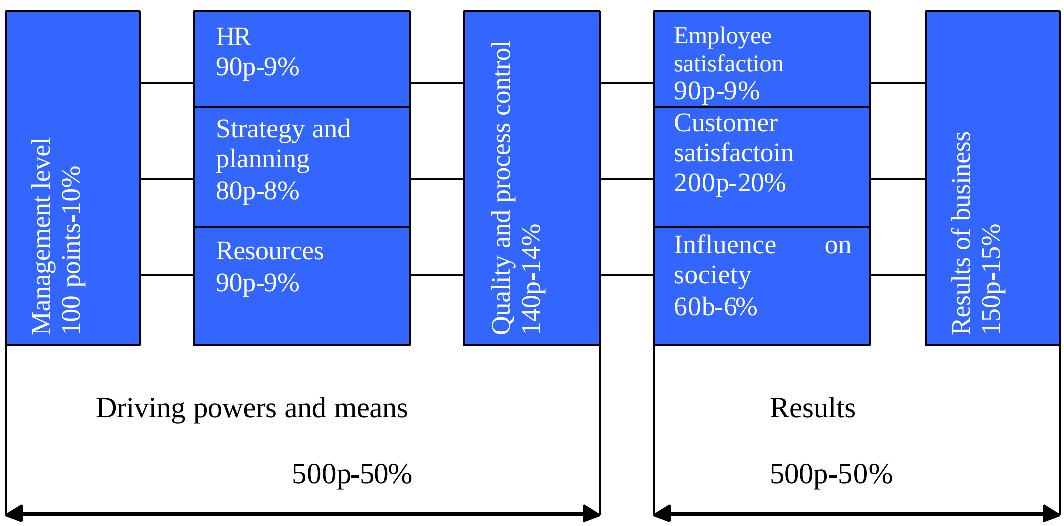

Fig. 3: BUSINESS EXCELLENCE MODEL (EFQM)

Another model, which includes the philosophy of customer perspective of the company, is the model of Balanced Scorecard –BSC (see.Fig.4), which is used as the strategic system of the measurement of the company efficiency, which should help managers during their decision making regarding the reaching of determined targets. Evaluation of the company efficiency can be done – according to this model – on the basis of the set of tools by the means of which are transformed visions and strategies of the company into the system of scale of financial and non-financial efficiency. The foundations of the measurement system are four balanced perspectives –financial, customer, internal company processes and learning and growth.

Customer perspective covers:

- identification of customer and market segments of company businesses
- determination of key customer rates of target customers and segments
- determination and explicit measurement of value advantage

BSC in the customer perspective tries – except of the above mentioned – to put these rates into the relation with profitability. This brings into the knowledge of TCS philosophy new, very important view, satisfied customer does not have to be profitable customer for the company. Companies should endeavor for more than only satisfied customers. Financial rate – profitability of customer helps the companies oriented to customers not to become slaves of own customers. Company should satisfy the needs of the customer, but still it should make profit.[5]

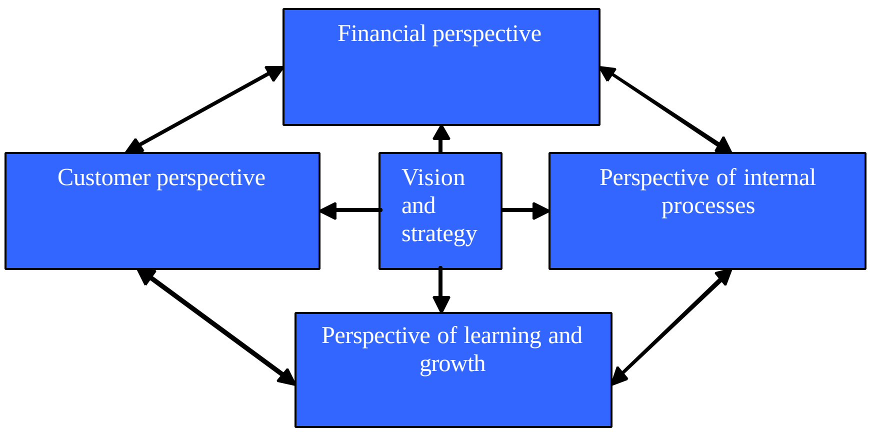

Fig. 4: BALANCED SCORECARD

For the successful implementation of BSC is important to preserve certain basic principles: forming of BSC is a process, which has its rules on one hand, but on the other is unique for each company.

It is formed by 4 basic steps:

- definition of measurement architecture
- reaching of consent regarding the strategic targets
- selection and proposal of rates
- creation of the implementation plan

Which rates are used in the customer perspective? There exist certain basic ratios such as market share, winning of customer, maintaining of customer, profitability of customer and satisfaction of customer, but these can be completed according to actual needs of the company.

From the point of discussed problem we will focus our attention on the measurement of the satisfaction of the customer which is important both for keeping of customers and winning of new ones. Contemporary research shows that the "basic satisfaction" is not sufficient for the loyalty of the customer and by that, of course, his profitability. Customer must be highly satisfied, this is the fundamental starting point. Each company must define the criteria of the measurement of the satisfaction according to their existing situation mainly, as recommend from their experience from the use of the method the authors BSC in three categories. In these categories it concerns mainly the measurement of the value advantage of customer in the target segments. These categories are: characteristics of product/service, relations with customers and image of the company.

BSC includes also in its other perspectives the substance of the marketing philosophy –TCS:

- In the financial area it tries to be more efficient with the aim to maintain the existing value for the customer by the means of three financial fields: growth of turnover and marketing mix of products/services; decreasing of costs/increasing of productivity; the use of sources/investment strategy.
- In the area of internal company processes by the means of characterizing of such processes which are the most important for the reaching of customer and shareholder targets (innovation process, operational process, post-sale service).
- In the area of learning and growth it supports all other perspectives of forming of infrastructure for the fulfilling of the individual targets. Investments in this field were considered as costs, crossings-out of which was the simple solution of forming of short-term income. Here is the stress placed to the long-term importance of this investment. In BSC are in this field tipped three basic fields: abilities of employees; abilities of information system; motivation, delegation of authorities and involvement.

Common features and differences of the individual models:

- Pre-requisite of their formation was the effort to find criteria according to which it would be possible to measure success or effectiveness of the company
- At all models is stressed customer and his satisfaction
- All models are limited by the status of knowledge in the period in which they were created
- First two models (ECSI, ACSI are aimed rather at macroeconomical (comparison to national, European and international level) in spite of the fact that the creators of ACSI declares its use also in the microeconomcial field
- EFQM enables to evaluate the individual companies by the means of set microeconomical criteria which enable to compare the individual companies with the aim to find out the best one, the most successful one
- BSC was formed rather for the improvement of the competitiveness of companies, i.e. for the use in the microeconomical field
- EFQM and BSC are framed into the complex framework of the company processes in harmony with the strategic aims
- ACSI and ECSI concentrates upon the one of the main targets of the market orientation – customer satisfaction without considerations regarding the complexity of all processes active in the company
- EFQM comes out from TQM philosophy where is included the idea of the quality controlled by the customer through the whole organization and control of all employees so as the continuity in the continuous improvement of quality is guaranteed
- BSC we can -from its idea point of view –set to the starting point of TQM, but here is the difference in the stressed strategy and its implementation, at this model is the typical stress on the concreting of the strategic targets into the individual fields of the company activity

Typical problems of Czech companies which we can consider as barriers of the implementation of the marketing philosophy

- Non-existence of strategic progresses and linked methods of control
- Limited application and use of informational system with the content of market information
- Non-using of the market segmentation for the identification of customer groups
- Products coming out from the ideas of companies, their tradition and not from the needs of customers
- Price calculation is unwound from cost conditions of the company and not in relation to market prices
- Companies in the faulty way uses logistics for the control of sale routes
- Used costs for the sale support have low effectiveness for the limited targeting to the final customer and insufficient selection of the communication media

Here it does not matter the definition of all limiting conditions, but – above all – identification of basic problems, which could be identified from the research. [1,2]

Performed research defined existing point of view how the representatives of czech companies see some factors. From these views are in the below summary presented selected and according to the appearance in the response the most important opinions:

- Maximal satisfaction of customer as one of the items of company philosophies which gain foreground in the company management
- Another important item of philosophy of the researched companies is the survival and maximization of profit
- As the significant factor of the company success is considered tradition and approach to customers.
- Out of work requirements to employees the managers stress mainly the loyalty to company and moral qualities
- The flexibility and adaptability of the individuals occupied other places
- As the most significant factors playing role in the loss of customers the companies now consider lower prices of competitors and quality of products as understood by customers.

New trends of influencing of target thinking

The core of the customer satisfaction from the point of TCS philosophy is the need for the understanding to their requirements; however, it is not sufficient for the total result in the form of their satisfaction. It is essential to think within the framework of the following thinking: [9]

1. Attributes of companies aiming at total customer satisfaction

- Orientation of company to high standards
- Strong orientation to the recognition of customer requirements
- Establishing and control of customer expectations
- Designing of new products and services of the company with the emphasize to customer satisfaction
- To concentrate sources for the execution of obligations against the customer irrespective to costs
- Each dimension of the company is structured from the point of the customer
- Measurement, measurement, measurement of all activities leading to the customer satisfaction

Companies in the transitional economies are aware of the importance of the orientation to customers and satisfaction of their needs. Nevertheless, the significant difference is the considerable discrepancy in what the companies declare in their strategies and approaches against the consecutive real application of individual principles of marketing philosophy in the everyday life.

The latest knowledge shows that services accompanying the product in significant way decide about the customer satisfaction with the use of such product. Decisive role of services within the use of the product significantly decide about the future decision making during the buying of the new product with the new technical level substituting the existing product. Therefore, the care to customer in the time of the using of the product is very important so as he could still feel the presence of the producer and his insistent willingness to help him immediately with the use of all advantages of the used product.

During this activity leading to the customer satisfaction it is necessary to be aware of the fact that customers are more and more demanding and more and more educated and that they differentiate their requirements. This differentiation is still being increased due to the situation that in the market operate more and more companies among which can the customers divide their customs; hence, these companies must search for their singularity.

Just the offer of services guaranteeing the maximization of the use of the products can be one of the factors which can hold the customer's favor together with the continuous effort of the company to offer these services by the means of suitable reminding of them.

So as these efforts are aimed purposefully, in marketing plans we have to come out from extension of existing approaches to customers by the means of marketing mix using the combination of four P for further four items, which are:

- Segmentation of groups of customers so as to find out their needs
- Determination of the rate of the use which to these customers bring purchased products
- Satisfaction to the company behavior and services offered hand in hand with the product
- Consistent care for the customer in the whole period of the use of the product

2. Satisfaction of owners, management and employees

Satisfaction of individual groups is of different feature; nevertheless, we can say that in case the interests of these groups are in mutual harmony, the company development will be without conflicts and all groups would have the maximal interest in the prosperity.

Satisfaction of owners come out from their revenues derived from business results of the company. It is the share of the risk of investment of means into the development or establishment of the company and then expectation that revenues from this deposit would exceed the revenues reached from deposits of money in the bank institutions.

In case these ideas of owners are fulfilled, it is their concern not to intervene into the operation and run of companies and to let the management to control the company. From that can be derived the interest of management in the prosperity of the company and owners – shareholders would not intervene in the run of the company. In such case they can freely and peacefully perform their management activities.

Fundament of their consequent loyalty to company and efforts for the long-term development is also their satisfaction with the level of the reward, which for such executed work they get. There is essential the constant harmony of rewards and condition of the growth, which then stimulate the management for the development of the company.

Different is the position of employees who - in case they are not introduced and with applicable tools interested in the development of the company – will be only passive performers of orders and they are not interested in the improvement and development of the company. It is interest of both parties participating in the company management to stimulate the employees in the way so as they would feel the identification with the company and search for the new methods of their work focusing on the development of the company.

3. Processes developing the basic marketing approach to customers, which are suitable for the further development of the company

These are mainly:

- focusing on values felt by customer
- ability of reaction to changing requirements of customers
- reliable and fast control of flow of information into the company and inside the company
- reliable and defect-free deliveries
- change in the control of company processes
- behavior of employees in relation to company
- control of production according to orders
- forming of long term relations with suppliers and customers
- development of changes in the area of purchasing and sales
- virtual control of production and deliveries

Individual above described points are the basis for the concrete processes of control in the further development of companies and they will play the decisive role in their market application. It is also important to remind of the fact that non-acceptance of these tendencies can for the individual companies mean the important change of their market position.

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Direct Marketing as an Integral Part of Marketing Communication – Some Observations from the Slovak Republic

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Abstract

This paper considers the role of marketing communications and direct marketing in an increasingly global economy. Direct marketing has also its own position in the frame of marketing communication as a specific approach of a company to customers, based on creation of long-term relationship. It focuses on the emergence of the concept of integrated marketing communications, which involves the aim of achieving a greater synergy. It discusses the nature of marketing communications and direct marketing Direct Response Advertising, Database Marketing, Internet Direct Marketing and Direct Marketing Ethics. A discussion of Direct Marketing in Slovakia will then follow. The paper then describes the role of direct marketing in the Slovak Republic. Some comments will then be made about the future of Direct Marketing in general and in Slovakia in particular. It concludes by noting that while there has been an increase in the uptake of Direct Marketing in the Slovak Republic, further growth will depend largely on the state of the economy.

Introduction

In an increasingly global economy, the success of any organization will very much depend on understanding the needs of customers. Organizations need to be in touch with customers and to find the best way of doing this. Production has moved away from standard goods to individualized goods for individual customers. The demand is for companies to produce goods and services of high quality. There is, in addition, very little price differentiation amongst modern day goods and services. Consequently organizations need to be able to differentiate their goods and services on issues other than price and quality. An emerging economy, such as the Slovak Republic, faces considerable competition from the ever-growing European Union. Consequently means by which it can defend itself from the competition and facilitate growth must be welcomed. Marketing communications and its sub-set Direct Marketing has an important role to play in providing this advantage.

This paper will consider the nature of Direct Marketing and highlight its use in the global economy. It will then go on to discuss developments of certain aspects of Direct Marketing, namely Direct Response Advertising, Database Marketing, Internet Direct Marketing and Direct Marketing Ethics. A discussion of Direct Marketing in Slovakia will then follow. Some comments will then be made about the future of Direct Marketing in general and in Slovakia in particular.

Direct Marketing

Marketing communications consists of Advertising; Personal Selling; Public Relations; Direct Marketing (DM) and Sales Promotion. Marketing communications is about more than persuasion and selling. It also transmits messages about brands and the shared cultures of the consumers. Knowledge about shared cultures allows consumers to give tacit approval to other consumers about their purchase decisions (Patterson 1998). Integrated Marketing Communications ensures that each part of the communications mix is not utilised in isolation. Such integration might however mean that one agency could be in control of all an organisation's marketing communications. This may not be popular with clients who fear putting 'all their eggs in one basket'. Nevertheless with good relationships and trust this is still a possibility (Eagle and Kitchen 1999).

Contemporary DM is an important contribution to achieving marketing communication objectives and it is used across a wide range of consumer and organisational markets. Kotler (1997, p. 718) considers DM as “the total of activities by which products and services are offered to market segments in one or more media for informational purposes or to solicit direct response from a present or prospective customer or contributor by mail, telephone or other access”. The US Direct Marketing Association has defined DM as “an interactive system of marketing which uses one or more advertising media to effect a measurable response and/or transaction at any location” (Stone 1997, p. 4). The response can have the form of a direct order, an enquiry or a visit to a store or business.

Definitions of DM have common features: the stress on communication effects; the main objective is to achieve direct relationships with members of target groups and the interactive communication between the initiator of the DM and target group, which provides a measurable response. DM should be considered as a specific approach of a company to customers, based on the creation of long-term relationships (Brassington and Pettitt 1997). McCorkell (1997) states, there are four building blocks in DM; Targeting - to find out who will be interested; Interaction – information on how the consumer last responded to an offer; Control – was the interaction worthwhile and Continuity – understanding how to build relationships with customers. The main issue for any organization with regard to DM seems to be ensuring that the most is made of the information gathered. The approach of DM to customers differs from mass marketing. It allows us to use large volumes of customer data to predict their future behaviour and estimate their lifetime value to a particular business. Other advantages of DM are that it allows stealth marketing and the opportunity to create a stable client base as a result of engendering positive perceptions of goods and services.

DM in its very nature is tailor made marketing –“Of course you can’t devise a unique strategy for every customer or prospective customer. But neither does a tailor design a suit for each customer. The tailor merely ensures the basic design is adapted to match the shape, size and taste of the customer. The tailor’s efforts are perfectly focused on the individual customer” (McCorkell 1998, p. 20). DM can also be used in building brand awareness (Gardiner and Quinton 1998). They present a case study, which created brand awareness of a product amongst local government officers. Methods used were well laid out letters and newsletters, word of mouth referrals and seminars to discuss the firm’s products. They also suggest that DM is used to track local government officer’s careers and market appropriate offers to them according to their positions.

The reasons for the increase in DM are (Brassington and Pettitt 1997): changes in demographics and lifestyles; increased customer confidence; increasing competition; media fragmentation; increasing media and sales costs; new distribution channels; increasing computer power and lower costs and new communication technologies (for example call centres).

A survey in New Zealand showed however, that firms there do not practice DM on a large scale and that it tended to be dominated by the use of direct mail (Brooksbank et al 2000). In China there appears to be some DM in the form of direct selling. Luk et al (1999) suggest that direct selling and the relationships thereon built, taps into an important Chinese cultural aspect. In the US research by Korgaonkar et al (2000) has shown that DM can be used to segment the Hispanic market to take account of varying levels of acculturation.

Developments in Direct Marketing

There have been a number of developments in DM. Four are discussed here – direct response advertising, database marketing, the use of the Internet and DM ethics.

Direct Response Advertising

There has been an increase in the use of direct response advertising. This is where customers are asked during the advertisement to respond to a number, address or send in a coupon. Patterson (1998) notes a growth in direct response television advertising. With the burgeoning number of television channels, many of them with specialised appeal, it is possible to target more finely. He sees this as the fusion of mass appeal with individual treatment. Thus overcoming a concern he has with DM – that it does not allow the creation of a shared culture. Another advantage of direct response television advertising suggested by Patterson is that it allows a dialogue between consumer and advertiser, without accusations of invasion of privacy. Radio advertising and direct marketing advertising are also on the increase (Verhoef et al 1998). They suggest that the advantages of radio advertising are that it is relatively cheap, geographically and interest selective, flexible and that it is harder to change radio stations. Direct response advertising on radio can be used to: build customer databases, recruit people, sell goods, services and ideas, generate leads and supply information.

Database Marketing

One of the most important issues for a company using DM strategies is the eventual creation of a database of potential and existing customers. As DM becomes more and more reliant on information held on computer, it is now often known as database marketing. Databases are considered one of the most powerful tools of marketing in the last decade. “Marketers must learn to use their customer data bases not only as a tactical tool, but also as an information source that drives strategy throughout their organisation” (Harvey 1998 p. 11). The value of the right information at the right time is priceless.

Jackson and Wang (1996) suggest what data base marketing allows: the ability to target only those people who are likely to be interested; to create long term relationships with customers; to offer varied messages to different customers; an advantage in distributing products and increased knowledge about customers. Patterson (1998) adds: the ability to individualise/personalise messages; the cost effectiveness of direct communications and the measurability of the outcomes of DM.

Internet Direct Marketing

The use of DM has shifted to a new level, it is now moving to the most progressive medium – the Internet. “Direct marketing has evolved over the years, from word of mouth to pen and paper to radio and television. Now DM has reached the next in its continuing evolution: the Web.” (Hunt 1998 p. 8). The Internet offers to direct marketers a lot of advantages. The World Wide Web is a new medium, which can be characterised by relatively low set-up costs, interactivity (customers can get involved with designing the product, for example jeans or bicycles), time and border independence. Simeon (1999) notes that whilst the Web has been viewed mainly in the past for basic communication and marketing, it is now being used for more strategic purposes. However the extra richness of the Web sites is making it more difficult to evaluate its strategic use. A sentiment echoed by Roxas et al (2000) who warn that companies who have a presence on the web must make sure that they are accessible and that the content is firmly connected to the organization’s marketing strategy. Simeon (1999) goes on to suggest a model for evaluating Web strategies – one referred to as the AIPD model (Attracting, Informing, Positioning and Delivery).

Lynn et al (1999) note that the traditional advantage large companies have had over small companies in communicating with customers and potential customers is being eroded. This is because the cost of technology has been dramatically reduced. For example web sites and e-mail addresses provide ways of not only communicating with customers, but also provide an inexpensive means of market research. Small firms will also be able to become more international in outlook. There is the added possibility to look after a DM campaign in real time and in this way increase revenues and cut costs. Today’s direct marketers are the primary users of e-commerce, especially in the USA. The US Direct Marketing Association has reported that 84% of direct marketers responding to its survey use web sites for marketing and information, while 55% use them for lead generation and 49% for sales. Just about 17% of respondents noted they are profitable (Harsh 1998)

Direct Marketing Ethics

Appropriate DM activities and exploitation of particular techniques of DM should always bring profit and satisfaction to the company. On the other hand the vast usage of DM could negatively influence consumer attitudes. Most people living in developed countries come across DM daily – sometimes they become very annoyed. In the US the Direct Marketing Association is concerned about the possibility of outlawing unsolicited commercial e-mail. This because it wishes to preserve e-mail as a marketing tool (Wientzen 2000). In Australia the Australian Direct Marketing Association has released its code of practice, which is to be exercised in addition to any legal requirements (Sweeney 2000).

Direct Marketing in Slovakia

It is noticeable, that the role of direct marketing in Slovakia is constantly evolving and enlarging. The Association of Direct Marketing in Slovakia (ADiMa) published the economic results of its members from the year 2000 and it recorded (compared to the year 1999) a 30% increase in DM. This could be considered as a signal that DM in Slovakia is growing and it has potential to grow further. According to a telemarketing survey organised by DMMS Bratislava for ADiMa in the period of March 8 - March 23, 2001 the positive approach of Slovak companies to DM in practice is remarkable. 37% of companies involved to this survey are using DM in marketing communication. 54% of these companies are using some of direct marketing tools regularly and 30% often. In the area of direct marketing tools there is an increase in the use of direct mail and direct response advertising. Direct mail takes the form of a personal letter, information material or an offer distributed through the postal service to the recipient's home or business address to promote a product or service. The direct response advertising is of the type where customers are asked during the advertisement to respond to a number, address or send in a coupon. 75% of companies in DM prefer direct mail and 40% direct response advertising in various media. Many companies realised that the future of marketing communications is bellow the line. They are retreating from mass marketing and replacing it by customised marketing (for example, direct marketing and Customer Relationship Management). That said, DM is not yet to the standard found in highly developed countries such as the US.

Aspects of the Slovakian situation, which are favourable to DM, are the technology boom of the past decade and the fact that consumer lives are coming under a great deal of competitive pressure. For a small economy such as Slovakia’s, DM could be a defensive weapon against outside competition. However in Slovakia most companies rely on advertising and there is not much of a move towards DM. One DM technique that is well known in Slovakia is mail order. It allows the purchase of product seen in advertisement or catalogues. Direct response advertising is also used. Telemarketing, fax mail, and e marketing are just starting to be used, but there are legal constraints on doing so. For instance, according to the Act no. 147 on advertising of April 5, 2001 it is prohibited to run advertising by automated computer telephony, fax and e-mail unless recipient approves it in advance. Direct addressed advertising cannot be spread when addressee refuses delivery in advance. Lots of DM techniques are, in fact, legally prohibited, but used in practice.

Legal issues are not the only reasons for a slow uptake of DM in Slovakia; there are also other reasons. For example: customers may not be able to accept the new techniques (this is less likely amongst younger Slovakians) and companies using DM techniques are mainly foreign companies or those with foreign financial backing. Another aspect is evolving business environment. Every day number of entrepreneurs, especially small sized is starting business and another number is closing it in the same time. Here is also a lot of non-active companies, approximately 25%. Therefore the stress is on ongoing creation of databases and their updating. DM cannot exist without adequate database.

The effective marketing campaign must be carefully targeted and managed. As noted above, the objectives of DM must be integrated with the wider marketing communications objectives. Campaign objectives should be measurable and target groups clearly defined. DM may be organised internally or with the help of a specialised outside DM agency. In Slovakia there are DM agencies able to provide a full service in this field. These agencies established the Direct Marketing Association (ADiMA) in 1997. The key aim of the ADiMA is to support the growth and use of DM and to support positive attitudes toward DM amongst the public. This latter activity has arisen because some businesses in Slovakia utilising DM do not care about privacy and guidelines. There are poor legal requirements to ensure compliance. In Slovakia ethical business behaviour has still not been intensively developed or maintained. These organisations must be taught how to respect individual customer privacy and to be ethically responsible. The ADiMA has also constituted the Code of Ethical Principles. Consumers may also indicate via the ADiMA that they do not wish to receive material.

Conclusions

DM is particularly powerful when it is applied to integrate marketing programmes that incorporate multiple sales channels and a wide range of marketing communications. DM has reached a new level of its development – the level of interactive marketing. In Slovakia both individual and business customers have observed a large number of companies involved in DM. Whether organisations take advantage of the rapidly expanding e-commerce, emerging new media and the possibility of global one-to-one marketing stimulus will be influenced by the economy of the country. Stagnation of buying power, a low growth rate and high unemployment will not encourage the use of DM[1]. Nor will a lack of transparency surrounding DM in Slovakia. The establishment of the Direct Marketing Association is a positive step with regard to DM ethics. DM could be used very effectively in Slovakia but it is difficult to predict its future use. It is up to marketers to evaluate the advantages and the disadvantages of DM and implement them into business.

[1] Unemployment in the Slovak Republic is higher than average, it is standing at about 19%. The average income is about 12000 SKK per month and a lot of professionals and state officials are poorly compensated. The Slovak inflation figure in present days is at 8 % and the official figure for economic growth is 2,5%.

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Export Performance of Foreign and Local Manufacturing Firms in Turkey

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Abstract

This study examines 500 largest industrial firms in Turkey for a five year (1995-1999) period to determine whether ownership and age characteristics of a firm significantly influence its propensity to export. By using export/total sales ratio as an indicator of export propensity, it is found that while age variable significantly affects firm's export propensity ownership does not. This is an implication of the fact that regardless of their nationality firms established during the import substitution development period are less likely to export compare to those established during the export-led development period.

Introduction

As the role of exporting in a nation's economy becomes increasingly important, interest in the export behaviour of firms has grown. According to previous researchers [1,2], this increased attention in the literature may be partially explained by the growth in the number of countries experiencing actual or anticipated balance of payment deficits. It is generally accepted that an increase in the exports of a country has a positive effect on the growth of a country's economy, as well as the prosperity of the individual firms involved [2]. Moreover, since the presence of foreign capital activates host countries' potential resources and promotes the export of manufactured goods it is plausible to suggest that foreign investment has favourable effects on employment generation [3,4.]From this point of view, it could be argued that export development or internationalisation may be a viable growth alternative for many countries however, for Turkey, with relatively low per capita income hence lower demand, unstable national currency, continuos trade deficit, and higher unemployment rate, it is more of an imperative than an alternative.

The increased interest in exporting has been driven by changes in the world economy and is characterised by the spread of new technology around the world, reducing trade barriers, the formulation of multiple country trade agreements (e.g., the EU, NAFTA, etc.), financial market deregulation, and the convergence of consumer tastes [5]. Drucker [6] contends that from now on any country and any business, especially a large one that wants to do well economically will have to accept that it is the world economy that leads and that domestic economic policies will succeed only if they strengthen, or at least not impair, the country's international competitive position.

One way of strengthening the country's (particularly developing ones) international competitive position is attracting foreign investment. Developing countries' expectations from foreign investment range from technology and know-how transfer to employment creation and exporting. It is the aim of this study to evaluate the export performance of foreign and local firms operating in Turkish manufacturing sector. Additionally, in order to assess the influence of import substitution and export-led development policies over firms' export performance a variable is designed and tested.

The remaining of the study is as follows. First, a brief literature review is carried out to evaluate the factors affecting firms export performance. Second, the hypothesis and rationale of the study are devised. Third, the data and methodological issues are introduced. Then, the results are discussed, and finally, conclusions are made.

A brief literature review

Export Activities of Foreign Firms

Studies on export performance have a long tradition in international business literature. Despite the extensive research, consensus about the extent of foreign firms contribution to developing countries export or trade balance has not been fully established [4, 7,8]. It has often been implied that one of the major contributions of foreign firms to the local economies is their export promoting activities that allows a given country (particularly those of developing ones) to get integrated in and to compete within international arena [9]. Thus, it is generally believed that the presence of foreign firms has significant favourable effects on the export of manufactured goods of the host nations. This is often attributed to belief that compare to their local rivals, foreign firms are in a better position to choose those industries which are more in line with the comparative advantage of the host country. Moreover, with their comparative advantages in technical and managerial know how, and experience in international marketing, foreign firms in developing countries have a higher export propensity than local firms [4]. Consequently, the presence of foreign firms will promote a more efficient use of resources in the developing host economy and concomitantly increase the output and export of manufactured goods of that economy [10].

Export Performance

There is not a uniformly accepted conceptualisation and operationalisation of export performance [11, 12]. Export performance has been typically measured using a single indicator approach, such as export sales, export profits, and export intensity represent the most frequently used indicators [12, 13]. However, there is increasing evidence that export performance is considered as a multifaceted construct and should not be captured by a single indicator [13,14]. Moreover it is argued that there is no a set of 'prescriptions' for export success since each firm's export performance is dependent on the context in which the firm operates [15].

Factors Influencing Export Performance

A bulk of studies suggests that firm-specific characteristics such as size, industry, skill-mix, technology, management, and products/ services affect its export performance. Apart from these firm-specific advantages, 'ownership' and age of firm also plays an important role in firms export performance [12, 13, 16]. In addition to these firm-specific (internal) factors external environmental factors are also affect firm performance in general and export performance in particular. In international business it is pivotal for management to consider the general environment, with the socio-cultural and the political environment comprising the main dimensions [17]. The socio-cultural environment is composed of foreign countries' specific customs, languages, and religions, whereas the political environment includes economic (e.g., exchange rates) and legal dimensions (e.g., import restrictions) [14].

According to Czinkota and Ursic [18] the most closely scrutinised firm-specific factors that have impact over firm's propensity to export are age and size. Other common variables included in such studies are industry and ownership [16]. In Turkish case we argue that ownership and age of the firms are interrelated hence need to be investigated for a major reason. 1980 is a cornerstone for Turkish economic policy. It resembles transformation from inward-looking (i.e., import-substitution) development policy towards outward-looking (i.e., export-led) one. After this transformation, both export capacity and inward foreign investment stock of the country increased dramatically [19]. Since external environmental factors, particularly that of economic development policy, are important determinants of firms' export propensity [14], it is plausible to assume that firms established before 1980 were mainly motivated to serve for the local market hence are less likely to export compare to those established after 1980. For example, Balasubramanyam et. al. [1, 20] use cross-sectional annual data averaged over the period 1970-85 for a sample of 46 developing countries and find that Foreign Direct Investment is more productive and export prone in countries that have pursued export promotion rather than import-substitution policies.

Hypothesis and Rationale

Our brief literature review indicates that the most cited firms specific variables affecting export performance are ownership, age, size and industry. We dropped the last two variables from the analysis due to the nature of the sample. Since the sample contains the '500 largest industrial firms' all firms are 'large', hence, comparison between small, medium and large firms cannot be made. Industry variable is also dropped from the study again due to the nature of the sample and the data. The sample contains only industrial firms hence service and agriculture sectors are excluded. Moreover, in certain industry sub-sectors due to limited number of firms with opposite ownership a statistical comparison is not possible. Additionally, the aim of this study is evolved around ownership variable i.e., to test if there is significant differences between the export performances of foreign and local firms.

Ownership of Firm: Few studies investigating propensity to export have included a firm ownership variable, and those that do measure ownership in terms of foreign versus domestic [21]. The explanation offered is that foreign-owned firms within the same size categories are more likely to send goods out of the country, perhaps back to company headquarters for distribution or inclusion in other products, due to their firm-specific advantages over local firms [22].

Age of Firm: Czinkota and Ursic [18] report that much research exists illustrating the contribution of firm age to export propensity. Previous studies indicate that younger firms exhibit more interest in foreign markets than older, established firms [23,24]. Conversely, evidence also suggests that older firms are more likely to export than younger firms [25]. Finally, Cooper and Kleinschmidt [26] contend that the age of an exporting firm varies by its strategy. Firms identified by them as “world marketers” were significantly younger than firms guided by other strategies.

From the above discussion it is possible to develop two hypotheses:

H_1: There is significant difference between export performances of foreign and local firms,

$H_{2:}$ Regardless of their ownership there is significant difference between export performances of the firms established up to 1980 and after 1980.

Our data allows us to apply a single indicator as a measurement of export performance i.e., export/total sales ratio.

Data and Methodology

Evidence suggests that 500 Largest Industrial Firms of Turkey are making over 40 per cent of the export of the country. Hence by analysing these firms it is possible to shed light on the general exporting pattern of Turkey. The data used are mainly gathered from Istanbul Chamber of Industry’s annual surveys of “500 Largest Industrial Firms of Turkey”. Other supplementary documents such as annual company reports, Istanbul Stock Exchange’s databases, and various official statistics including Treasury and Foreign Trade Offices’ statistics are also used.

For private Turkish (domestic) firms the conditions for inclusion in the survey were that: (a) the firm must be all-Turkish owned; and (b), at least 90 per cent of it must be privately owned. On the other hand for foreign firms 20 per cent of foreign ownership was regarded enough to be labelled as a ‘foreign firm’ and included in the sample. This is consistent with numerous other studies carried out in this field [27]. Moreover, as Banaji and Hensman [28] put it, ‘management control over corporate activities is not something we can quantify; there is no precise mathematical limit beyond which it declines or increases substantially’ (p.15).

In making our sample two prevalent flaws of previous studies have taken into account. First in many studies comparing export performance of foreign and local firms the comparison is made between ‘exporting’ foreign and local firms and firms with no exporting reports are excluded from the samples for several methodological reasons (see for example [29]). However, when the ‘zero-export’ firms are excluded the remaining sample is representative of only the export sector, not the manufacturing sector as a whole. Hence, all domestic private and foreign firms satisfying above conditions are included in the sample.

It is also important to note that, a distinction between foreign firms must be made between those operating in export processing zones for solely exporting and have no right to sell domestic market (exporter by decree) and those who have freedom to sell both domestic and foreign markets. For the sake of the reliability of the results only the latter group should be included in such studies since the former group needs no explanation at all. Hence, whether foreign firms have greater propensity to export as compared with their local counterparts becomes a meaningful issue. We attempted to make such a distinction and found that all firms amongst the 500 Largest Industrial Firms of Turkey are operating outside of Turkish EPZs.

Number of firms satisfied the conditions to be included in the sample and their export and ownership patterns are displayed in Table 1. Two major conclusions can be drawn from the table. First, although 500 largest firms are composed predominantly of Turkish private firms, number of foreign firms (at least with 20 per cent of foreign ownership) included in this list raised from 78 in 1995 to 107 in 1999. This can be interpreted that foreign firms presence in Turkey is becoming evident second, over 80 per cent of firms included in this list are involved with some degree of export activities.

Table 1: EXPORTING PATTERN OF FIRMS INCLUDED IN THE STUDY

Year	**Domestic** (private)				**Foreign**			
	Exporting (1)	Non-exporting	Total (2)	1/2	Exporting (1)	Non-exporting	Total (2)	1/2
1995	309	38	347	0,89	69	9	78	0,88
1996	295	50	345	0,86	76	19	95	0,80
1997	314	36	350	0,90	81	9	90	0,90
1998	307	37	344	0,89	88	9	97	0,91
1999	301	44	345	0,87	97	10	107	0,91

The breakdown of annual mean employees, sales and export data of the firms are exhibited in Table 2. At first glance, it seems that in terms of number of employees, i.e. size, foreign and local firms are very much akin to each other. On the other hand mean annual sales and export or the two groups of firms seem to differ.

TABLE 2: ANNUAL SALES, EXPORT AND EMPLOYMENT OF THE FIRMS EXAMINED

Year	**Domestic**			**Foreign**		
	Mean. Employees	Mean Sales 1.000.000 TL*.	Mean Export 1.000.000 TL*.	Mean. Employees	Mean Sales 1.000.000* TL.	Mean Export 1.000.000 TL*.
1995	441	2,760,000	2,359	436	4,910,000	1,741
1996	475	5,470,000	15,912	447	11,420,000	12,890
1997	503	13,530,000	103,850	460	27,600,000	62,730
1998	489	22,130,000	84,370	481	43,210,000	85,280
1999	474	33,690,000	61,950	464	58,320,000	41,300

* It should be noted that annual inflation rate in Turkey was over 60 % in the given period hence increases in sales and export are nominal, not real.

The statistical technique to investigate if the ownership and age variables have significant influence over firms' export performance is independent sample t-test.

The Findings

The results of the test indicate that ownership does not play an important role in firms export propensity. As can be seen from Table 3, within the five year period statistically significant difference between domestic and foreign firms did not exist. Hence the hypothesis that there are significant differences between foreign and local firms export performances is not confirmed. This can be attributed to the fact that since all firms included in the study are 'large' the advantages, including higher export propensity stemming from foreign firms' size are discarded. In another word, foreign firms have higher export propensity than local firms only when they enjoy their size advantages.

Second, local firms might have a high capacity of imitation (demonstration effect) to follow managerial and technical practices of their foreign counterparts and reduce the performance gap that, at least theoretically, exists.

TABLE 3: EXPORT PROPENSITY OF THE FIRMS BY OWNERSHIP

Year	Domestic		Foreign		T-test	
	mean	std. dev.	mean	std. dev.	t value	sig.
1995	,25	,232	,29	,239	-,692	,490
1996	,27	,225	,21	,233	1,665	,097
1997	,30	,235	,32	,261	-,350	,727
1998	,31	,252	,27	,274	1,217	,224
1999	,33	,279	,28	,278	1,615	,108

To test the second hypothesis the same statistical technique is applied and the results are displayed in Table 4. The results imply that age is a more affective determinant of export performance than ownership. This is to say that firms established during the import substitution period behave significantly differently from those established during the export-led development period.

Table 4: EXPORT PROPENSITY OF THE FIRMS BY AGE

Year	Up to 1980		After 1980		T-test	
	mean	std. dev.	mean	std. dev.	t value	sig.
1995	,23	,219	,33	,262	-2,338	,021
1996	,25	,218	,35	,258	-2,962	,003
1997	,28	,245	,34	,258	-1,892	,059
1998	,28	,253	,34	,276	-2,029	,043
1999	,27	,265	,37	,291	-3,531	,001

Conclusions

This study contributes to the literature on exporting by testing the influence of firm characteristics on export propensity by using Turkey's 500 Largest Industrial Firms data. Through the formulation and testing of hypotheses, the research expands the knowledge regarding the influence each of ownership and age variables exerts on export propensity. With regard to the goals of this study, ownership variable did not appeared as a significant factor influencing export propensity of the firms operating in Turkish manufacturing sector. On the other hand, age variable is more likely to have significant effect with regards to export performance. This can be interpreted as that regardless of their nationality, firms decision to export (or not export) is influenced by the economic development policy. Firms established during the import substitution policy period are less likely to adjust themselves for international competition compare to those established during the export-led policy period.

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Global Sourcing
Creating Strategic Advantage in the Global Business

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Abstract

Global business creates new global competitive strategies. All successful companies built on their strengths global competitive strategies creating strategic advantages.

Competitive strategy includes not only the marketing of selling process on global markets, but in global business is constantly very important to have effective mechanism to create strategic advantages also in the sphere of product innovation - connected with global sourcing.

Global sourcing presents the strategy in the sphere of creating new products or services for global markets with sustainable competitive advantages and long run profitability.

Global sourcing formulates the effective priorities in business - in the process that combines inputs of raw materials, allocative efficiency of capital, labor and management skills to produce first quality goods and services in order to learn profits on global market.

Global sourcing is also available for all companies and firms in transformational economies as well as in the Slovak Republic.

Globalization brings new important qualitative conditions in the whole sphere of factors of production. Global economy presents a mechanism those allocated factors of production among competing uses. Productive resources include capital, labor and land (natural scare resources).

The first factor of production - capital - is used to produce goods and services. In the era of globalization the productivity of this factor - capital - have to be in full competition with the best international companies. In our transitive economy the high productivity of capital can be guaranteed only trough cooperation with international companies, mainly trough direct capital investments.

Very typical and good example of foreign capital investment in Slovak Republic is the global company - Volkswagen Slovakia. This company presents up to 10% the whole Slovak economy and export capacity with prosperous future.

The productive factor - labor - is also full submitted the global effective terms. The international companies are using intensively this productive factor throughout the world.

For example the international company Fiat reduces in the factory in Poland - based on polish labor market - the wages ten times - in comparison with the wages in Italy.

The low wages in transitive economies - as well as in our economy - is also till now, the very important competitive advantage.

The third productive factor - the land - especially with natural scarce resources - creates in global economy also very important part. It creates very substantially the cost advantages and has very often-decisive contribution for the whole success of the firm's enterprise, because of the global strategic search for the low cost buying the raw material inputs.

Global sourcing is so important in the global economy as presents the following example: The global special Norwegian firm, the first in the branch putting up shipwrecks, ordered - 26 special hooks for excavation the Russian submarine "Kursk" this year- in Czech Republic - mainly for the best quality and the global lowest price.

All this principles have the importance not only for the global companies, but also for medium and small firms - and also for all our firms. The global sourcing is especially important for firms producing goods with 50% and more raw materials in their products.

We can characterize the global sourcing as a corporate strategy aimed at the worldwide utilization of material recourses.

Practically global sourcing in global economy presents the principle of consistently using the lowest cost in input on the field of global supplier's raw materials.

The activities to the new strategy on global sourcing are as the following:

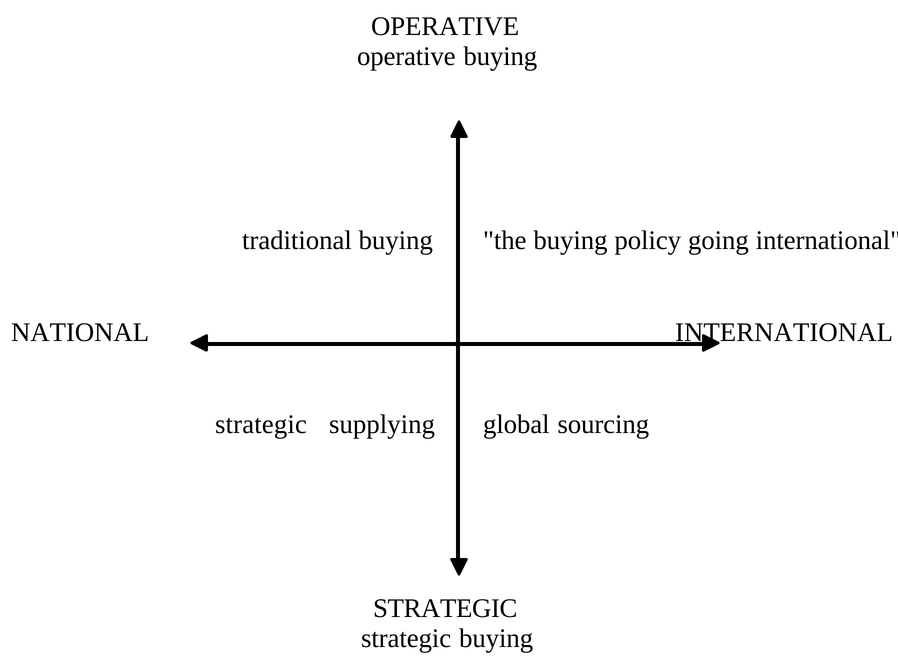

Fig. 1 THE OBTAINING MANAGEMENT OF RAW MATERIAL INCLINING TO GLOBAL SOURCING

The global sourcing strategy's advantages:

1. The differences in cost and prices of raw material inputs:
- Quality and quantity of raw material resources;
- The productivity in mining and adjusting of different raw materials;
- The differences of transport cost;
- The differences in wages and social costs;
- The differences of state politics (subsidies, tariffs, taxes, commissions)

2. Permanent global obtaining raw material at JUST IN TIME (JIT) strategy:
- Permanent quality and quantity raw material global obtaining strategy;
- Stability JIT strategy;

3. Using possibilities import/export relations:
- Import of raw materials initiates export of ours products;
- Import of raw material initiates mutual cooperative relations;
- Helping to create optimal market structure of goods and services;

4. Another factors mutual cooperation's advantages:
- Creation mutual business activities;
- Mutual cooperation in raw material global obtaining strategy, especially among medium and small firms;

- Creating the global sourcing permanent strategy;
- Positive influence on the equilibrium balance of payment in an open global economy.

Very important is global sourcing is the JIT strategy:

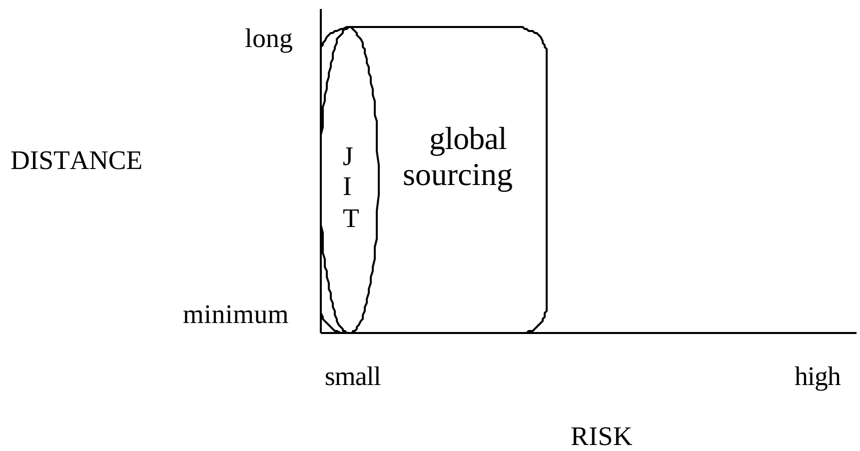

Fig. 2 GLOBAL SOURCING AND JIT STRATEGY

Global sourcing represents very progressive and effective global obtaining raw material input strategy.

Beyond this, we have to pay attention, that wit global sourcing a variety of risks are also connected and numerous tasks must been aware.

By the marketability of the global sourcing an intensive conceptional procedure is prerequisite for success of this strategy.

From the aspect, that global sourcing is mainly used on global markets for the competitive advantages - it is obvious, that global sourcing is very important global obtaining strategy and is also available for all companies and firms in transitive economies, as well as in our republic.

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Image of a Bank in the Mind of an Individual –
Its Contents and Effect on Decision-making

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Abstract

This article presents the initial results of a research carried out within the grant project GACR No. 406/00/0505 entitled 'Corporate image as a reflection in the mind of an individual'. The aim of the first part of the research was to find out what influence do attributes, theoretically defined as attributes of primarily rational character, have on the respondents' tendencies of choosing and recommending the particular banks under investigation. The research has indicated that the tendencies in consumers' behaviour are related to rational attributes only to a limited extent and, as a result, when dealing with banks it is necessary to consider influences of emotional-evaluative character.

The concept of corporate image, currently a relatively frequent term in the discourse of entrepreneurs and managers, has become quite a frequent subject of scholarly research in the field of banking services. The reason for this state of affairs is quite obvious – competitive companies offer products which are more and more similar to each other, the consumer is literally flooded with a great amount of information and such tools of differentiating oneself from competitors as innovation or low prices tend to have only a short-term effect in the field of banking [1]. In their effort to influence both consumers' decision-making and their after-sale behaviour, banks seek to ensure that their image as a reflection in the minds of the public is positive, strong, and with a specific and clear-cut content.

While researchers and practitioners do not have any doubts that the image of a company in the eyes of the public does influence the decision-making of consumers, the issue of what components of the image determine the consumers' behaviour and in what ways has not yet been satisfactorily answered.

Considering that the current definitions mainly emphasize the view of the corporate image as the result of human processes of perception which is determined by the manner of receiving and processing information and "the recipient's perception of corporate identity and his or her own reflection and interpretation of various attributes…" [2] influencing a person's behaviour, then it may be assumed that corporate image is a reflection in the mind of an individual containing components with a different character (with either more rational or more emotional basis) and a different effect on a consumer's behaviour. Moreover, it may be assumed that the criteria of decision-making do not necessarily have to be conscious: although consumers consciously consider certain attributes as important, their behaviour may also be influenced by such other components of the image that are the result of processing externally obtained information about a bank.

The Aims of the Research

The aims of the research were:

- to find out what conscious criteria consumers use when selecting a bank
- to find out what images the individual banks under investigation have
- to find out respondents' conative tendencies and to compare them both with the contents of the banks' images and the consciously stated criteria of selection

Methodology

The research was based on two questionnaires. The items of the first questionnaire contained characteristics concerning the banks' equipment, management and marketing, and the contents and quality of their services. In other words, these were attributes theoretically delimited as attributes of a primarily cognitive character. Out of the 27 characteristics of banks listed in the questionnaire, it was the respondents' task to select 1 to 10 characteristics which they personally consider as particularly important if they were to choose a bank.

The second questionnaire consisted of the same items in the form of an attitude scale. The respondents were asked to indicate how much they agree with the statements for each of the 4 selected banks. The scale had five degrees reflecting the following attitudes: -2 = 'I strongly disagree'; -1 = 'I disagree rather than agree'; 0 = 'half-and-half, I cannot decide'; 1 = 'I agree rather than disagree'; and 2 = 'I strongly agree'. In addition to the items which were identical with the first questionnaire, the second one also contained two questions with the aim of ascertaining the level of personal and mediated experience with a bank and two questions concerning the respondents' conative tendencies (whether they would opt for this bank if the choice was being done now, and whether they would recommend the bank to their friends).

The Sample

The research was carried out on a sample of 199 persons. There were 109 men and 90 women.

Table 1 provides the composition of the sample as regards the respondents' age, Table 2 as regards their education, and Table 3 as regards their employment.

Table 1 COMPOSITION OF THE SAMPLE AS REGARDS AGE

age	**n**	**%**
18 – 25	35	17.6
26 – 35	46	23.1
36 – 50	63	31.7
50 +	53	26.6

Table 2 COMPOSITION OF THE SAMPLE AS REGARDS EDUCATION

education	**n**	**%**
primary	15	7.5
secondary	99	49.7
university	85	42.7

Table 3 COMPOSITION OF THE SAMPLE AS REGARDS EMPLOYMENT

employment	**n**	**%**
self-employed or a company owner	38	19.2
employee in a managerial post	20	10.1
employee in a non-managerial post	94	47.5
student	24	12.1
pensioner	10	5.1
unemployed	12	6.1

The research was carried out in May and June 2001 with the questionnaires being distributed by interviewers.

Results

Criteria of decision-making in bank selection

The first research questionnaire was intended to obtain data about what criteria are considered by respondents to be most important when making a decision to choose a bank. Absolute and relative frequencies of answers were calculated for the individual decision-making criteria listed in the questionnaire for the sample under investigation. The results are provided in Table 4.

Table 4 ABSOLUTE AND RELATIVE FREQUENCIES OF RESPONDENTS' CHOICES OF PARTICULAR CRITERIA

Characteristics	**No. of answers**	**%**
the fees charged for its services are reasonable	124	62.0
it provides faultless service	119	59.5
it provides financial benefits (low credit interest rates, good interest rates on deposits, ...)	114	57.0
it provides fast service	105	52.5
its branches are suitably located (it is accessible, easy to reach)	93	46.5
it is 'guaranteed' for by the state (the state will not let it go bankrupt)	93	46.5
it provides progressive services (payment via the Internet, mobile phone, ...)	91	45.5
it has its own ATMs	91	45.5
it has suitable opening hours	76	38.0
its employees are able to provide comprehensible and complete information	75	37.5
it values its clients	74	37.0
its employees are competent (with good knowledge and skills)	61	30.5
its employees are active in relation to clients (pointing out things, offering)	58	29.0
its employees are helpful and polite	56	28.0
it provides a wide range of products/services	52	26.0
it provides information openly (about its management of funds, ...)	44	22.0
its managers are competent	43	21.5
its employees have individual approach to clients	38	19.0
it provides good input conditions (the necessary amount of deposits, ...)	35	17.5
it provides some very advantageous products/services	32	16.0
its employees are pleasant and keep smiling	28	14.0
it provides clients with a pleasant environment	21	10.5
its employees understand clients' needs	20	10.0
it has a good internal organization	19	9.5
its employees know their clients	9	4.5
it is well promoted	5	2.5
it does sponsorship in the right places	4	2.0

Table 4 shows that the most often stated criteria of selection are the financial ones (reasonability of fees for service – 62% of respondents; financial benefits, i.e. low credit interest rates, good interest on deposits etc. – 57% of respondents); and the quality of service (faultlessness of service – 59.5%, speed of service – 52.5%).

These criteria are followed by characteristics concerning the availability of banking services (suitably located branches – 46.5%; its own ATMs – 45.5%), the state ‘guarantee’ (46.5%) and other aspect of service – its progressive character (45.5%).

The image content for particular banks

The differences in perceiving individual banks as based on the items of the attitude scale are provided in Table 5.

Table 5 AVERAGE SCORES OF ITEMS IN THE ATTITUDE SCALE FOR PARTICULAR BANKS

	Bank No. 1	Bank No. 2	Bank No. 3	Bank No. 4
it provides faultless service	0.63	0.71	0.52	0.17
it provides progressive services (payment via the Internet, mobile phone, ...)	0.92	0.83	1.39	0.09
it provides fast service	0.50	0.71	1.21	-0.17
it provides financial benefits (low credit interest rates, good interest rates on deposits, ...)	-0.43	0.09	0.09	-0.13
it provides a wide range of products/services	0.85	0.79	0.54	0.63
it provides some very advantageous products/services	0.20	0.35	0.55	0.25
it provides good input conditions (the necessary amount of deposits, ...)	0.18	0.19	0.16	0.50
the fees charged for its services are reasonable	-0.19	-0.02	-0.12	-0.20
it has suitable opening hours	0.96	0.77	0.86	0.46
it has its own ATMs	1.44	0.88	-0.39	1.66
its employees are competent (with good knowledge and skills)	0.79	0.74	0.65	0.53
its managers are competent	0.05	0.64	0.59	0.12
its branches are suitably located (it is accessible, easy to reach)	1.02	0.35	0.01	1.29
it has a good internal organization	0.17	0.36	0.35	0.04
it is well promoted	0.85	0.61	0.06	0.75
it does sponsorship in the right places	0.18	0.16	-0.32	0.49
it is ‘guaranteed’ for by the state	0.98	0.58	-0.75	1.08
it provides information openly (about its management of funds, ...)	-0.17	-0.02	-0.36	0.00
it provides clients with a pleasant environment	1.09	0.97	0.85	0.75
it values its clients	0.38	0.76	0.73	0.22
its employees are able to provide comprehensible and complete information	0.65	0.80	0.65	0.45
its employees are helpful and polite	0.66	0.82	0.59	0.46
its employees know their clients	-0.10	0.10	-0.14	-0.11
its employees understand clients’ needs	0.26	0.35	0.41	0.27
its employees are active in relation to clients (pointing out things, offering)	0.33	0.51	0.39	0.25
its employees are pleasant and keep smiling	0.53	0.71	0.45	0.44
its employees have individual approach to clients	0.16	0.38	0.26	0.09

Table 4 shows that the bank No. 1 reached the highest scores in comparison with the other banks for the items ‘it provides a pleasant environment’, ‘it has suitable opening hours’, ‘it provides a wide range of products’, and ‘it is well promoted’. On the other hand, it reached the lowest scores on the items ‘it provides financial benefits’ (this is the statement that respondents agree with the least in case of this bank), ‘it provides some very advantageous products and services’ and ‘its managers are competent’.

The data shows that the bank No. 2 is characterized by being seen as the best in terms of the human side of services and the competence of its management. It reached the highest scores for the items 'the bank provides faultless service', 'it values its clients', 'its employees are able to provide complete and comprehensible information', 'its employees are helpful and polite', 'its employees are pleasant and keep smiling', 'its employees have individual approach to clients', and 'its managers are competent'. The bank did not reach the lowest score out of the four banks under investigation for any of the items.

The average figures indicate that out of the four banks, the bank No. 3 is seen as the one with the most progressive services, financial benefits and some very advantageous products and services. However, the respondents tend to disagree with the statements that it does sponsorship in the right places and openly provides information about itself. They do not find it 'guaranteed' by the state and point out that it does not have its own ATMs.

Out of the four banks, the bank No. 4 reached the worst result as regards the quality of its services – both from the technical and the human point of view. This bank reached the lowest scores for the items 'it provides faultless services', 'it provides progressive services', 'its employees are competent', 'it values its clients', 'its employees are able to provide complete and comprehensible information', 'its employees are helpful and polite', 'its employees are active in relation to the client', 'its employees are pleasant and keep smiling', 'its employees have individual approach to its clients', 'it has a good internal organization', and 'it has suitable opening hours'. On the other hand, this bank reached the highest scores on the items 'it provides good input conditions', 'it has its own ATMs', 'its branches are suitably located', 'it does sponsorship in the right places', and 'it is "guaranteed" by the state'.

The degree of readiness to choose and recommend particular banks and a comparison of this degree with the image contents of the banks.

The degree of readiness to choose each bank if the respondents were currently making their choice is illustrated by answers to question No. 30, while the degree of willingness to recommend a bank to their friends is revealed by answers to question No. 31. Question No. 28 was included to find out the extent of personal experience with each bank, whereas question No. 29 was intended to reveal the extent of mediated experience with each bank (see Fig. 1).

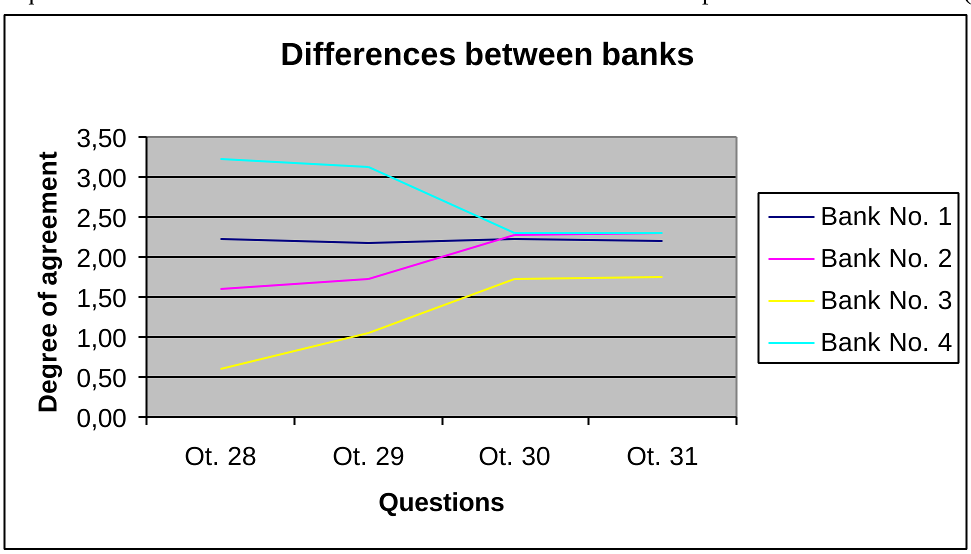

Fig. 1 DIFFERENCES BETWEEN BANKS AS REGARDS THE RESPONDENTS' READINESS TO CHOOSE AND RECOMMEND THEM

The figure clearly shows that there is almost no difference between the readiness to recommend banks Nos. 1, 2, and 4. There is less readiness to recommend bank No. 3.

When this result is compared with the image content of each bank, it appears that the readiness of respondents to choose or recommend particular banks is not determined by the quality of their services or financial benefits. This is because the degree of readiness to choose and recommend a bank to others is almost the same for banks which have, according to respondents, different levels of quality of their services. The results even indicate that it is highest for the bank No. 4 which reached the lowest score from all the banks under investigation in almost all parameters of services.

When this result is compared with the results of a questionnaire survey of the importance of criteria in selecting a bank, there is not much correspondence, either. While the most frequently stressed criteria by respondents turn out to be the financial criteria and the faultlessness and speed of services, the survey undertaken with the second questionnaire does not indicate the readiness to choose and recommend banks in harmony with such criteria. Nevertheless, the readiness to choose and recommend a bank is in harmony with the criterion of a state 'guarantee' (the banks Nos. 1, 2, and 4 are seen as being 'guaranteed' for by the state, i.e. the respondents assume the state will not let them go bankrupt, whereas they disagree with this statement for the bank No. 3). A similar trend in answers is apparent for respondents' opinions as regards the extent to which banks are equipped with ATMs. Both criteria are considered as particularly important by more than 45% of respondents.

Although the differences in the extent of readiness to choose and recommend particular banks seem to be in correspondence with the answers for the items concerning the 'state guarantee' and the number of ATMs, it cannot be assumed that these two criteria are the only ones in causing the difference in respondents' conative tendencies. The opinions about banks, the identification of which was the goal of the second questionnaire, are likely not to be the major determinants of respondents' behaviour because their decision-making processes need not have a logical and rational basis. The extent to which the decision-making is related to image components of a primarily emotional character is to be revealed by research data obtained by other methods which the authors of this article are currently processing.

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Impulse Purchasing as it Relates to Cultural Identity
The Case of Vietnam and the U.S.

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Abstract

As retailers expand into international markets they must develop understanding of consumers who are very different from themselves. Understanding of the unplanned purchases, or impulse purchases, will pose an enigma to international researchers. Previous research regarding such purchases has focused primarily on domestic impulse purchasing behavior, and primarily that of the U.S. market. International retailers should be concerned more with differences between cultures when they examine differences in shopping behavior. In this paper we examine the relationship between impulse purchasing and cultural values for respondents in two very culturally different environments, the United States and Vietnam. A tested model for this relationship is presented, as well as a model proposed for future research.

Introduction

Impulse purchasing is primarily examined from a domestic perspective. This perspective holds culture as a relative constant. Variables examined include normative influences (Rook and Fisher, 1995), time pressure and familiarity with the shopping environment (Iyer 1989), browsing, felt urge to buy, affect state, and time and money available (Beatty and Ferrell, 1998), and gender differences (Dittmar,Beattie, and Friese, 1995), to cite a few. In the research presented below variables such as those identified above are assumed to remain constant, with the remaining differences in the way impulse purchasing is experienced by consumers in different countries resulting from cultural differences.

Prior research has focused on a variety of aspects related to impulse buying. Most of this research has examined the underlying nature of impulse buying. Rook (1987) investigated the phenomenology of consumers' impulse buying episodes and behavior features of this buying behavior. Later studies have focused on the influence on impulse purchases of a single situational or personality variable. They examined variables range from mood states and emotions (Rook and Gardner, 1993; Weinberg and Gottwald, 1982); in-store influences such as displays (McGoldrick, 1982), to demographic variables (Dittmar, Beattie, and Friese, 1995; Bellenger, Robertson and Hirschman, 1978; Guerts, 1979). More recently impulse buying has been treated as an individual difference variable, which is likely to influence individuals across situation (Rook and Fisher, 1995; Weun, Jones, and Beatty, 1998). The study of Beatty and Ferrell (Summer 1998) represents a significant advance in understanding more fully the antecedents of impulse buying.

As in many other areas of consumer research, studies on impulse buying have been based on theoretical frameworks developed using evidence from Western cultures, primarily from U.S. culture (Aaker and Maheswaran, 1997). Further, much of the previous research focused only on impulse behavior in specific shopping trips and situations affected by situational and/or individual difference variables. In other words, the research is limited by looking into what might happen at the end of the impulse buying process as the result of its precursors' influence. As indicated above, past research studied the impulse buying behavior of consumers who vary in their levels of impulsiveness within a country (primarily the U.S.). Given the increasingly important role of international retailing this suggests that an area for examination might be the cross-cultural differences of impulse buying behavior as well as the distinctive characteristics of these different cultures.

With the objective of filling a part of the research gap regarding impulse purchasing, the study reported here attempts to develop and test a conceptual framework that specifies the relationships between cultural orientation (individualism vs. collectivism) and buying impulsiveness and impulse buying. Several key sociodemographic variables will also be examined as covariates that influence the impulse purchase behavior.

This study is expected to make two major contributions. First, a conceptual framework that examines cultural orientation, a new variable in this area of research, and its impact on buying impulsiveness and impulse buying. Second, we will test hypotheses in a cross cultural context using samples from two culturally diverse countries, the U.S. (highly individualistic) and Vietnam (highly collectivistic).

Literature Review

Cultural Orientation

The individualism and collectivism dimension is arguably one of the most important factors in a culture (Hofstede, 1980; Triandis, 1990; Triandis, Brislin, and Hui, 1999). Hofstede (1984) identified four underlying dimensions of cultural values. They are: individualism vs. collectivism, low/high power distance, low/high uncertainty avoidance, and feminine vs. masculine. Among these dimensions, individualism/collectivism is perhaps considered to be the most central dimension of cultural variability identified in cross-cultural research and has received considerable attention in the cultural psychology literature (Aaker and Maheswaran, 1997).

Hofstede (1991) provides the following definitions for individualism and collectivism:

Individualism pertains to societies in which the ties between individuals are loose: everyone is expected to look after himself or herself and his or her immediate family. Collectivism as its opposite pertains to societies in which people from birth onwards are integrated into strong cohesive in-groups, which throughout people's lifetime continue to protect them in exchange for unquestioning loyalty.

Consequently, between individualist and collectivist cultures there are differences in terms of the way people thing and the way people do. Members of individualist cultures tend to have a more favorable attitude toward differentiation and uniqueness, while members of collectivist cultures tend to have a more favorable attitude toward building relationships and maintaining connections. In terms of behavior, individualists tend to be motivated by personal preferences and inner drives, while collectivists tend to be more influenced by the preferences and needs of close others (Aaker and Maheswaran, 1997).

Triandis (1989) also suggested that a person's dispositions and behaviors are affected not only by his or her own makeup, but also by the norms and beliefs of the cultural environment. By extension this suggests that cultural orientation may influence buying tendency and buying behaviors of consumers.

In Hofstede's study (1991), western countries are suggested to be strongly characterized by individualism, and many Asian countries are characterized by collectivism. Among the fifty studied countries, the U.S. reflects the highest Individualism Index Score (IDV), while most Asian countries have low IDV scores (Hofstede, 1991). This is consistent with Brislin's statement that individualism is commonly found in North America and Western Europe, while Asia is one of the regions where collectivism is common (Brislin, 1993).

Buying Impulsiveness and Impulse Buying

Consumer researchers have investigated impulse buying for nearly fifty years. In the marketing literature 'impulse buying' has traditionally been defined simply as unplanned purchasing (Cobb and Hoyer, 1986). More recently this definition has been criticized in that 'unplanned' behavior is not necessarily 'impulsive (Rook and Gardner, 1993). Rook (1987) redefined a 'buying impulse' as a sudden, unexpected, often powerful and persistent urge to buy something immediately. This urge is felt suddenly and strongly and is often irresistible.

An impulse purchase is characterized by: 1) relatively rapid decision-making, and 2) a subjective bias in favor of immediate possession (Rook, 1987; Rook and Hoch, 1985). The definition of 'impulse buying' is extended slightly by Beatty and Ferrell (1998) who state, "impulse buying is a sudden and immediate purchase with no pre-shopping intentions either to buy the specific product category or to fulfill a specific buying task". The definition includes the idea of impulsiveness, which involves acting spontaneously without full consideration of the consequences (Gerbing, Ahadi, and Patton, 1987). Accordingly, impulse buying does not include the purchase of a simple reminder item such as buying a gift for someone that fulfills a planed, although perhaps forgotten, task.

There are a number of studies examining the antecedents of impulse buying. Several of these investigate the influence of some single situational or individual variable on impulse purchase. Rook and Gardener (1993) examined and discussed how affect (mood states) influenced impulse purchasing. They found that positive mood would be more conducive to impulse buying than a negative mood.

Rook and Fisher (1995) examined the impact of normative judgment, and the results demonstrate that consumers' normative evaluations moderate the relationship between the impulse buying trait and buying behavior. Recently, Beatty and Ferrell (1998) investigated a set of exogenous antecedents, including situational variables and individual difference variables, and a set of endogenous variables, including affect, browsing activity, and felt urge to buy impulsively.

Buying impulsiveness as an influencing variable has received a certain level of attention from researchers (Rook and Gardner, 1993; Rook and Fisher, 1995); Beatty and Ferrell, 1998). According to Rook (1987) and Rook and Hoch (1985) psychological theory and research has long regarded 'impulsiveness' per se to be a fundamental personality trait. Extending this to the consumer behavior domain, it means that consumers vary in their levels of 'buying impulsiveness'. The literature (Rook and Fisher, 1995; Weun, Jones, and Beatty, 1998) supports this idea. Some studies have mentioned that a significant number of consumers identify themselves as 'impulse shoppers'. Accordingly, Rook and Fisher (1995) conceptualized individuals' impulse buying tendencies as a consumer trait and labeled that as *buying impulsiveness.* They defined buying impulsiveness as a consumer's tendency to buy spontaneously, unreflectively, immediately, and kinetically. In the research of Beatty and Ferrell (1998), this variable was called 'impulse buying tendency' (IBT). They suggest that a high IBT individual is likely to experience more urges to buy impulsively and will tend to act more frequently on those urges.

Previous research has contributed to a better understanding of impulse buying, however, there are still some gaps in this understanding, such as the consequences of impulse buying action, and impulse buying's antecedents, more specifically, the impact of culture on this aspect of consumer behavior. Although impulse buying has been the topic of research for many years, it has mainly focused on examining the relationships occurring 'in store', in the shopping environment. There is less, if any, research studying cross-cultural situations. Moreover, in the consumer research domain, there seem to be no studies that studied impulse buying across cultures. Even within a country, for example within the U.S., no research has looked at culture values as factors that can influence consumers' impulse buying behavior. Consequently, there is no comparison for impulse buying tendency and behavior in a cross-national context and from a cultural perspective. The situation is similar to other research domains (Aaker and Maheswaran, 1997).

Sociodemographics

While the primary focus of the research reported here is on cultural orientation, buying impulsiveness (the tendency) and impulse buying (the act), previous research suggests that sociodemographic charactics of consumers might also influence impulse buying behavior (Wood, 1998). Of those which might relate, only one, income, is examined in this report. Income is also suggested in the literature as one factor which may affect impulse buying (Abratt and Goodey; Mogelonsky, 1994) in that in order to afford an impulse purchase a certain level of income is required.

Conceptual framework and hypotheses

Based on the literature review we propose the conceptual framework illustrated in Fig.1.

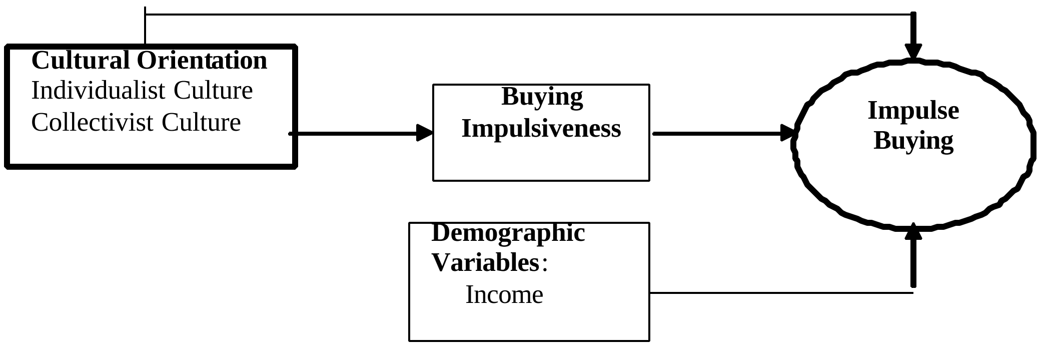

Fig. 1: CONCEPTUAL FRAMEWORK

Prior studies on impulse buying suggested that impulse shoppers are likely to experience spontaneous buying stimuli; their shopping lists are more ‘open’ and receptive to sudden unexpected buying ideas (Rook and Fisher, 1995). Impulse buying behavior is characterized as less deliberate, more arousing and irresistible purchase behavior, in which the decision is made relatively rapidly (Rook and Gardner, 1993).

The premise above suggests that impulse buying action may be more likely to occur when shoppers/consumers do not face blocks which impede the buying decision making process. According to Roth (1995), in individualist societies, people tend not to follow social norms, but rather make decisions and initiate behaviors independently of others. A child would learn very early to think of him or herself as ‘I’ instead of as a part of ‘we’, whereas the converse holds for collectivist societies (Hofstede, 1991). Therefore, individualists would have less constrained feelings when exposed to buying impulse stimuli. It would be easier for them to open their shopping lists and accept some new buying ideas without considering much about others’ influence. Consequently, they are more likely to make a purchase decision quickly because they place their personal goals, motivations, and desires ahead of those of the in-group (Kagitcibasi, 1997).

In collectivist cultures, however, people consider themselves more members of the community than independent individuals, the opinions of others or group norms are emphasized (Aaker, 1997), and the individuals care more about the needs and desires of the other. Accordingly, when they are exposed to impulse buying stimuli, they should be more likely to experience some feelings of constraint. They may think of the need to have more consultation before making a buying decision, or others may more easily influence them. There are likely more things for them to take into consideration before buying.

These feelings may block their ability to experience spontaneous buying. Consequently, the purchase decision-making process may be slowed down, and the impulse buying action less likely to happen. Based on the above discussion we hypothesize the following:

H1a: Cultures that score high on collectivism are likely to exhibit a lower level of buying impulsiveness than those from cultures that score low on collectivism.

H1b: Cultures that score high on individualism are likely to exhibit a higher level of buying impulsiveness than those from cultures that score low on individualism.

Similarly we propose:

H2a: Cultures that score high on collectivism are less likely to report fewer impulse purchases than those from cultures that score low in collectivism.

H2b: Cultures that score high on individualism are likely to report more impulse purchases than those from cultures that score low on individualism.

Relative to individuals in these cultures we propose:

H3: An individual's level of buying impulsiveness negatively relates to Family and Friend collectivism, and positively to Family and Friend individualism.

H4: The number of reported impulse purchases for an individual negatively relates to Family and Friend collectivism and positively to Family and Friend individualism.

According to Rook and Fisher (1995) "impulse buyers are more likely to act on whim and to respond affirmatively and immediately to their impulses," and impulse buyers are likely to experience buying impulses more frequently and strongly than other consumers. Although prior research suggested that in a particular buying process the level of impulsiveness may not directly and significantly impact the actual impulse buying action, it has a strong indirect impact on impulse buying through influencing the urge to buy (Beatty and Ferrell,1998), and its impact on impulse purchase is moderated by normative judgment (Rook and Gardner, 1993). However, our study examines the relationship cross-situationally, instead of looking at a single situation, in a specific buying process. Accordingly, we expect that shoppers with impulsive buying tendencies are likely to buy on impulse more frequently than others in both types of cultures. Thus we hypothesize:

H5: Buying impulsiveness positively relates to impulse buying in both individual and collective cultures.

Sociodemographics have been suggested as having influence on impulse buying behavior, however, there is little conclusive research regarding this influence (Wood, 1998). Abratt and Goodey () conducted research which suggests that higher income is one of several factors which could account for the higher level of impulse buying in the U.S. compared with some other countries. A study by Mogelonsky (1994) logically suggests that impulse buying may be reserved only for those who can afford it. Further, we expect that in general those consumers who have higher income would have less constraint in acting on their impulses. They could have a more 'open' shopping list to receive sudden and unexpected buying ideas with less difficulty in payment ability. Consequently, they may be able to buy things on impulse more frequently than others may. For those people who have lower income, their impulse buying tendency may be more likely interrupted by the 'income block', which may lead to less buying action on impulse. Accordingly, we hypothesize that:

H6: In both individual and collective cultures, those with higher income exhibit higher buying impulsiveness tendencies and are more likely to buy things on impulse than those who have lower income.

Methodology

Sample and Data Acquisition

Vietnam and the U.S. were selected for an initial study primarily as they represent extremes in cultural orientation with Vietnam viewed as being more collective, and the U.S. being the more individual culture. While it is always desirable to use probabilistic sampling, this study was more exploratory in nature and a probabilistic sample was not realistic. In the U.S. the sample was drawn from classes at two U.S. universities, one in rural Maryland, the other, a private university in New Jersey. In Vietnam the sample was drawn from classes at universities in Hanoi and Ho Chi Minh City. Using the instrument described below, respondents were asked to circle the answer that most closely corresponded to their position.

Data Acquisition

In both countries a survey instrument developed by Lee and Brislin (1998) was used. This instrument is shown in appendix A. The survey instrument was translated into Vietnamese for use with the Vietnamese sample (translation was made to Vietnamese and back into English to check for accuracy). For purposes of this research it is broken down into the following measures.

Measures

Cultural Orientation
The scale used was the IC-Dimension Scale developed by Lee and Brislin (1998) to measure cultural orientation. The scale includes four dimensions: self-concept, goals, cognitions, and evaluation of relationships. The scale measures the dimensions of individualism and collectivism in relation to family (in-group), friends (mixed) and people in general (out-group). We consider the first and second relationships to be the most important for our study. For each relationship there are 16 items, including eight individualist items and eight collectivist items. The response format is a nine-point scale anchored by 'strongly agree' and 'strongly disagree'.

Buying Impulsiveness
Two scales were used to measure this variable. The first was developed by Rook and Fisher (1995). The scale includes nine items which are measured on a five-point Likert scale. The second scale was developed by Weun, Jones, and Beatty (1998) and was also used in the research of Beatty and Ferrell (1998). It includes five items.

Impulse Buying
Two measures were used for the action of Impulse Buying. First, using a four-point scale in which 'almost every day' represented the highest frequency of impulse buying and 'almost never' the lowest, respondents were asked to indicate how frequently they buy on impulse. Second, respondents were asked to estimate how many impulse purchases they had made in the past month.

Data analysis

The data were analyzed using SPSS version 10. For the first hypothesis mean collectivism scores relating to family and to friends were calculated for both countries and the means were compared using ANOVA. As was expected, the mean scores for collectivism relative to family and relative to friends were significantly higher for respondents from the U.S. than those from Vietnam. (see Table X for the results of both). Referring to Hypotheses 1a and 1b we find that the hypotheses are supported; there is support that those in more collective cultures exhibit less buying impulsiveness as well as reporting fewer impulse purchases.

Analysis for Hypotheses 2a and b was similar to that for 1a and b. As expected, individualism scores for Vietnamese respondents were significantly higher than for those from the U.S. The hypotheses are supported, indicating that the expected relationship between individualism and buying impulsiveness are as expected.

To test hypotheses 3 and 4 regressions were run with Buying Impulsiveness the dependent variable in the regression for hypothesis 3, and the number of Impulse Purchases reported in the last month the dependent variable in the regression testing hypothesis 4. The independent variables for both regressions were the measures of family collectivism and independence, and friend collectivism and individualism. Only the regression involving Buying Impulsiveness was significant and only the measures for family collectivism and individualism were significant. For hypothesis 3 a reduced model including the two family measures provided significant results, supporting the hypotheses in terms of significance and directions of relationships. The results of the regression are provided in Table 2.

Table 1
MEAN VALUES AND ANOVA RESULTS FOR HYPOTHESES 1A, 1B, 2A, AND 2B

	Mean	**Values**	**ANOVA**	**Results**
Variable	*United States*	*Vietnam*	*F-value*	*Significance Level*
Individualism with respect to family	51.21	44.67	29.7	.000
Collectivism with respect to family	46.91	50.62	8.80	.003
Individualism with respect to friends	56.58	52.21	11.60	.001
Collectivism with respect to friends	40.75	44.96	9.25	.003
Buying Impulsiveness	46.67	40.03	25.61	.000
Impulse purchases in last month (#)	2.86	3.075	6.25	.013
Frequency of Impulse purchases	4.11	1.95	16.95	.000

Hypothesis 5 was tested using regression with the independent variable being Buying Impulsiveness, and the dependent variable the number of reported Spontaneous Purchases in the past month. The positive relationship between the two variables was as expected, providing support for Hypothesis 5. Regression results are shown in Table 2.

Table 2
REGRESSION RESULTS FOR HYPOTHESES 3, 4, AND 5

	Hypotheses			
	H3 – full model	***H3 - Reduced***	***H4***	***H5***
Buying Impulsiveness	Dep. Variable	Dep. Variable		.222 (.000)
Impulse Purchases in last Month			Dep. Variable	Dep. Variable
Family Collectivism	-.147 (.081)	-.131 (.049)	-.003 (298)	
Friend Collectivism	.002 (.758)		.004 (.887)	
Family Individualism	.133 (.096)	.139 (.038)	.003 (.331)	
Friend Individualism	.014 (.858)		-.017 (.597)	
Constant	42.28 (.000)	43.003 (.000)	3.998 (.072)	
Adjusted R^2	.021	.029	-.005	.30
F-value	2.377	4.735	.695	111.439
Significance level	.052	.010	.596	.000

Note: Significance levels for individual variables reported parenthetically with coefficients for the independent variables.

Hypothesis 6 was tested using ANOVA with the independent variable being reported income quartile. High income was considered the top two quartiles and low the bottom two. The dependent variables were Buying Impulsiveness and the number of impulse purchases in the past month. Significant differences in the means of both measures resulted, with the means of the higher income groups higher than those of the lower income groups for both measures. The results of the ANOVA are reported in Table 3.

Table 3
ANOVA RESULTS TESTING HYPOTHESIS 6

	Mean	Values		
	Low Income	High Income	F-Value	Significance Level
Buying Impulsiveness	40.8	44.50	6.201	.013
Impulse Purchases in Last Month	2.32	3.36	3.093	.080

Conclusions and Suggestions for Future Research

The research supports that people from individualist and collectivist cultures experience differences in impulse purchasing. It is interesting to note that shoppers from both cultures admit to having impulses to buy and to making impulse purchases.

Impulse purchases represent a significant profit area for U.S. retailers. U.S. respondents demonstrated a greater propensity to impulse purchasing than did the Vietnamese subjects. This would have an impact on the nature of sales for retailers entering markets that exhibit collectivist tendencies. Retailers should recognize that impulse purchases might not represent as significant profit potential in collectivist markets.

For the retailer, the research demonstrates that shoppers with more collective orientations do not exhibit as strong of impulse tendencies as do shoppers from cultures with more individual orientations. While this research supports that shoppers from the different cultural orientations do exhibit differences in impulse tendencies, it does not address whether there are differences in the types of products purchased on impulse. This should be of interest to retailers. It is logical to expect that if cultural orientation influences impulse tendencies, it might also influence the nature of the product purchased on impulse. This would be an interesting factor to add for future research.

Prior research suggests that gender is a demographic that influences impulse tendencies. Dittmar, Beattie and Friese (1995) found that men and women tend to impulsively buy different product items. For example, men tend to buy instrumental and leisure items on impulse, while women tend to buy symbolic and self-expressive goods. Others have examined this issue, but with inconsistent results (Cobb and Wayne, 1986; Kollat and Willett, 1967). This is a demographic which has should be examined further in terms of cultural differences.

Future research should examine the nature of the products the different culture types demonstrate impulse tendencies toward and purchases of. This would change the proposed model to that displayed in Fig. 2. It includes moderating factors of the type of product, as well as the demographics variables of income and gender.

We would further suggest expansion of the countries from which samples are drawn to include additional countries representing individualist and collectivist cultures. The two countries examined represent what was believed to be extremes in collective/individual cultural orientations. Other cultures should be examined as well to ascertain whether these results are representative of other collective and individual cultures.

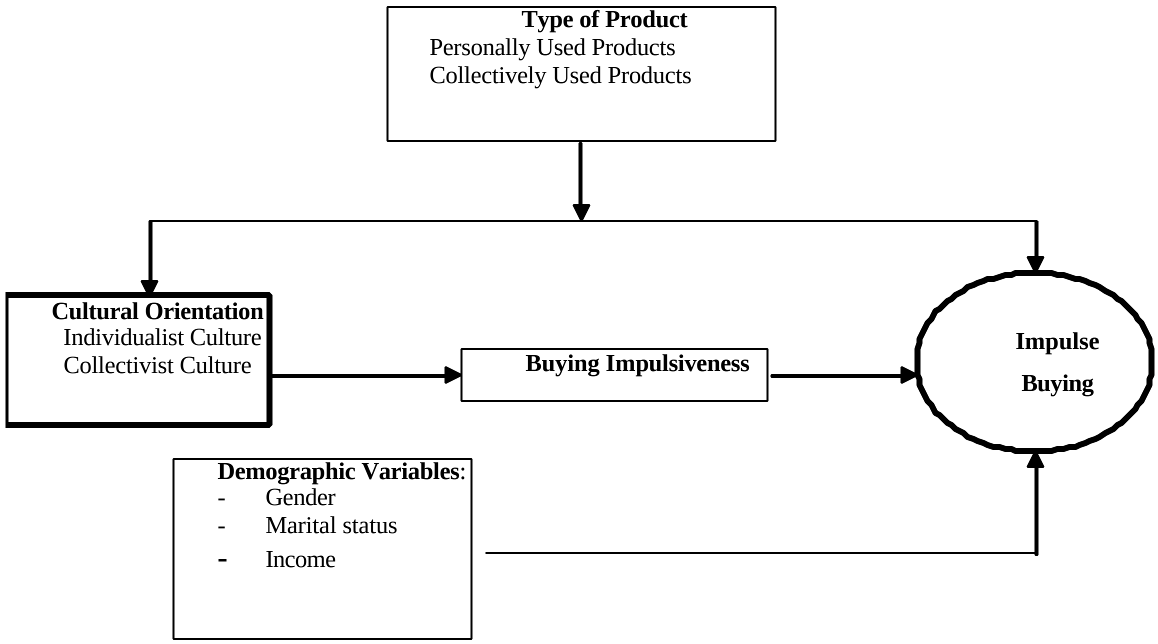

Fig. 2: PROPOSED CONCEPTUAL FRAMEWORK

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Market Pressures for Tournament Type of Organization in Emerging Central Europe: Evidence, Implications and Sustainability

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Abstract

This article suggests that the change in labor market quality in Emerging Central Europe (ECE) can be described as a shift from egalitarian to tournament types of systems. The author defines the term "tournamentality" as the degree to which a company or labor market is based more on tournament rather than egalitarian principles. Research shows that the level of tournamentality has not only increased significantly over the past decades but it is currently stronger than in Western Europe. This reveals the presence of major market pressures on organizations for tournament type systems in the emerging region. The implications of these pressures are summarized into four business and human resources issues. At the end, the paper addresses the sustainability of the current level of tournamentality, concluding that this is expected to prevail in the coming years.

The emerging region of Central Europe has recently experienced noteworthy times. Only ten years ago, Poland, the Czech Republic, Slovakia and Hungary were economic and political satellites of the former USSR operating under the model of a command economy. In a span of a decade they have got rid of the communist directives, raised idealistic[1] hopes for quick achievement of comparable standard of living with Western Europe, and gained memberships in political and economical organizations that should ensure stability and prosperity for the region. Most importantly, the countries decided that they want to foster democracy and free market economies around Western European values and principles with the ultimate goal of integration with the EU and NATO.

Low wages, geographic proximity to EU, and a large internal market potential resulted in a strong business and political attractiveness of the region. The average manufacturing wages in the region is 15% of the average EU15[2]. It has a combined population of over 60 million people. Many companies do not seek to compete internationally, and governments often act under strong macroeconomic pressures, especially in privatizing strategic state companies.[3]

Recent political and economical changes have had considerable social consequences with possible implications towards management of human resources. When broken down into small geographic areas, all countries of Emerging Central Europe (ECE) exhibit significant regional differences in terms of unemployment, salary level and GDP per capita. For example, in 1995 in eastern Hungary 11.3% of the population was out of work, while the rate in the western part did not exceed three percent[4]. Salary levels in the capital of the Czech Republic are 43% higher than in the country's poorest region (the east), while second best region does not reach 80% of the average of the capital[5]. Slovakia as a whole produces less than half of the EU average GDP per capita[6], however, Bratislava region alone matches the EU average.

This stands in stark contrast with the days of a command economies, which exhibited little or no regional pay differences and virtually no unemployment. At the same time, there was just a loose link between performance and reward. The actual salaries were not a result of labor market forces but rather were determined by seniority and state defined compensation tables. These individual observations lead to an idea that, whereas a decade ago the labor characteristics could be described as egalitarian, nowadays the market exhibits tournament features.

This paper looks for evidence to support or decline the hypothesis that *the labor market in ECE evolved from egalitarian ten years ago to a tournament one in the late 1990's.* Furthermore, the paper asks *what are the implications for business and sustainability of the current level of tournamentality in the region.*

Egalitarian and Tournament Systems: Differentiating Factors

The tournament theory seeks to explain pay dispersion in an organization. It asserts that people at any level of the organization are willing to sacrifice part of their current salary for being rewarded later when they move higher in their career. When there is an open position within the organization, there is only one person that will be promoted and will win the tournament and associated prize, an increased salary. The more incumbents for the position, the bigger the prize and the bigger the pay dispersion between two levels in the organization[7]. The egalitarian system on the other hand tries to eliminate pay dispersion among the employees.

[0]The two theories, tournament and egalitarian, are often studied in relation with the pay dispersion and other individual organizational issues such as performance of individuals and organizations[8], managerial turnover[9] or motivation[10]. Drawing from the available theory and practice we have identified several factors differentiating egalitarian and tournament systems (Table 1).

Table 1. EGALITARIAN V TOURNAMENT SYSTEM: ORGANIZATIONAL LEVEL

	Differentiating Factors	**Egalitarian System**	**Tournament System**
1	Career related salary increases	Small	High
2	Salary setting	Internal Consistency	Market Competitiveness
3	Role of seniority	Important	Irrelevant
4	Role of pay for performance	Small	High
5	Psychological factors/Culture	Paternalistic	Competitive

While the egalitarian system tries to eliminate any unnecessary differences between pay levels within the company, the tournament system is based on a steep salary progression throughout one's career. Hence, career related salary increases for tournament systems are higher, especially at top end of the organization ladder, while the increases in egalitarian systems are relatively smaller.

When setting the pay line, companies need to balance internal consistency and market competitiveness.[11] It is expected that egalitarian systems would place more emphasis on the former one – rewarding the jobs based on their relative value for an organization. On the other hand, tournament type of organization would place more emphasis on what the job would be paid in the external market.

The tournament system is based on the idea that the prize of the tournament, career progression associated with salary increases, is based on individual's ability rather than seniority. Egalitarian systems would, on the other hand, be more likely to emphasize seniority.

Another differentiating factor between egalitarian and tournament systems is the role of pay for performance. The more tournament-like environment places more emphasis on rewarding exceptional performance, hence placing importance upon pay for performance. On the other hand, egalitarian systems try to put more emphasis on group performance rather than on individuals. Field studies support the links between egalitarian system and higher organizational performance[12] as well as between tournament system and individual performance[13]. The author believes that the appropriateness of the both systems depends on the type of business that the company is in as well as its business and Human Resource strategy.

Besides the factors mentioned above, both systems create their own intangible unique cultures that serve to support the organizational strategy. The egalitarian system is said to inculcate feelings of fairness, community, cooperation and teamwork[14]. On the other hand, tournament systems recognize individual performance. For the purpose of simplicity I use term "Paternalistic" for the first system and "Competitive" type of culture for the second one.

While there is research that examines the value of tournament spread[15], no one has yet attempted to quantify the difference between the egalitarian and tournament type of systems. For this lack of comparable scale, I introduce the term of "tournamentality" – *the degree to which company or labor market is based more on tournament rather than egalitarian system.*

Quantification of Tournamentality

The five differentiating factors summarized in Table 1 are only expressed in relative terms such as low and high or important and irrelevant. In order to arrive at a more precise description of the tournamentality in Emerging Central Europe (ECE), I have looked at quantitative expression of the identified five factors.

Career related salary increases is the pay dispersion between two levels in the organization. Research usually compares the pay of a CEO with that of the lowest paid positions in the organization. The author argues that such a comparison could be misleading; especially as such ratio will justly vary with the size of the organization. Instead, I suggest that to determine career related salary increases; one should compare standard size positions such as Head of Function with entry-level white-collar employee or a worker. To measure the extent to which an organization leans towards "external competitiveness" rather than "internal equity" might be very subjective. For the purpose of this research (evolution in Emerging Central Europe) it is needed to explore the pay determination in both the past and present and relate this to internal versus external labor market determination. The role of seniority is higher if the career advancement is a factor of tenure with the company or number of years of experience. In an organization that puts less importance on seniority, one would find younger workforce and/or the age distribution would be more diverse. The role of pay for performance could be determined by two factors: what is the prevalence of variable pay and what is its relative value when compared with the base/fixed salary. Thus when quantifying the importance of pay for performance, one needs to look at what percentage of the companies use variable pay linked to the individual performance, and what is the value of bonus paid as a percentage of annual base salary. The last differentiating factor is a group of psychological pressures that create the culture of tournamentality and increase the competitiveness among the employees. Though these might be hard to measure objectively, I have picked certain measurable ones that could be influential: level of national unemployment rate, salary difference among the regions, and nominal versus real salary increases. The higher the disparity in unemployment rate and higher the salary level in the regions the stronger the feeling of achievement for those that have the fortune or ability to be in a "preferred" region or in better paid jobs. Though not supported by any rigorous studies, I believe that in two economies both having the same real salary increases, the one that exhibits higher nominal salary increases would have positive psychological effects on tournamentality of an employee[16].

The five factors that distinguish egalitarian and tournament systems are summarized in Table 2 along with the measurable factors that would quantify the level of tournamentality in an organization and labor market.

Table 2. QUANTIFICATION OF TOURNAMENTALITY

	Differentiating factors	**Quantification of a factors**
1	Career related salary increases	Pay Dispersion
2	Salary setting	Salary Determination
3	Role of seniority	Average Incumbent Age
4	Role of pay for performance	Prevalence of Pay for Performance Relative Value of Variable Pay
5	Psychological factors/Culture	Unemployment Regional Differences Nominal/Real Salary Increase

Research on Practice

The main source of data for the research of the level of tournamentality was a Human Resources consultancy Watson Wyatt. One of its divisions, Data Services, focuses on conducting compensation surveys worldwide. The data sample in ECE is mainly based on information from multinational subsidiaries. The final results are highly cross-country consistent as the same format of a survey is applied to every single country. The data used for the analysis were taken from the official Watson Wyatt Compensation Reports. This covers samples of over 401 survey participants in ECE and 474 companies in Western Europe.

The research of tournamentality was divided into two parts. One part analyzed the evolution from ten years ago until the years 1999 and 2000 in the following Emerging Central Europe countries: Poland, the Czech Republic, Slovakia and Hungary. The second part of the research compared the current level of tournamentality in ECE with the following sample of Western European countries: Germany, France and the United Kingdom. The selection of Western European countries was based on their size and economic stability.

The paragraphs that follow summarize and discuss the findings of the research around the five main areas of tournamentality. Each factor is discussed from the perspective of evolution in ECE as well as comparison with Western Europe practice.

Career Related Salary Increase (Pay dispersion). To calculate the pay dispersion ratio I compared the salary level of Head of Function to that of an unskilled worker. The average pay dispersion for ECE is 10.5 with little country differences. In Western Europe sample the same ratio calculated on identical positions is 4.8 (see Table 3). Further analysis on comparison of different combination of positions from the top and bottom of the organization shows that the ratio in ECE is around double the number in Western Europe. These findings indicate that the career ladder is, in terms of reward, steeper in ECE than in Western Europe, supporting the idea of higher tournamentality. This is in contrast with a decade ago when the pay dispersion was estimated to be around 2-3.

Table 3. SELECTED INDICATORS OF THE LABOR MARKET IN EMERGING CENTRAL AND WESTERN EUROPE

	Emerging Central Europe '89	**Western Europe '99**	**Emerging Central Europe '99**
1. SALARY INCREASES			
Pay Dispersion	2-3	4.8	10.5
2. SALARY SETTING			
Salary Determination	State	Market	Market
3. ROLE OF SENIORITY			
Age of Head of Function	43-47	43-47	37-40
4. PAY FOR PERFORMANCE			
Usage of Pay for Performance	Limited	69%	71%
Bonus as % of ABS	Limited	14%	15%
5. PSYCHOLOGY			
Nominal/real Salary Increases	0/0	3.6/2.0	11.8/2.9

Source: Roman Weidlich; Watson Wyatt Data Services: Compensation Reports 1999 and 2000; The Economist Intelligence Unit; OECD.

Salary Setting (Salary Determination). In the command economies of ECE the salary of an employee was determined based on specific factors such as education level, number of years of experience or managerial responsibilities.[17] There existed little or no differences in pay level between regions and industries. In general, the pay was strictly determined by internal guidelines with absence of labor market. In contrast, these days the labor market freely influences the salary to be paid by companies. While the companies still follow their internal policies, the market balances the supply and demand for specific skills, knowledge or capabilities. The spread between the regions and industries is considerable in all four ECE countries. When we analyze the salary paid for specific benchmark positions, we can find that the salary spread is considerably higher in ECE than in WE[18]. In summary we can conclude that the region has experienced a significant shift in salary setting. While in the past the salary was determined by internal guidelines, nowadays the role of the market place is considerably more significant.

Role of Seniority (Average Incumbent Age). The analysis of average age of Head of Functions shows a significant difference of seven years between ECE and WE. The results support previous study[19] of Watson Wyatt indicating that in average employees in ECE are up to eight years younger than their counterparts in WE in comparable function at the top of the organization. Due to lack of data from a decade ago and the importance placed upon seniority in egalitarian systems, I assume that the average age in ECE was comparable with Western Europe. This leads us to a conclusion that seniority in ECE has come to play a diminishing role over time. In other words, young people have relatively more opportunities these days to hold higher positions within organizations, which consequently increases the current level of tournamentality (see Fig. 1).

Role of pay for performance. Current practice of variable pay in ECE is almost identical with that in Western Europe. In average, 71% and 69% of the workforce is eligible for variable pay in ECE and WE, respectively. Levels of variable pay are almost identical. In average the paid out bonuses equal to 15% of Annual Base Salary in ECE and 14% in WE. This is in contrast with the variable pay policy within the region in the past. While the concept was known, in most cases it was inefficiently implemented. Its failure had often its roots in history[20]. Employees in planned economies were rewarded for meeting and exceeding the plans. With no ownership 'working for the good of the society', people were motivated to set the targets lower rather than come up with innovations that could move the targets even higher.

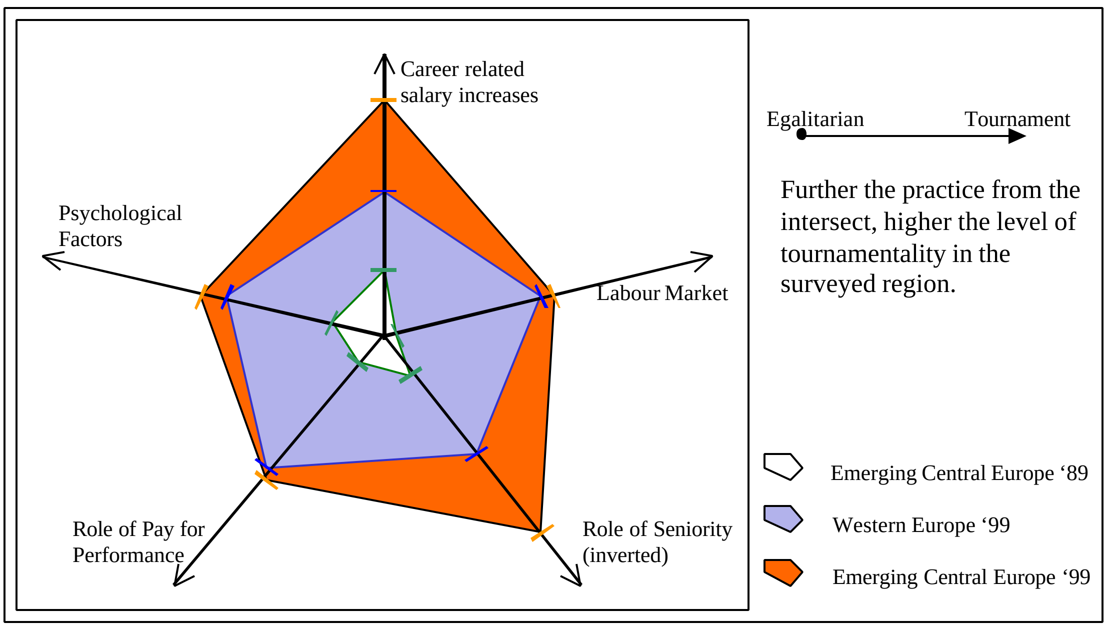

Fig. 1. TOURNAMENTALITY IN EMERGING CENTRAL EUROPE AND WESTERN EUROPE
Source: Based on figures from Table 3.

Psychology/Culture. It is often said that economical changes bring cultural ones. Under the planned economy system, the ECE has reported virtually zero unemployment rates with pre-determined factors influencing the actual salary level for each position. During the past ten years the unemployment has risen and in some cases later fallen significantly. Country statistics differ too greatly to be generalized for the whole region. While the unemployment rate is below 7% in Hungary, the rate exceeds 18% in Slovakia[21]. Increased unemployment in the region indicates a shift towards tournamentality. These disparities between the countries do not allow us to draw reliable comparisons with Western Europe where the unemployment rates also vary greatly[22]. Similarly, regional comparisons cannot be generalized and require deeper analysis beyond the scope of this paper. Individual studies show that in three out of four ECE countries, the economy is polarized between the capital region and the rest of the economy[23]. According to Watson Wyatt, the regional salary differences among multinational subsidiaries could go up to 24% in ECE and 17% in Western Europe. In summary, the region has clearly experience a shift towards tournament in terms of unemployment and regional salary differences. However, more research will be required to compare the ECE region with Western Europe.

A comparison of nominal versus real salary increases reveals more consistent results across the region. However, the data from the past are missing to make comparison between ten years ago and present. In average the ECE shows just below three-percent real salary increases. The same statistics for the three selected Western European economies reaches two percent. While the nominal increases vary among the ECE along the inflation rates, in average these are substantially higher than in Western Europe. Nominal salary increases for Western Europe and ECE are 3.6 and 11.8 percent, respectively. Our hypothesis earlier in the text said that for two environments with relatively similar real salary increases, the one that has higher nominal salary increases would psychologically support tournament culture. Even though this hypothesis needs to be validated, it preliminary results support the notion of increased tournamentality in the ECE.

Implications

The results of the study show that the region has exhibited noteworthy change over the past decade. The analysis has clearly recognized the shift from the egalitarian model towards a highly tournament labor market. Comparison with Western Europe indicates that the tournamentality of the region of Emerging Central Europe is higher than the Western European standard.

Labor market characteristics and HR practices in individual companies are mutually influencing. While the practices used by the majority of the companies form market characteristics, the companies take the market practice into consideration when making their decisions about what HR policies to adopt.

The findings clearly demonstrate that there is market pressure from the market on firms to adopt tournament types of organizations. Hence, for companies that are sensitive to outside changes, the business environment influences the company's strategy and dictates what is the most appropriate managerial style. Business implications resulting from these forces could be grouped into the following four areas: Clash with strategy, Performance management, Career management, Local versus Regional approach.

Potential clash with HR strategy. Tournament type of organizational structure influenced by the market might be inconsistent with the firm's business strategy. Change can be a major threat to companies that have historically adopted an egalitarian type of structure or to those that have little practical experience with pay for performance systems. High pay differences and low stress on seniority suggest that the attraction and retention of key talent might become an issue for an organization pursuing an egalitarian system.

Importance of performance appraisal. Performance differentiation is the corner-stone of tournament type organizations. The ability to recognize the best performers for promotions and distribute the business gains based on the relative contribution of employees is what makes the system succeed or fail. Companies must make sure that the system is not only based on clear and logical factors but that the performance appraisal process is both fair and perceived as such by the employees. This might be a challenge in countries with no or little past experience with managerial performance appraisal.

Effective career management, (Turnover and Costs). Shortage of required managerial skill ten years ago gave opportunities to young people. Better opportunities, in turn, create higher expectations. What to offer to and how to motivate a young manager who holds positions similar in size to his or her eight years older counterpart in Germany might be an issue for many ECE companies. In connection with tournament types of organizations turnover in general might become a major issue as it is usually higher. The financial gains often linked to companies with pay for performance system might be offset by higher than desired turnover rates and increase in labor related costs.[24]

Balance between local and Global Approach to HRM. Anecdotal evidence suggests that some western managers overseeing the region treat it as part of the global business, ignoring the regional difference[25]. The findings of the study have quantified the feeling of many regional practictionaires that doing business in the emerging region requires a different approach than the one successfully applied in western economies. Business and HR decisions concerning the region should be made after considering local labor market characteristics, some of which are presented in this paper.

In summary, labor markets in Emerging Central Europe lean towards tournament types of organizations. This brings possible clashes with the business/HR strategies; and live-or-die emphasis on effective performance management system. In addition, it demands effective career management and reinforces an importance to differentiate between the management approach adopted in Western Europe and Eastern Europe.

It is clear that historical experience has made the current HR practice in ECE quite different from those in Western Europe. The next section asks how sustainable are the current characteristics of the labor market and how soon can we expect alignment of the practice with Western Europe.

Sustainability

The value of identified implications depends on how long these will be relevant. To estimate the sustainability of the tournament-like environment in the Emerging Central Europe, we identified and explored three areas that could provide an appropriate proxy for future development: GINI Coefficient, Foreign Direct Investment and Salary Gap between Western Europe and the region.

GINI Coefficient of Inequality. GINI coefficient (statistics that describes inequality in income distribution) is measured on scale from 0 to 100. Coefficient 100 means that one person holds all the income in the country, whereas 0 represents perfect equality. It is expected that with tournament-like systems there will be a higher level of inequality than in an egalitarian system. According to World Bank research, the transition in Eastern Europe has brought on an average increase in inequality, from a GINI coefficient of 25-28 to 35-38 (Milanovic, 1998).[26] Compared to the OECD, this means that whereas before the transition income distribution in former socialist countries was more equal than in Western, nowadays the situation is opposite. Furthermore, the study shows that the process of globalization is widening the gap between poor and rich countries as well as the gap within the emerging countries themselves. If we use GINI coefficients as a proxy of the tournamentality in a society and labor market, then the figures suggest that ECE countries that face gradually higher pressure of globalization will maintain their current level of tournamentality.

FDI Confidence Index. The shift from an egalitarian system to a tournament one is a result of economic, political, cultural and social changes in the region. The momentum of the reforms and transformation in emerging economies is often contingent upon an inflow of Foreign Direct Investments. The countries of ECE attract increasing inflow of FDI during the past years. The stock inward direct investment has accelerated during the past few years[27]. Looking at the future, the study by the consulting firm ATKerneay (2001)[28] places three countries of Emerging Central Europe among the world top 25 destination of FDI (with Poland at 11th place; Czech Republic at 16th; and Hungary at 21st). Central and Eastern Europe dominated European first - time FDI, taking in roughly 50 percent of planned investment. Furthermore, non-financial services executives ranked the Czech market as the third most-attractive destination for investment worldwide. A steady inflow of FDI in combination with optimistic forecasts suggests that the current level of tournamentality is likely to continue.

Gap between salaries in EU and ECE. As indicated throughout the paper, a major driving force behind the tournamentality is a difference in salaries between top and lower employees in the organization. Average worker salary that equals 15% of the EU 15 average[29], makes the region an attractive destination for investments. On the other hand, higher demand than supply for experienced managerial talents increases the salary levels at the top of the organization. We can expect that the current level of tournamentality will be decreasing with closing the gap between the salaries in EU and ECE. However based on some research, this will not be sooner than in 10 years time.[30]]

All three proxy indicators of how sustainable the current tournament-like environment in ECE is suggest that there is no indication of a turnaround in the current trend. Indeed, the slow process of closing the salary gap between EU and CEE, stable interest in FDI in the region, and the increased inequality suggest that the tournamentality will prevail for some time, perhaps even for decades.

Discussion

The paper illustrates that labor market characteristics have moved from egalitarian to tournament. While the data sample from Watson Wyatt Data Services was essential in the practical analysis, it needs to be recognized that it has its limitations in representing mostly subsidiaries of multinational companies. Thus, one can ask several questions: Does the sample represent the real labor conditions in the ECE labor market? What role does the world economy play in the observed trends? To what extent do the findings of tournamentality correspond exclusively to multinational companies and have little to say about local labor markets? While the author recognizes these questions as eligible and worth further research, the evidence suggests that multinational companies often represent a practice that is followed by the locals. If a local company wants to attract people working for multinationals they need to consider the labor conditions in those companies.

While the original intention of the study was to analyze the four ECE labor markets independently, in the end the author opted for an analysis of the region as a whole. The preliminary results on the surveyed factors showed that there is no significant difference between the economies and thus any meaningful differentiation would require deeper analysis that available for the research.

Conclusions

A review of past and current practices has revealed that the region has experienced dramatic change in moving from egalitarian to tournament-like labor markets. Current level of tournamentality in Emerging Central Europe does not only match that of Western Europe, but on many criteria exceeds it (see Fig. 1) Companies operating in the ECE or those intending to move in should consider the level of tournamentality as an external business factor. Increased level of tournamentality reveals strong market pressures favoring tournament system. In turn, this creates potential clashes with firms' business and HR strategy and demands special attention in implementing Human Resource activities such as performance appraisal or career management (see Appendix A). The current level of tournamentality is expected to remain constant in the current years and therefore it should be considered in both short and long run perspectives.

The wider merits and contributions of this research paper are many. First, it coins the term "tournamentality" and offers an approach on how to assess its relative level in a country or region, based on a combination of HR and macroeconomic criteria. Second, it puts together unique data describing the evolution of tournamentality, specifically in the emerging region of Central Europe. Third, it identifies business implications and suggests areas requiring special attention. Last, but not least, the paper suggests how to assess the sustainability of tournamentality levels in the emerging market economies.

In the future, further research will be needed to explore the psychological factors influencing the level of tournamentality and test the hypothesis of nominal versus real salary increases. Furthermore, it might be worthwhile to repeat the study for other emerging markets (e.g. Far East Asia or South America) and compare the level of tournamentality with the results in Emerging Central Europe.

APPENDIX 1: REVIEW OF THE PAPER

TOURNAMENTALITY is a degree to which a company or labour market is based more on a tournament rather than egalitarian system.

Differentiating Factors	*Tournamentality*	*Evidence*	*Implication*	*Sustainability*
Differentiating the Egalitarian and Tournament type of systems on the organisational level	**Quantification of tournamentality on the labour market level**	**Findings of the research show the shift towards higher tournamentality.**	**Four business issues identified that deserve special attention.**	**Three proxy that suggest that the shift towards tournamentality is not expected to turn around.**
1. Career related salary Increases 2. Salary Setting 3. Role of Seniority 4. Role of Pay for Performance 5. Psychological Factors	1. Pay Dispersion 2. Salary Determination 3. Average Age of Incumbent 4. Variable Pay: prevalence and its relative value 5. Unemployment, Regional differences, Nominal/Real Salary Increases	1. Higher salary dispersion in the organisations 2. Free labour market 3. Seniority is not important 4. Increased importance of pay for performance 5. Strong tournament-like macro environment	• Potential Clash with HR/Business Strategy • Importance of Performance Management • Effective Career Management • Balance between Local and Global HRM Approach	• GINI Coefficient of Inequality • Foreign Direct Investments • Salary Gap between Western and Emerging Central Europe
Theory		**Practice**	**Business Relevance**	

Notes

I would like to thank Watson Wyatt Data Services team for providing me access to its European compensation databases.

[1] Common estimates back in 1989 said that it would take between five and ten years to complete the transition period from command to market economy and to reach the GDP level of Western Europe.

[2] Weidlich, Roman. "Compensation Review in Central Eastern Europe" WW Regional Compensation Forum Brussels: Watson Wyatt Data Services, 2001.

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[9] Bloom, Matt, and John Michel. "The Relationship Among Organisational Context, Pay Dispersion, and Managerial Turnover." Academy of Management Journal (in press).

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[14] Bloom, Matthew, and George Milkovich. "Issues in Managerial Compensation Research." Working paper 95-24. ," Cornell University. Ithaca NY.

[15] Crystal, G.S. In Search of Excess: The Overcompensation of American Executives. New York: Norton. 1991.

[16] It is expected that this would apply to an environment with medium level of inflation.

[17] Úprava Federalneho Ministerstva Práce a Sociálnych Vecí zo Dna 12. Septembra 1984 cj. 51-12430-3156 o Odmenovaní Technickohospodárskych Pracovníkov. Bratislava: Federálne Ministerstvo Práce a Sociálnych Vecí SSR , 1984.

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Marketing of Store - Basic Operating Unit of the Retail Trade

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Abstract

Business is one of the important elements affecting the development of the economy. It belongs to the kind of industry which is mostly affected and is going to be affected by the process of the globalisation.

Doing business in the field of retail trade is an interesting opportunity for the entrepreneurs, but it encompasses many hidden obstacles and potential problems. Numerous entrepreneurs often lack elementary knowledge that would help them in the beginning. Many of them for example underestimate the opportunities of the communication with customers, technical equipment et cetera.

For more effective communication with different groups is recommended to apply a combination of communication means:

- **advertising**
- **sponsorship**
- **publicity**
- **public relations**
- **direct marketing**
- **actions of sales promotion**

Retail trade can be defined as a composition of the activities that are directly related to the sale of the goods or services to the final consumers for private, not commercial use.

Business is one of the important elements affecting the development of the economy. It belongs to the kind of industry which is mostly affected and is going to be affected by the process of the globalisation.

Doing business in the field of retail trade is an interesting opportunity for the entrepreneurs, but it encompasses many hidden obstacles and potential problems. Numerous entrepreneurs often lack elementary knowledge that would help them in the beginning. Many of them for example underestimate the opportunities of the communication with customers, technical equipment et cetera

Retail trade can be defined as a composition of the activities that are directly related to the sale of the goods or services to the final consumers for private, not commercial use.

It is a crucial fact to enquire store space for the beginning entrepreneurs. The entrepreneur can basically decide between two alternatives – a construction of new retail store or a re-construction of an existing one. He/she must bear in mind the fact that the building will be used for the storage, exhibition and retail of the products. The exterior and interior of the store have to fulfil this purpose.

The exterior of the retail unit represents the main form of the sales promotion. Great emphasis is on the facade that promotes the firm. That is why it should represent the character of the retail uniting (boutiques, foodstuffs, do-it-yourself). The facade should grasp the attention of walkers-by. They should instantly understand what kind of store it is, what kind of products the store provides, and how it differentiate from others or near-by business unites.

The important part of the exterior is a signboard, the show-windows and entrances to the store.

The use of signboards is an effective form of communication. They enhance the firm image, help customers know the firm. It is recommended to invest in signboards, because it fulfils an important promotional function to the firm. A signboard should be designed as an invitation for walkers-by, our customers.

The show-window can be the cheapest and most effective means of promotion. It should capture the attention and allure walkers-by into the store. The show-window represents the store, its supply, quality, price, product, although some retail dealer do not place the price of the products into the show-window. The show-window and the facade create the first impression of the store. The way the goods are presented in the show-window can make walkers-by enter the store and consequently buy something.

The entrance into the store is another important component of the exterior. If there is one entrance to the store, then it should be placed right form the show-window. If there are two the show-windows, the entrance should be between them. In every retail store there should be a backdoor for the delivery of the goods used as an emergency exit i.e. in case of conflagration. The backdoor are not obviously for the use of customers.

The interior should correspond with the exterior of the store. The whole should be enjoyable for the customer. In designing the interior, the elements that are interrelated and inseparable have to be taken into account.

The space of retail outlet is better to be divided into parts for the realisation of the sale of goods, for the manipulation with the goods, for the communication room, the nook for the employees and so on.

The interior helps to the creation of the store as well as the culture environment for the realisation of the goods. The soul of the interior is constituted by multiple components e.g.: the creative substantiation of the walls, the design of the floor, ceiling, the illumination, the proportional resolution of the room and space. The aesthetic effectiveness and value of the interior could be consulted with a consulting firm that deal with this business or one can rely on one's own taste.

The proper atmosphere of the interior that is makes customers associate the sort of the store /according to sold products/ should not be neglected. It is proved by scientific investigations that proper atmosphere of the sales room forwards the purchase of goods. For instance, it is appropriate to tune the atmosphere with modern music in a ladies boutique. The retail dealers, in doing so, can evoke the desired emotions that invite their feelings.

The painting of the walls and ceilings should accompany the colour of the floor, the colourity of interior equipment in harmony. The bright pastel colours are better for the striking assortment so as not to throw into the shadow the colourity of the goods. The colourful environment can brighten the assortment that is colourless and dull. The bright and lively colours that bring the feelings of cleanness and vigour are recommended in the kind of store that supplies food-character products.

The warm and exciting colours are chosen for day-to-day consumption goods.

For occasional-demand goods, stimulating environment and deep darker colours are to be chosen. The wall inside should split up the space of the store and divide the to-sale space from the not-to-sale space.

The choice of the material for the wainscoting of the wall is the matter of the character of retail store.

The design of the floor should be up to the character of the store, its requirements utility.

The shelves in a retail store talk about the quality, the price of the goods and about the position of the store.

A retail store is the place of immediate contact with the promoted product. It re minds of the existence of products and draw attention to them. It is a unique chance for an effective interconnection of the advertising and sales promotion.

Taking into consideration the above stated cohesion, we can put a question what is marketing in aretail outlet all about?

The retail outlets are distinguished by various attributes: the scale of services, supplied production line, price, the level of subjection, territorial concentration.

A retail store is the place of immediate contact with the promo ted product and here marketing plays a significant role.

In a retail outlet, there is a unique chance for an effective interconnection of the advertising and the actions of sales promotion. Here can be exhibited and presented products, and some can be zoomed in throw mediums. In the sale place customers are best prepared to soak the information about products and what is also important, is the fact that the customers route to the purchase directly in the store.

The advertising directly at the place of purchase is a special chance mainly for small businesses. There is an opportunity cut down on the costs of MEDIUM promotion. The moment of final decision the retail store should not be underestimated, because the goods are the centre of customer's attention what could consequently lead to the purchase of goods. The customer is better prepared to absorb information about products. The cunning, skills and the know-how of staff also adds to the invocation of the purchase.

In the marketing of retail outlets the price policy, communication policy, the location of the store and the goods play a crucial role. It has been mentioned a retail store, its exterior appearance and the position of goods.

A retail mark used by large business network introduce their products is a new marketing element for us. Retail dealers cannot yet offer such a tactic.

An irreplaceable role in marketing mix communication belongs to sales promotion. The aim of marketing communication does not have to be only sales promotion but also the achievement of the admittance as well as acceptance of the sent idea by the public or some interest groups.

The idea or message can be sent through a personal or an impersonal channel; eventually the channels can be combined.

A personal communication channel is made of sales agents that themselves visit their business partners or optionally they use personal phone calls in order to inform about goods.

Also media can be used for communication with customers. The way is indirect impersonal. The most important tool of impersonal communication is advertising.

For more effective communication with different groups is recommended to apply a combination of communication means: advertising, sponsorship, publicity, public relations, direct marketing, actions of sales promotion. Retail dealers communicate with customers by the exhibitions and packages of goods.

Not every business unit can use all mentioned communication means in full, because it depends on the financial resources.

An irreplaceable role in retail trade plays promotion.

In recent years advertising activities quickly shipped to the retail store. It is sophisticatedly proved that the place of purchase has an irreplaceable role in the process of decision making, selection and realisation of purchase. That is why marketing professionals do not consider the activities at the place of retail trade only as additional but elaborates actions for so-called point-of-sales advertising at the strategic and tactic level as carefully as they plan next promotion means.

The covering design is recognised as the first stage in efficient promotion of a product. The covering design is marketable article. The design organisations are becoming more active and leading/directional promoters of branded articles. Attention is to be paid to the full integration of a product and its design, otherwise the package could be perceived as of higher quality class as the product itself. The immediate interrelation of the covering design and the promotion of the product are as essential for a brand as its overall image.

The sort article was to highlight the opportunities of some communication tools in the retail trade purchase.

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Marketing Strategy in the Pharmaceutical Industry, Issues – Trends – Options

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Abstract

Advances in research and development have traditionally led the pharmaceutical industry, but, despite huge investment, the rate of discovery of new drugs has slowed in recent years. There has been a corresponding growth in the importance of the marketing function in selecting and reaching the most appropriate segments of the markets and for positioning new and existing products. The paper provides the selection of the panoramatic view from the mind of a marketing strategist. It presents both a strategic view of the role of the marketing in the pharmaceutical industry and a partial explanation of the applications of that strategy to the ethical sector of the industry, examining legal and ethical issues surrounding pharmaceutical promotions and the benefits of pharmaceutical advertising and promotion, discussing the effectiveness of industry self-regulation and the potential for further legislative or regulatory response. It offers a framework for understanding the informational effects of pharmaceutical promotion programs from a marketing and economic perspective.

Strategic marketing in the pharmaceutical industry – selection of the value

The basic role of marketing in the pharmaceutical industry is to transform the innovations from research and development (R&D) of new treatment options to the value added quality of life – in terms of protection, prevention, stabilization and/or recovery of the health – in order to become as close as possible to the final consumer, individual patient and his/her needs (Foltán, 1997).

The reason of any kind of the business is to offer effective and efficient value (usually with "making profit" dimension). The marketing understanding of the value creation and utilization is the basement for the best possible satisfaction of market options and needs (see also Fig. 1). The value creation chain, however, could be derived only after the precise value selection in the process of the strategic marketing realization in its several phases – segmentation, targeting, competitive analysis and product positioning (Kotler, 1998).

Valeu Selection	***Value Creation***	***Value Expansion***
Segmentation	Research and Development	Sales Force
Targeting	Pricing	Promotion
Positioning	Resources Allocation	Distribution and Services
Competitive Analysis	Production and Logistic	Advertisment and Others

Fig. 1: VALUE CREATION CHAIN

In the meantime, the standard business oriented organizations use the marketing tools to create the added value and profits, while the role of the marketing within the pharmaceutical industry and healthcare system is somehow relatively specific. Marketing of the Pharmaceuticals is the most organized, the most detailed and the most broad in scope information system, which serves as the up to date knowledge management, capturing availability, safety, efficacy and effectiveness of treatment options for the sustainable growth of the basic human value - the Health (France and Grover, 1992).

Increased regulation, generics competition, movement towards harmonization of regulations around the globe, pressure on margins and proliferation of “me-too” products are all factors that will severely constrain the strategic thinking of pharmaceutical companies. Biotechnology and more rational drug development approach, mergers and acquisitions, new communications technologies and global economies of scale are all opportunities that will have to be integrated into practical strategic management in the drug industry (Corstjens, 1992). The primary product of the industry is the drug and/or treatment option - more recently called disease management (Tindall, 1996). The real value of such product is about to be realized only on condition that the treatment is available in the right time, on the right place, of the right quality and for the right price (Kolassa, 1996).

Moreover, the pharmaceutical products includes prescription and non-prescription (“over the counter” or OTC) drugs. Thus, while OTC products are somehow similar to consumer goods and therefore not explicitly treated by the “core” pharmaceutical marketing, the main focus of the pharmaceutical marketing is on prescribing drugs, which share some characteristics in common with industrial goods and some others characteristics with consumer drugs (see also Fig. 2). The similarities with industrial gods are due to the multi-party aspect of buying process. For ethical drugs the following different buying parties can be identified (Corstjens, 1992 and Foltán, 1997):

- Prescriber - Doctor
- Influencer – Hospitals, Nurses, Professors, Reimbursement agencies (government)
- Consumer – Patient
- Financer – partly Patient, partially Government and/or the 3rd Party (varies by country), Managed Health Care Organizations, etc.

	Consumer goods	Industrial goods	Pharmaceuticals
Customer	Large population Simple decision Consumer pays	Small population Complex buying Buyer pays	Large population Complex process Consumer pays a part
Product	Small transactions Low units Purchase not critical	Large unit value Medium risk Purchase is critical	Small transactions High risk involved Ethical dimension
Regulations	Relatively minor Patents not crucial	Relatively minor Patents are presented	Very important Patents are crucial Government policies
Research & Development	Not very crucial	Can be crucial Customer suggestions	Complex and risky Try & Error

Fig. 2: CONSUMER, INDUSTRIAL AND PHARMACEUTICAL GOODS – THE DIFFERENCES

Given the particular long lead-time in research and development in the pharmaceutical industry, building a market-driven organization demands close integration of corporate and marketing strategy. Together these strategies should address two crucial issues :

- Which customer needs and markets to serve ?
- How to allocate the corporate scarce resources to the selected target customer needs ?

Segmentation, targeting, positioning and competitive analysis are the main components of the successful marketing strategy, and the primary preoccupations of marketing managers on day-to-day basis.

Identifying Market Segments

There is almost an infinite number of ways in which to segment a market. Before concentrating on a particular disease, companies need to know its potential return – which is known, rather awkwardly, as the “disease profit pool" – and how easy it would be to capture and defend a sizable share of it. We define this pool as the difference between annual revenue from the treatment of a disease and the cost to the industry of proving treatment (Bastianelli, 2001). A company can work out how much of any disease profit pool it can capture and defend by comparing its strengths in attacking the disease – its product and project portfolio as well as its marketing, licensing and financial capabilities – with those of its competitors.

Four fundamental criteria can be used to evaluate a segmentation scheme. First, a god segmentation scheme identifies segments that are (1) homogenous within the segment and (2) heterogeneous across segments. The potential profitability or the minimum size of a segment must be known. Since the objective of segmentation strategy is to develop and communicate a product offering to a target segment, it is a "conditio sine que non" that these segments also (3) be identifiable and reachable. The optimized segmentation is thus reachable once the each segment (defined based on the criteria listed above) is accessible and differentiable via available marketing tools (4).

The potential advantages and drawbacks of the market segmentation

The fact that so many companies in the pharmaceutical industry have come to accept and implement the notion of market segmentation bears witness to the significant advantages to be gained from such an approach. Overall, market segmentation is vital tool, which improves both the effectiveness and the efficiency of the marketing programs. It improves effectiveness ("doing the right things") by enabling the company to develop products and marketing strategies that have a better fit with the customer and by allowing for niching and differentiated marketing approaches. It also reinforces efficiency ("doing things right") by reducing the competition in the market place and by creating the opportunity for more focused and cost-efficient marketing-mix programs.

However, it is important for marketing managers to be aware of some potential problems with market segmentation. The fact that certain companies in the pharmaceutical industry have not yet adopted a market segmentation philosophy cannot be explained exclusively by an intrinsic aversion to new, management tools on the part of management.

First, market segmentation as a "rifle" approach, as opposed to an undifferentiated marketing "shot-gun" approach, suffers from the idea that it "puts all its eggs in one basket". Limiting the scope of the business to a particular segment when an attractive overall market exists for the specific product is sometimes really very difficult to manage and achieve.

Secondly, market targeting may give rise to "tunnel vision". Almost all pharmaceutical companies that adopt the segmentation approach, at some point in time, develop a specific segmentation scheme and select particular target segments and then keep working within those segments, in some cases, for a number of years. Those companies are usually not ready to carry out a segmentation analysis several times in the course of mid-term and/or even long-term time expired. Market dynamics, however, may be such that the original target segment has, in fact, modified itself and the market developed in a totally different segmentation structures.

Thirdly, any market segmentation system is by definition arbitrary. Nobody can justifiably say that he or she has developed a perfect scheme. The reason is mainly derived form non-perfect homogeneity in the real life.

Fourthly, any segmentation (or even strategy in general) strategy is only "as good as" its weakest link. Usually, some companies have been reticent in adopting a segmentation approach because it implies another way of managing the business and it requires new skills in analyzing the market, in developing marketing strategies and in the organization of the sales departments.

In order to make any segmentation strategy and scheme to work, we have to set up the measurable and achievable criteria for the regular monitoring, fine-tuning and adopting of the specifically designed segments. Standardized syndicated data bases (e.g., IMS Statistics) might not be the best basis for segmenting markets. We have to try to incorporate one of the several new frameworks and tools, such as disease management, standardized therapeutic approaches, etc.

Target market selection

After having segmented the market, the choice of the actual target market will depend on three key issues:

- The economic attractiveness of the target segment – the size, growth, price sensitivity and entry / exit costs are important indicators for the appeal of alternative target markets.
- The competitive activity in the proposed target markets – the size and power, expected reactions, expected market shares, etc.
- The strength of the differential advantage for the target customers, SWOT analysis, the level of "me-too" risk, etc.

In general three possible market approaches follow from the target market selection process: (1) A single niche strategy (micro monopoly), (2) A differentiated or multiple niche strategy (disease management) and (3) An undifferentiated strategy ("big pharma"). The choice between these strategies depends on the company's resources, the differential advantage of the product offering and the heterogeneity of the customer population.

Product positioning

The positioning involves the projection of the offer/supply, which has a chance to be appreciated by the market/demand via competitive position in the mindset of target market and/or target customer (Kotler, 1998). It requires the decisions of how many features and benefits should the product consist of, and which of them are necessary to present for the target segments of market/customers. The positioning of the product will determine the following:

- The type of conditions for which the product will be prescribed (indications, the target specialists group, etc.).
- The type of patient for whom the product will be considered suitable (the first line treatment, add-on therapy, new diagnosis, the last weapon tool, etc.).
- The products with which it will compete most closely (including the internal competition of our own portfolio).

In fact, the product positioning reflects the specific customer perceptions and needs, that is way there has to be the specific sub-strategy of the product placement within the individual groups of targeted segments.

Differential advantage

A differential advantage is one or more features of the product offerings which satisfied at least three fundamental criteria:

- It differentiates the product from all others, creating a perception of uniqueness.
- It is important, or can be made to seem important, to the target audience.
- It is sustainable, over time, against the competition.

The distinction between product features and benefits is not always well understood or applied in the pharmaceutical industry. The misunderstanding manifests itself in two common types of error. Firstly, the use of claims, well supported by clinical trials, which are not in fact perceived as important by prescribers. Secondly, a series of claims, for which evidence is provided in the clinical trials process, are used to position the product, the implicit assumption being that the more claims a product can make the better.

Types of positioning

The manager has to react on the market needs and company resources the way that the product placement should reflect all those challenges, in order to be as accurate as possible for the specific product and segment. Thus, six main approaches used to position pharmaceutical products can be identified (Aaker, 1982).

- Positioning based on a specific attribute
- Positioning with respect to use or application
- Positioning with respect to the end user (type of patient)
- Positioning with respect to a competitor
- Positioning with respect to a product class
- Positioning with respect to marketing-mix variables

Several specific methods have been developed in order to measure and evaluate the right strategy for the product placement. The process of measuring product position involves three steps:

- Identifying the competitive product offerings
- Determining how these competitive product offerings are perceived (uniqueness)
- Determining how the target market evaluate these product offerings (importance)

A number of methods have been developed to help capture the perception of products. Broadly defined they fall in one of two categories: compositional and decomposition methods (Green, 1988). Compositional methods are based on the belief that prescribers can decompose their perceptions of brands into separate attributes and can evaluate each of the brands on this set of attributes. This leads to methods such as semantic scales (Wilkie and Pessemier, 1973). Decomposition methods are based on the idea that people have global perceptions of objects, which they are not necessarily able to decompose. The typical method from that subgroup is the perceptual map (Green, 1988).

Implementing some specific market conditions, dynamic of the organization as well as the new environment influences (new communication tools, regulatory affairs, etc.) we can observe, in addition to those product placement types we have listed above, some alternative forms of positioning, such as (1) multiple segment positioning, (2)”me-to” positioning, (3) defensive positioning of a second (“fighter”) brand and/or various combinations and derivations of those methods.

A Concluding note

No positioning strategy can guarantee complete sustainability, but a good positioning strategy will be one that is sustainable for a longer period of time that other positioning strategies. Price is usually a weak differential advantage, unless it is based on substantial cost advantages. Strategic marketing and positioning are all about making price less important to the customer, and some of the other benefits of the product more important, thus incorporating the marketing to the overall strategy from the very beginning of “the willingness to sell our product, service or idea”. In addition, looking at the value chain of the pharmaceutical company, the strategic marketing part is the most crucial momentum in that process. “The rest” is a pure marketing-mix and/or marketing communication skills (Fig. 3).

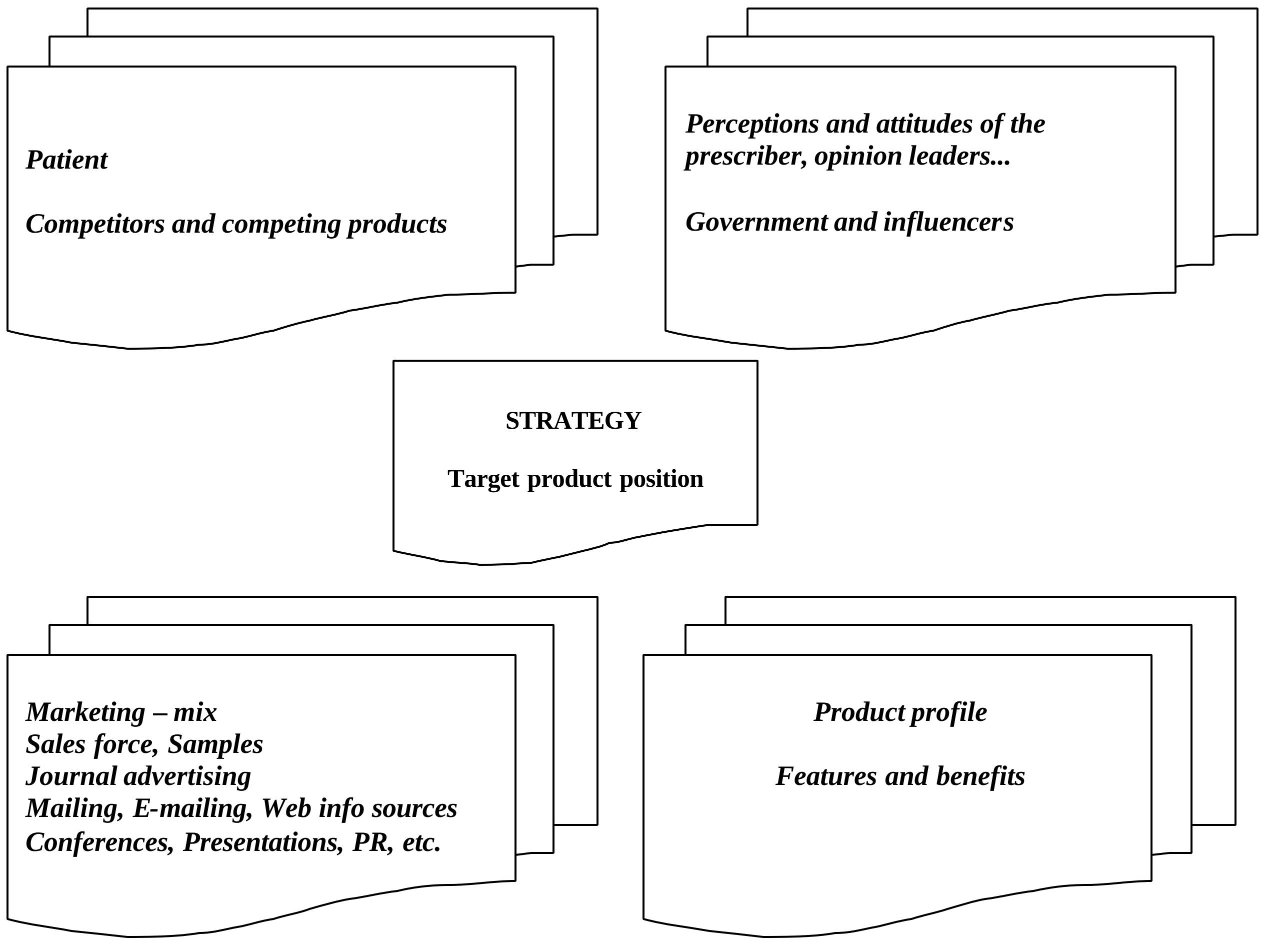

Fig.3: STRATEGIC MARKETING FRAMEWORK IN THE PHARMACEUTICAL INDUSTRY

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Models for Some Slovak Economic Time Series

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Abstract

It is well known from econometric literature that the USA inflation data have relatively complicated behavior and are therefore used for illustration of functioning of recently developed time series models. We analyze analogical Slovak data and find out certain structural similarities between the two models. Moreover, we treat time series of total hard currency reserves of Slovak banking system in the form of nonlinear model, similar to one that had been successfully applied for German unemployment data.

1. Models for USA and Slovak inflation

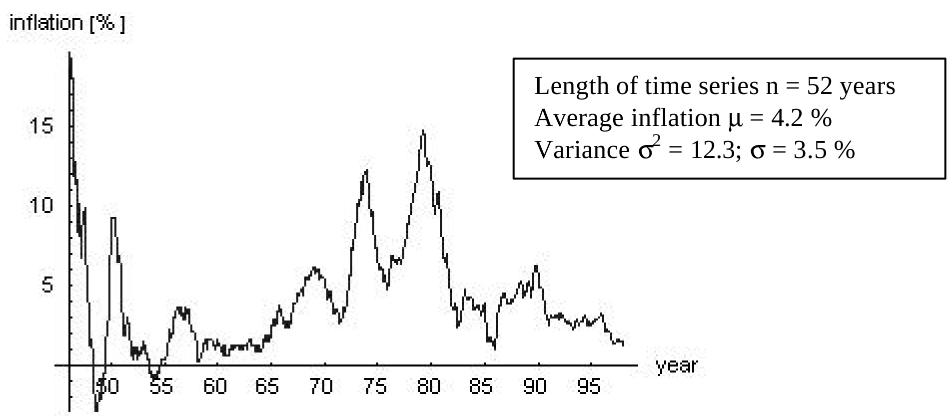

Fig. 1: DEVELOPMENT OF ANNUAL INFLATION IN THE USA (RECORDED MONTHLY), 1947 - 1995

There is no obvious global trend in the above time series. Postwar high inflation years were followed by a short deflation period and a new pick accompanying the Korean conflict. Two major extremes in 1974 and 1979 are related to oil crises. It is not immediately obvious if there are any significant periodic tendencies influencing this time series.

Using periodogram and tests for significant periods we concluding that significant periods were:

312 months = 26 years, 60 months = 5 years, 84 months = 7 years.

Applying linear regression we estimated the following cyclic component:

$$C_t = 4.20 + 1.91 \operatorname{Cos}\left(\frac{\pi}{156}t + \frac{\pi}{4}\right) + 2.59 \operatorname{Cos}\left(\frac{\pi}{30}t + \frac{\pi}{5}\right) + 0.55 \operatorname{Cos}\left(\frac{\pi}{42}t + \frac{\pi}{6}\right).$$

The residual variance $\sigma^2_{res} = 6.95$ ($R^2 = 0.43$).

We continue our analysis by plotting values of residuals ε_t and their partial autocorrelation function.

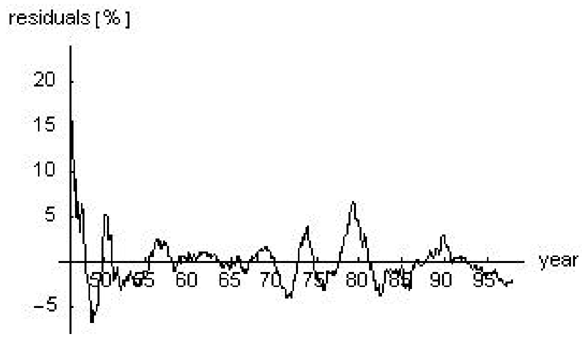

Fig. 2: RESIDUALS AFTER REMOVING THE CYCLICAL COMPONENT

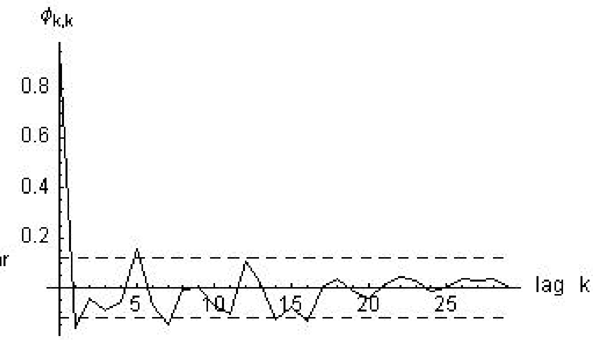

Fig. 3: PARTIAL AUTOCORRELATION FUNCTION OF RESIDUALS

Applying Box – Jenkins methodology [1] we concluded the residuals are optimally fitted by the model AR(5) with only two nonzero coefficients:

$$\varepsilon_t = 1.0825\ \varepsilon_{t-1} - 0.123\ \varepsilon_{t-5} + u_t\ .$$

Next we analyze residuals u_t of AR(5) model.

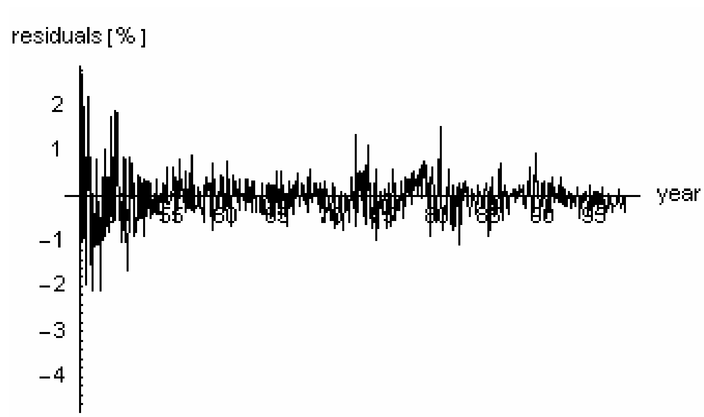

Fig. 4: RESIDUALS AFTER AR(5) MODEL

From this graph we can conclude that the residuals are heteroskedastic and we try to find GARCH class model for them. The best in this class is the model ARCH(4) (see [5]):

$$u_t = \nu_t \sqrt{h_t}\ ,$$

$$h_t = 0.036 + 0.359\, u_{t-1}^2 + 0.209\, u_{t-2}^2 + 0.224\, u_{t-3}^2 + 0.314\, u_{t-4}^2$$

where ν_t is a white noise with $\sigma^2 = 0.225$.

Finally we compare the original data with the fitted model.

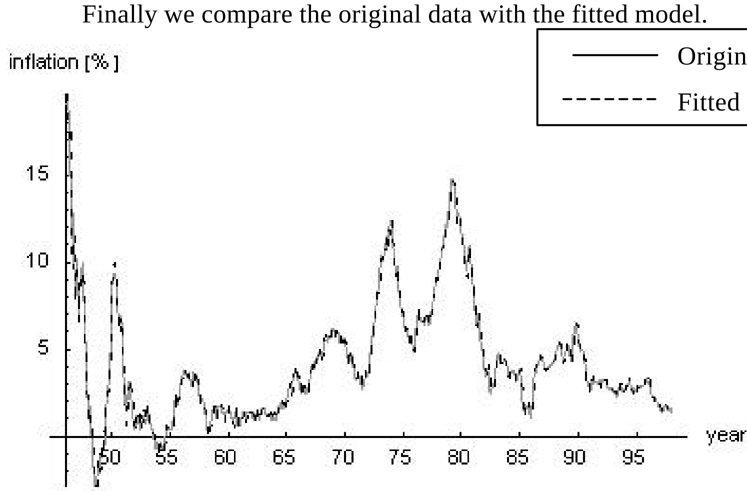

Fig. 5: USA INFLATION DATA AND THEIR APPROXIMATION BY THE MODEL

Now we perform analogical analysis for Slovak inflation data.

Length of time series n = 8 years
Average inflation μ = 10.99 %
Variance σ^2 = 33.17; σ = 5.76 %

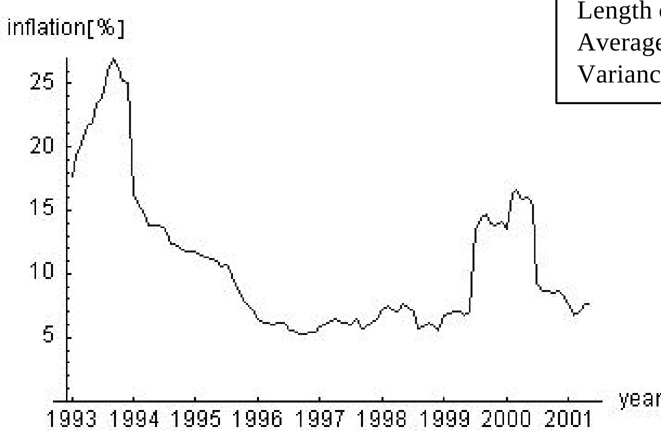

Fig. 6: DEVELOPMENT OF ANNUAL INFLATION IN SLOVAKIA (RECORDED MONTHLY), 1993 - 2001

We can observe two periods of high inflation: the first one following the division of the Czech and Slovak Federative Republic and introduction of the Slovak national currency; the second between 1999 – 2000 in connection with so-called "package of economic measures" and related release of controlled prices of gas and electricity. We again analyze significance periods and found out that the only significant period was two years. The cyclic component:

$$C_t = 11.05 + 0.89 \sin\left(\frac{8\pi}{96} t\right) - 1.86 \cos\left(\frac{8\pi}{96} t\right).$$

After removing the cyclic component we again received the best model for residuals ε_t in the form AR(5) with only two nonzero coefficients:

$$\varepsilon_t = 0.8011\ \varepsilon_{t-1} - 0.1605\ \varepsilon_{t-5} + u_t\ ,\ R^2 = 0.64.$$

Next we analyze residuals u_t of AR(5) model.

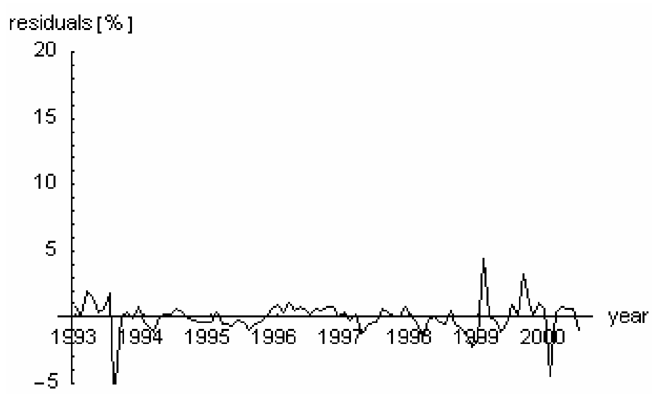

Fig. 7: RESIDUALS AFTER AR(5) MODEL

Again from this graph we can conclude that the residuals u_t are heteroskedastic there we try to find GARCH class model for them. The best in this class is the model ARCH(1):

$$u_t = \nu_t \sqrt{h_t}\ ,$$

$$h_t = 0.785 + 0.783\, u_{t-1}^2$$

where ν_t is a white noise with $\sigma^2 = 1.41$.

Finally we compare the original data with the fitted model.

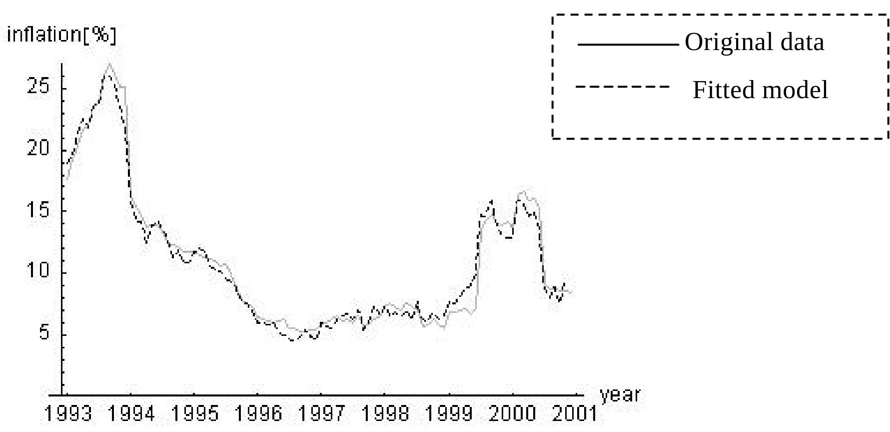

Fig. 8 SLOVAK INFLATION DATA AND THEIR APPROXIMATION BY THE MODEL

2. Nonlinear models

The famous example of time series fitted by a nonlinear model are German unemployment data:

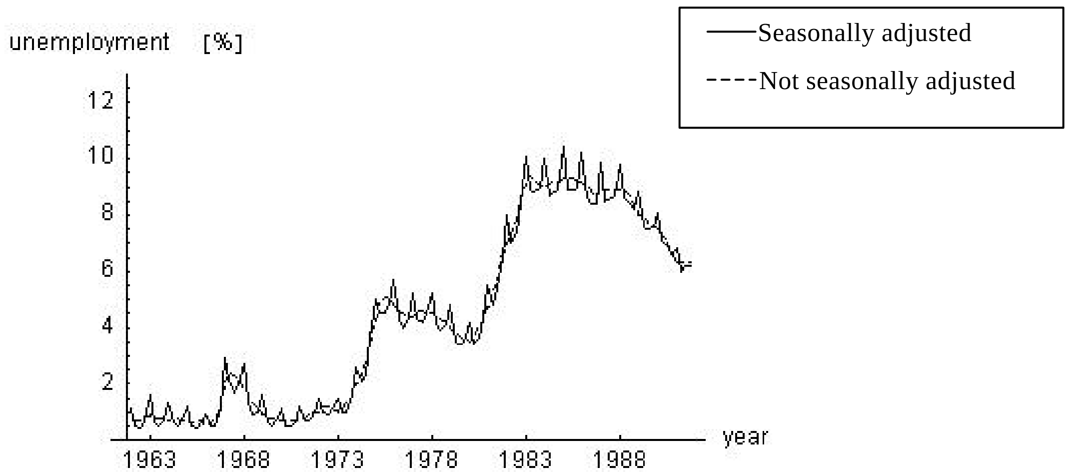

Fig. 9 QUARTERLY UNEMPLOYMENT RATE IN GERMANY (1962 – 1991)

A suitable model for seasonally adjusted version of this time series has the form (see [4]):

$$y_t - y_{t-1} = \mu_1 I_t \text{ [expansion year]} + \mu_2 I_t \text{ [recession year]} + \varepsilon_t$$

where I_t [.] is an indicator variable, which allows the absolute value of the rate of change to vary across the two states, say, "decreasing y_t" and "increasing y_t" from μ_1 to μ_2, where μ_1 may be different from $-\mu_2$. For the German seasonally adjusted unemployment rate $\mu_1 = -0.040$, $\mu_2 = 0.388$, indicating that when the unemployment rate increases (in recessions), it rises faster than when it goes down (in expansions).

The above form of models enables us to fit time series with steep jumps in values. We will make use of this property by modeling time series of hard currency reserves of the Slovak banking system.

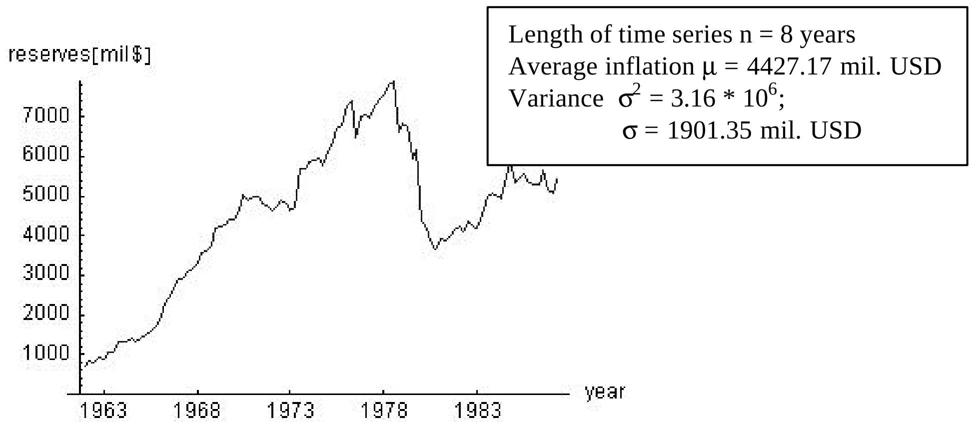

Fig. 10: HARD CURRENCY RESERVES OF THE SLOVAK BANKING SYSTEM (1993 – 2001)

We see that clearly increasing global trend has been dramatically reversed in several critical months. For example in September 1998 and February 1999 the value of reserves dropped by more than 1 billion USD. We identified 9 critical months (with dramatic reductions of reserves) and used their identification function in our regression model for first differences of the original data. We received the model:

$y_t - y_{t-1} = \mu_1 I_t$ [standard month] + $\mu_2 I_t$ [critical month] + ε_t ; $\mu_1 = 127.424$, $\mu_2 = -624.064$ ($R^2 = 0.47$).

We continue by analyzing residuals ε_t of the above model:

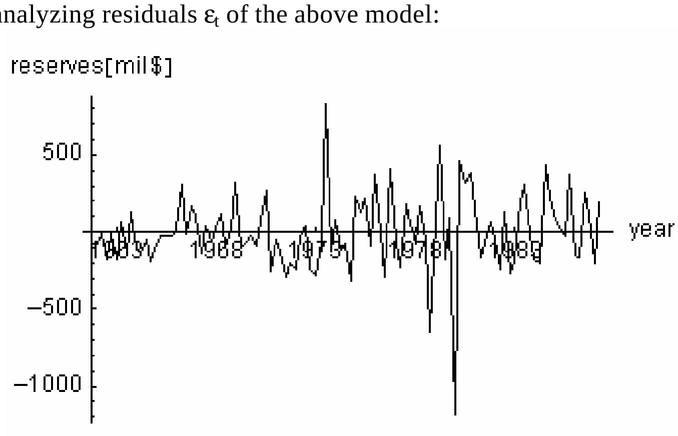

Fig. 11: RESIDUALS OF THE NONLINEAR MODEL FOR HARD CURRENCY RESERVES DATA

Using Box – Jenkins methodology [1] we received the model of ARMA(1, 1) type:

$$\varepsilon_t = 0.85\ \varepsilon_{t-1} + u_t - u_{t-1}$$

where u_t is white noise with σ^2 = 56 064.4.

Finally we compare the original data with the fitted model.

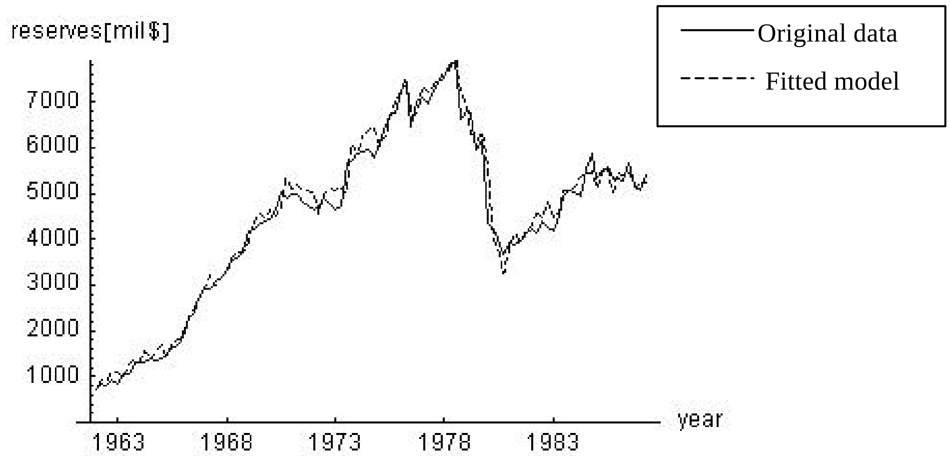

Fig. 12: SLOVAK HARD CURRENCY RESERVES DATA AND THEIR APPROXIMATION BY THE MODEL

Acknowledgements

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Price Strategy in Chemical Enterprises of the Slovak Republic

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Abstract

The market mechanism creates complicated and demanding conditions for the viability and prosperity of enterprises. In functioning the market economy the dominant factor is price. By means of prices, mutual relations are being formed and objectivized on the basis of the continual dialogue conducted in the market between the effective demand and supply.

The liberal formation and price movement are fundamental prerequisites for the existence of the market economy. In conditions of the operating market mechanism the price is a principal bearer of information necessary for enterprise decisions on what, how and for whom to produce.

Important elements in the well functioning market are also state interventions (mainly in the sphere of prices within the price policy) which should serve mainly for protection of the economic competition, for determination of the competitive principles, etc. The legislative price regulation is a basis for the price control activity which is an integral part of the state price policy.

The price is an important instrument of the enterprise management. On the one hand it reflects:

- the product usefulness which is given by an extent of the ability to satisfy the customer,
- the rareness of the supplied product, i.e. the measure of the customer's satisfaction viewed from the aspect of the significance, width and quality,
- production costs for the product.

On the other hand, price has a remarkable influence on a lot of factors characterizing the level of the enterprise economy and, at the same time, functions as an intermediator between the supply and the market. Every implemented decision about the price movement activates such categories as profit, turnover, market share, etc.

From the above-mentioned facts it follows that in the process of purchasing or selling price has an informational as well as a stimulation function which is important for the business orientation of entrepreneurs to achieve the higher product quality, improve services, reduce costs, or to promptly react to demand, increase the quality of supplementary services or, in general, to achieve the higher level of the customer’s satisfaction. Such a process leads to the enterprise stability and development.

The reaction of demands to the change in prices is monitored by enterprise marketers via detection of the price elasticity of demand. In principle, the matter in question are two demand curves demonstrating the relation between price and demand in the way shown in Fig. 1.

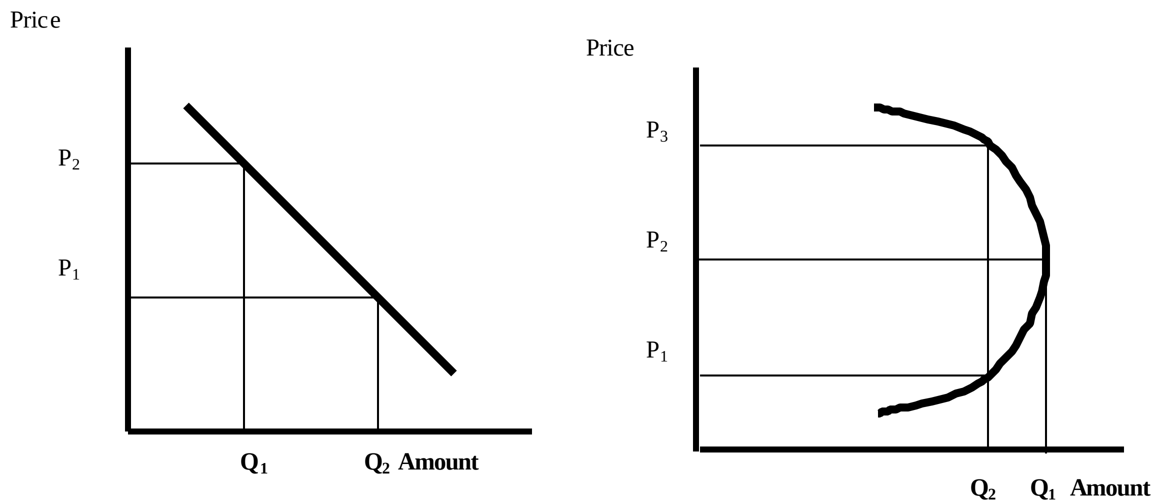

Fig.1 TWO HYPOTHETICAL DEMAND CURVES

The following situations are possible:

- market equilibrium: DEMAND = SUPPLY
- market disequilibrium: a) DEMAND < SUPPLY $\rightarrow$ prices will decrease
  b) DEMAND > SUPPLY $\rightarrow$ prices will increase

The above-indicated considerations are based on the condition that besides the price other factors must remain unchanged. If the demand at small price variations does not change, it is non-elastic but if the demand changes markedly at these variations it is elastic.

The price movement with a downward tendency is limited by costs. The market character (the pure monopolistic or oligopolistic competition or the pure monopoly) and the above-mentioned demand determine the upper limit of prices. The factors influencing price decisions are external. They include also other ones such as price and competition, economic factors, intermediators and the public administration.

On the other hand, the price decisions are influenced by the firm's marketing objectives, marketing mix strategy, costs (determining the lower price limit) and the organization of pricing.

The firm must made decisions primarily on its production strategy. It chooses the target market, sets the market position and subsequently the marketing mix strategy inclusively price or other supplemental goals. The precise determination of objectives facilitates the process of the price determination.

The generally valid objectives include the survival, profit maximization, market share maximization, and supremacy of the product quality (leader).

The price decisions can have different consequences for the firm which often prefers compromises in order to respect not only marketing objectives but also the level and possibilities of financial services, action of competitors, interests of collectives, choice between traditional and new approaches and methods, etc. The sensitivity of the influence of prices and their fluctuations on the action area of the business activity and its effectiveness is extraordinarily high and therefore the measure of responsibility for pricing decisions is considerable.

The firm's price policy is represented by all activities associated with the price assessment or sales price alterations, or conditions by which the price is affected. The purpose of the price policy is to define and compare various pricing requirements for potential consumers and enforce decisions made on certain solutions of the price problems.

The pricing decisions are connected mainly with:

- the price determination of new products, entry in the market and job order,
- price variations caused by a change in the demand or production costs, or with an effort to promote the demand,

- price variations induced by the competition,
- introducing the optimum relations of prices for products within the given price level set on the basis of their mutual price and cost relations.

The price and political decisions are associated primarily with the determination of:
- price and political objectives,
- the scope of price and political decisions.

Price and Political Objectives

are derived from the firm's objectives and serve as a relevant criterion for a choice of the suitable price. The point in question can be the maximization of the profit volume, the maximization of profitability and sale, or the maintenance and improvement of the market share, the enterprise effort to completely dominate the market by nipping the competition, or the firm's objective to survive in the market.

If the (internal) viewpoint of an enterprise is considered as an aspect in determining its objectives, then the pursued goals can include:
- the sale adjustment to production conditions,
- the thorough exploitation of production sources – total employment,
- the creation of the optimum cost situation.

If an enterprise prefers the market (external) viewpoint, then the achievement of its goals will require:
- to maximize the sale,
- to acquire a favourable position in the competition (to gain a market share),
- to edge the competitors out of the market.

In the enterprise practice an important role usually plays the combination of objectives which are to be achieved in the certain time period.

The Scope of Price and Political Decisions

can be divided into:
- the action field of the price policy representing the extent of free negotiation possibilities, action parameters available in the given situation,
- the data field of the price policy comprising facts which demarcate the action field of the price policy, namely by:
  - legislative factors or laws such as Act on Protection of Economic Competition, Price Act, statutory provision on dumping but also many other market-regulating legal measures,
  - institutionalized standards, i.e. traditions and customs having the natural influence on the behaviour of a firm which is afraid that if it does not respect them, the neighbouring community will react negatively,
  - economic factors including both internal and external ones which prevent the firm from implementing some of its price and political alternatives, for example, when the production capacity is limiting the production volume or when the demand is limited, etc.

Which Factors Have Influence on the Pricing Strategy in Chemical Enterprises?

At the beginning of the last decade, i.e. after the change of political and economic conditions in Central and Eastern Europe Slovak chemical enterprises found themselves in the new situation. In these countries the market disintegration caused that even in the previous local Czech market the chemical enterprises faced the strong competitive environment and were obliged to search for other possibilities of establishing themselves in the foreign markets. In nineties, the enterprises were focused due to this fact primarily on solving the short-term objectives associated with their short-term physical survival in the new conditions. The process of internationalization and globalization forces them to adhere to new practices based on the segmentation of the global market, on the comprehensive analysis of needs of the potential consumers, on the analysis of the competition, distribution channels as well as on other factors in the micro- and macroenvironment.

The analysis of the price strategy in Slovak chemical enterprises refers not only to a lot of problems exerting an influence on it, but also to the way how these problems should be clarified and dealt with.

The principal problems of our enterprises include a low consumption in the local market caused by the attenuation of the majority of sectors. For example, this can be observed in the industry of packing materials, building industry, and in the sphere of mining and wood exploitation where a low consumption of the explosive agents is reflected, etc. This problem leads to the low exploitation of production capacities and to higher costs per product. In solving these difficulties the enterprises are concentrated to gaining the price advantage. They are sacrificing part of the profit to the detriment of the higher market share which will ensure the acquisition of higher financial sources for them in order that the reproduction and modernization of production processes could be extended. The highly important basis of information required for the decision-making in this sphere is the intradepartmental controlling, the objective of which is to help in managing the profit by employing such instruments as budgets, costing, standards, and accounting.

In the orientation to the West-European market the certification process of products has a braking effect associated in the case of specific chemical products with legislative restrictions. This can be explained by an effort of individual countries to keep the dominant or even monopoly position of their home producers owing to the fact that they are very often at a disadvantageous position caused by the low exploitation of their production capacities and by their more expensive labour and energy in comparison with the Slovak market. But on the other hand, when Slovak producers want to certify their specific production assortment, for example in Spain, Switzerland and Germany, they must certify their products in each country separately, which is, of course, a great disadvantage for them. After the year 2002, the guidelines about individual criteria for approval and certification of the industrial explosive agents and explosive technics should come into effect. This standard will be valid in member countries of the European Union and will accelerate the certification process and entry in the new markets.

Considering the interests of our enterprises the Czech market is the most convenient for them. After the disintegration of our previous republic two independent states were established and thereby two independent markets. Nonetheless, business activities and good partnership relations continue with the majority of Czech buyers. However, our producers are oriented primarily to west markets which are from the point of view of profitability interesting and advantageous because of the solvency of business partners.

The Slovak chemical enterprises base the price determination of their products largely on competition prices and on the existing market situation and saturation. It is necessary to stress that our enterprises are as a rule under the great competitive pressure, especially in the sphere of prices.

The solution of these and of many other problems will never be final. In the competition environment new problems will permanently arise and will have to be solved by enterprises if they are to survive.

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Problems of Insurance of Export Credit Risks in the Czech Republic

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Abstract

Long-term statistics show that even in case of seemingly safety countries and confirmed customers there may arise problems, either as a result of own bad management or secondary financial insolvency. Indispensable is also the significance of credit insurance as a tool for bank financing. If the claim is insured, it can be used as a guarantee for the bank for granting operating credits. In connection with revival in the European Union, other volume increasing of insurance of short-term commercial risks can be expected both in export and home claims.

Introduction

Development in economy forces all participants in barter relations, entrepreneurs in particular, to get consistently familiar with risks and, thus, to create certain possibilities preventing them from arising or, at least, reducing their impact.

Compared to sale in the home market, export is connected with higher financial, transport, packaging, storage and goods handling costs as a result of a higher credit demands. Higher risk causes mostly necessity to insure risks, make various securing operations, etc.

Sale of goods or provision of services in foreign markets entails a lot of risks in different phases of preparation and implementation of a business case. It is, on the one hand, incomplete or incorrect market research, i.e. situations when, compared to expectations, the goods are difficult to be positioned in the market, price level is adjusted incorrectly or the territory is not secure enough from the perspective of political and economic stability.

Another type of risks is a selection of a supplier, his ability and willingness to fulfil his obligations. If a firm is addressed by a person interested in its products, it must try to get as much information about him as possible. The firm can also use international agencies for this purpose collecting this type of information and selling them for the amount of several thousand Czech crowns. These are, e.g. Dun & Bredstreet, Intercredit or Creditreform operating in the Czech Republic. Political and economic situation in the country of a customer's registered office should be observed and also whether he is releasing his financial statements fully in accordance with law, whether he does not occur in the state of an official financial insolvency or does not head towards this state, whether a payment order was not issued against him, whether he observes obligations towards the state in time and whether he routinely uses invoices with deferred maturity. A very suitable form of insurance, especially for the second type of insurance, is the insurance of supplier credits.

Maximum sureness that we do not lose payment for goods in trading on invoices is provided by insurance of claims with credit insurance company with international force. Part of services of these insurance companies is not only the proper guarantee for the client's claims up to the level of the so called credit limit representing an agreed maximum amount of claims indemnification by an insurance company per a given customer but also reliability and solvency evaluation of the customers all over the world and, sometimes, even recovery of outstanding debts.

1 Export Insurance Characteristics

One phenomenon of present international economic relations is that a great part of foreign-trade transactions is performed on credit with short-term, middle-term and long-term deferment of maturity of implemented deliveries.

Insurance of export credits is a tool of management of structure of modern enterprise claims, including evaluation and continuous observance of customers reliability and solvency with the aim to eliminate possible damages incurred by unpaid claims in case of financial insolvency of customers of the insured.

1.1 Territorial Risks

The facts resulting from political and macro-economic situation of a foreign buyer country, its total financial insolvency, foreign-exchange limits, wars, etc., in particular, are qualified as territorial (political) risks. Here belong also the risks resulting from a contract where a buyer is the state or a directly state-managed institution financial insolvency of which depends more on a financial standing of the country than on the results of its proper economic activity.

Thus, the **territorial risk** may be:

- War, civil war, revolutions, up-rising, riots, strikes;
- Impossible transfers of payments to the Czech Republic as a result of serious economic troubles of the country of a buyer's registered office;
- Announcement of financial insolvency;
- Declared moratorium on payments or foreign-exchange regime limiting transfer of payments abroad
- Impossibility to pay the claims as a result of administrative decisions of bodies of the buyer's state – withdraw of import licence, cancellation or withdraw of already issued licenses required for contract performance, freeze of deposits;
- Administrative or political measures in third countries through of which the payments are carried out, embargo or limitation of payment transfers.
- Natural disasters.

1.2 Commercial Risks

The facts caused by economic or financial situation of a foreign buyer himself, his financial insolvency caused by bankruptcy proceedings or settlement with debtors or his financial ill-will are considered to be commercial (economic) risks and must be taken into consideration in case of buyers functioning as private subjects on a commercial principle.

1.2.1 Financial Insolvency

In case of commercial risks, the insurance companies consider a debtor to be financially insolvent (= expected to be financially insolvent), if he does not pay even after expired waiting time. Commercial insurance mostly relates to claims with a short maturity within 360 days, max. 720 days. Substantiated financial insolvency is considered the one that was proved by:

- A court decision about bankruptcy proceedings of the buyer's assets or its refusal due to lack of bankruptcy assets;
- Court decision about settlement between the buyer and the insured persons of which it is evident that the insured person sustained injury to his property;
- Certified documents about extrajudicial settlement of which it is evident that the insured persons sustained injury to his property.

1.2.2 Financial Ill-Will

In case of payment ill-will, reason of non-payment, whether this is a customer's insolvency or a secondary financial insolvency is not detected in principle, and it is not necessary to take bankruptcy proceedings. The insurer is obliged to indemnify insurance, if the goods are not paid even after expiration of a certain period after the claim maturity agreed in the insurance policy. This so called waiting time differs with the individual insurers and countries but it usually makes 5-9 months after the claim maturity.

Commercial and technical disputes are excluded from a waiting time. It means in practice that if a claim is impeached from the part of a debtor (e.g. by means of a dispute of delivery quality or quantity), a waiting time is stopped. The insurance company cannot indemnify the insurance premium earlier than it is proved unambiguously whether the impeachment was rightful or not.

2 Present Situation in Insurance Product Offers in the Field of Export Insurance of Entrepreneurs

Insurance of export credits against commercial risks is offered by Exportní garancní a pojištovací spolecnost, a.s., CESCOB, úverová pojištovna, a.s. and GERLING-Konzern Všeobecná pojištovací, a.s.

Territorial and combined risks are insured in the Czech Republic exclusively by Exportní garancní a pojištovací spolecnost, a.s.

2.1 Exportní a garancní pojištovací spolecnost , a.s.

Based on experience from developed economies, *Exportní garancní a pojištovací spolecnost* (EGAP) was established in the Czech Republic in 1992. EGAP has a form of a joint-stock company and its founders and share-holders are economic ministries of the Czech Republic.

EGAP offers insurance products of a similar structure, range and quality as foreign credit insurance companies operating for a long period of time. It complies with the rules valid in the OECD and European Union countries for insurance of export credits. It is a member of the International Association of Credit and Investment Insurers of Bern union.

Amendment No. 188/1999 Coll. of the Export Insurance and Financing with State Support Act No. 58/1995 Coll. enables EGAP to support the most significant European credit insurance companies. This means in practice a support of the Czech exporters' participation in extensive contracts where the goods and services are delivered and provided from several countries. The credit insurance companies of the individual states participate in their insurance protection to the extent of participation of their mother country exporters.

EGAP made contracts on mutual co-operation and risk-sharing in third markets transactions with foreign insurance companies like German insurance company HERMES, Austrian Kontrollbank, Dutch NCM, French COFACE, Belgian OND, Spanish CESCE, Canadian EDC and Eximbank in the USA.

Survey of insurance products offered by EGAP to exports is listed below:

- **A1, A2 – insurance of short-term export credits (claims)**
  It covers risk of unpaid foreign claim where the length of the credit may not exceed 12 months. It is possible to insure cases of export by the buyer, especially from developed countries, some countries with transient economy and also some developing countries.
  Payment of short-term export claims can be insured by means of a general or individual insurance policy. One general policy can insure export claims into approximately 80 countries where the insurance can be provided. Premium rates and participation rate are negotiated individually with regard to the kind of goods, total structure and volume of export, reliability and solvency of territories and buyers, terms of payment. They are re-covered on the basis of actually implemented export. Credit limit is determined in general contracts, i.e. the amount which will be indemnified by the insurer in case the claims are not paid by a concrete foreign buyer.
- **B – insurance against short-term territorial risks**
  It covers risks of export credits within two years and namely as:
  - insurance of combined commercial and territorial risks;
  - insurance of credits to buyers from public sectors;
  - additional insurance to insurance of commercial risks.
- **C – insurance of middle-term and long-term supplier's export credits against territorial and commercial risks**
  It covers risks of unpaid credits provided by the Czech exporter to a foreign buyer for two and more than two years.

- **D – insurance of middle-term and long-term export credits against a combination of territorial and commercial risks**
  Insurance of credit risk concerns the credits granted by an exporter's bank to a foreign buyer or his bank for a period longer than 1 year (protection of a bank).
  Related insurance of a manufacturing risk protects the manufacturer against losses as a result of cancellation or interruption of an export contract before the delivery is executed abroad due to financial situation of a buyer or an economic or political situation of a country.
- **E – insurance of confirmed letter of credit**
  It covers risk of a commercial bank connected with confirmation of an irrevocable documentary letter of credit issued by a buyer's bank in connection with a short-term financing of exports, however not more than within 50% of the amount of the letter of credit.
- **F - insurance of credit for pre-export financing of manufacture for export against risk of non-fulfilled export contract.**
  It covers risks of a commercial bank connected with unpaid granted pre-export credit; it must be linked with insurance of export credit.
- **G – insurance of short-term home claims**
  It covers risk of unpaid credits the length of which may not exceed 6 months. This type of insurance policy can be made provided that the insured had already negotiated insurance of export credits with EGAP. It is executed in the form of general policy made for 12 months.
- **I – insurance of investments of legal entities abroad**
  It covers territorial risks resulting from reduction or losses of yields from investments as a result of impossibility to transfer them into the Czech Republic, expropriation of the investment without compensation or damage of the investment as a result of politically motivated outrages.
- **Z – insurance of guarantees issued by a bank for an exporter's obligations resulting from export contract or its preparation**
  It covers unauthorised draw-down = misuse of guarantee from the part of a foreign buyer and authorised draw-down = risk of failure to meet obligations from the part of a Czech exporter.
- **GA - combined insurance**
  A new product since 2000 means a considerable administrative simplification both for EGAP and its clients. While it is necessary to make individual contracts for previous products of EGAP marked “A” (insurance of commercial risk of export claims), “G” (insurance of commercial risk of home claims) and “B” (additional insurance of territorial risk), a modular conception of an insurance policy according to “GA” conditions makes possible to cover all these risks by means of one policy with a unified course and terms of insurance. Credit limit has a revolving character. Connection of EGAP to Info Allianz data base makes possible to use information about tens of millions of subjects from all over the world.

Besides the above mentioned products, the insurance company EGAP offers also another one, the so called complementary insurance, as e.g. promise to grant insurance, additional insurance against loss by exchange and additional insurance against subsequent costs from default interests.

2.2 Pojištovna CESCOB, a.s.

CESCOB, úverová pojištovna, a.s. is specialised in insurance of commercial risks of supplier's credits and relies on financial strength and experience of its share-holders. Ceská pojištovna a.s. is the biggest universal insurance company in the Czech Republic owning 50% shares as well as COBAC, S.A., the biggest credit insurance company in Belgium being a part of supranational group Euler. CESCOB, úverová pojištovna, a.s. is a pioneer in modern forms of communication in credit insurance in the Czech Republic. The main target and focus of the company is insurance of short-term commercial risks, insurance of risks of unpaid supplier's credits for deliveries of services and goods both for export transactions and home supplier-customer's relations.

In this insurance company, the insurance of claims is based on the base of an insurable turnover. The insurable turnover is defined as a part of receipts of an insured company for a period of insurance in selling the goods or services to private customers (these are not government, state-owned enterprises, and public-law institutions) with their registered offices in the states included in the insurance policy. It is **impossible to insure export to the countries of the former Soviet Union** in CESCOB**, except for Baltic Republics – Latvia, Lithuania and Estonia**. Selected portfolio of suppliers must be always insured; the minimum number is five. Turnover to insurance should vary minimum about CZK 10 mill. This amount is thought as a sum of receivables attained in the course of a period of insurance from all insured customers. Insurable turnover is usually lower than the actual turnover attained by the insured person in the given territory due to a lower actual insurance.

Rates of insurance premium for the individual groups of states are listed in the insurance policy. The rates of insurance premium are stated individually, usually in per milles from the insured turnover, and consider a lot of factors:

- Systematic risk of the state;
- Mean length of claims maturity;
- Risk rate of the sector of enterprising;
- Quality of risk management with the insured;
- Volume of the insurable turnover; …

Insurance premium is paid in several instalments (per one quarter, most often) which are usually invoiced uniformly in the course of the whole period of insurance. The amount of the individual instalments is given by rates of insurance premium listed in the policy and from estimate of the insurable turnover made pursuant to the test of actual insurance. After termination of the period of insurance and after receiving declaration of actually insured turnover, the insurance company calculates the actual insurance premium and issues an additional invoice (in case of an additional payment) or an invoice credit note (in case that the overcharge of the insurance premium is returned to the insured).

CESCOB is preparing a combined product for commercial and the so called political risks. This product should be introduced in 2001.

2.3 GERLING-Konzern Všeobecná pojištovací akciová spolecnost

Gerling-Konzern Všeobecná pojištovací akciová spolecnost, organisational branch has been operating in the Czech Republic since 1993. Besides this company, there is also operating in the Czech Republic a joint-stock company Gerling-Konzern poradenská spolecnost pro pojištení, zabezpecení a podnikání, spol. s r.o. as a service company of the organisational branch.

In the Czech Republic, Gerling is an insurance company specialised exclusively in insurance of industrial and entrepreneurial risks according to the firm slogan "Gerling – your partner in industrial insurance". A high quality of services provided by Gerling-Konzern is ensured by a professional approach of only own staff and co-operation with reputable intermediary firms.

Gerling-Konzern Všeobecná pojištovací akciová spolecnost, organisational branch is a member of the Czech Association of Insurance Companies and the Czech-German Chamber of Commerce and Industry.

It insures trading, industrial and other companies for economic risks arising from granting trade supplier credits, i.e. when the suppler agrees with deferred payment. Insured are especially short-term supplier's credits.

Insurance coverage relates to losses incurred by unpaid deliveries of goods or services, mostly as a result of:

- Declaration of bankruptcy or refusal of bankruptcy for the lack of assets in bankruptcy;
- Institution of legal proceedings with the aim to avert bankruptcy;
- Extrajudicial settlements with creditors;
- When the execution performed by the insured did not lead to full satisfaction;
- Payment seems to be hopeless due to proved circumstances because the bankruptcy or other measures do not promise success.

The following items are excluded from insurance protection:

- Political and territorial risks;
- Default interests, sanctions and penalties, legal representation costs;
- Claims against public-law enterprises and enterprises where the insured has a controlling influence on the management;
- Claims against physical entities – non-entrepreneurs
- Damages caused by war, riots, strike, confiscation, Force Majeure, etc.

Insurance can be extended by:

- Coverage of old balances – claims existing before a policy is made,
- Insurance of unnamed clients;
- Coverage of payment ill-will.

Insurance applies to customers with their registered office in the territory stated in the insurance policy. Commencement and termination of insurance protection for each individually named insured customer is determined in an insurer's advice. If an insured loss did not take place, the insurance of all insured claims expires by termination of the insurance policy.

The insurance company imposes a limit of the total supplier's credit which is insured (limit of claims) for each customer based on a proposal of the insured. This limit is the highest level of the insurance indemnification. Besides the loss incurred from claims decreased by participation, the insurance company will cover transport and insurance costs, discount of a bill and bill cost having a direct relation to the insured loss.

The offer for those who are interested is processed entirely individually based on a preliminary confidential declaration.

3 Development of Export Insurance

Volume of insured export in the total export from the Czech Republic is relatively small, about 5%, while in the countries of the European Union it exceeds 15%. It should be stated, however, that the development is positive because in 1995, only 2% of the Czech export was insured [2]. In 1999, the total volume of export made CZK 928.8 bill. so that the insured export represented 5.4%.

Only EGAP itself insured export in total for CZK 146.8 bill. to more than 70 countries from the beginning of its existence, i. e. from 1992 to1999, of which cc 60% with state support (CZK 88 bill.). In 1993, EGAP obtained, in the form of deposits from the state budget, CZK 4 296 bill. for its insurance funds to cover export credit risks. It follows from this fact that each crown from these budgetary deposits made possible to insure almost CZK 20.50 of export credit while at the end of 1998, the same indicator made cc CZK 15.

Final results for 2000 are not available up to now and the insurance company staff is not authorised to provide information from preliminary results.

As it can be seen in Table 1, the prescribed insurance premiums of export credits insured against commercial risks increased in 1999 by 67.7% to CZK 151,400,000. Value of the insured export reached CZK 23.6 bill., i.e. the increase compared to 1998 by 49.1%. Number of policies increased from 413 to 696 at the end of the year.

Table 1: INSURANCE OF EXPORT CREDITS AGAINST COMMERCIAL RISKS [13]

Indicator	***Unit***	***1997***	***1998***	***1999***
Prescribed insurance premium	Ths CZK	91,225	90,284	151,427
Value of insured export	Ths CZK	9,815,000	15,802,000	23,555,000
Stem premium from the policies valid by 31.12	Ths CZK	40,083	61,400	83,095
Stems – number of insurance policies by 31.12.	Pcs	346	413	696
Mean insurance premium per 1 policy	CZK/pc	263,656	218,605	217,568

The prescribed insurance premium in case of export credits insured against territorial risks increased in 1999 by 79.8% to CZK 710,100,000. The value of insured export made CZK 26.1 bill., i.e. the increase by 26.8% compared to 1998. There was 394 policies in the premium stem by the end of 1999 (see Table 2).

In 1999, the total volume of newly concluded insurance policies against export credit risks with state support was more than CZK 26 bill. The prescribed insurance premium reached almost a double value of the previous year (CZK 710 bill.).More than 320 new insurance policies were made during the whole year 1999 which is a double number of insurance policies compared to 1998. The reached result, beside the increase of number of new policies, was considerably influenced by insurance of credit for the first two blocks of Afshin Elbistan power plant in Turkey which made the amount of more than CZK 7 bill. in the total insurance premium value.

Table 2: INSURANCE OF EXPORT CREDITS AGAINST TERRITORIAL RISKS [13]

Indicator	***Unit***	***1997***	***1998***	***1999***
Prescribed insurance premium	Ths CZK	704,765	394,965	710,095
Value of insured export	Ths CZK	16,388,000	20,618,000	26,141,000
Stem premium from the policies valid by 31.12	Ths CZK	704,765	394,965	710,095
Stems – number of insurance policies by 31.12.	Pcs	94	211	394
Mean insurance premium per 1 policy	CZK/pc	7,497,500	1,871,872	1,802,272

Small enterprises make 31.5%, middle ones make 29.5% and the large ones 39% from the total number of enterprises insured against short-term commercial risks (i.e. from insurance premium stem).

Like in previous years, D type of insurance (insurance of export customer's credit) with share of cc 59% prevailed in the structure of the total volume of newly made insurance policies. The second most significant component was E type insurance – pre-export financing. There was originally not expected increase of insurance premium volume of B type of insurance policies for short-term supplier's credits.

In 1999, export credits were insured against export credit risks to total 49 countries. Majority of newly made insurance policies had relatively a small volume and less than 2% of the total volume of insured export was directed to the individual territories (see Fig. 1). In 1998, insurance was directed to 40 countries.

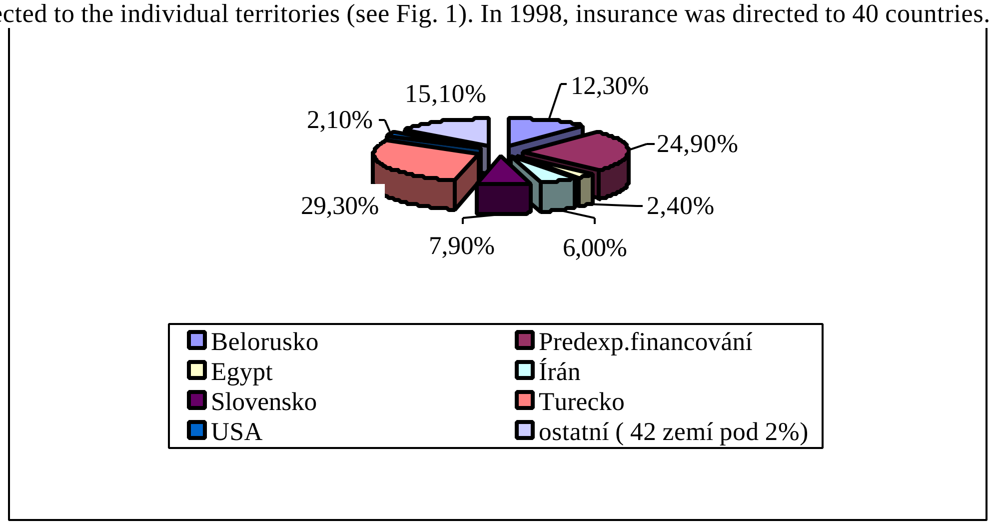

Fig. 1: INSURANCE POLICIES MADE IN 1999 ACCORDING TO THE INDIVIDUAL COUNTRIES [13]

It follows from Fig. 2 that Turkey, Slovakia and Byelorussia have the greatest insurance involvement in the territorial division.

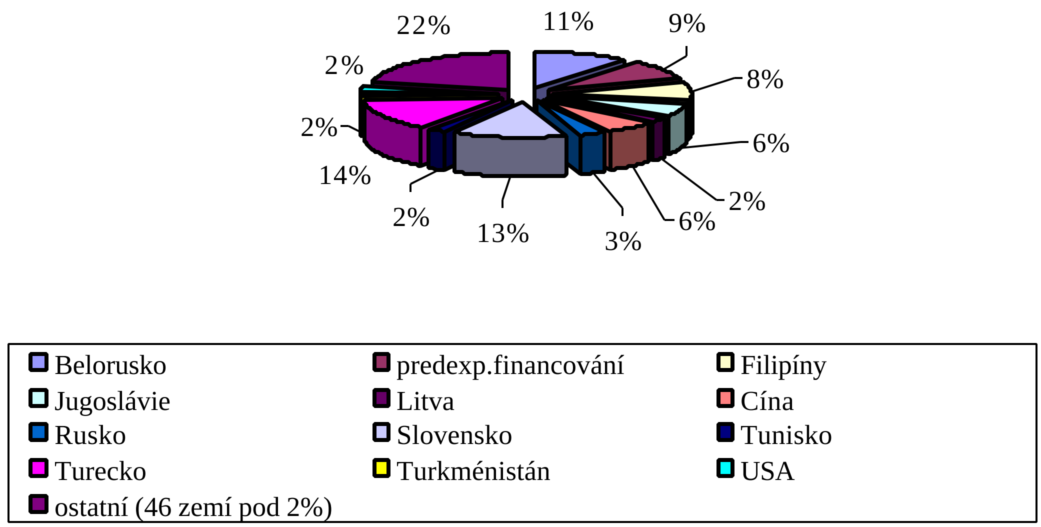

Fig. 2: TERRITORIAL STRUCTURE OF TOTAL INSURANCE INVOLVEMENT OF EGAP BY 31.12.1999 [13]

The year 1999 was a watershed also in the extent of insurance indemnification. Besides a double volume of paid damages from commercial insurance of CZK 36 mill., the sum of paid insurance indemnification from insurance with state support reached the amount of CZK 497 mill, i.e. more than seven multiple of the amount paid for 1998. This is, above all, a result of financial crisis in Russia in 1998 and also insurance losses in Yugoslavia, Croatia, India and Mongolia [12]. Preliminary estimate for 2000 is almost CZK 800 mill (see Table 3).

Table 3: INSURANCE INDEMNIFICATION WITH COMMERCIAL AND TERRITORIAL RISKS [12]

Indicator	Unit	1997	1998	1999
Insurance of commercial risks				
Paid out insurance indemnification	Ths CZK	114,460	63,975	61,831
Mean insurance indemnification per 1 insured loss	CZK/pcs	823,453	353,453	475,623
Number of settled insured losses	Pcs	139	181	130
Number of unsettled insured losses	Pcs	129	295	214
Insurance of territorial risks				
Paid out insurance indemnification	Ths CZK	5,399	62,712	496,736
Mean insurance indemnification per 1 insured loss	CZK/pcs	5,399,000	10,452,000	17,128,828
Number of settled insured losses	Pcs	1	6	29
Number of unsettled insured losses	Pcs	1	11	1

Some damages incurred in 1999 had a considerable extent. For example, insurance indemnification at the amount of CZK 126,000,000 was paid out in the field of export credit insurance due to financial insolvency of a supplier from the Russian Federation.

In accordance with the practice of OECD Concensus members, a harmonised system of insurance rates has been used uniformly since April 1999 by all member-states, their credit insurance companies respectively. The lowest rates are applied to insurance of exports to the so called sovereign debtors (Ministries of Finance and central banks), a little bit higher rates are applied to exports to public-law debtors and the highest rates are applied to the private debtors. These harmonised rates are minimal; however, each country can determine different rates, at a higher level, and to create thus a space for granting a premium discount.

While a table of insurance premium rates is made for other insurance products of EGAP, they have been determined entirely individually for GA type insurance so far. The premium varies in pro milles from the value of the insured export value. It is calculated only from the credit security. Insurance premium rates are decreased in dependence on the coverage extent. Client participation is expected; it varies at the level of 10-15%.

Insurance commences as soon as the goods are dispatched with a respective invoice to a debtor. The goods must be invoiced not later than within 15 days as of dispatch. Maturity of the claim may be prolonged only with a prior written consent of the insurance company. The insured is obliged to report unpaid claim in writing and a threat of an insured loss within 6 months as of the invoice maturity expiration. The insurance indemnification will be paid out within 45 days as of the receipt of the announcement of a threat of the insured loss to the insurer, or as of the expiration of a waiting time in case of territorial risks or payment ill-will.

Conclusion

Long-term statistics show that even in case of seemingly safety countries and confirmed customers there may arise problems, either as a result of own bad management or secondary financial insolvency. This fact is best documented by the statistics of bankruptcy proceedings e.g. of which as much as 70 thousand takes place in France each year. In Belgium, a country comparable in area with the Czech Republic, there are about seven thousand bankruptcies each year [8].

Indispensable is also the significance of credit insurance as a tool for bank financing. If the claim is insured, it can be used as a guarantee for the bank for granting operating credits. In case of an insolvency of a customer, the insurance premium goes directly in favour of a bank by means of a loss payable clause. Especially now when the banks are leaving a classical system of credits security in the form of real-estate guarantees, the credit insurance becomes an increasingly used guarantee means.

In connection with revival in the European Union, other volume increasing of insurance of short-term commercial risks can be expected both in export and home claims. The trend of unification of terms of insurance of export and home credits continues with private European insurance companies which has an indispensable impact on decrease of administration and operation costs both with credit insurance companies and, above all, clients.

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Retail Chains versus Suppliers

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Abstract

The paper is focused on relation between the retail chains and/or their suppliers. In Czech environment – similarly to retail business at all – a retail chains role has two sides.

The positive contribution of retail chains in means lower consumer prices, producer motivation, product quality growth etc. Nowadays, the negative role of retail chains looms more, and results in a waste of producer competitive ability, esp. in food sector, loss of growth resources.

The retail chain claims are „not to bear“ for small- or middle-size producers or suppliers. A retail chain demands refer to listing fees, entry prices, slotting fees, invoice due dates, and other things.

A solution for small- and middle size firms brings marketing, which shows and/or helps in process „how to became the retail chain supplier“.

Introduction to the problem

The paper is focused on the role and position of retail chains in the Czech Republic, on their relations to suppliers and on practices of the retail companies used towards them.

Firstly, we have to explain the term *chain in retail*. According to the theory of retail (reference number 4), it is possible to characterise the retail chain on the basis of one of four points of view, or on the basis of their combination:

a) sale of similar goods in the most of shops,
b) similar architectural style of shops,
c) centralised purchase,
d) joint ownership.

The US rule for the number of shops in retail chain is different from European rules. In the USA, eleven and more shops with the same product lines in supply can be placed into this category, in the European countries the number of shops varies.

One of the important roots of retail concentration origin is an effort to control the market, which means to control a system of distribution by a region, or by a product. These are *vertical marketing systems* (VMS), when one of participants in a distribution chain is trying to gain a power, to control the whole distribution system and to determinate rules in the system. By this the most of other distribution channel participants are getting into a subordinate position. If they want to distribute the products, they have to accept the retail chain rules.

The situation in the Czech Republic

The Czech retail market – as the whole society and economic environment – has undergone great changes during the last ten years. The market became more concentrated on needs of customers, more various, and more or less it copies the situation in other countries. As abroad, also in the Czech Republic the main *trends* are an expansion of retail networks established by international business companies, and a reduction in number of small retail firms. The trends also influence the retail market concentration on modern trading forms, like supermarkets, hypermarkets and discount shops, especially. The most considerable development is on the food market.

The important phenomenon of our market is a rapid expansion and a strong position of the supranational retail chains, which results in chains dictate and in use of specific trading practices towards producers and distributors. Especially it concerns charges, terms of delivery, terms of payment, complaints and guarantees, it also concerns requirements for a products price reducing and so on. Czech producers and/or distributors are paying for their weaker negotiation positions, and if they want to ensure sales of their goods, they have to accept such requirements. Just over a few recent years they were forced by their experience to start concentrating their forces and to look for appropriate ways of product distribution.

A negative impact of the retail chains position means an increased pressure towards retail suppliers concerning a price reduction to a level of a loss-making production for producers. The producers of fast moving goods (food products especially) appears to have a shortage of sources for their development and for maintaining their competitiveness. All financial sources given for these purposes are lost in the requirements of the chains. The financial sources are spent on supplying goods prices, on quantity discounts, on payments for placing the goods in a lucrative place in the shops and on another retail chain claims.

The situation has originated due to two basic problems of the home market. The first problem is a glut of home manufacturing capacities. For example food is still produced by too many companies and besides, in the same structure of goods, which results in an overhang, of such products supply to shop networks. Then, shopkeepers can simply choose their suppliers, and suppliers are towards them in a disadvantageous situation.

The second problem looms with the fact that those foreign firms own the most of the retail chains, by which the financial sources supply for chains is ensured. The question regards the percentage of Czech goods that the customers of retail chains will meet on their counters in the future. In the case of import, the trade balance would increased, on the market would be less amount of Czech producers, and all this would have an impact on the efficiency of economy.

Generally, we can say the retail chains have a lot of “admirers” and also a lot of opponents – it is hard to say which side is stronger. Such concentration brings a lower consumer price of foods, a higher quality of production, a stronger motivation for the producers, and so on.

A possibility to entry the chain is a windfall for the suppliers. They are willing to pay for such chance. But, a big customer, the retail chain, is a more powerful partner, his turnover per year is a few billion crowns and it is the chain that fixes the conditions up. The position of suppliers towards retail chain is influenced by their own market position. Big (supranational) companies have an easier situation not just thanks to their position but also because of their worldwide co-operation with chains. The problems concerning the entry of the retail chain and/or another co-operation with the chain meet mainly the regional or local producer and distribution companies, with weaker negotiation power.

The practice of retail chains in the Czech Republic

In co-operation of retail chains and their local suppliers we can find various procedures. The most common practices follow:

1. Listing fees

To make a deal with retail chains the suppliers must pay certain amount of money. Although they don’t think these conditions as admissible, in most cases the investment returns in a few months. For all suppliers one thing is clear – kind of trade conditions only depends on people from buying department. Opening of a new supermarket it means for suppliers to contribute „the involvement fee“. If a retail company starts with businesses in several places it calls for new fees of each of them. For example retail chains could ask for entry fees in the amount 10% of annual turnover.

2. Free first supply

The retail chains very often ask suppliers for free first supply of goods to fill the relevant rack or box, or for free goods - for example – in equivalent value of goods to 40.000 crown. The frequent requirement of retail chains is „the free supply“ to the new opening of shop. Of course, suppliers find such conditions as adverse conditions and they are willing to accept them only in case of very restrict discount.

3. Entry prices for a new product

For a new product the retail chains often require additional discounts (it means discounts of fixed prices list of goods). It is a combination of per cent discount compared to the fixed prices list and time section of discount. Most suppliers don't agree with such requirements because of the fact that the risk of new product sale is already included in the fixed price list.

4. Low purchase prices and quantity „bonus"

Retail companies struggle for the lowest purchase prices to make the space for consumer-oriented pricing. Of course, they want to reach better price conditions in comparison to suppliers fixed price list. Such requirements are based on the fact of suppliers' possibility to realise a delivery of great amount of goods (the principle of quantity rebate). The retail chains call for additional discount if the amount of contract goods breaks the contracted quantity. A customer could ask for a discount of 12 – 14%, there are also extreme requirements like 30% discount, etc.

5. Placing of goods

Retail chains call for an additional financial requirement also in connection to the placement of the goods in sales rack or in other places in sale space. Uplifting requirements refer to fees for putting the goods in rack (for example – for one month and one salesroom), for placing the good to separate display, for goods placement in a long time term and in each of the chain shops, etc. Payments for goods placement are considered as suppliers` unrightfully act, the only exceptions are payments for special displays. However, sale companies make the shop layout on the base and/or rules of category management – according to the turnover of goods and their market position. In a long-time point of view, sales company behaves in a rational way if does not make placement of goods according to "who pays more money" as the only criterion.

6. Due date of invoices

Generally, terms of invoices due date are one of the biggest problem of business relations in the Czech Republic market. The contract terms are even more sensitive in the case of suppliers and customers relations on a fast moving goods market. Retail chains quite exceptionally offer due date of invoices in the interval of 14 – 21 days, mostly in the area of fresh goods. They call for additional discounts of invoicing price after goods delivery and in terms of payment they call for due date of invoices during the period of 75 – 90 days or even 120 days of due date.

7. Additional one-side changes and trade terms adjustment

It could concern one-sided requirements for additional discounts, additional free supply, extended guarantee period, a response to customers` operational requirements, … . Such negotiation is impossible in case of companies with the same power, respectively if there is a possibility to change the partner for another who does not push such in-proper biased requirements. For a dominated or monopoly partner a prohibition adjustment of abusing market position can be used.

How to solve the situation?

Role of co-operative chains

Supplier co-operation could be one of the possibilities how to gain a stronger position towards retail chains. The co-operative chains and purchase alliances mean a wide commercial net, a centralised purchase with fully competitive conditions, united purchase policy, a sophisticated logistics, etc. The result could be an establishment of several strong Czech purchasing and manufacturing alliances which could be (at least partly) able to compete in the face of international business groups.

Role of government

To support the development of Czech trade more profoundly, a change of government authority approach is needed. The main effort should lead to the Czech entrepreneurial subject and does not make any difference if it concerns an entrepreneur or a corporate body. The development of retail companies should lead to grouping of small entrepreneurs to big defendable and/or competitive nets with maximum state support, for example via favoured credit and profitable capital conditions.

Role of municipality

Development of new buildings for supermarkets or hypermarkets is still depends on the approbation for territory and building proceedings. It means all the responsibility is transferred to the municipal boards that have herewith a great possibility to influence the structure and the range of the retail net in the certain area.

Role of customer

The seller-purchaser relations create a base for another possibilities of solution. The personal contact should be the beginning of retailers business. They should search gaps in the market to profile themselves as a seller of a certain merchandise line. Sellers have to start with selling goods via the Internet, to create more services like door-to-door service, appropriate opening hours and so on, to use co-operation methods, to execute fax orders, etc.

There is not any possibility to prevent fast retail chains development - business in the Czech Republic is fully liberal and the market development is similar to that in other industrial countries. The main factor that could influence such hectic process is the subject toward whom all effort leads, the final customer.

Practical examples

Problems fully coherent with the distribution of goods to retail chains are put down in the following examples from Czech companies.

A. The small-scale company with only Czech capital acting on the cosmetics market failed in its effort to become a retail chain supplier even if the company has developed (according to its business director words) a considerable effort. Its negative experience concerns partly a bargain aspect (a retail chain refused a personal contact, “the hard selection” already on the level of a switchboard operator, etc.), partly a financial aspect (inadequate financial demands of the chain). As well unacceptable seemed the criteria for maintaining the concrete products in assortment (the reason for product disqualification can be a high price, week advertising and so on). Retail chains demands discouraged this company from any other effort to get in the group of retail chain suppliers.

B. A small Moravian company acting on the grocery market for rational nutrition has had similar problems as the above-mentioned company. For solving such situation the company has chosen a different approach, and thanks to this nowadays it co-operates successfully with most of significant retail chains in the CR. The success nub lays in implementing of the marketing management principles and in the running co-operation with marketing specialists.

The first step to master the situation was to identify and to analyse problems that the company met. It concerned especially:

- Market situation on grocery products, strong competitors.
- Week bargained position of a small company and its limited financial possibilities.
- Difficulties in asserting its goods to the lines of certain retail chains.
- High fees for chains entry, another barriers of entry (distrust to small companies).
- Inconveniences with merchandising.
- Retailer’s distrust against company products (missing experience with such products).

Marketing research became the following step on the way to the solution of recognised problems, its aim was to provide arguments accommodating the wishes and needs of customers. Detected arguments were used during discussions with chain representatives and thanks to their origin coming from demands of customers, the result was the enlistment of the company product into the chain merchandise list. The reached success made company’s next entry of retail chain companies easier.

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Semialgorithmical Approach to Global Strategic Decision Making

(Slovak-Czech Decision-Making School with the Subconscious Decision Support Engine Utilisation)

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Abstract

The changing social and natural environment in our days, named as the globalisation, breeds for our economy and society a categorical challenge. The managers remarked it too late that something was going wrong and now face serious problems. Recognising and defining those problems are necessary first steps toward taking corrective actions. To state the case more precisely, whatever problems occur or wherever the improvement potential is, depends most heavily upon correct diagnosis. That contribution bears an original approach to Semialgorithmical decision-making school, based primary on perfect diagnosis of inquired decision-making's object and utilized the subconscious decision support engine.

Prologue

Over political, economic and personal relative separation from world, it were formed during the communist regime on different universities of former Czechoslovakia by means of State programme of economic research (doped for the rest even basic-scholastic and massive technical forecasting only by perhaps 1,5% financing of entire State research) **not only silent preparations to the transition into market economic mechanism,** but also interesting directions of management research. After the state division on the Slovak and Czech republic main author of this article wants world's professional public behind hand to refer about of long years intensive research and his pragmatic improvement of one's own decision making approach in incoming era till too electronized access upon DSS there through, how it forms the chances for modern hybrid accesses to the managerial decision-making.

1. History

Long years (since 1970) provided research on managerial decision-making processes leaded author to the amalgamation of different business like schools to step by step formation of whole managerial making process. At first, one simple multiple phases formed model was published as embedded of introductory diagnostic recognized phase[4] in this form:

I. phase ***diagnostic recognized***
II. phase ***analytic- synthetic***
III. phase of ***optimal acceptable solution***
IV. phase of ***realization and control***

Fig. 1 BASIC PHASES OF A DECISION-MAKING PROCESS

According to the medical research's analogy[10] has the diagnostic in the economics the same or perhaps yet greater signification as in the medicine. Century trying in business field confirmed it. HADORN'S statement of his book has happened worldwide, that: ***bad diagnostician cannot be a good therapist.***

Of course each analogy must be confirmed **prudent.** For the time being the medical diagnostics is old as the medicine self, the economic diagnostic is finding till to half of past, nineteenth century in a small book[11]. Author William KENT, a stockholder of American firm and at the same time a physician, considered unprofitable company as a sick man, and that is why he used perhaps like first the word diagnostic inside of economic environment.

Contemporary stand of economic diagnosis under up to date globalization's environment with their challenge was described in a contribution on the international conference[1]. We can read in abstract *"The changing political and economic environment in our days, named as the **globalisation**, breeds for our economy and society a serious challenge. The managers of these organisations realised too late that something was going wrong and now face serious problems. Recognising and defining those problems are necessary first steps toward taking corrective actions. To state the case more precisely, whatever problems occur or wherever the improvement potential is, depends most heavily upon correct diagnosis. By analogy as in medicine the correct diagnosis is crucial for further treatment of a patient. Managers or consultants are in any political, economical, public funds organisation like doctor too responsible under elaboration proper diagnosis. Only then they could have as before about remedy starting position. That article describes so-called **social-economic diagnostic (SED)** as an original approach for solving of that in a municipal mending.*

2. What is the Social-economic Diagnostic (SED)

Social-economic diagnostic (SED) is based on the A. F. OSBORN's[12] idea of common (team's) creativity thinking to use brainstorming to make the best advantage of them. He advised then to use this today well-known technique also in other cases as an idea finding, in which brainstorming can bring similar advantages. Just such a case is defining the overall problems in an organisation.

The decision making process which has been changed can vary an intuitive approach to something more formal, inviting in a consulting firm. You will agree that intuitive decisions are sometimes too risky and most of the shareholders will not support them. Inviting in a consulting firm sounds as a better choice. An outside specialist with unbiased view can discover some ignored facts and overlooked reality. But what is the price for that and where are the limits? Can someone, whose time in the organisation is limited, substitute (replace) the knowledge of organisation's own employees about the immense complex structures? If not, then there a question arises how to gather the employee's knowledge about the current situation. It is apparent that **no one man** is suitable to decide about what is going on in the in the organisation. According to the Information-Glacier Concept, the top management knows only 2% of all problems. The middle management knows c. 1/3 of all problems. The primary level management knows the remainder 2/3. This concept assumes that 100% of problems is known by all of the organisation's employees. Then we see those that only groups of people or teams are able to make a reliable diagnosis. The state diagnosis made by teams in comparison to an individual-made diagnosis is in all probability better in quality as well in quantity. Such a diagnosis is then much more suitable as a starting basis for developing alternatives and choosing one of them to improve the given state.

Author recommends using besides this method also other methods to check final results such as a SWOT analysis. In the case when both of these methods lead to the same diagnosis the managers can trust the final results. Otherwise there is a place for discussion of the results. Conditional upon organisational culture, corporate identity, working atmosphere and other factors the employees haven't been necessarily prepared to express themselves objectively. One of these helpful techniques is **PARETO's ABC Analysis**. Then evaluated problems can be divided into categories according to their importance. Then the A-category is crucial for stating the final diagnosis of an organisation's state. To use the advantage of collective knowledge - the importance order of all problems left to be evaluated by particular team-members. However, this step is to be done individually. Then the final result is the sum of individual evaluations and the highest-score problems build up the core for taking corrective actions.

During the long years the **full scheduled 8 steps algorithm** for SED was approved almost without change. The stratificated teams (the teams of all levels of organizational management structure) perform step 1. - 5., 6. - 8. Step is destined for the plenary session of all teams. The intern time-scheduling is protected know-how:

1. ***Identification and determination of 20 problems in the team brainstorming.***
2. ***Discussion about the elimination of 7 to 13 problems.***
3. ***Individual evaluation of all 13 problems in each team in the cardinal scale <10, 0>.***
4. ***Team aggregation (summarisation) of individual scores of all 13 problems and their preferential order.***
5. ***Designing of the column graph of the first 10 problems.***
6. ***Comparison of results of all teams in the plenary session.***
7. ***Synthetics: the choosing of the semantic consensus between the designated 10 problems of all teams in the plenary session mutually.***
8. ***Problem's clustering and designing of the final column graph after the A, B, C principle of Winfred PARETO.***

Following conditions are needed generally for the algorithm of accomplishment SED:

- **Min. 3 heterogeneous teams** formed from the multi-level representation (stratificated) of the analysed company (enterprise, institute, school, office, hospital, town citizen etc.).
- **Time** - for presentation of each method for all participants min 180 minutes
  - for realisation (simulation) of each method completely **only !!!** 90 - 100 minutes
- **Forms of decision matrix** in three performances for the **n** - problems and **m** - criteria, limited by **n** <2,20> and **m** <1,10>.

Results of SED and similar methods are the good begin for subsequent phases of managerial decision-making process. The great psychological advantage lies in it, that decision-making subject (arbitrator, top-manager) has the members of diagnostic team as his helpers, who are identified with the preferred problems and in the future always ready to participate on their solution and implementation of the improve measures. Constitution of this scientific hypothesis laid the base for longleaf presented and using **of own Slovak and Czech Semialgorithmical decision-making school**. Up to now we use the occasion to present this school on this worldwide international conference.

3. Whole Managerial Decision-making Process

The notion "whole D-M process" will express the course of the sequence four basic phases in the time and within the volume of information in it. Differently from the famous progenitor of descriptive decision-making schools Herbert A. SIMON[15], who knows only two phases in his so called General Problem Solver (GPS), we conceptualize full decision-making process more span.

GPS assumes, that arbitrate has to disposal given identified problem and to him remains to find its resolution only and to proclaim optimum from themselves as a decision. Ours conception considers it to be the inner speculative part of the decision-making process. It broadens out GPS from the left (in terms of time course) for one's own reconnaissance, identification of preferential problem structure on the decision making object. The decision like optimal solution from their variety we subjective as an optimally for the arbitrate acceptable solution and we continue up it a post decide phase, in the course of it will be examinate the real decision's realization on the object of decision making.

3.1 Curve Q=f(t, S, E, DM)

This curve represents the course of whole (entire) decision-making process[2] on time axe **t** within the changing volume of information **Q**.

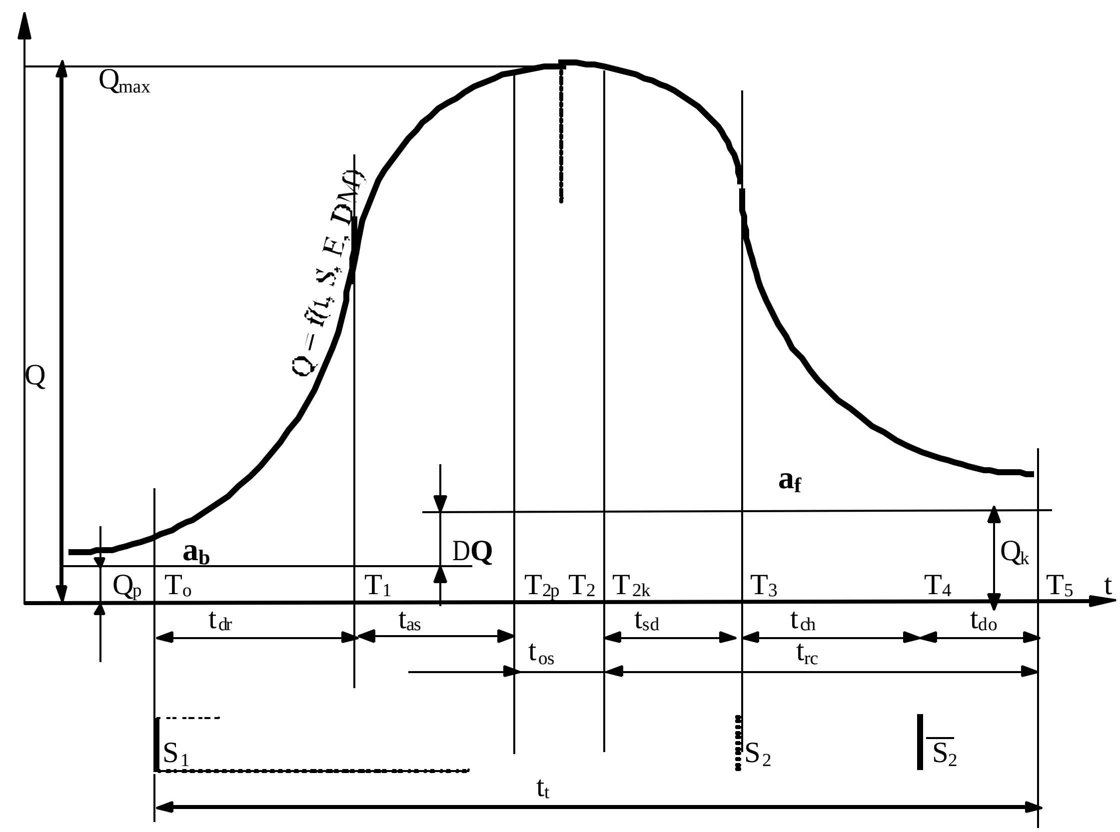

Fig. 2

Legend:

t …time develop axe (independent variable, argument)
Q …quantity of information (dependent variable, function)
T_o …up to date starting position of decision-making process
T_1 …possible time border between the up to date start position and the begin of solving
T_2 …the moment of decision (by Q_{max})
T_{2B}…decision starting (beginning)
T_{2F}…close (fin) of decision act
T_3 …close of decision change into the action on object of decision making
T_4 …fin of decision change into the desirable object's state
T_5 …closing of decision-making
S_1 …up to date starting position of the object of decision ma king called as "ist Stand"
$\underline{S_2}$ …future spontaneous decision-making object's state
$\overline{S_2}$ …future desirable decision making object's state, called as "soll Stand"
t_{dr} …time of the diagnosis of the up to date starting position decision making's object (diagnostic recognizing phase)
t_{as} …time of the problem solving (analytic synthetic phase)
t_{os} …time of the decision giving (optimal solving phase)
t_{sd} …start's demurrage of the decision's implementation
t_{ch} … time of the change from future spontaneous decision making object's state to the desirable decision making object's state
t_{do} …time of the decision damp out

t_{rc} …total time of the decision's realization and damp out (phase of the realisation and control)

$t_t = \sum_{t=0}^{t=5} t_i$ total time of decision making

a_b … asymptote of the initial (begining) knowledge level

a_f … asymptote of the final knowledge level

Q_b… the minimal starting quantity of information

Q_f… the maximal final quantity of information

D**Q** = $Q_b - Q_p$ the improvement of information's potential, acquired during the decision making

$T_5 > T_4 > T_3 > T_2 > T_1 > T_0$ to read: Decision making performs in the in temporal irrevocable striking segments

$\Delta Q_i > 0$ to read: the improvement of information's potential of the decision making subject is always positive

$\overline{S_2} \Rightarrow\rangle S_2 \Rightarrow\rangle S_1$ to read: future desirable decision making object's state must be always better as its future spontaneous decision making object's state and its starting position of course, otherwise it would no-brought to the decision-making subject the satisfaction.

3.2 Top management team decision-making

In the beginning of the second half of the twentieth century a notion '**team**' has been transferred from sport environment to management. The attempts to implement teamwork, a part of innovations of a typical pyramidal management organizational structure, have started especially after publishing of a work by American Alex OSBORNE[12]. This book introduced one of the most popular techniques of a team work- **brainstorming**.

We know classical **functional and linear management** structures from the works by American TAYLOR[16] or French FAYOL[9] since the beginning of the past, 20th century. Notwithstanding the attempts of all their followers, who tried to join their completely different ideas based on a **line and staff system** (to utilize a TAYLOR functional structure of management as a complement of a FAYOL line, almost army, structure), more liberal and untypical management structures were implemented after the World War II.

The difficulty of a societal division of labor is observed not only in the field of production (or business), but also in its management. Classical formulas of managerial behavior, based on a development of managerial theories, are influenced much more by an opposite of centralism - **decentralization of decision making** to those levels of management, which have the best professional solution for a given problem. Even if a solution must be done at the highest level - so called **top-management**, for example at the Council of Board about basic strategic questions of a company, members try to achieve **consensus** nowadays. If a consensus is not complete, they try to obtain an agreement at least of a majority of the Council of Board, and thus to oppose to President of the Council of Board self will, often connected with a function of Chief Executive Officer (CEO).

New teams have existed from the second half of the last century, which have been created as a natural reaction of workforce development to rigid organizational structures. They are able to quickly diagnose and solve difficult, horizontally tied problems, even design completely new or redesign existing, not effective, production program. These groups are so far the most effective; connected by a **team leader, team structure and team spirit**. Therefore we are used from sporting area to call them as **the teams**. Contemporary team and team work development brought in practice and decision-making theory a fundamental break transition point from once untouchable axiom - principle of only one responsible leader leading to the conception of the consensual team decision making[6].

Teamwork is a notion, which should express its specificity and distinction from the work of every other work groups or committees, and boards of directors; even also those can introduce some of a teamwork principles. Naturally, team composition is also associated. Therefore, we express this idea in signs:

1. **High intensity**. Especially expecting a full, voluntarily and synergetic participation of each team member in all team activities could achieve this.

2. Limiting of **a number of team members in a range 2-8**. The smallest team, consisting of 2 people is called tandem, in a decision making process there is not voting, but agreement is achieved based on the highest mutual variable. Having more than 8 team members leads to a situation, where submissive members do not have a chance to talk and thus they gain a feeling of redundancy. **Optimal number of team members is 6**.
3. **The team spirit**. This intangible phenomenon deserves more attention than is given.
4. **Deadlines ability** into all components of teamwork. The amount of time of all times should not be more than 90 or 100 minutes without a break.
5. Individual work, pair dialogues, collective judgment. Their mutual interaction represents **a main fr amework of teamwork.**

Our Faculty of management withal applied behind 5 last years in frames of wide scientific research of HRM and come to this definition of **the team organization**[13]**:**

"Team organization is created, because a team organizational structure provides the best conditions for an integration of activities, through which higher effectiveness, quality, faster speed of innovation processes and also customer satisfaction could be achieved. "

4. Knowledge Management on Help to the Multiple Criteria Decision-making

Inflation of information instead of to make reducing of uncertainty and decrease of risk in managerial decision-making, makes his overloading. Steerage, information, motivation and decision making mingle and generates space with great density of information's concentration The CESTNEJŠÍ's model describing since the first printing[5] the spheres of business administration highlights the intersection of management, information processing and motivation as the space highly overloaded with information (see the following figure). These notions are illustrated on axonometric projection in ideal ball-shaped entities.

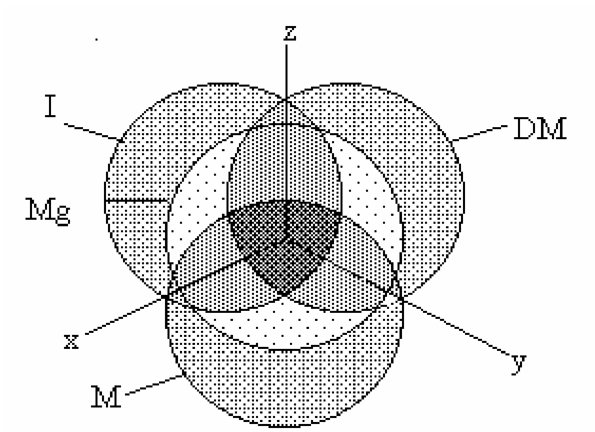

Fig. 3

Legend: **Mg** **management**
I **information**
M **motivation**
DM **decision-making**

The decision-maker is to implement advanced approaches to selection of the relevant information. Knowledge Management is supposed to provide means to support managerial decision-making with relevant information created by using both **soft and hard knowledge** available to the organization[7]. There are two major opposing trends in the CESTNEJŠÍ's theory. One of them calls for the most thorough description of the variants **of solutions** through the ***multiple criteria set*** of:

- ***Time***
- ***Politics***
- ***Social and natural environment***
- ***Economy***
- ***Technology***

The other trend says that the number of criteria should be minimized via eliminating all the criteria that don't have significant effects by evaluation of compatible social economic phenomena. We know, that in decision-making process there are more occasions, to decide about the order of inquired objects of decision-making. Let's try to find out how knowledge management can help us produce better decisions.

Knowledge management systems enhance and enable knowledge generation, codification, and transfer. *"Knowledge generation requires tools which enable the acquisition, synthesis, and creation of knowledge."*[14] However, an effective knowledge management system should be able to identify and employ means to minimize those thus allowing individuals to gather relevant information and utilize the corporate knowledge asset to its maximum potential.

Having realized the necessity to process the corporate knowledge, one has to distinguish two forms, **explicit and tacit**, that knowledge takes in regards to decision-making. Explicit knowledge is easy to store and transfer, but impersonal. On the other hand, tacit knowledge is more subjective and experiential. It is rather difficult to manage tacit knowledge due to its nature.

About 80% of all the decisions made in a corporation are made intuitively CESTNEJŠÍ[3], p.18. That does not mean that most of the decision-makers have divine powers, but they just employ their strong decision aid engine that they have been developing throughout all their lives. The natural decision support system needs an intensive knowledge support in order to be effective. Whether we like it or not this system is our primary decision aid tool. The potential to be discovered to this system is associated with the facts that:

- Every time the decision-maker identifies with many decisions, the system is unconsciously it runs spontaneously
- Put to work
- It helps to save time when compared to other methods and techniques
- It always runs even on the background of one's mind and verifies the decisions that one arrived at using any method
- It is ready to support one's decision instantly and it simulates the decision often unwillingly

Effective multiple-criteria decision-making ensures successful experience in dealing with change, which are these days inevitable in the global business environment. Change is perceived as the agent provocateur of knowledge leading to better decision-making. *"…Managers of all levels of the organization are the keepers of wellsprings of knowledge. To them falls the responsibility for selecting the correct knowledge sources, for understanding how knowledge is accessed and channelled, and for redirecting flows or fighting contamination."*[8]

Knowledge management that works contributes to rising of inner complexity of organizations allowing them to survive in an environment with ever increasing entropy. In other words, cultivation of teaching/learning culture, master/apprentice culture, open-trusting-knowledge-sharing, inclusion of diversity of viewpoints, distributed decisions, stakeholder solutions, knowledge networks, knowledge culture and knowledge competencies should help corporations come to sound decisions through correct criteria identification, assigning weights and alternatives generation. And the last point is that all of these tools should not only be available to the executive level decision bodies but also they should contribute to development of individual natural decision support systems. Achieving this, a corporation is ready to face challenges of the current turbulent business environment.

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Statistical versus Non-statistical Methods in Quality Assurance

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Abstract

There was a strict requirement in ISO 9000: 1994 to implement statistical methods in quality assurance. A new version of ISO 9000: 2000 does not require using only statistical methods, but any suitable method, which means that company can use statistical also non-statistical methods in quality assurance.

This is an important point because both statistical and non-statistical methods have their own advantages and disadvantages, therefore only their common application can bring companies maximal benefit.

There many well-known statistical methods, certainly there are useful, but mostly advantages are stressed in the literature not their disadvantages. Therefore, this paper explains several disadvantages that statistical methods comprise. The paper pays attention to different quality control methods from different perspectives and deals with several non-statistical methods because there are not well-known among companies and their explanation here can be useful for companies to implement requirements of new ISO 9000: 2000.

1. Understanding of Quality Assurance

There are two basic views regarding understanding of quality assurance. The first view characterizes quality assurance as the assurance of current and future customer needs. In this case quality assurance includes quality planning, because especially future needs are assured by designing and producing new products. The second view understands quality assurance as consistent assurance of product quality in the phase of their production without any quality defect occurrence. Quality assurance is here understood as the observation of quality manuals and working instructions.

The aim of quality assurance is then consistent assurance of the company output by building quality into processes so that we would eliminate conditions leading to quality defects.

Both views have their own meaning and significance. It depends only on how we approach these views. But for effective quality management we have to distinguish them, because actions in quality planning and quality assurance have different content and they require using different methods and tools in their implementation.

Fact is that number of defects exists throughout production phase. Irrespective of how good we design the product, they are produced and measured in the implementation and inspection phases. The approach of how we carry out these two phases chiefly influences product quality and defect rate occurrence. Besides this the implementation phase is influenced by the inspection phase on the condition that time interval between these two phases is as short as possible.

One of the basic aims in quality assurance in manufacturing companies is continuous reduction of mistakes and resulting from that defect occurrence. If we express quality by defect rate, then quality will be completely assured only when there will not be any defect that is 100 % quality. If there will be defect occurrence, it means that quality assurance is still not reached. One of the basic reasons of why is that can be the application of wrong methods and tools like control charts and acceptance sampling in quality assurance. Generally there is a valid assumption for any method or tool that the better the method or tool the more effective are in reaching an aim. On the other hand if they are wrongly used they hinder in reaching the aim for which they were selected.

In quality assurance is also important the scope of quality inspection: inspect every piece of product or only certain sample. The first belongs to 100 % inspection; the second belongs to statistical sample inspection. Sample inspection is based on probability theory and statistics and represents the basis of almost all statistical methods of quality assurance. Traditionally 100 % inspection is not recommended with the exception of critical significance, for example food, medicaments, and health care instruments. 100 % inspection can give wrong outcomes because inspection of every piece of product is monotones and therefore can cause fatigue and inattentiveness of those who perform an inspection. Therefore is generally accepted the view that statistical sample is inevitable for effective quality assurance.

But these statements and assumptions especially in manufacturing companies contradict to some degree to quality inspection based on the application of industrial methods. Today's technological advance in automation of quality inspection allows reliable implementation of 100 % inspection. Microprocessor technique, automation and different kinds of sensors revolutionized the significance of inspection and quality measurement. Sensors allow excluding a human factor from inspection reliably and cheaply and in this way they abolish disadvantages of traditional application of inspection by human factor and also they doubt about the application of certain statistical methods in quality assurance such as control charts and acceptance sampling.

Statistical sample methods are based on the view that certain number of defects is inevitable. Probability theory makes statistical sample methods more rational, but it does not more rationalize quality assurance, that is reaching 100 % quality. Therefore we cannot use statistical sample methods if our aim is to reach zero defect rate. Defect rate measured in parts per million (ppm) cannot be reliable detected by statistical sample methods.

2. Advantages and Disadvantages of Statistical Methods

A basic question in using any method is if this method is suitable for chosen aim, if this method has sufficient affirmative value. In quality management still prevails the excessive stress on the application of statistical sample methods especially known under the abbreviation of SPC (Statistical Process Control). Every SPC method has its own advantages and disadvantages, its own place and function in quality assurance. Problem does not lie in if these methods function or not. Every SPC method has its own significance and aim of usage, but only in the frame of its own possibilities, in the frame of what they can do and what they cannot do. Their effective usage depends on the problem and aim, which we want to solve and reach by means of them.

Statistical sample methods have the following advantages and disadvantages in their application in quality assurance:

1. Many professionals consider process and product variability as one of the main causes of defect occurrence. They see solving of this problem in variability reduction. Variability is discrepancy between nominal and measured product or process characteristics. As a tool for reducing this variability professionals recommend statistical sample methods. It is the truth that through application of these methods variability can be significantly reduced but not completely eliminated.
2. Variability is considered to be brought about by two factors: special causes, which can be eliminated, and common causes, which cannot be eliminated and are inherent to process and its cause cannot be defined. Therefore it is thought that quality cannot be completely assured. But professionals from industrial engineering field claim that in their praxis they did not encounter on the example when they could not find a cause of a defect. When we are able to find the cause of a defect then we are able to completely eliminate defects.
3. Quality defects are not caused only because of the existence of variability, which can be measured by some gauge. Defects can be brought about by wrongly connected or assembled two pieces together or from paying inadequate attention to operation by worker. The gauge itself cannot measure such defects and therefore statistical sample methods cannot by here applied successfully. We have to use different methods and tools.
4. Statistical sample methods require certain number of data in order to come to relevant conclusion. It takes different time span to collect and analyze these data depending on the type of method and skills of statistician. But generally there is excessively long time span for finding cause of a defect. We can produce a number of defects within this time span. It is necessary to shorten as much as possible this time span between origin and disclosure of defects for their successful elimination. This cannot be done successfully by statistical sample methods.
5. Statistical sample methods have built up errors of first and second degree in it. The outcomes are therefore never 100 % reliable and this is unsatisfactory for complete elimination of quality defects. If we want to reach 100 % quality, we have to implement 100 % inspection and absolute elimination of defects as the objective.

Probably it will not be possible to reach 100 % quality in every aspect of quality assurance. But in the real praxis some companies, especially in electronic and automobile industry, have reached a level of quality where defects are measured in parts per million. It is not possible to catch up such a small number of defects by statistical sample methods. We need to use 100 % inspection together with automatic detection technical device.

6. We can gain a number of data in industrial companies. Data are collected so that we could correctly understand actual situation on the shop floor and correctly define procedure of producing goods. It is important because a process will be effective only when decision-making is based on correct understanding of a situation on the basis of having real data from real situations at workplaces that means from facts, not from managers intuition. One of the biggest fault people can do is to make a decision on their own opinion, skills, and intuition rather then on the basis of the real facts and analyses. Therefore it is important to collect and analyze data on the real condition of situation workplaces and here comes the meaning and significance of statistical methods in quality assurance.
7. Statistical sample methods have their meaning in data collection, data analyzing, and coming to conclusion from those analyses. They can tell us if some problem has occurred or not. But they cannot tell us what the true cause of a problem is. To find the true cause of a problem we need to use information, knowledge, methods and tools from different discipline, in manufacturing companies especially from the industrial engineering field.
8. Statistical sample methods can be successfully applied in monitoring of quality systems that is in audits, for example Pareto analysis. Buy they are not suitable in inspection. Here we can use better kinds of inspection methods like self-control and source inspection together with automatic detection technical devices for disclosing and following elimination of quality defects.
9. Statistical sample methods have one major area where we can implement them successfully. They are useful in those areas where we still did not define unambiguously optimal working conditions or optimal product characteristics. They are then useful in quality planning, but not in quality assurance after having defined these optimal conditions. Here in quality assurance there are better methods and tools from the industrial engineering field.
10. One of the problems in literature dealing with the application of statistical methods is a fact that it is written on them by standard way, that is, it is described only basic explanation of certain statistical method with some practical example. This standard method represents certain permanent implementation of it within some work, represents certain normalized procedure, which does not allow individual problem analysis. But on the real shop floor every application of statistical methods is unique and individual, there is not possible to transform statistical methods into working procedures for stable or repetitive work. It means that miscellaneous applications differ each other since different problems exist. It does not mean that we cannot use standard procedures. But we always have to analyze which procedures should be used regarding the problem character and data. We have to know: when, why, for what, what to use, what questions to rise and in what order [1].

A scientific or technical study always consists of the following three steps [7]:

1. One decides on the objectives.
2. One considers the method.
3. One evaluates the method in relation to the objective.

In statistical methods application is absolutely necessary to know by the user of these methods for what purpose certain statistical method is appropriate, which input data he/she needs, how he/she can utilize outcomes of using statistical methods, and evaluate accuracy and dependability of these outcomes. Not knowing this means certainly wrong selection of suitable method, their wrong application, wrong input data, wrong evaluation of outcomes, and following from this wrong decision-making. A main risk of statistical methods application does not stem from their imperfection, but rather from misunderstanding of basic principles, thus from misunderstanding of statistical thinking [3].

3. Robust Design

The ideal quality a customer can expect is that every product delivers the target performance each time the product is used, under all intended operating conditions, and throughout its intended life, with no harmful side effects.

The performance of a product is measured by the quality characteristic and varies due to miscellaneous variability causes. The fundamental principle of robust design is to improve the quality of a product by minimizing the effect of the causes of variation without eliminating the causes. This is achieved by optimizing the product and process designs to make the performance minimally sensitive to the various causes of variation. This is called parameter design [4]. In *parameter design*, we determine the best setting for the control factors that do not affect manufacturing cost. Thus, we must minimize sensitivity of the product or process function to all noise factors and also get the mean function on target.

Three methods of reducing variance can be used in order of cost effectiveness:

1. Screening out bad products. Here, products that are outside certain limits are rejected as defective. The rejected pieces are either reworked or scrapped. Because inspection, scrap, and rework are expensive, this method of reducing variance leads to higher cost per passed product.
2. Discovering the cause of malfunction and eliminating it. Discovering the cause of malfunction and eliminating it can also reduce variance. This method is also expensive but usually less expensive than screening.
3. Application of the robust design method. The aim of this method is making a product's performance insensitive to noise factors by exploiting the inherent nonlinearity of the relationship among the product or process parameters, the noise factors, and the quality characteristics. As a result of applying the robust design, in many cases the manufacturing tolerances do not have to be tightened, the product's usage environment does not have to be controlled tightly, and cheaper material or components can be used, all of which make robust design the most economical of the three methods.

A block diagram shown in Figure 1 can represent a product.

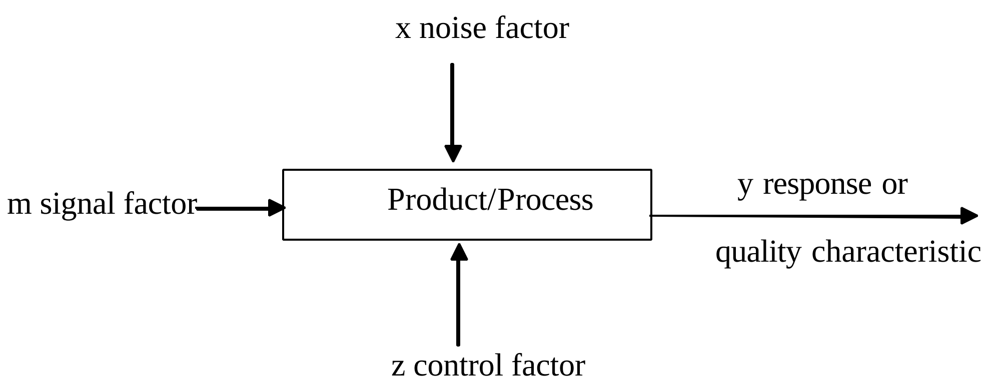

Fig. 1 BLOCK DIAGRAM OF A PRODUCT/PROCESS: P DIAGRAM

Factors which can influence the required quality characteristic or response y of a product or process are classified into the following three classes:

1. *Signal factors* m. These are the parameters set by the user or operator of the product to express intended value for the response y of the product. The signal factors are selected by the design engineer based on the engineering knowledge of the product being developed.
2. *Noise factors* x. These are the parameters, which cannot be controlled by the designer or the parameters whose settings (also called levels) are difficult to control in the field or whose levels are expensive to control. The

levels of the noise factors change from one unit to another, from one environment to another, from time to time. Only some statistical characteristics of noise factors can be known or specified but the actual values in specific situations cannot be known. The noise factors cause deviations of the response y from the target specified by the signal factor m.

3. *Control factors* z. These are parameters that can be specified freely by the designer. In fact, it is the designer's responsibility to determine the best values of these parameters. Each control factor can take multiple values, called levels. When the levels of certain control factors are changed, the manufacturing cost does not change.

4. Sporadic and Chronic Defects

Eliminating quality defects is a big issue on the shop floor. Defects appear in two ways: as sporadic or chronic defects.

Sporadic defects occur suddenly and infrequently. Typically, they result from a single cause that is easy to identify. Because cause-and-effect relationships in sporadic defects are fairly clear, corrective measures are usually easy to formulate.

Chronic defects, on the other hand, are the outcome of complex cause-and-effect relationships. Each time a chronic defect occurs, a different combination of factors, or causes may be involved, so it is difficult both to identify causes and to clarify their effects. This makes it equally difficult to devise effective countermeasures.

Failing to find out how chronic defects occur is a major obstacle to their elimination. We tend to focus too narrowly on a given cause because we have not sufficiently understood the phenomenon: the physical event or precisely what happens to produce the defect.

To achieve an elimination of chronic defects we must do three things:

- identify all factors that conceivably cause a defect,
- thoroughly investigate each factor,
- eliminate any malfunctions or suboptimal conditions discovered in the process.

Even when we understand the nature of chronic defects, we can use a flawed problem-solving approach. We have to avoid three types of errors in chronic defect analysis:

1. Phenomena are insufficiently stratified and analyzed. For example, there are several ways that just one phenomenon - dimensional variation - can occur:

- during morning startup,
- before and after tool replacement,
- before and after changeover,
- during normal operation.

When we focus on the result - dimensional variation - without studying the various ways it can appear and the different reasons in each case, it is more difficult to respond correctly to the reasons behind an individual occurrence. By contrast, when we stratify the phenomenon into types, the causes are easier to identify an appropriate countermeasures are easier to devise.

2. Some factors related to individual phenomena are overlooked and are thus not controlled. Uncontrolled factors can easily lead to chronic defects.
3. Abnormalities hidden in individual factors are not addressed because people literally do not see them. This is especially true of slight abnormalities. Large defects are obvious to almost everyone. We are more alert to larger problems because they appear more significant. Conversely, the smaller the problem, the more likely we are to ignore it.

P-M analysis physically analyzes chronic defects according to the inherent principles and natural laws that govern them. P-M analysis clarifies the mechanics of their occurrence and the conditions that must be controlled to prevent them.

What “P” and “M” stand for is shown in the Figure 2.

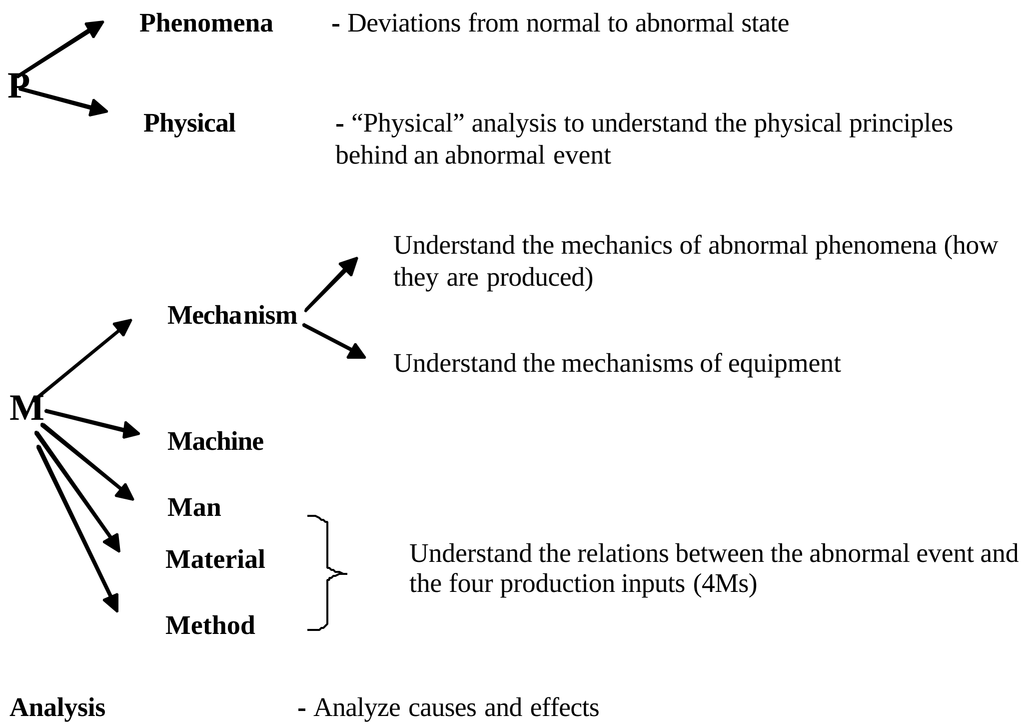

Fig. 2 DESCRIPTION OF THE P-M ANALYSIS

The basic principle behind P-M analysis is to first understand in precise physical terms what happens when a machine breaks down or bad parts are produced, and how it happens. Only then we can identify and address all causal factors and thus eliminate the chronic defects. Looking at it another way, P-M analysis is a refined variation of cause-and-effect analysis that considers all causal factors instead of trying to decide which are most influential.

Physical analysis is a logical investigation such as defects or breakdowns that explain how the phenomena occur in terms of physical principles and quantities. Physical analysis uses basic operating principles to clarify how various parts of a given subject being under investigation interact to generate abnormal phenomena. Abnormal phenomena are those that deviate from what is normal or expected. Physical analysis is a bridge that helps us draw logical relationships between abnormal phenomena and their potential causes [6].

Conventional approach is based on the concept of priority. In other words, teams select improvement projects based on:

- the most numerous or costly defects or failures,
- factors having the greatest impact,
- the most obvious abnormalities related to those factors,
- measures that promise to be the most effective (against defects).

Teams use Pareto charts, cause-and-effect diagrams, or factor analysis to identify the most likely factors contributing to breakdowns and defects. Then they implement improvements on a priority basis. Conventional approach to making improvements is useful and effective, but its cardinal weakness is that while it can help reduce defects dramatically, it cannot eliminate them completely, because it cannot address the chronic defects that block the paths to zero defects or zero breakdowns.

P-M analysis has evolved in response to a need - as a way to eliminate those chronic problems left behind by the conventional improvement approach. P-M analysis does not attempt to prioritize the most influential factors. Why? Because it is very rare that a recurring defect or malfunction is clearly attributable to one, two, or even several distinct recurring defects or causes. Instead, we typically encounter a tangled web of factors that may or may not be contributors. Rather then prioritizing, consider all factors that might have an impact on the chronic defect.

The conventional improvement approach and P-M analysis can be used together as follows: in areas where the defect or failure rate is high, first implement the conventional (priority-based) improvement approach to greatly reduce the defect or failure rate. Thereafter, follow up by implementing the zero defect strategy by using P-M analysis. Adopting zero defect strategy too early - when the defect rate is high - is likely to be time-consuming and unproductive.

5. Inspection Methods

It is an inescapable fact that defects in production actually occur in production where their causes occur at the stage of implementation and control. No matter how good the product design, that is planning stage may have been carried out, the products are actually made at the implementation and control stage. The approach to carrying out these stages strongly influence product quality and number of defects while implementation stage is influenced by control stage provided that a time interval between these two stages is as short as possible. But these two stages can only guarantee the product quality they cannot improve it. For quality improvement we need to implement the planning stage.

When we do something, we have to control the outcome of our work. A decisive factor here is a time interval between work accomplishing and obtaining information about the outcomes of our work. For reaching 100 % quality this time interval must as short as possible, which means that control activities must follow immediately after accomplishing work activities. A communication of needed information must be assured in the real time of management of our work which Cestnejší [2] calls it *the real time of management*.

From the point of time span and the aim of method we recognize three inspection methods [5]:

1 Inspection that discovers defects: *judgement inspection*.
1. Inspection that reduces defects: *informative inspection*.
2. Inspection that eliminates defects: *source inspection*.

The purpose of **judgement inspection** is to categorize finished products as defective or acceptable after processing has been completed. The point of this method is to keep defective goods from moving on to customers or subsequent processes, and in this sense it is an effective method. However, no matter how accurately and thoroughly it is performed, it can in no way contribute to lowering the defect rate in the plant itself.

If we want to actually reduce the number of defects processes must be informed on a timely basis about the occurrence of defects so that we could take the measures in restoring the process and thus avoiding of repetitive occurrence of defects. Inspection, which fulfills this role, is called an informative inspection.

The **informative inspection** is an inspection in which, when a defect occurs, information to that effect is fed back to the work process involved, which then takes action to correct the method of operation. The adoption of this method of inspection will have the effect of gradually reducing production defect rates through continuous process improvement.

Even though, the informative inspection is higher ranked than judgement inspection, it is still inefficient in reaching zero defects because this inspection is able to detect defects only after operation has been completed on a product rather than before or during an operation.

Judgement inspection only discloses defects, while informative inspection reduces them. In any case both in judgement inspection and informative inspection correction is done after the fact, that is after disclosing a defect. What we need is a preventive action before defect occurs, which only source inspection can assure.

Source inspection can be described as inspection method that, rather than stimulating feedback and action in response to defects, is based on the idea of discovering errors in conditions that give rise to defects and performing feedback and action at the error stage so as to keep those errors from turning into defects.

Many people maintain that it is impossible to eliminate defects from any task performed by humans. Indeed, inadvertent errors are both possible and inevitable. But this view stems from the failure to make a clear separation between errors and defects. Defects arise because errors are made; the two have a cause-and effect relationship.

Yet errors will not turn into defects if feedback and action take place at the error stage. In this way, the elimination of defects by clearly distinguishing between errors and defects is the principal feature of source inspection.

An effective strategy for reaching zero defects is using source inspection in combination with 100 % inspections and poka-yoke devices to speed up feedback and action. Poka-yoke means error prevention (poka – error, yoke - prevent). Poka-yoke devices are means for machines to implement 100 % inspection with the use of sensors for error detection which otherwise would be concealed like missing part in assembly.

Poka-yoke device is appropriate to use in the situations statistical methods have their disadvantage, which is in the situations where optimal working conditions or optimal product parameters have been definitely correctly defined. On the other hand the use of poka-yoke device should be avoided in the situations where these conditions have not been defined yet. On the other hand statistical methods can be appropriately used there. Thus, statistical methods and poka-yoke devices rightly compliment each other.

Conclusion

Quality management methods and tools should not be applied so that companies can declare their use; they should be rather used for quality management products and processes in a more efficient way. If these methods and tools are not rightly applied, they can lead to incorrect outcomes. The better the methods and tools are, the more effective in reaching the objectives are. If on the other hand are used incorrectly, they can hinder in objective accomplishing for which they were created.

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Turkish Consumers' Perceptions of the Quality of Foreign and Local Products: Effects of Nationalism and Worldmindedness

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Abstract

This paper aims to investigate the role of COO effect in consumers' evaluation of products in Turkey. In particular, we wanted to examine the effects of "nationalism" and "worldmindedness" in consumers' perceptions of quality of products with different origins. Our findings indicate that scales used in the operationalisation of the constructs of nationalism and worldmindedness need to be readjusted and refined in accordance with the targeted cultural environment. Consumers tend to make distinction among the qualities of products from different countries which are a clear indication of the COO effect. However, there were significant differences between the perceptions of the two groups of respondents (nationalist and worldminded) with regard to a particular country's products. Also, findings indicated no differences between nationalist and worldminded respondents' demographic characteristics. When it comes to evaluation products, people tend display incongruent behaviour with their ideological/political affiliations.

Introduction

In today's globalising world economy, consumers are exposed to a wider range of "foreign" products than ever before [1]. This, on the part of consumers, makes product evaluation and selection decisions more difficult and complex. Consumers tend to use various cues such as product quality, and product's capability of meeting consumer demand in the evaluation and selection of products [2]. These cues may be extrinsic (i.e., price and brand name) as well as intrinsic (i.e., country of origin). The findings in the literature indicate that consumers tend to perceive price and brand name as an indication of product quality [3]. Also, it is argued that, in addition to price and brand name, knowledge of the country of origin of a product tends to influence consumers' evaluation of, especially, products with foreign origin [4]. This is called country of origin (COO) effect in product evaluation. Hence, knowledge of COO and the image of the particular country are important criteria used in consumers' evaluation of products with different origin.

In the international marketing literature, there is a long-going debate concerning the influence of COO on consumers' evaluation of products. On the one hand, some studies have concluded that consumers tend to prefer domestic products over foreign products [5,6]. Among the factors leading to such conclusion are nationalistic feelings and widespread availability of after-sales support services, especially for durables. On the other hand, there are some studies indicating that consumers tend to perceive some foreign products with particular origin (i.e., Japan and German) better quality and give them a priority in their preferences [3,7]. Furthermore, some researchers have concluded that COO effect does not play a primary role in the selection and purchasing behavior of consumers unless they do not have any cues concerning the quality of the product [3]. Also, Ettenson has observed that there are significant differences in cue uses among countries [1]. However, as Samiee concluded, the literature concerning the influence of COO on consumers' evaluation of products is far from creating a consensus among researchers regarding the nature of COO effect in product evaluation [3].

Also, in the COO literature there are some studies examining the influence of nationalism on the evaluation of products with foreign origin [4,8,9]. For example, in Turkey and many other countries governments formally or informally give support to such programs encouraging the use of the domestic products. However, there are some findings in the literature that the evolution of the "worldmindedness", a natural outcome of globalization concept, is likely to affect consumers' perception and evaluation of products [8]. In this respect, it would be reasonable to say that consumers tend to make their choices on the basis of value package (a combination of price and quality) meeting their needs and desires rather than product's origin.

In the Turkish COO literature, there is a limited number of studies examining the Turkish consumers' evaluation and purchasing behavior of products with foreign origin. In a study, Varinli and Babayigit have observed that the Turkish consumers tend to have a more positive perception of Turkish apparels compared to those of German, American, French, British and Italian ones [10]. In another study carried out by Kaynak and his colleagues, Azerbaijani consumers are asked to rate the products of six countries [11]. It was concluded that while American and Japanese products are evaluated positively, Turkish products were regarded as high tech, expensive, luxurious, and include superior design specifications. Products from Russia, China and Hong Kong are perceived as poor.

Purpose of the Study

Most of the leading studies on the effects of nationalism and world-mindedness on consumers' evaluation and selection of products with foreign origin are carried out in the West. Hence, the scales used in these studies tend reflect the Western values and cultures. It is questionable, however, whether these scales are transferable to other countries without some modifications. In this study, we wanted to examine the applicability of nationalism and world-mindedness scales used by i.e. Rawwas *et al*.,[8] Boatler [12], Balabanis *et al.* [9] and Herche [13]. Also, we sought if there were differences between two groups of people (those with a nationalistic tendency and those with a worldminded view) in respect to the quality perception of products from six countries. In line with these objectives, we wanted to find answers to the following questions:

1. In the context of Turkey, can we use "nationalism" and "world-mindedness" scales without modifications?
2. Are there any differences between the demographic characteristics of those with a tendency of nationalistic view and those with a worldminded view?
3. Is there any relationship between the political preferences and having nationalistic or worldminded tendencies?
4. Do consumers with nationalistic tendencies behave differently from those of worldminded ones in the evaluation of the quality of products with different origin?

Data and Methodology

As a data collection instrument a questionnaire was used. The questionnaire was made up of four parts. The first part contains demographic questions while the second part concerns the concepts of "nationalism" and "world-mindedness". In the development of "nationalism" and "world-mindedness" scales we have utilized several scales used in other studies. We used the scale by Kosterman and Feshbach [14] in the assessment of nationalism while scales developed by Hett [15], Boatler [12] and Sampson and Smith [16] were used in the assessment of "worldmindedness". In the translation of these scales some methodological rules are followed (i.e. translation and back-translation procedures are carried out before deciding the final version of the questionnaire). But, upon completion of a pilot study, we have made several modifications to the original scales in accordance with socio-cultural characteristics of the Turkish consumers. For example, we have to make some adjustments for the religious believes and some of the social issues occupying consumers' mind in Turkey. Also, some new items (i.e. EU membership) concerning nationalism and worldmindedness are developed and tested for inclusion in the questionnaire. Questions in the second part are organized in 5 point Likert format. Respondents are requested to indicate the degree of agreement or disagreement towards 35 statements aimed at measuring the respondent's view (nationalistic or worldminded). In the third section, respondents are requested to evaluate three different products (automobiles, electrical small kitchen appliances and music appliances- hi-fis) from six countries (Turkey, Japan, Germany, Korea, the USA and Italy) in terms of perceived quality. In the final part of the questionnaire, respondents were asked to indicate the country of origin of 32 brand names (in white goods, automobile, electronic home appliances, kitchen appliances and apparel industry) from 14 different countries. The findings of this part is partly used in this paper. It was mainly aimed as a control question regarding the respondent's knowledge of COO of various brands.

The survey has been carried out on consumers in shopping malls located in Adapazari (in the province of Sakarya) and Izmit (in the province of Kocaeli) in Turkey. Although in similar studies, researchers tend to use phone book as a sampling frame and systematic sampling as a sampling technique via postal survey, we used the mall-intercept method in collecting the data (see, for example Varinli and Babayigit [10]; Rawvas *et al.*, [8] due to low response rate in mail surveys in Turkey and the time limitation. There are two reasons for conducting the survey in these malls. First, it would be relatively easier to find respondents with varying demographic characteristics. Second, these two cities are located very close to each other and there is a very good public transportation facility between them. Hence, people can travel from one city to another on a daily bases for shopping. By doing so, we wanted to increase the representativeness of the sample for the population of interest. Out of these efforts, a sample of 284 respondents volunteered to complete the questionnaire.

In the selection of the two provinces, two main reasons have dictated us. First, given the most recent national ballot results, each of the five political parties (liberals, nationalists, social democrats, and Islamists) holding seats in the Turkish Grand National Assembly has an MP from both of these provinces. It is our belief that this would guarantee that we would be able to reach people with both nationalistic and worldminded tendencies. The second reason is the fact that these two provinces are among rich ones in Turkey, and people in these provinces have a higher chance of reaching the product groups included in the study. Furthermore, time and financial limitations have forced us to carry out the study within a limited geographical setting.

Analysis of Data

Following a preliminary examination of the data for outliers, errors and other problems, we have carried out a Principle Component Factor analysis (PCF) in order to investigate the applicability of the scales in the context of Turkey, and to seek if we can group the respondents as nationalist and worldminded. A review of the "anti-image correlation" matrix in the PCF analysis indicated that two of the statements should be dropped from the analysis since they were causing deterioration in the unity of factors. In the PCF analysis, initially, as a cut off point, factor solutions with an Eigen values over one is accepted. This analysis has resulted in 6 factor solution, three of them were concerned with the concept of "nationalism" and the other three were related to the concept of "world-mindedness". Following the initial 6 factor solution, we have examined 5,4,3 and 2 factor solutions consecutively by forcing the program to the desired solution. In this study, our aim was to determine those items loading on each of the two factors, one for nationalism and the other for worldmindedness. Review of the two factor solution indicated that four of the items loading into the worldmindedness dimension did not fit with the rest of the items on this dimension and was causing deterioration in internal consistency among the items loading on the same factor. Factor loads calculated as a result of the Varimax-Rotation for each factor are shown in Table 1.

Following the factor analysis, the respondents are divided into two groups (as nationalist and worldminded) on the basis of factor loadings. In the classification process, cluster analysis technique was utilized. In the classification, factor loadings for the two factors are used. Also, two cluster analyses was carried out by using Factor 1 and Factor 2 individually, and almost no difference was observed between the results of the two analysis. Hence, the cluster analysis was carried out on the two factor loadings. Also, we have applied the t-test statistics on the factor loadings for the two factors in order to see if there were any significant differences between the respondents with nationalistic and worldminded tendencies in terms of the perceptions of the quality of products with different country of origins.

Findings and Discussions

Table 2 shows the demographic characteristics of respondents. Due to the nature of the questionnaire it was very difficult to find a good representative of the population of interest. For example, some of the respondents had difficulty in understanding some of the concepts and phrases in the questionnaire due to insufficient education level. Hence, nearly 2/3 of the respondents in our sample had a university degree. Similarly, nearly 2/3 of the respondents were male. More than two-thirds of them were single and majority of them aged less than 25. This general trend in the demographic characteristics of the respondents reflects itself in the nationalistic and world-minded groups. In particular, no significant differences were observed between those with nationalistic view and worldminded view in terms of education level and age since these two variables are expected to be different between the two groups.

For the purpose of this study it is important to examine the relationship between the respondents' political tendencies and their being a nationalist or a worldminded person since it is important to understand the influence of the individual's ideology within the context of "understanding and explaining the world". In other words, it is important to determine how congruent the respondent's political tendency and his world view as a nationalist or worldminded person. Out of 143 respondents who provided their political tendencies, 80 of them are identified themselves as nationalist while 63 of them were identified as worldminded. Around 76% of those who call themselves as nationalist were identified as nationalist while the remaining 24% is identified as worldminded. On the other hand, 55% of those who call themselves as liberal were identified as worldminded. However, 64% of those who call themselves as Islamist are identified as nationalist. Approximately 33% of social democrats were nationalists while the remaining two third were identified as worldminded.

These results indicate that consumers tend to behave differently when evaluating issues, particularly the economic issues closely related to the quality of life. It may be concluded that consumers have a tendency to separate economic issues from their political preferences. In other words, they do not have an absolute ideological perspective or framework dictating the whole areas of their lives. Those who call themselves as nationalist might have a worldminded view while those who call themselves as liberal might adopt a nationalistic view of the world, or wise versa. But the findings indicate that majority of those who call themselves as nationalist tend to have a nationalistic feelings and the majority of liberals and social democrats tend to entertain a worldminded view. The Islamist group displays a tendency which is relatively closer to the nationalist than to the liberals. This is not an odd result for two reasons. First, they are nationalist due to Islam's contribution to national values. Second, they support a worldminded view due to the universal nature of the Islam's message (unity of humanity) to the world.

In the second part of the analysis, independent sample t-tests are carried out in order to test whether there were any statistically significant differences between the perceptions of nationalist and worldminded respondents regarding the quality three products (automobiles, music sets- Hi-Fis and electrical small kitchen appliances) with different country of origins (Turkish, American, Italian, German, Japanese and Korean). T-test statistics indicated no significant differences at five percent significance level between the perceptions of the two groups (nationalist and worldminded respondents). That is, there is no difference between the nationalist and worldminded respondents in relation to the evaluation of the quality of products from various countries.

In the Tables 5-7, the results of the two groups of bivariate comparison of two country products for each group of respondents (nationalists and worldminded) are displayed. Appropriate test statistics for this purpose would be the "paired samples t-test". A review of the tables indicate that consumers tend to evaluate each country's products differently and they recognize the differences across country products.

Table 1: TWO-FACTOR SOLUTION WITH VARIMAX ROTATION

Variables	Factor 11 Factor Loads	Factor 2 Factor Loads
Imports should be banned	,719	
Purchasing foreign goods is un-Turkish.	,714	
Purchasing foreign goods is not right.	,697	
Foreign goods should not be allowed to get into Turkey.	,668	
Real Turkish should only buy Turkish-made products.	,663	
Buy Turkish products, Keep Turkey working.	,662	
Domestic products should be the first and last preference.	,657	
Turkish consumers who purchase products made in other countries are responsible for putting their fellow Turks out of work	,653	
We should purchase products made in Turkey instead of letting other countries get rich of us	,645	
I am willing to stop purchasing imported goods.	,644	
It is always best to purchase Turkish products	,636	
Imported goods that threaten local industries should be banned.	,627	
Only those products that are unavailable in Turkey should be imported.	,608	
We should raise taxes in order to prevent foreign goods entering Turkey.	,604	
Imported goods from unfriendly countries should be banned.	,571	
We should only accept imports from countries that accept our imports.	,517	
I would prefer not to purchase goods in countries that are former enemies.	,474	
There should be very little trading or purchasing of goods from other countries unless out of necessity.	,362	
Immigrants should not be permitted to live in Turkey if they compete with our workers.	,333	
Cronbach Alpha: 0,90		
It would be better to be a citizen of the world than of any particular country.		,702
I prefer to have a globally recognized “Human Rights Law” rather than national laws.		,666
All national governments should be abolished and replaced by one central government.		,625
Our responsibility to people of other races ought to be as great as our responsibility to people of our race.		,578
War should never be justifiable even if it is the only way to protect our national rights and honor.		,551
Immigration should be controlled by an international organization rather than by each country independently.		,475
Any healthy individual, regardless of race or religion should be allowed to live wherever he wants to in the world.		,408
I believe that membership to the European will be beneficial for Turkey.		,380
I find imported goods more desirable than domestically produced products.		,218
My quality of life would improve if more imported goods were available.		,218
Cronbach Alpha: 0,68		

KMO: 0.81

Table 2: DEMOGRAPHIC CHARACTERISTICS OF RESPONDENTS

Variable	**Nationalists** (n= 98)				**Worldminded** (n= 186)				**Overall** (n= 284)			
Sex	**Male**	**Female**			**Male**	**Female**			**Male**	**Female**		
	64	34			140	46			204	80		
Marital Status	**Mary.**	**Single**	**Others**		**Married**	**Single**	**Others**		**Mard.**	**Single**	**Other**	
	27	68	3		64	118	4		91	186	7	
Age	**16-25**	**26-35**	**36-45**	**46-+**	**16-25**	**26-35**	**36-45**	**46-+**	**16-25**	**26-35**	**36-45**	**46-+**
	58	22	6	12	122	50	11	3	180	72	17	15
Education	**Primary**	**High**	**Univ.**		**Primary**	**High**	**Univ.**		**Primary**	**High**	**Univ.**	
	3	32	63		2	41	143		5	73	206	
Occup.	**Civ.Ser**	**Wrk**	**Free.**	**Oth.**	**Civ.Ser**	**Wrk**	**Free.**	**Oth.**	**Civ.Ser**	**Wrk**	**Free.**	**Oth.**
	21	17	16	44	43	32	59	52	64	49	75	96
Income	- 300	301-500	501- +		- 300	201-500	501- +		- 300	301-500	501- +	
	42	25	31		65	65	56		107	90	87	

Table 3: POLITICAL PREFERENCES OF NATIONALIST AND WORLD-MINDED RESPONDENTS

Political Preference	**Nationalist**		**Worldminded**	
	N	**%**	**N**	**%**
Liberal	11	13.8	13	20.6
Nationalist	32	40.0	10	15.9
Social Democrat	9	11.3	18	28,5
Islamist	23	28.8	13	20.6
Others	5	6.3	9	14.3
Toplam	**80**	**100**	**63**	**100**

In the case of automobiles, except for American and Japanese ones for the worldminded group and except for Italian-Korean, American-Japanese, and German-Japanese cases for the nationalist group, respondents tend to perceive significant differences between the quality of products across countries.

For the case of music appliances, both groups do not see any significant differences between the quality of Turkish-Italian, Turkish-Korean and Italian-Korean products. Interestingly, nationalists perceive no differences between the American and Turkish music appliances while worldmindeds are indifferent between the German and American appliances. For the rest of all bivariate comparisons, both groups perceive significant differences between the quality products with different origins. This result is an interesting one since, for example, although there is no hi-fi brand with Italian origin in the Turkish market, the respondents tend to attribute a quality level for a non-existent product. This result can be attributed to the bias created by COO effect in consumers' evaluation of products. That is, in the absence of extrinsic cues regarding the product quality, consumers evaluate products in light of intrinsic product attributes.

Table 4: DESCRIPTIVE STATISTICS FOR CONSUMERS' PERCEPTIONS OF PRODUCT QUALITY WITH VARYING COUNTY OF ORIGIN

	Nationalists			**Worldminded**			**Overall**		
	n	**Mean**	**Std**	**N**	**Mean**	**Std.**	**n**	**Mean**	**Std.**
ITALIAN									
Automobile	97	3,27	1,11	130	3,59	0,80	227	3,44	1,02
Music Sets	84	3,21	0,72	126	3,37	0,77	210	3,24	0,93
KitchenApplian.	90	3,36	0,71	126	3,27	0,94	216	3,31	0,92
AMERICAN									
Automobile	92	3,90	0,98	138	4,30	0,74	230	4,10	0,95
Music Sets	84	3,81	0,80	226	4,06	0,78	210	3,93	0,84
KitchenApplian.	82	3,58	0,89	228	3,86	0,84	210	3,87	0,92
GERMAN									
Automobile	96	4,51	0,71	131	4,65	0,69	227	4,58	0,74
Music Sets	84	4,19	0,77	226	4,20	0,64	210	4,17	0,80
KitchenApplian.	85	4,23	0,68	225	4,17	0,89	210	4,22	0,81
TURKISH									
Automobile	84	2,65	1,08	146	2,41	1,01	230	2,50	1,08
Music Sets	85	3,33	0,98	123	3,41	1,03	208	3,36	1,06
KitchenApplian.	45	3,78	0,90	64	3,63	0,86	213	3,56	0,85
JAPANESE									
Automobile	96	4,27	0,76	133	4,15	0,67	229	4,15	0,81
Music Sets	94	4,53	0,67	112	4,48	0,86	206	4,37	0,91
KitchenAppli.	84	3,98	0,82	127	4,14	0,73	211	4,18	0,82
KOREAN									
Automobile	88	3,08	0,84	137	3,22	78	225	3,12	0,91
Music Sets	88	3,48	0,71	222	3,45	0,95	210	3,43	0,90
KitchenApplian.	86	3,27	0,69	225	3,11	0,73	211	3,26	0,85

In the case of small kitchen appliances, both groups evaluate similarly all bivariate comparisons, However, nationalists tend to see no difference between the Italian-German and Turkish-Japanese products while worldmindeds do. The COO effect reflects itself here, as well.

Table 5 COMPARISON OF THE PERCEPTION OF THE QUALITY OF AUTOMOBILES WITH VARIOUS COUNTRY OF ORIGIN

	NATIONALIST				**WORLDMINDED**			
COUNTRY PAIRS	**Paired Differences**		**t**	**Sig.**	**Paired Differences**		**T**	**Sig.**
	Mean	**Std.**			**Mean**	**Std.**		
ITAL-GERM	,63	1,13	3,916	,000	,71	1,02	5,676	,000
ITAL-AMER	1,24	1,16	7,485	,000	1,08	,92	9,399	,000
ITAL –TURK	,60	1,57	2,670	,010	1,18	1,38	6,956	,000
ITAL –JAPN	-1,00	1,41	-4,950	,000	-,58	1,05	-4,552	,000
ITAL –KORE	,18	1,56	,822	,415	,37	1,04	2,864	,006
AMER-GERM	,61	,93	4,602	,000	,33	,75	3,606	,001
AMER –TURK	1,27	1,73	5,075	,000	1,88	1,37	11,362	,000
AMER-JAPN	-,37	1,39	-1,844	,071	,13	,83	1,320	,191
AMER-KORE	,82	1,38	4,142	,000	1,06	1,04	8,319	,000
GERM –TURK	1,85	1,41	9,085	,000	2,20	1,38	12,900	,000
GERM-JAPN	,24	1,09	1,572	,122	,45	,93	3,966	,000
GERM-KORE	1,43	1,06	9,428	,000	1,41	1,08	10,590	,000
TURK-JAPN	1,62	1,28	8,782	,000	1,75	1,12	12,831	,000
TURK-KORE	,49	1,42	2,303	,026	,94	1,56	4,947	,000
JAPN- KORE	1,28	1,04	8,445	,000	,80	,92	6,996	,000

Table 6 COMPARISON OF THE PERCEPTION OF THE QUALITY OF MUSIC APPLIANCES WITH VARIOUS COUNTRY OF ORIGIN

	NATIONALIST				**WORLDMINDED**			
COUNTRY PAIRS	**Paired Differences**		**t**	**Sig.**	**Paired Differences**		**T**	**Sig.**
	Mean	**Std.**			**Mean**	**Std.**		
ITAL-GERM	,60	,89	4,358	,000	,70	1,03	5,403	,000
ITAL-AMER	1,00	1,04	6,256	,000	,86	,94	7,309	,000
ITAL –TURK	-,12	1,23	-,625	,535	-6,25E	1,30	-,386	,701
ITAL –JAPN	-1,33	,87	-10,046	,000	-1,13	1,22	-7,304	,000
ITAL –KORE	-,26	1,01	-1,675	,102	-,11	1,15	-,775	,441
AMER-GERM	,40	,94	2,795	,008	7,69E	1,11	,560	,578
AMER –TURK	,49	1,32	2,433	,019	,66	1,38	3,854	,000
AMER-JAPN	-,70	,99	-4,626	,000	-,43	1,12	-3,108	,003
AMER-KORE	,37	1,00	2,439	,019	,56	1,25	3,557	,001
GERM-TURK	,88	1,17	4,868	,000	,76	1,18	5,227	,000
GERM-JAPN	-,33	,92	-2,324	,025	-,37	1,11	-2,677	,009
GERM-KORE	,74	,99	4,836	,000	,70	1,12	4,966	,000
TURK-JAPN	1,19	1,24	6,275	,000	1,12	1,13	8,048	,000
TURK-KORE	,12	1,18	,647	,521	6,35E	1,42	,354	,725
JAPN- KORE	1,07	,94	7,495	,000	1,00	1,24	6,515	,000

Table 7 COMPARISON OF THE PERCEPTION OF THE QUALITY OF SMALL KITCHEN APPLIANCES WITH VARIOUS COUNTRY OF ORIGIN

	NATIONALIST				WORLDMINDED			
COUNTRY PAIRS	Paired Differences		T	Sig.	Paired Differences		t	Sig.
	Mean	Std.			Mean	Std.		
ITAL-GERM	-,22	1,13	-1,324	,192	-,59	1,01	-4,766	,000
ITAL-AMER	,86	,85	6,727	,000	,91	1,01	7,237	,000
ITAL-TURK	,42	1,18	2,406	,020	,36	1,35	2,130	,037
ITAL–JAPN	-,64	,94	-4,480	,000	-,89	1,11	-6,394	,000
ITAL-KORE	6,82E	,79	,573	,570	,15	1,09	1,135	,261
AMER-GERM	,61	1,02	4,004	,000	,30	,98	2,522	,014
AMER –TURK	,20	1,36	,988	,329	-,26	1,31	-1,604	,114
AMER-JAPN	-,41	1,11	-2,453	,018	-,29	,91	-2,579	,012
AMER-KORE	,30	1,11	1,763	,085	,75	1,09	5,575	,000
GERM–TURK	-,45	1,25	-2,417	,020	-,54	1,31	-3,309	,002
GERM-JAPN	,23	1,03	1,462	,151	,02	1,08	,000	,998
GERM-KORE	,93	,86	7,124	,000	1,06	1,03	8,318	,000
TURK-JAPN	-,16	1,35	-,784	,437	-,56	1,17	-3,754	,000
TURK-KORE	,55	1,28	2,818	,007	,52	1,20	3,452	,001
JAPN- KORE	-,70	,88	-5,322	,000	-1,06	,92	-9,202	,000

Conclusions

In respect to research questions raised in this study, it is plausible to extract several conclusions out of this study.

1- Regarding the applicability of the scales proposed by other researchers mainly from the West, it is observation that some of the questions included in these questionnaires did no make much sense to the Turkish respondents. For example, items concerning the religious believes, ethnicity, and migration do not have much application within the context of Turkish social structure and culture. Also, the construct of "nationalism" is attributed to different meanings within cultural contexts. This observation is consistent with Balabanis *et al*.'s [9] conclusion that in Turkey the term nationalism contains positive meanings i.e. it is not antagonistic towards other nations (patriotism). Hence, it is reasonable to conclude that scales developed within the context of the Western culture needs some modifications and adjustments before applying them in a different cultural environment.

2- No significant differences were observed between the two groups of consumers (nationalist and worldminded) with respect to demographic characteristics. This might be attributed to several factors. First, the respondents included in this study live in the same geographical area and use similar areas for shopping and other purposes. Second, the nature of the questionnaire requires some level of knowledge and open-minded view of the world around us. In particular, middle aged and old generation have a tendency not to participate this type of surveys due to lack of knowledge and suspicion about the purpose of the study. This point needs further examination.

3- There is an incongruency between the respondents political affiliations and their entertainment of a nationalistic or worldminded view. It is normally expected that ideological identities induce people to be worldminded or nationalist. For example, liberals and social democrats are expected to be mainly worldminded while the Turkish nationalist are mainly to be nationalist. However, this expectation is not consistently supported by the findings.

4- Findings indicate that there are no significant differences between quality perceptions of nationalist and worldminded respondents for a particular country product. That is, these two groups of consumers tend to evaluate products with a particular country of origin similarly.

5- However, consumers in either group (nationalist or worldminded) make distinction between the quality perception of products with different country of origins. That is, consumers are aware of the differences in the quality of products from different countries. This point is much clear in the case of worldminded group. This might be a reasonable result since respondents with a worldminded view are expected to be more open to different views, and relatively less biased towards other countries and products from other countries.

6- The COO effect is clearly in action in consumers' assessment of product quality in the context of foreign origin products.

Lastly, it should be noted that the findings of this study is valid within the boundaries of the study. It would be easier to generalise the findings if the study were carried out in a larger area and on a bigger sample size. Also, the scales and concepts need to be refined in order to better reflect the perceptions of the Turkish consumers in regard to nationalism and worldmindedness constructs.

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Section 8

Accounting & Legal Issue

International Accounting Standards and Accounting Transparency Effect on Russian Accounting and Analysis

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Abstract

For many years accounting in Russia has been viewed as a control- bearing activity only. Now it is widely recognized that accounting should be considered as a combination of several interrelated areas: financial accounting, managerial accounting, auditing, financial analysis and management control. An important part of accountability process is the issue of financial reports.

Many enterprises in Russia are tightly connected with their foreign partners and that is why it is necessary to follow international standards in arranging financial statements.

The main objectives of financial statements are: the first – to appreciate the performance of the enterprise and the second – to evaluate the risk of the enterprise.

It is necessary to adjust financial ratio system for the various industries as well as work out norms in order to obtain reasonable results.

Many methods were provided in Russia clueing the last decade to perfect accounting system and its user identical comprehension. But still discrepancy between Russian and International accounting and audit standards can be detected.

Avoiding Business Failure – the Role of IAS

Every management decision should be preceded by analysis. In recent times, analysis was for the most part retrospective, in most cases it served for study of the past and wasn't used enough for planning. Now, in transition market economy enterprises must account various circumstances. Disregard can lead to financial losses and even bankruptcy. So, analysis and forecasting now gain great importance for Russia.

The most of common problems that can lead to business failures should also be viewed from the perspective of IAS, especially with respect to the impact that financial and management information can have in causing or preventing these problems. The following is a brief summary of the causes of failure and some comments on their management information aspects.

One of the problems is insufficient capitalisation and loss of financial backing. This usually involves having too little working capital, not keeping the ratio of debt to capital in proper proportion, and having bankers and other creditors lose confidence in the business and withdraw their financial support.

Insufficient working capital and other cash flow problems caused by insufficient analysis may be the first step to the bankruptcy. Such problems usually arise because the growth of the business is not properly balanced or controlled. Also, because too much credit is extended to customers (especially those in weak financial condition as it is widely spread in Russia), too much is invested in long-term assets, there is a lack of credit control, etc.

Lack of adequate budgeting and planning often results in the inability of management to forecast accurately the future activities and related elements of earnings and expense, not having accurate, current analyses of actual results as compared to budgets, or not reacting properly to unexpected changes.

Consequences of precipitate decisions to lease property and equipment can lead to an undesirable result. If these decisions are not based on good information and analysis of their long-term consequences, they can have adverse results in terms of cost/benefit, along with the potential to lose other assets pledged to secure the leases.

Tough competitive situations may push managers to poor decisions on pricing of products. In their drive to increase market share and introduce new products, managers may not properly calculate production and selling costs, on which their selling prices should be based. They also may not have determined the impact of different levels of production and sales volumes on costs and potential selling prices.

On the other hand, manufacturers don't account market factor in pricing. This is reflected in Russian weakness character – lack of co-ordination between market and industrial prices. Manufacturers and final customers suffer, because manufacturers get smaller earnings and customers pay more funds. The only beneficiary is trading sector enriching from price difference and becoming more and more corrupted.

Some managers don't pay enough attention to risk factors. It can lead to insufficient usage of risk avoiding instruments as well as under-insurance. The right types and amounts of insurance are very important in optimising coverage and protecting against major exposures to loss.

It is clear that a first-class management information system, and management's ability to use it to good advantage, is needed to overcome the problems listed above. Management must obtain capital, organise the business, manage risks, prepare budgets, and execute business plans on the basis of "fair value" financial information. The investors and creditors must be kept informed through periodic information prepared on the same basis. Major customers must be evaluated, and the credit extended to them carefully controlled, by reference to the same types of "fair value" data.

Thus we can see that implementation of an IAS-based accounting system, and installing adequate management information and financial reporting systems to make good use of accounting data, is fundamental to avoiding or managing the potential problems that could lead to business failure. Need in authentic information is indisputable.

Economy globalization is also must be taken on account. Different countries aspire to combine their economies and as consequence to unify their reporting standards. Russia is going to integrate into world community and it needs to make its information system more transparent for internal and external use.

International relationships are widely expanded in Russia in contrast to the former Soviet period. First of all, Russia became a desirable investment medium. Foreign investors need to recognize real company's position at the market, its profitability and stability. They have to possess adequate information about company's activity for making any investment decisions and forecasting.

For making analyses it is necessary to collect primary data about the object. In our case, it is a question of financial and accounting reporting. It is well known that reporting based on Russian Accounting Standards (RAS) was not valid sufficiently before transition to the market economy. For many years accounting in Russia has been viewed as a control- bearing activity only, and the initial purpose of RAS was taxation. There was no need to analyze accounting reports in order to appreciate its further performance and evaluate the risk of enterprise in conditions of Soviet economy and accounting standards were not adapted for that. The old accounting standards were not able to provide new Russian economy with essential informational support and necessity of International Accounting Standards engagement is obvious now.

In market conditions vendors and customers, investors and shareholders need to possess valid data about their partners. Due to the lack of valuable financial statements, it is impossible to assess the performance of large enterprises in need of restructuring. Reports composed according to RAS are not able to reflect structure of a big joint-stock company. This lack of transparency, in terms of financial reporting and management, is often at the expense of outside and minority shareholders. As well, RAS don't allow consolidating reports from various local departments, if company operates in different regions of the country and abroad.

Besides, facilitating of more transparency in accounting meets interests of enterprises and most of commercial banks, especially those who are going to actively collaborate with western partners. Transfer to international standards means more clarity and more transparency in their accounting, and this will facilitate western partners work with them.

And there is another reason for IAS implementation: some foreign large corporations set up their branches on the territory of Russian Federation. It results in necessity of unified reporting system in head offices and locations establishings.

During last years there have been transition program implemented and there have been some positive steps in regulatory reform in trying to move towards IAS based accounting. Now financial bodies consider the introduction of IAS financial statements in enterprises, as one of the priority needs. It is widely recognized that accounting should be considered as a combination of several interrelated areas: financial accounting, managerial accounting, auditing, financial analysis and management control. An important part of accountability process is the issue of financial reports.

Reform of the Accounting System in Russia

Who are the interested parties of Accounting System reforming and IAS implementation? Some main motive powers can be identified:

– World community (which is represented first of all by International Monetary Fund) and European Economic Community. In July of 1999 Russian Government approved plan of measures on economy policy for 1999 agreed with International Monetary Fund and International Bank of Reconstruction and Development aimed to get a loan for structural economy reorganization. One of the requirements for loan provision was the following condition: the biggest natural monopolies had to perform and publish quarterly reports based on IAS and checked by independent auditors beginning from 2000.

– Foreign strategic (transnational corporations) and portfolio investors (that posses large share holdings of Russian companies). They influence Russian managers interested in their appeal increasing for foreign investors or who seek to meet requirements of foreign investors to perform accounting reports in accordance with IAS. IAS based reports (checked and approved by auditors) presence is necessary (but not sufficient) requirement for penetration into international capital market and strategic investor attracting. Why investors are so insistent and flat in their demands? The reason is that transparent and reliable reporting is the form of investment defense. IAS place high requirements to economic activity sense reflecting (essence, shape), as well as financial results and information disclosure.

– Companies' top and financial managers. They are of opinion that company's ability to perform IAS based accounting reports can increase investment appeal, as well as the way to reflect true economic position and financial results of activity more accurately. IAS has been worked out directing information needs of reports users. Financial reports based on IAS are more informative and useful, besides, they have more advantages for adequate decision making. Also, shareholders insist more vigorously on using IAS in corporate governance by managers, because these standards comprise advanced experience of company management and transparency providing.

It is well known that financial information must possess two characteristics:

Relevance – financial information must be useful for decision-making and timely.

Reliability – financial information must be truthful, verifiable and neutral.

Russian financial statements did not meet the requirements of relevance and reliability for the following reasons:

- There are principal differences in accounting for similar transactions within accounting process
- The materiality principle is not observed
- The high rate of inflation distorts financial information[1]

IAS provide accountants with ability to get more reliable data about financial position of enterprise acting in conditions of high inflation and non-payments crisis. For example, IAS #29 defines rules of accounting in hyperinflation economy. Russian accounting doesn't have inflation accounting mechanisms (exception is currency exchange rate differences re-calculation or possibility to re-valuation of fixed assets). Many Russian companies showing profit according to RAS would be detrimental if they use IAS # 29.

Another example – financial assets valuation (including accounts receivable). According to IAS assets are to be shown at "fair value" that characterizes real value of an asset. Russian standards assume that any asset is to be accounted at their initial value, at practical costs.

Russian accounting system admits application of other estimation methods, including reserving (assets depreciation reserve creation), but there are series of practical obstacles, i.e. accountants are still direct their efforts towards tax accounting. They don't have satisfactory number of methodical manuals; they don't have habits on subjective making decisions in assets and liabilities estimation.

The Reform was turned to remove these defects in Russian Accounting System and make it corresponding to International Accounting Standards.

A consortium consisting of the international audit and consulting company KPMG and the UN Conference for Trade and Development (UNCTAD), who achieved a success in performing several accounting and financial reporting projects in CIS countries, won in September 1999 a contract under the TACIS program financed by the European Union, to provide technical assistance in the development of Russian accounting regulations. This project is directly related to the Accounting Reform Program to bring the Russian accounting into line with international accounting standards, approved by the RF Resolution of 6 March 1998. A partner organization on the project is the Inter-Agency Commission for Accounting and Financial Reporting Reform (IAC), founded in 1997 with the aim of improving accounting and financial statements in Russia.

An active role in the implementation of this project is played by the Academy of the National Economy (ANE), which is dealing with dissemination of new knowledge and propagation of the main changes in the accounting and financial reporting system by providing professional training. The following constitutes the three main components of the project:

– development of a number of accounting standards which are most in demand;
– development of detailed commentaries on existing and new Russian standards for accounting and reporting;
– development and dissemination of teaching materials among professionals and practicing accountants.

The project was launched on 1 September 1999.

The following constitutes the key success factors of accounting reform:

– co-ordination of accounting changes with other spheres of the economy and law
– close co-operation between Russian leading experts and international experts who have international qualifications and expertise
– active participation of users in the process of preparation of new documents
– participation of practicing Russian and Western accountants and auditors
– preparation of new standards only as part of a package of detailed explanations as to how these changes may actually be implemented in Russia

The accumulated experience of specialists involved indicates the greatest effort is required to form and improve a system's foundation, which is constituted by adequate understanding of underlying accounting principles and concepts. Without such a foundation, the practical introduction of new standards is impossible, however perfect they may be.

The main direction of reforming Russian Accounting System is reflected in the following standards:

– Standards on Assets
– Standards on Income
– Equity Standards
– Standards on Cash Flow
– Standards on Depreciation of assets
– Standard on Impairment of Assets
– Standard on Impairment of Assets
– Standard on Exchange Rate Differences
– Standard on Accounting for the Effect of Changes Prices
– Standard on Inflation Accounting
– Standard Interim Reporting
– Standard on Contingencies

According to the Reform Program established by the Government Decree # 283 dated of March 06 1998, 14 new Russian accounting standards (PBU) have already been set up. 17 new standards are going to be set up in

2001 as well as additional commentaries (methodological guidelines) and appropriate training materials for these new standards. Besides, operating standards are to be corrected.

The main innovations are:

– Accounting Policy implementation [2]
– Re-making of Income Statement Report and Balance Sheet Report[3]
– Inputting a new reporting form – Cash Flow report[4]

Besides, a new Chart of Accounts was suggested for use in 2001 and will be obligatory since 2002. Commentaries will also be drafted on three existing Russian accounting standards (PBU 1 "Accounting Policy" ,PBU 4 "Financial Statements of an Organization" and PBU 6 "Fixed Assets"[5]), that play an extremely important role in the formation of the basis of a new accounting system.

The most sufficient innovation to accounting principles is introduction Cash Flow report as new reporting form. Standard on it establishes the base rules for the accounting and presentation of reliable information on cash flows of organizations for the accounting period in financial statements, which is required by the users to make informed economic decisions.

To achieve this objective, this Standard describes the general criteria for classification of the cash flows by the cash flows from operating, investing and financing activities. Also this Standard provides guidelines for disclosing. This Standard is applicable for all types of commercial organisations (hereinafter organisations) with exception to the state-owned and municipal enterprises. Non-profit organisations and organisations from the state sector, as well as financing and credit institutions, may apply this Standard with due regard to the specific terms and reporting formats that they use.

This Standard does not contain the norms and rules that are to be regulated by special documents. In particular they include accounting and reporting for small businesses and the compilation of consolidated statements.

As for accounting principles renewals that took place in 2001, the main of them is fixed assets accounting. IAS fix that property plant & equipment are recorded at acquisition price or cost of production including transportation and assembly costs. No cost criterion is included when an item is recorded in any accounting category. Before reforming RAS assumed that there had to be cost criteria determined as a stated number of minimum wages (100). The reform fixed four criteria on fixed assets:

– usage in production process;
– life period (more than 12 months);
– ability to make profit;
– “not for resale”[6]

So, now cost criteria is absent as per RAS. This feature and some other introduced by the reform approach Russian accounting to international standards of accounting.

Moreover it is necessary to consider human factor. Generally, people are conservative by nature and by no means all the Russian accountants recognize need of new accounting standards introduction. Most of enterprises, especially those acting in small business sector, don’t have any relations with foreign partners and don’t expect any investments from abroad. Besides, many companies still try to hide reliable information about themselves to escape taxes and don’t intent to make their reports more transparent. But this problem is caused by global economic disadvantages in Russia rather than specific accounting system transition to the new internationally accepted standards.

The role of transition to new standards in analysis

It would be unjust to say that in Soviet Russia analysis and business- planning was not highlighted. The fact is analysis was conducted in conditions of stability, central setting of prices and costs and risks absence and was not called for enough. Existing not long ago accounting system was sufficient for existing analysis.

It is obvious that enterprises need more careful and perspective analysis considering company operating in market conditions, including competitive activity, further risks, inflation, RUR exchange rate change, etc. Some standards of existing accounting system cannot provide analysts with valid information. They must be corrected first in order to be useful for analysis.

For example, bad debts on accounts receivable are to be written off when their period is more than 90 days according to international standards. As for Russian standards this period is 12 months. As it was described above, Russian standards still assume that assets are to be accounted at their initial value, at practical costs, not at “fair value”. There are some other discrepancies that need to be corrected before reports analyzing. So, users of based on RAS reports need to waste their time for corrections and adjusting before proceed analysis [7].

A very popular way of analyzing the performance of business is through the use of financial ratio analysis. This method is useful for managers when they have basis for comparing. Previous periods indicators or planed ratios can be chosen as basis, as well as ratios in similar firms in the same industry or the standards (norms) for the particular sphere of activity.

As for planned to fact or different periods ratios comparison, problems of inflation and exchange rate change arise. Russian accounting doesn’t have any inflation account mechanisms in contrast to IAS that provide accountants with ability to get more reliable data about financial position of enterprise acting in conditions of high inflation and non-payments crisis (exception is currency exchange rate differences re-calculation or possibility to re-valuation of fixed assets).

As for comparison similar firms, it is necessary to work out a data base with true information of at least the biggest companies acting in Russia. Unfortunately, such data base does not exist in present time in the form it should be. One of reasons for that is unwillingness of managers and owners to make information about their companies inquirable. Statistics Committee announces industrial ratios, but they are abstract and not valid. It is necessary for analysts to have access to more specific references of smaller industry segments for making analysis. That’s why it is necessary to adjust financial ratio system for the various industries as well as work out norms in order to obtain reasonable results.

Many methods were provided in Russia clueing the last decade to perfect accounting system and its user identical comprehension. But still discrepancy between Russian and International accounting and audit standards can be detected.

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Accounting and Financial Reporting for Environmental Costs and Liabilities

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Abstract

Accounting and financial reporting for environmental costs and liabilities has become increasingly relevant to enterprises because how an enterprise's environmental performance affects its financial health is of increasing concern to investors, creditors, governments and the public at large. Since the late 1980s, the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has given extensive attention to issues relating to environmental accounting. ISAR formulated detailed Position Paper on Accounting and Financial Reporting for Environmental Costs and Liabilities. The purpose of this position paper is to provide assistance to enterprises, regulators and standard – setting bodies on what is considered best practice in accounting for environmental transactions and events in the financial statements and associated notes.

Accounting for the environment has become increasingly relevant to enterprises because issues of the availability/scarcity of natural resources and pollution of the environment have become the subjects of economic, social and political debate throughout the world. Steps are being taken at the national and international level to protect the environment and reduce, prevent and mitigate the effects of pollution. Consequently, there is a trend for enterprises to disclose to the community at large data concerning their environmental policies, environmental management programs, the costs and benefits related to these policies, objectives and programs and the impacts of environmental performance on their financial performance. Accounting and reporting for the environment has become increasingly relevant to the stakeholders of an enterprise because how an enterprise's environmental performance affects its financial health is of increasing concern to investors, creditors, governments and the general public. In particular, disclosure of environmental data can be used to assess an enterprise's financial and environmental risk.

In accordance with the need to collect, record, evaluate and report financial information related to enterprise's impacts to the environment, we talk about "**environmental accounting**".

In foreign literature [1] there is the term environmental accounting used in following context (see Table 1).

Table 1 TYPES OF ENVIRONMENTAL ACCOUNTING

Type of environmental accounting	Focus	Audience
1. national income accounting	nation	external
2. financial accounting	firm	external
3. management accounting	firm, division, facility, product line, or system	internal

National income accounting is a macro-economic measure. Gross Domestic Product (GDP) is a measure of the flow of goods and services through the economy. It is often cited as a key measure of our society's economic well-being. The term environmental accounting may refer to this national economic context. For example, environmental accounting can use physical or monetary units to refer to the consumption of the nation's natural resources, both renewable and nonrenewable. In this context, environmental accounting has been termed natural resources accounting.

Financial accounting is a source of information for processing of financial reports for use by investors, creditors, and other stakeholders. Pieces of information about financial position of an enterprise, about economic result and/or about accounting balance of assets and liabilities are given to stakeholders by means of these reports. In this context, environmental accounting provides information about environmental liabilities and financially material costs related to environmental impacts of enterprise's products, activities and services.

Management accounting is the process of identifying, collecting and analysing information principally for internal purposes. Management accounting can involve data on costs, production levels, inventory and backlog, and other vital aspect of a business. The information collected under a business´s management accounting system is used to plan, evaluate, and control in a variety of ways:

- planning and directing management attention,
- informing decisions such as purchasing (e.g., make vs. buy), capital investments, product costing and pricing, risk management, process/product design, and compliance strategies, and
- controlling and motivating behaviour to improve business results.

Management accounting practices and systems differ according to the needs of the businesses they serve. Just as management accounting refers to the use of a broad set of cost and performance data by an enterprise's managers in making a myriad of business decisions; environmental accounting refers to the use of data about environmental costs and performance in business decisions and operations.

In the paper, attention is paid to environmental financial accounting, which provides information about environmentally induced financial impacts mainly to external users (stakeholders). Environmentally induced financial impacts are expressed in monetary units as impacts to economic result of an enterprise, and to assets and liabilities which are related to enterprise's impacts to the environment.

A stakeholder of an enterprise is any individual or group who has an interest in the enterprise because he can affect, or is affected by the enterprise activities [2]. The term stakeholder indicates that these groups or individuals have a stake in the enterprise. Stakeholders using environmental information are, for example, creditors, investors, shareholders, customers, suppliers, management, employees, tax agency, insurance companies, media, environmental protection agency, general public, etc. The success of an enterprise depends on the co-operation with stakeholders, because only they provide the resources needed to ensure the viability of an enterprise [3]. Enterprises need material as well as immaterial resources (including information and services) in order to perform, and these will be supplied by individuals and groups as long as relations are perceived as favourable and fair. To verify if this is the case, stakeholders require information that must be continuously collected, organised and reported. In case, that management accepts social requirements in the area of the environmental protection and strengthens its responsibility then very strong and positive feedback is formed with stakeholders.

Information about environmental costs and liabilities are main matters of interest within environmental financial accounting. Environmental costs and liabilities arise from transactions and events that affect or will likely affect financial position and results of an enterprise and, as such, should be reported in an enterprise's financial statements. Considering that interested parties are also external users, it is necessary to ensure comparability and unity of presented financial information. Accounting and reporting for environmental costs and liabilities is connected to several problems:

- it is necessary to define the terms environmental costs and environmental liabilities,
- next issue is a question of a period when environmental costs and liabilities should be recognized and therefore reported in the financial statements,
- since it has been very difficult to estimate of environmental liabilities, it is necessary to discuss possible methods for measurement of liabilities which will be included in financial statements,
- attention must be paid to additional and supplementary information which should be disclosed to clarify items in financial statements.

Since the late 1980s, the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has paid the extensive attention to issues relating to recognition, accounting and reporting for environmental costs and liabilities and has developed the large amount of activities at the enterprise’s as well as at the national level. These activities illustrate deficiencies in environmental reporting and help with formulation of recommendations aimed to remedy declared deficiencies.

ISAR discovered in its first survey in 1990 that there were no national accounting standards specific to environmental information disclosure in financial statements in annual reports. Moreover, it was found out that top management of an enterprise is convinced that environmental information is not necessary to express true and fair view of the enterprise’s performance or that it is impossible to distinguish environmental expenses from other expenses. To rectify this situation, ISAR formulated guidance in 1991 dealing with a number of environmental items. ISAR supposed that these items should be considered for disclosure in reports and that they should be subject of management discussions. This guidance was well received and experts advised enterprises seeking to develop their environmental reporting to use this guidance as the backbone of their efforts because these recommendations represent current interpretations of best practice, fall comfortably within the current financial reporting framework, and importantly have been shown to be practicable [4].

In 1992 and 1994, ISAR monitored impacts of the guidance on statements of transnational corporations. The surveys detected that disclosures remained qualitative, descriptive, partial and comparable with difficulties. The surveys of ISAR stated explicit reluctance by enterprises to disclose environmental information voluntarily. The need for more comprehensive national and international guidance and recommendations to ensure comparability of statements arose. Many enterprises evidently awaited until their national Governments take a firm lead and provide guidance on the treatment of these environmentally-related accounting questions.

In 1995 ISAR judged up to developments of national standards. It found out (although a survey at national levels began) that it is still necessary to spend a significant effort to study and evaluate ascertained information as well as to identify the most appropriate recommendations that would serve Governments and other interested parties. If issues were not solved immediately, in experts’ opinions, then differences in procedures of individual countries would arise and member States would eventually get into situation that they would be forced to reconcile their independent standards and procedures with those of other member States.

With the financial support of the World Bank and the technical assistance of experts working for the Association of Chartered Certified Accountants and the Canadian Institute of Chartered Accountants, ISAR deepened and specified recommendations in a revised guidance called „**Position Paper on Accounting and Financial Reporting for Environmental Costs and Liabilities**“ [4] (thereinafter as recommendations). The best practices at the national levels became the base of the recommendations.

The purpose of recommendations is to provide assistance to enterprises, regulators and standard-setting bodies, which consists in interpretation of the best accounting practice to record environmental transactions and events in the financial statements and associated notes. Recommendations try to summarize most of questions and issues, which arose in business accounting and reporting of environmental impacts. ISAR found out that IASC (the International Accounting Standards Committee) deals with a number of these issues as well. According to experts’ opinions, it is unlikely that the IASC will issue such a comprehensive statement in the near future. It is more likely that it will incorporate environmental issues in each of its individual standards, as appropriate [4].

Matter of interest is accountability of enterprise’s management for financial impacts due to consumption of resources entrusted to it and connected to enterprise’s activities. As mentioned above, the attention is paid mainly to accounting and reporting for environmental costs and liabilities.

Environmental costs [4] comprise the costs of steps taken, or required to be taken, to manage the environmental impacts of an enterprise’s activity in an environmentally responsible manner, as well as other costs driven by the environmental objectives and requirements of the enterprise. Examples include costs of disposal and avoidance of waste, preserving or improving air quality, cleaning up oil spills, removing asbestos from buildings, researching for more environmentally-friendly products, carrying out environmental audits and inspections, etc. Fines, penalties and compensation would be regarded as environmentally-related costs, and would not be included in this definition of environmental costs, but would be tracked and disclosed separately. Environmental costs that are capitalized because they satisfy the criteria for recognition as an asset are environmental assets. An asset is a resource controlled by an enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise. To capitalize is to record an environmental cost as an integral part of a related asset, or as a separate asset, as appropriate.

Environmental liabilities [4] are obligations relating to environmental costs that are incurred by an enterprise and that meet the criteria for recognition as a liability. A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. A contingent liability is a potential obligation arising from past events that exists at the balance sheet date, but whose outcome will be confirmed only on the occurrence or non-occurrence of one or more uncertain future events that are outside the control of the enterprise. An obligation is a duty or responsibility to others that entails settlement, by future transfer or use of assets, provision of services or other yielding of economic benefits, at a specified or determinable date, on occurrence of a specified event, or on demand. When the amount or timing of the expenditure that will be incurred to settle the liability is uncertain, environmental liabilities are referred to in some countries as „provisions for environmental liabilities". An obligation does not have to be legally enforceable for an environmental liability to be recognized. There may be cases where an enterprise has a constructive obligation, either in the absence of a legal obligation or that expands on the legal obligation. For example, it may be the enterprise's established policy to clean up contamination to a higher standard than that required by law, because its business reputation would be affected if it did not live up to this commitment, or because it is the right and proper thing to do.

Environmental costs and liabilities are expressed in financial statements of an enterprise. **Financial statements** (balance sheet and profit and loss account) represent large potential of information about structure of assets and capital. They comprise of final accounts, which are a flash point and finalization of accounting period. The purpose of final accounts is to present to owners, management and other users truthful view of assets and capital and to provide them with information about attained economic result. Final accounts are a source of data for further statistical processing and have an important role in tax procedure. Final accounts are a complex set of information about the economical and financial position of an accounting entity.

Following information should be included in financial statements on basis of the recommendations:

Balance Sheet	– Environmental costs capitalized – Environmental liabilities – Environmental provisions – De-commissioning provisions – Expected recoveries
Profit and Loss Account	– Operating and non-operating environmental costs – Exceptional/extraordinary charges – Fines, penalties and compensation
Notes to the Accounts	– Types of cost items distinguishing operating and non-operating environmental costs – Amount of environmental costs capitalized during the period – Fines and penalties for non-compliance with environmental regulations – Compensation to third parties for past pollution – Separate environmental liabilities – Basis of environmental liability measurement – Nature of environmental liability, timing and terms of settlement – Significant uncertainty over amount or timing of liabilities and range of possible outcomes
Accounting Policies	– Environmental expenditure (types) – Basis for measurement environmental provisions and contingencies – Capitalization policies – Impairment policies – Depreciation policies – De-commissioning and land remediation policies

Seeing that recommendations of ISAR for accounting and reporting for environmental costs and liabilities are in unity with basic accounting principles and accounting conventions from which Czech accounting arises, and that interest of stakeholders in environmentally induced financial impacts increases. We assume, that it is necessary to pay attention to these recommendations and that it is possible to use them within final accounts, in annual reports and in environmental reports.

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Environmental Accounting and Financial Reporting

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Abstract

This has to do with a new area including Accounting, Financial Reporting, Information Systems, and a whole range of other areas with links to the environment, and to "Environmental Accounting and Financial Reporting." Accounting's role here is the definition of comparable indicators by which the benefit to the environment by the enterprise will be measured. Environmental Financial Accounting involves the accounting and financial reporting of transactions relating to the environment and to events that influence, or that will influence the financial position of the enterprise. An inter-governmental working group of experts for international accounting standards and financial reporting working for the United Nations (ISAR) discovered that no specific national accounting standards exist which would have a bearing on the publicising of information regarding the environment. In this regard, it is necessary to define such basic accounting concepts such as assets, liabilities and costs.

At the current time, in which more and more frequently, consequential impingements and impairments to the Environment as a result of the ever increasing exploitation of natural resources and escalating demands placed upon it by human society regularly occur, there exists an ever greater emphasis for the need for the publicising of information regarding the environment. The only (reasonable) way in which to achieve economic development to the benefit of mankind is within the framework of the concept of a continuously sustainable development. The Principle of Continuously Sustainable Development was formulated by the then Prime Minister of Norway, Mrs. G. H. Brundtland in 1987: "Sustainable Development is such a form of development, which satisfies current needs without threatening the opportunities available to future generations to also satisfy their own needs. In essence, it is a process of change, in which resources are exploited, and where the orientation of developments in technologies and the transformation of institutions is aimed at the harmonic increase of present day, but also future potentials for the satisfaction of mankind's needs and aspirations"[6].

Czech legislature defines Sustainable Development in Law No.: 17/1992 §, Of the Environment. "Continuously Sustainable Development of society is such a form of development, which enables and preserves present day, but also future generations, the opportunity of satisfying their basic needs and which, at the same time, does not diminish the diversity of nature and which conserves the natural functioning of the ecosystem"[5].

So as to be able to track the upholding of, and adherence to, the concepts and precepts of Continuously Sustainable Development, it is necessary to define and to delimit such indices, which would prove able to express such realities. The aim of these indices is the provision of reliable information regarding the measure of the degree to which progress has been achieved towards sustainable development. The World Business Council has created the term eco-effectivity for sustainable development. The behaviour of enterprises according to eco-effectivity means the diminishing of the impact of the enterprise's activities on the environment, and thereby to increase their profitability. For this purpose, it is necessary to define and to delimit a system of evaluative indices, by which eco-effectivity will be measured. Enterprises, striving to achieve eco-effectivity, would thereby be able to (dispassionately) measure this, through the ascertaining of precise information regarding the actual costs and benefits of the environment and the efficiency of the steps and measures taken regarding the environment.

The source for such information as to the costs, benefits and efficiency of the enterprise is the Accounting process, which has a variety of functions within an enterprise. Information as to the financial position and effectivity of the enterprise, which is oriented predominantly on external users, is contained in Financial Accounting; information, which assists in the planning and management of the enterprise's activities, is the subject of Management Accounting. Eco-effectivity, therefore, can be measured with the assistance of the accounting process, which is directly oriented to the tracking of costs, revenues or benefits and efficiency or performance in the domain of the environment.

The organisation, which occupies itself with the issue of Environmental Accounting on the company or enterprise level, is The United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting - ISAR). This organisation began to occupy itself with Environmental accounting some seven years ago, since it realised that accountants were being “left out of the loop” during discussions and negotiations regarding the question of the environment, and thereby their role in the management process was also being limited. ISAR discovered that specific standards, which would have to do with the publicising of information about the environment, simply did not exist. In 1991, ISAR formulated the first directive guidelines, which defined and delimited the extent and scope of information, which should (ideally) be contained in Final Account Statements, such as to be able to provide their users with a fair and true depiction of the environment. This directive guideline was expanded in 1998, where it was supposed to lead to a harmonisation of the given issue. The fundamental problem encountered in the harmonisation process was the definition and delimitation of the basic conditions governing the recognition of assets, costs and obligations. The International Accounting Standards Committee, which formulates, approves and publishes the International Accounting Standards, has published in connection with the harmonisation of accounting processes a Conceptual Framework, in which it defines and delimits the basic terms such as assets, costs, and liabilities. This Conceptual Framework is also the basic theoretical starting-point for the declaration of assets, costs and liabilities in Environmental Accounting. The Environmental Accounting Framework for the publicising of information regarding the environment should therefore provide information as to the financial position of accounting entities, the efficiency or performance of accounting entities and any changes, on which their users would be able to base their economic decision-making, and which show just how the enterprise is protecting the environment, and how the management of the enterprise are administering the resources which have been entrusted to them.

The Recognition of Assets, Costs and Liabilities Connected with the Environment

If we take as our point-of-origin the basic definition and delimitation of costs, as is set out in the IAS Conceptual Framework, then we can define costs as a diminution of economic benefit, which it turn leads to a diminishment of assets and which arise other than from the direct withdrawal or drawing down by the owners. The ISAR has expanded this definition of costs such, that:

Environmental Costs contain expended costs, or else costs, which are intended to be expended on the assurance of the management of those activities of the enterprise, which (will) influence the environment and for which the enterprise is responsible, to the same extent as those costs, which the enterprise incurs from its aims and requirements in the domain of the environment. Environmental costs should be recognised and declared in that period, in which they are first identified. Should the environmental costs meet the criteria governing the recognition and declaration of assets, they should be capitalised. Environmental costs should be capitalised, where they have a direct or indirect correlation or connection with a future economic benefit, which flows into the enterprise through increases in capacity or improvements in the safety of or effectivity of the other assets owned by the enterprise, the diminution or prevention of contamination of the environment, which in all probability arise as a result of future operations or the conservation of the environment.

Assets is defined and delimited as resources controlled by the enterprise, which arose in the past, and of which are anticipated future economic revenues, which will directly or indirectly flow into the enterprise. Liabilities arising from the environment are governed by the general criteria for liabilities enunciated within the IAS Conceptual Framework, where the liabilities is the duty or responsibility (of the enterprise) to conduct itself in a certain way. Liabilities arising from the environment are obligations, which are recognised and declared as environmental costs, and which are caused by the enterprise and which meet the recognition criteria in the form of a debt. (Environmental) Debt is a current obligation of the enterprise, which arises from past events, by whose defrayment (settlement) a diminution of the assets is anticipated.

It is clear that the definition and delimitation of environmental costs is, to a certain extent, contentious and that it will be up to each enterprise to decide just what to include under the heading of Environmental Costs. For this reason, it is recommended that the Final Account Statement contain an explanatory commentary as an addendum.

Environmental Accounting in the Czech Republic

The improvement of the environment is one of the priorities of the government of the Czech Republic. Enterprises have an influential and significant role on the environment, whether this regards the exhaustion of natural resources or the pollution of water resources, air pollution or the production of wastes. From the perspective of current development, environmental protection is a significant factor in the competitive abilities of enterprises. Information regarding the influence of enterprises on the environment is tracked on several levels. A standardised form of Environmental Accounting does not yet exist, and for this reason, in certain cases inter-enterprise data are not comparable.

According to a research study, which was conducted by students at the Tomas Bata University in Zlín on a selective sample of 100 enterprises having an influence on the environment, it was ascertained that, of those enterprises questioned, some 68 % drew their data from the data contained in their Financial Accounting, some 10 % from their Management Accounting, some 6 % from some other method (e.g. the tracking of only investment actions), and the rest of the enterprises investigated did not track costs relating to environmental protection at all. It goes without saying that the procedures for establishing and calculating data in individual enterprises differed even when using the same sources.

Financial Accounting concerns itself above all with information elaborated above all for use by external users, investors, suppliers, banks and the State. It is regulated by the State and amended by the Law on Accounting, and normatively adjusted accounting guidelines and directives, which is a detailed list of accounts, complemented by precisely defined titles and enumerated accordingly. At the same time, there exists a binding Accounting Procedure, which sets out in detail the accounting of individual operations. The Directive Guidelines do not directly contain Accounts associated with and related to the environment, but (they enable) their creation in more detailed, so-called analytical (accounting) record keeping. Management Accounting provides information for senior managers of enterprises as to the costs incurred on individual products, estimates of future costs and revenues, and is oriented on planning and budgeting. It is not normatively set, and the way it is carried out lies within the competencies of the enterprise's management. Within the framework of Management Accounting, it is possible to develop the tracking of environmental costs and revenues completely according to the actual needs and requirements of the enterprise. In view of the fact that there do not exist any binding norms governing these calculations, it is not possible to compare enterprises results (within this domain).

The data ascertained are most often presented in the Annual Reports of enterprises, in the print media, professional journals and magazines, on (company) web pages, in statements prepared and intended for the (State) Office of Statistics, and so on.

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Influence of Slovak Legislation on Capital Structure of Slovak Companies

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Abstract

Companies need sources of financing for their business activities. They have to take into account different factors in order to choose between different sources of financing and make decision about their capital structure. One of factors that have to be considered in the process of decision-making about capital structure of a company is legislation. Legislation creates an environment that influences the type of financing that is available for a company. It is necessary to analyze how legislation influences the possibility of getting sources of financing in order to get acquainted with the environment in which sources can be obtained and to use the possibilities in the most efficient way.

1. Analysis of legislation in the area of capital structure

Slovak companies have to face the decision how to finance their business activities. They can consider different types of financing such as issuing of equity, bonds, convertible bonds or taking a loan from the bank. Every type of financing is regulated more or less by certain provisions in the Slovak legislation. A company has to take into consideration the given legislation and to find the most appropriate way of financing.

According to the theory, which emphasizes the role of taxes in decision-making about capital structure, the Slovak legislation also provides incentive for companies in this area. It is possible to reduce tax payments due to tax deductibility of interest payments from loans according to the article 24 paragraph 3k of Act. No. 366/1999 about income tax. The current tax rate is 29 %. The bankruptcy costs are associated with pursuing the provisions of Act No. 328/1991 on the bankruptcy and settlement. The height of direct bankruptcy costs depends on the management of the estate of bankrupt by the administration including the loss of control of the debtor over its property. However, the provisions about usage of an auction for realization of the estate of bankrupt help to lower these costs.

According to the agency theories capital structure is used to solve the moral hazard problem that occurs because of different interests of shareholders, managers and bondholders. Slovak legislation provides some guidelines that help to solve this problem. The agency costs arise mainly from lack of information available to shareholders about the company and its management. The legislation tries to avoid this situation by imposing certain requirements on managers to provide information to the public. In the Act No.600/1992 on the securities and in the Act No.530/1990 on the bonds Slovak legislation contains some provisions on informational duty of the issuers of shares or bonds towards the shareholders or bondholders. Distribution of information helps to restrict the activities of the management that could lead to dilution of funds of a company or appropriation of wealth of one group to the other group. Provision of information plays an important role in the relationships between managers and shareholders or shareholders and bondholders. If each of the interested parties has an access to the information then it is able to control the other party or to take measures that refrain the other party from such activities.

The Commercial Code also regulates the relationship between managers and shareholders. Shareholders have the right to appoint the Board of Directors and to dismiss them as well. In this way shareholders can force managers to follow the shareholders` interest.

The Commercial Code provides further regulation of the relationship between shareholders and managers in the provisions about restriction of acquisition of own shares by the joint-stock company. The joint-stock company can acquire its own shares only in certain circumstances, but it is not allowed to exercise the shareholder’s rights attached to them. Otherwise, the control that is exercised by the shareholders could dilute because the joint-stock company represented by the statutory body would be able to participate in the General Meeting and to exercise voting power in the interest of statutory body.

The relationship between shareholders and debt holders is regulated in broader way. The first there are stringent requirements in the case of reduction of the capital stock. When the joint-stock company wants to reduce its capital stock, it has to inform the creditors about the reduction of capital stock. The creditors can require further security for their claims or settlement of their claims. In this way, the law protects the creditors from being appropriated of wealth by the shareholders. The shareholders cannot realize the reduction of the capital stock without taking the creditors into account because the deed is not valid until the Commercial Register makes an entry about it and the Commercial Register makes an entry only after the duty of notification of creditors has been fulfilled.

Then the Commercial Code further regulates the relationship between shareholders and bondholders by stipulating that the shareholders do not have right to distribute the remaining assets among themselves prior to the satisfaction of all the creditors` claims when the joint-stock company is liquidated. This point on the fact that the Commercial Code tries to protect the creditors from the activities of shareholders, which would cause loss to them.

According to the Commercial Code the creditors can protect themselves by securing their claims by mortgage or suretyship. Mortgage gives a special right to the creditor to sell the object to which mortgage is attached. In the case of bankruptcy the creditor with mortgage is better protected than the creditor without mortgage because the former creditor has the right to have his claim settled from the pawned object before the other claims are settled.

The asymmetric information theories are also taken into account in the provisions of Slovak legislation. Slovak legislation tries to minimize the asymmetric information by imposing informational requirements on the issuers of securities or bonds by the Act No.600/1992 on the securities, the Act.No.330/2000 on the stock exchange and the Act.No.530/1990 on the bonds. The issuer of securities and bonds has to prepare the prospectus in which it is necessary to state different kinds of information in order to enable the investors to make decisions about their investments. After getting the permission to issue bonds or shares, the issuer is obliged to continue in providing the information to the investors in the form of disclosing the annual reports and notifying the state supervisory body about important changes.

Theories based on the allocation of control rights find support in Slovak legislation. The shareholders have to weigh the costs of sharing control with new shareholders against the costs of losing all control in bankruptcy. In Slovak legislation the loss of control in the case of bankruptcy is stated by the provisions in Act.No.328/1991 on the bankruptcy and settlement. The partial loss of control is characterized by restriction of activities that can be carried out by the debtor after the proposal for adjudication of bankruptcy has been delivered to him. After the adjudication of bankruptcy the control is transferred on the administrator whose duty is to manage the estate of bankrupt and to satisfy the claims of creditors.

2. Empirical findings in the area of capital structure

The following graphs show the real situation in financing in Slovakia.

2.1 Banking sector and structure of loans

The banks are the most important providers of sources of financing in Slovakia. They provide loans to companies. Fig.1 shows the situation of loans that were provided to the whole private sector in Slovakia by the banks including their maturity structure. The development of the loans suggest that from the end of 1999 the banks started to be more cautious in granting the loans to the private sector because of their previous experience with non-repayment of loans.

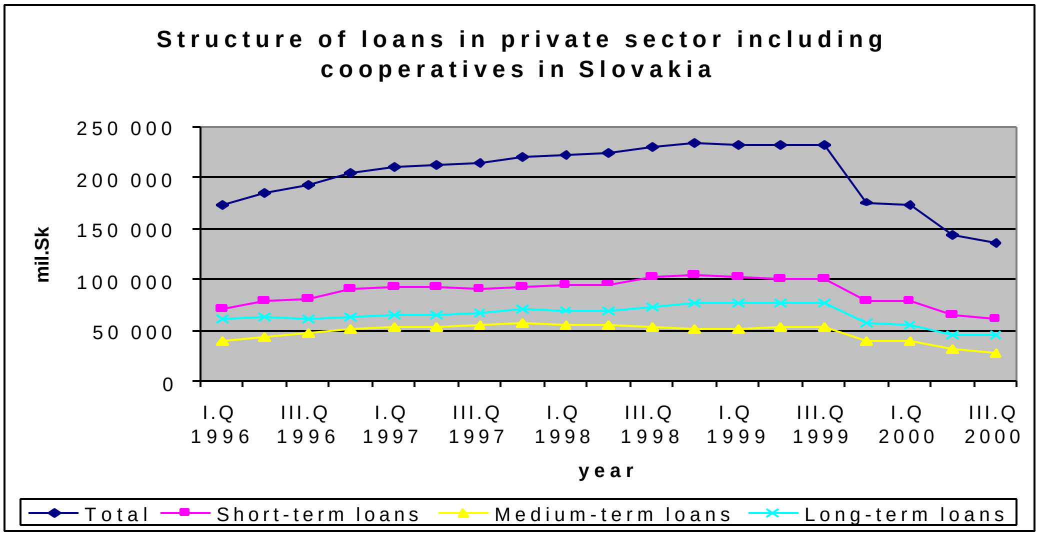


Fig. 1

Source of data: The National Bank of Slovakia

Fig. 2 shows the shares of short-term loans, medium-term loans and long-term loans on the total amount of loans that were provided by the banks. It can be seen that short-term loans represent the majority of the loans that were provided by the banks, then long-term loans follow and the lowest proportion is represented by the medium-term loans. The above-mentioned proportionality has been maintained since 1996 with slight variation in the height of proportions.

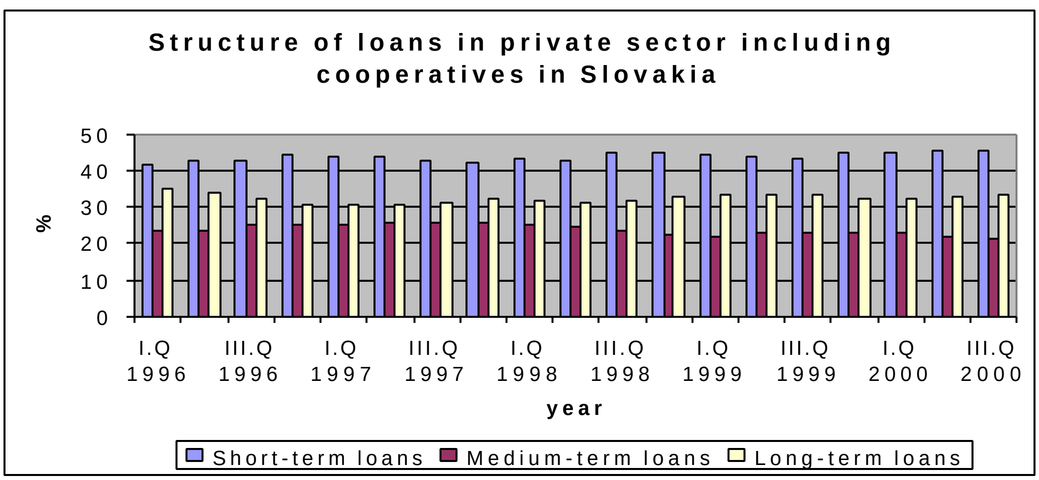


Fig. 2

Source of data: The National Bank of Slovakia

2.2 The biggest increases and decreases in debt of important Slovak companies

Table 1: THE BIGGEST INCREASES IN DEBT

Rank	Company	%, 1999/98	Rank	Company	%, 2000/99
1	Cemmac, a.s.	602,8	1	Transpetrol, a.s.	174,8
2	Coca-Cola Beverages Slovakia, s.r.o.	238,6	2	Jednota, s.d. Bratislava	148,1
3	Jacobs Suchard Figaro, a.s.	129,0	3	SEKO Slovakia a.s.	136,1
4	Tabak, s.r.o.	122,2	4	Cementáren Turna, a.s.	112,9
5	Neografia, a.s.	109,1	5	Sauer-ZTS, a.s.	80,4
6	Wienerberger-Slovenské tehelne, s.r.o.	97,3	6	Osram Slovakia, a.s.	71,1
7	Pal-Inalfa, a.s.	88,9	7	EuroTel Bratislava,a.s.	70,1
8	Východoslovenské energetické závody, š.p.	88,3	8	Slovglass, a.s.	60,4
9	INA Skalica, s.r.o.	88,1	9	Whirlpool Slovakia, a.s.	51,4
10	OMV Slovensko, s.r.o.	85,1	10	Kinex, a.s.	50,8
11	Slovak International Tabak, a.s.	83,0	11	Kon-Rad, s.r.o.	49,8
12	Sony Slovakia, s.r.o.	75,7	12	Volkswagen Slovakia, a.s.	47,0
13	Henkel Slovensko, s.r.o.	73,2	13	Biama, a.s.	47,0
14	**Leoni Slowakia, s.r.o.**	72,9	14	Škoda Auto Slovensko, s.r.o.	45,6
15	Jednota Nové Zámky, s.d.	68,2	15	**Leoni Slowakia, s.r.o.**	43,8

Source of data: Trend Top 200

Table 2

Rank	Company	mil. Sk, 1999/98	Rank	Company	mil. Sk, 2000/99
1	Slovenské elektrárne, a.s.	14 432	1	Slovenské elektrárne, a.s.	5 572
2	Železnice SR	8 074	2	Volkswagen, a.s.	5 439
3	Slovnaft, a.s.	6 848	3	EuroTel Bratislava, a.s.	5 067
4	VSŽ, a.s.	3 737	4	Slovenský plynárenský priemysel, š.p.	5 051
5	Východoslovenské energetické závody, š.p.	1 973	5	Železnice SR	3 045
6	Slovenské telekomunikácie, a.s.	1 803	6	Transpetrol, a.s.	1 282
7	Severoslovenské celulózky a papierne, a.s.	1 477	7	Whirlpool Slovakia, a.s.	1 103
8	Slovenské lodenice, a.s.	1 422	8	Škoda Auto Slovensko, s.r.o.	1 004
9	Slovenský plynárenský priemysel, š.p.	1 295	9	Heineken Slovensko, a.s.	754
10	Stredoslovenské energetické závody, š.p.	1 132	10	Východoslovenské energetické závody, š.p.	590
11	OMV Slovensko, s.r.o.	1 123	11	Fides Zdravotnícke zásobovanie, a.s.	505
12	Nafta, a.s.	1 039	12	ZTS Dubnica nad Váhom plus, a.s.	409
13	Chemlon, a.s.	945	13	Tatravagónka, a.s.	400
14	Coca-Cola Beverages Slovakia, s.r.o.	932	14	Fermas, s.r.o.	333
15	Duslo, a.s.	557	15	Nylstar Slovakia, a.s.	286

Source of data: Trend Top 200

Leoni Slowakia, s.r.o.; Slovenské elektrárne, a.s.; Železnice SR; Východoslovenské energetické závody, š.p. and Slovenský plynárenský priemysel, š.p. have increased their debt since 1998. Slovak International Tabak, a.s.; Slovnaft, a.s.; VSŽ, a.s.; Slovenské telekomunikácie, a.s.; Severoslovenské celulózky a papierne, a.s. and Stredoslovenské energetické závody, š.p. increased their debt in 1999 and then decreased in 2000.

Table 3 THE BIGGEST DECREASES IN DEBT

Rank	**Company**	**%, 1999/98**	**Rank**	**Company**	**%, 2000/99**
1	VSŽ Ocel , a.s.	-63,7	1	VSŽ, a.s.	-78,3
2	VSŽ Keramika, a.s.	-61,3	2	Tipos, a.s.	-48,0
3	Inžinierske stavby, a.s.	-56,7	3	Slovak International Tabak, a.s.	-45,0
4	Škoda Slovakia, s.r.o.	-49,9	4	Renault Slovensko, s.r.o.	-43,4
5	Matador Machinery, a.s.	-48,0	5	Kovoúprava, a.s.	-41,4
6	Cesty Nitra, a.s.	-47,6	6	Slovenské telekomunikácie, a.s.	-41,0
7	Sibamac, a.s.	-46,3	7	Farmet, a.s.	-40,4
8	Trens, a.s.	-44,7	8	EZ Elektrosystémy, a.s.	-37,3
9	Renos, a.s.	-42,3	9	Ecco Slovakia, a.s.	-32,5
10	Siemens Automotive, s.r.o.	-41,5	10	Hydrostav, a.s.	-28,5
11	OVP Orava, s.r.o.	-40,4	11	BSH Drives and Pumos, s.r.o.	-28,0
12	Kinex, a.s.	-33,9	12	Punch Products Trnava, s.r.o.	-22,7
13	Slovenská Grafia, a.s.	-33,6	13	Slovenergo, s.r.o.	-20,9
14	Slovakofarma, a.s.	-33,0	14	Omnia, a.s.	-20,6
15	EZ Elektrosystémy , a.s.	-30,6	15	Proxar Slovakia Int. Spedition, a.s.	-20,1

Source of data: Trend Top 200

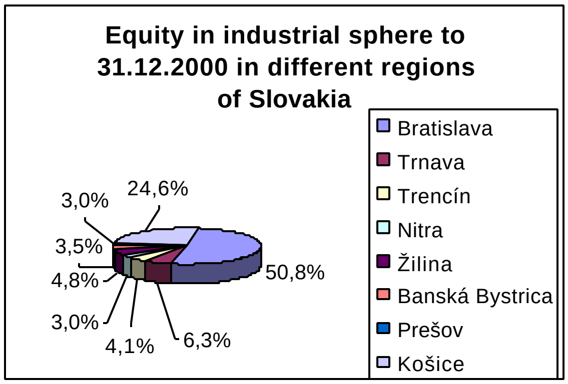
Table 4

Rank	Company	mil. Sk, 1999/98	Rank	Company	mil. Sk, 2000/99
1	VSŽ Ocel, a.s.	-12 363	1	VSŽ, a.s.	-24 292
2	Hydrostav, a.s.	-2 093	2	Slovenské telekomunikácie, a.s.	-11 784
3	Slovenské energetické strojárne, a.s.	-1 019	3	Slovnaft, a.s.	-2 999
4	Matador, a.s.	-928	4	Hydrostav, a.s.	-2 469
5	Slovakofarma, a.s.	-861	5	Severoslovenské celulózky a papierne, a.s.	-1 459
6	Slovnaft Benzinol, a.s.	-820	6	Stredoslovenské energetické závody, š.p.	-822
7	Inžinierske stavby, a.s.	-775	7	Paraplynový cyklus, a.s.	-524
8	Volkswagen Slovakia, a.s.	-667	8	Matador, a.s.	-509
9	Chemosvit, a.s.	-616	9	Slovnaft Benzinol, a.s.	-505
10	Omnia, a.s.	-592	10	ZSNP, a.s.	-501
11	Siemens Automotive, s.r.o.	-541	11	Slovak International Tabak, a.s.	-482
12	VSŽ Keramika, a.s.	-538	12	Omnia, a.s.	-414
13	Škoda Slovakia, s.r.o.	-503	13	Palma-Tumys, a.s.	-400
14	Doprastav, a.s.	-427	14	Slovalco, a.s.	-328
15	Tatravagónka, a.s.	-384	15	EZ Elektrosystémy, a.s.	-324

Source of data: Trend Top 200

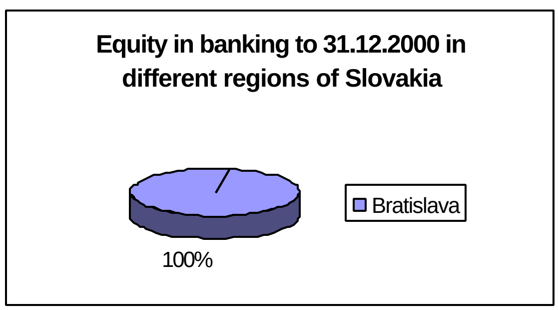
EZ Elektrosystémy, a.s.; Hydrostav, a.s.; Matador, a.s.; Slovnaft Benzinol, a.s. and Omnia, a.s. have decreased their debt since 1998. Kinex, a.s.; Volkswagen Slovakia, a.s. and Tatravagónka, a.s. decreased their debt in 1999 and then increased in 2000.

2.3 Foreign direct investment to Slovakia



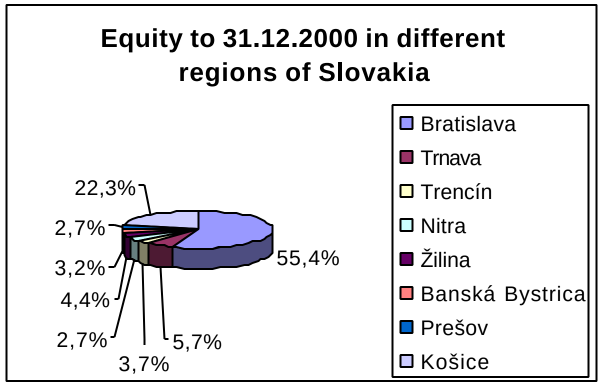
Source of data: Hospodárske noviny

Fig. 3



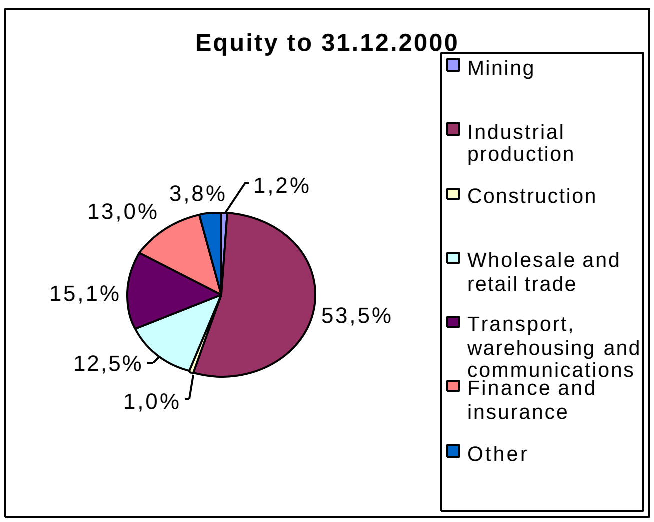
Source of data: Hospodárske noviny

Fig. 4



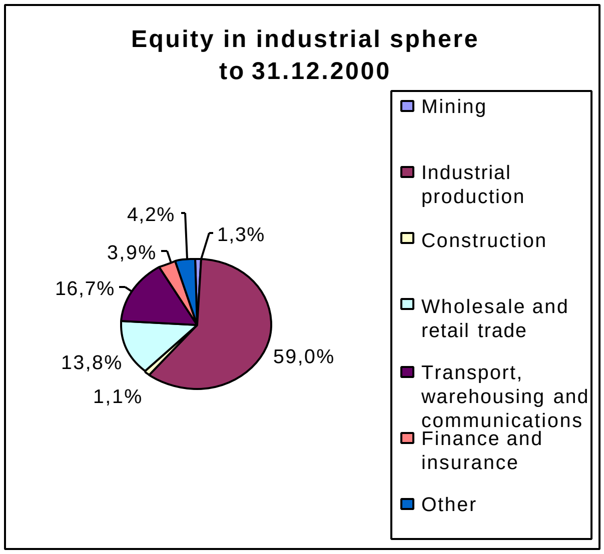
Source of data: Hospodárske noviny

Fig. 5



Source of data: Hospodárske noviny

Fig. 6



Source of data: Hospodárske noviny

Fig. 7

Capital market in Slovakia

Market economy cannot properly function without appropriately developed and competitive financial market including capital market as well. Slovak economy is not able to finance its economic growth from its own internal sources of capital. One of the decisive conditions for attraction of foreign investments is efficient, liquid and transparent capital market. Despite of some positive achievements in creation of institutional framework in the area of capital market, Slovak capital market is still not able to form transparent environment for domestic and foreign investors and it does not fulfill its basic allocation and information functions in economy. The situation in the Slovak capital market was also influenced by the fact that beside its allocation and information functions the capital market had to fulfill other functions, which were associated mainly with privatization of state property, in the process of economic transformation as well. The system of privatization in the form of direct sales in capital market, which were used in the preceding period, had negative effect on transparency of the capital market, which in turn led to decline of interest of foreign investors.

Slovak capital market belongs to emerging markets and it suffers from lack of liquidity, transparency and more significant foreign investors are missing in it. Therefore it is important to make some changes in legislative and institutional framework of the capital market that would lead to its efficient functioning. These changes involve mainly:

- preparation of legislation that fulfills requirements for association of Slovakia to the European Union;
- effective supervision over the capital market;
- increase the level of provision of information by the issuers of publicly marketable securities;
- creation of conditions for an effective protection of minority shareholders;
- removal of tax regulation which does not provide incentives to invest in the capital market and enforcement of regulation that provides incentives to invest in capital market.

According to the preceding legislation the Ministry of Finance was responsible for regulation of the capital market. It gave permissions to brokers, organizers of public markets, companies that print securities, the issuers of publicly marketable securities and bonds and it imposed penalties for not complying with legal provisions that regulate the capital market. So the Ministry of Finance represented the only authority in the area of state supervision over the capital market. In order to form environment for qualitative and active performance of state supervision, it was necessary to adjust supervisory procedures, procedure for awarding the permission to act in the capital market and imposing sanctions and it was needed to secure an appropriate level of independence and qualification. Solution to the above-mentioned needs has recently been the foundation of Office for Financial Market, which is an independent supervisory institution with the needed authority. This institution acts in the area of regulation of capital market and it mainly publishes regulatory rules and norms in compliance with the laws in this area, gives permissions for the activity in the capital market and performs state supervision including controlling, monitoring, imposing penalties and enforcing the claims by legal means.

In the interest of increase in transparency of the capital market the organizers of public market should further develop internal controlling systems and ensure suitable differentiation of the issues of securities in accordance with the valid standards in the markets of the Member states of the European Union. The organizers of public markets should accept the measures for an increase of a share of anonymous price making transactions on the whole volume of transactions realized in the public market. Other necessary adjustments to the legislation in this area are introduction of more levels in registration of securities and creation of conditions for introduction of other instruments of the capital market such as financial derivatives including rules for their accounting and taxation.

One of the characteristics and problems of the Slovak capital market is the high number of illiquid publicly marketable securities. This problem is closely associated with remaining consequences of establishment of Slovak capital market in the process of coupon privatization. In the previous years in the most of joint-stock companies major shareholders were formed and this led to the suppression of trading with issues of securities. However, the recent change in the legislation allows the issuers to apply for termination of trading of their issue in the stock exchange. Therefore, this adjustment could lead to elimination of illiquid publicly marketable securities from the market and market could become more transparent and active.

In addition, the system and rules for leave of issuers from the official public market should take into consideration protection of interest of minority shareholders. The protection of interest of minority shareholders is going to be enforced by prepared amendment of the Commercial Code that requires the Board of Directors to declare public promise for purchase of publicly marketable shares from shareholders that did not vote for decision about termination of the issue to be publicly marketable at the General Meeting or were not present at the General Meeting.

Another problem that occurs in the Slovak capital market is the lack of information provided by the issuers. Even though the legislation requires the issuers to provide information about their business activities and financial situation, many issuers do not comply with this requirement or provide the information with significant delay. Non-fulfillment of information duties has a negative effect on transparency of the market and therefore on interest of investors in the Slovak capital market.

The primary sale and issue of the security is possible on the basis of the prospectus. The requirements on content of the prospectus, procedure of its assessment and its publication should be approximated to the regulation of the European Union. If the prospectus does not satisfy the requirements, its publication will not be approved. The prospectus is not going to be assessed on the basis of the fact whether the stipulated information is true or not because the issuer is responsible for the truth of the presented facts. The presentation of the false information leads to penalties imposed on the issuer. The obligatory part of the prospectus is information about the operation with the security after its issue. The issuer of security can apply to the organizer of the public market for the admission of security to the market. The publicly marketable securities have to be registered in the Register of securities and the identification number of the security is given to the security on the basis of the issuer's request by the Register of securities.

Further development of capital market is contingent on entry of new issues of securities in the market. A weak development of primary market with securities is associated mainly with the dominant way of financing of companies via loans from banks. New issues are also limited by low interest of investors to buy securities in the market. Low interest of investors is caused mainly by unattractive dividend policy of the issuers or other administrative barriers such as process of granting permission for the issue of bonds. The necessity of taking measures to support primary market and eliminate administrative barriers for issue of securities stems also from the requirements for admission of Slovakia to the European Union.

From the point of view of the issuers of securities it is necessary to achieve such situation when it is going to be easy and convenient for companies to obtain means of financing in the capital market as an alternative for bank loans. In addition, it is suitable to accelerate and make easier the process of issue of securities for placement in primary market. An incentive for recovery of primary and secondary markets for securities could be new issues of shares of important state-owned joint-stock companies. Initial public offerings of big issues would lead to increase of the interest of investors and new issuers to enter the Slovak capital market and this would have a positive effect on the liquidity of capital market.

Efficient functioning of capital market is based on its transparency, understandable rules and investors` trust. Therefore, information of market participants in the meaning of content and procedure of publication of information must be exactly specified. Information provided by the issuers of securities is especially important and it must be available to all investors at the same time and to the same extent, so that investors could make decisions under equal conditions. In association to this, it is necessary to consider the extension of information duty of the issuer whose shares are traded in the public market by information about important transactions with entities that own certain share of issuer’s equity.

Recent extension of information duty to the organizers of public market and supervisory body about members of statutory board of a joint-stock company that is an issuer of publicly marketable securities contributed to the increase of level of transparency of the capital market. Further information about business linkage to other companies, ownership of securities, membership in statutory boards of other companies could be helpful. Except of extension of information provided by the issuer, an increase in frequency of their provision and efficient control and imposition of penalties in the case of breach of the issuer’s obligation to inform would further contribute to better transparency of the capital market.

One of other reasons for the current situation in the capital market is inefficient system of protection of investors. Without solution of this problem, it is not possible to expect an increase of activity level of investors. An increase of protection of investors can be achieved by elimination of failures in the system of protection of minority shareholders. Lack of protection of minority shareholders leads to unwillingness to invest in the capital market. Solution of this aspect involves formation of measures against leakage of the profits from joint-stock companies, which could be achieved by greater personal liability of members of statutory boards, and measures for elimination of abuse of internal information during performing transactions in the capital market, known as insider trading. The amendments of some provisions of the Commercial Code and the Criminal code could create prerequisites for restriction of unethical transfer of profits from join-stock companies and could determine efficient punishment for this activity.

Admission of other standards that are commonly used in the developed capital markets could also contribute to the improvement of investors` protection. The procedure of takeover of a company could be defined on the basis of experience from foreign markets, so that the principle of equal treatment of all shareholders of publicly marketable securities is maintained. It is important to find efficient way of realization of obligation to offer and to restrict getting around it. Another way of enhancing the minority shareholders rights is to enable them to let the company to be audited in certain circumstances. Minority shareholders rights will be enforced in prepared amendment to the Commercial Code by reduction of the limit for definition of a minority shareholder who is entitled to convene the General Meeting from 10 % to 5 % of subscribed capital.

Another measure that could help to increase activity of investors in the capital market is adjustment of the tax law, which could motivate investors to invest their money in the capital market for longer period mainly via entities of collective investment. The entities of collective investment could be taxed by lower tax rate. In the interest of increase of liquidity in the capital market it would be useful to lower taxation of investments of natural persons into securities. In this way the natural persons could deduct from the tax base certain limited amount of investments into securities of domestic issuers. Admission of any form of tax adjustment for motivation of investors would appear as increased interest in investment of savings of the population in the capital market, as increase in the volume of transactions in the public markets and increase of the number of entities for collective investment present in the capital market.

Conclusion

Slovak companies face the difficulty in financing their business activities because of the weak capital market and therefore bank loans are used the most as the sources of financing.

Slovak capital market suffers from lack of liquidity, transparency and more significant foreign investors are missing in it. Slovak legislation needs some changes in order to make the capital market functioning in an efficient way. These changes involve mainly: increase in the level of provision of information to the investors in order to increase their interest to invest in the capital market and to provide capital to the companies; the increase in the supervision of the capital market in order to enhance trust of investors in the capital market; provision of incentives to invest in capital market via lower tax burden for investors and creation of conditions for an effective protection of minority shareholders that could prevent dilution of funds of the companies. In this way the capital market could recover and start to fulfill its allocation function in economy.

The recent changes in Slovak legislation show that it orientates on increasing the transparency of the capital market by enhancement of the supervision over the capital market. An Office for Financial Market has recently been established. This should lead to improvement in regulation and control of the capital market and improvement in fulfillment of information duties of the issuers of securities. In this way, Slovak legislation should approach to elimination of some discrepancies in provision of information, which plays an important role in the legislation of the European Union and is the subject to accession of Slovakia to the European Union.

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International Accounting Standards

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Abstract

The present-day world-wide trends in the financial management point to the important task of ensuring the approximation and correspondence of the generally valid accounting rules, statements, principles and procedures applied in various countries in the world. The approximation should proceed to such a degree that the submitted statements might be understandable to every adequately educated user. The main objective is to compare data with the sufficient redeemable power of the final accounts of various companies and also to compile correctly the consolidated accounts of supranational groups.

Nowadays, the increasingly strong commercial globalization, world-wide economic integration, growing number of supranational companies, and world-wide capital market development manifest themselves throughout the world. In these conditions, however, the accounting regulation at a national level has shown to be already insufficient. For this reason the situation calls for the application of supranational and world-wide valid accounting standards.

Differences in the national accounting principles are economically relevant with regard to the growing economic globalization. The management overpasses state borders and proceeds on a world-wide scale – it undergoes the internationalization. The globalization leads to the development of the international financial management which lays down the new tasks on accounting, especially the requirement for the approximation of accounting rules and procedures of different countries that can be fulfilled in the form of harmonization (achievement of comparability) or standardization (unification).

In the last decades, an expansion of economic interests has assumed the stronger and stronger global dimensions. This is evident from:

- generally comparable tendencies towards the internationalization of all economic activities,
- the expansion of the international business,
- the international integration of monetary and capital markets,
- the growing demand of the foreign capital,
- the constantly increasing number of enterprises with international activities and subsidiary companies and joint ventures abroad.

These changes lead to the better possibilities of actions during the implementation of economic decisions, which results in the growing demand for the understandable and reliable financial information on enterprises in the other states and for their comparability.

The goal of the international harmonization of accounting is to achieve the international comparability of two or more national accounting systems through the adjustment of international accounting directions and thereby to achieve also their annual financial statements. The process is directed to the elimination of several differences existing in the access of national accounting systems to individual items of the annual financial statement. Both harmonizing accounting systems will approximate each other by their contents, which will enlarge the space for concurrent common international accounting procedures.

The approximation of accounting systems is proceeding in two ways:

- as a harmonization in the particular economic-political blocks, e.g. the management of accounting within the European Union,
- as a world-wide harmonization.

The national accounting systems have generally a long tradition and reflect some specificities of the particular country, its economy and of its historical, political, economic, cultural and social development. The harmonization of accounting is the concordance of traditions differing in the economic, legal, tax and social systems of individual countries.

The fundamental internationalization instruments of accounting include:

1. US Generally Accepted Accounting Principles (US-GAAP),
2. International Accounting Standards (IAS),
3. EU Council Directions.

The generally accepted accounting principles are the technical term of accounting. They include conventions, rules and procedures carried out from the aspect of a certain temporal horizon to define the accepted accounting practice. The GAAP include not only broadly comprehended general rules but also detailed directions and procedures. They have the conventional character, which means that they become generally accepted on the basis of the agreement and not on the basis of the formal derivation from a set of postulates or basic conceptions. The principles were drawn up in virtue of the existing experience, arguments, habits and procedures and, to a large extent, on the evidence of practical needs.

The GAAP represent principles, the demand of which is initiated by enterprises or auditors. They comprise also other rules such as those of the Financial Accounting Standards Board (FASB) and of the American Institute of Certified Public Accounts (AICPA), but also generally accepted accounting procedures and dominant opinions from the technical literature dealing with accounting problems.

An observance of these principles is obligatory, primarily for enterprises listed in the U.S. stock exchanges. In the case of the non-observance of these principles the final accounts statement is defined as misleading and unacceptable. In such a case it is possible to impose some sanctions on the enterprise in the form of the temporal or permanent exclusion from the stock exchange, or it is possible to impose money penalties or the imprisonment of members of the responsible management.

The GAAP offer comparable and lucid rules for all relevant enterprises. They are binding also for those enterprises, which let the annual financial statement verify by auditors either voluntarily or on the basis of a contract.

The official publisher of IAS is the International Accounting Standards Committee (IASC) residing in London. The committee is an independent and a non-governmental organization, the members of which are professional accounting organizations. It was founded on 29th June, 1973 in London as a civil-law organization of the professional associations of auditors from nine countries – Australia, France, Netherlands, Japan, Canada, Mexico, Germany, U.S.A., Great Britain and Ireland.

The international professional institutions gathering professionals from the field of accounting include:

- European Accounting Association (EAA) assembling national accounting associations in European countries with the aim to exchange the new facts and experience gained during international undertakings in theoretical and practical questions.
- International Federation of Accountants (IFAC) assembling accounting and auditors´ organizations with the aim to co-ordinate their activity in harmonizing accounting standards in agreement with the requirements of banks and stock-exchange institutions.
- Federation des Experts Comptables (FEE) – the successor of the Union Européenne des Experts Comptables Economiques et Financiers (UEEC).

The basic goal of IASC is:

- in the interest of the public to formulate and declare accounting standards which should be adhered to in submitting financial statements and to publicize their world-wide acceptance and observance,
- to work on the general improvement and harmonization of legal regulations, accounting standards and procedures associated with submitting the final accounting statement.

The member organizations have made a commitment not only to propagate the international standards in their countries but also to exert influence on institutions responsible for making standards, on authorities controlling security markets, and on the chambers of industry and commerce in order that all of them should accept or promote the observance of international standards. Table 1 illustrates a survey of international accounting standards published up to this time.

Table 1
A SURVEY OF INTERNATIONAL ACCOUNTING STANDARDS PUBLISHED UP TO THIS TIME

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 3	At present inefficient
IAS 4	Depreciation Accounting
IAS 5	At present inefficient
IAS 6	At present inefficient
IAS 7	Cash Flow Statements
IAS 8	Net Profit or Loss for the Accounting Period, Fundamental Errors and Changes in Accounting Principles
IAS 9	At present inefficient
IAS 10	Uncertain Facts and Events Occurring after the Balance Sheet Date
IAS 11	Job-Order Manufacture (Construction Contracts)
IAS 12	Income Taxes
IAS 13	At present inefficient
IAS 14	Reporting Financial Information according to the Economic Activity
IAS 15	Information Reflecting the Effects of Changing Prices
IAS 16	Land, Plant and Equipment
IAS 17	Accounting for Leasing
IAS 18	Revenue
IAS 19	Retirement Benefit Costs
IAS 20	Accounting of Government Grants and Disclosure of Government Assistance
IAS 21	Effects of Changes in Foreign Exchange Rates
IAS 22	Business Combinations
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures about Data Transactions
IAS 25	Investment Accounting
IAS 26	Accounting and Reporting on Retirement Benefit Plans
IAS 27	Consolidation Financial Statement and Investment Accounting in Affiliated Companies
IAS 28	Investment in Associates
IAS 29	Financial Reporting on Hyperinflationary Economies
IAS 30	Disclosures of Financial Statements of Banks and Similar Financial Institutions
IAS 31	Financial Reporting on Interests in Joint Ventures
IAS 32	Financial Instruments – Disclosure and Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 35	Discontinuing Operations
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Land Investment
IAS 41	Agriculture

In principle, each standard modifies the accounting problem, which very often results in the repeated modification. The priority of standards consists in their accuracy and transparency in relation to fundamental principles, in the precise definition of concepts and in the authentic explanation and interpretation of individual standard articles.

International accounting standards are the most extended form of harmonizing accounting statements or else of the accountancy. The development process of IAS is permanently in progress. However, nowadays there still prevails an effort to improve, modify and revive the existing standards rather than to publish the new ones.

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The History and Results of Contractual Savings for Housing in Slovak Republic

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Abstract

The papers analyses the Slovak experiences with contractual savings for housing (CSH), that were introduced in Slovakia in the beginning of the last decade as the important part of the housing policy reforms. The author provides the information on the development of the CSH market, accompanying legislature, and partnerships of the CSH banks with other actors in the housing markets. He also discusses the relationships of the CSH banking products with other housing financial products that can be used for the construction and reconstruction of the housing units. Finally he addresses the most pressing problems if the CSH system in Slovakia.

Introduction

Slovakia was the first transitional country of the Central and Eastern Europe, which has implemented Contractual Savings for Housing (CSH). The legislation was prepared in the early stages of the economic reforms when the banking system operated mostly in the old ways. The policy makers just started with the privatization. The capital markets were practically non-existent; the first ideas about the market oriented banking regulations have been just implemented into practice. The old housing policies based on the heavy subsidies were dismantled; the new housing policies had not been yet elaborated. Moreover at that time the elaboration of the housing policy was not considered to be important by the policy makers. At that time the macro-economic reforms and the preparation of the split of the former Czechoslovakia have dominated the political agenda. Although in 1992, when the CSH system has been practically implemented, the Slovak government had already existed, its role and responsibilities had only the regional character, and the strategic issues were solved in capital of Czechoslovakia in Prague. The policy making capacity of this government was definitely limited not only before the split of the country, but also some years after it, just because the development of the functioning public administration in the new state, that is undergoing the transition and the democratic changes at the same time, takes its time.

Contractual savings for housing have been highly successful systems after the post-war reconstruction of the Western Europe. The economists have sometimes understood transition from socialistic system to the free market economy and post war reconstruction of Europe, as the similar processes. Yet the situation in Slovakia, but also in other countries of the Central and Eastern Europe, was different. The market environment and market institutions had to be created, while they existed in the Western Europe after the war.

Contract saving scheme for housing

Contractual savings for housing (CSH) system is essentially a contract between a household and financial institution concerning the granting of the loan, provided that the household meets the minimum savings commitment over the specified period of time at the prescribed rate. The accumulated savings can be the household's equity to the loan. By design, CSH attempt to insulate households from financial market volatility.

The system integrates the households into the banking system. That is, in the absence of sufficient sources of long-term deposits for banks, CSH offer disciplined regular saving pattern for households. From the perspective of financial institution, the savings period provides monitoring of the creditworthiness of the contingent borrowers. Hence the CSH reduces information asymmetries that are prevalent in credit markets. Furthermore the accumulated savings minimize the maturity gap of short term borrowing and long-term financing within the financial institution. Since the deposits are kept for specified purpose, they are not easily called off and can form part of long-term loan funds of the bank. [9]

The contractual savings for housing (CSH) system (the German bauspar model) has been introduced in Slovakia in 1992 on the basis of German and Austrian know-how. In the typical scheme the CSH banks provide 3% interest rate on savings and in addition the government provides the state premium. The value of this premium is calculated as the percentage from annual deposits, and its absolute value is limited by the existing legislation. The deposits of savers state premium and interests on both items form the contractual savings fund from which the housing loans are provided.

The amount of money available for housing loans is therefore the function of available money in the contractual savings fund. The CSH contract contains the target sum that client would like to achieve after several years of savings. The target sum is composed from his savings, state premia, and interests on both items and the loan. The size of loan depends on the size of multiplier. The value of the multiplier varies from 1 to 1,5. The size of loan will be found as the product of the sum of savings, premia and interest multiplied by the multiplier. The value of the multiplier is not very high, that make the loans less attractive, but it enables to decrease the liquidity risk of the CSH bank that provides the loan.

The target sum in the CSH system can be used for the construction of the new houses in private ownership, for the rehabilitation, maintenance or enlargement of housing units. Depending on the performance of the economy as the whole, the interest rates on loans from the CSH banks are more or less attractive. In the past decade these rates were usually substantially lower then the interest rates on commercial credits.

Actors in the CSH banking

The first CSH bank in Slovakia PSS (Prva stavebna sporitelna – First building savings bank) was created in November 1992 through the joint effort of three banking institutions: Slovenska sporitelna SLSP (Slovak savings bank) (35% of shares), Bausparkasse Schwäbisch Hall, AG (32,5% of shares), and Reiffeisen Bausparkassen Managementservice und Beteiligungsgesellschaft m.b.H, Wien, Austria (32,5% of shares). Soon after in June 1993, the Vseobecna uverova banka VUB (General Credit Bank of Slovakia) and Wustenrot established another CSH bank: Stavebna sporitelna VUB Wustenrot (SSVW). Three stockholders own it: - VUB, Wustenrot (Germany), and Wustenrot (Austria). In such a way the competitive market was created with the participation of two Slovak state banks SLSP and VUB and private Austrian and German banks. The SLSP was recently in March 2001 privatized by Erste bank. VUB will be privatized in the near future. The third CSH bank CSOB – stavebna sporitelna (Czechoslovak trade bank – building society that is 100% affiliate of CSOB owned by the Belgium bank) has entered into the market only recently. It was founded on June 8, 2000 and it has begun to provide its services on December 1, 2000. In December CSOB – stavebna sporitelna has been able to close 26 000 contracts with the target sum more than SKK 6 890 mil.[1] In the year 2000 this bank has acquired 7,5% of the market according to the number of the closed contracts or 10.9% of the market according to the total target sum. This was the result of the introduction of the new housing contractual savings products.[3] Thus the penetration of the new banking agent brought the new impulse for the creation of the more competitive environment on this market. Three Slovak CSH banks have closed in the first two months of 2001 41 801 new contracts, with the target sums SKK 7 557 billions. The youngest bank - CSOB Stavebna sporitelna has closed 41 801 new contracts (that number represents 11% of the market in the year 2000, or 12% of the market, if we take into account the total target sums in the closed contracts). All three CSH banks have managed 854 720 contracts with the target sum SKK 562 billions at the end of February 2001.[3]

The strongest actor in the CSH market is PSS. Its growth during the last decade has been really remarkable, and PSS was considered to be the second best bank in Slovakia in the years 1998,1999, 2000. It is likely that it will keep its position also this year.

When the contract savings scheme was introduced, it was estimated that the first loans would be provided in 1998. Because of already large number of people who saved their money within the contract saving scheme, the CSH banks started to provide first loans in 1995. These were not regular CSH loans but interim housing loans.

The condition for the provision of the interim loans is 2 years of savings. The saver receives the money, and then he starts to repay the debt. At the same time he continues to save the money within the CSH scheme, and thus he is entitled to obtain the state premia until the end of the savings period. He repays the credit until the end of normal CSH savings and borrowing cycle. The person, who will obtain the interim loan, will be obligated to pay off only interests with the interest rate 14 % until he will receive the regular housing loan. Then the amortization scheme of the regular housing loan will follow the conditions of loans provided within contract saving scheme with low interest rates. In 1997, under the political pressure to show results, the CSH banks cut this rate in an effort to encourage additional borrowing, even at effective rates to them that were much less than what was available on government bonds, the major alternative form of investment. Soon after the CSH banks introduced "instant loans", which do not require any prior regular savings, but do require deposit of an amount equal to half the loan amount with the Bauspar.

The CSH products of the CSH banks are to some extent different. The differences are mainly in the following areas:

- Conditions of receiving the CSH loans (interest rate, time of repayment, etc.),
- details of the family contracts on CSH, long-term CSH savings for children with the lower monthly savings installments, details on different regimes of savings, such as target sums, details on the possibilities to obtain the CSH or interim credits, interest rate on credits,
- interest rates on deposits and state premia,
- insurance of repayment of the credit and interim credits by the contracts with life insurance company,
- different forms of compensations on deposits for those savers, who have completed the saving cycle agreed in the written contract and decide to continue to save the money regularly, the special compensations on children‘s savings etc.,
- different forms and regime of collaterization on provided housing loans that depend on the value of target sum (by real-estate, third party, the trust based on the regularity of the savings, etc.),
- benefits resulting from the partnerships of the CSH bank with other banks.

Competitive forms of funding of housing construction

The CSH loans are not the unique forms of housing finance. The Slovak citizens can obtain the housing loans also from the mortgage banks and State Housing Fund.

The mortgage credits have been reintroduced relatively late, that is in 1996, after 50 years of their non-existence. At present there are several banks that provide these types of credits. VUB, Slovenska sporitelna, Istrobanka, Tatrabanka, Hypoivereinsbank and Bank of Austria Creditanstalt. In spite of the generous interest subsidies from the government, the mortgage credit provision is developing slowly. The underwriting process is too long; fees high and the clients yet do not like to provide the real-estate collateral.

The loans from State Housing Fund exist since 1996. This institution was created with the goal to make housing loans more affordable especially for the younger people. The Fund has started to provide subsidized low cost housing loans, as well as subsidies for the construction of new housing units. The provided financial funds could have been used for a variety of purposes, such as the construction of apartments, hostels, housing for the handicapped, and maintenance of the existing housing stock. The contributions from the Fund have helped to elevate substantially the new housing construction starts after 1996 (See the graph of new housing production on Fig. 1).

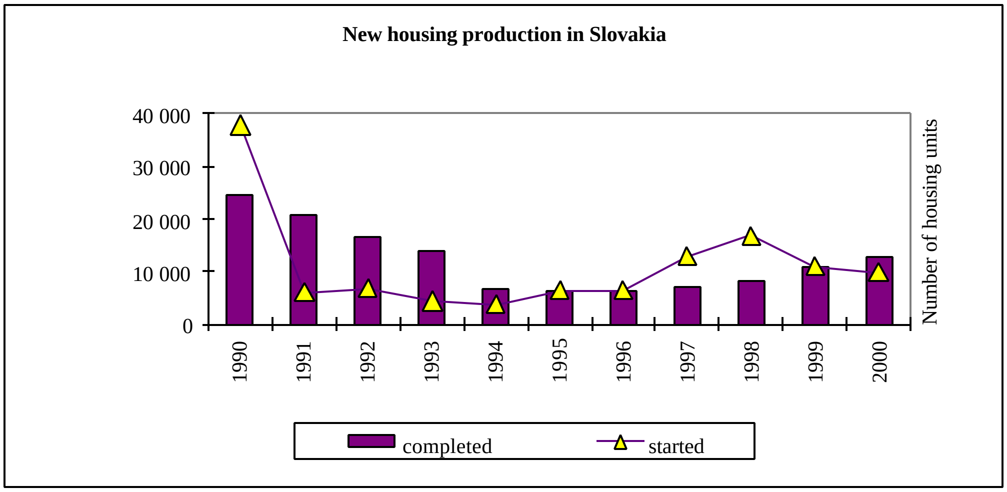

FIG. 1: NEW HOUSING PRODUCTION IN SLOVAKIA

It was not easy to find the financial sources for the operation of the State Housing Fund. The government had already high expenses in the housing sector (provision of governmental premia for CSH banks, subsidies to banks on the old below-market interest loans, subsidies for heat and warm water). The government therefore used its negotiation position toward CSH banks, and argued that in the period 1994 –1997 the CSH system had almost no real impact on housing. A result has been an *ex post* extrication of subsidies through the successful "persuasion" by the government for the purchase by the CSH bonds issued by the State Housing Fund at a below-market rate. In such a way the government has been able to obtain SKK 1 billion at the rates of 15 percent or more on conventional government debt.

However, the results achieved by Fund could have been higher if the functioning of the Fund was not burdened by excessive bureaucracy and the non-transparency of the distribution of funds for the construction of new housing units. In fact almost 40 % of its resources were used for the construction of luxury apartments 1998[10], which is in the contrast with the original intention of the Fund – to provide credits and subsidies from the Fund mostly to those who really need it. The perverse behavior of the Fund is maybe less surprising if we take into account the absence of firm guidelines for the utilization of the financial sources and their control. The large demand for the cheap credits from the Fund and the inadequate amount of funding coming mainly from state budget became the testing ground for shadow economy practices. This was the reason why the government has introduced the new rules of loan eligibility, raised the below-market interest rates, and removed lump sum subsidies for young households (SKK 150 000). The subsidized loans became accessible (through often not affordable) only for low or medium income population, and then for the special purposes, such as the reconstruction of the panel buildings.

At the same time the large governmental debt and deficit of the state budget led to the limitation of the expenses of the State Housing Fund. In 1999 it attenuated its activities, and only in the year 2000 it started to provide more loans. Such a situation was then reflected in the reduction of the housing starts, as can be followed from the graph of the housing production in Slovakia.

The alternative forms of housing funding (in the year 2 000) are providing less financial funds in comparison with the CSH banks. This can be observed on the following graph on Fig. 2.

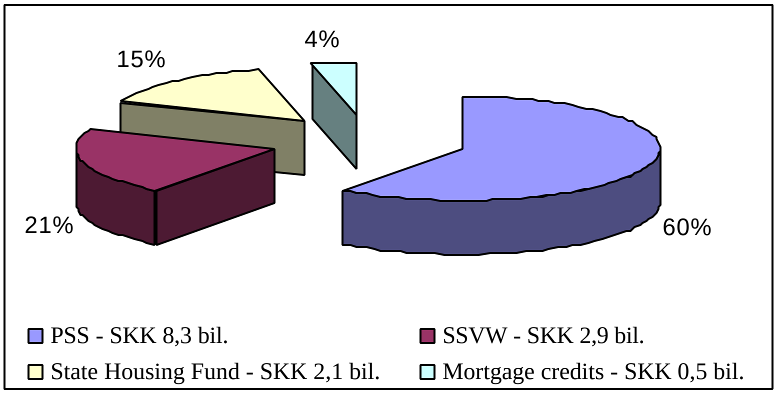

Fig.2: HOUSING FUNDING FROM DIFFERENT FINANCIAL SOURCES

The changes in the CSH legislation and its impact on the behavior of the savers

The CSH legislation has undergone several changes. In the first act on CSH the government agreed that it would pay to each saver the state premium calculated as 40% of the value of annual savings. Maximum value of the premium was SKK 6 000. Such a premium has enticed many savers to deposit their money to CSH banks, and that resulted in the steep growth of the number of the contracts, fast growing overall sum of the governmental CSH premia. However, many of the savers were not enticed to save because they would like to use the option to take the building loan, they just wanted to raise the value of their savings.

The legislation supported the existence of the “friendly savers” or “ bon fréres”, that is the persons who are willing to save the money in the CSH system, but they do not intend to draw the loan. Friendly savers are important part of the CSH, since CSH is closed system built on the basis of German know-how, and thus the total sum of the provided loans depend on the total amount of deposits from CSH clients. As counter-value for such a behavior, the friendly savers are entitled to keep the CSH state premia and use it not necessarily for the building purposes. It is considered that such a behavior supports anyway the channeling the financial sources of the majority of the savers to the construction or reconstruction of the housing units by the accumulation of the funds.

The first CSH act contained the serious legislative loophole. The original contracts allowed for withdrawal of the savings, interest and premium at any time after the very short waiting period. This has prevented also the maturation of a large number of early contracts into regular loans. The friendly savers have been able to close contracts at the end of year, and the next year to cash out their savings as well as the accumulated premia and interests. Then they put their savings on some highly earnings savings accounts in another banks and at the end of the year opened the new CSH contracts. That was quite a bargain for the particular clients, but it had the negative impact on the image of the CSH system.

It is quite typical for the policy making that their decisions are often extreme. At first the undertaken measures go to far, and then it comes the criticism and negative reaction that pushes the system in the opposite direction but also further then it is necessary. Thus often the both moves are the sources of the system dysfunction. It happened at the end of 1996 when the amendment of the CSH act was adopted. In the amendment the support for "bon fréres" was liquidated. The contractual savers, who were not going to use the saved money for the housing purposes, and who have been saving the money for the minimum contractual period (for example for 6 years) were not be able to keep the state premium anymore. Thus the “bon fréres” where not willing to support the housing contractual savings by their presence and that has led to the augmentation of the liquidity risk of CSH banks. It had the impact on the rise of the interest rate after April 1998 on interim credits from 5% to 8%, and on instant credits from 7,5% to 9,5%. At the same time the level of state premium was reduced to 30% on deposits with the unchanged maximum value of premium. The number of savers has been reduced. The specialists have seriously criticized the liquidation of “bon fréres” system.

The support for “bon fréres” was reestablished after the change of government in October 1999, but under more reasonable conditions than before 1996. The savers can keep the governmental premium, and use their money for any purpose on conditions that, they save the money in CSH system for at least 6 years. They may keep the premium also if they spend their savings for the housing purposes. In the second case they must accumulate the money in the CSH bank for at least two years.

The last amendment of the CSH act was made at the end of the year 2000. The government has reduced the state premium again. The value of the premium was established on the level of 25% of contractual savings, and maximum amount of premium for the saver was reduced to SKK 4 500 per annum. This cut-down is quite high especially when we take into account that when the contract saving scheme was introduced in 1992 in Slovakia when the average wage was SKK 4 543 and the premium SKK 6 000, while in 2000 the average wage was SKK 11 430 and premium SKK 4 500. Moreover the Minister of finance envision the further cuts in the state premium in the year 2002. The state premium should be reduced to 20% of the annual savings.

The last reduction of the state premium (both absolute value and the percentage) has enabled the ministry of finance to make the economy of SKK 500 mil. of budgetary expenses. This will enable the government to allocate more money for other purposes including the subsidies of interest rates on mortgage credits for natural persons.

Yet PSS is convinced, that it was not a great bargain for economy. PSS estimates that by reduction of the maximum amount of premium, PSS will lose SKK 2 billion on savings from the population in 2001. This will mean the reduction of number of CSH loans for the new housing construction and reconstruction, and less additional revenues coming from VAT and income taxes into the state budget. According to their calculations, the loans provided for the housing purposes from additional SKK 2 billion of CSH savings, can bring SKK 400 mil. of additional revenues for the state budget. That can practically offset the economy of the financial funds from the reduced state premia. The real additional revenues could be even higher, if the multiplicative effects from additional new housing construction and reconstruction would have been taken into account. At the same time some new job places could be created and that would have an impact on the reduction of the overall amount of social allowances paid to unemployed people. The last problem is quite serious, since the reported unemployment rate in 2001 has already hit 20%, and there is growing risk of the social unrest in the country. Thus the revenues from the collection of the additional taxes can according to analysts in PSS almost offset the growing expenses of the budget related to the growth of the total value of state premia paid to clients. The reasoning of PSS, however does not take into account the other aspects of the problem, such as the fact that more money means also higher prices of housing units, the fact that alternatively used money from the state budget can have also the important macroeconomic effects, etc.

The reduced premium is still interesting for the natural persons, in spite of the fact that the inflation in the last years has been growing rapidly as the result of reform systemic changes. The problem is that before the inter-banking rates where quite high, and thus the banks were trying desperately to find more clients by augmenting the interest rate on savings. This is not longer true, and the after-tax interest rate on savings is at present much lower then the annual inflation. Thus the after-tax value of savings is degrading rapidly. There is of course the option that, one could invest his money into the non-banking investment funds that offer the higher returns. The allocation of the money to such institutions is however more risky[6][2], and the degree of risk is further amplified by low level of the governmental regulation of the activities of non-banking financial institutions. That often means that these institutions promise the high returns on the allocated fund, but they are often becoming bankrupt because of the fraudulent activities. The government promised to enforce in near future the legislation that will force the non-banking institutions to behave in the more transparent ways. For many people in such a situation is the best option to save the money in the CSH system.

Partnerships of CSH banks with other actors in the housing sector

The important feature of the CSH banking activities is partnership relationships with other institutions. Although these relationships have started not long ago, and they have still a large potential for their development, they may become the important contribution for achieving the higher quality of the housing financial services in the near future. They may help to create the better match between the supply of the banking products and the objective housing needs, and in such a way to augment the housing affordability. Moreover such arrangements may influence the overall management culture in the housing sector where the development of the partnerships, especially between public and private sector, is badly needed.

The examples are numerous. For example PSS cooperates closely with some vendors of the construction materials in Slovakia. These vendors have signed the agreements with the CSH banks, that they will sell the building materials to the clients of PSS for the discount prices (less 10-15%). This is done also by SSVW. SSVW provides to each client W card, that enable the client to buy the building materials for the discount prices with up to 20 % reduction in 400 shops of the vendors of building materials in Slovakia.

The CSH banks would like also to buy the mortgage-backed securities, however Slovak banks hesitate to emit such securities in the important amounts. At present the situation on the capital market is not very good. There is the lack of good investment opportunities, the banks prefer to cover the provided mortgage credits by the short-term savings from the population, although the banking law recommends to use for these reasons the mortgage-backed securities. The preferential coverage of the mortgages by the short-term deposits is at present economically more advantageous. In the last two years the interests on savings has declined substantially – and now they make 3-6%, while the inflation in the year 2 000 achieved almost 10%. The inter-banking interest rates have also declined to the unprecedented level (7,45-7,7%).[1]

The accumulation of the financial sources enabled to CSH banks to fund the housing needs also through other financial institutions. For example the CSH bank were able to buy the debentures of the Slovak savings banks, that were covered by the housing loans, and to buy the bonds from PKB (First communal bank). PKB bank funds the activities of municipalities including the housing construction.

Cooperation may have also the form of different housing partnerships, with the government and the local authorities. For example recently the Ministry of Construction and Regional Development (MCRR) has proposed the subsidies for the construction of the social rental housing units. PSS also announced its willingness to take part in the funding of such units by the provision of the loans to municipalities, and it elaborated the pilot project.

The CSH banks also seek the partners among the developers or building firms. Some of the developers have been able to create the preferential relations with the CSH banks. In this case the CSH bank signs the contract with developer and provides him the necessary loan. The developer – the legal person -is not obligated to undergo the savings phase before obtaining the loan. When the construction is finished, the developer will sell the housing units to individual owners. Technically that means that the construction-housing loan is transferred on the individual owners, who receive CSH loan (regular, instant or interim) and they are obligated to repay it. At the same time the lien against the developer is removed from the land and real estate registry (cadastre) and it is transferred to the individual owners. The debt of the construction firm will thus be fully amortized, and the lending risk of loan default distributed among the new owners. This is quite important since the long-term existence of many developers in the market is not the rule in the rapidly changing economic situation of the country undergoing the economic transformation.

In the last two years the new partner of CSH banks has emerged. It is Slovenska zarucna a rozvojova banka SZRB (Slovak guarantee and development bank). SZRB has the different programs. From the point of view of the housing sector there are interesting its initiatives toward small and medium entrepreneurs. The building developer of the small or medium size may receive the loan limited by SKK 100 mil. from CSH bank for housing construction. The loan must be used for the new housing construction or reconstruction/revitalization of the existing housing units. Then the developer may ask the SZRB to guarantee this loan (usually up to 65% of the provided principal). The developer-borrower has to pay the fee for the guarantee, prove the healthiness of his firm and present the realistic marketing plan. The guarantee is provided for the limited period (usually 36 months). Guarantee is finished at the moment when the housing units are sold, or the credits are transferred to the new owners. This mechanism provides additional incentives to finish the construction works as quickly as possible. Big entrepreneurs cannot use the program. It is because the activities of SZRB are partly funded by the national budget, and therefore government regulates them. The government has issued the bill on the governmental support of the small and medium enterprises that already comply with the legislation of European Union. The fees paid for the guarantees on the loans do not cover all default risk. Part of the risks is covered from the governmental sources.

SZRB has also launched another guarantee program supporting the small and medium entrepreneurs that are related to some extent to housing. One of the goals of this program is to provide better access to credits to those entrepreneurs who want to fund the project targeted on the energy savings. Thermal insulation of the houses is one of the important ways of achieving the energy savings, and they are still pretty well neglected, and therefore the financial funds can be used also for these purposes. The mechanism of the guarantee provision is similar as in the preceding case.

The efficiency of the CSH loans for the entrepreneurs with the guarantees of SZRB is yet difficult to evaluate, since some of them had started some one and half years ago. There are some signals that the cooperation between the CSH banks and SZRB is not too intensive. CSH banks are rather cautious in their activities within the partnership relations, and they do not want to be involved at present in the large-scale cooperation with other banking institution, in case when the new products are not well tested in the practice. Moreover the closing of such loans often needs the realization of the complex underwriting procedures, that are not easy to standardize. Some difficulties stem also from the imperfect legislative business framework, legislative loopholes, and frequent legislative changes that often affect the business environment negatively. Growing number of defaults of developers also hinders the eventual larger scale cooperation.

Recently SSVW signed the partnership with VUB bank, that is the provider of the mortgage credit. The new partnership will enable the natural person to start to build the new housing unit from the credit provided by VUB. The client can guarantee SSVW the credit by the guarantor up to SKK 400 000. In such a case the collateral in the form of real estate is not required for SSVW. The started, but not yet completed house, can then be registered in the cadastre as the collateral of the mortgage credit provided by VUB bank. Thus the natural person will be able to finance the completion of the house from the mortgage credit. In the ideal case such an arrangement will enable the natural person to start the construction of the new housing unit valued by SKK 1 mil. with equity of SKK 200 000. SSVW is prepared to sign the similar arrangements with other mortgage banks in Slovakia. [12]

Generally we must say that CSH banks are interested to show the better results in the area of the funding of housing construction, and that is why they are trying to extend the range of their banking products related to the satisfaction of the housing needs. The functioning of the CSH banks is not independent from the decision making of the Slovak government, but on the contrary it depends strongly on its policy. At the same time it is not insulated from the opinions of the population. Moreover the other banks are not always happy because of too strong position of CSH banks on the deposit market. The preferential rules of savings cause that the substantial deposits from the population are moved into CSH banks and fewer deposits are flowing to the regular saving accounts in the savings banks. The opinion of Ministry of finance on the effectiveness of the CSH system is not always optimistic. On the informal meetings, they claimed to me that too much money in the form of the governmental premia has been invested to CSH system, and yet target sums provided from the system are rarely high enough to aid to fund the new housing construction.

Impact of the CSH on economy

The CSH savings have several positive outcomes. First of all it is the enticement of the population to save the money regularly that can be used for the building purposes. They play more limited role in the new housing construction since the target sums are usually not large enough. However the funding of the maintenance and the reconstruction works may be equally important especially when we take into the account the extent of deferred maintenance in the multifamily housing units.

Moreover more funds flowing into the housing sector bring multiplicative effects into the other sectors of the economy. This means more economic activities in other sectors and the creation of the job places. That also means that the large part of the national budget expenses allocated to the state premia can be offset by the growing incomes from levied taxes from higher level of economic activities. People are also enticed to invest their money into the satisfaction of their housing needs, and that means also the support for the domestic industries, since the large part of the building materials are produced in the country. That also means that people buy less exported goods and that may impact positively the balance of the foreign trade. As the result of more housing construction, the mobility of the population may grow, and that has the positive impact on the job markets.

Problems of the contractual savings and their future perspectives

When the CSH system has started to operate in 1992, some policy-makers thought that it will be really the most important market oriented instrument for the acceleration of the new housing construction. This was the wrong opinion, because there does not exist any country in the world where the contract savings scheme operates in such a way. Through CSH it is possible to receive the access to housing loans, but these loans in most cases can cover the part of really needed funds. Although the inflation rate in Slovakia during the last decade was relatively modest in comparison with the many of the Eastern European countries, it was still quite high in the comparison with the developed countries. Moreover the problem is that the real wages of the employees still do not achieve the end of the pre-revolutionary period. This is, however, not true for all Slovak regions. While the average incomes in Slovakia are rather low, the capital of Slovakia, Bratislava is in much better situation. Also average wages do not reflect the incomes of the entrepreneurs, yet they provide the certain perspective. The other problem is that while both the nominal wages and the living costs are growing, the indices of the prices of construction works are growing even more quickly (see the figure 3). This growth is reflected into the prices of the new housing units. Yet the housing prices are growing even faster than the prices of the construction works. There might be the structural reasons for such a situation. The large part of newly built houses are of higher standard then the houses built in the previous epoch, but the price growth may be influenced also by the land prices and the structure of demand and cost of the capital. That also means that the housing prices grow faster than inflation, although in the last year there are the first signs of positive change of such situation.

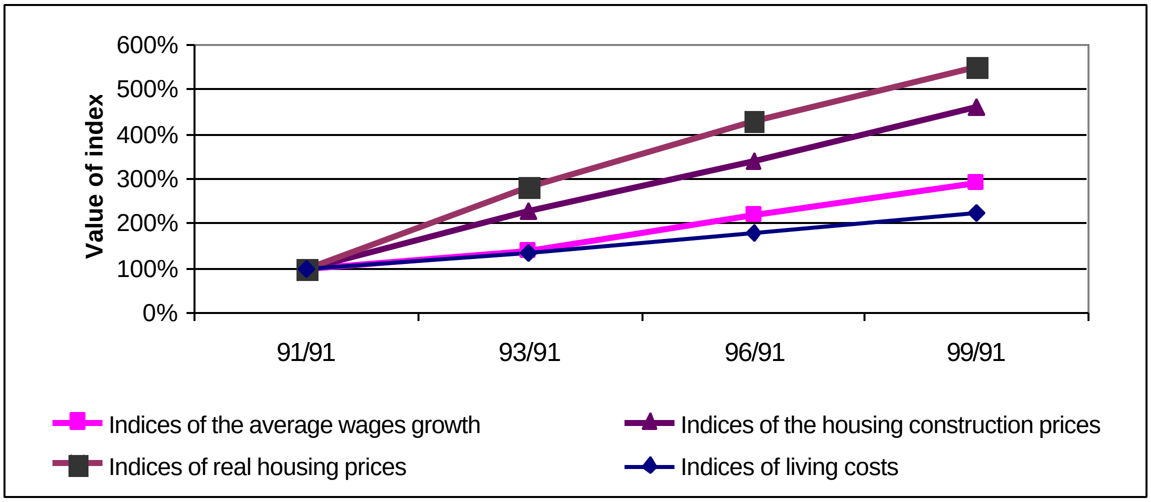

Fig.3: VOLUTION OF INDICES: AVERAGE WAGE OF EMPLOYEES, LIVING COSTS, PRICES OF CONSTRUCTION WORKS AND MARKET HOUSING PRICES PER 1 M^2

One of the important problems of the CSH banking is the liquidity. This problem does not arise in the early stages of the evolution of CSH, when many new savers are becoming the part of the system. When the system comes to its maturation, the influx of the new savers may not be high enough to ensure fast access to credit and that may influence the popularity of the system and its viability. Our CSH banks have not yet achieved this state of development, so it is difficult to say to which extent it will influence their functioning. One thing is clear however – the frequent changes in the state legislation have hardly positive impact on the system.

In our opinion there is at present also the problem of the governmental supervision. The Ministry of finance that supervises the CSH system lacks the exact data on the functioning of the CSH banks. I was trying to put together the exact data from the different Ministries, but the data were really contradictory. That makes the serious analysis of the system difficult. Ministry of Finance is trying to get more detailed data on results of CSH system only recently although CSH system exists almost ten years. The banks oppose such efforts. Moreover the system of the statistical monitoring of the CSH banks is not developed well. Then the results of the monitoring process are hardly comparable. The exact definitions necessary for the correct statistical data gathering and processing are being elaborated only recently. The regulatory agency, i. e. the Ministry of Finance, controls only randomly selected contracts in order to find out if they comply with existing laws. More sophisticated methods of regulation of the CSH system are not so far applied.

The other regulatory agency – the Slovak National bank – applies to CSH banks the same supervising procedures as to the other banks. The situation in France and Germany, where the tradition of the CSH savings is quite long, is different. In Germany, Bausparkassen are regulated by the Federal Banking Supervisory Office. In France, a long-established regulatory unit in the Treasury is responsible for monitoring other forms of savings including insurance and pension funds and their impact on financial markets.

The need for more sophisticated regulation of the CSH system will be obvious very soon. The primary regulatory concern in the developed countries using CSH system is the structural instability of the CSH system when it reaches maturity. In their early years, CSH systems have too much liquidity because many more contracts are signed than loans granted. When the system reaches market saturation the reverse can be expected.

The other problem is the problem of the housing policy as the whole. Since the housing policy has many different aspects: economic, technical, legal, environmental, spatial, financial – many ministries are participating in the elaborating the legal acts related to housing policy: Ministry of Environment, Ministry of Finance, Ministry of Construction and Regional Development, Ministry of Interior, and Ministry of Justice. The legislation is then often incomplete and contradictory. That is the result of inadequate cooperation, excessive bureaucracy, and even the conflicting relationships. Then to some specific problems is not dedicated adequate attention. Moreover it is difficult to have the good information on the totality of the regulations relevant to housing, construction and the real estate sector, since the different ministries and agencies elaborate such legislation.

CSH system faces some problem with the targeting of the subsidies to the reconstruction works. The construction specialists claim that the loans are targeted to less important aspects of the housing reconstruction, while the more important technical problems are not being removed, such as reparation of flat roofs, facades, stairways are neglected. It is the question whether the legislation should not treat in the preferential ways the treatment of the mentioned problems of the maintenance. There are also other problems. One of them is, for instance, the housing kernels (the kernels are usually constructed from the lower quality materials and they contain the sanitary installations – bathroom and toilette) in the concrete panel houses. The problem is that the reconstruction funded by CSH bank does not always take into account the different technical aspects such as the access to cross-connected frames.

The reconstruction of the common parts of the multiple family houses by the CSH loans is not in practice easy. After the privatization of the housing units, the majority of the apartments in the panel multiple family houses were moved into private hands. According to the law, the new condominium owners are obligated to create the association that would take care of the management of the property or to charge some management organization to take care of the management of the property. If the condominium owners want to rehabilitate the building, they first have to find the consensus. If they save regularly the money in the CSH system they may ask for the loan. Then every individual owner will have to provide his housing unit as the collateral against the loan. Such loan is expensive to underwrite, because the lien against each individual property must be registered in the cadastre. That means that every individual involved in such a loan must pay the fees to notary and to cadastrial office. The condominium association cannot guarantee the loan, because it cannot own the property. At the same time the achievement of the consensus on the maintenance and reconstruction issues is in practice very difficult. The simplification of the credit provision is thus depending from the change of the legislation.

There are also convictions, that if CSH contracts generate a significant amount of excess funds, these could be used to fund other types of housing loans with potentially disruptive competitive consequences for specialist lenders who fund themselves through the capital markets and not through retail deposits. Analysts pointed out that the administered CSH system born in another era had become incompatible with full market liberalization.

The important problem of the CSH system is its efficiency. There are many ways of creating and distributing subsidies to housing, including direct grants, low-rate government loans, interest rate subsidies, tax subsidies, and so on. If we take into the account the secondary effects stemming from the multiplicative effects that are generated by the growth of the building industry, some of the inefficiencies are offset by the growing activity in the economy.

Subsidies to CSH systems can lower the cost of finance but not the cost of housing. When the level of the housing price-to-income ratio is too high, say significantly above 5, a large proportion of moderate and low-income households are excluded from access to housing ownership. From a cost perspective, the attractiveness of a CSH loan depends critically on the inflation and interest rate environment. The attractiveness of the CSH is reduced with inflation.

At present the CSH system in Slovakia has the largest funds that can be used for the housing purposes. With the development of the mortgage credits, it will probably play less important role in comparison with the mortgage banks. The higher efficiency of the CSH subsidies can be maybe achieved by the better regulations of the CSH system from the government. For this reason the profound study of the system is needed, and the recommendations applied in the practice.

The experience gathered by the CSH banks can be used in the creation of the housing partnerships that enable to combine the financial funding and experience from different institutions and firms. Such arrangements may help to build more new housing units in the country. In this case the CSH banks may act as the catalysts of such partnerships. Whether they will be able to do so, that is of course the question, since such a role is overcoming traditional understanding of the content of operations within the system of contractual savings for housing.

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1. 1 EURO is approximately SKK (Slovak crown) 43.

2. Non-banking investment funds and institutions in Slovakia have been able to collect so far SKK 12 billion from the Slovak citizens after the year 1990. SKK 4 billions will never be returned to their owners, because the collecting non-banking institutions became bankrupt. The average life of such institutions does not exceed 4 years. The amendment of the Banking Act has therefore limited the possibilities of the non-banking institutions to collect money. But soon these institutions found out that with the silent partners they can continue their often-fraudulent practices. The final blow to their fraudulent activities should be hopefully the approval of the new security law. Meanwhile their activities will be monitored and regulated by the Financial Market Office.

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The Role of Slovenská konsolidacná, a.s. in a Banking Sector Restructuring in Slovakia

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Abstract

The main reasons of impending financial crisis. Mistakes in transformation process, formalism and favouritism in a privatisation process, cumulative increase of non-performing loans. Importance of international experience in solving financial crises and the project of Slovenská konsolidacná, a.s.(SKAS). Knowledge of SKAS´s portfolio. Basic principles, regulations and procedures of SKAS´s activities by handling with non-performing loans. Results, experience and open problems by performing restructuring tasks from SKAS´s point of view.

In the last 20 years there were more than 130 countries faced up to solving of non-performing loans, which was accompanied by different forms of financial crises. Slovakia started to solve this problem among the last ones. This resulted on the one hand in higher recovery costs of the banking sector but, on the other hand, there was a possibility to profit by international experience.

Although the necessity of restructuring the country's commercial banks, particularly the three largest banks under the government's control, became apparent as early as 1993 and 1994 when the overall volume of their non-performing loans had reached approximately 15 billion SKK, the actual and realistic solution to the problem was not implemented until late 1999. Repeated failures to adopt efficient measures in the meantime considerably multiplied the costs of the banking sector's restructuring and made it impossible for the banks involved to handle the task on their own, without the government's help. In December 1999 the amount of non-performing loans in the banking sector reached the critical level of SKK 190 billion Simultaneously, the financial statements of Všeobecná úverová banka, a.s. (VUB,a.s.), Slovenská sporitelna, a.s. (SLSP,a.s.) and Investment and Development Bank (IRB,a.s.) worsened ominously. By the end of 1999, these three banks were in imminent danger of losing their creditworthiness as well as their business partners´ and clients´ trust. Slovakia found itself on the verge of a serious financial crisis that would have had far-reaching detrimental consequences for its national economy as well negative implications for the country's efforts to join the OECD and its ambition to open accession negotiations with the EU.

Empirical experience and economic theory concur that when a financial sector crisis occurs, represented by huge amounts of doubtful and loss assets, it is necessary to solve it in a proactive manner. Delaying this state only increases the problem and decreases the percentage of recovery. As a result of this many countries decided to establish special loan rehabilitation institutions, into which the doubtful and loss categories in the loan portfolios were transferred. Coming out from this experience the Slovak government approved the same approach for Slovenská konsolidacná, a.s. (SKAS).

Due to the abovementioned circumstances it appeared inevitable that in August 1999 the Government of Slovakia adopted a comprehensive programme of restructuring banks and enterprises. The scheme was based on bad - assets swap, in which the doubtful and loss categories of loans from the portfolio of the three troubled banks were carved out and transferred into a special loan rehabilitation institution (SKAS). SKAS was legally authorized by the Government resolution No. 908 on October 21, 1999 and registered on October 26, 1999. After several changes during the year 2000 through the Government issued bonds SKAS became a fully state-owned company and the Ministry of Finance the 100 % shareholder of SKAS.

In December 1999 a substantial portions of non- performing loans from the three major state-owned banks were transferred. SKK 44.9 billion were carved out from VUB, a.s., SKK 22.8 billion from SLSP, a.s., SKK 6.4 billion from IRB, a.s., i.e. total SKK 74.1 billion. From this amount SKK 62.7 billion were transferred to the SKAS and SKK 11.4 billion to the state-owned Konsolidacná banka (Consolidation Bank Bratislava).

In June 2000 the second carve out followed and of around SKK 34.2 billion were transferred to SKAS. The loans carved out within this second wave were of “better” quality, being rated as watch and doubtful loans. This completed the clean up of the banks prior to privatisation, so they could be privatised as quickly and for as high a value as possible. The banks themselves will work out about 15 –20 percent of non-performing but still recoverable loans, which remained in the banks´ portfolios.

As of the day of transferring loans, SKAS registered a total of 3,481 debtors and 5,772 loan accounts as more than one loan had been provided to one entity. These loans are of poor quality – in about 70 % of cases bankruptcy has already been declared or are in liquidation. After the second carve-out of non-performing loans, SKAS managed a loan portfolio amounting to SKK 96.9 billion. Recoveries are estimated at around 5-10 % and will be used to offset both the costs of the SKAS and the costs of servicing government bonds issued to finance the carve-outs from the banks.

According to the legal form, the largest groups consist of sole traders (45.84 %), followed by limited companies (29.22 %) and joint stock companies (9.5 %) respectively. As far as number of clients and amount of loan are regarded, the highest number of loans (to 1,304 clients) were granted in the amount from SKK 1 mio to SKK 10 mio. The highest amount of loans about 46 percent represents unsecured loans. As far as loan portfolio by sectors is regarded the highest amount of loans was granted to retail (18.58 %), wholesale (11.17 %) and building industry (4.75 %).

SKAS has the role of liquidating the acquired assets of state owned or controlled banks by speeding up the liquidation of unviable companies, restructuring the obligations where practical of viable companies. On the basis of the loan portfolio analyses, SKAS identified 38 debtors of being able restructuring.

Since SKAS has a relatively small staff and a limited life, it will relatively rapidly dispose of the assets acquired for market value through the use of various sales initiatives. SKAS is focused on the pooling and packaging of loans and assets either for immediate sale to investors or, where an immediate sale is not possible, the pools of loans will be transferred to and managed by private sector asset management firms.

It has been shown that a proactive approach to loan sales is key to success in solving a financial crisis such as the one in Slovakia. Experience of RTC in the United States in 80s, in Sweden in 90s and recent experience of the South Korean liquidation agency, KAMCO are the clear evidence.

Experience and framework procedures and principles of the countries, which successfully cope with non-performing loans, were very useful in establishing SKAS and by stating regulations of its activities. SKAS stresses transparency, quick informed resolution, fairness in approach for potential investors, where an important competition role plays price aspects. Other important principles are as follows: elimination of political and other out of economic pressures, adequate authority (discretion) and effective tools in the hands of a special consolidation agency, need for flexible settlement and bankruptcy proceedings including a prompt action of courts (judges), adequate adopting of tax matters, etc.

Assets market conditions play an important role in speeding up the overall liquidation process and enhance the overall recovery of the various assets. Taking into account the small size of Slovak economy, its undernourishment and a relative large amount of non- performing loans, there is a necessity for foreign investors participation, not only due to expanding an asset market in Slovakia, but also due to it's incorporating into the global assets market and coping with the problem of non performing loans in Slovakia.

In addition to realization of the individual sales of loans in 2000, the preparation of the chief methods of settling the transferred loans subsequently led to holding the first public tenders. In June 2001 SKAS announced the public tender for loan portfolio sale against 116 debtors amounting to SKK 13.01 billion. It was the first loan pool packaging sale to institutional investors.

In the second half of 2001 important changes necessitated to update the strategy of claims disposal. By the government decision SKAS will take over the state owned Konsolidacná banka Bratislava. As the result of this, the amount of non-performing loans will exceed SKK 100 billion. Many local and international factors necessitated spending up asset disposition. As the appeal to this situation, Slovenská kosolidacná is considering to establish joint venture with prestigious foreign investors, through which it assume to dispose of a loan package amounting to at least SKK 40 –50 billion. International experiences prove that sale and setting up joint ventures with the private sector is a very effective method of solving problems with non- performing loans.

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Upgrade of Slovak Bankruptcy Law by Application Re-Engineering Principles

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Abstract

We know the name of process control and process analysis from beginning of 90 especially in USA and some countries of Western Europe. Application of process control and analysis brings revolution changes similarly principles of functional control structures, worked out by Taylor and Fayol at the beginning of 20 century. Application of these methods is not limited just for field of entrepreneur activities control. We can use them always to manage and structure processes in complicated organisational structures. Stated report describes original use of these principles to upgrade of bankruptcy law and to manage bankruptcy processes.

Even when transformation process in Slovakia took 10 years, we were not able to solve re-structuralisation of firms definitely. Results of this status are huge mutual debts of firms and the state, lack of capital and low efficiency. After due receivables passed 2/3 of GDP at inconvenient tendency. Because the banks are striving to cure their loan portfolio and there is permanent decrease in shareholder equity of firms, so financial covering of activities is not easy. The power of creditors has been moved from firms to banks and to public finance in the last few years. Their portion from total amount of after due receivables are dangerously amounting of 50% from amount of these receivables. Reasons of this situation are lately realised re-structuralisation of banks and firm's sector. This change of structures ran in other Eastern European countries much earlier.

Important part of programme of banks and firm's sector re-structuralisation, approved by Slovak government in 1999, is improvement of bankruptcy law. The bankruptcy law was approved in former Czechoslovakia in 1991. Its application showed very low effectiveness. This resulted in many changes of law (11 changes in 10 years) and very low number of bankruptcy processes in the light of number of firms, which theoretically and practically should apply it.

	1995	1996	1997	1998	1999	2000
Number of calls for bankruptcy	1530	1321	1755	1831	2161	2050
Bankruptcy cases processed	76	122	229	378	1067	638
Not completed bankruptcy cases	939	2663	3896	5025	5857	6348

More than 56% of law subjects (organisations) comply with conditions to apply bankruptcy specified by law. This is clear from analysis of economy situation of non-financial institutions. It is about 40.000 law subjects.

It is clear that 5% bankruptcy cases of law subjects cannot improve situation of economy and is characterised extremely high chain-insolvency which amounting 2/3 of GDP.

Low efficiency resulted not only from low number of calls for bankruptcy (against firms which comply with bankruptcy law) but also from low number of calls completed and from long-term processes with ineffective collecting money from realisation of assets. Duration of the processes is clear from several tenths bankruptcy calls completed (17 at the end of year 2000) against 2510 bankruptcy calls started within 1995 - 2000[1].

In spite of high effort to fix shortages of law, we experienced that other co-operating laws and instructions and also efficiency of institutions influence efficiency (courts, heads of bankruptcy calls) of bankruptcy cases.

Current experiences from application of the law revealed following shortages:

- Conditions for application of the law are not specified precisely, as well as, obligation of debtors and other bodies involved to the process
- Ineffective and long-term bankruptcy processes to satisfy creditors claims

- Negotiations and processes on the court are complicated and capacity of the courts is limited
- Some articles of the law are ambiguous so debtors can avoid effective actions of the courts and head of bankruptcy processes
- Low application of claims of creditors

It is clear, from above mentioned, that there is several areas which should be precisely identified and used for improvement of bankruptcy law:

- Identification of the conditions to start bankruptcy processes
- Identification bottlenecks of bankruptcy processes
- Identification of ambiguity of the law
- Identification of the new quality and quantity requirements to complete processes effectively

Complex change of the bankruptcy law is planned for year 2002, to exclude the shortages and to set the bankruptcy law as natural regulator of insolvent organisations. Re-engineering principles are suggested to use for this complex change, even when, these were used especially in firm’s field.

Goal of the project is an establishment of process model of bankruptcy processes, which will:

- Identifies lead times and effective time consumption of activities
- Identifies complexity of individual activities and amount of work for executive bodies
- Identifies barriers which complicate and slow down bankruptcy processes from side of:
    - Creditor
    - Debtor
    - Court
    - Head of bankruptcy cases
    - Law
    - Others
- Identifies law norms and instructions which describe ways of doing individual activities
- Evaluation of law norms and instructions for quality and timing

Working team for upgrading of bankruptcy law will model consequences of recommended changes for processes of bankruptcy processes and other its characteristics, in phase II of the project.

Working manuals for individual activities and system for permanent evaluation of the bankruptcy processes as important tool of bankruptcy courts, will be prepared in phase III.

This principle, based on specific tools of process analysis ARIS of IDS Scheer together with tools to control performance PPM, allows:

- Understanding bankruptcy processes and activities in details, in the light of time consumption, capacity, financial criteria and law
- Identification of bottlenecks of bankruptcy process
- Optimising of models of bankruptcy processes with suggestions:
    - Change of structure to strengthen parallel activities, elimination of cycles and simplifying
    - Change in competence and qualification of the participants of bankruptcy processes
    - Decrease in quantity and content of documents to simplify and accelerate stream of information
    - Correction of process and law norms, which brake bankruptcy processes
- Preparation of suggestions to improve bottlenecks of bankruptcy processes
- Control of how processes are running

It is clear, from the preliminary analysis, that structure of the bankruptcy processes and law norms are not adequate to the complex processes and sub processes, which are involved. Their putting to the groups with legislative, organisational and institutional consequences, in the light of these processes, can lead to transparency, speed and financial efficiency.

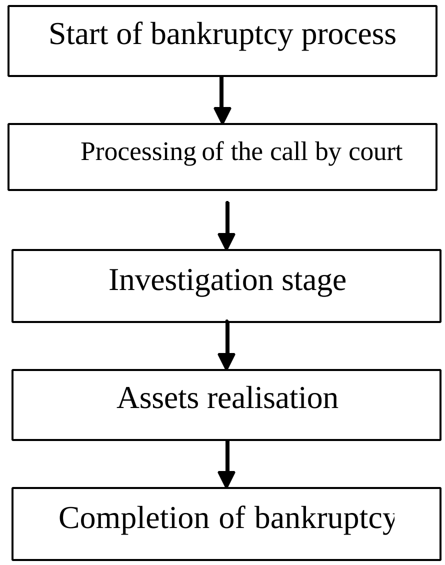

Fig. 1 BANKRUPTCY PROCESS

It is possible to split individual activities into single sub activities that should be basic element of analysis. These sub activities will be described in the light of content, time consumption, capacity and qualification needs, as well as description of suitable law and process standards (attributes). Having groups of these sub activities as activities and individual processes information network will be created. This all allows us to model whole process at different attributes. Activities with character of decision-making processes will be equipped with adequate criteria.

Even when, number of activities and sub activities can not be described and quantified precisely, because of individual characteristics of organisation in bankruptcy, head of bankruptcy process, etc., we can get probable behaviour of the process through change in attributes.

Result of this should be precise identification of needs of sources to reach quick and not interrupted bankruptcy processes. Side effect, but important, will be application of the Process Performance Management, which will monitor progress of bankruptcy processes. Such a way we will get valuable information about performance of individual organisational structures to protect loss of time.

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[1] Statistic data are not available, until end of 1994, but there were a few tenths of bankruptcy calls.

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